Chapter One

Talent Matters

In the last several decades, an avalanche of business books, articles, speeches, and seminars have stressed the importance of human capital—people—in gaining competitive advantage. Executives seem to be paying attention. According to a recent survey of senior executives from all over the world, the two most important management challenges are

- Recruitment of high-quality people across multiple territories, particularly as competition for top talent grows more intense
- Improving the appeal of the company culture and work environment

Fifty-five percent of the respondents to that survey reported that they expect to spend more time on people management than on technology in the next three years. More than 85 percent of the respondents said that people are vital to all aspects of their company's performance particularly their top strategic challenges: increased competition, innovation, and technology.[1]

What's more, according to another recent survey of over a thousand global CEOs, 72 percent are more concerned about the availability of individuals with key skills than they are about energy and commodity prices and intellectual property rights.[2]

Apparently, people are front and center on managers' radar, as well they should be. Increasingly, companies in a wide variety of businesses are finding that people can be their number one source of competitive advantage. But it is not enough for leaders to say that people are important, or to put people issues high on their mental to-do list. What is needed are organizations that are designed and managed—from the boardroom to the front line—in ways that optimize talent attraction, retention, and performance. I call this type of organization human-capital–centric, or HC-centric.

Today, most organizations are still managed in a bureaucratic, structure-centric manner, and they have been managed that way for decades. In these companies, you'll often hear managers at all levels talking about the importance of people, but the walk really doesn't follow through on the talk. Their managers do make an effort to see that they attract and retain the people they need to make their bureaucratic structure operate efficiently, but they are not designed to make their human capital a competitive advantage.

In one of my favorite Dilbert cartoons, the boss says, "I've been saying for years that 'Employees are our most valuable asset.' It turns out that I was wrong. Money is our most valuable asset. Employees are ninth." When asked what came in eighth, he says: "Carbon paper." I realize that not everyone remembers carbon paper, but I hope those of you who don't still get the joke—and the real point: Lip service and window dressing are not enough.

To be clear, a bureaucratic, structure-centric approach to management can still work. A modest effort to attract, retain, and motivate talent is all that's needed in some organizations, because it achieves good enough performance from their human capital, and people are not their primary source of competitive advantage.

But for companies that are truly competing on the performance of their people—their human capital—it is not enough. They need to adopt an HC-centric approach to organizing. It is not just about controlling people costs because they are a major expense—it is about how well people perform, because their performance is the critical factor in determining whether the organization is effective.

Competitive Realities

So how do you tell whether an organization should be HC-centric or not? Multiple factors have contributed to the creation of the knowledge economy and the rise of talent as a potential source of competitive advantage. The extent to which an organization has been influenced by these factors is the major determinant of whether it needs to be HC-centric.

One of these factors is access to financial capital. Having access to financial capital used to be a major source of competitive advantage, but today financing is easily obtained and therefore is rarely a potential source of competitive advantage. In developed countries, financial capital moves quickly and efficiently and is easily accessed. Evidence of the ready availability of capital is prevalent. More and more corporations are buying back their stock because they have an abundance of cash, and private equity funds are buying major corporations with their large cash positions. Oh yes, new public offerings continue to be common, even though they are not as hot as they were in the dot-com era.

Another factor in the creation of a new competitive landscape—perhaps the most obvious change—is the information technology that has been created in the last decade. It has reshaped the global economy as well as the internal operations of corporations.

Information technology (IT) has contributed to the growing need for technical knowledge as well as to the development of new technical knowledge and businesses. Perhaps equally important is the impact of IT on the ability of organizations to move work across internal, external, and geographic boundaries. It is now possible to outsource manufacturing, software engineering, and many other activities to other companies and countries, and to coordinate the results on a global basis.

IT has made it possible for people to work more flexibly and to change what they work on with increased rapidity. It also can give people a better understanding of what they are doing and why they are doing it.

Time Magazine recognized the impact that IT has had when it made "you" the person of the year for 2006. According to *Time,* the World Wide Web is about people being able to do new and important things. It is about the "many" gaining power—and not just changing the world but changing how the world changes. In the case of organizations, it is changing what people do, how they do it, their importance to organizations, and how they are managed and organized most effectively.

