




THE STATE OF HUMAN CAPITAL 2012

False Summit



**Why the human capital function
still has far to go**



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False Summit

Why the Human Capital Function Still Has Far to Go

A Report by McKinsey & Company and The Conference Board

RESEARCH REPORT R-1501-12-RR

by Rebecca L. Ray, Charles Mitchell, Amy Lui Abel, and Patti Phillips of The Conference Board; and Emily Lawson, Bryan Hancock, Allison Watson, and Brooke Weddle of McKinsey & Company



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Executive Summary

Worldwide, and in organizations of every type, “people processes” are failing to keep pace with a changing business landscape.

For human capital (HC) professionals everywhere, the new operating environment can be daunting. They must cope with the uneven pace of global economic growth; the explosion of local, national, and international regulations; the continuing convulsions of the technological revolution; new and unpredictable sources of competition; and a geographic and skills mismatch that finds many talented workers far from the job openings they are best suited to fill.

Compounding these difficulties, fiscal stalemate in the United States and persistent economic uncertainty in Europe are prompting business leaders to crimp expansion plans, cut spending, and hold off on hiring.¹

At the same time, long-standing obstacles to HC are still firmly in place. The talent shortage has not diminished: projections show that, in the United States alone, the 2020 job market will have 1.5 million fewer college graduates than are needed.² HC leaders still battle entrenched issues such as limited workplace diversity and the “glass ceiling” for women. Some barriers seem higher and more immovable than ever, including keeping employees engaged in an environment of constant distraction, free-flowing information, and punishing workloads.

But current circumstances also offer rich opportunities. The HC leaders who are the first to find ways to master the mix of strategies, practices, and processes needed to knock down these barriers—and keep them knocked down—will have created a sizeable and durable competitive advantage.

HC Is Willing to Seize the Opportunity

In recent focus groups, HC executives expressed frustration that, despite their best efforts and their many well-meaning initiatives, so little progress is being made. In this report, McKinsey & Company and The Conference Board examine four opportunities for HC executives to better manage the global talent pool in an unpredictable business environment:

- 1 **Anticipate and plan for the HC of tomorrow** From the increased presence of the highly connected millennial generation to the proliferation of the “virtual” office,

tomorrow’s workplace will look very different from today’s. There are big opportunities to rethink organizational design and workplace flexibility and recraft jobs and the characteristics of how work gets done across organizational and geographic boundaries.

- 2 **Secure a steady, reliable pipeline for skilled workers—and tomorrow’s leaders** The war for talent continues to rage, inflamed by relatively high growth in emerging markets and the previously mentioned mismatch between worker skills and jobs in most regions of the world. One of the opportunities with the highest potential impact: securing adequate numbers of skilled future workers and leaders.
- 3 **Develop strategies to reenergize your employees’ attitudes toward what they do and what the organization stands for** Some have claimed that an engaged workforce drives financial performance, and other studies have claimed that employees who are truly engaged are more likely to stay and contribute to an organization. But engagement can differ for various segments of the workforce. Younger employees, for example, are seeking to have their needs for connection, autonomy, and purpose satisfied.
- 4 **Ensure that HC becomes much more agile** Organizational agility is an essential response to the volatility of today’s business environment. A study conducted at MIT shows that agile organizations grow revenue 37 percent faster and generate 30 percent higher profits than nonagile organizations.³ HC has a huge opportunity to prepare the workforce for constant change.

As the pace and sweep of change intensify, HC professionals are coming under unprecedented pressure to be innovative, to be strategic, and to implement their programs and initiatives more efficiently. There are many programs and projects currently in play, ranging from streamlining benefits administration to experimenting with recruitment via social media.

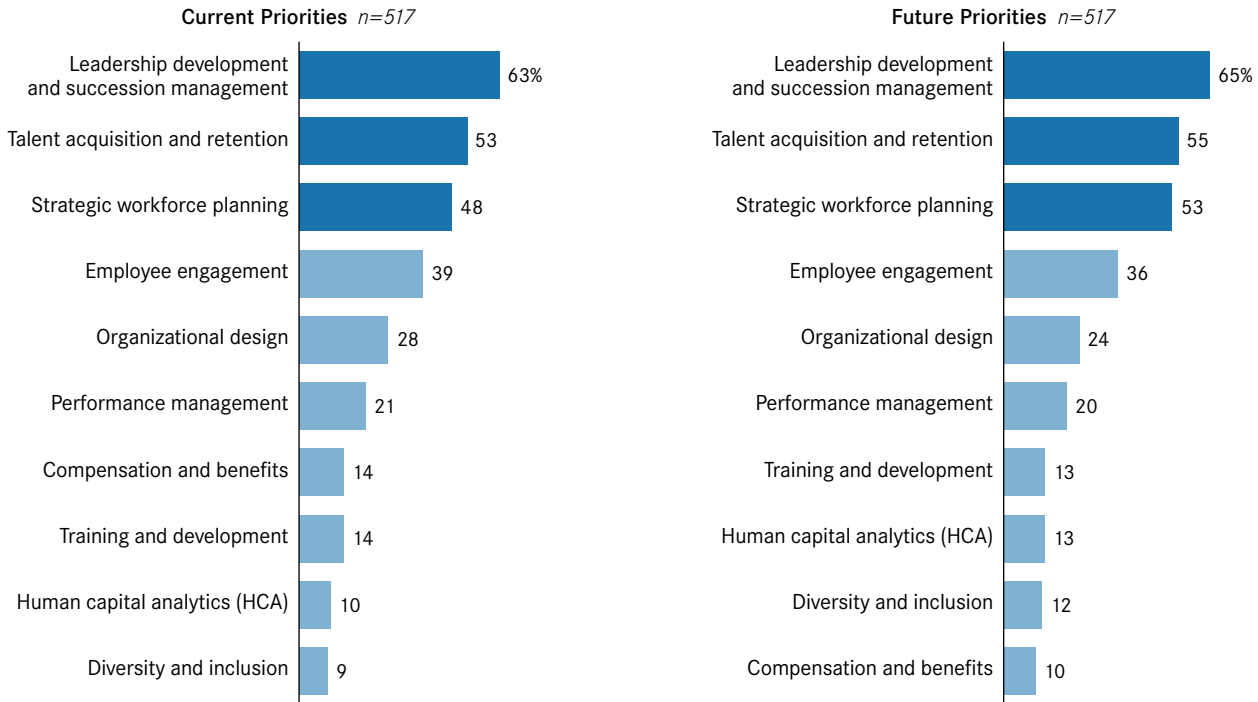
But the bigger picture shows little change. From this perspective, there has been little innovation, little confidence within the HC function, and little correlation between program and impact. HC professionals don’t feel they are getting a handle on the issues, let alone the knowledge needed to address them effectively. They are stuck with old solutions that don’t always work for the old problems, let alone the new. If they continue to stand still, they will only fall further behind.

Chart 1

Current and future human capital priorities are almost identical

What would you consider to be the critical human capital priorities for you and your organization right now (last 12 months, coming 12 months)? (Rank top three)

What would you consider to be the critical human capital priorities for you and your organization, in the next 2-3 years? (Rank top three)



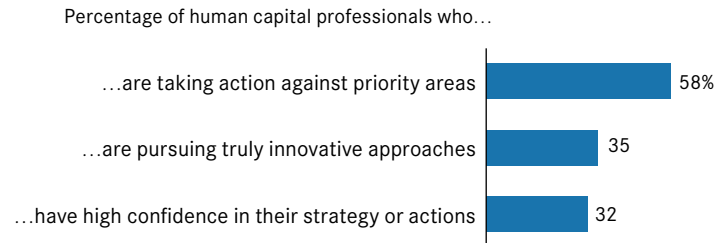
Note: Percentages are based on respondents' top three choices.

Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

Chart 2

Approaches to human capital concerns

HC professionals are seeking ways to meet their priorities, but less than 40 percent of respondents express high confidence in their current approach or consider their efforts innovative.



Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

Why the Limited Progress to Date?

Why can't HC achieve the tangible results it so keenly wants to deliver? The focus groups we convened see the following challenges.

A lack of capability Human capital professionals are still unable to confidently and assertively solve business issues with line leaders and define the subsequent HC implications. As a result:

- There are few or no strategy-related roles.
- Administrative burdens squeeze out the time HC leaders need to address strategic endeavors.
- HC leaders have low strategic “authority” with executives.
- HC executives have difficulty assessing deep strategic capabilities within the function and in outside hires.

A support function mindset Human capital staff continue to have a support-function mindset, a low tolerance for risk, and a limited sense of strategic “authorship.” These attributes often result in relatively low status among executive peers, no budget for innovation, and a “zero-defects” mentality that means they rarely take chances.

An inability to relate the ROI or business impact of their function The difficulty many human capital professionals experience in talking the business language of ROI prevents them from gaining buy-in for innovation, no matter how much it is needed. This hesitancy results in:

- A paucity of data-driven analysis or, if it does exist, analysis that is not tied to financial measures or communicated well.
- Too little of the data-based forecasting needed to create “burning platforms” for innovation.

Where Do We Go from Here?

There is no one overarching answer to these questions. But according to the research conducted by McKinsey and The Conference Board for this report, and in line with decades of close observations of HC's trajectory, it is possible to identify the characteristics of actions that have already been successful for some HC functions or are likely to be successful.

Engage with the organization's business leaders strategically Declare the role HC will play to deliver business value, address the investments required and the projected ROI, and present richly detailed, fact-based projections of the future workforce.

Take risks in the pursuit of innovation Clearly communicate the business case, including the costs of not taking action, and hunt for new ideas outside the familiar sources (e.g., leveraging the “network effect” of ideas beyond existing personal contacts) to better meet the changing needs of a diverse workforce.

Redouble every effort to manage HC efficiency These efforts should focus not just on the need to “keep the lights on” through more tactical or transactional responsibilities, but also on the need to really reshape the function and take advantage of available technology to rebalance the HR “to do” list from administrative to strategic activity.

The HC function needs many things, but most of all it needs daring and a willingness to expand its reach; take on the opportunities offered by changing employee attitudes, improved technology, and “big data”; and create real and lasting change in how top talent is identified, recruited, engaged, and retained worldwide.

Preface

Mountaineers are familiar with the idea of the false summit—the high point that they strive for, only to find that the real summit is much further away. Most HC leaders are in a similar situation. Just when they think they have reached the point where they can make a truly strategic difference to their organizations, they realize, with some discomfort, that they have far to go before they can achieve that goal.

Indeed, many human capital departments are at risk of becoming irrelevant. There is no shortage of indicators. For a start, the function is still typically referred to as “HR”—a sign that their role as stewards of prized capital is not yet accepted. “HR is a contaminated brand,” management thinker Charles Handy told *HR Magazine* last year.⁴ Study after study cites chief executives’ lukewarm views about the function. Less-than-favorable descriptors such as “box-ticking” and “detached from reality” are still used as regular criticisms of the function.

What’s most worrying is that these signals are not new. HC leaders have been recognizing them for a long time, including when McKinsey & Company coined the “war for talent” in the late 1990s. In a 2002 study entitled “The Future of HR: Longitudinal Study and 2010 Survey,” the SHRM Foundation stated, “HR executives and managers say that an emphasis needs to be placed on HR’s role as a business partner and on improving decisions about human capital.”⁵

While the HC function has achieved a great deal in the last 15 years (e.g., improved treatment of women in the workplace and the management of diverse workforces), it has not kept pace with the seismic changes in the global business landscape. When it comes to establishing itself

as a strategic contributor, the profession may be thinking, but, for the most part, it is not doing. And in the instances where it is doing, it is not doing enough quickly enough to affect organizational success. What has prevented HC from doing what it takes to work toward the true summit? How will HC overcome the barriers that have hampered efforts to make the shifts that are considered essential to fulfill its true value?

With this in mind, The Conference Board and McKinsey & Company joined forces to help HC professionals understand and implement the changes that are needed. Our comprehensive research, backed by decades’ worth of data, allowed us to pinpoint the most significant trends, challenges, and opportunities identified by the HC executives surveyed.

Whereas other studies have focused on one of HC’s new imperatives—talent acquisition, perhaps, or the need to understand global demographic shifts—we have identified the four opportunities where HC achievement will make the most difference to business success, most quickly. In this report, we put those opportunities in context of the ruptures and the rapid pace of change in the global business landscape. We also present concrete ideas that HC leaders can act on immediately.

The HC function alone cannot provide all the answers, and chief executives and their boards of directors will also need to “rewire” business strategies to include human capital considerations. Our hope is that these findings and recommendations will spur HC leaders to make the changes needed to start the profession’s journey to the true summit.

The State of Human Capital Today

If there is one word to describe the state of human capital departments today, that word might be “paralysis.” There cannot be an HC leader alive who doesn’t sense the urgency and the size of the challenges facing the function. But awareness doesn’t automatically translate into action or results. Also, there is the far bigger challenge in that few HC executives can confidently say they know what to do about everything that now confronts them. Along with too much uncertainty, there are too many factors to manage, too many unfamiliar operating environments, too little support, too many risks.

The paralysis and resignation are all too apparent in the statements coming from the senior HC executives who participated in our focus groups. One very experienced executive said:

Much of what the new generation is discussing is alien to me. They want to leverage technology, they speak a digital language, they see their networks as well beyond our walls. Perhaps the best way to enable our transformation is simply to allow myself to be leapfrogged?

Another HC leader acknowledged deep concerns about the changing nature of the workplace:

We have a long way to go with our culture and our efforts to reconceive work. Attracting and retaining key talent seems increasingly tied to flexibility and new working models. Many of our candidates are asking about flexible work arrangements, telecommuting, and what is unique about our offering. We don’t really have answers at the moment.

These challenges by themselves are not a surprise. They have been present for a long time, but until recently the HC function has not viewed them as a large package labeled “crisis.” We would argue that the package has been delivered. Moreover, these challenges are being accelerated by technology and are starting to collide.

As Chart 3 on page 10 shows, business unit leaders give the HC function higher scores for transactional affairs than for more complex and value-added responsibilities like strategic planning and staff development. Little improvement has been made in these areas over the years, which only further supports the argument that the “crisis” has been here for longer than many HC professionals are willing to admit.

McKinsey and The Conference Board set out to see past the first peak—to look toward the true summit—and provide HC leaders with the beginnings of a path toward their ultimate objective. Both organizations have spent decades tracking the evolution of the human capital function, including investing heavily in primary and secondary research, and both can draw on deep contextual reservoirs of knowledge and trend data about HC practices in many countries. This year’s report—the product of a detailed survey of 517 HC professionals, combined with comments from 18 follow-up focus groups—breaks new ground in that it brings together the four opportunities that will have the most substantial impact. (See “Methodology” on page 11.)

A Reminder of the Fundamentals in Flux

Although HC professionals can readily recite the challenges in front of them, it’s worth taking a quick detour through some of the subtleties behind those challenges.

At the highest level, the challenge is to gain a perspective on macroeconomic patterns and their likely evolution. For example, there is currently a vigorous debate among U.S. economists about what constitutes normality. One prominent view is that high levels of unemployment will be the “new normal” because of structural changes in the global economy, yet this is not the only possible outcome.⁶ HC professionals need to have strategies that address both this scenario and any alternatives.

Of more immediate concern is the mix of jobs and the skills they entail. According to the U.S. Bureau of Labor Statistics and McKinsey Global Institute analysis, the types of jobs created in the United States during the past decade involved complex problem solving and contextual judgment.⁷ A similar emphasis is true around the world. Fewer jobs are based on one-to-one transactions, and fewer still are repetitive. Instead, as technology has vastly extended the importance and reach of brainpower, the marketplace is demanding workers who are versatile, creative, responsive, and articulate.

Educational offerings have not kept pace with this new demand. Around the world, the talent shortage persists, and especially in North America and Asia. Despite the current high unemployment rates, companies are desperate to find and hire workers whose skills match their needs.

Does No Confidence Lead to No Courage?

