

# McKinsey On Organization

## CHROs and talent management



Power to the new people analytics



Getting beyond bureaucracy in human resources



Ahead of the curve: the future of performance management



Learning at the speed of business



Decoding leadership: what really matters

Organization Practice June 2016



McKinsey On

# Organization



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# Introduction

“The most valuable of all capitals is that invested in human beings.”

– Alfred Marshal



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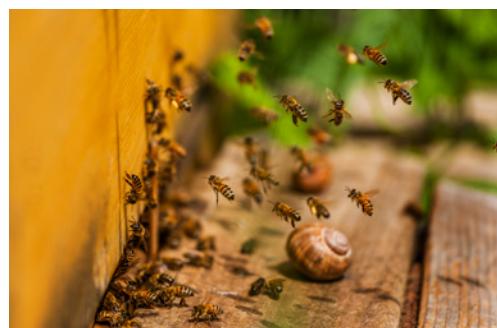
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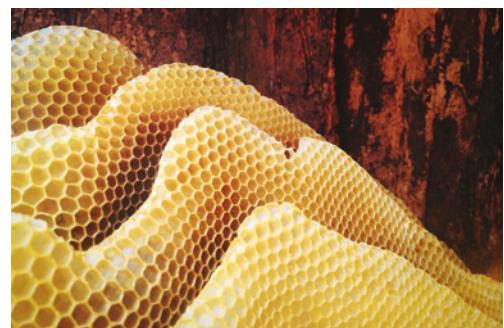
## **What makes an organization successful?**

A successful organization is like a colony of bees – a well-structured entity with clear processes and talented contributors who work effectively together.

We are delighted to share with you our latest thinking on how organizations can release their full potential. In this McKinsey On Organization series, we will focus on four critical topics:



**Agility and Organizational Design**



**Merger Management**



**Transformational Change**



**Talent Management**

This second book is focused on the topic of talent management and the role of the CHRO. It explores the potential behind the application of digital and analytics to improve talent management decisions. It provides a perspective on how the role of the CHRO should become more strategic and a thought partner to the CEO. It also applies critical thinking to the topic of performance management and shares insights on how companies could transform traditional performance management processes. On the topic of learning, it analyzes the implications of digital for corporate academies. Finally, it presents the four behaviors that have been found to drive effective leadership.

# Power to the new people analytics

Bruce Fecheyrs-Lippens, Bill Schaninger, and Karen Tanner

Techniques used to mine consumer and industry data may also let HR tackle employee retention and dissatisfaction.



The latest data and analytics buzz comes from the field of advanced HR analytics, where the application of new techniques and new thinking to talent management is becoming more mainstream. The implications are dramatic because talent management in many businesses has traditionally revolved around personal relationships or decision making based on experience – not to mention risk avoidance and legal compliance – rather than deep analysis. Advanced analytics provides a unique opportunity for HC and HR professionals to position themselves as fact-based strategic partners of the executive board, using state-of-the-art techniques to recruit and retain the great managers and innovators who so often drive superior value in companies.

Some leading organizations we know are already using advanced HR analytics successfully in certain talent management areas. A leading healthcare organization, for example, has used these techniques to generate more than USD 100 million in savings while simultaneously improving the engagement of its workforce. The organization found that highly variable and unequal compensation levels were disturbing employees and driving high rates of attrition. Once the data analytics had identified an optimal minimum and maximum compensation threshold, the healthcare group increased the engagement and productivity of its employees – and reduced not only their rate of attrition, but also its total compensation expenditures.

Another company we know reduced its retention bonuses by USD 20 million – and employee attrition by half – thanks to the use of predictive behavioral analytics. Through this process, and contrary to expectations, the company found that limited investment in management and employee training as well as inadequate recognition were the main drivers of staff defections. Expensive retention bonuses, to which the company had resorted in desperation, were simply an ineffective and costly Band-Aid. Many companies conventionally try to tackle retention issues by conducting in-depth exit interviews. The important advantage of the new analytics techniques over that approach is that they are predictive, rather than reactive, and they provide more objective information than the more qualitative findings of a one-on-one discussion.

At McKinsey, we have been developing our own approach to retention: to detect previously unobserved behavioral patterns, we combine various data sources with machine-learning algorithms. We first held workshops and interviews to generate ideas and a set of hypotheses. Over time, we collected hundreds of data points to test. Then we ran different algorithms to get insights at a broad organizational level, to identify specific employee clusters, and to make individual predictions. Last, we held a series of workshops and focus groups to validate the insights from our models and to develop a series of concrete interventions.

The insights have been surprising and at times counterintuitive. We expected factors such as an individual's performance rating or compensation to be the top predictors of unwanted attrition. But our analysis revealed that a lack of mentoring and coaching as well as "affiliation" with people who have similar interests were actually top of list. More specifically, "flight risk" across the firm fell by 20 to 40 percent when coaching and mentoring were deemed satisfying.

Our North American consultants who pursue a functional affiliation and capability-building program in areas such as operations, marketing and sales, or corporate finance were three times more likely to stay with the firm than those who do not pursue such options. When consultants do, they receive specialized training, gain access to a community of colleagues who share the same passion, and get exposure to senior leaders. Subsequently, the data we retrieved helped us devise new programs to monitor and further strengthen our coaching and mentorship relationships, especially for our younger colleagues, and to intervene proactively to retain those “at risk.” Given our six-month review period and rapid engagement-cycle times, our predictive-retention algorithm is now refreshed every six months.

