Leadership in context

Organizational health matters more than you might expect.

by Michael Bazigos, Chris Gagnon, and Bill Schaninger

Great leaders complicate leadership development—a notion that may seem paradoxical until you stop and consider just how much has been written about Winston Churchill, Mahatma Gandhi, Abraham Lincoln, Golda Meir, Ernest Shackleton, and countless other celebrated leaders. The sheer volume is overwhelming, and the lessons that emerge from one leader's experience may be completely inapplicable to another's.

The complications run deeper for business leaders. In the corporate context, effectiveness depends less on the traits of any one executive (or of that person's direct reports) and more on a company's competitive challenges, legacies, and other shifting forces. If only we had a clear set of keys to effective organizational leadership—a "decoder ring" to understand which practices produce the best outcomes. Our latest research, however, does point to one major element of the equation: organizational health. For people seeking to lead companies effectively and for organizations seeking to develop managers who can deploy different kinds of leadership behavior when appropriate, recognizing and responding to a company's health is far more important than following scripts written by or about great leaders. And that's true even of great leaders whose circumstances might, on the surface, seem relevant under a given set of conditions.

To be sure, certain normative qualities, such as demonstrating a concern for people and offering a critical perspective, will always be part of what it takes to be a leader. But the importance of other elements, such as keeping groups

on task and bringing out the best in others, vary in importance depending upon an organization's circumstances. Organizational health changes over time. Effective situational leadership adapts to these changes by identifying and marshaling the kinds of behavior needed to transition a company from its present state to a stronger, healthier one.

'HOW HEALTHY ARE WE?'

All this presupposes, of course, that leaders have an accurate sense of how healthy their organizations are. Developing such a view is easier said than done: it's only natural for leaders to overestimate the health of their organizations and the effectiveness of their leadership, given the way many of them identify with their companies and roles. In our experience, too many executives default to describing their companies as good and striving to be great. But this can't be true; by definition, more companies can't be above the median line of organizational health than below it. When we examine survey data through the lens of the different levels of an organization, we find that leading executives typically have more favorable views of its health than do its line workers—who are, after all, much closer to the true center of gravity.

What's more, surveys, interviews, and a significant amount of honest self-reflection all go into more robust assessments of organizational health. Since a rigorous self-diagnosis isn't always possible, we've developed some rules of thumb, such as those depicted in Exhibit 1. These move a bit beyond guesswork and provide a more informed sense of what it feels like to be in one type of company or another.[1] In ailing organizations, for example, the leadership tends to rely on very detailed instructions and monitoring—a symptom of excessively tight control. A healthier organization's leadership, by contrast, shows greater support for colleagues and subordinates, and sensitivity to their needs. And the leaders at elite organizations challenge employees to aspire higher still by setting stretch goals that inspire them to reach their full potential.

THE SITUATIONAL-LEADERSHIP STAIRCASE

To explore the effectiveness of different kinds of leadership behavior at companies in different states of organizational health, we surveyed more than 375,000 people from 165 organizations across multiple industries and geographies. Drawing both from our own work experience and from evolving academic research, we focused on more than 20 distinct kinds of behavior that cover a broad range of leadership characteristics and appear, at least

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[1] Readers seeking an additional indication of their organization's health quartile are invited to take McKinsey's nine-question quiz, "How healthy is your organization?," available at ohisolution.com.

Exhibit 1

When a rigorous self-diagnosis isn't possible, these rules of thumb are helpful in assessing the health of organizations.

	Ailing	Able	Elite
Direction	Strategy fails to resolve tough issues	Compelling strategy reinforced by systems and processes	Sense of purpose and engagement about the vision
Leadership	Very detailed instructions and monitoring (high control)	Sensitivity to needs of subordinates (high support)	Stretch goals to inspire working at full potential (high challenge)
Culture and climate	No coherent sense of shared values	Baseline of trust within and across organizational units	Strong, adaptable organization-wide performance culture
Accountability	Excessive complexity and ambiguous roles	Clear roles and responsibilities; performance and consequences linked	"Ownership" mind-set encouraged at all levels
Coordination and control	Conflicting and unclear control systems and processes	Goals, targets, and metrics aligned and managed through effective processes	Value from collaboration captured and measured across organizational boundaries
Capabilities	Failure to manage the talent pipeline or deal with poor performers	Institutional skills developed as required to execute strategy	Distinctive capabilities nurtured to create long-term competitive advantage
Motivation	Low engagement accepted as norm	Motivation promoted through incentives, opportunities, and values	Extraordinary effort generated through employees' sense of meaning and identity
External orientation	Energy of organization directed inward	Primary objective to create value for customers	Focus on creating value for all stakeholders
Innovation and learning	No structured approaches to harnessing employees' ideas	Ideas captured and converted into value incrementally and through special initiatives	Internal and external networks leveraged to maintain leadership position