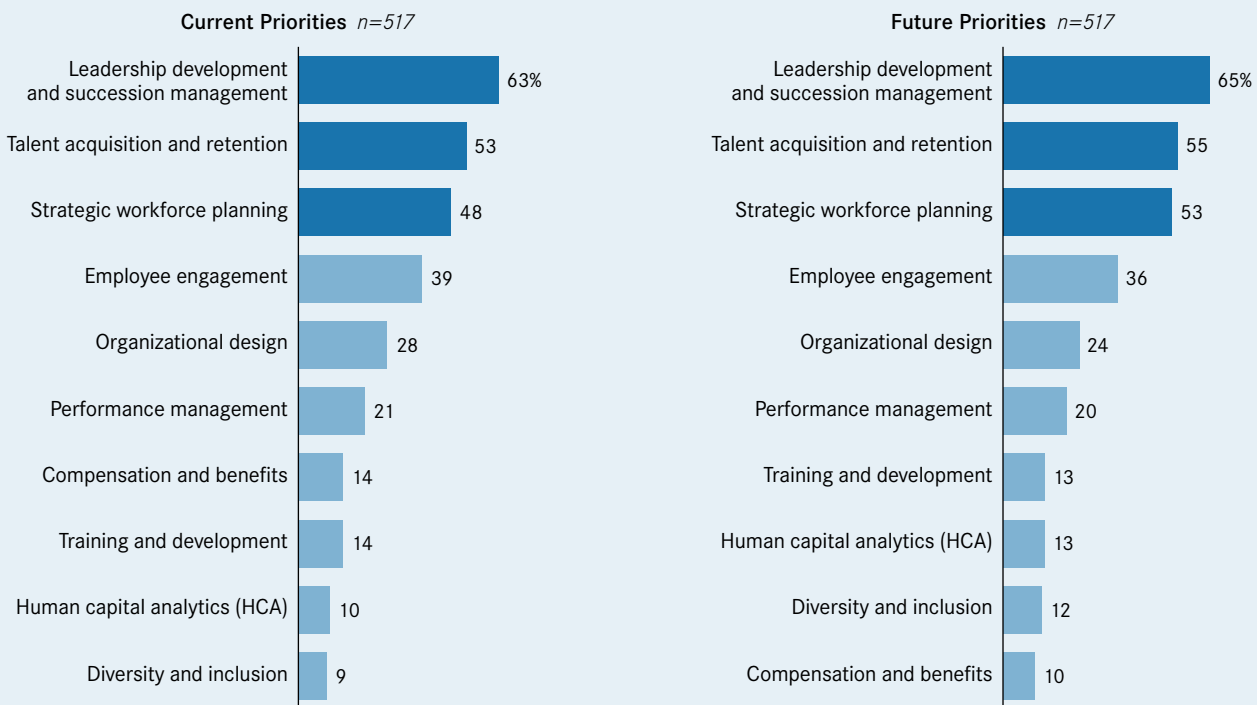
HC professionals responding to the survey said they see *leadership development* and *talent acquisition and retention* as their top priorities, both now and in the immediate future (Chart 1). Unfortunately, respondents do not have a firm conviction that the actions they are currently taking to meet these priorities will lead to success (Chart 2). A self-confessed failure to take innovative approaches may be leading to a self-fulfilling prophecy of limited achievement.

Chart 1

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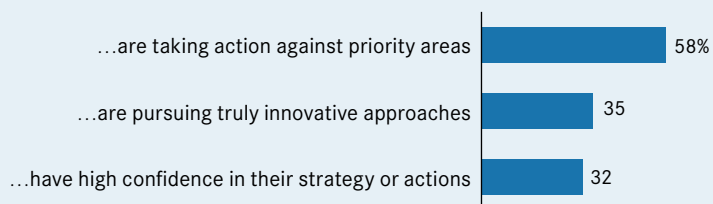
Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

Chart 2

Approaches to human capital concerns

HC professionals are seeking ways to meet their priorities, but less than 40 percent of respondents express high confidence in their current approach or consider their efforts innovative.

Percentage of human capital professionals who...



Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

This shortfall will only increase when the global economy returns to healthy growth. Based on current trends in GDP and productivity growth, the McKinsey Global Institute projects that employers in advanced economies will likely demand 16 million to 18 million more workers with tertiary education by 2020 than their labor markets are likely to have. Despite high college completion rates, “aging advanced” economies such as Germany could also face a shortage of workers with tertiary degrees that

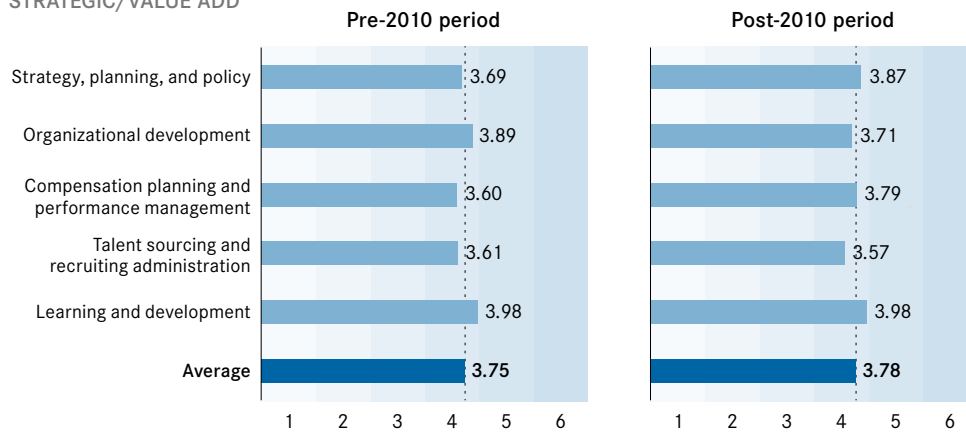
is equivalent to 10 to 11 percent of demand. In “young advanced” economies, the gaps will likely be less severe (about 6 to 8 percent). McKinsey projects that the United States will have a lower gap of 3 percent (i.e., 1.5 million too few workers with college or graduate degrees) in 2020. In certain fields—educational services, government, and health care—employers require work experience as well as advanced degrees, making the difficulty of finding the right employees that much greater.⁸

Chart 3

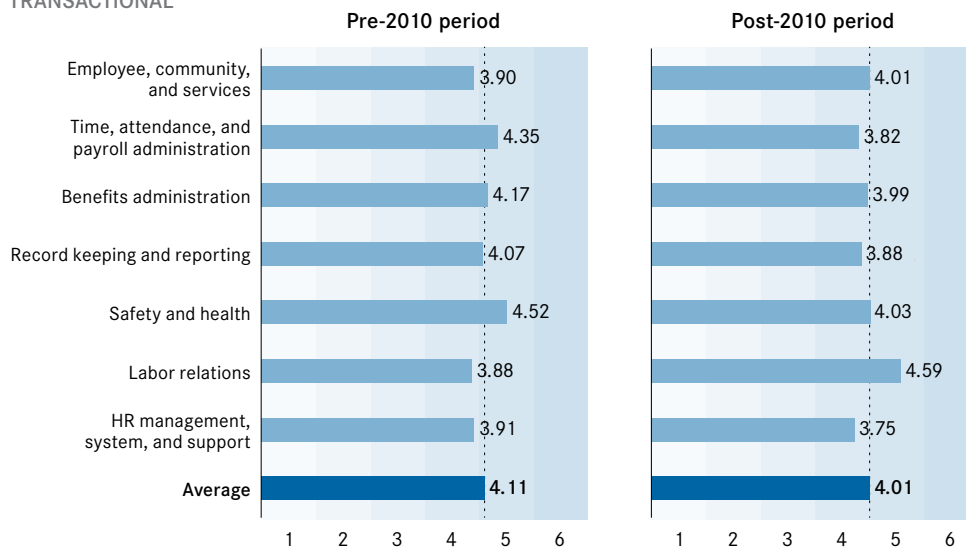
How do business units rate HR's performance?

Business unit leaders view HR as lagging in strategic performance relative to transactional duties.

STRATEGIC/VALUE ADD



TRANSACTIONAL



Note: Entries are based on an average of respondent ratings on a scale of 1 (needs significant improvement) to 6 (best practice). Responses are based on a survey of 74 McKinsey client companies from 2008 to 2012 that asked business units in those companies to rank HR performance.

Source: McKinsey Business Support Functions practice, 2012

And those hard-to-find employees also have a different set of requirements than earlier generations. Millennials, for example, have such an intimate relationship with technology that some have postulated they are neurologically different.⁹ This relationship to technology can lead them to new ways of developing ideas and sharing information. Millennials also make different personal demands of their work, including a deeper need for a sense of purpose and different expectations about job flexibility and rewards, which must be addressed by new styles of management.¹⁰

The global economic downturn has led to headcount reductions and organizational changes that have already had plenty of unwelcome consequences. The already demanding cycles of quarterly results have intensified,

and the scrutiny of financial analysts has increased pressures to cut costs and reduce investments.¹¹ The youth unemployment rate is appallingly high and rising.¹² In a number of developed countries, including the United Kingdom, Portugal, France, and even Sweden, it topped 19 percent in 2010. Minorities have been hit hard. In the United States, the latest figures show unemployment rates among young blacks that are twice as high as those for their white counterparts.¹³

While these numbers are bad enough at the moment, they bode even worse for the future because many of the affected youngsters will fail to develop the work skills and habits that will be critical for getting work later on, which could lead to a “lost generation” and cause significant social unrest.

Methodology

This report is based on three major elements: a global survey, a comprehensive literature review, and comments from members of domestic and international focus groups.

Survey

The Conference Board and McKinsey & Company jointly designed and fielded a survey that targeted human capital professionals at all levels and across various fields. The survey was launched online, and responses were collected between March 8, 2012, and April 6, 2012.

Respondents ranged from managers to senior executives, and their areas of expertise spanned the HC spectrum, including diversity and inclusion, compensation and benefits, talent management, leadership development, employee engagement, strategic workforce planning, and organizational design.

There were 517 responses altogether. Respondents were based in North America, Europe, Asia, Latin America, the Middle East, Africa, and Australia. Their companies ranged from small to large, and the industries from government to financial services. (For further details about respondents, see the demographic information on page 43.)

Literature review

The Conference Board and McKinsey both reviewed HC research to gain insights about a range of HC themes. Sources included academic and business school publications (*Harvard Business Review*, *MIT Sloan Management Review*), peer-reviewed journals, industry magazines, and consultancy publications, as well as research conducted by McKinsey Global Institute, Society for Human Resources Management, Gallup, and The Conference Board.

Focus groups

Members of the research team held 18 focus group discussions between January 25, 2012, and May 22, 2012, to get the perspectives of leaders in the field. All of the meetings, which lasted about an hour, took place during regular meetings of councils of The Conference Board, which are designed to bring professional peers together for lively exchanges regarding their experiences on the job. Anywhere from 11 to 28 members were involved, with the larger groups divided in half to encourage more individual participation. Thirteen of the focus groups were held at various sites across the United States, and the remaining five were in Europe and Asia. The facilitator asked each group the same five questions about HC challenges and trends, and analysts from McKinsey and The Conference Board recorded the sessions when approval was given.

A Plan for Workforce Readiness in China: Business Is Getting Involved

China's latest Five-Year Plan (2011-2015) is very significant for HC professionals. Released in March 2011, it places new emphasis on the human factor in economic development. Plans for education reform are intended to improve the readiness of graduates for work, and the contributions of leading multinationals are welcomed as well. The trick is to build quality into the vast quantity of graduates and matriculates. Leading companies in China are partnering with educational institutions at local levels to develop critical business skills.

Source: "China's 12th Five-Year Plan—Implications for Human Capital," The Conference Board China Center, Special Briefing Paper, April 2012.

Pinpointing the Barriers to Progress

The HC function cannot be faulted for idleness. In a number of organizations, laudable efforts have been made to cut administrative costs and find untapped sources of talent. But a cohesive effort is still missing in most companies. It is rare to come across an integrated and coherent HC strategy that incorporates marketplace trends and forward-looking projections and aligns them with cost-effective HC solutions to meet corporate goals.

What are the factors that have prevented HC leaders from becoming more effective? Here are some of the most common reasons that emerged from the research conducted for this report.

A heads-down attitude Too often, HC executives busy themselves with small-bore administrative tasks that simply keep the lights on—and accomplish little more (Chart 4).

Not enough data and insufficient metrics Data are often very difficult to access, housed across multiple systems, or not captured at all. Metrics are often reported historically and focus only on HC activities, not the metrics' impact or forward-looking implications.

No status Among their executive peers, HC leaders are often considered relatively low status; within their own function, they are rarely able to find strategy-related roles. Given that HC professionals in many cases have a support-function mindset, a low tolerance for risk, and a limited sense of ownership, this isn't entirely surprising. These attributes are often exacerbated by difficulties related to talking the business language to gain buy-in for innovation.

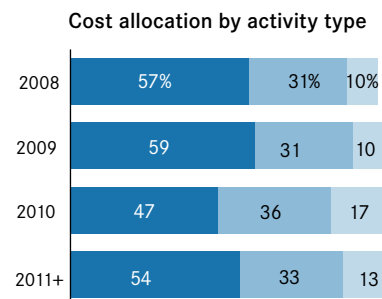
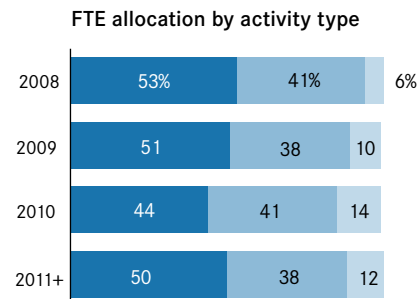
No money Low HC budgets have reduced ambition and cut commitment. Without the data and the metrics to demonstrate the urgency of the broader HC issues, HC professionals often miss the mark of communicating a "burning platform" for investment and lose out to a host of other business concerns that top management deems more pressing.

Chart 4

Should HR be doing more?

According to business unit leaders, resource allocation between value-adding strategies and administrative and transactional activities are uncomfortably close.

■ Value adding ■ Administrative ■ HR management and systems



n=74

Note: "2011+" represents the combined responses for 2011 and 2012. Percentages may not equal 100 due to rounding. Responses are based on a survey of 74 McKinsey client companies from 2008 to 2012 that asked business units in those companies to rank HR performance.

Source: McKinsey Business Support Functions practice, 2012

Four Areas of Opportunity

The cause is far from lost. Research conducted by McKinsey and The Conference Board clearly expose the “white space” in which far-sighted HC leaders have abundant room to maneuver. We have pinpointed four critical opportunities that human capital professionals and organizations must seize if they are to effectively manage the global talent pool in an unpredictable business environment.

The next sections of this report will explore these opportunities in detail, linking the specific solutions we propose to three broad strategic imperatives for HC: the need to engage and collaborate with the organization strategically, the need to take measured risks in the pursuit of innovation, and the need to redouble every effort to manage HC efficiency in execution. In each chapter, we will offer immediate solutions that are designed to help the majority of HC executives, as well as longer-term solutions that are applicable to HC organizations that have already mastered the basics.

- 1 Look ahead: anticipate and plan for the HC of tomorrow** It is up to HC professionals to understand all of the dimensions of the future of work and its relevance to their organizations, to articulate these perspectives to everyone—from the CEO to the rank and file—and to prepare today’s and tomorrow’s employees for the much more nuanced and flexible workplace that will result.
- 2 Secure a steady, reliable pipeline for today’s skilled workers—and tomorrow’s leaders** The war for talent still rages, despite chronically high unemployment rates in many regions. There is much more that HC organizations can and must do to close the talent gap (e.g., fostering long-term external partnerships with academia). HC professionals have a golden opportunity to distinguish their organizations by the caliber of the leadership that they foster and the continuity of the leadership pipelines that they develop.

- 3 Develop strategies to reenergize your employees about what they do—and about what the organization stands for** Greater employee engagement translates to greater business success and lower costs in talent recruitment. Aside from direct economic benefits, research by both The Conference Board and McKinsey has found that high levels of engagement also boost workplace creativity and customer satisfaction, collectively building culture as a productive asset. It should be a top priority across the board, even with those who say they are already quite engaged. HC professionals must carefully consider the satisfiers and dissatisfiers of each employee segment and craft highly personalized employee value propositions for each one. Overall, they will need to commit to initiatives that improve the quality of the work and make work not only meaningful, but emotionally and intellectually rewarding. Leading organizations are likely to benefit by evaluating what are being termed “motivation systems.”
- 4 Ensure that HC becomes much more agile** In a world of ceaseless volatility, organizational agility is the only appropriate response. By extension, that means that HC organizations must be more agile than the organization as a whole. HC leaders must be able to build a workforce that ensures that the right people with the right skills are assigned to the right roles at the right time at the right cost and in the right location. They must also ensure the workforce can be reconfigured to suit tomorrow’s needs.

In the pages that follow, we will offer detailed advice and commentary on each of these four central opportunities, as well as lay out what to do about them. HC executives will, however, require much more than a will to win. They will need to ensure all initiatives are grounded in compelling and integrated strategies and executed successfully.

OPPORTUNITY

Anticipating the Workplace of the Future

The workforce and workplace of tomorrow will be very different from those of today. Organizations need specific skills and attributes from their leaders. Employees will have markedly different needs and preferences, and workers will have different views based on their experiences, culture, ethnicity, and education. Workflows and work processes will change, and, for knowledge workers in particular, the workplace is as likely to be an airport conference room or a lakeside vacation cabin as the office. Yet many HC professionals continue to think and act as if today's organizational structures, processes, hierarchies, and networks will have perpetual relevance—or at least don't require modification any time soon.

The challenges in workplace and workforce planning are wide ranging and complex, and they apply to knowledge workers as well as technical workers. Organizations need leaders who can act quickly, source facts and opinions from a wide-ranging network, and collaborate frequently and seamlessly across boundaries and silos—all of this while accessing fragmented pockets of growth (Chart 5).

Human capital professionals must ask themselves: How will we win with talent? How will we develop the type of leaders and talent we need and want without coming up with innovative ways to redefine what work means and looks like? How will we address employee engagement if our employees don't feel like they belong to a workplace that brings new ways to engage, collaborate, and innovate? How will we develop and reward our talent if we don't incorporate new ways of learning, preferences, and perspectives on motivation and compensation? There are copious challenges

inherent in managing a workforce composed of multiple generations (in some cases, five generations working alongside each other), with differing styles and experiences (e.g., different levels of familiarity with technology, the rise of dual-career households, and others). There are also the concurrent challenges that this heterogeneous, amorphous workforce represents in terms of wants, needs, and ongoing employer-employee “contracts.”

Some changes are tangible, such as differences in the layout of office space; others are about the intangibles, such as how business is conducted and what work habits and behaviors are encouraged or discouraged. What job categories are expanding? What training is required for those in “growth” segments to narrow the skills mismatch? Taken together, these changes make the relationship and the contract between employer and employee far more challenging to initiate and maintain (Chart 6).

It's crucial to consider the journey: where the workplace is coming from, where it is today, and where it might be headed. No two organizations will share precisely the same set of conditions or descriptors, but more than likely, each has been shaped by at least a few of the factors below.