We are still developing our understanding of how data analytics can drive better people decisions, but we are already actively using these techniques beyond retention, to improve everything from talent acquisition to performance management to diversity. Our work confirmed that while top-notch technological capabilities are critical, they are not a silver bullet. Getting the right talent – be it experts in risk, marketing, or behavioral economics – to interpret and act on the data is just as important. So are leadership engagement and alignment. Moreover, an HR analytics approach is no substitute for engaging directly with employees in an effort to understand their mindsets, challenges, and needs. HR analytics, if done well, generates data-driven, organization-specific insights for executives and HC professionals to make more strategic decisions about their people.

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# Getting beyond bureaucracy in human resources

Neel Gandhi and Bryan Hancock

By becoming more strategic and operating with an edge, corporate human resources departments can boost their effectiveness and shed their bureaucratic reputation.



At big corporations, HR organizations frequently conjure up images of bureaucratic weight and paper pushing. Need that be true? This question comes into sharp relief in McKinsey alumnus Peter L. Allen's description of HR approaches at his company, Agoda, which has been trying, with some success, to minimize the need for many traditional HR processes while transferring others to business leaders. (See "Toward a new HR philosophy," on mckinsey.com.) Although it is easiest to see how some of Agoda's human- resource initiatives apply to start-ups, our experience shows that it is also possible to right the balance in large organizations without going too far. Getting more strategic and operating with an edge often are two keys to success.

### Getting more strategic

One reason large organizations end up with a supersized HR infrastructure is that the business rationale for HR processes has been lost. But there is an antidote to massive HR systems, questionnaire overload, and multipage templates: stimulating a dialog about the underlying strategic purpose of those tools – a dialog that often helps management realize that they can be controlled and applied more effectively. A global healthcare company, for example, realized that its performance review process gave it only a superficial understanding of who its high performers were and what feedback helped them to develop. It decided to deemphasize a time-honored nine-box calibration grid in its evaluation procedures and radically simplified employee reviews. We also know a senior leader who reduced his company's performance review form from four pages to four questions – but who rightly insisted that those four questions had to be answered and tracked more rigorously.

In the latter case, the leader was a chief human resources officer (CHRO) with the insight to identify core business issues and the discipline to eliminate redundancies. Strategic leadership can come from outside HR, too. A financial-services company recently charged its second-highest-ranking executive with personally directing talent-review procedures for top professionals across the firm. That required him to take a step back and assess the business' most significant talent indicators, which turned out to be poorly reflected in its HR systems. The company's leaders, previously stuck in a process-oriented rut, have now articulated the strategic rationale for what they are doing and why it is important – in this case, to understand the company's people, help fill talent gaps, and thereby improve returns. It is now building a database and infrastructure to capture those results and make the highest performers more visible. HR might have had a difficult time, on its own, committing the company to new performance criteria and gaining the resources to update its systems, but collaboration with a major leader gave the effort teeth.

### Operating with an edge

It is easy to say, "HR needs to let go and get out of the way," but the pendulum can easily swing too far in the other direction: granting managers unlimited freedom in making HR decisions can generate too much variability, potential liability exposure, and cost creep.

Moreover, when HR pulls back too far, it misses opportunities for using rigor and facts to gain predictive insights, whose potential is growing with big data and advanced analytics.<sup>1</sup>

### Talent pools and gaps

High-quality, timely information about talent pools and gaps represents a competitive advantage that HR is uniquely positioned to provide. For example, a grocery line manager in a global retail organization may have proved herself in Argentina just as a gap opened up in Mexico. An oil and gas organization may have a budding leader who is running out of growth headroom in the Middle East and a need for similar expertise in a bigger role in Houston. HR should ensure that these critical connections get made and then help line managers seize opportunities. The best HR organizations also offer a perspective on emerging gaps. For example, as digitization becomes more critical to cars,<sup>2</sup> leading automakers need to put more emphasis on recruiting computer engineers – a challenge for organizations accustomed to recruiting mechanical engineers.

### Compliance

Compliance efforts in areas such as labor and antidiscrimination obligations can easily make forms and layers of bureaucracy proliferate. But while an overly assertive HR department can constrain the smooth functioning of a business, companies are no better served by a “wallflower” department that misses red flags or neglects to enforce discipline. A rigorous HR function – an “adviser with an edge” – should track and interpret data and assert a point of view: “yes, we are doing well realizing internal goals or meeting industry benchmarks” or “no, we may begin to run off the rails.”

One leading consumer packaged goods manufacturer and distributor, where onsite generalists had previously taken the lead, recently created a “SWAT team” for labor relations and compliance. The team discreetly monitors metrics for proven warning signs and moves in when the company needs subject-matter expertise. Oversight has improved and line managers have clear incentives to get compliance right – without forcing HR professionals to become omnipresent process police. Rather, their mission is to interpret events and respond rapidly to potentially significant breakdowns.

### Leadership development

Many leadership development efforts do not achieve their goals, because they ignore the business context and offer insufficient opportunities for personal reflection and individualization.<sup>3</sup> While it would be easy to conclude that corporate HR can add little value to leadership development, the reality is more complicated. Letting “a thousand flowers bloom” often

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<sup>1</sup> See Bruce Fecheyr-Lippens, Bill Schaninger, and Karen Tanner, “Power to the new people analytics,” McKinsey Quarterly, March 2015, mckinsey.com.