Source: Alice Breeden, Aaron De Smet, Helena Karlinder-Ostlundh, Colin Price, Bill Schaninger, and Eilidh Weir, *Building healthy organizations to drive performance: The evidence*, McKinsey & Company, 2009

under certain circumstances, to correlate closely with strong corporate performance.[2]

Analytically, we studied organizational health and leadership effectiveness in turn. First, health: We sorted companies into organizational-health quartiles, then observed which leadership behaviors were most prevalent in each quartile. We were particularly interested in identifying leadership behaviors that were almost always present (as it turned out, there weren't many), and those that were more (or less) prevalent, depending upon an organization's current state of health. Next, we repeated the quartile approach but this time, we focused not on health but on leadership effectiveness. Which behaviors did respondents perceive to be most effective? The purpose was to address the possibility that we were giving too much prominence to behaviors exhibited at companies that were otherwise healthy, but which survey recipients thought were ineffective practices nevertheless. Instead, we sought to identify behaviors that matched organizational health with perceived leadership effectiveness, and to isolate those behaviors that were most effective in different situations.

The analysis yielded what we call a leadership staircase—a pyramid of behavior analogous to Maslow's hierarchy of needs (Exhibit 2).[3] In our hierarchy, like similar ones, some kinds of behavior are always essential. As organizational health improves, quartile to quartile, additional behaviors become apparent. More tellingly, some appear to be differentiators: emphasizing them in different situations can lift the organizational health of a fourth-quartile company to the third quartile, a third-quartile company to the second quartile, and so on. This staircase model aligns squarely with our own real-world observations.
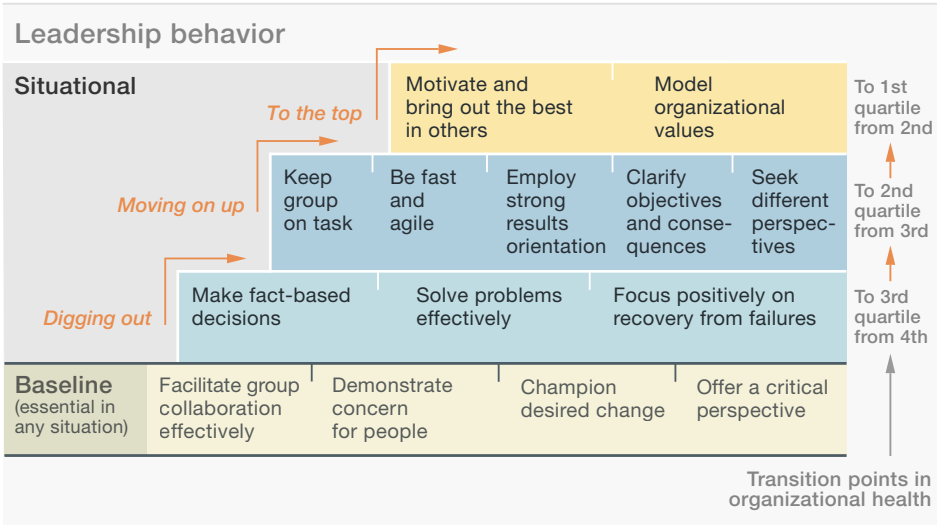
Baseline behavior

For companies at every level above the truly dysfunctional, a set of threshold forms of behavior appears to be essential. We call them "baseline behavior." Others may also be called for, depending upon an organization's state of health, but the following practices are appropriate no matter what a company's health may be: effectiveness at facilitating group collaboration, demonstrating concern for people, championing desired change, and

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[2] For a more detailed review of a substantially similar list of such leadership behaviors, see Claudio Feser, Fernanda Mayol, and Ramesh Srinivasan, "Decoding leadership: What really matters," *McKinsey Quarterly*, January 2015, mckinsey.com.