Closely tied to the evolution of information technology is the increased amount of technical knowledge required for many of the products and services produced and offered in developed countries. This increase is fueling a parallel increasing need for knowledgeable, skilled, and motivated employees. It's also a major reason why the market values of S&P 500 companies are over three times their book values, and why the value of publicly traded companies' intangible assets has been growing for decades.[3] One estimate is that in 1982 intangible assets accounted for 38 percent of company assets, and that by 2000 they accounted for 85 percent.[4]

Another factor in the creation of a new competitive landscape is the result of the changes just described: The U.S. economy is increasingly service-driven. IBM, for example, once a computer and office equipment manufacturer (do you even remember IBM typewriters, or better yet, time clocks?), has evolved into a predominantly service-oriented organization. There also has been tremendous growth in food service organizations, such as McDonald's, and retailers, such as Wal-Mart (the largest U.S. employer). As a result, manufacturing employment now represents only 8 percent of the U.S. workforce, down from over 30 percent just a few decades ago.[5]

Why is the growth of service organizations important? The major reason is customer interface. One thing that distinguishes service organizations from manufacturing organizations is the importance of the relationship between the customer and the service provider. This often is distinctively personal and is critical to the success of the organization. It is noticeably dissimilar from the relationship between a manufacturing employee and the product. What works from a management point of view for producing a product often does not work when the issue is interfacing with customers.

Because of the amount of change that has taken place in the last several decades, it is increasingly clear that the source of competitive advantage in many industries has shifted from effective execution and reliable processes to the ability to innovate and change.[6] And it has changed from the ability to provide satisfactory customer service to the ability to excel in the area of customer relationships on a grand scale.

Simply stated, for companies that are truly competitors in the knowledge economy, what was good enough performance yesterday is rarely good enough today—and will almost never be good enough tomorrow. For most organizations, the best way to meet this challenge is to become HC-centric, to focus on making talent their most important source of competitive advantage.

The corporate landscape today is littered with once-successful large corporations that are failing, dying and going out of business because they have not changed. One only need look at the amount of change that has occurred in *Fortune Magazine*'s list of largest corporations to see just how unstable corporate performance has become. Between 1973 and 1983, 35 percent of the companies in the top twenty were new. The number of new companies increases to 45 percent when the comparison is between 1983 and 1993, and it increases even further, to 60 percent, when the comparison is between 1993 and 2003. The comparison between 2003 and 2007 shows a high level of change continuing (25 percent).

Some major corporations have disappeared entirely. Westinghouse used to be a peer of General Electric. Arthur Andersen used to be one of the world's largest public accounting firms before the Enron scandal. Polaroid used to be a cutting-edge technology imaging company. Digital Equipment Corporation was second only to IBM in the computer business.

I could go on and on, but it's hardly necessary. The simple fact is that fewer and fewer companies can be successful by practicing an old-school bureaucratic approach to management. Yes, it still works in transactional sales businesses (such as parking lot fee collection), in low-value-added manufacturing (garment sewing), and in food production (harvesting and packaging). But for companies that are competing on innovative products and services for which employee contact with customers is central, an HC-centric approach is essential.

Talent as a Competitive Advantage

What does it take to create an effective HC-centric organization? The first answer many give is "the right people." It is hard to argue with this, as talent is certainly critical to innovation, change, and high performance. Talent that brings needed expertise and ideas to corporations is fundamental to innovation, as is talent that accepts change and is capable of learning and executing new processes. The right talent is the fundamental building block when it comes to creating an organization capable of innovating and changing and using this as a source of competitive advantage.

What's more, acquiring the right talent is becoming an increasingly complex and challenging activity. The workforce itself has become more global, virtual, and diverse than it ever has been. Increasingly, a surplus of investment capital is chasing a scarcity of talented people.[7] The future is sure to hold more of the same; thus, organizations that excel at talent management will continue to enjoy a competitive advantage.

There is also a good reason to believe that, in the United States at least, the educational system is not keeping up with the expected need for talented, well-educated employees.[8] For example, the share of the U.S. workforce that has a post–high school education is not expected to rise significantly in the next twenty years, despite the fact that more and more of the work in the United States is expected to require at least a high school education.

Meanwhile, the supply of educated workers outside the United States is expected to continue to grow. Increasingly, customer service representatives, radiologists, engineers, software developers, and editors can be sourced many places in the world. The challenge for organizations, therefore, is to create an infrastructure that will allow them to find the talent they need, develop it, motivate it to perform, and retain it. The ability to do this and to do it well is a critical part of creating a competitive advantage that is difficult if not impossible to duplicate.

Organization as a Competitive Advantage

Finding, acquiring, and retaining the right talent is a necessary, but *not* a sufficient, step in creating an organization with a sustainable competitive advantage. To do this, an organization also has to have the right structures, systems, processes, and practices in place. All too often, organizations have great people, but do not manage or support them correctly. People are stifled by systems and processes that restrict experimentation, limit learning, hinder the transfer of knowledge, fail to motivate, and suppress innovation.[9] As a result, organizations fail to capitalize on the talent they have and in the long run perform poorly.

Why is this the case? Bureaucratic systems and processes are created in the name of execution, control, and the short-term optimization of performance. In a time of slow change or little change, innovation may not be an important source of competitive advantage, so a bureaucratic approach may be best.

