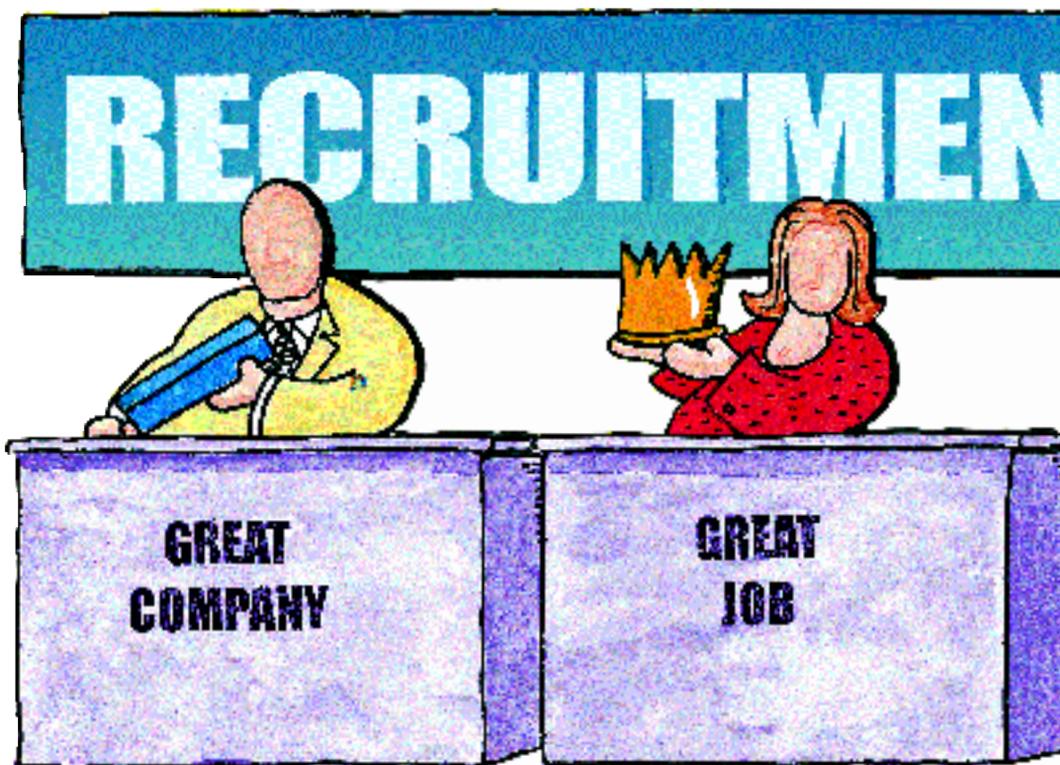


THE WAR FOR TALENT

Elizabeth G. Chambers, Mark Foulon,
Helen Handfield-Jones, Steven M. Hankin,
and Edward G. Michaels III



Tell me again: Why would someone really good want to join your company?

And how will you keep them for more than a few years?

Yes, money does matter

BETTER TALENT IS WORTH FIGHTING FOR. At senior levels of an organization, the ability to adapt, to make decisions quickly in situations of high uncertainty, and to steer through wrenching change is critical. But at a time when the need for superior talent is increasing, big US companies are finding it difficult to attract and retain good people. Executives and experts point to a severe and worsening shortage of the people needed to run divisions and manage critical functions, let alone lead companies. Everyone knows organizations where key jobs go begging, business objectives languish, and compensation packages skyrocket.



In addition to the five authors, a team consisting of Stephanie Durr, Larry Kanarek, Nikitas Koutoupes, Bill Kunze, Mathias Lingnau, and Drew Scielzo worked extensively on this research. Jude Rich of Sibson & Company, a human resource and compensation consulting firm, also made a considerable contribution.

Libby Chambers is a principal in McKinsey's New York office, Mark Foulon is a former consultant in the Washington, DC office, *Helen Handfield-Jones* is a consultant in the Toronto office, *Steve Hankin* is a principal in the Charlotte, North Carolina office, and *Ed Michaels* is a director in the Atlanta office. Copyright © 1998 McKinsey & Company. All rights reserved.

ABOUT THE RESEARCH

To investigate the talent problems faced by large organizations, we studied 77 companies from a variety of industries. The companies chosen were in either the top or the middle quintile within their industries in terms of 10-year total return to shareholders. We grouped the companies into sectors so as to compare high performers with average players.

