RESEARCH HIGHLIGHTS

How the Top 20 Companies Grow Great Leaders

2005

About the Research

Hewitt Associates initiated the *Top Companies for Leaders* research in 2001. We set our sights high—to identify the combination of factors that allow financially successful organizations to consistently produce great leaders. We examined the variables that influence a leader's growth in an organization, including developmental experiences, senior leader interaction, compensation, organizational culture, and succession planning processes. The research uncovered a link between financial success and great leadership practices, and identified the few differentiating elements found uniquely at top companies.

Top Companies for Leaders Project Team

The 2005 *Top Companies for Leaders* research study was managed by a team of consultants from Hewitt's Talent and Organization Consulting Practice, listed below.

Michelle Salob—*Top Companies for Leaders* Project Manager
Michelle consults with clients in the design and implementation of talent management processes and programs, including leadership development, organizational development, performance management, and HR transformation. She can be reached at **(770) 956-7777** or by email at **michelle.salob@hewitt.com**.

Shelli Greenslade—*Top Companies for Leaders* Research Manager
Shelli designs and conducts original research studies on critical HR issues including leadership, talent management, and the global workforce. She can be reached at **(847) 295-5000** or by email at **shelli.greenslade@hewitt.com**.

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Research Methodology

Hewitt Associates surveyed human resources executives from 373 public and private companies in the United States in early 2005, a 16% increase from our last survey, in 2003. The median revenue of participating organizations was approximately $2 billion, with a median employee size of 7,300. More than half of the participating companies had employee populations under 10,000.

Based on the three-step screening process described below, the list of possible companies was narrowed to 75 finalists. An independent Judges Panel, composed of renowned authors, professors, and executive coaches, selected and ranked the 2005 Top Companies for Leaders.

All participating companies completed a 41-item questionnaire that broadly examined factors that influence leader quality and depth in organizations. All surveys were analyzed for responses that were consistent with strong leadership practices. Of all participants, 75 were asked to complete an interview with Hewitt to gain greater clarity and detail regarding specific practices. All interviewed companies were then screened for financial performance, using a three-year compound annual growth rate in net income metric. Net income was selected as the primary screening metric so that both public and private companies could be evaluated consistently.

The Judges Panel discussed this data in a full-day meeting and selected the 2005 Top 20 U.S. Companies for Leaders. The judges considered many variables in selecting and ranking the list, including the survey and interview data, company reputation, industry trends, diversity practices, and what they deemed "fresh approaches to leadership development." The Judges Panel acknowledged that there may be companies that are good at growing great leaders that were not considered for the Top 20 Companies since they did not elect to participate in the study.

Hewitt is also conducting a 2005 *Top Companies for Leaders* study in Europe, and the results will be published in a separate report.

Key Findings

In Hewitt's previous research studies on leadership development, we uncovered several building blocks—the "Three Fundamental Leadership Truths"—that Top Companies for Leaders use to build a sustainable pipeline of leadership talent. These findings still apply. In fact, the Top 20 Companies continue to distance themselves from other companies in these areas and make continuous improvements to better support the direction of their organizations. The Leadership Truths are:

- CEOs and Board of Directors Provide Leadership and Inspiration. One of the key enablers of building leadership quality and depth is active involvement from the CEO and Board of Directors. This is certainly the case among the Top 20 Companies, which boast CEOs and boards that are actively engaged in leadership development programs and are personally involved in the selection, review, and development of their best talent.
- Clear Differentiation of High-Potential Talent. The Top 20 Companies are serious about investment in their top talent. They more actively manage and develop their best talent as compared to other companies. High-potential leaders at the Top 20 Companies receive clearly differentiated compensation, development, and exposure to senior leadership.
- The Right Programs, Done Right. Although companies may have the right programs in place, it is the integration and execution of these programs that make the most difference. The Top 20 Companies differentiate themselves by effectively utilizing their practices to develop leaders in support of their business strategy.

Additionally, two important differentiators emerged among the Top 20 Companies in 2005. They have a clear focus on accountability and execution, which apply across all three Leadership Truths.

Practical Accountability. The Top 20 Companies formally hold their leaders accountable for the success of leadership programs, the development of their employees, and the development of their own leadership capabilities. Leaders are held accountable for these results through their annual incentive, with up to 20% or more of incentive pay impacted by these behaviors.

