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ECONOMICALLY CORRECT LEADERSHIP

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In September 2000, United Nations Secretary General Kofi Annan addressed the General Assembly at the end of the Millennium Summit of world leaders. He concluded that if only one thing had been learned in the 20th century, it is that "centrally planned systems don't work." As recently as a decade ago, such an assertion would have been cause for U.N. delegates to walk out of the assembly hall in mass protest - and not just the Communist Bloc delegates but representatives of many Third World countries as well.

But now the world clearly has changed: Even the ambassadors of Russia and China were unfazed by Annan's conclusion. Many seemed to be nodding (or perhaps nodding off) at the recitation of what, in a remarkably short time, has morphed into a self-evident truth: *The collective intelligence of the market is greater than the directive smarts of one individual (or cadre of commissars).* And that truth doesn't apply just to economics. While some in Beijing (and in Singapore) remain unconvinced, most of the world also has bought the notion that political decisions in which citizens participate are better than fiats of dictators.

In an ongoing study of the leadership practices of corporate members of the World Economic Forum (known for their annual gathering in Davos, Switzerland), we are documenting the beginnings of a similar sea change in the way business organizations think about their structure and governance. Using in-depth interviews and a survey of over 6,000 executives and managers in Asia, Europe, and North America, Booz-Allen & Hamilton is creating a global database of effective (and ineffective) leadership practices. While we have seen cases in which an all-powerful business leader has compelled an organization to achieve a focused end (such as American Airlines' Robert Crandall, an acknowledged master of change by command), we also have found that such leadership is unstable in the long run.

The Old Way of Leadership

Solo corporate leadership has become inefficient and ineffective for much the same reasons that Kremlin dictators ultimately destroyed the system they attempted to control. In businesses with overly centralized leadership, the risk of serious error is extremely high. No one, no matter how gifted, can be right all the time, and no one has all the information required to make every important decision, particularly in large organizations. When one or a handful of people are making all the calls, over time resources become misallocated, opportunities missed, and innovation stifled. Overcontrol saps initiative and fosters routinized, bureaucratic behavior. Organizations dependent on a single individual - even a brilliant individual - are at risk when that individual leaves, retires, or dies. Harold Geneen could single-handedly run ITT, but after him that conglomerate crumbled like the Warsaw Pact after the demise of the Soviet dictatorship.

That said, we cannot deny the success of the charismatic leadership of Larry Ellison at Oracle, Sandy Weill at CitiGroup, Scott McNealy at Sun Microsysterns, and, in particular, that of McNealy's mentor, Jack Welch at General Electric. There is good reason why these powerful individuals are cited in the business press as examples of the standard, one-man model of corporate leadership: the companies they run have impressive financial records. Ellison has demonstrated, while centralizing decision-making authority for development, marketing, and pricing, that he could turn Oracle into the world's leading producer of databases and Internet-based software. Weill has shown that he can produce extremely fast growth through an acquisition strategy that he himself leads and executes. At Sun the CEO is so powerful that, in the public eye, the company is Scott McNealy. And starting in the 1980s the all-powerful Welch became the iconic corporate leadership figure of the age when he single-handedly forced G.E.'s managers to undergo a revolution in corporate practices - at a time when they were content to bask in their manifest success.

The New Shape of Leadership

Given the performance of such individuals, it is no wonder that leadership in this country is still represented in the business press in the guise of personalities.

Yet, below and beyond this personification of leadership lies a pattern of emerging behavior. At General Electric, in fact, Jack Welch works overtime to build leadership bench strength throughout his organization - seeking, as he prepares to retire, to institutionalize leadership in the company's structure and systems. Even in Asia, where corporate power often is centralized in the hands of an owner and founder, we see a countertrend in which large, publicly traded companies in Korea, India, and Japan now seek to make leadership institutional - as opposed to individual - by cascading power down the organizational hierarchy. Since the death of Akio Morita, Sony has moved to a more decentralized leadership model, and as the legendary CEO of Fuji-Xerox, Yotaro Kobayashi, prepares to retire, he has worked to make that company far less dependent on any individual in the future.

Lost in the hype surrounding the high-profile, do-it-al1-themselves leaders of the e-biz and high-tech industries, is the fact that some of the most impressive corporate performances are being turned in by three companies that were traditionally in decidedly unglamorous industries: Corning, Continental Airlines, and Enron. Significantly, many key leadership tasks in those companies are institutionalized in organizational systems, practices, and cultures. Leadership in these firms is not a solo act, an aria sung by a prima dona CEO, instead it is a shared responsibility, a chorus of diverse and complementary voices. Without a single, charismatic (or commanding) leader goading them on, individuals down the line act more like owners and entrepreneurs than like hired hands. To an unusual degree, these companies are chock-full o' leaders - men and women who take responsibility for financial performance and managing risk, people at all levels who take initiative to solve problems and even to start new businesses.

A Rational Market Model

Significantly, the emerging model of leadership is in keeping with principles of accepted economic theory. For example, economists put their trust in markets rather than structures because people are rational (and organizations only rarely so). While the details of their business models vary, these three companies adhere to a few organizational basics that true capitalists celebrate in principle but often ignore in their own companies.