We also asked the companies to provide disguised performance data on their executive pools, grouping senior managers into 20 percent high performers, 60 percent average performers, and 20 percent low performers. This allowed us to compare the responses to survey questions of groupings of high-, average-, and low-performing executives.

We questioned corporate officers (CEOs and their direct reports; 359 respondents)

about the strength of their company's talent pool and how it might be improved. We talked to the top 200 executives in each company directly to understand why they work where they do and how they became the professionals they are (5,679 respondents). We asked senior HR executives (72 respondents) about the way their company manages its top executive group; for some companies that meant 50 people, for others 400. The quotations in the article are taken from these interviews.

In addition, we interviewed a dozen leading academics in the field of organization and mined the research base. As a reality check, we relied on a steering committee comprising HR leaders, executive search, compensation, and assessment experts, and McKinsey partners with experience in organizational consulting.

In an effort to understand the magnitude of this war for talent, we researched 77 large US companies in a variety of industries (*see* text panel). We worked with their human resources departments to understand their talent-building philosophies, practices, and challenges. And to gain a line manager perspective, we surveyed nearly 400 corporate officers and 6,000 executives from the “top 200” ranks in these companies. Finally, because numbers never tell the whole story, we conducted case studies of 20 companies widely regarded as being rich in talent.* What we found should be a call to arms for corporate America. Companies are about to be engaged in a war for senior executive talent that will remain a defining characteristic of their competitive landscape for decades to come. Yet most are ill prepared, and even the best are vulnerable.

You *can* win the war for talent, but first you must elevate talent management to a burning corporate priority. Then, to attract and retain the people you need, you must create and perpetually refine an employee value proposition: senior management's answer to why a smart, energetic, ambitious individual would want to come and work with you rather than with the team next door. That done, you must turn your attention to how you are going to recruit great talent, and finally develop, develop, develop!

* They were: AlliedSignal, Amgen, Arrow Electronics, Baan, Enron, First USA (Banc One), General Electric, Harley-Davidson, Hewlett-Packard, The Home Depot, Intel, Johnson & Johnson, Medtronic, Merck, Monsanto, Nabisco, NationsBank, Sears, SunTrust, and Wells Fargo.

Our survey reveals that some companies do all of these things, but many more fall short of the mark.

There is a war for talent, and it will intensify

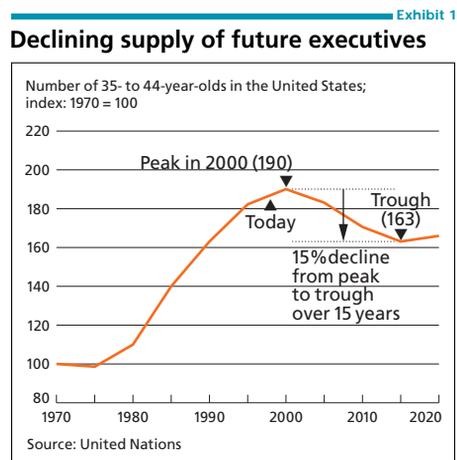
Many American companies are already suffering a shortage of executive talent. Three-quarters of corporate officers surveyed said their companies had “insufficient talent sometimes” or were “chronically talent-short across the board.” Not surprisingly, search firm revenues have grown twice as fast as GDP over the past five years.

Part of the cause may be cyclical, the product of a strong economy at the peak of its cycle. But what should keep CEOs awake at night is a number of trends that threaten a wide-ranging shortage in talent over the next five years.

Until now, the executive population has grown roughly in line with GDP. This means that an economic growth rate of 2 percent for 15 years would increase demand for executives by about a third. But *supply* is moving in the opposite direction: the number of 35- to 44-year-olds in the United States will decline by 15 percent between 2000 and 2015 (Exhibit 1). Moreover, no significant countervailing trends are apparent. Women are no longer surging into the workforce, white-collar productivity improvements have flattened, immigration levels are stable, and executives are not prolonging their careers.

This would be challenge enough, but the numbers tell only half the story. Large companies also face three qualitative challenges. First, a more complex economy demands more sophisticated talent with global acumen, multi-cultural fluency, technological literacy, entrepreneurial skills, and the ability to manage increasingly delayed, disaggregated organizations.