Consistent Execution. Great leadership practices are not simply designed at the Top 20 Companies—they are consistently well executed. Top 20 Companies focus on building lean, non-bureaucratic practices and ensure that they are executed by line leaders. The Top 20 Companies find that this focus on execution allows them to better identify more great talent within their organizations, as well as to attract the best talent from outside the organization. (See The Right Programs, Done Right on page 5, for more detail on this finding.)

CEO and Board of Directors Provide Leadership and Inspiration

Commitment Starts at the Top. CEOs and Boards of Directors are actively involved in developing leadership talent at the Top 20 Companies. Their involvement goes beyond succession planning and talent reviews. All of the Top 20 Companies' CEOs are actively involved in developing leadership talent, compared with only 65% of CEOs at other companies. "My number one job is developing leaders," stated one Top 20 Company CEO. The CEO at another Top 20 Company maintains a mentoring partnership program in which he meets with early- and mid-career high potentials throughout the year. Nearly all of the Top 20 Companies' CEOs regularly teach leadership courses within their organizations. This involvement, particularly with the CEO, is a critical factor in building leadership quality and depth.

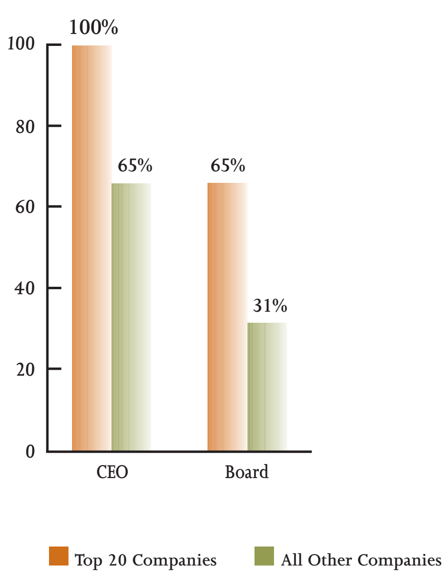
The more active the CEO is in developing leadership talent, the more effective a company rates itself in developing leaders. Not surprisingly, participating companies rated senior team support as one of the most important enabling factors in successful development of leader quality and bench strength. Those companies with active CEO involvement also show higher financial performance.

Boards of Directors Are Actively Involved. The role of the Board of Directors continues to expand. Sixty-five percent of the Top 20 Companies report that their Boards of Directors are actively involved in developing leaders. What's more, this involvement reaches beyond succession planning at the senior executive level. For example, at one Top 20 Company, the board sponsors all leadership development at the organization. Several of the Top 20 Companies' board members visit with high potentials at their locations and make a concerted effort to get to know them on a personal level. In contrast, less than a third of other companies report such active involvement of the board. Consistent with the CEO findings, companies rate themselves as more effective in developing leaders when the Board of Directors is actively involved in leadership development.

Active Participation Yields Positive Results. Consistent with Hewitt's 2002 and 2003 findings, active CEO and board involvement is linked to a stronger focus on developing leaders at both the corporate and business-unit levels. All of the Top 20 Companies report a strong to very strong focus on leadership development at the corporate level, while 81% of the other companies report the same.

Similarly, 100% of the Top 20 Companies believe that there is a strong to very strong focus on leadership development at the business-unit level, compared with 72% of other companies. In those organizations with little or no CEO and Board of Directors involvement, the focus on leadership development at the corporate level is not strong in 33% of participating companies and leadership development at the business-unit level is not strong in 41% of firms.

Are the CEO and Board of Directors actively involved in developing leadership talent?



Clear Differentiation of High-Potential Talent

The Top 20 Companies are maniacal about their best talent.

High Potentials Are Formally Identified and Tracked. Ninety-five percent of the Top 20 Companies formally identify high-potential leaders, while 77% of other organizations do the same. All of the Top 20 Companies use their succession planning process to identify high potentials, compared with 86% of other companies. High potentials are told of their status at 68% of Top 20 Companies. In contrast, just over half (53%) of other companies tell high potentials of their status. Seventy-two percent of the Top 20 Companies formally track high-potential turnover, compared with 60% of other companies. The Top 20 Companies take high-potential retention seriously. One Top 20 Company has a policy that the CEO must be notified if a high potential resigns, and a counteroffer must be made within 24 hours to that high potential, at any level within the organization. Moreover, leaders at this company are required to retain 90% of the high potentials in their departments or their bonuses are reduced.