But in periods of rapid change, emphasizing execution and historical best practices almost always causes an organization to lose its competitive advantage. It ends up using outdated practices because it lacks the ability to innovate and change. As a result, it cannot attract or properly manage the best talent, and its performance declines.

Even acquiring an existing organization that has the right mix of talent may not be enough to improve an organization's competitiveness. All too often, organizations that are mired in past practice mismanage the acquisition process, and as a result lose the very people and capabilities that were the justification for the deal.

One way to think about this is to distinguish between the need for organizations to "get better" and their need to "be different." For many businesses, most notably those based on knowledge and technology, "getting better" is simply not good enough. Focusing on improving processes (in the spirit of Six Sigma) or reducing costs is important, but if it is the predominant focus of the organization, it can lead to failure in the long term. What is needed is a strong emphasis on being different from what used to be good enough, and different from what competitors are offering, because that is how new competitive advantages are created.

Becoming different is possible only if an organization can be creative and innovative. This requires a strong emphasis on learning and gathering new knowledge from internal and external processes. It also requires an organization-wide understanding that any competitive advantage based on new products or tactics will probably be relatively short-lived. They can be copied, and the continuing growth of knowledge and innovation means that better products and services will appear quickly. The focus needs to be on creating an organization that can continuously innovate and change, not just come up with a new product or a new service offering.[10]

An organization that can develop the capability to innovate and manage change has a competitive advantage that can be a barrier to entry for other companies. Companies trying to compete quickly realize that success is not simply a matter of raising capital, buying new equipment, or recruiting top talent. Rather, it involves a much more complicated and difficult undertaking: developing internal systems that attract and retain the right talent and organize the talent in ways that lead to continuous innovation and change. In other words, it requires creating an organization that is HC-centric in its design, structures, policies, and practices.

Performance and Change

Simply stated, the best way for organizations to gain a competitive advantage and to sustain it in today's business environment is to perform so well and change so fast that they string together a series of temporary competitive advantages. Needless to say, this is easy to say but extremely difficult to do. It requires a special combination of human capital and organizational policies, practices, and designs. It is precisely because it is difficult to create organizations that change quickly and easily that being able to do so is such a powerful and sustainable source of competitive advantage. If it were easy to do, it would not be a competitive advantage and a significant barrier to entry.

Why is it so difficult? In large part, the issue is the gap that exists between *knowing* and *doing*. Most managers know that talent is critical to innovation, change, and sustained organizational effectiveness. The surveys cited at the beginning of this chapter reflect this. So, too, does the increasing amount of lip service that is given to "people are our most important asset."

However, it is one thing to know talent is important and it is altogether another to make talent a source of competitive advantage. This requires both attracting and retaining the right talent and organizing and managing it effectively. Attracting and retaining the right talent is not easy, but most organizations can get it done if they devote enough resources to it. Actually developing and employing organizational structures and management practices that lead to talent being a source or the source of competitive advantage is another story, however. That requires a major change in managerial behavior as well as changes in most of the major features of an organization.

New companies, building from the ground up, can start with an HC-centric approach to management and create systems and practices that fit it. Older companies (and *old* here is a relative term) that have to transform themselves from being structure-centric organizations have a much harder time.

Hiring some highly talented individuals won't do it! Training programs won't do it, either! It requires much more than making some quick fixes to a structure-centric organization.

Structures need to change, and practices need to change, but even that is not enough. People inside and outside the organization need to change the way they think about the organization. The organization needs to become recognizable from all angles as HC-centric.

Becoming an effective HC-centric organization is difficult but well worth the effort required. For many organizations, it is the only sustainable competitive advantage that they can develop. In Chapter Ten I return to the topic of managing organizational change. Before examining it further, I need to provide an in-depth look at how an HC-centric organization should be organized and managed.

The HC-Centric Organization

What does an HC-centric organization look like? To begin with, it's important to understand what its core is. Above all else, an HC-centric organization is one that aligns its features (reporting systems, compensation, division and department structure, information systems, and so on) toward the creation of working relationships that attract talented individuals and enable them to work together in an effective manner.

Staying at that high level of description for the moment, here are some of the major features of an HC-centric organization. (The rest of the book delves deeper into these features and provides much more detail.) In an HC-centric organization:

Business strategy is determined by talent considerations, and it in turn drives human capital management practices.

Talent considerations are central to both the development and to the implementation of business strategy. HC-centric organizations do not just take the business strategy and shape a human capital management plan to fit it; considerations of talent are upstream with respect to the business strategy. They are carefully considered when decisions are made about what business strategy to pursue and how to pursue it.

Once a business strategy is established, talent is front and center in terms of implementation. Careful attention is paid to making sure that employees understand the strategy and support it. In addition, the right mix of skills is developed in the organization so that it has the competencies and capabilities it needs to execute its strategy.