Second, the emergence of efficient capital markets in the United States has enabled the rise of many small and medium-sized companies that are increasingly targeting the same people sought by large companies. Small companies exert a powerful pull across the whole executive spectrum, offering opportunities for impact and wealth that few large firms can match. As Julian Kaufmann, director of organization development and information systems, human resources at AlliedSignal, explained, “We are competing with startups, not General Electric. We are not getting access to a whole raft of talent.”



Third, and not surprisingly given the above, job mobility is increasing. Ten years ago, a high performer might have changed employers just once or twice in a full career. According to 50 senior executive search professionals we surveyed, the average executive today will work in five companies; in another 10 years, it might be seven. A war once conducted as a sequence of setpiece recruiting battles is transforming itself into an endless series of skirmishes as companies find their best people, and in particular their future senior executives, under constant attack.

All are vulnerable

Our research suggests that executive talent has been the most undermanaged corporate asset for the past two decades. Companies that manage their physical and financial assets with rigor and sophistication have not made their people a priority in the same way. Only 23 percent of some 6,000 executives surveyed strongly agree that their companies attract highly talented people, and just 10 percent that they retain almost all their high performers. Perhaps more alarmingly, only 16 percent think their companies even know who their high performers are. And only 3 percent say their companies develop people effectively and move low performers out quickly.

Companies skilled at attracting, developing, and retaining talented senior executives do exist, however. Of 20 cases that we studied, seven appear to have thrived largely because of a strong performance ethic. Nine had combined strong corporate aspirations with rapid growth, as well as wealth accumulation and attractive jobs for employees (what we describe later as an attractive employee value proposition). But many of these companies had not managed talent particularly consciously until they began to see problems emerging on that front. Even now, they face important talent-building challenges.

Make talent management a burning priority

Superior talent will be tomorrow's prime source of competitive advantage. Any company seeking to exploit it must instill a talent mindset throughout the organization, starting at the top.

Leaders with a talent mindset share AlliedSignal CEO Larry Bossidy's conviction that "At the end of the day, we bet on people, not strategies." They understand why, when Jack Welch met with The Home Depot to share what is distinctive about GE's approach to managing growth, he took two human resources executives with him. They believe building their bench is a crucial part of their job. "If it's the most important thing," says Dick Vague, CEO of First USA, "your calendar reflects it. I have been personally involved in hiring everyone in the top management group, and many three or four levels below that."

Leaders put in place a gold standard for talent, and act on it. The leadership group, whether CEO, COO, or executive committee, should be directly responsible for applying the standard to the top 200 to 500 executives. At medical devices company Medtronic, “Over the past seven years, CEO Bill George has upgraded the talent pool of our top 300. At present, 25 percent come from the outside. Some people left because they could not meet the new bar.” Similarly, when SunTrust’s banking units needed more people to expand the business in large markets, “We assessed our top 120 line of business managers [and found] about 15 percent were underleveraged and about a third were over their heads. We’ve moved on more than half of those over their heads.”

Once united by a talent mindset, the leadership group must foster the right talent-building behavior by holding regular discussions to review the performance of executives at every level. The backbone of a company’s talent effort, these reviews must be candid, probing, and action-oriented, and link talent to strategy. They must set high standards, ensure that performance is assessed fairly, and act as a vehicle for fostering personal development. Ultimately, they should improve the quality of decisions about staffing.

Human resources executives at half our top-quintile companies strongly agree that “Discussions in our meetings are frank and open, and everyone contributes actively.” For mid-quintile companies, the figure is just 17 percent. At The Home Depot, the ethos is “To say what you think in the room, not after the meeting.”

Companies must insist that their line managers are accountable for talent. At Monsanto, half a senior executive’s bonus is based on his or her people management skills. At First USA, the ability to recruit talented new people is understood to be a criterion for promotion. Although 78 percent of corporate officers questioned in our survey agree that companies should hold their line managers accountable for the quality of their people, only 7 percent believe that their companies actually do so. It seems that many line managers are not accountable for the quality of their staff. This was perhaps our most shocking finding. Clearly, things must change.

To support the talent-building challenge, the role of human resources should be redefined and its capabilities strengthened. More than process managers, HR executives need to be effective, proactive counselors with personal and business credibility and strong relationships with business units. The need for such a dynamic profile is fast becoming conventional wisdom (78 percent of corporate officers agree HR should be a partner in efforts to build a stronger talent pool), but it is more honored in the breach than the observance (only 27 percent of corporate officers strongly agree that HR plays this role at present).

