# THE WAR FOR TALENT

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# THE WAR FOR TALENT

In 1997, we at McKinsey & Company coined the term *the war for talent* and soon realized we had named a phenomenon that many people had been experiencing but had not fully articulated. The forces shaping this war had been brewing for some time, then came to a head quite suddenly. Overnight, it seemed, everyone was talking about the war for talent.

The economy was burning white hot in the late 1990s and companies were scrambling to hire and retain the people they needed. Companies were offering large signing bonuses, employees were asking for raises three months after they joined, and headhunters were cornering hot recruits before they had even settled behind their desks. Many companies had hundreds of vacancies they couldn't fill, and some of the venerable bastions of talent (such as investment banks and consulting firms) were losing talent to dot-com upstarts. It was easy to see the war for talent raging in the recruiting and retention frenzy of the late 1990s.

Then the dot-com bubble burst, the Nasdaq crumbled, and fears of recession spread. As the economy cooled off it was easy to think that the war for talent was over. But the war for talent is far from over. In fact, we assert that it will persist for at least another two decades.

## A Strategic Inflection Point

In his thought-provoking book, *Only the Paranoid Survive*, Andy Grove wrote that it's easy to miss the potential of new technologies, the impact of new competition, and the shifting power of customers and suppliers—critical points in time that Grove called *strategic inflection points*. For example, the ports of New York and San Francisco lost business by missing the shift to containerization, whereas the ports of Seattle and Singapore prospered. Likewise, Steve Jobs nearly ran his second computer company, NeXT, into the ground by ignoring the emergence of mass-produced, Windows-fueled PCs.[1]

We believe the war for talent is a similar strategic inflection point. It rose quietly from the ashes of the Industrial Age in the 1980s, jumped into the headlines in the 1990s, and will continue to reshape the workplace in the decades ahead.

It is an inflection point that says that *talent* is now a critical driver of corporate performance and that a company's ability to attract, develop, and retain talent will be a major competitive advantage far into the future. "The only thing that differentiates Enron from our competitors is our people, our talent," said Enron Chairman Kenneth Lay recently. "The whole battle going forward will be for talent. In fact, it has been that way for the last decade. Some people just didn't notice it."[2]

It seems like an easy message to understand, but many companies haven't fully grasped it. Like the ports of New York and San Francisco did, they are continuing with the status quo.

Although the war for talent rages on many fronts, this book is about the war for managerial talent: people who can lead a company, division, or function; guide a new product team; supervise a shift in an industrial plant; or manage a store with 15 or 150 associates. Managerial talent is not the only type of talent that companies need to be successful, but it is a critical one and it is at the epicenter of the war for talent.

## The War for Talent Will Persist

There are three fundamental forces fueling the war for talent: the irreversible shift from the Industrial Age to the Information Age, the intensifying demand for high-caliber managerial talent, and the growing propensity for people to switch from one company to another. Since these structural forces show no sign of abating, we believe the war for managerial talent will be a defining feature of the business landscape for many years to come.

### Irreversible shift from Industrial Age to Information Age

The war for talent began in the 1980s with the birth of the Information Age. With it, the importance of hard assets—machines, factories, and capital—declined relative to the importance of intangible assets such as proprietary networks, brands, intellectual capital, and talent.

Companies' reliance on talent increased dramatically over the last century. In 1900, only 17 percent of all jobs required knowledge workers; now over 60 percent do.[3] More knowledge workers means it's more important to get great talent, since the differential value created by the most talented knowledge workers is enormous. The best software developers can write ten times more usable lines of code than average developers, for example, and their products yield five times more profit.[4] Cisco CEO John Chambers put it this way: "A world-class engineer with five peers can outproduce 200 regular engineers."[5]

The shift to the Information Age is far from over. As the economy becomes more knowledge-based, the differential value of highly talented people continues to mount.

### Intensifying demand for high-caliber managerial talent

In addition to this broad demand for talent, the demand for high-caliber managerial talent is growing. The job of managers is becoming more challenging as globalization, deregulation, and rapid advances in technology change the game in most industries.

Companies today need managers who can respond to these challenges. They need risk takers, global entrepreneurs, and techno-savvy managers. They need leaders who can reconceive their business and inspire their people.

Our War for Talent research shows just how hungry companies are for strong managerial talent. Ninety-nine percent of the corporate officers participating in our survey in 2000 said their managerial talent pool needs to be much stronger three years from now. Only 20 percent agreed that they have enough talented leaders to pursue most of their companies' business opportunities.[6]

In addition to the increased demand from established companies for highly capable managers, start-ups have added a whole new layer of demand on this talent pool. Though a number of talented managers have always been attracted to small companies, the flood of venture capital in the mid- to late 1990s and the burst of high tech and Internet business opportunities suddenly made small companies a hot destination. Since the Nasdaq crash in 2000–2001, the migration of talent has slowed and people probably have a more realistic view of the risks of going with a start-up. We believe, however, that start-ups and small companies will continue to absorb a fair amount of talent, particularly as the venture capital firms make seasoned managerial talent a prerequisite to investing. Ray Lane, a partner with Kleiner Perkins, comments on this shift: "The venture business is going to change enormously—from simply raising funds to teaching companies how to build a great management team and make the right deals."[7]