Compensation Is Clearly Differentiated. Seventy-five percent of the Top 20 Companies say that compensation is clearly linked to a leader's potential to advance, while the same is true at only 38% of other companies. Similar to our previous study findings, different practices underlie these statistics. Among the Top 20 Companies that differentiate pay for potential, 100% use stock options and restricted stock as key compensation vehicles. In contrast, only 65% of other companies use stock options, and even fewer (44%) use restricted stock. Moreover, 87% of the Top 20 Companies use long-term incentives, compared with 53% of other companies. Seventy-eight percent of other companies use base pay to reward potential, which sharply reduces their ability to differentiate pay. Only 53% of the Top 20 Companies do this.

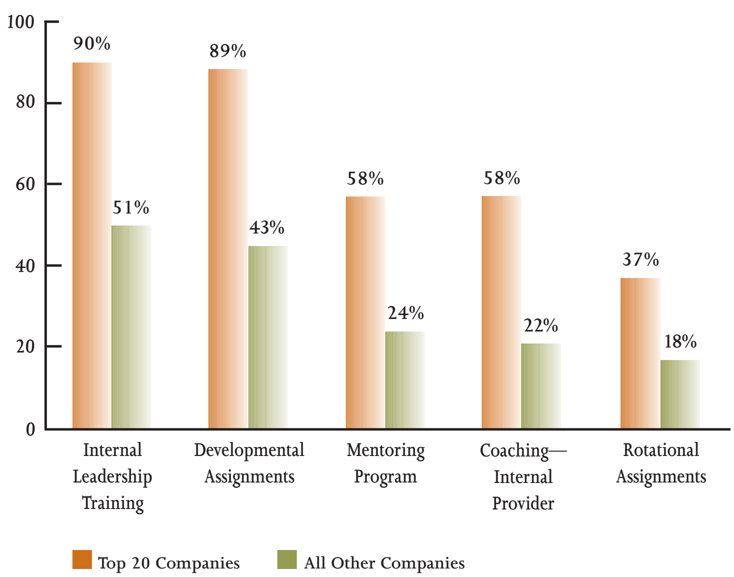
The Top 20 Companies reinforce a performance culture through their compensation systems. More than two-thirds of the Top 20 Companies target long-term incentive pay for high potentials between the 90th and 100th percentile, compared with only 13% of other companies. Undoubtedly, the Top 20 Companies realize the value of their top talent and reward them accordingly.

Increased Access to Senior Leadership. Nearly all of the Top 20 Companies (95%) provide their high potentials with frequent opportunities to interact with senior leadership. More than two-thirds of the Top 20 Companies say that their high potentials almost always or always have regular exposure to the CEO, while fewer than half of the other companies report the same. The Top 20 Companies often provide opportunities for their high potentials to interact with senior leaders on specific projects. Several Top 20 Companies have talent showcases where high-potential leaders present to the board at meetings. In other Top 20 Companies, high potentials are invited to various lunches and dinners with board members during training sessions or board meetings.

Developmental Assignments Propel High Potentials' Growth. Eighty-nine percent of the Top 20 Companies regularly grow high potentials' capabilities through developmental assignments, while only 43% do so at other companies. For example, one Top 20 Company provides its high potential-swith challenging assignments as Six Sigma black belts and master black belts, and works to ensure appropriate stretch assignments upon reintegration from a Six Sigma role. Another Top 20 Company encourages leaders to serve on nonprofit Boards of Directors to accelerate their development and demonstrate skills beyond their job responsibilities.

The Top 20 Companies also target their efforts more cost-effectively than do other companies. For example, 90% of Top 20 Companies say that internal leadership training is almost always or always used, compared with just 51% at other companies. Rotational assignments are used for high potentials in 37% of the Top 20 Companies, while 18% of other companies do the same. Even more compelling, other companies are not utilizing the developmental programs that are the least costly—namely, internal coaching (22%) and mentoring (24%). More than half of the Top 20 Companies consistently use internal coaching and mentoring with their high potentials.