When all these things are in place, managers can take risks and deploy innovative solutions in the quest for talent. They can hire 650 military officers over two years, as General Electric did, or replace half their 400 manufacturing managers, like AlliedSignal.

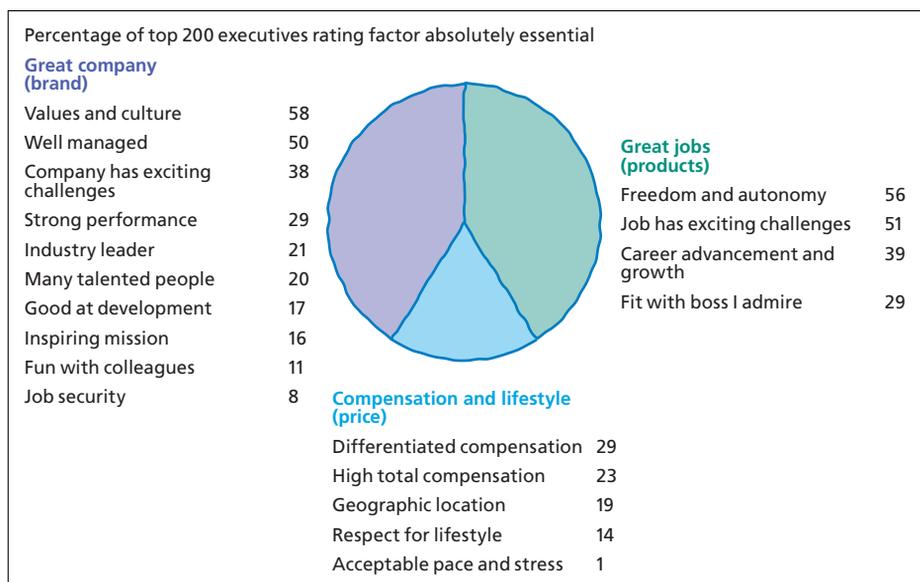
Create a winning employee value proposition

Companies with superior employee value propositions have a compelling answer to the question, “Why would a talented person want to work here?” A store manager at The Home Depot told us, “This is my \$50 million business; I can double it or run it into the ground. Where else could I get that independence and challenge at 33?”

The top-quintile companies in our survey in terms of shareholder value outperform mid-quintile companies in 13 out of 19 employee value proposition dimensions we measured (those listed in Exhibit 2), and perform about the same in the other six. This stronger employee value proposition translates into a stronger pull on talent: 83 percent of top-quintile HR executives say their job offers are rarely turned down compared with 60 percent for mid-quintile executives, and 88 percent of top-quintile executives say they seldom lose top performers to other companies as against 73 percent of mid-quintile executives.

Exhibit 2

What motivates talent?



Creating a winning employee value proposition means tailoring a company’s “brand” and “products” – the jobs it has to offer – to appeal to the specific people it wants to find and keep. It also means paying what it takes to attract and retain strong performers (the “price”).

A company's "brand" is the face it presents to the world. At its heart must be an appealing culture and inspiring values: qualities that apply to every activity and function within the company, and to every aspect of its behavior.

If we carry our analogy with marketing a step further, the executive talent pool can be segmented into four groups. All care deeply about culture, values, and autonomy, but each differs in what it looks for in a company:

"Go with a winner" executives seek growth and advancement in a highly successful company; they are less concerned with its mission and location. This cluster most closely mirrors the overall "top 200" population.

"Big risk, big reward" executives value compensation and career advancement over their company's success or its active role in their personal development.

"Save the world" executives demand an inspiring mission and exciting challenges, and care less about compensation and personal development.

"Lifestyle" executives are more interested in flexibility with respect to lifestyle choices, geographic location, and compatibility with the boss than in company growth and excitement.

We found that successful organizations tend to have a dominant talent segment, while their weaker peers have a bit of everything. But no company can be all things to all people. Ideally, a company should simply figure out who it is aiming for, and make sure its brand is tailored to the talent segment it seeks to attract.

No brand can be transformed overnight, however. It's an enormous task, and to be undertaken only in the most extreme situations, although the excitement generated by a turnaround can itself be a powerful component of a new employee value proposition. Arthur Martinez's commitment to shaking up Sears, for example, transformed perhaps the United States' most traditional retailer into "a compelling place for employees, customers, and investors."