[3] Psychologist Abraham H. Maslow contended that human needs are structured in a hierarchy; as each level of needs is satisfied, the next higher level of unfulfilled needs becomes predominant. See Abraham H. Maslow, "A theory of human motivation," *Psychological Review*, 1943, Volume 50, Number 4, pp. 370–96; and Abraham H. Maslow, *Motivation and Personality*, first edition, New York: Harper & Brothers, 1954.

Exhibit 2

The importance of employing different kinds of leadership behavior to improve organizational health will vary according to a company's starting point.

Leadership behavior

Situational							
		To the top →	Motivate and bring out the best in others		Model organizational values		To 1st quartile from 2nd
	Moving on up →	Keep group on task	Be fast and agile	Employ strong results orientation	Clarify objectives and consequences	Seek different perspectives	To 2nd quartile from 3rd
Digging out →		Make fact-based decisions		Solve problems effectively		Focus positively on recovery from failures	To 3rd quartile from 4th
Baseline (essential in any situation)	Facilitate group collaboration effectively		Demonstrate concern for people		Champion desired change	Offer a critical perspective	

Transition points in organizational health

Source: 2014 McKinsey survey of >375,000 people from 165 organizations in multiple industries and geographies; McKinsey analysis

offering critical perspectives. The absence of such fundamentals of healthy interpersonal interaction invites disorder; shoring up these behaviors, on the other hand, serves to keep organizations from sliding backward into organizational trouble. But in themselves, they don't spell the difference between mediocre and top-tier organizational health. Companies need additional practices to climb the staircase.

Digging out

Companies in the lowest (fourth) health quartile confront stark—even existential—challenges, such as low levels of innovation, declining customer loyalty, wilting employee morale, the loss of major talent, and critical cash constraints. Typically, these companies lack some or even all of the baseline forms of behavior. Implementing the full complement is essential. But under trying conditions, our research suggests, the most effective forms of leadership behavior are making fact-based decisions, solving problems effectively, and focusing positively on recovery. Ironically, these additional behaviors are often the opposite of what distressed organizations actually do. Leaders at too many fourth-quartile companies, in their urgency to act, seek quick top-down fixes (such as replacing senior executives one or more times) but forego granular, fact-based analyses or well-rooted strategies. Those missteps often mark a company in its death spiral.

No doubt it's a bit dangerous to draw too many lessons from well-known historical examples; memories are selective, and researchers can easily see what they want. Yet we're struck by the parallels between these findings and the experiences of IBM in the early 1990s and of Continental Airlines later that decade. When Lou Gerstner, hired from the outside, took over as the new chairman and CEO of a then–deeply troubled IBM, he prioritized clear, fact-based problem solving. One measure of this mandate was his insistence that the executive team essentially abandon slide presentations and submit plans in jargon-free prose. He also refused to accept the idea that the company's decline, partition, or even liquidation was inevitable. The ability to see the facts clearly and to demonstrate resilience helped Gerstner and his team to break a long downward slide, reconsider a product category previously dismissed as obsolete, and turn what many had presumed to be an inevitable asset breakup into a new trajectory for growth. The leadership's mind-set, moreover, became ingrained in the enterprise; members of Gerstner's team who rode out the reorganization bought into his practices, and passed many of them on to their own working teams.

So too at Continental: morale had been so broken that workers were reportedly tearing the Continental logo off their uniforms to avoid being recognized as company employees off the job. As part of the company's turnaround, members of the new leadership team embraced effective attitudes and behaviors, drilled down to assess profitability on a route-by-route and flight-by-flight basis, and took decisive action grounded in reality. In fact, this uncompromising focus on facts led then-COO Greg Brenneman to discover, over Thanksgiving, that the company would run out of cash in less than two months. With spirited resilience, the leadership team eliminated unprofitable routes, implemented specific initiatives for recovery (such as bonuses for on-time departures), and brought a loss maker into the black within 12 months.[4]