Are these practices regularly used to develop high-potential leaders?



The Right Programs, Done Right

The Top 20 Companies understand the unique type of leadership that their businesses and cultures demand. Not only do they differentiate themselves by the breadth and depth of their leadership practices, but they specifically tailor these practices to align with their organizations' goals. The Top 20 Companies' focused approach to leadership strategy differs sharply from other companies, as it is linked to business strategies and not simply to the accepted practices popular today.

It Starts With Strategy. The Top 20 Companies' approaches to building leaders are firmly rooted in strategy. The Top 20 Companies consistently offer more programs for growing leadership talent and are distinctively more successful in making them work. This success may be due to having specific strategies for developing leaders, a feature at 100% of the Top 20 Companies but at only 62% of other companies. All of the Top 20 Companies have a strategy for selecting leaders from within and rewarding leaders, compared with only 55% of other companies. One Top 20 Company created a new leadership competency model to match its new business strategy, then integrated the competencies into practices such as succession planning, selection for developmental assignments, and performance management.

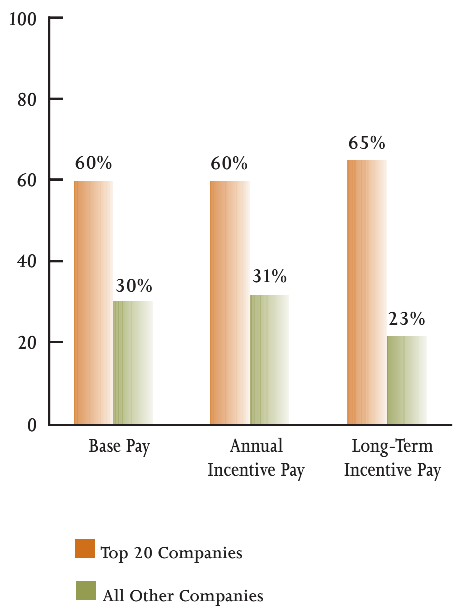
At the tactical level, the Top 20 Companies offer a greater range of developmental opportunities to leaders than other companies, and the differences are striking. While 95% of the Top 20 Companies offer mentoring, only 45% of other companies do. All of the Top 20 Companies also offer developmental assignments, compared with just 57% of the others. Ninety percent of the Top 20 Companies have a defined process for assimilating leaders into new positions, while only 44% of other companies do the same, and only 64% of those companies believe that the programs are effective. More important, the Top 20 Companies are decidedly more effective in executing these programs.

Execution Elevates the Best. The Top 20 Companies get more from their leadership practices by executing them effectively. While 100% of the Top 20 Companies and 73% of other companies have leadership competencies, the Top 20 Companies are significantly better at integrating these into leadership processes. All of the Top 20 Companies integrate these competencies into the succession planning process, while only 78% of other companies do so. At 60% of Top 20 Companies, leadership competencies are used in determining base pay and annual incentive pay, compared with approximately 30% of other companies. This focus on execution might be why the Top 20 Companies find more of their leaders inside, including their future CEOs, and deliver significantly better returns to shareholders.

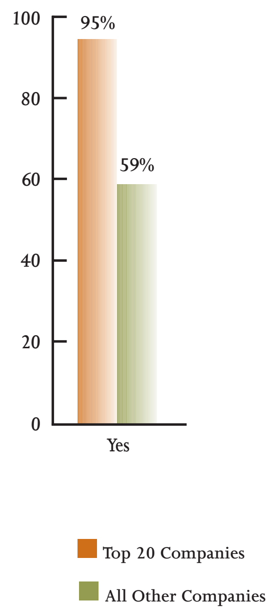
Other companies clearly underutilize their leadership infrastructure. While 65% of the Top 20 Companies say that they choose middle managers using their succession planning process, only 42% of other companies do. Those numbers improve only slightly for choosing senior leaders; 85% of the Top 20 Companies rely on their succession planning information, compared with 53% of other companies. One Top 20 Company not only consistently utilizes its succession plan, it formally measures the success of succession planning decisions three years after a placement.

Given these numbers, it's not surprising that 85% of the Top 20 Companies consider themselves effective at developing leaders, with only 37% of other companies holding a similar opinion.

How often are leadership competencies used in determining pay?



Is diversity a formal part of your leadership strategy?