Meanwhile, the supply of managerial talent is limited. Although the size of the total workforce in the United States will grow a total of 12 percent over the ten years from 1998 to 2008, the number of twenty-five- to forty-four-year-olds—the demographic segment that will supply companies with their future leaders—will actually *decline* 6 percent during the same period.[8]

To some extent, companies could compensate for this decline in younger managers by relying on a greater number of older managers, because during this period the number of fifty-five- to sixty-four-year-olds will increase by more than 45 percent.[9] This, however, will leave companies even more exposed when these older managers retire in large numbers during the second decade of the millennium. Although some older managers might be enticed to stay in the workforce longer, it is far from certain that they will do so in large numbers. For the last twenty years, the average age of retirement has remained between sixty-two and sixty-three.[10]

Companies are already feeling the shortage of great managerial talent. "Leadership is the biggest single constraint to growth at Johnson & Johnson, and it is the most critical business issue we face," commented CEO Ralph Larsen, recently.[11] Similarly, Jim Robbins, CEO of Cox Communications, said in early 2000, "Talent is the single gating factor for us in realizing our growth vision."[12]

Over the coming two decades, then, companies will be competing intensely for the limited supply of very capable managers. Short-term fluctuations in economic activity will make the talent market a little looser or tighter from time to time, but the long-term trends are clear. In fact, it would take a substantial and long-lasting slump in the economy for this pressure to ease.

The executive search firms tell us that the demand for top managerial talent is still strong, despite the recent slowing in the economy. Revenues of two of the large, prestigious search firms grew at double-digit rates in 2000 and strong single-digit rates in the first quarter of 2001.[13]

### Growing propensity to switch companies

Just as companies have come to recognize their need for highly skilled managers, however, managers have come to recognize the advantage of switching companies. It was the corporate downsizing of the late 1980s that first broke the traditional covenant that traded job security for loyalty. That was followed in the mid-1990s by a surge in job opportunities, and, coincidentally, greater transparency about those opportunities through Internet job boards and career sites. Within a few short years, the old taboos against job-hopping had evaporated and it had become a badge of honor to have multiple companies on one's resumé.

Today, many managers have become passive job seekers; they have their antennae up all the time for other opportunities. Our research shows the extent of this trend: 20 percent of managers said there is a strong chance they will leave their current company in the next two years, and another 28 percent said there is a moderate chance of leaving.[14] We also found that the challenge for companies is likely to get worse in the coming years: Younger managers are 60 percent more likely to leave than older managers.[15]

As Peter Cappelli said in *The New Deal at Work*, "While employers have quite clearly broken the old deal and its long-term commitments, they do not control the new deal. . . . It is hard to see what could make employees give that control and responsibility back to the employer."[16]

The structural forces driving the war for talent, then, are inexorable and widespread. The economic and demographic forces are replicated in many developed countries. The war for talent is creating a new business reality.

| **The Old Reality** | **The New Reality** |
|---|---|
| People need companies | Companies need people |
| Machines, capital, and geography are the competitive advantage | Talented people are the competitive advantage |
| Better talent makes some difference | Better talent makes a huge difference |
| Jobs are scarce | Talented people are scarce |
| Employees are loyal and jobs are secure | People are mobile and their commitment is short term |
| People accept the standard package they are offered | People demand much more |

## Implications of the War for Talent

The structural forces fueling the war for talent yield two profound implications. First, the power has shifted from the corporation to the individual. More than ever, talented individuals have the negotiating leverage to ratchet up their expectations for their careers. The price for talent is rising.

Although this is good news for individuals, it presents yet another challenge for companies in the war for talent. Companies will have to work harder if they are going to win the battle for highly talented managers.

The second implication is that excellent talent management has become a crucial source of competitive advantage. Companies that do a better job of attracting, developing, exciting, and retaining their talent will gain more than their fair share of this critical and scarce resource and will boost their performance dramatically.

Our War for Talent research shows this. The companies that scored in the top quintile of our talent management index earned, on average, twenty-two percentage points higher return to shareholders than their industry peers. The companies that scored in the bottom quintile earned no more than their peers.[17] Certainly, many factors other than talent management are driving return to shareholders, but these data provide compelling evidence that better talent management results in better performance.

Clearly, having more capable people isn't the only thing companies will have to do to win. They will also have to set high aspirations and enact the right strategies and performance initiatives. They will have to energize and align all their people so they deliver their best performance. But talented leaders are needed to make these other performance drivers happen.

As companies respond to the war for talent, they will develop more powerful and more sophisticated approaches to talent management. Over the next decade we believe talent management will advance as far as marketing did in the 1960s and quality did in the 1980s. Some companies will advance in building this capability; others will fall behind.

It's intriguing that even the best companies are striving to improve the way they manage talent. When we launched the War for Talent research in 1997, we asked twenty-one companies with excellent financial performance and a reputation for great talent management to be our case studies. Most of these firms are asked daily to host best-practice visits, and they routinely reject the vast majority of such requests. Surprisingly, only three of the twenty-one we asked turned us down. The high acceptance rate had little to do with our persuasiveness and everything to do with their recognition that even they needed to raise their talent game. Indeed, they bordered on paranoia about the war for talent around them.