<sup>2</sup> See Paul Gao, Russell Hensley, and Andreas Zielke, “A road map to the future for the auto industry,” McKinsey Quarterly, October 2014, mckinsey.com.

<sup>3</sup> See Pierre Gurdjian, Thomas Halbeisen, and Kevin Lane, “Why leadership-development programs fail,” McKinsey Quarterly, January 2014, mckinsey.com.

means that leadership gets ignored in some corners of a company and that others reinvent the wheel too often. An assertive HR department clarifies expectations for leadership development across the company, provides a baseline backbone of proven tools and methodologies, and flags priorities to adapt them to the needs of businesses and individuals. HR and business-unit leaders then collaborate to fine-tune programs.

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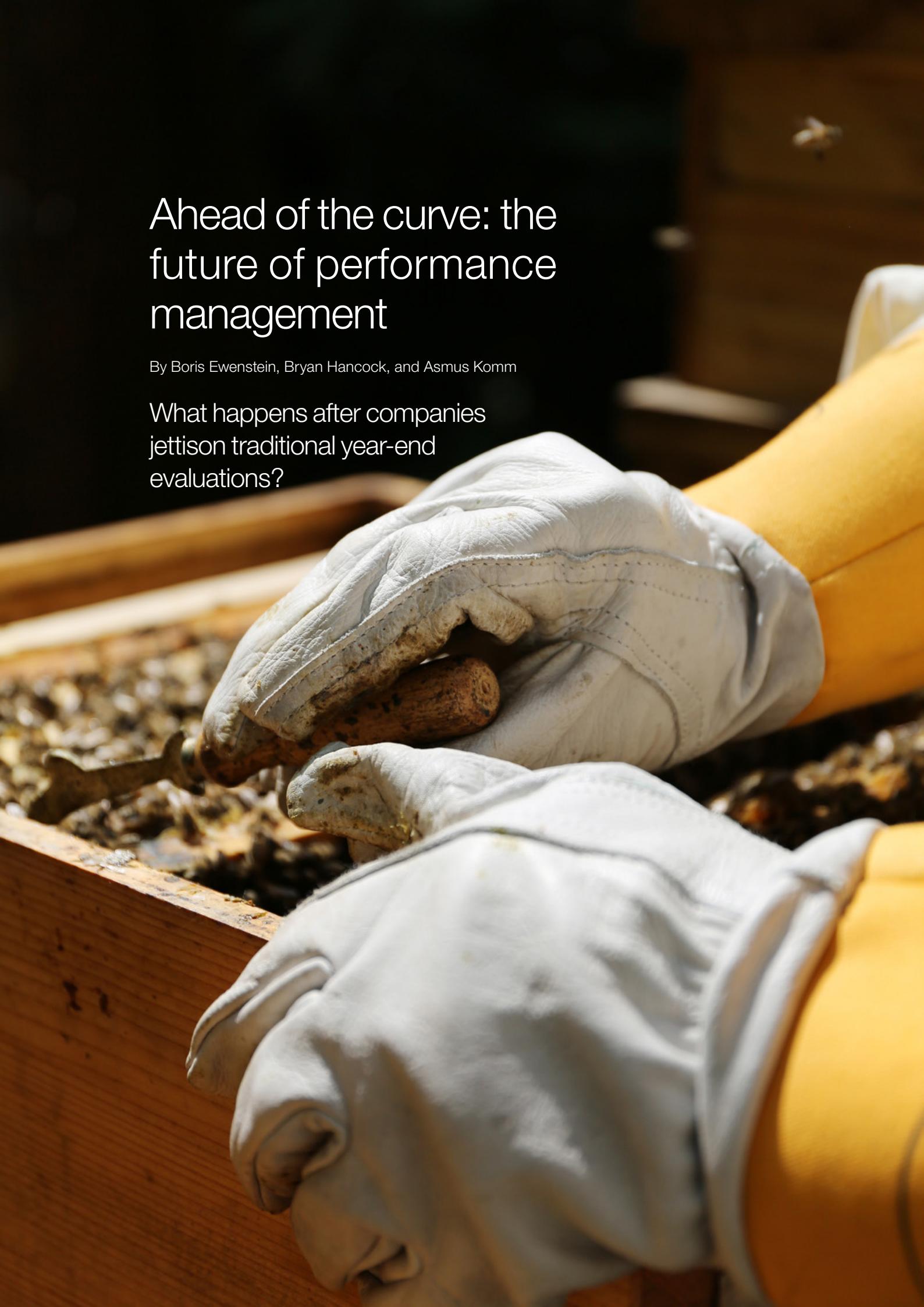
Managers must lead, and HR must help them to do so. But the well-founded inclination to swing the HR process pendulum away from bureaucracy and toward a freer hand for management should not lead organizations to veer from “ditch to ditch.” Shifting too drastically is plainly a bad idea; in many cases, a complete HR overhaul is unnecessary. At all events, HR has opportunities to assert its expertise and strategic thinking in a low-profile, nonintrusive way. That requires both rigor and restraint – but, we have found, provides the sort of insights about talent, leadership, and performance management that all companies need, regardless of their size.

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# Ahead of the curve: the future of performance management

By Boris Ewenstein, Bryan Hancock, and Asmus Komm

What happens after companies jettison traditional year-end evaluations?