Moving on up

Our research and experience suggests that a major differentiating leadership characteristic of companies on the upswing is the ability to take practices that are already used at some levels of the organization and use them more systematically, more reliably, and more quickly. This shift calls for behavior that places a special emphasis on keeping groups on task and orienting them toward well-defined results. Such situations also favor leaders who embrace agility and seek different perspectives to help ensure that their companies don't overlook possibly better ways of doing things. But under

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[4] Greg Brenneman, "Right away and all at once: How we saved Continental," *Harvard Business Review*, September–October 1998, hbr.org.

these circumstances, qualities (such as the ability to motivate and bring out the best in others and to model company values) found at the top tier of organizational health typically have a less pronounced effect.

A US-based financial-services company we know supplies a practical example. Its leadership aspired to strengthen the organization's financial performance, innovate in the core business, and use an integrated package of health, performance, and leadership initiatives to capture more value at risk. At the outset, this company's organizational health was in the third quartile—below the median. Key challenges included a lack of clear objectives or accountability (highlighted by committees with muddled or overlapping missions; poor development and career opportunities for high performers; and weak management of financials, operations, and risk (reflected, among other ways, by the absence of robust metrics). Exacerbating these problems, the leadership's approach to running the company was pervasively top down.

To meet the challenges, the leaders implemented an integrated set of health and performance initiatives—for example, they developed clear standards and outcomes to clarify day-to-day tasks. The company made its objectives (and the consequences of not achieving them) transparent by articulating a forceful strategic vision marked by specific operating goals and milestones. The leadership also aimed to foster bottom-up, employee-driven solutions and actively encourage new perspectives. Although many things went right for this company beyond its walls, these internal moves undoubtedly strengthened it, and the results were tangible. Within two years, it had achieved its topline objectives in health, performance, and leadership, and its stock price had increased by 250 percent.

Why not start at the top?

If identifiable forms of leadership behavior are associated with companies in the higher quartiles, can an organization in the lower ones apply them immediately and leap to the top? Our research and experience suggest that attempts to do so typically end poorly. Emphasizing kinds of behavior that are not attuned to an organization's specific situation can waste time and resources and reinforce bad behavior. Worse, it can make an upgrade to a higher health quartile even more difficult. This makes intuitive sense: the leaders of a company in deep trouble should not prioritize, for example, modeling organizational values, a first-quartile behavior.

We observed one cautionary example at a joint venture that ended badly for a number of related health, performance, and leadership reasons. Its board installed a highly charismatic leader with an outsized focus on top quartile–

style motivational behavior. He traveled globally with his chairperson, for example, touting the joint venture's "premium on innovation" and declaring that despite its merger-like characteristics, there was a "job for everyone" who was passionate about its vision. Unfortunately, at the time of these pronouncements, the organization had done little groundwork on critical issues of integration, including the difficult how-tos of harmonizing disparate IT systems and organizational cultures. Both legacy organizations responded by continuing to execute and perform as if nothing had changed. There was evidence they hoped that nothing ever would.

The joint venture responded to missing its first-quarter targets by setting even more ambitious ones. It handed accountability to the executive responsible for sales and marketing, but no root-cause analyses were undertaken. When it discovered a cash crisis, it made no credible efforts to craft a practical response; instead, the top executive continued to trumpet his mission throughout his global visits. But a "job for everyone" fell victim to the joint venture's alarming cash position, which forced mass layoffs, and with them came the end of the leadership's credibility. The venture was dissolved after just over a year of misguided operation.

Even the best scripts can ring hollow in the wrong settings. Our research suggests that the most effective leadership behavior reflects the state of a company's organizational health. Top-management teams that are serious about developing vibrant businesses and effective leaders must be prepared to look inward, assess the organization's health objectively, and ask themselves frankly whether their leadership behavior is strong enough in the ways that matter most at the time. This question has implications not just for developing but also for assessing a company's leaders. However much an executive may seem to have a leadership "it" factor, the organization's health, not the claims of individuals, should come first when companies determine which kinds of behavior will be most effective for them. In short, they should spotlight different sets of actions in different situations. Fortunately for aspiring leaders, they don't have to do everything at once. ⓠ