Practical Accountability

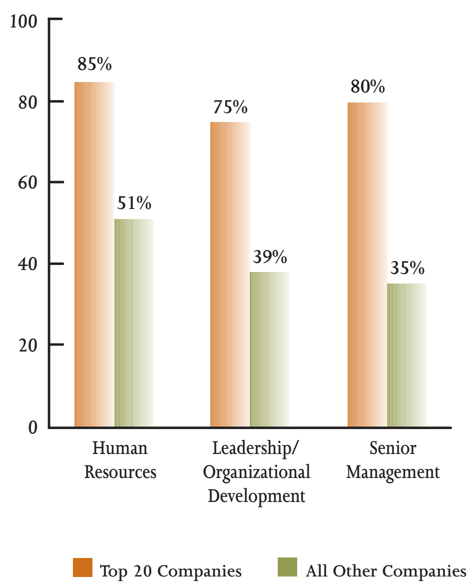
The Top 20 Companies hold leaders accountable for practices that build leadership quality and depth, which further distinguishes them from non-Top 20 Companies. Top 20 Companies leaders are held accountable for:

- The success or failure of leadership programs;
- Their own development; and
- The development of others.

Accountability for Leadership Programs

The Top 20 Companies place accountability for the success of leadership programs on all parties more frequently than other companies, with the greatest gap found in senior management accountability. While 80% of Top 20 Companies hold senior management accountable for the success of programs such as succession planning, performance management, and high-potential development, just over one-third of other companies have the same rigor. In other companies, the human resources department is most likely to be held accountable for these processes. At one Top 20 Company, business leaders are rated on six dimensions of talent management, and the scorecard results are shared publicly with other business-unit leaders.

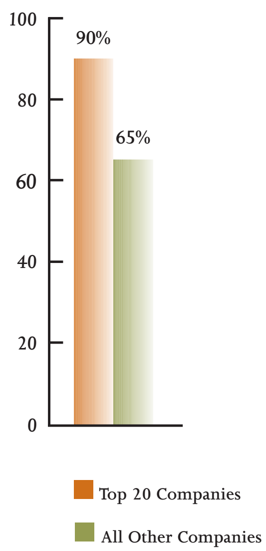
Who is held accountable, through performance management, for the success or failure of leadership programs?



Accountability for Personal Development

Leaders at the Top 20 Companies are measured on both their leadership behaviors today and improvement in those behaviors over time. At 95% of Top 20 Companies, leaders are measure-don performance against competencies; 90% of Top 20 Companies also have follow-up measures to gauge progress. At other companies, only 69% measure performance on competencies and just 65% follow up.

Companies that both measure performance on leadership competencies and monitor progress against those competencies.

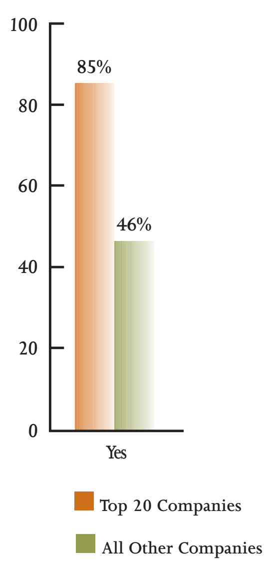


Accountability for Others' Development

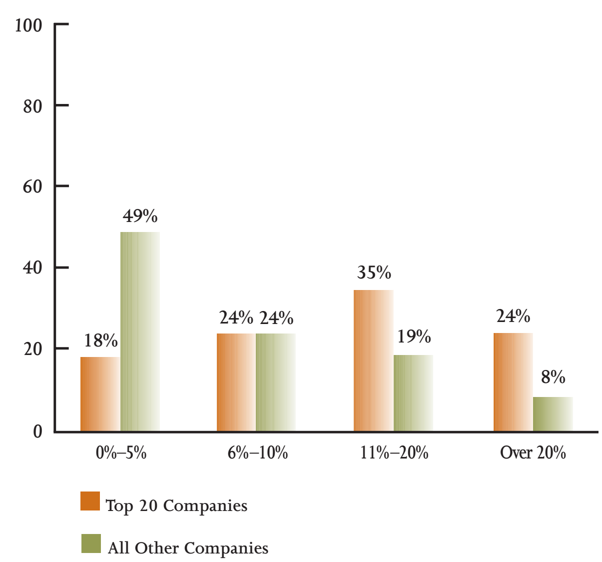
Improving talent quality across the organization is a priority at Top 20 Companies, with 85% holding leaders accountable for developing others. Only 46% of other companies do the same. More important, the percentage of the annual incentive dedicated to this factor was significantly higher in Top 20 Companies. While nearly 75% of other companies dedicated 10% or less of a leader's annual incentive to people development, many Top 20 Companies allocated up to 20% and more. This higher percentage sends a clear signal to leaders that building the organization's talent is truly a priority.