The worst-kept secret in companies has long been the fact that the yearly ritual of evaluating (and sometimes rating and ranking) the performance of employees epitomizes the absurdities of corporate life. Managers and staff alike too often view performance management as time consuming, excessively subjective, demotivating, and ultimately unhelpful. In these cases, it does little to improve the performance of employees. It may even undermine their performance as they struggle with ratings, worry about compensation, and try to make sense of performance feedback.

These are not new issues, but they have become increasingly blatant as jobs in many businesses have evolved over the past 15 years. More and more positions require employees with deeper expertise, more independent judgment, and better problem-solving skills. They are shouldering ever-greater responsibilities in their interactions with customers and business partners and creating value in ways that industrial-era performance management systems struggle to identify. Soon enough, a ritual most executives say they dislike will be so outdated that it will resemble trying to conduct modern financial transactions with carrier pigeons.

Yet nearly nine out of ten companies around the world continue not only to generate performance scores for employees, but also to use them as the basis for compensation decisions.<sup>1</sup> The problem that prevents managers' dissatisfaction with the process from actually changing it is uncertainty over what a revamped performance management system ought to look like. If we jettison year-end evaluations – well, then what? Will employees just lean back? Will performance drop? And how will people be paid?

Answers are emerging. Companies, such as GE<sup>2</sup> and Microsoft,<sup>3</sup> that long epitomized the “stack and rank” approach have been blowing up their annual systems for rating and evaluating employees and are instead testing new ideas that give them continual feedback and coaching. Netflix<sup>4</sup> no longer measures its people against annual objectives, because its objectives have become more fluid and can change quite rapidly. Google transformed the way it compensates high performers at every level.<sup>5</sup> Some tech companies, such as Atlassian,<sup>6</sup> have automated many evaluation activities that managers elsewhere perform manually.

The changes these and other companies are making are new, varied, and, in some instances, experimental. But patterns are beginning to emerge:

- Some companies are rethinking what constitutes employee performance by focusing specifically on individuals who are a step function away from average – at either the high or low end of performance – rather than trying to differentiate among the bulk of employees in the middle.

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<sup>1</sup> See “The measure of a man,” Economist, February 20, 2016.

<sup>2</sup> “Why GE had to kill its annual performance reviews after more than three decades,” Quartz, August 13, 2015, qz.com.

<sup>3</sup> Nick Wingfield, “Microsoft abolishes employee evaluation system,” New York Times, November 13, 2013, nytimes.com.

<sup>4</sup> Patty McCord, “How Netflix reinvented HR,” Harvard Business Review, February 2014, hbr.org.

<sup>5</sup> Richard Feloni, “Inside Google’s policy to ‘pay unfairly’ – why 2 people in the same role can earn dramatically different amounts,” Business Insider, April 11, 2015, businessinsider.com.

<sup>6</sup> “8 automations that improved our HR team’s productivity,” Atlassian blogs, blog entry by Jluijke, November 29, 2011, atlassian.com.

- Many companies are also collecting more objective performance data through systems that automate real-time analyses.
- Performance data are used less and less as a crude instrument for setting compensation. Indeed, some companies are severing the link between evaluation and compensation, at least for the majority of the workforce, while linking them ever more comprehensively at the high and low ends of performance.
- Better data back up a shift in emphasis from backward-looking evaluations to fact-based performance and development discussions, which are becoming frequent and as-needed rather than annual events.

How these emerging patterns play out will vary, of course, from company to company. The pace of change will differ, too. Some companies may use multiple approaches to performance management, holding on to hardwired targets for sales teams, say, while shifting other functions or business units to new approaches.

But change they must.

### Rethinking performance

Most corporate performance management systems do not work today, because they are rooted in models for specializing and continually optimizing discrete work tasks. These models date back more than a century, to Frederick W. Taylor.

Over the next 100 years, performance management systems evolved, but did not change fundamentally. A measure like the number of pins produced in a single day could become a more sophisticated one, such as a balanced scorecard of key performance indicators (KPIs) that link back to overarching company goals. What began as a simple mechanistic principle acquired layers of complexity over the decades as companies tried to adapt industrial-era performance systems to ever-larger organizations and more complicated work.

What was measured and weighted became ever more micro. Many companies struggle to monitor and measure a proliferation of individual employee KPIs – a development that has created two kinds of challenges. First, collecting accurate data for 15 to 20 individual indicators can be cumbersome and often generates inaccurate information. (In fact, many organizations ask employees to report these data themselves.) Second, a proliferation of indicators, often weighted by impact, produces immaterial KPIs and dilutes the focus of employees. We regularly encounter KPIs that account for less than 5 percent of an overall performance rating.

Nonetheless, managers attempt to rate their employees as best they can. The ratings are then calibrated against one another and, if necessary, adjusted by distribution guidelines that are typically bell curves (Gaussian distribution curves). These guidelines assume that

the vast majority of employees cluster around the mean and meet expectations, while smaller numbers over- and underperform. This model typically manifests itself in three-, five-, or seven-point rating scales, which are sometimes numbered and sometimes labeled: for instance, “meets expectations,” “exceeds expectations,” “far exceeds expectations,” and so on. This logic appeals intuitively (“aren’t the majority of people average by definition?”) and helps companies distribute their compensation (“most people get average pay; over-performers get a bit more, underperformers a bit less”).