What Does the Trajectory of the Workforce Look Like Now?

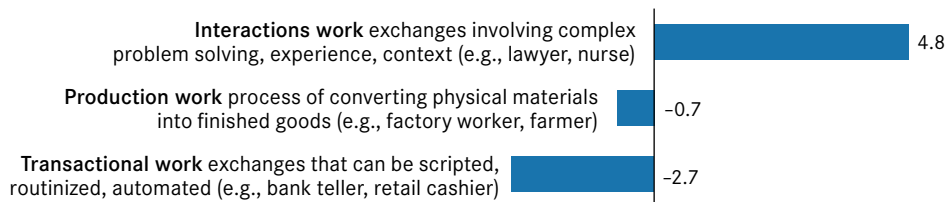
The workforce has grown far more complex, splintering into five generations: ranging from those born in the 1940s and 1950s, who are used to a commute to work and face-to-face meetings, to millennials, who find office

Chart 5

Job growth across types of work

Job growth in the United States involves complex interactions, not routine production or standardized transactions.

New jobs created in the United States: 2001–2009 (millions of jobs)



Sources: U.S. Bureau of Labor Statistics; McKinsey Global Institute analysis

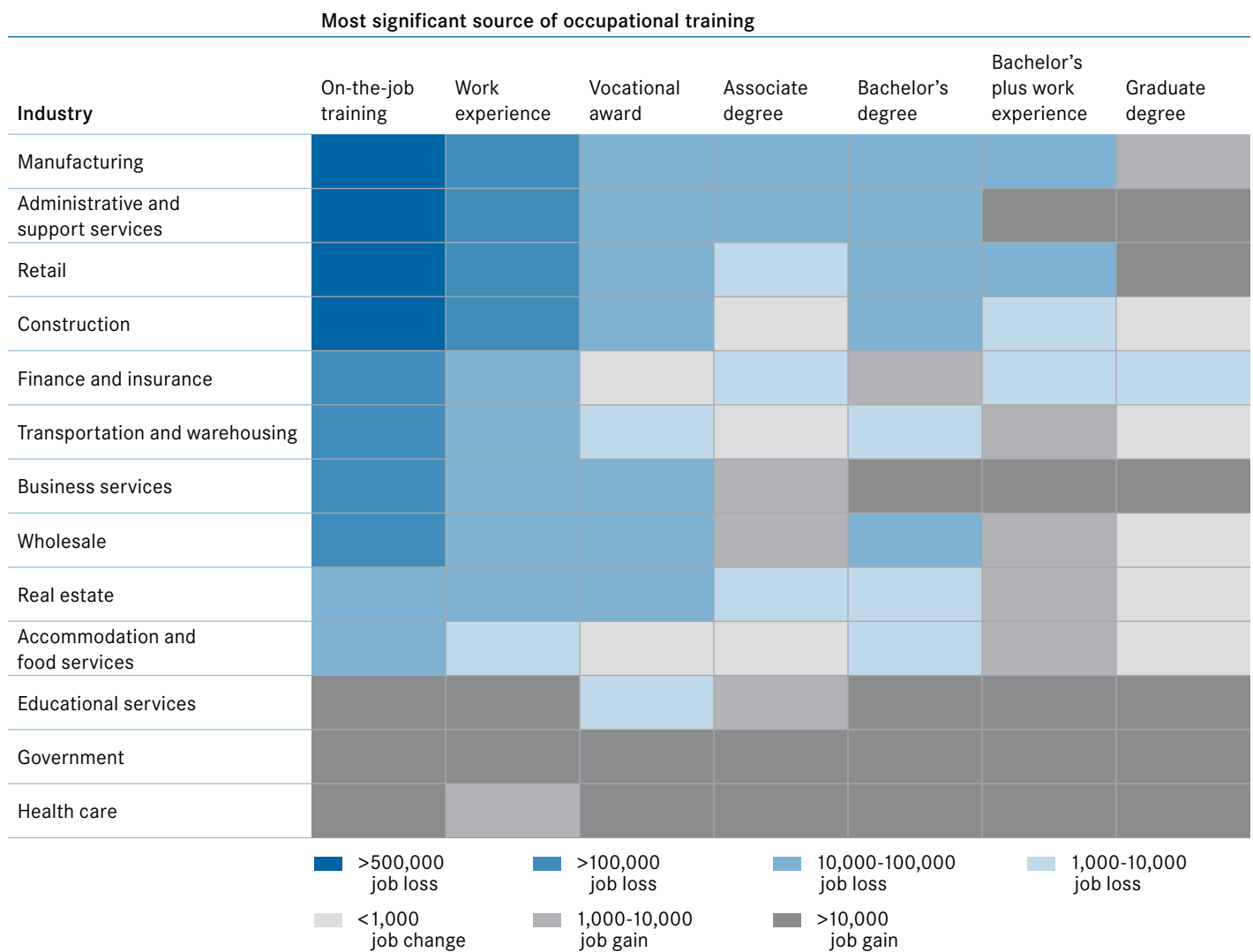
walls, fixed work hours, and “lifelong employment” alien.¹⁴ Every generation brings its own views and attitudes to the workplace, shaped by the culture, political events, technology and the stages of life those individuals have successfully passed through. Participants in focus groups expressed a desire to balance the needs of different generations: “The new workforce paradigm surely includes the use of social media to enhance engagement for the younger generation. But the older generation has different needs. How do we reconcile this?” Raised in an

era of social media—for both work and leisure—the millennials have radically different expectations for work-life balance. All this must be managed in a workplace that now includes global teams with peers and customers of divergent cultures communicating in different languages via a variety of media—including text, phone, instant messaging, and video conference. According to one academic source, these generational forces are “converging and producing a profound disconnect between the nature of the workforce and the structure of the workplace.”¹⁵

Chart 6

Annual net employment change from 2007 to 2009

There is a mismatch of skills needed versus skills available in the United States.



Note: This chart can be used to view the various sources of occupational training in context. For example, the job areas in business services that saw the highest growth required the most formal education and the number of those requiring on-the-job training shrank. This chart was prepared using U.S. Bureau of Labor Statistics Occupational Employment statistics data, which do not include farm workers, the self-employed, or new entrants to the labor market.

Source: U.S. Bureau of Labor Statistics; McKinsey Global Institute analysis

The fundamental design of the organization will be critical to meeting the needs of tomorrow’s workforce. Today, actions to meet “workforce needs” are not being well prioritized. Our research found that 56 percent of HC professionals are going slow on organizational design improvements, which might suggest either fatigue or a lack of clarity about how to evolve organizational design to keep pace with workplace changes (Chart 7).

The workforce of today is quicker and more responsive. As one group of academics put it, it is “leaner and more agile, more focused on identifying value from the customer perspective, more tuned to dynamic competitive requirements and strategy, less hierarchical in structure and decision authority, and continually reorganizing to maintain or gain competitive advantage.”¹⁶

Why Is This Hard?

What is perhaps most striking about the evolving workforce and workplace is that these issues have been prevalent for a while. Even in areas designated priorities by HC professionals, there is not necessarily full confidence that their actions will achieve their goals (Chart 8 on page 17). Lack of confidence aside, why is it hard for HC to gain traction in these areas? There are four overarching reasons why it is difficult to achieve impact.

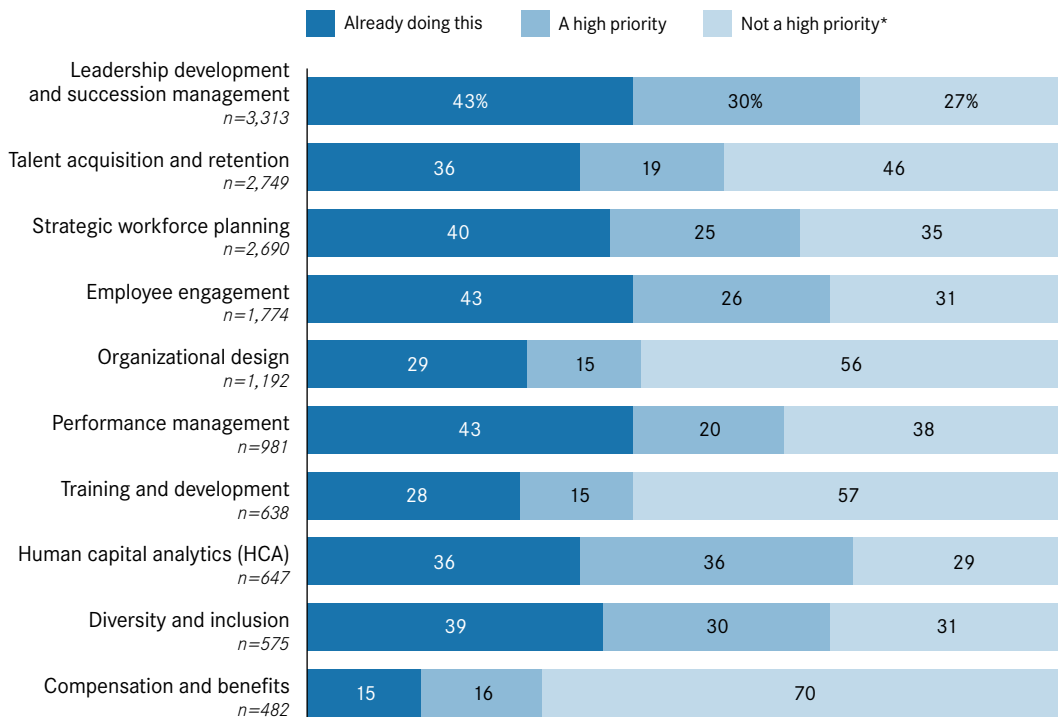
- **Change is fast and uncertain** Fact: it is difficult to keep up with rapid changes in the workforce and the workplace—employees are slow to accept other cultures, work in teams, and develop radically new skills. As mentioned in the introduction, it is challenging to develop a strategy amid uncertainty. Rapid changes in the workforce and the workplace and global economic uncertainty mean that once one challenge is mastered, there is a new one to wrestle with. How can any initiative keep pace with the speed of change?

Chart 7

HR priorities and workforce needs

Organizational design and training and development are not high priorities.

Current plans to implement actions within each human capital priority



**Not a high priority” indicates the respondent said the topic was either a medium priority (i.e., plan to start in the next two years), a low priority (i.e., plan to start sometime in the next three years), or was not a priority at all.

Note: The chart shows the average of the responses to the question “What actions are you planning to take to address the trends in this focus area?” which was asked for the 10 planned actions within each human capital priority. N sizes were calculated by summing the number of these responses. Respondents were prompted to reply only if they ranked the human capital priority as either a 1, 2, or 3 in response to the question “What would you consider to be the critical human capital priorities for you and your organization right now (last 12 months, coming 12 months)?” Percentages may not equal 100 due to rounding.

Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

Chart 8

Confidence in actions across all human capital priorities

Respondents express low confidence that the actions they are currently taking against priorities will be successful.

Percentage of respondents who are highly confident that the set of future actions for each HC priority will work*



*Sample includes respondents who ranked each human capital priority in their top three most critical priorities right now.

Source: The Conference Board and McKinsey & Company, State of Human Capital Survey, 2012

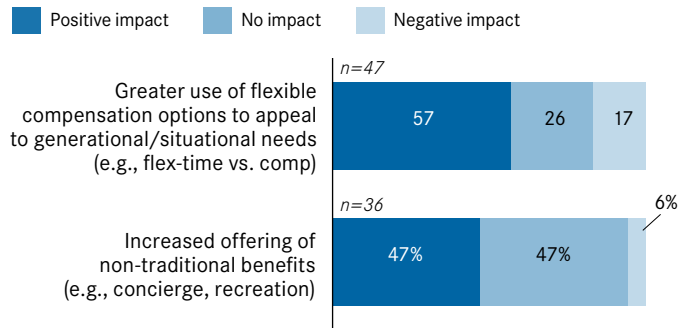
- Segmentation overload? Or not enough?** With a workforce made up of so many different generations and dispositions, HC professionals wonder whether and how to segment, what the appropriate segmentation criteria are, and how to treat each appropriately. Many of the companies represented in the focus groups said they were attempting to address the mismatch between worker and workplace, but many weren't sure they were doing it correctly. Talent acquisition was the second highest priority for respondents, but only 23 percent were confident about what to do. For example, how can HC professionals motivate, reward, and retain young employees without alienating older generations (Chart 9)? The policy implications are intricate, and the potential unintended consequences disruptive. While a one-size-fits-all system will hardly be satisfactory, a tailored approach poses problems, too. As researchers Cathleen Benko and Anne Weisberg wrote in a 2007 report, "Faced with mounting pressures from the changing workforce, managers and those they supervise have strung together a

Chart 9

Trends in compensation and benefits to address talent acquisition and retention challenges

Respondents report tailored flexible compensation options have a positive impact on retention.

Percentage of respondents indicating an impact from the subtrends*



*Sample includes respondents who ranked each human capital priority in their top three most critical priorities right now.

Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

series of individualized, one-off point solutions in an effort to retain top talent and meet the needs of the business.”¹⁷ But such a fragmented approach will only send conflicting messages to the workforce.

- Disparate initiatives** Organizations often identify areas where they can achieve traction but don't necessarily integrate those with efforts in other areas of human capital. As one focus group participant said, "It's a challenge to incorporate all of our new models: part time, flexible work, contingent workforce, [and] flexible and virtual teams. Making sense of all these options at the same time is incredibly difficult." Further, a recruiting strategy won't succeed if the organization lacks the proof points to back it up—yet that proof won't be forthcoming without a more sweeping approach to the problem.
- The organization can't get out of the way** A brilliant idea about how to fix things doesn't necessarily mean the data needed from the organization to test it are available. Focus groups say their organizations are too "conventional," doing things like buffing the corporate brand to attract talent while neglecting anything more innovative or fundamental.

This is when the job of an HC professional can seem impossible—and when it is doubly necessary to build the business case for change.

Solutions and Recommendations

It is important to take a step back and realize that context matters—a lot. This is not the time to simply study up on best practices and apply them.

Foundational solutions

Superior workforce planning The HC leader’s first move should be to conduct a rigorous, superior workforce planning assessment of the organization’s current workforce and workplace and gauge where the organization needs to be in the future to meet its business needs. This is an assessment that the HC professional must repeat, just as the organization repeats its strategic planning process, to predict and anticipate the requirements for the workforce

and workplace. However, research by The Conference Board shows that for most organizations a mature and effective strategic workforce planning function is still aspirational. Human capital practitioners should consider the suggestions recommended here to be critical actions within the “execution excellence” and “strategic capabilities” imperatives outlined in this report (Chart 10).

Begin with linkages to business imperatives Don’t change the workforce or workplace using only an internal lens; the changes have to be tied to business imperatives and an understanding of the external environment. Test questions include: How will we interact with customers? How will we gain feedback? How will knowledge be shared internally and externally?

Chart 10

The Conference Board SWP Maturity Model

The maturation of SWP is not a uniform or linear process. For example, a company may advance to the middle stage in some areas and remain stuck in an early stage of another.

Dimension	Early	Middle	Mature
Reach	Pilot project(s)	Enterprise wide	Key supply chain partners
Planning period	12-18 months	2-3 years	3-5 years+
Who drives?	HR	Business with HR support	Senior executives
Scope	All or critical jobs	Selective focus on critical jobs/skills	Internal talent plus some external (contingent workers)
Prerequisites	Critical business issue that SWP can address	Integration with business planning, strategy	Data and metrics re suppliers
Inputs	Workforce data	Common taxonomy of jobs/skills Business strategy Performance data External data	Data re external stakeholders (suppliers, contractors, JVs, etc.)
Outputs & outcomes	Workforce analytics, forecasts, action plans	Alternative scenarios Mid-cycle report of plan vs. actuals	Input to business strategy & planning
Communication	Push: HR/SWP deliver reports to business	Pull: business units can generate own reports, models, scenarios	Employee access to selected areas?

Source: Adapted from Mary Young, *Implementing Strategic Workforce Planning*, The Conference Board, Research Report 1444, 2009, pp. 19–25.

Assess your current workforce and anticipated future needs

Step one should start with building an understanding of what the company's workforce looks like today and what it needs to look like in the future. This will differ by industry (e.g., Do we have a large manufacturing base requiring production workers or are we mostly a services organization with knowledge workers?), by organization (e.g., Are we mostly local or global?), and by employee makeup (e.g., Do we have an aging workforce or are we an entrepreneurial company with younger workers who have not led others or survived an economic downturn?). This step will be intricately interwoven with the strategy to source and develop a cadre of future leaders; it will help determine how the company intends to engage future leaders and how to measure success in the future.

Envision the workplace that meets future business needs

Truly understand what the workplace needs to look like to support tomorrow's employees. Features of the workplace might include: global teams, virtual environments, deliverable-based governance and performance management, cultural training, or social media. An organization's combination of these features, suited to its own circumstances, will make the challenge and solution set unique.

Be clear about your strategy: craft initiatives, a timeline, and how to measure results Armed with the aforementioned information and a solid foundation on the other pillars of its human capital strategy, each organization should develop a set of actions intended to put these items into practice. These actions should be holistic, encompassing multiple facets of the workplace and workforce experience. Research suggests that "there is the possibility that any 'failure' or detrimental outcome from workplace design may stem from the fact that only a partial view of workplace design was considered."¹⁸ Workplace and workforce interventions should be considered strategically, with solid analysis of trade-offs and unintended consequences. They should be treated as investments and tested in rigorous ways that will yield insights into what is working and what is not. Those tests should reveal what kind of impact and outcomes a particular initiative achieves.