For example, one Top 20 Company links 30% of senior leaders' incentive compensation to talent development. Managers are assessed on how effectively they develop talent over a 12-month period, and incentive compensation is affected accordingly.

Are leaders held accountable, through the performance management process, for developing their direct reports?



What percentage of average annual incentive is tied to this development objective?



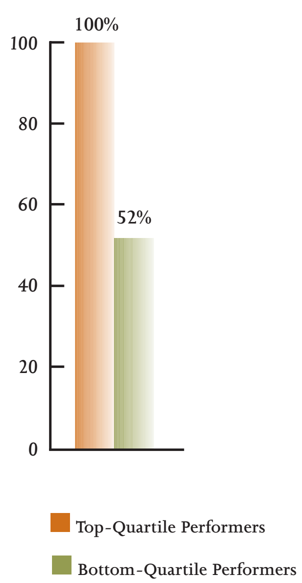
Better Financial Performance

Based on the financial analysis of the 2005 *Top Companies for Leaders* results, several significant relationships were found to exist between leadership development and a company's business results.

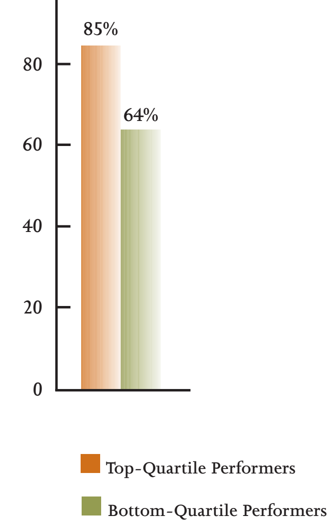
There is a clear relationship between a company's financial performance and its approach to building leaders. Better-performing companies:

- Hold senior leaders accountable;
- Use metrics to assess the effectiveness of leadership programs;
- Link performance management to succession planning; and
- Have CEOs and Boards of Directors that are actively involved in developing leadership talent.

Compensation is linked to a leader's future potential.



Strategy for developing leaders is effectively utilized.



In 78% of companies that perform at the 75th percentile or higher in industry-adjusted return on equity[1], senior management is formally held accountable for the success or failure of leadership development programs, but only 55% of companies that perform below the 25th percentile do the same. Additionally, better-performing companies[2] (85%) hold leaders accountable, through a formal performance management process, for developing their direct reports. The same is true of only 55% of bottom-quartile performers.

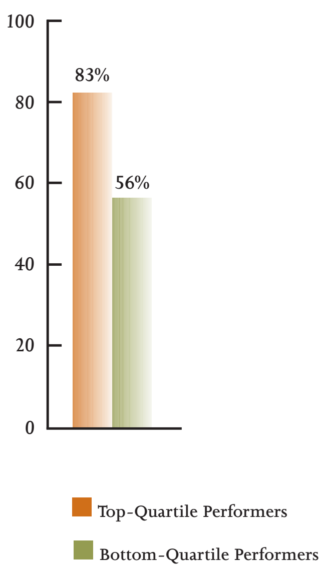
1 All return on equity (ROE) calculations are based on industry-adjusted, five-year compound annual growth rates of ROE.

2 Ibid.

Not only do high-performing organizations hold leaders accountable, they also use metrics to assess the effectiveness of their leadership programs. Nearly half of companies that perform in the top quartile for total shareholder return (TSR) have metrics in place to assess effectiveness of programs for developing leaders, while only 19% of bottom-quartile performers do[3]. Moreover, ratings from the performance management process are formally incorporated into the succession planning process at 71% of companies performing in the top quartile for TSR, compared with just 46% of bottom-quartile performers.