We therefore agree with Andy Grove's chilling mantra, "Only the paranoid survive." However, we will take the concept one step farther. Whereas Grove wrote that companies should be paranoid about the next wave of technology over the horizon or the next shift in markets, we think the greatest challenge will be whether a company can strengthen its talent pool dramatically enough and fast enough to stay ahead of the competition. *That* is the critical strategic inflection point that companies and managers must recognize and address.

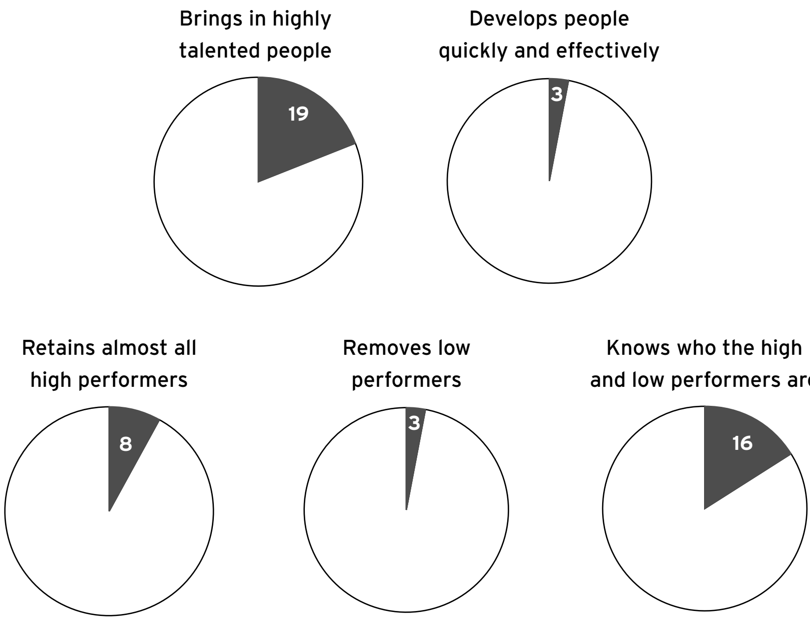
## Most Companies Have a Long Way to Go

A few companies have been managing talent effectively for some time, the most renowned being General Electric (GE), long admired for the strength and depth of its managerial talent. Most companies, though, have not managed talent effectively. Companies proclaim that people are their most important asset, but many don't act that way. Most companies struggle with talent management.

Figure 1-1 shows managers' perceptions of how well their company manages talent. As you can see, the scores are very low. Even if we were to add "somewhat agree" answers to these questions, the scores would still not be very good. More than half of the managers believe their company does *not* develop people quickly, retain high performers, or remove underperformers. Imagine if these were five

**Figure 1-1 Most Companies Are Poor at Talent Management**

*% of senior managers who strongly agree that their company:*




*Source: McKinsey & Company's War for Talent Surveys, 1997 and 2000 combined*

key questions about productivity, customer service, or quality—no company would accept such low scores.

It's not that companies aren't aware there is a war for talent: 72 percent of respondents strongly agreed it is critical their companies win the war for talent. However, companies haven't yet taken sufficient action: Only 9 percent are confident that the actions they are taking will lead to a stronger talent pool.[18]

Some companies are realizing that their current approaches to talent management are inadequate. "We spend four months per year on the budget process, but we hardly spend any time talking about our talent—our strengths and how to leverage them, our talent needs and how to build them," said Cox Communications CEO Jim Robbins. "Everyone is held accountable for his or her budget. But no one is held accountable for the strength of the talent pool.

Isn't it the talent we have in each unit that drives our results? Aren't we missing something?"[19]

Why have so few companies been successful in raising their talent game? Many have not consciously made the link between better talent management and business performance. Many have failed to make talent-building a priority: Only 26 percent of respondents said improving their talent pool is a top three priority in their company.[20] Virtually no company has held leaders at all levels accountable for the talent pool they build.

Is talent one of your top three priorities? How do you think your senior managers would rate your company on the five key questions in figure 1-1? There seems little doubt that most companies need to muster the courage and conviction to fundamentally change their approach to managing talent.

## A Whole New Approach to Talent Management

In recent years numerous books have been written on the subject of talent management. Some discuss in depth the change in the relationship between companies and employees. Others suggest that companies structure their workforce into temporary and permanent groups of employees. Still others offer detailed advice on how to conduct recruiting interviews or design a leadership development program. Although all of these are useful topics, they are not what this book is about. Instead, this book offers a strategic view of the levers every company and every leader should pull to attract, develop, assess, excite, and retain highly talented managers.

We will show you what some very capable leaders have done to build the strength of their companies' talent pools. You will see how they came to understand that the war for talent is a strategic inflection point and how they realized that a stronger talent pool can be a crucial source of competitive advantage.

From our War for Talent Surveys of nearly 13,000 managers, our study of 27 case companies, and McKinsey's experience serving more than 100 companies and holding discussions with 100 more, we