Communicate, communicate, communicate It is important to support any new initiative with coherent messaging across the organization. Enlist workers as partners by involving and engaging them in the innovation process so they help spread positive news about the changes. Leverage high-potential staff and the company's best leaders and managers to define the future employment setting and add to the positive messages. Make use of all

the technology tools available to get the word out, and, more important, ask employees what they need.

Optimize the use of data and technology to enable more targeted strategies Some examples of initiatives organizations have implemented successfully:

- **Revolutionize the employment contract** Consider modifying traditional working conditions, such as development programs and competitive and flexible benefits, as well as introducing less conventional ideas such as flexible work models based solely on agreed-upon deliverables. For example, companies can take steps to retain the skills and institutional knowledge of their older employees while accommodating their lifestyle preferences. Instead of losing experienced workers overnight to full retirement, companies can give older workers the option to cut back to part-time or remote work arrangements. Toyota has a reemployment program under which about half of all retiring employees are rehired, taking on new half-time roles at Toyota or in affiliate companies, making use of the skills and specialized capabilities developed throughout their years of employment.¹⁹
- **Use technology to boost productivity and meet business needs** Answer the call of the millennial generation and allow "leapfrogging" when developing new work processes and where appropriate. According to McKinsey Global Institute research, large organizations that use social platforms as a primary way to communicate and collaborate could realize improvements in knowledge worker productivity in the range of 20 percent.²⁰ The savings would come from vastly reducing the time it takes to write and answer emails, eliminating lengthy searches for internal knowledge and expertise, and cutting down on other tasks that consume the equivalent of a day's work per week. So far, few corporations have been willing to commit fully to social technologies, which require levels of open communication and information sharing that challenge existing norms.
- **Optimize knowledge and communication flows** Rethink your workplace in terms of networks, connections, and flows. For example, in designing its workforce and workplace strategy, Cisco spent significant time upfront analyzing not only how the workforce spent its time (one finding: 33 percent of the company's office space was idle at any time) but also what its workplace needed, such as more flexible seating, increased team space, and more video conferencing. Since addressing these needs, Cisco has seen greater mobility, less air travel, faster response times, reduced safety risks, better space utilization, and more extensive collaborations between team members in multiple locations.²¹

Advanced solutions

Some leading organizations have successfully implemented the foundational initiatives mentioned in this report and are ready to take their HC strategies to the next level. What follows are some more sophisticated solutions that warrant consideration for those organizations and for others with a long-term view of what they need to do.

Manage uncertainty: because you know more than you think you do Many factors that now seem unknown to an organization are discoverable if the right analyses are performed. For instance, the outcomes of certain workplace interventions can be measured, and competitors' offers to key talent can be ascertained. The uncertainty that remains is "residual uncertainty" and it, too, can be managed constructively. McKinsey research has shown that there is a four-part process to managing uncertainty effectively: identify the nature and extent of residual uncertainties, choose a strategic posture based on the nature of the residual uncertainty, build a portfolio of actions, and actively manage the strategy.²²

Consider "dynamic" evolution Successfully responding to the evolving workforce and workplace of the future requires the ability to develop tailored employee value propositions (EVPs). HC practitioners can take a lesson from the strategies of their marketing groups and leverage "employee research" to develop segmented approaches to key employee needs in the workplace. Don't assume that the core employee value proposition can stay the same. It merits constant reevaluation; indeed, reevaluation should be a standard HC process. Innovative approaches, such as crowd sourcing, can be used to test the effectiveness of modifications to the EVP—testing, for instance, the impact of building truly personalized career maps. The "test-and-learn" approach to change is invaluable (i.e., launching and running many pilot programs and measuring their payoffs).

OPPORTUNITY

Securing the Pipeline of Skilled Workers

Fifteen years after McKinsey coined the term “war for talent,” the war is still raging. To the man in the street, this makes no sense when unemployment rates run far into the double digits in many nations. But to HC professionals all over the world, there is no mystery at all. Simply put, the bar for real talent keeps rising, and the supply of qualified candidates still falls well short of demand.

Today more than ever, organizations need to be specific about the talent they need and innovative about how to acquire and develop it. The fundamental charge, of course, is to build a robust, reliable pipeline of skilled workers and actively and continually identify talent; assess candidates for the right skills, competencies, experience, and cultural fit; “onboard” new hires and integrate them; and motivate and retain the so-expensively-hired staff. But HC departments must also cultivate future leaders with the new competencies required to compete globally. In other words, it’s not enough to identify, acquire, and develop the best skilled workers, organizations must also ensure an adequate supply of general managers—or rather, leaders—to manage those workers. (See “Developing the Leaders of Tomorrow” on page 28.)

It is not hard to build a potent business case for aggressive action to bridge the talent gap. Most line managers can reel off a string of stories about the projects that had to be shelved or the problems that ensued because top talent could not be found. There is quantitative evidence to support the anecdotes, too: McKinsey research shows that companies that are better at strategically managing global talent realize superior economic returns.²³

Building a Pipeline of Skilled Workers

The global talent shortage is the product of a slew of factors both economic and social. Two of the most influential are the relatively high growth rates in emerging economies and the continuing mismatch between available skills and job needs in most regions of the world.²⁴

Addressing this shortage clearly ranks as a priority for the HC professionals surveyed by McKinsey and The Conference Board: 75 percent say the talent shortage continues to negatively affect their business. Furthermore, many of those who participated in the focus groups

expressed concern that their organizations won’t have enough capable leaders in the future. This corroborates evidence from another survey by The Conference Board, which found that human capital is the second-ranked critical challenge for CEOs worldwide. In China and India, it is the top challenge for CEOs. The report found that shortages of highly skilled talent and inflated wages complicate the operating environment and frustrate growth plans.²⁵

New research from McKinsey clearly shows that the impact of the global talent shortage is deep and widespread: 87 percent of respondents are experiencing the talent shortage. Of particular concern, they note the limited availability of qualified talent for open positions and the scarcity of available technical workers or science, technology, engineering, and mathematics (STEM) job candidates. The shortage is felt globally, although most pronounced in North America and Asia (see Chart 11 on page 22). Many focus group participants cited the global talent shortage as their number one challenge. Among the solutions they said they are starting to explore in response: focusing on education, starting as early as K-12; making strategic investments in competency building; and using new technologies to increase the competencies of talent within organizations.

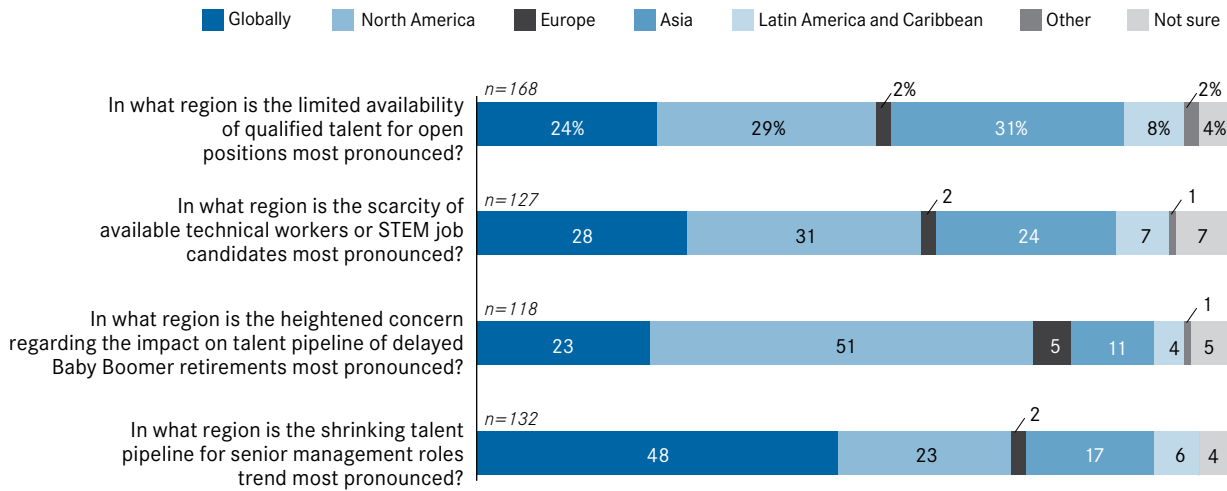
Unfortunately, all the indicators show that talent shortages will persist. Even more alarming, they are set to grow. Short of an unprecedented, international effort to raise workers’ skills, the McKinsey Global Institute (MGI) projects that the global supply of talent will be out of balance by 2020, when there will be a shortfall of as many as 40 million workers with tertiary education and a surplus of 90 million to 95 million workers with mid-level and low-level skills.²⁶

According to McKinsey Global Institute research, “Businesses operating in this skills-scarce world will need to dramatically step up their role in public education and training, invest in their own training programs, and develop innovative strategies to hire, train, and retain workers from underleveraged labor pools, such as older workers and women.”²⁷ If HC leaders believe they need a burning platform to promote change, they surely have one.

Chart 11

Regional Issues

Respondents report that a talent shortage in Asia and boomer blockage in the United States are major issues. The largest issue in Latin America is the availability of talent; similarly, in Europe, it's an aging workforce.



Note: Percentages may not equal 100 due to rounding.

Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

China's Demographics: A Special Case

China's strict family planning policies have resulted in a population that is both shrinking and aging, with dire effects for the workforce and society. The government has been making large investments to strengthen its social security systems, and it has made other expenditures to support China's aging population as well. But those moves will also require a host of workplace changes to accommodate an aging workforce—intergenerational workforce management, workplace health and safety measure adjustments, disability accommodation, and pension and retirement contributions and planning.^a

Furthermore, while the number of elderly in China is increasing significantly, there are also fewer young people. Coinciding with this trend is a rapid increase in the percentage of young people enrolled in senior secondary schools and postsecondary programs, resulting in China's young workforce entrants being vastly more educated than the general population.

On the one hand, this trend supports the government's goal of increasing labor productivity and moving the country's economy up the value chain. On the other hand, it means that there will probably be fewer low-skilled young workforce entrants willing to work in basic manufacturing or basic service jobs. This will clearly affect the talent acquisition and retention strategies of companies in industries that need those types of workers. Long term, this trend will also create upward wage pressure for lower skilled workers, who will then find themselves in better bargaining positions.

^a "China's 12th Five-Year Plan-Implications for Human Capital," The Conference Board China Center, Special Briefing Paper, April 2012.

Why Is This Hard?

Many of the challenges underlying the global talent shortage may seem gargantuan, such as macroeconomic or social policy issues that cannot possibly be addressed by business enterprises, let alone by their human capital departments.

For example, it's clear that there is an issue with education systems that fail to produce future workers with the kinds of skills required by today's organizations—let alone those of tomorrow. Many organizations may consider making certain investments in the education of younger people (for example, technical programs for high school or college students) to lessen this disconnect, but with the time it can take for such initiatives to have an impact and with the risk of not being able to “convert” those investments in training into valued employees, the efforts may be difficult to justify.

Potentially more practical—though not without their own difficulties—are the societal changes required to free up underleveraged sources of talent. There are widespread efforts to hire and promote more women worldwide, for example. Even in nations with fiercely defended rights for women, female representation at senior levels can be woefully low. To date, the scale and notoriety of some of these difficulties may have prevented HC from making much of an attempt to attack them.

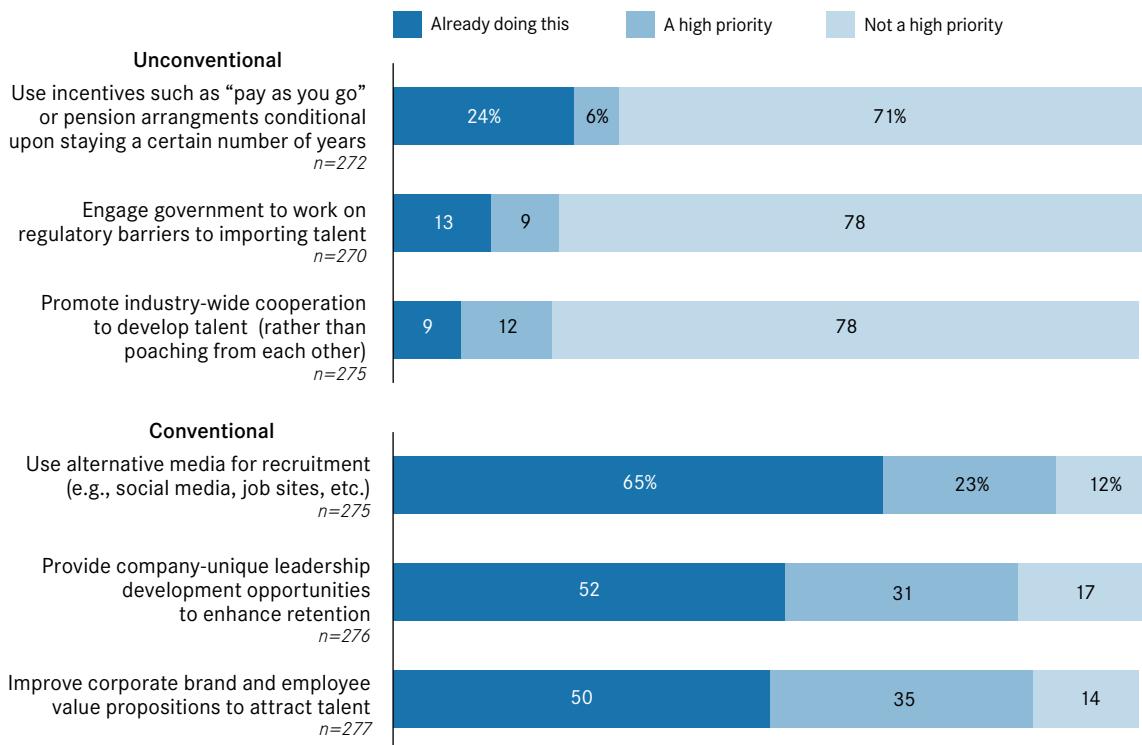
Given all of these circumstances, securing a steady pipeline of talented employees is one of the most difficult responsibilities for the HC group to master. They may succeed for a while with some types of jobs, but struggle mightily with others. Too often, HC professionals take refuge in conventional best practices for activities such as talent acquisition or leadership development (Chart 12). But best-practice thinking is its own curse because it tends to stifle innovation—one of the three imperatives identified by McKinsey and The Conference Board.

Chart 12

Conventional and unconventional talent acquisition and retention actions

Unconventional or innovative talent acquisition practices are not common.

Percentage of respondents indicating the level of priority for each action*



*Sample includes respondents who ranked each human capital priority in their top three most critical priorities right now.

Note: Percentages may not equal 100 due to rounding.

Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

Solutions and Recommendations

So what can an organization do to fill its talent gap? Research conducted for this report turned the spotlight on these fundamental actions.

Foundational solutions

Define, assess, and understand the talent gap The first step in doing this is to define the skills necessary to execute business. With these in mind, assess the skills currently available to understand the size and scope of the current talent gap. To do this effectively, organizations must commit to putting the HC strategy on par with the business strategy. This involves a very intentional, rigorous strategic workforce planning (SWP) process in which HC and business leaders work together—they determine the skill sets needed to meet company objectives, understand the skill sets they already have, and gauge the difference between the two. This process is essential to value creation and doing it right is more complex than current approaches often account for. The analytical skills needed, for example, go beyond basic analytics and require staff with PhDs in neural logic, machine learning and statistics. The systems required to process this information need to unite data on skills (from assessments), employee productivity, and demographics. This is made more challenging by the antiquated nature of most HRIS systems.

Articulate the value at stake By being able to state, for example, “we will lose X revenues from Y opportunity if we don’t have Z skills,” HC professionals are better able to build the business case for action. This should be a repeated, dynamic process where the model and assumptions can be adjusted based on changes in the business strategy, market conditions, and customer preferences. Ultimately, this process should form the basis for all strategic actions designed to acquire and develop talent—and resourcing should reflect choices and trade-offs made at this point.

Identify potential sources for the skills and capabilities needed Once the skills and capability requirements have been identified and articulated, the next step is to map them to different sources across the value chain. This means, for example, identifying how to get supply chain expertise, digital marketing capabilities, and globally experienced managers—and how to develop a differentiated plan for each source. The “skills adjacencies”

approach has been productive at this point for many companies, building on IBM’s famous recognition in the early days of computer programming that although qualified computer programmers were scarce, music majors had the same symbolic recognition skill set and could be retrained accordingly. Employers would do well to recognize that there are talent pools with the right level of attainment but the wrong kind of specialization, and develop strategies to help these groups convert from a supply surplus to a more in-demand skill set.

Ultimately, for each “point” on the skills source map, HC leaders should include the strategy for filling roles (for example, external recruitment or internal “reskilling”), interdependencies with other roles, implications for career paths, and time to impact—how long it will take to achieve results for a specific capability or skill group.

Reframe the problem of (and the solution to) acquiring the best existing talent This two-pronged approach—rethinking the limits of the applicable talent pool and identifying and sourcing from previously untapped communities—fits well with the imperative to take measured risks in the pursuit of innovation.

As an example, consider the opportunity to source and develop more local leaders in emerging markets. Survey respondents confirm that, in emerging economies, relying too much on expats to drive local market growth has a negative business impact. Many HC executives have already begun to reframe this problem (and solution) by investing more in locally sourced talent. However, few organizations are taking truly innovative approaches when “going local” with their talent acquisition in emerging markets. That needs to change: multinationals have to compete directly with regional organizations for the same talent.