Active CEO and board involvement is more prevalent at higher-performing organizations. Eighty-three percent of companies that perform at the 75th percentile or higher in TSR have CEOs who are actively involved in the development of leadership talent, compared with 56% of those companies that performed below the 25th percentile. Similarly, Boards of Directors are actively involved in leadership development at nearly half of higher-performing organizations[4]. Only 38% of bottom-quartile performers can say the same. Not surprisingly, 61% of companies that perform in the top-quartile for TSR believe that their organizations are more effective in developing leaders, compared with 31% of bottom-quartile companies.

CEO is actively involved in leadership development.



3 All total shareholder return (TSR) measures are based on industry-adjusted, five-year averages of TSR.

4 Ibid.

The Judges Panel

Hewitt partnered with The Human Resource Planning Society (HRPS) to identify the Top Companies for Leaders. The Judges Panel, composed of renowned authors, professors, and executive coaches, selected and ranked the Top 20 U.S. Companies for Leaders. The members of the Judges Panel are listed below.

John Byrne is the Editor-in-Chief of *Fast Company* magazine and the author of eight books on business, leadership, and management. He was previously a senior writer at *BusinessWeek* and the author of 57 cover stories at the magazine. He is a frequent commentator and public speaker on topics ranging from creativity and innovation to leadership and corporate governance.

Price M. Cobbs is an internationally recognized psychiatrist and management consultant. Pacific Management Systems, the company he founded, consults with organizations on leadership, executive development, and diversity strategies. He is the author of several books, including *Cracking the Corporate Code: From Survival to Mastery*.

Marshall Goldsmith is a leading executive coach, prominent speaker, and author of many books and articles on leadership. He is an authority on how to help leaders achieve positive, measurable changes in their own behavior and that of their people and teams. The author of 18 books, he has been named one of the five most respected executive coaches by *BusinessWeek*, and one of the 50 greatest thinkers in the field of management by American Management Association.

Jay Jamrog is the Executive Director of the Human Resource Institute and identifies and analyzes the major issues and trends affecting the management of people in organizations. He is an associate editor of *Human Resource Planning*, and is frequently quoted in business publications on topics relating to the future of people management.

Joseph McCann is Dean of the John H. Sykes College of Business, Dean of Graduate Studies, and Co-Chief Academic Officer at the University of Tampa. He is a consultant, researcher, and author on organizational design and strategic change, mergers and acquisitions, rapidly growing technology companies, and new business venturing. He is an associate editor of *Human Resource Planning*.

The 2005 Top 20 U.S. Companies for Leaders

1. 3M Company
2. General Electric Company
3. Johnson & Johnson
4. Dell Inc.
5. Liz Claiborne, Inc.
6. IBM
7. The Procter & Gamble Company
8. General Mills, Inc.
9. Medtronic, Inc.
10. American Express Company
11. Capital One Financial Corporation
12. Whirlpool Corporation
13. Colgate-Palmolive Company
14. Pitney Bowes Inc.
15. Pfizer Inc.
16. FedEx Corporation
17. Washington Group International, Inc.
18. The Home Depot, Inc.
19. Avery Dennison Corporation
20. Sonoco Products Company

Moving Forward

Hewitt started the *Top Companies for Leaders* research to help companies understand the facts about how financially successful companies grow great leaders. Our studies have provided clear direction on leadership practices and built a strong business case for action.

We would like to help your company achieve the same results as the Top 20 Companies for Leaders. Hewitt Associates' Leadership Consulting group offers a strategic, fact-based, and practical approach to building great leaders. Equipped with the latest knowledge from the 2005 *Top Companies for Leaders* research, our global team of experienced leadership consultants can:

- Audit your company's leadership practices, identifying critical gaps and making practical recommendations for improvement.
- Develop a comprehensive leadership strategy with detailed plans for sourcing, aligning, developing, and rewarding leaders that aligns with your organization's business strategies.
- Design and implement world-class leadership practices, including executive assessment and coaching, succession planning, executive education, and senior team effectiveness.

You can grow great leaders and Hewitt can help. Please contact Michelle Salob at (770) 956-7777 or by email at michelle.salob@hewitt.com or Shelli Greenslade at (847) 295-5000 or by email at shelli.greenslade@hewitt.com for more information.

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