What a company can and should consider changing straight away are the particular products it offers: its jobs. If a company succeeds in attracting a target executive group with great jobs, the brand should take care of itself as the changing mix of employees reinforces the values the company is seeking to build.

So what is a great job? We see some half-dozen attributes: "elbow room" to allow executives room to maneuver; "head room" to allow them to make decisions without seeking constant approval from above; a clear link between daily activities and business results (even if not a P&L); a position that stretches

but does not defeat, while being something an executive can “get their arms around”; something new to work on as often as possible; and great colleagues, above, around, and below. If this seems too much to think about, companies might adopt Dick Vague’s rule of thumb: “I aspire to create an enterprise where everyone’s job consists of at least 80 percent of things they love doing.”

And naturally there is the question of money. As Jude Rich, chairman of HR consulting firm Sibson puts it, “Highly competitive compensation – particularly long-term wealth accumulation – is an essential ticket to the game of attracting and retaining top talent. Companies that can distinguish truly great talent and have opened the vault find the return on their investment is terrific.”

Many companies fear that deep differences in pay will create cultural problems, but the issue is too important to ignore. Money alone can’t make a great employee value proposition, but it can certainly break one. To get the people they want, 39 percent of top-quintile companies pay whatever it takes, compared with 26 percent of their mid-quintile counterparts. Once they are on board, faster career progression is the most effective way to put individual high performers on a different compensation trajectory without disrupting overall pay structures.

Making sure top performers’ compensation is considerably higher than that of their average colleagues is a relatively straightforward way to keep the exit price high and raise barriers to poaching. When a senior manager at GE was told a division was going to give its highest performers a 10 percent salary increase and its average performers 5 percent, he said, “Ten percent? Not nearly aggressive enough! Go for 15 percent, 20 percent, or 30 percent!”

The ability to define, develop, and deliver a superior employee value proposition will be especially critical for large companies facing the small-company challenge. Small companies offer employees a chance to satisfy their desire for meaning, excitement, flexibility, impact, and reward. They may also offer equity ownership in a business small enough that a few talented executives can drive the stock price.

Large companies need not be too defensive, however. They possess natural advantages of their own: magnitude of impact (be a big fish in a big pool), depth (the resources to take risks, particularly with people), capital (the resources to support big decisions), and variety (a range of experiences over the course of a career). They can also make themselves feel smaller in a number of ways: by creating smaller, more autonomous units, improving mentoring, differentiating pay, and so on.

Sourcing great talent

Instilling a new talent mindset and developing a powerful employee value proposition will operate as a compelling advertisement for your company,

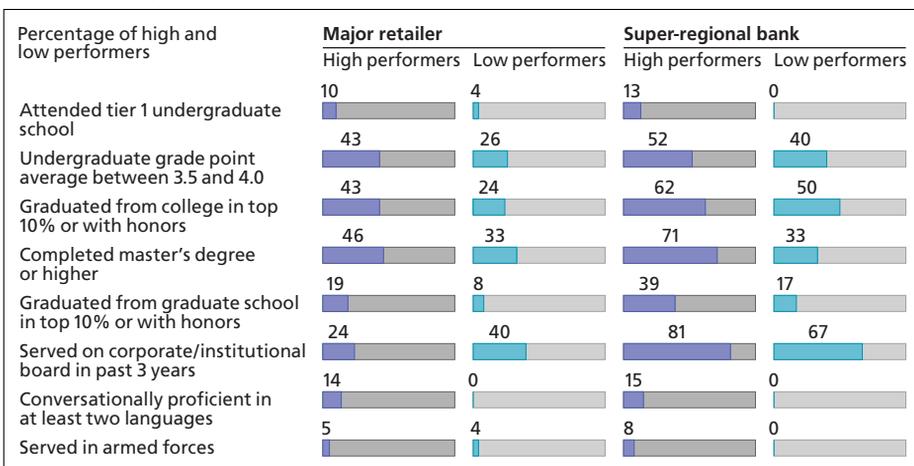
but they aren't enough. A robust sourcing strategy is crucial. That means being clear about the kinds of people that are good for your organization, using a range of innovative channels to bring them in, and having a complete organizational commitment to getting the best.