- *Decentralization.* Because "Better information leads to better decisions," decision making is delegated to the lowest appropriate level (where the best information resides), unless there is a compelling reason for making it elsewhere.
- *Market Mechanisms.* "The market is the most efficient process for allocating resources." Thus central planning staffs and powerful budget offices are shunned in favor of market-style processes that allow scarce resources to flow to individuals or departments based on an assessment of risk and reward (for example, to a division that is willing to bid most for a day of salesforce time).
- *Minimalism.* The corporation engages only in those activities that cannot be bought more cheaply from others in the market, and those few things that require scale or technical expertise.

- *Ownership.* Since "entrepreneurial behavior is desirable," the rule is to fix accountability wherever possible by making people at all levels feel the consequences of their own decisions. Need it be said that "people respond to incentives?"
- *Rule of Law.* As newly democratic Russia is discovering, capitalist nations need the rule of law for markets to operate effectively. Ditto companies. Hence, to make it simpler for people to manage in complex organizations, leaders need to establish a few unambiguous values that every one understands - and that leaders themselves uphold without exception.

Exercising Restraint

Why, when we move from society to individual enterprises, are these principles so often honored in the breach? The reason is simple: the leader's ego gets in the way. Since nearly all CEOs like to think of themselves as the sort of all-knowing, tough, and take-charge leader who gets profiled on the cover of *Forbes,* they are tempted to centralize authority, make all important capital allocation decisions themselves (Larry Ellison is said to review all decisions involving sums above $50,000) and, in general, to structure their organizations as if there was need for only one entrepreneur.

Yet our research shows that companies whose operations are predicated on market principles require complementary; decentralized leadership behavior to be fully effective-particularly in the long term. For example, such successful CEOs as Enron's Kenneth Lay, Continental's Gordon Bethune, and Corning's Roger Ackerman resist the ego-satisfying (and media-approved) urge to lead by push - particularly when times are rough and the faint-hearted call for "a strong hand at the helm." They understand that reverting to a Stalinist model of leadership would only destroy their own credibility - and their organizations' overall capacity to be self-governing and self-renewing. Instead, they use the pull of incentives linked to purpose. They maintain the discipline to trust in people and markets. They understand that people - and markets - can be cultivated but not controlled.

The difficulty of exercising leadership restraint is acknowledged by economist Oliver Williamson who compares it to Odysseus' having to "lash himself to the mast" to avoid being seduced by the song of the Sirens. Presumably, modern organizational Sirens sing an irresistible refrain that goes some- thing like, " *You* must manage everything. *You* must control everything. ..."

Disciplined adherence to the economic model focuses the executives' attention on the true requirements of effective leadership and away from managerial tasks that should, in any event, be delegated. Leaders like Lay, Bethune, and Ackerman practice executive restraint-they have a bias against intervention, particularly in tactical decisions. They create conditions that are predictable - as opposed to arbitrary - and they build trust in the process. But that doesn't mean they create static systems - or that they themselves are uninvolved. When the inevitable exceptions to their few organizing principles force them to make a decision, they decide clearly and promptly - but in a way that sets clear precedent for the future, instead of creating the need to decide again tomorrow. For example, a few years back car maker Renault experienced a bad case of that common bureaucratic conflict known as siloing or stovepiping, in which manufacturing, sales, and marketing failed to engage in necessary cross-functional cooperation. Carlos Ghosn, then COO, stepped in and changed the structure, measurement, and reward systems, creating cross-functional, self-managing teams, each fully responsible for all decisions relating to a particular piece of a car: power train, interior, body, and so forth. Moreover, when such leaders are successful they find they need to make fewer and fewer decisions themselves because they will have spent as much as a third of their time developing other leaders who, in turn, make more (and better) decisions. "Economically correct" leaders also encourage conflict resolution at lower levels-instead of tolerating the inefficient habit of kicking all problems upstairs.

Spending Time Wisely

What do they do with the rest of their time? The most effective leaders we have studied spend over half of their time communicating the visions, strategies, values, and missions of their organizations, and rewarding managers down the line for translating those generalities into the specific behavior required to realize over- all objectives. They spend time selecting and developing a leadership team. Finally, they create and maintain systems in which others can do their work effectively. Since markets are all about rationality, these technical and organizational systems must be transparent and provide the information, resources, and authority so that followers can get their work done without interference.

Here are some examples of what economically correct leadership means in practice: In the mid-1990s, Roger Ackerman began a change process that has led to the total revamping of Corning's core technologies. He asked 300 employees from all levels to identify opportunities for process and product improvements, and to initiate activities based on their own ideas. The actual work of change was done by those same people, organized in teams that they led themselves. Top management limited its role to setting stretch goals, holding the teams accountable, and communicating the purpose of the change effort. Another example of dispersed leadership: a $3 billion acquisition recently was executed by a third-echelon Corning manager.

