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The War for Leadership Talent: Creating a Superior Employee Value Proposition

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In May 2013, 40 participants gathered at an IMD Discovery event on how to attract and retain talented employees and leaders by adapting to the changing business environment and offering a compelling employee value proposition.

Discovery Events are exclusively available to members of IMD's Corporate Learning Network. To find out more, go to www.imd.org/cln

Why should your organization care?

Five seismic shifts are taking place within the business environment, and human capital is increasingly replacing financial capital as the primary promoter of growth and profitability within organizations. For companies, this has meant that attracting, developing and retaining talent has become the primary imperative.

However, today's talents have virtually unlimited opportunities, and as demand outstrips supply, it has become increasingly difficult to motivate and retain them. The internet provides easy access to information on people's market worth and open positions around the world, so employees easily know if they are currently getting a good deal or whether there is a better one out there for them. Thus, a superior employee value proposition is increasingly the key to ensuring you attract, keep and engage the talent you need to drive your firm's sustainable growth.

The five seismic shifts

1 Shift in basis of competitive advantage

From the 1920s to the 1980s, a company's price to book value was based on tangible assets. Over the last 40 years, intangible assets such as brand, culture, leadership and innovativeness have assumed greater importance in terms of a company's competitive advantage, and now account for three times more than tangible assets in a company's price to book value.

The principal driver of intangible assets is people. Remove employees from intangible assets and their value falls to zero. For example, Apple's market value grew substantially once the market finally recognized the ability of its employees to innovate repeatedly, but it took the company well over a decade of bringing out innovative products time and again for that to happen. If the people that drive the innovation leave the company, Apple's market value will likely drop dramatically. As competitive importance has shifted from tangible assets that companies own to intangible assets that are driven by employees (which companies don't own), the power has shifted from the employer to the employee.

2 Shift in competitive scope

Stock prices have long been an indicator of investor faith in a company, and historically about 80% of their variation could be attributed to changes in earnings. Since 1990, this has gone down to around 40%, mainly because of the change in companies' competitive scope and the advent of globalization.

In 1980 only 5% of the world's GDP was invested outside home markets. By 2011 this had risen to around 27% as companies actively engaged in prospecting international markets (*see* ***Figure 1***). The ensuing shift from primarily "known" domestic competitors, customers, regulators, etc. to global competitors, customers, regulators, etc. shifted the focus of power from the

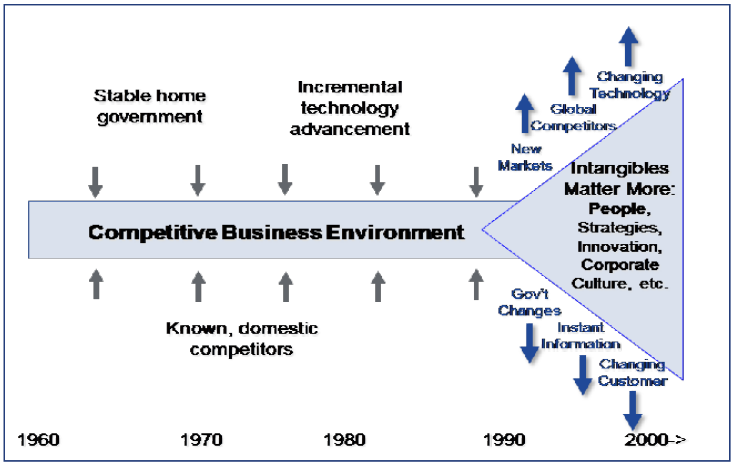

Figure 1: Changes in the competitive business environment

sustainability of a firm's strategy to the sustainability of a firm's strategists (i.e. the leadership, leadership pipeline, regional/ local talent).

Human capital is increasingly replacing financial capital as the primary promoter of growth and profitability within organizations.

3 Shift in information symmetry

Information relating to employment, such as salaries, open positions and market worth, used to be costly and thus relatively inaccessible to employees while employers would pay large amounts to external companies to find talents and conduct market research. The internet has changed that by making most of this information widely available to all for free or at relatively low cost. Companies advertise their open positions on their corporate website and on various job websites; employees can consult and post their CV on job websites such as Monster. com, and they can use social media websites, such as LinkedIn and Facebook, or their personal networks to identify potential opportunities, obtain information and evaluate their current employment circumstances.

The shift from high cost, inaccessible information to low cost, readily available information has meant that employers no longer have an advantage over employees. On this dimension as well the power has shifted from employers toward employees, and employers have to have a better employee value proposition in order to attract and hang on to talented employees.

4 Shift in firm-specific benefits

In 1985 approximately 70% of retirement plans were defined benefit plans in which the benefit was tied to the company and backend-loaded (i.e. the benefit was higher with longer tenure). This gave companies leverage and increased employees' switching costs. By 2005 over 70% were defined-contribution plans (employees bear the risk of achieving their payout objectives), with contribution rates that were independent of tenure and where the plan was portable.

Nokia, Motorola and Apple: The changing competitive arena

In 1991 Motorola was the undisputed leader in mobile communications. The company, which had invented the technology for mobile communications in 1979, was far ahead of any competitors in terms of its product range. It enjoyed "home court advantage" in the largest market (US). Although Nokia was an up and coming player in the mobile phone market, at that time its market share was less than 3% and its roots were in trading and manufacturing paper products, rubber boots, tires and so forth. Consequently, Motorola at first did not consider Nokia as a serious rival and paid little attention to its promise to deliver a new digital phone technology that would revolutionize the mobile communication space.