But bell curves may not accurately reflect reality. Research suggests that talent performance profiles in many areas – such as business, sports, the arts, and academia – look more like power-law distributions. Sometimes referred to as Pareto curves, these patterns resemble a hockey stick on a graph. (They got their name from the work of Vilfredo Pareto, who more than a century ago observed, among other things, that 20 percent of the pods in his garden contained 80 percent of the peas.) A 2012 study concluded that the top 5 percent of workers in most companies outperform average ones by 400 percent. (Industries characterized by high manual labor and low technology use are exceptions to the rule.<sup>7</sup>) The sample curve emerging from this research would suggest that 10 to 20 percent of employees, at most, make an outsized contribution.

Google has said that this research, in part, lies behind a lot of its talent practices and its decision to pay outsized rewards to retain top performers: compensation for two people doing the same work can vary by as much as 500 percent.<sup>8</sup> Google wants to keep its top employees from defecting and believes that compensation can be a “lock-in”; star performers at junior levels of the company can make more than average ones at senior levels. Identifying and nurturing truly distinctive people is a key priority given their disproportionate impact.

Companies weighing the risks and rewards of paying unevenly in this way should bear in mind the bigger news about power-law distributions: what they mean for the great majority of employees. For those who meet expectations, but are not exceptional, attempts to determine who is a shade better or worse yield meaningless information for managers and do little to improve performance. Getting rid of ratings – which demotivate and irritate employees, as researchers Bob Sutton and Jeff Pfeiffer have shown – makes sense.

Many companies, such as GE, the Gap,<sup>9</sup> and Adobe Systems,<sup>10</sup> have done just that in a bid to improve performance. They have dropped ratings, rankings, and annual reviews, practices that GE, for one, had developed into a fine art in previous decades. What these companies want to build – objectives that are more fluid and changeable than annual goals, frequent feedback discussions rather than annual or semiannual ones, forward-looking coaching for development rather than backward-focused rating and ranking, a greater emphasis on teams than on individuals – looks like the exact opposite of what they are abandoning.

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<sup>7</sup> Ernest O’Boyle Jr. and Herman Aguinis, “The best and the rest: Revisiting the norm of normality of individual performance,” *Personal Psychology*, 2012, 65, pp. 79 - 119. Researchers canvassed studies involving more than 600,000 people in academia, politics, entertainment, and sports. They found performance power curves consistent across different jobs, performance measures, and time frames.

<sup>8</sup> Google’s senior vice president for people operations, Laszlo Bock, wrote about these practices in his book, *Work Rules: Insights from Inside Google That Will Transform How You Live and Lead*, New York, NY: Hachette Book Group, 2015.

The point is that such companies now think it is a fool's errand to identify and quantify shades of differential performance among the majority of employees, who do a good job, but are not among the few stars. Identifying clear over- and underperformers is important, but conducting annual ratings rituals based on the bell curve will not develop the workforce overall. Instead, by getting rid of bureaucratic annual-review processes – and the behavior related to them – companies can focus on getting much higher levels of performance out of many more of their employees.

### Getting data that matter

Good data are crucial to the new processes, not least because so many employees think that the current evaluation processes are full of subjectivity. Rather than relying on a once-a-year, inexact analysis of individuals, companies can get better information by using systems that crowdsource and collect data on the performance of people and teams. Continually crowdsourcing performance data throughout the year yields even better insights.

For instance, Zalando, a leading European e-retailer, is currently implementing a real-time tool that crowd-sources both structured and unstructured performance feedback from meetings, problem-solving sessions, completed projects, launches, and campaigns. Employees can request feedback from supervisors, colleagues, and internal “customers” through a real-time online app that lets people provide both positive and more critical comments about each other in a playful and engaging way. The system then weights responses by how much exposure the provider has to the requestor. For every kind of behavior that employees seek or provide feedback about, the system – a structured, easy-to-use tool – prompts a list of questions that can be answered intuitively by moving a slider on the touchscreen of a mobile device. Because the data are collected in real time, they can be more accurate than annual reviews, when colleagues and supervisors must strain to remember details about the people they evaluate.

Employees at GE now use a similar tool, called PD@GE, which helps them and their managers to keep track of the company's performance objectives even as they shift throughout the year. The tool facilitates requests for feedback and keeps a record of when it is received. (GE is also changing the language of feedback to emphasize coaching and development rather than criticism.) GE employees get both quantitative and qualitative information about their performance, so they can readjust rapidly throughout the year. Crucially, the technology does not replace performance conversations between managers and employees. Instead, these conversations center around the observations of peers, managers, and the employees themselves about what did and did not help to deliver results. GE hopes to move most of its employees to this new system by the end of 2016.

In other words, tools can automate activities not just to free up time that managers and employees now spend inefficiently gathering information on performance, but also transform what feedback is meant to achieve. The quality of the data improves, too. Because they are collected in real time from fresh performance events, employees find the information more credible, while managers can draw on real-world evidence for more meaningful coaching

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<sup>9</sup> Vauhini Vara, “The push against performance reviews,” New Yorker, July 24, 2015, [newyorker.com](http://newyorker.com).

<sup>10</sup>Adobe Life Blog, “The dreaded performance review? Not at Adobe,” [adobe.com](http://adobe.com).

dialogs. As companies automate activities and add machine learning and artificial intelligence to the mix, the quality of the data will improve exponentially, and data will be collected much more efficiently.<sup>11</sup>

Finally, performance development tools can also identify the top performers more accurately, though everyone already knows subjectively who they are. At the end of the year, Zalando's tool will automatically propose the top 10 percent by analyzing the aggregated feedback data. Managers could adjust the size of the pool of top performers to capture, say, the best 8 or 12 percent of employees. The tool will calculate the "cliff" where performance is a step function away from that of the rest of the population.