When Gordon Bethune took over at Continental in 1994, the company had recently been in Chapter 11 bankruptcy, and was ranked last in its industry on every measure that mattered. To turn the company around, Bethune chose the radical strategy of meeting customer needs. To get Continental's planes to arrive on time, Bethune offered all employees a bonus check of $65 each month the company ranked among the nation's top five airlines in on-time performance. Bethune set the goal, but he left it up to the employees to creatively come up with ways to achieve it. At the end of the first month, the company had moved from tenth to seventh place on the government's on-time rankings. The next month they hit fourth pace (and got their first bonus checks, cut with the words" Thank you for helping us to be on time" printed on the bottom.) The following month, they hit first place - and have stayed there rather consistently. What did Bethune do as an economically correct leader? He says, " The challenge is to keep people focused." And linking customer needs to the self-interest of employees is the best way to keep people focused on their real job.

In the 1980s, Enron was a slow-growing Texas-based gas pipeline company. Today it is a global world-beater engaged in such fast-growth industries as power marketing and bandwidth trading. The change came about as the result of CEO Lay's decision to create an environment in which bright young MBAs with entrepreneurial instincts would have "the resources to succeed and freedom to fail without penalty." Over the years, Enron has recruited nearly a thousand new leaders to create and run their own businesses - and to have a healthy financial stake in their success. To cope with constant change, people are free to move around in the company as new growth areas emerge or once-promising areas dry up. To make this work, Lay has implemented a system in which employees who change jobs don't have their salaries lowered - even if they move into a lower - level job than the one they held previously. Because even titles are portable, executive VPs in slow-growing businesses are willing to take second-tier technical jobs in areas where they can make a greater contribution to the corporation. And what does Lay do? He creates the environment in which the entrepreneurial efforts of thousands of employees can make him a successful leader, and Enron's shareholders wealthy.

Making Strategy Effective

Paradoxically, what seems natural in theory requires counterintuitive behavior on the part of many practitioners. For example, our research shows that the performance of few companies meets the aspirations of their leaders (and none fulfills its true potential). When leaders are asked why, they typically explain this gulf between performance and expectations as a shortcoming of vision or strategy - or lay it at the feet of people down the line whose behavior or skill is inconsistent with policies proclaimed on high.

While a sound strategy is necessary for superior performance, most strategies can be quickly copied (and many are little more than statements of aspiration that offer little real direction to employees). The gap between performance and aspiration is usually caused by the way an organization shapes the decisions of individual managers and employees. Organizational performance is the collective result of all the effort and activity that goes on inside a firm, and that behavior is determined by the operating environment - that is, the system in which people work.

Most leaders acknowledge the importance of such organizational systems as

- Goal setting
- Performance appraisal
- Recruiting
- Knowledge transfer
- Capital allocations

- Communications

Yet surprisingly few leaders know the degree to which such systems lead to alignment between strategy and behavior. And even fewer understand the ways in which such systems work to encourage (or impede) innovation and initiative - that is, the organizational adaptability needed to cope with an ever-changing environment. Indeed, the sources of organizational misalignment and maladaptation are so numerous, diverse, complex, and cross-cutting that they are hard to identify, and thus are seldom the focus of concerted leadership actions.

We have learned that it is exactly such organizational systems that drive performance - and it is such systems that leaders like Lay, Ackerman, and Bethune spend almost all their time creating and maintaining. In our World Economic Forum research we applied a standardized survey that helps leaders to assess which systems in their organizations are most effective at driving performance, and to assess the effectiveness of those systems relative to those in other companies. The survey instrument asks respondents at all hierarchical levels to score their organization on 65 measures of behavior. Instead of measuring attitudes, the instrument asks respondents to use its seven-point scale to score the degree to which leaders do specific things (for example, "hold people accountable for their performance"). By using this diagnostic method, leaders pinpoint the systemic sources of alignment and adaptability in their organizations and, the manner of CEOs Lay, Ackerman, and Bethune, then build agendas that focus their leadership actions on those few things that really influence performance.

As it turns out, all complex organizations contain built-in conflicts and disincentives that cause people to behave in ways that are inconsistent with overall strategy and goals. These relatively low-level points of conflict (for example, when business units are asked to cooperate on one hand, but are rewarded for maximizing their own profits on the other) are not apparent to top-level leaders but, when added up, significantly affect corporate performance. Thus the most effective point of leadership leverage is to identify and unblock impediments to group performance. Surveys, focus groups, and other tools can identify such counterproductive decision points. Then a detailed analysis of the incentives that influence the managers making these decisions often reveals the sources of misdirection. Armed with that knowledge, new and more rational rules governing who makes what decisions can be created to better align behavior throughout the organization with the leader's overall strategy.

In sum, effective leadership is not about charisma or the exercise of power; instead, it entails the creation of information and incentive systems that allow others to make decisions that, cumulatively, advance organization objectives. The role of leaders in an economically correct enterprise is less about "showing the way" to sheeplike followers, and more about providing the context in which capable individuals can find their own best paths to meeting overall goals. Senior leaders thus create the environment that motivates good decision making: they recruit competent people, develop them, give them appropriate tools, authority, and resources, hold them accountable, and reward their "right" behavior. They focus on organizational results rather than on personal position. It is the lasting power of those results, not the imputed power of the individual, that defines real leadership.