A few companies are good at specifying the qualities likely to translate into success for them. Hewlett-Packard looks for smart engineers who are good team players. The Home Depot wants customer-obsessed, entrepreneurial leaders. Enron seeks independent deal makers with a financial bent. Dick Vague of First USA asks, "Are they really smart? Can they get things done under pressure and in unfamiliar circumstances? Are they nice? We can't tolerate high-performing inconsiderates. Are they straightforward and trustworthy? I can't stand obfuscation. They can't be high maintenance. We need to have fun here."

But most companies don't really know who they want. They must find out, and quickly, or their recruiting programs will be flawed before they even begin. We found that it is relatively straightforward for individual companies to develop detailed profiles of the kind of people they are after by analyzing the background and experience of their current high performers (Exhibit 3). Once you know what you are looking for, there are a number of routes you can take. Some get what they need largely through acquisitions, which is fine if acquisitions are an intrinsic part of corporate strategy. Some "outsource" by snapping up people they believe are better trained elsewhere. Those who can attract the best college graduates and excel at early development "insource" instead.

Exhibit 3

Performance profiles at two companies



Some strategies will work better for some companies than others. Companies that grow slowly, for example, have fewer opportunities to develop people

through rotation, so they will tend to get talent in from the outside. But while each company will gravitate naturally toward a dominant sourcing method, no company should rely exclusively on one strategy, just as no company would rely on a single vendor for a critical commodity. Continuing to invest in secondary sourcing strategies helps achieve balance and diversity.

Hewlett-Packard captures people early through summer internships and part-time jobs for high school students. One US-based accounting firm hired a third of one year's graduates from a top Indian college. The Home Depot hires its competitors' best employees. Enron recruits retired military officers because "people from the army are used to traveling a lot, and this work is like what they have been doing." Ten years ago, McKinsey's new hires were almost all MBAs; now over 40 percent are lawyers, doctors, economists, scientists, military officers, or former government officials.

Talent-winners also recruit continuously, rather than simply to fill openings. Thirty-one percent of HR directors at top-quintile companies strongly agree that they are always looking for great talent and bring it in whenever they find it, compared to only 9 percent at mid-quintile companies. Arrow Electronics is "constantly looking at our competitors, suppliers, and customers to spot great people." At Baan, "Everyone must be a talent scout." Companies whose approach to hiring is to fill any open slot within three months should expect to lose the talent game.

Even where the dominant strategy is to spot talent early and train it within, companies should consider regularly hiring senior executives from outside. Rather than seeing this as a failure of the internal development pipeline, they should view it as a way to accommodate rapid growth, refresh the gene pool, and calibrate the internal talent standard.

Bill George recruited many new hires to facilitate Medtronic's moves into new products and geographies. Amgen has hired in close to a quarter of its top 500 people to feed 50 percent annual growth. Despite the success of its internal development efforts, General Electric routinely fills up to a quarter of its senior openings from the outside to calibrate its talent and raise the bar. Nor should companies hesitate to go outside their own industry. Sears hired Gulf War general Gus Pagonis to run its logistics; Banc One hired Taco Bell head Ken Stevens to lead retail banking.

Developing talent aggressively

Elevating talent as a priority throughout the company, developing a sound employee value proposition, and ensuring your sourcing strategy is a powerful one will do much of what is needed to make your position in the market for talent compelling. Our research suggests that there are also a number of

specific steps to do with development that companies should take to complete their talent program.

Put people in jobs before they're ready

Academics and HR professionals have long known what our research confirms: the key to development is “a big job before I expected it.” Yet only 10 percent of “top 200” executives strongly agree that their company uses job assignments as a very effective development lever. Forty-two percent have never made crossfunctional moves, 40 percent have never worked in an unfamiliar business unit, 34 percent have never held a position with P&L responsibility, and 66 percent say they have never had a leadership role in starting a new business.

All sorts of reasons explain this sorry state of affairs: there's often precious little clarity about who should be developed, let alone how; senior people worry that moving people around is not worth the disruption; divisions hoard their best staff; and HR executives, who should know better, are often preoccupied with training and other “auditable” initiatives. But like it or not, people learn by being put in situations that require skills they don't have – a truth poorly served when “Who can do this job best right now?” dominates staffing decisions.