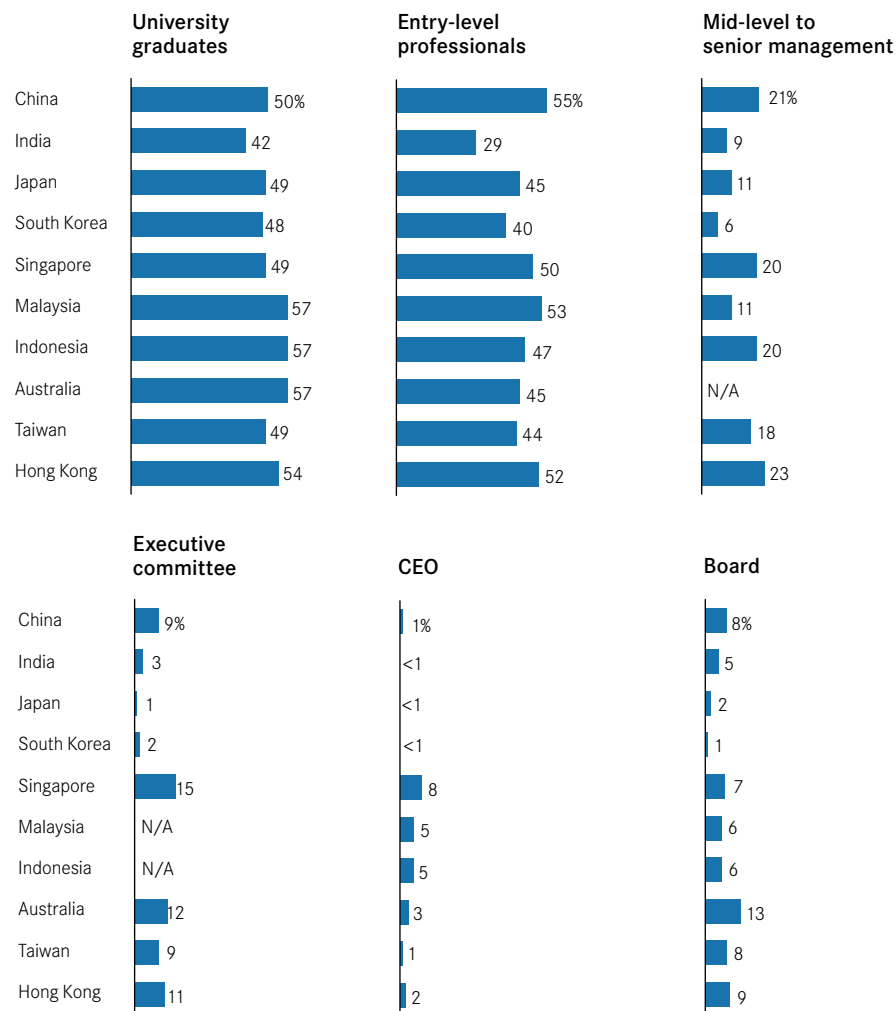
Clearly, there is a tension between the global application of talent management practices and the ability to innovate locally. However, as a recent *MIT Sloan Management Review* article states, “Companies that find a balance between global standardization and integration and local implementation have the best of both worlds. They can align their talent management practices with both local and global needs, resulting in a deep, diverse talent pool.”²⁸ Yet McKinsey’s latest research on global organizations shows just how hard it is for multinationals to develop emerging market talent at a pace that matches their desired growth.²⁹

The second part of the approach, reframing the solution, involves radically rethinking the sourcing and development of underleveraged talent. There are a number of underleveraged talent groups that organizations “miss” because they don’t know how to source and develop them. Women are a good example of a significantly under-leveraged talent pool, especially in emerging markets. Women are flooding into universities and graduate schools in these markets, and they represent 65 percent of college graduates in the United Arab Emirates (UAE), 60 percent in Brazil, and 47 percent in China.³⁰

As can be seen in Chart 13, women have a small presence in the senior levels of corporations in Asia,³¹ given that “family-related pulls and work-related pushes conspire to force women to either settle for dead-end jobs or leave the workforce.”³² To leverage this talent, organizations must first recognize that women in emerging markets face complicated challenges that are fundamentally different from those of women in the developed world: elder care, powerful gender biases, and travel and safety issues, just to name a few.³³ But even if recruited into an organization, keeping them onboard requires intense and innovative efforts.

Chart 13
Losses along the line

While there are significant percentages in Asia of women in entry-level positions, their presence is small at higher levels of employment.



Sources: McKinsey proprietary database, 2011, government publications, literature search

Advanced solutions

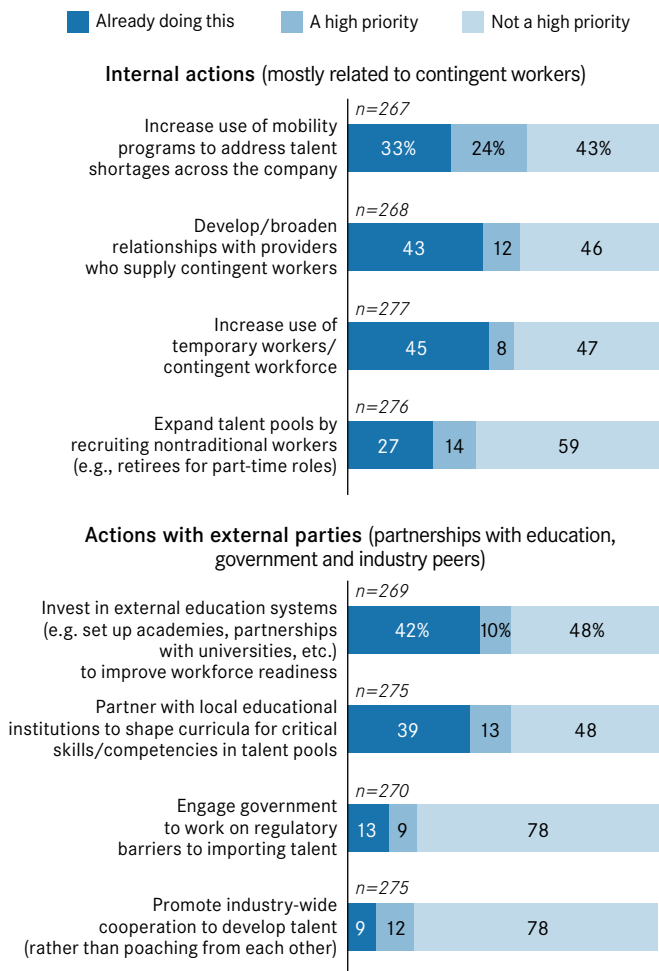
If a solid foundation of these actions has been established and traction achieved in the early stages, consider more innovative ideas. The following solutions are designed to build on the foundational actions discussed earlier.

Chart 14

Internal and external actions to address the global talent shortage

The expansion of nontraditional talent pools is one way to address this issue.

Percent of respondents indicating the level of priority for each action*



* Sample includes respondents who ranked each human capital priority in their top three most critical priorities right now.

Note: Percentages may not equal 100 due to rounding.

Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

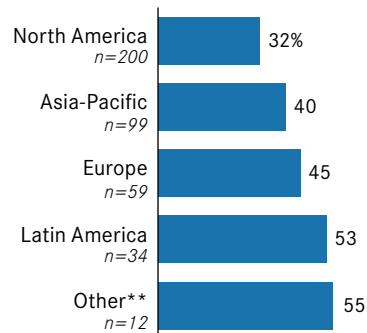
Increase engagement with external partners Partnerships with schools, universities, and governments help articulate the skills and capabilities needed and ensure that they are being developed. Research by McKinsey and The Conference Board shows that HC professionals' most commonly planned responses to the talent shortage are investing in external education systems and boosting their use of contingent workers. By contrast, very few are promoting industry cooperation or engaging the government (Chart 14). Everything is relative, of course: the number of HC professionals worldwide who are taking any action is relatively low (39 percent), and even lower in North America (32 percent). The one exception is Latin America, which appears to be more forward-thinking about forming partnerships. Fifty-three percent of the Latin America survey respondents reported that they are already pursuing partnerships in this area (Chart 15).

Chart 15

Addressing the talent shortage: actions taken with external parties

Talent strategies in North America are more inwardly focused than in other regions.

Percentage of respondents who indicate they are already pursuing actions with external parties or view as a high priority*



* The external actions aim to address the talent shortage. They include invest in external education systems (e.g., set up academies, partnerships with universities, etc.) to improve workforce readiness; partner with local educational institutions to shape curricula for critical skills/competencies in core talent pools; engage government to work on regulatory barriers to importing talent; and promote industry-wide cooperation to develop talent (versus poaching from each other).

** Companies in this category came from the Middle East, Africa, etc.

Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

It's apparent that there is a lot of space for organizations to explore in this area. Partnerships can include alliances with educational institutions, branches of government and public sector agencies, and industry peers, among other entities. They can certainly involve private sector organizations, through, for example, industry consortia or organizations that may need similar skills but aren't direct competitors in the same industry. The optimal partnership structure and goals, however, will be highly context dependent for each organization.

The data confirm the potential value of innovative approaches such as external partnerships. Long-term investments in skills building start to snap into focus when considering, for example, that India produces as many young engineers as the United States does, but only 25 percent of them are suitable for employment by multinational organizations, and that fewer than one out of 10 university graduates in China has what it takes to succeed in a multinational corporation.³⁴

One note of caution: when forging such partnerships, it is critical to present to stakeholders the value of such partnerships in terms of business value. The HC leader has to be comfortable placing some strategic bets and taking risks. It's a long-term payoff, but for HC leaders who do nothing, there will almost certainly be no payoff.

In general, such partnerships tend to be characterized by a long-term vision and prolonged time to expected impact, although this shouldn't exclude the possibility of achieving some short- and medium-term results. Other positive potential outcomes: investments in developing the skills of a particular population, the social impact of a partnership, or the promotion of a corporate brand that can result.

Leverage the talent you already have by recruiting and reskilling internally There are many ways to leverage your existing talent more effectively. Research points to two areas where there are sizeable opportunities to improve: internal recruiting and management of expats.

- **Strengthen the internal talent market** Promoting from within—from the chief executive down—can deliver more benefits for companies than hiring outside talent, according to research. Organizations should consider making their internal process as systematic and nuanced as external recruitment. For example, it's possible to create an internal talent market that is fully supported by HC processes (i.e., performance management, learning and development, recruiting, and retention). Once it is up and running, the internal market will become a natural first step in recruiting processes. Internal job seekers in some cases may not have quite the same skills as external candidates, but topping up their skills can be easier, cheaper, and more effective in the long run than looking exclusively outside the four walls. Managers should celebrate internal mobility, and those who export it to other parts of the broader organization rather than hoard it should be rewarded.
- **Use expats more effectively** The HC professionals surveyed certainly did not advocate for abandoning the use of expats, despite an increased focus on cultivating local leaders. Their continued support of the expat model makes sense, given the globalization of markets and talent pools. However, it has been widely acknowledged that it is hard for expats to adapt to local cultures and environments, which slows learning and increases churn. Based on research by McKinsey and The Conference Board, there are several actions that organizations can take to more effectively harness the talent of expats. Chief among them is replacing short-term expat jobs with longer-term assignments, which helps build expertise and blunts the potentially negative aspects of expats becoming "lame ducks" when the end of their overseas posting is getting close. The longer expat assignment concept rests on the critical foundation of a well-thought out reintegration strategy.

Developing the Leaders of Tomorrow

While most HC professionals admit to some confusion when it comes to attracting talent, they tend to think they have leadership development nailed. In the survey by McKinsey and The Conference Board, respondents say leadership is their organization’s top priority; 73 percent are actively implementing solutions, and 70 percent claim to be seeing positive impact. Ninety-one percent of respondents say their organizations are changing their leadership competency models to reflect current and future realities, and have increased efforts to measure leadership performance against established leadership competencies. More than 80 percent of respondents report a “positive” impact from their efforts (Chart 16). Compared to other areas, organizations seem to have relatively high levels of confidence in leadership development actions—43 percent are highly confident.

However, there are serious cracks underneath this glossy veneer that represent a sizable leadership deficit in most organizations. Many organizations have implemented or are

in the process of implementing common practices to help develop leaders that can handle global cultures, complexity, and ambiguity. These include involving senior executives in the development of “high potentials,” leadership development activities, and performance management initiatives. Yet the focus groups revealed that most HC professionals believe there is actually a shortage of leaders, and organizations need to consider new approaches.

Solutions and Recommendations

So what can an organization do to develop multifaceted, twenty-first century leaders effective at leading cross cultural teams, building networks, inspiring innovation, and dealing with decision making amid ambiguity and the need for speed?

Foundational solutions

Identify the leadership competencies your company needs It used to be that the leader was thought to be the one who “knows everything and everyone,” but that is true no longer. That definition suggested a stable business environment that has now been replaced by a volatile, uncertain, complex, and ambiguous (VUCA) environment. That doesn’t mean that the swirling uncertainty is the same for every company—or that all should respond to it the same way.

In a Council Perspectives report, members of The Conference Board councils identified several attributes that will be essential for leaders in the future.⁹ They must be able to:

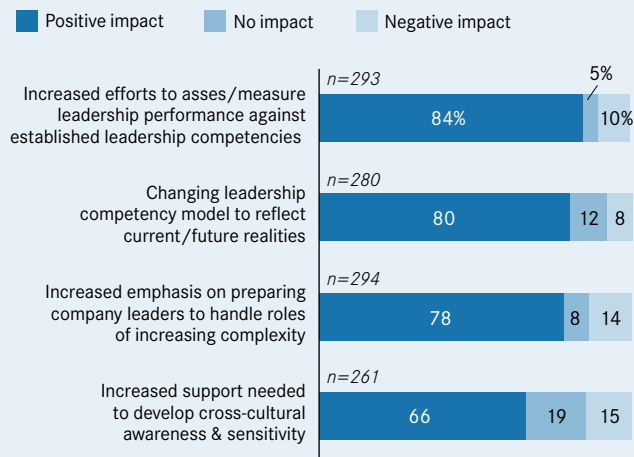
- **Build trust** A leader must be ethical and be able to inspire.
- **Reflect** Twenty-first-century leaders will be required to be thoughtful about figuring out what really matters and then be willing to step backward to go forward.
- **Influence** Influence is not about command and control.
- **Be a T-shaped thinker** Have deep subject expertise in one or more areas and be knowledgeable about functions and issues important to the organization.
- **Facilitate the possible** The leader will need to connect the dots within his or her own organizations, know the

Chart 16

Developing global leaders with the necessary competencies and skills

Measuring leaders against competency models has a positive impact on development.

Percentage of respondents indicating impact of subtrends*



* Sample includes respondents who ranked each human capital priority in their top three most critical priorities right now.

Note: Percentages may not equal 100 due to rounding.

Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

corridors where knowledge is created, and then forge links within the organization so the knowledge spreads.

- **Be comfortable with ambiguity** Leaders must be willing to make and drive decisions with limited or unreliable information under pressing time constraints.
- **Build and manage networks** Be comfortable with multiple relationships outside traditional comfort zones. Leaders and organizations that stay siloed are doomed.
- **Tell a compelling story** The true skill is creating knowledge from information. Twenty-first century leaders must be able to communicate a visionary story that inspires and engages the workforce.
- **Inspire innovation and creativity/open-source thinking** Leaders will need to create a culture that rewards innovation and allows failure.
- **Lead with empathy** Leaders should show social and emotional intelligence and an understanding of their own and others' limitations.
- **Model adaptability** Do the things you hope to see in others.

Some global organizations may need to choose between a “hub and spoke” model of global leadership, which allows expats drive growth outside of headquarters, or a diversified model, which is a networked cohort of global leaders and no central headquarters. It all depends on business needs, and of course the kind of leader depends on the kind of role he or she is to play. McKinsey Global Institute research shows that the diversity of roles that fall under the broad category of global leadership argues for substantial customization around some core competencies.

Rethink how to learn to lead In the future, development of leadership capabilities will involve “social learning,” as well as instant on-demand delivery, to deliver more personalized information. Organizations should anticipate this by developing on-demand models, with innovative delivery mechanisms (e.g., crowd sourcing), as part of their leadership development programs.

Some organizations are developing their leaders' talent by lending them out to noncompetitors for a few years to widen their experience. A major healthcare company in

the United States does this through an executive swap program. Other companies encourage their emerging-leader talent to join civic and philanthropic organizations and cultivate different sets of competencies.

Learning, of course, is not just experiential—it is conceptual, too. Global leaders need to grasp the ideas behind the international interactions in their businesses and cross-country differences and understand their effects. Such understanding adds important depth to their awareness. A recent *McKinsey Quarterly* article suggests, “When executives can fit their personal experiences into an accurate global perspective defined by conceptual frameworks and hard data, they can gain more from their typically limited time abroad and avoid costly mistakes.”^b

Advanced solutions

Tailor your leadership competency model to different employee segments Once the leadership competency model has been redesigned to focus on the organization's needs, consider developing a more nuanced version that considers different employee segments, separated by self-selection, skill groups, or roles. By tailoring the leadership model to each employee segment, an organization can enhance its program's relevance and boost employee engagement, productivity, and retention at the same time.