Managers will therefore have a fact-based, objective way to identify truly distinctive employees. Companies can also use such systems to identify those who have genuinely fallen behind.

Relatively easy and inexpensive to build (or to buy and customize), such performance development applications are promising – but challenging (see the exhibit for a generic illustration of such an app). Employees could attempt to game systems to land a spot among the top 10 percent or to ensure that a rival does not. (Artificial intelligence and semantic analysis might conceivably distinguish genuine from manicured performance feedback, and raters could be compared with others to detect cheating.) Some employees may also feel that Big Brother is watching (and evaluating) their every move. These and other real-life challenges must be addressed as more and more companies adopt such tools.

### **Take the anxiety out of compensation**

The next step companies can take to move performance management from the industrial to the digital era is to take the anxiety out of compensation. But this move requires managers to make some counterintuitive decisions.

Conventional wisdom links performance evaluations, ratings, and compensation. This seems completely appropriate: most people think that stronger performance deserves more pay, weaker performance less. To meet these expectations, mean performance levels would be pegged around the market average. Overperformance would beat the market rate, to attract and retain top talent. And poor scores would bring employees below the market average, to provide a disincentive for underperformance. This logic is appealing and consistent with the Gaussian view. In fact, the distribution guide, with its target percentages across different ratings, gives companies a simple template for calculating differentiated pay while helping them to stay within an overall compensation budget. No doubt, this is one of the reasons for the prevalence of the Gaussian view.

This approach, however, has a number of problems. First, the cart sometimes goes before the horse: managers use desired compensation distributions to reverse engineer ratings. To pay Tom x and Maggie y, the evaluator must find that Tom exceeds expectations that Maggie merely meets. That kind of reverse engineering of ratings from a priori pay decisions

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<sup>11</sup>For additional insights, see Aaron De Smet, Susan Lund, and Bill Schaninger, "Organizing for the future," McKinsey Quarterly, January 2016.

often plays out over several performance cycles and can lead to cynical outcomes – “last year, I looked out for you; this year, Maggie, you will have to take a hit for the team.” These practices, more than flaws in the Gaussian concept itself, discredit the performance system and often drown out valuable feedback. They breed cynicism, demotivate employees, and can make them combative, not collaborative.

Second, linking performance ratings and compensation in this way ignores recent findings in the cognitive sciences and behavioral economics. The research of Nobel laureate Daniel Kahneman and others suggests that employees may worry excessively about the pay implications of even small differences in ratings, so that the fear of potential losses, however small, should influence behavior twice as much as potential gains do. Although this idea is counterintuitive, linking performance with pay can demotivate employees even if the link produces only small net variances in compensation.

Since only a few employees are standouts, it makes little sense to risk demotivating the broad majority by linking pay and performance. More and more technology companies, for instance, have done away with performance-related bonuses. Instead, they offer a competitive base salary and peg bonuses (sometimes paid in shares or share options) to the company’s overall performance. Employees are free to focus on doing great work, to develop, and even to make mistakes – without having to worry about the implications of marginal rating differences on their compensation.

However, most of these companies pay out special rewards, including discretionary pay, to truly outstanding performers: “10x coders get 10x pay” is the common way this principle is framed. Still, companies can remove a major driver of anxiety for the broad majority of employees.

Finally, researchers such as Dan Pink say that the things which really motivate people to perform well are feelings like autonomy, mastery, and purpose. In our experience, these increase as workers gain access to assets, priority projects, and customers and receive displays of loyalty and recognition. Snapping the link between performance and compensation allows companies to worry less about tracking, rating, and their consequences and more about building capabilities and inspiring employees to stretch their skills and aptitudes.

A large Middle Eastern technology company recently conducted a thorough study of what motivates its employees, looking at combinations of more than 100 variables to understand what fired up the best people. Variables studied included multiple kinds of compensation, where employees worked, the size of teams, tenure, and performance ratings from colleagues and managers. The company found that meaning – seeing purpose and value in work – was the single most important factor, accounting for 50 percent of all movement in the motivation score. It was not compensation. In some cases, higher-paid staff were markedly less motivated than others. The company halted a plan to boost compensation by USD 100 million to match its competitors.

Leaders should not, however, delude themselves into thinking that cutting costs is another reason for decoupling compensation from performance evaluations. Many of the companies that have moved in this direction use generous stock awards that make employees up and down the line feel not only well compensated, but also like owners. Companies lacking shares as currency may find it harder to make the numbers work unless they can materially boost corporate performance.

### **Coaching at scale to get the best from the most**

The growing need for companies to inspire and motivate performance makes it critical to innovate in coaching – and to do so at scale. Without great and frequent coaching, it is difficult to set goals flexibly and often, to help employees stretch their jobs, or to give people greater responsibility and autonomy while demanding more expertise and judgment from them.

Many companies and experts are exploring how to improve coaching – a topic of the moment. Experts say three practices that appear to deliver results are to change the language of feedback (as GE is doing); to provide constant, crowdsourced vignettes of what worked and what did not (as GE and Zalando are); and to focus performance discussions more on what is needed for the future than what happened in the past.

Concrete vignettes, made available just in time by handy tools – and a shared vocabulary for feedback – provide a helpful scaffolding. But managers unquestionably face a long learning curve for effective coaching as work continues to change and automation and reengineering configure job positions and work flows in new ways.