All companies could do better. At a structural level, they should consider what they can do to form smaller, more autonomous units, create the maximum number of P&L jobs each business will bear, and use special project teams to provide new challenges and ways of working together. Overall, the characteristics that make a job good for development are similar to those that make it attractive in the first place, with one notable exception: executives always prefer to have full control over everything they are responsible for, but jobs that require them to achieve results by influencing rather than controlling others contribute powerfully to their development.

Put a good feedback system in place

Everyone knows how important feedback and coaching are, yet most companies don't do them very well. Seventy-three percent of executives view informal feedback and coaching as essential or very important to development, but only 30 percent rate their company as excellent or very good at providing them. Sixty percent strongly value being mentored, but only 25 percent are content with their mentoring.

Good feedback and coaching raise everyone's game, not just that of the high flyers. Fortunately, companies can nudge leaders to offer more feedback through “360-degree feedback” programs (where contributions come from those above, below, and around an individual) and other formal mechanisms. Arrow Electronics uses its 360-degree feedback system, monitored by CEO

Steve Kaufman himself, to determine whether managers are actually providing the feedback and coaching that they should.

Understand the scope of your retention problem

Most companies recognize they could improve recruitment and development; few realize they have a retention problem. They focus only on the top 200 executives, where average attrition is below 4 percent a year. But it is the early and middle ranks of managers three to eight years out of college, their basic training already paid for, that represent a company's investment in its future. Senior executives seldom notice them, and they may not feel connected to the organization; they are also more mobile and demanding. All in all, this is a volatile mix. The situation will come to a head as the number of 25- to 34-year-olds continues to decline over the next decade, and as their perception of future opportunities dims with the preponderance of older executives occupying the top positions in most companies.

Paradoxically, it is the companies that have done the best job of recruitment and development that may be most at risk from poaching. But every company needs to understand why its high performers are leaving. Attrition must be tracked by performance level. The common practice of tracking voluntary as against involuntary attrition is not good enough: it's probably your high performers who are choosing to leave.

Creating and delivering a great employee value proposition is clearly the best way to retain people, yet only 16 percent of those surveyed say they are effective at giving high performers more exciting jobs to retain them. What can you do? Start by giving them a sense of belonging; as John Doe of Arrow Electronics points out, "It's harder to quit if you are having lunch every quarter with your mentor." Send them a clear message that they are valued: two very well-run companies recently discovered that several high performers had no idea that they were highly regarded and were being groomed. And wherever possible, give them a great boss.

Just as account managers nurture and develop their key accounts, someone in every company should be responsible for nurturing and developing each key employee. Top-potential people should never fall off the screen.

Move on the poor performers now

It's hard to give all your high performers a great boss if too few of your bosses are high performers themselves. Most companies have a number of weak players in their organization. They aren't exactly failing, but neither are they leading the way.

The cost of carrying such people is enormous. Don't fool yourself that weeding them out will destroy morale; it's probably lower than you think already.

Their low productivity drags down the performance of all they work with: teams go underdeveloped, and high performers get discouraged and leave. The weak performer ends up surrounded by a circle of weak performers, the ripple effects flow out across the organization, and the company's employee value proposition is damaged.

Our research suggests that taking action to deal with poor performers is the most difficult, least exploited talent-building lever for any company. Indeed, ineffective people often stay in position for years.

Different companies deal with weak performers in different ways. Allied-Signal moves them out: "When a career stalls, it is better for us and them to move them on." The Home Depot tries to move them into a job where they can do better. Arrow Electronics takes every care to make the process tolerable: "After we have made the decision to remove someone from a job, [we treat] the person with velvet gloves to make the transition as easy as possible for him or her."

The more respect and care that can be brought to this process, the better. But however you do it, do it.



Establishing the right mindset, crafting a powerful employee value proposition, sourcing, developing, and retaining talent – it all makes for an enormous challenge. Companies start from many different positions and vary widely in the strength of their existing bench. Some have powerful, sustainable employee value propositions; some cannot even articulate why a talented person should join them. Some companies have a talent-building process but no follow-through; others have no process at all.

There are also different ways of getting going. A company undergoing a turnaround will have to bring in top talent fast to bring about a transformation in its employee value proposition. Companies in less dire straits can work more gradually on refining recruitment, employee value proposition, development, and compensation simultaneously. The key is to start now. The coming war for talent may seem like a crisis, but like any crisis, it's also an opportunity to seize – or squander. 