Make the leadership competency model dynamic This requires a robust leadership competency model that takes into account both current and future performance. As well as the business environment in which the company operates, organizations must constantly take stock of their leadership capabilities as talent flows in and out of their workforce. Assessments should be embedded across all talent management platforms and processes. Such monitoring is essential to helping the organization stay abreast of its leadership needs.

a Charles Mitchell and David Learmond, *Go Where There Be Dragons: Leadership Essentials for 2020 and Beyond*, The Conference Board, Council Perspectives 23, October 2010.

b Pankaj Ghemawat, “Developing Global Leaders,” *McKinsey Quarterly*, June 2012.

OPPORTUNITY

Capitalizing on Employee Engagement

Apple may be stocked with more top-shelf, highly motivated talent than any other company in the world, yet its salary structure and benefits package are not out of line with its competitors, and the workplace is hardly undemanding. So why does it see such success? Because Apple provides a chance to do something that other companies can't offer: a chance to enlist in Steve Jobs's army, a "once-in-a-lifetime" opportunity, and as Jobs often put it, to "make a dent in the universe."³⁵ In short, to work at Apple is not a job, it's a crusade. And some of the world's finest computer engineers flock to it.

Engagement—loosely defined as the extent to which an employee expends discretionary effort in alignment with corporate goals—is a powerful indicator of a company's health and long-term performance. Higher levels of engagement mean more discretionary effort, which translates into better business performance, improved customer satisfaction, greater revenue growth, and quicker speed to market—not to mention less absenteeism and fewer quality defects (Figure 1). McKinsey's Organizational Health Index, a longstanding database that now includes more than 750,000 responses, indicates that organizations with top-quartile scores in employee motivation—just one aspect that drives engagement—are 59 percent more likely to have top-quartile overall health. The inverse is also true: in the United States, it's estimated that demotivated and actively disengaged employees cost the economy up to \$355 billion annually in lost productivity.³⁶

Additional measures suggest that engagement truly matters to performance. For example, studies show that companies with high levels of engagement outperform the total stock market index. They posted returns 22 percent higher than average in 2010, while organizations with low engagement levels had total shareholder returns 28 percent lower than the average.³⁷ In an analysis of 54 companies sorted by median earnings per share (EPS) growth during 2008–2009, those with higher engagement (the "top decile/exceptional growth" group) outperformed their industry competitors by more than four times.³⁸ Similarly, there are plenty of studies showing that companies with engaged employees have less turnover. It's hard to dispute the potential for business impact.

Respondents clearly agree on the importance of high levels of employee engagement. They ranked it their fourth

most critical priority in the survey by McKinsey and The Conference Board. Respondents also signal that they believe they are doing well with addressing engagement. More than a third (38 percent) said they have a "high" degree of confidence in their engagement-related actions (Chart 17 on page 31). Although this may not sound like much, it is one of the highest ratings for any human capital priority in the survey.

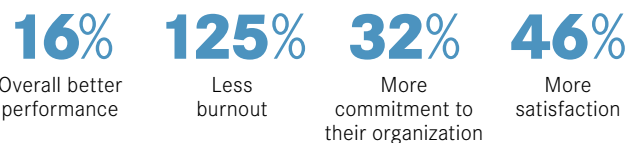
Yet all is not happy in many workplaces. A recent report from the consulting firm BlessingWhite found that fewer than one in three (31 percent) employees worldwide is engaged, and nearly one in five (17 percent) is *actively disengaged*.³⁹ Gallup research is even more sobering: of more than 47,000 employees surveyed globally, only 11 percent were engaged, 62 percent were not engaged, and 27 percent were *actively disengaged*. That's hardly a recipe for a productive and effective workforce.⁴⁰

In this vein, 92 percent of survey respondents report mounting pressure from business leaders and the C-suite to address engagement-related issues, including determining the specific actions necessary for improvement, articulating progress made, and actually raising levels of engagement. In addition, respondents cite the need to determine the link between engagement and business performance at their respective organizations (Figure 2 on page 31).

Figure 1

Motivation Matters

A recent study of more intrinsically motivated white-collar workers showed they had:



A recent study of more intrinsically motivated blue-collar workers showed they had:



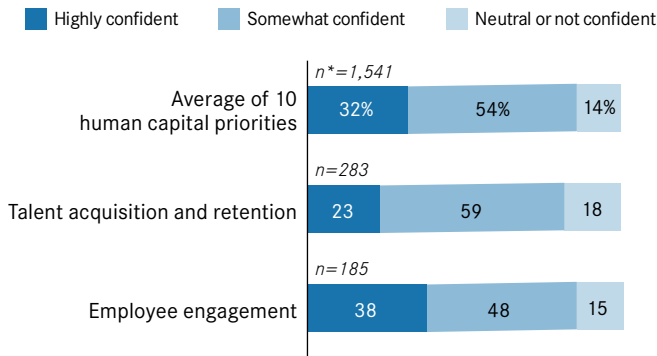
Source: McKinsey & Company

Chart 17

Confidence in talent acquisition and retention and employee engagement actions

HC professionals are more *highly confident* about their ability to improve employee engagement than their efforts to increase talent acquisition and retention.

Percentage of respondents' level of confidence in each action



* N calculated by summing all responses over each of the 10 human capital priorities.

Note: Percentages may not equal 100 due to rounding.

Source: The Conference Board and McKinsey & Company, State of Human Capital Survey, 2012

Figure 2

Employee engagement under pressure



Source: The Conference Board

New Thinking on Drivers of Engagement

New ideas are emerging about motivation—specifically, how to engineer “motivation systems” that use insights from motivational psychology, sociology, cultural anthropology, and business-to-consumer marketing to foster a passionate and loyal workforce. Part of the idea is to build a workforce that feels more like a community than a company—one model being a nonprofit organization.

Within the system, motivational psychology answers the question, “What are the psychological and emotional needs that, if fulfilled, ultimately lead to the outcomes we want to create within our talent base?” Sociology and cultural anthropology speak to the question, “What are the mechanisms that communities have used to sustainably fulfill these emotional needs at scale?” Finally, the marketing component addresses how to create and sustain systems that enable the organization to prioritize, achieve, and measure emotional fulfillment and ensure the desired outcomes.

Returning to the Apple example, it is clear that the company leverages intrinsic motivational strategies to create industry-leading productivity. “When you’re working for Apple, you feel like you’re working for the greater good,” says a former salesman. Thousands of incredibly talented professionals work behind the “Genius Bar” in Apple stores, delivering exceptionally good customer service.

There’s evidence to indicate that other companies are beginning to move in this direction. Research from The Conference Board, McKinsey, and others suggests that engagement drivers are evolving to include a sense of purpose gained through work and an alignment with the company mission, among other factors.⁴¹ This is not to say that traditional drivers—such as a good relationship with the boss and co-workers, pride in the company, and career growth opportunities—are not important; in fact, one of the stronger engagement drivers is the desire for self-development. But the real game-changer is the higher-order desire to derive meaning from work and to feel a sense of belonging—in other words, to be aligned with the company’s mission and to belong to the team that accomplishes that mission.

Why Is This Hard?

If there is no doubt that engagement really matters, why are so few workplaces filled with engaged employees?

Limited influence with the executive suite Effective execution of an engagement strategy requires enterprise-wide alignment and C-suite support—two things that are not always easy to come by. This emphatically underscores one of the imperatives this report presents: the critical need for HC leaders to engage strategically with the organization’s business leaders.

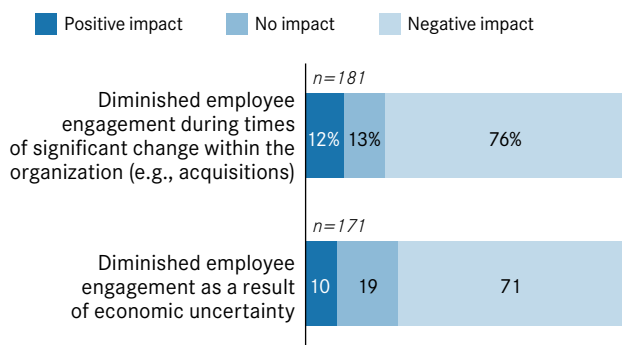
Workplace “toxicity” HC professionals in our focus groups voiced a host of concerns, ranging from the theory that recent events, such as reductions in force and mergers and acquisitions, have permanently damaged engagement. This affects retention rates for top talent and employee morale and productivity. Almost 90 percent of respondents to our survey report lower levels of engagement, coupled with an inability to reduce voluntary turnover in the last 12 months, and cite economic turmoil or significant organizational change as possible drivers (Chart 18).

Chart 18

Negative impacts of engagement

Respondents say that organizational change and economic uncertainty have a negative impact on employee engagement.

Percentage of respondents indicating impact of subtrends*



* Sample includes respondents who ranked each human capital priority in their top three most critical priorities.

Note: Percentages may not equal 100 due to rounding.

Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

While it’s tempting to explain low engagement rates across continents, industries, and demographic groups as a reflection of the turbulent economic times—the “new normal” of unprecedented volatility and uncertainty—that perspective is incomplete. Aggregate rates of engagement have been low historically. In truth, overall job satisfaction, an element of engagement, has been in a slow, steady decline in the United States for decades.⁴² There isn’t “new” toxicity, just a widespread failure to reverse the trend.

Difficulty balancing the benefits (and risks) of new technology In developed markets, HC professionals can add to the list of “engagement busters” the advent of ubiquitous technology creating an “always on, anywhere” workplace, and the nonstop pressure to do more with less and with fewer colleagues to share the load. Put it all together and it turns into a recipe for burned-out employees who are in survival mode—and much less engaged. On the flip side, technology can be an extraordinary engagement booster if leveraged effectively, but the optimal balance is often elusive.

Reasons for Optimism?

Despite the decades-long trend in declining job satisfaction in the United States, workers in 2011 were more satisfied about the basics—job security, wages, promotion policy, educational/job training, and bonus plans—than in previous years. Though the overall numbers remain negative (only 47.2 percent of Americans said they are satisfied with their jobs) it was an improvement from 2010 and 2009, when the figure stood at 42.6 and 45.3 percent, respectively. Satisfaction ratings for fringe benefits like vacation time, sick leave, health plans, pension/retirement funding, flexible-time plans, and family leave plans were up, and employees thought more highly of their supervisors, the physical environment, and the quality of equipment. Interest in the job, fellow employees, and recognition and acknowledgment received higher marks.^a

^a Rebecca L. Ray and Thomas Rizzacasa, *Job Satisfaction: 2012 Edition*, The Conference Board, Research Report 1495, June 2012.

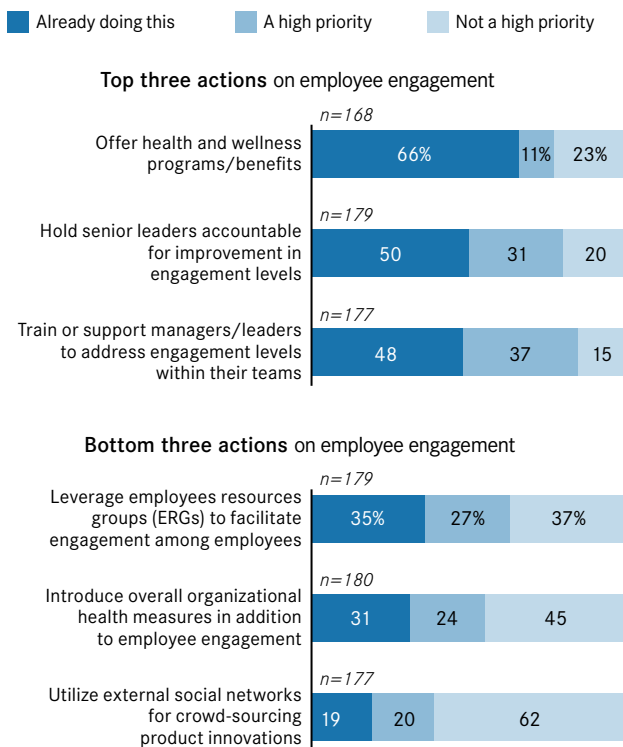
High mobility for top talent and ineffective retention strategies In high-growth markets, such as in Asia-Pacific, where talent acquisition is a critical challenge, many employees now flit from one job to another, searching for additional development opportunities and ever-greater compensation. As a consequence, employees fail to deliver value before leaving for the next adventure, let alone expend discretionary effort in alignment with corporate goals. Research reflects the lower levels of engagement: workers in Southeast Asia are slightly less engaged (26 percent) than their global counterparts, and, among Chinese workers, only 17 percent are engaged.⁴³

Chart 19

Actions to improve employee engagement

Lower-priority employee engagement approaches include the use of social media.

Percentage of respondents indicating the level of priority for each action*



* Sample includes respondents who ranked each human capital priority in their top three most critical priorities right now.

Note: Percentages may not add up to 100 due to rounding.

Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

Solutions and Recommendations

Focus group participants cited specific actions that they are taking to address low levels of engagement (Chart 19). Below is a sample of those actions in addition to others we have seen work effectively.

Foundational solutions

Make employee engagement a strategic initiative and link it to business value This solution speaks directly to one of the three imperatives urged in this report. HC leaders must make it their mission to partner with the CEO and the senior leadership team to role model and help the organization focus on engagement; more frequent and informal interactions will help foster a comprehensive transformation of the culture. Critically, HC professionals have to tie engagement outcomes to business measures and use these metrics to generate enthusiasm from senior leaders. And they need to agree on overall budget and strategy for workplace marketing and culture building.

Get the foundational elements of human capital right (from the start) This includes a meaningful organizational strategy and values; organizational design to create effective work teams and processes; meaningful roles with clear accountabilities; a diverse, well-trained, and well-compensated employee population; effective and inspiring leadership; and proper performance management. These motivation elements are well known and understood, but hard to execute, given the complexity of large organizations and the competing demands on management time. Nonetheless, flawless execution of HC “basics” will positively affect employee engagement levels and reflect the positive work environment. And without them, more advanced solutions will not deliver their full promise.

Set the right goals for engagement Goals will differ by worker segment and require a tailored approach. Segmentation is needed at both the identification and solution stage. For example, start by focusing where high potentials or those in critical roles have low levels of engagement. What do these populations need for engagement? Perhaps it’s something different than the broader workforce as a whole. Blanket “engagement” measures and initiatives directed at the whole organization rather than relevant segments can be a much tougher battle to fight than a nuanced approach. Rather than setting only overarching goals (e.g., reach “highly

engaged” for 50 percent of the workforce), HC leaders should set goals, but also understand needs, structure initiatives, and measure impact *at the community level*—knowing that the goals may be very different across these communities. Note that, even within communities, there may be relevant subsets who think about their workplace needs and fulfillment quite differently. And, as discussed earlier, compelling engagement approaches will differ by generation.

HC leaders must be more sophisticated in analyzing and identifying needs-based segments, measuring engagement, prioritizing employee segments, assessing root causes of lower engagement, aligning various initiatives by population, and then tracking not only the engagement impact of said initiatives but also the business impact.

Launch initiatives with a clear vision of outcomes, and provide the tools for success For example, coaching and mentorship were frequently cited in focus groups as a driver of motivation and engagement. On this point—and in light of the “efficient execution” imperative—HC leaders should offer training and support to managers and leaders to equip them to lead effectively. It is encouraging that many focus group participants cited a “conscious effort” to invest in training for midlevel managers and site supervisors, together with programs for senior leaders and provision of mentors. More advanced companies are going beyond thinking solely of top-down coaching and mentoring and using reverse mentoring and external networks as coaching opportunities. We imagine that it won’t be long before virtual coaching and mentoring is relatively commonplace among millennial staff, who tend to have a lower requirement for face-to-face connections to build trust.

HC professionals should work to increase a sense of connectedness in the workplace—face-to-face connectivity, even in this social media era, is still and will remain a critical part of reaching employees across distributed networks and continents. HC leaders might also rethink their processes and approaches: focus group participants cited initiatives in this area, ranging from minor tweaking of EVPs to major systems redesign. In between, themes included creative ways to retain people, including redeployment and contract labor versus reductions in force, and better succession planning to ensure opportunities are used both for development and recognition.

Advanced solutions

Some HC practitioners are already aware of the factors cited above and are probably ready to begin addressing the “pursuit of innovation” imperative and evaluating the following ideas.

Engineer an internally consistent, whole “motivation system” Rather than designing the incentives, career progression, job design, culture, and leadership systems independent of each other, HC leaders should engineer the motivation system so that it feels internally consistent to achieve maximum psychological effect. There are a few elements to this:

- **Find a way to link to the overall mission** Think about the ways in which your company does or does not articulate its higher purpose—the mission that lifts it out of the mundane. If you can succeed at identifying something elevating and can communicate it energetically, there’s a strong chance that your employees might connect with it on an emotional level. A strong mission can help to develop an onboarding tradition that teaches the “way” of the company, reinforcing the concept by teaching it in a natural setting—that is, not in a conventional classroom.

Apple has this by the gallon, as mentioned earlier, but it is not alone. The international aid organization Doctors Without Borders/Médecins Sans Frontières (MSF)—winner of the Nobel Peace Prize in 1999—boasts exceptional levels of engagement. The organization brings together doctors and health workers who risk their lives to provide medical and humanitarian aid to those affected by war, natural disasters, and epidemics, without regard to race or creed or political affiliation. Similarly, the U.S. Marine Corps attracts young men and women from all walks of life, many from challenging circumstances, and molds them into highly efficient teams dedicated to accomplishing key missions, even to the point of sacrifice for fellow Marines. Perhaps no other branch of the U.S. military engenders such loyalty, even after service. Its members continue to espouse, “Once a Marine, always a Marine.” (See “Agility in Action: The U.S. Military on page 36). Organizations with such strong missions have a clear advantage, yet companies with an everyday purpose can also find ways to make that purpose meaningful to their staff.