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Companies in high-performing sectors, such as technology, finance, and media, are ahead of the curve in adapting to the future of digital work. So it is no surprise that organizations in these sectors are pioneering the transformation of performance management. More companies will need to follow – quickly. They ought to shed old models of calibrated employee ratings based on normal distributions and liberate large parts of the workforce to focus on drivers of motivation stronger than incremental changes in pay. Meanwhile, companies still have to keep a keen eye on employees who are truly outstanding and on those who struggle.

It is time to explore tools to crowdsource a rich fact base of performance observations. Ironically, companies like GE are using technology to democratize and rehumanize processes that have become mechanistic and bureaucratic. Others must follow.

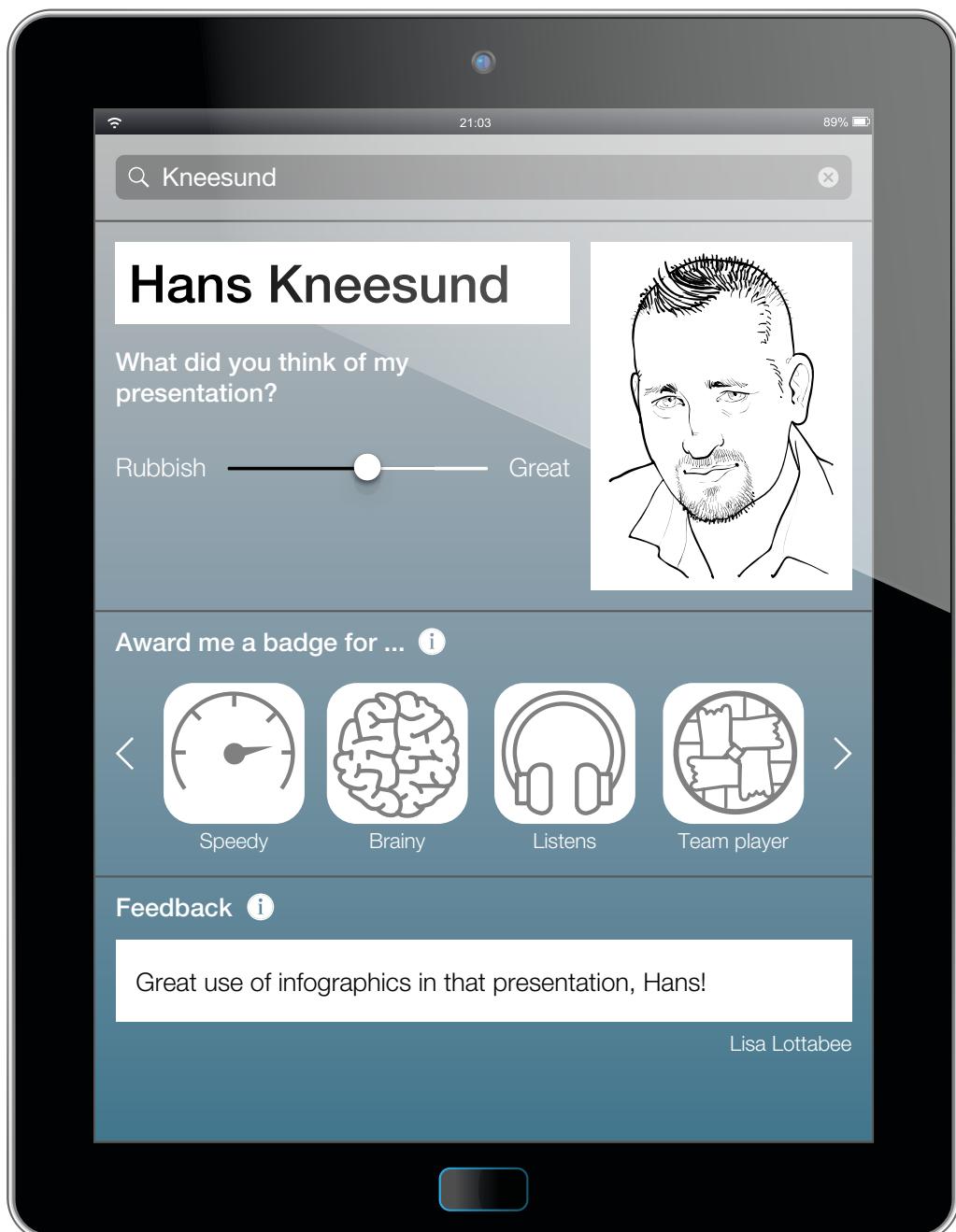
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The authors would like to thank the People & Organization team at Zalando SE for their valuable collaboration and contributions to this article.

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**Exhibit – Continually crowdsourcing performance data provides fresher and more timely insights**

An online app facilitates the collection of real-time peer feedback from multiple sources throughout the year



**Structure** feedback along set performance dimensions or treat more informally

**Request** feedback at any time – e.g., from leader, team member, or customer

**Use** badges and comment field for additional nuances

**Offer** unprompted feedback



# Learning at the speed of business

By Richard Benson-Armer, Arne Gast, and Nick van Dam

What digital means for the next  
generation of corporate  
academies.



Corporate universities are entering their second century, just as the businesses that rely on them are transforming themselves for the digital age. When pioneers such as General Motors and General Electric began offering standardized in-house training programs, about 100 years ago, they focused on imparting lower-level, day-to-day skills. Back then, it may have seemed fanciful to imagine the full-fledged academies that would emerge in later decades. But emerge they did: GE's Crotonville leadership center, in 1956; McDonald's Hamburger University, in 1961; and today's true learning institutions for global corporations such as Apple, Boeing, and Danone.