Motorola was still around three times bigger than Nokia by 1997, but the profits of both companies had reached similar levels (around $1 billion). Motorola reassessed Nokia as a serious rival. Between 1997 and 2001, Nokia, after several stunningly innovative product and market decisions, began capturing market share from Motorola and in 2001 overtook it in terms of revenues. By 2007, Nokia was the undisputed market leader in mobile communications with a 40% market share and an 80% profit share, relegating Motorola to second place.

Before 2007, Apple was not even on the radar of either Nokia or Motorola and was widely considered as external to this segment (being a computer manufacturer). So when the first generation iPhone was launched in 2007, it was dismissed as a product that would see limited adoption. But Apple soon overtook Nokia and Motorola in terms of revenues and profits by virtue of sales of iPhones and other exciting innovative products. Apple's market valuation is now $400 billion, around 100 times the value of either Nokia or Motorola.

Understanding Chinese demographics to plan for the future

China has been the poster child for growth over the past decade. GDP growth has averaged about 9% per year for the last 10 years, and foreign direct investment (FDI) has grown from $10 billion to $100 billion in the last 20 years.

This has led to phenomenal growth among both state-owned enterprises (SOEs) and privately owned enterprises (POEs). Across the board, Chinese firms have been innovating with products and processes in order to remain competitive. SOEs, which will soon no longer be funded by the state, are mobilizing to stay relevant because their survival depends on it. Combined with the nuances of the Chinese education system and the lack of international exposure among Chinese managers, this has meant there is a dearth of senior management talent in the country. As a result, executive salaries have increased at a rate of 20% per year for about a decade.

The imbalance between supply and demand has led to intense competition to secure talent, including targeted price wars. In addition to rising compensation, turnover among senior executives in China is more than 15% – double that of other growing countries in Asia and triple that of Western Europe and North America.

With the supply of graduates expected to grow more slowly than demand, this problem is expected to get even worse.

Since the cost of switching jobs has declined, the tendency to switch has increased to the point that the average tenure of a person aged 45 to 54 has declined by 35%, and the power has shifted from the employer toward the employee.

5 Shift in talent supply and demand

Talent is becoming a scarce commodity in some geographies and industries, and the gap between supply and demand is expected to widen even more rapidly over the next decade.

Because talent supply is primarily driven by birth, immigration and retirement rates, we can accurately project supply 20 to 30 years into the future. As a consequence, in China we know that the number of people in the workforce will start declining in about 2015 and will decline by over 17% up to 2050. If demand from domestic firms and foreign firms operating there continues to increase in China, we will see prices (i.e. compensation) for talent continue to steadily rise.

The "baby boom" and subsequent three generations of "baby busts" (lower birth rates) means that developed countries such as the US, Canada, UK, France, Germany, Italy, Australia and Japan, will see declines in the number of working people unless offset by immigration, as has been the case in the US but not in Japan. Thus, even in many developed countries, in particular Japan, we will see a significant drop in supply over the next 20 to 30 years. As a consequence, if demand comes back, as it always does after recessions, even deep ones, we will see a talent shortfall in both developed and developing countries.

Whenever demand exceeds supply, the balance of power shifts from employers toward employees.

Be the employer of choice

The five seismic shifts increase the importance of being an employer of choice; companies need to implement HR policies and practices that will help them address each of these dimensions. One approach is to focus on strengthening employee attraction, retention and engagement through a superior employee value proposition.

Measuring an employee value proposition is different from simply measuring employee satisfaction. For employees, as for customers, value is a function of not just what they get but what they pay for what they get. Employee satisfaction

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Figure 2: What employees care about most

measures only half the equation (i.e. what employees get) and that is why employee satisfaction is only weakly associated with outcomes such as employee engagement and turnover.

Value for an employee is a function of not just what they get but what they pay for what they get.

In contrast, Professor Black's research on measuring both what employees get and what they pay for what they get (i.e. hours, time away from home, stress, etc.) delivers twice the predictive power relative to outcomes such as employee turnover and employee extra effort. Consequently, constructing a superior employee value proposition is key to attracting, retaining and engaging talent.

Creating and executing a superior employee value proposition strategy

Fortunately, when it comes to what employees value, we do not have to measure everything. Four categories of "benefits" capture 80% of what employees care about: Leaders, Company, Job and Rewards (*see **Figure 2***).

A company's ability to attract, retain and engage talent has gone from nice to necessary.

While many firms measure these sorts of issues in their employee surveys, they measure them incorrectly. They measure them in absolute terms, such as "How satisfied are you with the amount of freedom you have in your job?" However, just like customers, employees do not think about the absolute benefits but the benefits they get relative to what they believe they could get elsewhere. Part of the trick of getting a much higher predictive measure of the employee value proposition is evoking a relative comparison.

Less than 15% of the more than 500 companies that Professor Black has surveyed over the years measured in any way the price that employees felt they had paid. Yet, when executives think about it, they readily see that employees care about price and that prices can vary enormously from firm to firm.

In the past, when the balance of power was more in favor of the employer, understanding and building a superior value proposition was less important. Today, employees, like customers, can access more information and have more choices and lower switching costs; consequently they have more power. In the past, measuring employee satisfaction was good enough, but it is no longer sufficient and its relevance will only decline going forward. The five seismic shifts move power away from employers toward employees, which means that truly understanding the dynamics behind catch phrases such as "employer of choice" and "building truly superior value propositions" moves from "nice to know" to "mission critical."

Conclusion

Over the past decades, a large part of the value attributable to companies has shifted from tangible to intangible assets, and employees have become the principal driver of these assets because they have more information, more choices and lower switching costs than ever before. As a result, a company's ability to attract, retain and engage talent has gone from nice to necessary. To do this effectively, companies will have to throw out simplistic notions and measures of employee satisfaction and step up to understanding and building superior employee value propositions.