- **Radically rethink the difference between satisfiers and dissatisfiers and ensure it is reflected in the investment levels made** Focus on satisfying lower-order and higher-order psychological needs rather than focusing

on total compensation as the primary motivation lever. The primary objective should be to maximize intrinsic motivation (i.e., the desire to do the job for the love of the job itself). Yes, compensation can be used to signal growth, but you have to gauge the point at which it can become “over-reinforcement.” There is evidence to suggest that other motivators—such as “choose-your-own-adventure” career pathways—can do a better job of developing self-determination and, thus, strengthening motivation.

Reinforcing this point, a 2003 study by Frederick Herzberg, a professor of management at the University of Utah, in the *Harvard Business Review* found that *personal achievement, being competent in one’s job, and the nature of the work itself* were the three most important factors for “extreme satisfaction” in the workplace.⁴⁴ On the negative side, *company policy and administration* was by far the leading factor causing “extreme dissatisfaction,” followed by *the level and type of supervision* and *the nature of the work itself*. A focus on job enrichment and ensuring a sense of responsibility and achievement among employees, therefore, may be a good starting point.

- **Focus on community** The idea should be to create a workplace that feels more like a community than, well, a workplace (Figure 3). Some of the best models we’ve found for such a sustainable, intrinsic motivation system are in non-“corporate” organizations—sports teams, for sure, but

also nonprofits and volunteer-based organizations, such as animal rescue organizations. To create a sense of community at work, the savviest HC leaders are taking a few pages from anthropologists’ playbooks by facilitating the development of natural communities. At WellPoint, for example, its Latino group has been helping the business think through Latin American marketing campaigns. At Prudential, enterprise resource groups are used to offer development opportunities early in staff careers.⁴⁵

Apply a “test-and-learn” approach, and establish a framework for measuring and tracking investments in productivity—not just satisfaction

HC leaders can borrow a few marketing ideas to establish a “campaign-based” methodology for employee engagement. At their core, the initiatives should feel “grassroots,” even if they have been designed and organized centrally. A test-and-learn process allows for initiatives and messages to be adjusted over time (and refined for best ROI). The team that manages this might actually look more like a business-to-consumer (B2C) marketing unit, displaying many of the accompanying analytical skills that top marketers possess and measuring not just outcomes, but also the different practices employed and the relative return on those practices.

Figure 3

Motivation systems

Using insights from motivational psychology, sociology, cultural anthropology, and B2C marketing, we can engineer “motivation systems” that create a passionate and loyal workforce.

Engineer an internally consistent whole motivation system rather than designing the incentives, career progression, job design, culture, and leadership systems independently of each other. The motivation system must feel internally consistent to achieve maximum psychological effect.

Focus on satisfying lower-order and higher-order psychological needs versus focusing on total compensation as the primary motivation lever. The primary objective should be to maximize intrinsic motivation (or the desire to do the job for love of the job itself).

The desired end-state should feel more like a community than a company. The best analogs we’ve found for the sustainable intrinsic motivation system is in long-lived communities and typically “noncorporate” organizations. An anthropological lens should be applied to this problem to create a sense of community at work.

Use psychometric mapping to guide the process and establish economic budgets and targets. Through a psychometric mapping process, ensure that all elements of the motivation system are effectively achieving the optimal psychological state.

Use B2C marketing capabilities to establish a test-and-learn, campaign-based methodology that:

- Feels “grassroots” even if it is designed and organized centrally
- Uses a campaign-based test-and-learn process
- Creates a team to manage it that looks more like a B2C marketing unit

Source: McKinsey & Company

OPPORTUNITY

Ensuring an Agile Workforce

Organizational agility is the only appropriate and durable response in a world in which prices swing faster, products flash and fizzle quickly, and businesses come and go more rapidly than ever. Any organization whose workforce can aptly reconfigure to suit tomorrow's needs has a tremendous inbuilt advantage.

It's not news to business leaders that their world is so volatile. They all have their hair-raising stories, and there are plenty of data to back them up. They are acutely aware of the need to be able to respond nimbly. Nearly 90 percent of executives responding to a 2009 Economist Intelligence Unit poll said they view organizational agility as critical for business success. Yet more than a quarter admitted that their organizations were at a disadvantage because they weren't agile enough to anticipate fundamental marketplace shifts.⁴⁶

The concept of agility was popularized in the 1990s in manufacturing by the Iacocca Institute.⁴⁷ The definition has been expanded to refer to an organization-wide ability to move quickly to see and act on changes, opportunities, and emerging trends, and to deal with unexpected threats and opportunities, regardless of the source. Think of the companies that were best able to bounce back from, say, Hurricane Katrina or the supply chain disruptions produced by Japan's 2011 tsunami—they were more agile than most. Truly agile organizations never wait for things to happen; they anticipate, model, plan, and rehearse their responses before a crisis occurs.

Agility's impact on financial performance has been the subject of academic study. Massachusetts Institute of Technology (MIT) research suggests that agile organizations grow revenue 37 percent faster and generate 30 percent higher profits than non-agile organizations.⁴⁸ McKinsey's Organizational Health Index (OHI) measures agility in terms of an organization's ability to renew faster than the competition. OHI data show that companies that are strong on organizational health are twice as likely to outperform their peers on financial measures, such as margin, book value, and income growth.

By extension, HC must be more agile than the organization as a whole. The workforce must be flexible *and*

responsive enough to ensure that the right people with the right skills are assigned to the right roles at the right time and at the right cost, anywhere in the world, and that the workforce can quickly be reconfigured to suit tomorrow's needs—again, with the right staff in the right places at the right time.

The Hallmarks of Human Capital Agility

While achieving agility requires investing in multiple aspects of organizational culture and capabilities, including leadership style and resilience, streamlined and adaptive processes, and a “continuous improvement” mindset, both McKinsey and The Conference Board have observed that agility, in human capital terms, has to start from the generation and use of data to drive

Agility in Action: The U.S. Military

According to the U.S. Marine Corps leadership manual, “adaptability” means a willingness to deviate from normal, accepted practices—even from doctrine—if that is what it takes to win on the battlefield. “No plan survives the first contact with the enemy” is a military aphorism. In a Marine Corps operation, an order issued by a commander outlines the general objectives, which are known as “commander's intent.” It is not expected to be the last word. Subordinates have discretion to issue orders for their areas of operation, as long as those orders are aligned with the intent. Soldiers are trained for uncertainty, and they encounter it, from friend and foe alike. Their resources in terms of troops and arms can change radically without warning, and they need to adapt quickly to achieve their mission.

Source: Boris Groysberg, Andrew Hill, and Toby Johnson, “Which of These People Is Your Future CEO? The Different Ways Military Experience Prepares Managers for Leadership,” *Harvard Business Review*, November 2010.

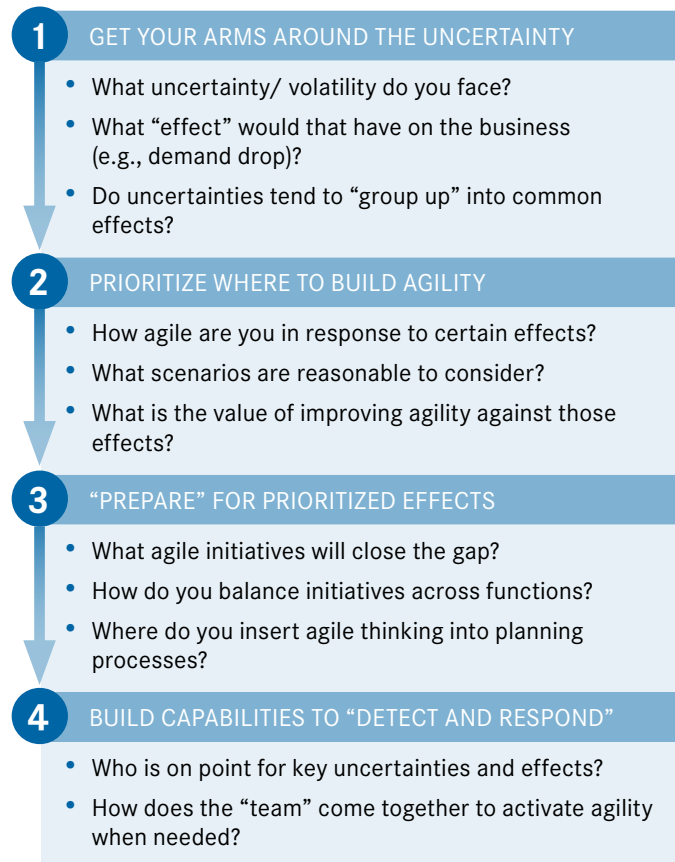
innovation, solve problems, and support strategy. The best organizations extend this analytical approach to continuously scan their external environments and analyze what they find to anticipate future skill requirements (Chart 20).

HC agility owes much to the effective implementation of strategic workforce planning (SWP), supported by robust analytical capabilities and honed by strengthening learning agility and a flexible organizational design. By aligning human capital strategy to business strategy, executing SWP, employing human capital analytics (HCA), and using these data to design and maintain an organization that supports and perpetuates agility, human capital initiatives can contribute to improvement in customer satisfaction, employee engagement, operational efficiencies, and organizational profitability. However, there is a huge gap between wanting to be agile and actually being agile.

Chart 20

A step-wise approach to drive an agile transformation

True agility requires changes in operational thinking and leadership skills.



Source: McKinsey Operations Practice

It all begins with SWP

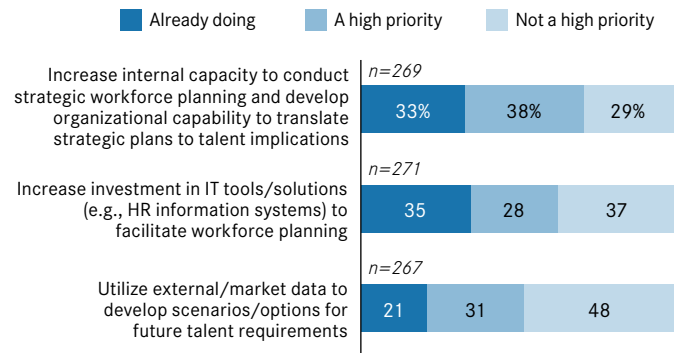
Research from McKinsey and The Conference Board shows that, while SWP is clearly recognized as a major priority both now and in the future—it was ranked third in both cases—HC professionals lack confidence in their ability to execute SWP successfully. Merely 27 percent of respondents say they are “highly confident” that the actions they are now taking to implement SWP will be successful—one of the lowest confidence scores among the top 10 priorities (Chart 21b).

Chart 21a

Strategic workforce planning actions

Organizations express uncertainty about how to execute SWP.

Percentage of respondents indicating the level of priority for each action*



*Sample includes respondents who ranked each human capital priority in their top three most critical priorities right now.

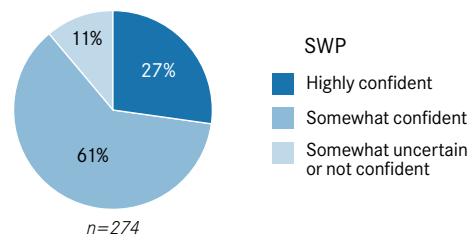
Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

Chart 21b

Level of confidence in strategic workforce planning actions

Only 27 percent of respondents say they are *highly confident* in their current strategic workforce planning efforts.

Respondents' level of confidence in strategic workforce planning actions*



*Sample includes respondents who ranked each human capital priority in their top three most critical priorities right now.

Note: Percentages do not equal 100 due to rounding.

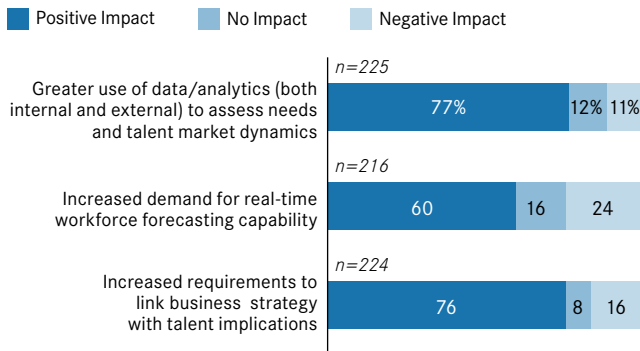
Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

Chart 22

Top three trends in strategic workforce planning

HC professionals see analytics as having a positive impact.

Percentage of respondents indicating impact of subtrends*



* Sample includes respondents who ranked each human capital priority in their top three most critical priorities right now.

Note: Percentages do not equal 100 due to rounding.

Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

The difficulty of designing HC agility is not, however, rooted in confusion about SWP’s impact. Survey respondents clearly recognize the need for and positive impact of SWP, and they fully understand the need to position HC as a strategic business partner (Chart 22).

Additional confirmation of the importance of SWP comes from the 76 percent of respondents who recognize the impact of increasing requirements to link business strategy with talent implications—to the imperative about HC engaging strategically with business leadership.

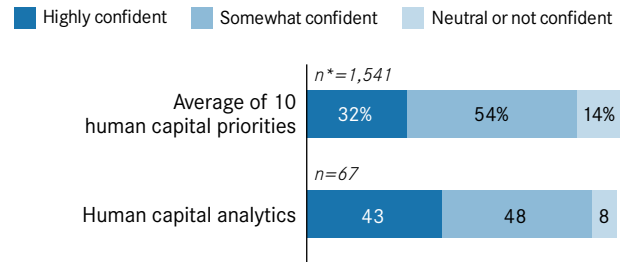
That said, there appears to be a disconnect between the recognized importance of SWP and the low priority assigned to the key elements of its successful implementation—human capital analytics (HCA) and organizational design. HCA ranked a lowly ninth out of 10 on the priority list. There is also concern about the ability to implement. Only 43 percent of the respondents choosing HCA as a top priority are highly confident about their actions (Chart 23).

Chart 23

Confidence in human capital analytics actions

Respondents who identified HCA as a priority are slightly more confident in their actions than those who identified other HC areas as priorities.

Percentage of respondents’ level of confidence in actions



* N calculated by summing all responses over each of the 10 human capital priorities.

Note: Percentages may not equal 100 due to rounding.

Source: The Conference Board and McKinsey & Company, State of Human Capital Survey 2012

Don’t underestimate the importance of analytics

SWP requires a head for data and an aptitude for decision making. Seventy-seven percent of survey respondents recognize the positive impact of greater use of analytics, and 60 percent recognize the positive impact of real-time workforce forecasting capability. When asked how companies are leveraging data to make people decisions, responses from HC professionals included:

- Identify competencies, and then find the people in the organization who have them.
- Provide performance management data to managers (this is often a matter of having a good analytics system and being able to provide data and foster a conversation).
- Examine the hierarchy in an organization to see which capabilities reside where and simulate different configurations of workforce capabilities.
- Identify shortages of critical skills, and pinpoint the gaps between talent capabilities and business goals.

And while HCA does not appear to be a top priority, it should be, as it is the linchpin of all human capital investment and supports many agility decisions (Figure 4).⁴⁹ It may come as no surprise, then, that of the respondents who view HCA as a top priority, 72 percent are taking and prioritizing many actions toward its implementation—a higher percentage than for many other focus areas.

Figure 4

Human capital analytics is the linchpin of human capital investment



Don't underestimate the importance of organizational design

As with HCA, most companies aren't focusing on designing an organization that supports agility. More than half (55 percent) of respondents do not prioritize actions to rethink organizational design. However, the actions of those that do speak volumes in terms of positioning physical and cultural environments to support an agile organization. Among that small subset, the top three planned actions include:

- Disaggregation of jobs to create more flexible roles
- Flattening layers of management to increase "span of control"
- Increased outsourcing of noncore functions to allow appropriate investment of time and capabilities on those activities that really drive business value

Why Is This Hard?

A prevalence of reactive versus proactive HC practices This is not the first report to point out that traditional HC practices are reactive, provide ad-hoc initiatives, overuse recruiting as a lever to solve human capital issues due to a lack of forward planning to fill gaps by less expensive and more long-term methods, launch new training programs with no explicit link to strategy, and use inconsistent approaches across the enterprise. Agility, by definition, requires a certain degree of proactive wiring, thereby reducing the need to react and allowing lightning-fast response times when needed.

An elusive fact base Too often, forecasts of workforce supply and demand are loosely defined, look out only one year at most, fail to incorporate external market information, and are high-level SWAGs. In many cases, models are based on assumptions that are not grounded in fact or that fail to incorporate the implications of critical business drivers. Absent hard data, they are little more than guesses. Agility is all about the data. It builds upon quantitative activities, especially analytics, and uses data to inform decisions relevant to organizational strategy.

Low ability to execute strategic planning in sync with business leaders Alignment with business strategy requires more than order taking: it requires a workforce plan that provides the basis for sound decisions and appropriate investments, clearly shows the expected impact of planned HC actions, summarizes the impact of previous actions, quantifies risks, and presents useful "what if" scenarios. Most of all, alignment with business strategy links all of this not only to HC measures of success—retention of high-potentials, for instance—but also to the impact on the business in measures such as customer satisfaction, growth in new emerging market regions, and so on. According to a recent report from The Conference Board, there are 10 strategic workforce planning skills and competencies HC leaders need to be effective.⁵⁰ The first three—business acumen, quantitative skills, and change leadership—are essential requirements.