Every aspect of the organization is obsessed with talent and talent management.

HC-centric organizations do everything they can to attract, retain, and develop the right talent. They create a strong employer brand that is targeted to the talent they need. They carefully assess, develop, and recruit talent that fits the skill needs of the organization. To ensure that talent is managed correctly, HC-centric organizations have sophisticated measurement systems that assess the state of their talent and facilitate decision making about its development and allocation. Careful studies are done to ensure that the best training and development approaches are used and that these approaches are justified in terms of performance improvement and development. Key positions are identified based on their impact on the organization's performance, and special attention is paid to filling those positions with the right talent.

Performance management is one of the most important activities.

Performance management is a critical activity in HC-centric organizations. It is not enough to simply go through the business-as-usual and much-disliked annual exercise of assessing performance and driving rewards based on a performance assessment. Instead, a systemic process establishes strategy-driven goals, modifies goals as needed, assesses performance against goals, and provides feedback on performance. In addition, multiple meetings focus on skill development, knowledge development, and career opportunities for individuals. Performance management starts at the very top of the organization and is carried down, so it provides a sense of common direction, an understanding of the business strategy, and a guide for the behavior of all employees.

The information system gives the same amount of attention and rigor to measures of talent costs, performance, and condition as it does to measures of equipment, materials, buildings, supplies, and financial assets.

The information system looks at how the organization is performing in critical areas where talent is a key determinant of performance effectiveness, and it reports on the condition of the human capital. It does not just report the traditional financial numbers, because they are often misleading in organizations that are highly human-capital intensive.

Most traditional measures are designed for companies whose assets are made up of tangibles such as equipment, natural resources, and money. These measures typically give little indication as to how productive individuals are and what the competencies and capabilities of the organization are. They fail to inform both employees and investors about the performance and condition of the organization.

HC-centric organizations have measures that report on the productivity, condition, and value of their talent and how effectively it is being applied. These data are shared not just inside the organization but with key investors and legitimate stakeholders who need to know about the condition of the organization's talent and its performance effectiveness.

The HR department is the most important staff group.

HR has the best talent and the best IT resources, and executives throughout the firm use it as an expert resource when it comes to business strategy, organizational change, organization design, and talent management. It is staffed with the best possible individuals, and it is a critical career stopping point for anyone who aspires to senior management in the organization.

HR has the kind of analytic skills that allow it to assess the cost-effectiveness of HR programs and to determine the impact of job designs, structure changes, and other policies on organizational effectiveness and financial performance. It has valid benchmark analytics and metrics that allow it to compare how well the human capital of the organization is performing and also what its current level of skill, motivation, and commitment to the organization is.

The corporate board has both the expertise and the information it needs to understand and advise on talent issues.

Board members of HC-centric organizations have expertise in all aspects of human capital management; in particular, they have the ability to work with the analytics and metrics that assess the talent of the organization. The board receives regular information about the condition of the talent and the organization's utilization of it. Directors know what the commitment level of the talent is. They know a great deal about the availability and condition of talent, and they understand and monitor the ability of the organization to attract, retain, and develop new talent.

The board spends at least as much time on talent issues as it does on financial and physical asset allocation and management. It spends as much time reviewing talent metrics and analytics as it does reviewing the public reporting that the organization does on its financial performance.

Leadership is shared, and managers are highly skilled in talent management.

Managers in HC-centric organizations understand and use sound principles when making decisions about motivation, development, hiring, organization change, organization design, and performance management. They make talent decisions in a manner as rigorous and strategically relevant as the one they apply to decisions about other resources. They adopt a leadership style that enhances the brand of the organization as a desirable employer. They also are willing and able to share decision making and recognition with the individuals they work with. They are not obsessed with gaining power; if they are primarily driven to achieve upward mobility in their careers, they have no place in an HC-centric organization. HC-centric organizations have individuals at all levels who are able to respond to business developments and the need for change.

Need for HC-Centric Organizations

I believe that unless more and more organizations adopt the HC-centric approach, the already large gap between how much it is used and how much it should be used will increase. The reason for this is simple: the world is moving more and more toward one in which competitive advantage depends on organizations' performing in ways that require being HC-centric. There is no way to achieve the rate of change, the amount of innovation, and the focus on customers that is required in an increasing number of businesses without adopting the HC-centric approach to management.

How many HC-centric organizations are there? How many should there be? Before I can address either of these questions, I need to go into more detail about what HC organizations look like and what business conditions create the need for the HC-centric organization.

In Chapter Two, I consider in detail the situations where the HC-centric approach will produce the best results and also the situations where the structure-centric approach will produce the best results. Making the right choice is the first and most basic step in determining how effective an organization will be. It is not as simple as choosing one or the other; each has different versions that produce different results and fit different strategies.