The absence of or a shortfall in those skills—particularly business acumen and quantitative skills—is often the highest barrier to agility for most HC professionals. McKinsey and The Conference Board have observed that more and more chief financial officers are becoming involved in SWP initiatives than ever before in an effort to inject these much-needed skills.

Solutions and Recommendations

As mentioned previously, to become agile, organizations must first embrace SWP, which means that the HC function has to be working strategically with the business leaders rather than transactionally—as embodied in one of the three imperatives highlighted in this report. To achieve this, HC leaders must possess the data and analytics skills to glean useful insights from the data. They must be able to come to strategy sessions armed with facts and messages to describe how talent can help or hinder the strategy, where the talent gaps are and why, and what the impact of new investments in HC areas would be. Figure 5 shows the continuum from traditional HC to strategic workforce planning.

Respondents to the survey by McKinsey and The Conference Board said they are taking specific actions to facilitate SWP (and move forward on the agility journey). Below are the most important signals (Chart 21a on page 37).

- Seventy-one percent of respondents are either developing or placing a high priority on developing organizational capabilities to translate strategic plans into talent implications.
- Sixty-three percent report increased investment in IT tools and solutions to facilitate workforce planning.
- Fifty-two percent of respondents are currently using or plan to use market data to develop scenarios for future talent requirements.

HC professionals who are making those kinds of moves are ready to consider other solutions.

Figure 5

Strategic workforce planning

Strategic workforce planning is based on working strategically with business as opposed to transactionally.

From traditional assessment of HR implications...	...to strategic workforce planning
Ad hoc initiatives such as hiring and training	The business strategy shapes all HR actions – customized by the business unit – including talent deployment, capability building, and career planning
HR attracts talent without a clear link to a specific business strategy	Better ability to attract the right talent to support the business strategy
Fragmented divisional focus	Comprehensive company-wide approach extending across entire employee body
Inconsistent approach across the businesses	Standardized practices and communications linked to an enterprise “playbook” that can be customized for businesses or functions
Little integration of HR planning with strategic, financial, and operations planning	Repositioning of HR as a strategic business partner in change programs
Predictions based mainly on assumptions, age pyramids, and historical statistical analysis	Modeling based on real and recent data, individual behaviors, business processes, and skill groups

Source: McKinsey and Company

Foundational solutions

Develop competence Build internal competency across SWP, HCA, and organizational design. This will require that companies develop a clear understanding of their current status in these capability areas, recognize and measure the gaps that exist, and candidly assess the levels of competence required to move their business strategy forward. Staff with the right skill set and aptitudes to fill all these needs may well not exist within HC right now. The function needs to use all the levers at its disposal to build the right cadre of professionals through recruitment and development of internal staff, borrowing from other functions, and creating strong networked relationships with the niche companies that can provide the deep expertise required.

Reinvent the organization Organizations must reinvent themselves, placing greater importance on how core HC processes, such as hiring and performance management, can support agility, as well as the broader set of processes, such as planning, budgeting, and customer relationship management. While these core processes and daily management routines should be robust and well managed, this does not mean they need to be fixed and rigid. For example, structural choices, such as morning meetings and team work plans open to others, as well as use of virtual communities to rapidly share information (internally and externally), will support the flow of information that is required.⁵¹ Building the capabilities to interpret that information will prevent the organization from being overwhelmed by the data available. All the structural elements need to be supported by a culture that allows bounded risk taking, has a limited hierarchy (and where information flows freely), and empowers managers and employees to make quick decisions based on the insight from the data. This is as true for HC as it is more broadly—and can be applied to making deployment or recruiting decisions as much as to a software build.

Engage stakeholders Too often, the HC function misses the opportunity to get input from business leaders and buy-in to its insights and decisions. This is crucial to building an understanding of the importance and payoff of larger investments in processes and skills that support human capital agility. It may take time and hard work, but it is also a skill-building opportunity for HC professionals—talking about HC analytics in a common business language will both build HC credibility and provide justification for decisions.

Advanced solutions

Organizations that are ready for higher levels of agility will do well to focus on the following solutions.

Create a culture of analytics-enabled agility Although many organizations are generating data, and there are often pockets of talent who are skilled in capturing and analyzing it, opportunities to drive strategic value are often missed unless the organization's culture embraces analytics.⁵² A culture that supports analytics-enabled agility includes:

- Promoting leaders with an understanding of, and passion for, data analysis at every level
- The breakdown of organizational “silos”
- Recognizing that human capital analytics is an organization-wide issue, not just something for HC to worry about
- Developing and retaining talent by up-skilling existing talent and hiring new talent with analytics in mind

Indeed, one useful technique in skill development will be to use some of the SWP approaches outlined earlier—identifying the adjacent skillsets and developing capability-building plans to shift the skills toward SWP and HCA expertise.

Develop advanced analytics capabilities According to an *MIT Sloan Management Review/IBM* study, the leading barrier to successful adoption of analytics is the ignorance of how to use it.⁵³ Organizations should advance their analytics capabilities by developing skills in advanced quantitative methods, scenario planning, risk analysis, simulation, and data visualization. In addition, organizations should employ appropriate technology to support the generation of real-time, useable data. Technological advances mean it is possible to more effectively collect, analyze, and deploy data than in the past.

Show the payoff for investing in human capital agility By properly promoting agility—implementing SWP, employing HCA, syncing up with the business strategy, and rethinking organizational design—HC can make a convincing case that there are big payoffs for investing in human capital agility. The HC group should have a proactive program for communicating to key stakeholders about its investment choices, along with the expected financial and nonfinancial benefits—all in context of the likely risks associated with those investment choices.

CONCLUSION

A Second Wind for the Climb Ahead

To be utterly candid, the HC function does not arrive at this time of great opportunity with an inspiring reputation. It has yet to prove that it can produce the workplace changes needed to not merely to match what competitors are doing, but to forge far ahead.

Too often, HC has been, and lets itself be seen as, the trailing member of the team. Now comes its best chance to put that right—not only to be noticed, but to be rewarded—perhaps even celebrated—for leading the push to the true summit of human capital excellence.

Which way will the function’s leaders go, and how? Onward and upward with determination and certainty? Getting their second wind and pushing forward collaboratively, and perhaps tentatively, with their business peers? Or will they stand still, anxious about and vulnerable to the next economic storm? Given the global and very immediate challenges outlined in this report, there should be only one answer.

To help galvanize the HC group—and set it up for enduring success—McKinsey & Company and The Conference Board have brought together their considerable bodies of knowledge about the world of human capital. These new research efforts have enabled us to pinpoint four vital opportunity areas—anticipating the workplace of the future, securing the pipeline of skilled workers, capitalizing on employee engagement, and ensuring an agile workforce—and to propose practical solutions with which HC leaders can act promptly.

We are excited by the opportunity. Now is the moment for HC to embrace technology, to become really strategic, as the more mundane aspects of HR become truly technologically enabled and, thus, less onerous and time consuming. Now is the time to embrace big data and create huge business value by combining the function’s understanding of human needs with the analytical insights that will link those insights to pragmatic strategies for delivering HC value in new ways. The value-creation potential of the HC function is an opportunity now as never before.

However, to be able to take advantage of any of these opportunities, HC leaders must think and act in terms of three mandates—mandates that our longtime studies of excellence in the field of human capital demonstrate are hallmarks of top-performing organizations.

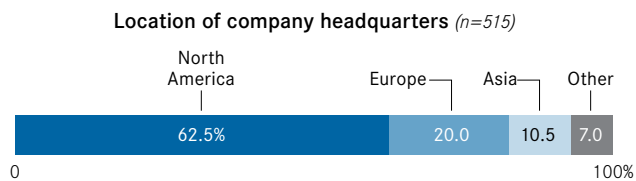
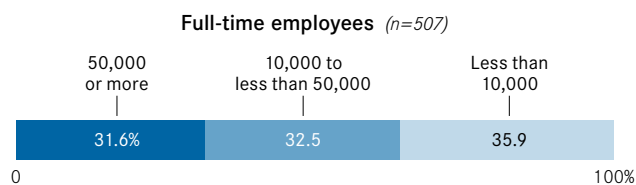
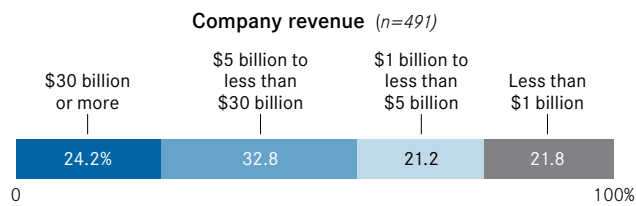
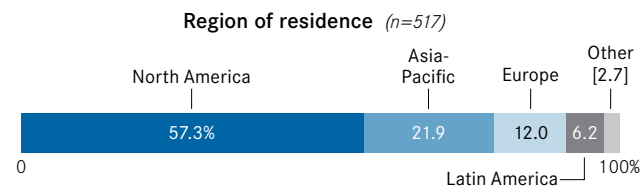
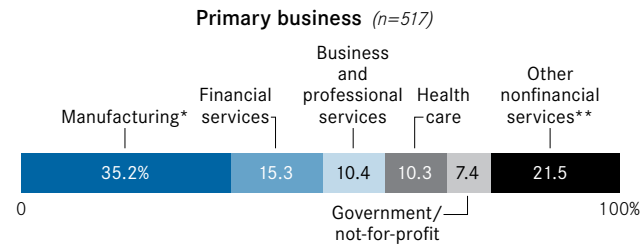
At an absolute minimum, HC professionals must look anew at every one of their “execution-related” activities, rigorously prioritizing them and regularly reprioritizing them so their available resources favor the efforts that matter most for business success. Leaders should leverage data and metrics, including forward-looking analyses, where possible, to inform agendas, investments, and, ultimately, dramatically improve efficiency.

HC leaders have to engage strategically with the organization’s business leaders, declaring the roles they will play to deliver business value, detailing the investments required and the ROI projected, holding themselves accountable for business impact, and painting compelling pictures of the future workforce. The HC group has to confidently take measured risks in the pursuit of innovation, clearly communicating the business case, and hunting for new ideas outside the familiar sources. That means looking beyond their own contacts and beyond the four walls of their own organizations, tapping into other networks and communities through crowdsourcing, social networks, new search tools, and more. Similarly, this means expertly balancing the need to “keep the lights on” with the need to innovate.

This is not to make light of the challenges of acting according to these mandates. We do not diminish the weight of the everyday difficulties HC leaders face or the impact many leaders have made in this space, providing remarkable progress in their organizations and positioning their companies for success. But every observation tells us that the human capital function still has not reached its full potential. It can. It must. The summit beckons. So what’s *your* plan for the climb ahead?

Survey Demographics

Responses to the “State of Human Capital” survey were collected between March 8, 2012, and April 6, 2012. The 517 respondents represent companies across the globe and include managers and senior executives spanning the HC spectrum, including diversity and inclusion, compensation and benefits, talent management, leadership development, employee engagement, strategic workforce planning, and organizational design.



* Manufacturing includes consumer, industrial, technology, energy, agriculture, and mining companies.

** Other nonfinancial services includes government offices, nonprofit organizations, and wholesale, transportation, communication, software, and utility companies.

Note: Percentages may not equal 100 due to rounding.

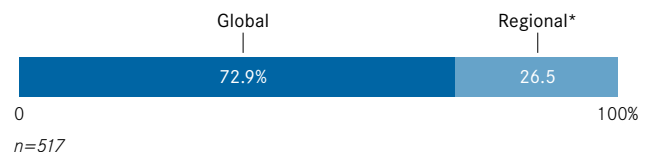
Regions of business operations (n=517)

North America	84.1%
Europe	66.0
China	57.8
Latin America and Caribbean	56.9
Rest of Asia/Asia-Pacific	56.1
Indian subcontinent	50.3
Middle East and North Africa	48.7
Australia and New Zealand	48.0
Sub-Saharan Africa	29.0

Primary business breakdown (n=517)

Financial services	15.3%
Manufacturing (industrial)	13.9
Manufacturing (consumer)	11.0
Business and professional services	10.4
Healthcare	10.3
Government/public administration/non-profit	7.4
Wholesales and retail trade	5.8
Energy	5.2
Computers/technology/software	4.6
Transportation and warehousing	3.7
Communications/broadcasting/publishing	2.7
Utilities	2.7
Construction	2.3
Manufacturing (computers/technology)	1.0
Other	1.9

Global versus regional companies



* “Regional” companies are those that operate in only one region.

Note: Percentages may not equal 100 due to rounding.

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About the Authors

Amy Lui Abel, PhD, is director of human capital research at The Conference Board and leads research efforts focusing on human capital analytics, labor markets, workforce readiness, strategic workforce planning, talent management, diversity and inclusion, human resources, and employee engagement. Abel was previously a director of leadership development with Morgan Stanley, supporting high-potential senior leaders globally. She has also held roles at Accenture, Adobe Systems, and JPMorgan Chase, and has led a private consulting organization performance practice. Abel was recently published in *The Handbook of Workplace Learning*, *Human Resources Development Quarterly Journal*, and *T+D Magazine*. She holds several degrees, including a doctorate from New York University in information technology, business education, and organizational learning and performance.

Bryan Hancock is a partner in the Atlanta office of McKinsey and Company. Hancock is a leader of the firm's service on human capital management. Currently, he serves clients in retail, airlines, manufacturing, healthcare, public sector, social sector, and professional services on a range of strategy and organization topics, with a focus on workforce and human capital development. Hancock has also been a faculty member at McKinsey's "Change Leaders Forums." Hancock holds a J.D. from Harvard Law School and a bachelor's degree in Government and Foreign Affairs from the University of Virginia.

Emily Lawson, PhD, is a partner in the London office of McKinsey and Company. Lawson is a leader of the firm's service on human capital management. She serves clients across a range of industries, including pharmaceuticals, telecommunications, financial services, and professional services, with a focus on change management, aligning and engaging the organization in delivering new strategies and substantive performance improvements. Lawson

leads McKinsey's work on gender diversity and was an author of *Women Matter Five: Making the Breakthrough*. She is part of the leadership team for McKinsey's internal leadership development offering. Lawson holds an MBA from the Said Business School, Oxford, a doctorate from University of East Anglia (UK), and a master's degree from Cambridge University.

Charles Mitchell is the executive director of knowledge content & quality at The Conference Board and publisher of *The Conference Board Review* magazine. Mitchell, who began his journalism career with the *Rand Daily Mail* newspaper in South Africa, spent more than a decade as a reporter and writer for United Press International and UPI Radio based in Johannesburg, Nairobi, Moscow, and Washington, D.C. The former foreign editor of the *Detroit Free Press* newspaper and European editor for *World Business* magazine, he is the author of several books dealing with international business travel, cultures, customs, ethics, and etiquette. Mitchell holds a bachelor's degree in economics from the University of Pennsylvania.

Patti P. Phillips, PhD, is president and CEO of the ROI Institute, Inc., and serves a principal research fellow, human capital, for The Conference Board. Phillips expertise is in measurement and evaluation and she helps organizations around the world implement the ROI methodology. Following a 13-year career in the electric utility industry, she has committed herself to research and practice in the measurement, evaluation, and use of ROI as a measure of financial success of investing in human capital. Phillips contributes to a variety of publications and is author and editor of several books, including *Measuring Leadership Development*, *10 Steps to Successful Business Alignment*; and *The Bottom Line on ROI: Basics, Benefits & Barriers to Measuring Training & Performance Improvement*, among others.

Rebecca L. Ray, PhD, is senior vice president and the leader of the human capital practice at The Conference Board. Previously, Ray held executive positions in global talent management for several companies. She taught at Oxford University and New York University (NYU) and led a consulting practice for many years, offering leadership assessment and development services to Fortune 500 companies and top-tier professional services firms. Ray was named “Chief Learning Officer of the Year” by *Chief Learning Officer* magazine and one of the “Top 100 People in Leadership Development” by *Leadership Excellence* magazine. She serves on the advisory boards for NYU’s Higher Education/Business Education program at The Steinhardt School of Education and University of Pennsylvania’s Executive Program in Work-Based Learning Leadership. She is the author of numerous articles and books, including *Measuring Leadership Development*. Ray holds a doctorate from New York University.

Allison Watson is an associate principal in the Washington, D.C., office of McKinsey and Company, where she focuses on human capital for the Americas Organization Practice. Watson serves clients across the energy, chemicals, automotive, industrial, and advanced electronics sectors, with a focus on workforce planning, HR transformations, and leadership development. She is currently leading McKinsey’s research on human capital transformations and advanced workforce analytics, with a focus on an overarching approach to talent supply and demand across internal and external global talent portfolios. Allison holds a bachelor’s degree in economics from Duke University.

Brooke Weddle, PhD, is an engagement manager in the Seoul office of McKinsey & Company. Weddle is currently leading efforts in Asia on organizational health using McKinsey’s Organizational Health Index (OHI) survey. She has served clients across multiple industries and sectors on predominantly organization and sales topics, including talent strategy, HR effectiveness, organizational design, leadership development, and capability building. Weddle is a member of McKinsey’s healthcare and organization practices and holds the firm’s “expertise” designation in organization, with a focus on human capital strategy. She holds a doctorate in international comparative education from Stanford University, master’s degrees in economics and Spanish from Stanford University, and bachelor’s degrees in economics and Spanish from University of Virginia.

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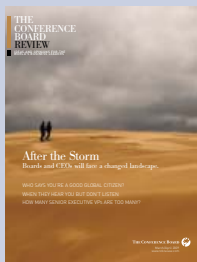
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