Now a new phase is unfolding at these organizations, which must grapple with tools and platforms that facilitate knowledge sharing and employee interactions on an almost limitless scale, challenging – and sometimes appearing to sweep away – the old brick-and-mortar model (see exhibit).

### Where the findings lead

In 2014, we queried some 1,500 global executives about capability building. Last year, we sharpened our focus, surveying approximately 120 senior learning-and-development (L&D) officers to gain a more in-depth understanding of the present state and probable trajectory of corporate academies.<sup>1</sup> We also conducted multiple benchmarking visits at best-in-class organizations and interviewed more than a dozen chief learning officers (CLOs) with experience at some of the largest, most successful companies around the world. Our findings derive, moreover, from insights we have gleaned through practical experience with corporate academies globally. That includes McKinsey Academy, this firm's digital offering, which serves not only our consultants, but also our clients, to help develop leaders and build functional capabilities.

The great majority of our respondents expect corporate learning to change significantly within the next three years – both the capabilities imparted and the new agility required to match the faster pace of business. Most also acknowledge that these developments will probably have a material cost: over that period, more than 60 percent of the respondents' companies plan to increase their L&D spending and 66 percent want to increase the number of formal-learning hours per employee.

What is worrying is the level of dissatisfaction with the status quo. Only 57 percent of the respondents believe that their academies are “very or fully aligned” with corporate priorities. Even fewer (52 percent) reported that these institutions enable their companies to meet strategic objectives. About 40 percent of CLOs say that their initiatives are either “ineffective” or “neither effective nor ineffective” in assessing the capabilities and gaps of employees. These shortcomings are most pronounced among mid-level managers and senior leaders – reflecting, in our experience, how difficult it is to instill new attitudes, particularly at the higher levels of a company.

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<sup>1</sup> The respondents' organizations spend roughly 4 percent of their payroll budgets to build capabilities and invest about 34 hours per employee a year in formal learning. Research, both by us and by others, suggests that the ratio of learning expenditures to payroll is generally inversely proportional to an organization's size. The Association for Talent Development (ATD), for example, reported that small organizations invest about 5.4 percent of payroll on learning, midsize organizations 3.0 percent, and large organizations 1.7 percent. See State of the Industry, Association for Talent Development, 2015, [www.td.org](http://www.td.org).

Many respondents also think that these organizations do not sufficiently deploy the full array of learning tools, methods, and approaches now available. They report that classroom training, experiential learning, and the on-the-job application of skills were in regular use. But less than half of the organizations avail themselves of peer and self-directed learning, educational initiatives that take participants outside their comfort zones, or risk-free learning environments. About one-third of the respondents reported that their organizations lack systems to share learning among employees. And the surveyed CLOs overwhelmingly think that their organizations' digital capabilities are too low.

### The digital learning opportunity

Digitization offers a huge opportunity to transform learning and address some of its current deficiencies, though it bears noting that digital learning tools are not new.

What is new – and disruptively so – is the fact that the content of learning is moving to the cloud, becoming accessible across multiple devices and teaching environments and often being generated, shared, and continually updated by users themselves.

Unsurprisingly, our research indicates that younger employees – millennials and post-millennials, or Generation Z – feel the greatest level of comfort with digitization. At China Fortune Land Development Company (CFLD), Han Qing, the head of CFLD University, explains that “deploying digital learning and using technology is part of our strategy because there are more and more young people joining the workforce. They are used to mobile phones and PCs. And they demand more digital learning.”

Integrated cloud-based platforms enable more than just new computer programs or nifty smartphone apps. Sophisticated organizations are now expanding their use of cloud-based learning to run such personalized applications as MOOCs (massive open online courses), SPOCs (small private online courses), instructional videos, learning games, e-coaching, virtual classrooms, online performance support, and online simulations.

One global Asian original design manufacturer we know offers a digital 3-D learning environment at its virtual model factory. This system lets employee participants “see” and “feel” complex equipment deployed at many of the company’s plants. Danone – long committed to encouraging professional and individual development through means such as more than ten learning facilities around the world – successfully rolled out its cloud-based Danone Campus 2.0 in 2014. Easily accessible and continually updated, this innovative approach to learning involves Danone employees in their own development by providing a digital, user-friendly space to share best practices, to highlight the latest internal and external knowledge, and to foster a culture of collaborative learning and networking.

Unleashing the power of collective intelligence is especially critical to the digital-learning transformation. Increasingly, the learner and the learner’s inner circle – colleagues who send each other articles or recommend content through a central online-learning system –

act as curators. In large global companies, HR or L&D cannot own (or even share ownership of) detailed knowledge about the existing and emerging skills a diverse workforce must have to improve the performance of each business. But employees themselves can be empowered to share knowledge across the company, an approach that also helps solve the perennial problem of who will be the trainer. When training is automated, consistency improves and C-suite messages go straight to the front line, avoiding potentially distorted “translations” passed on at a company’s middle levels.

Flattening the knowledge hierarchy not only sharpens the messaging and broadens the pool of available content, but also enables faster delivery and, potentially, more sophisticated performance measurement. We expect L&D and HR personnel to become less the authors of what gets taught in digital formats and more the facilitators who ensure that employee-generated content can be seamlessly dispersed throughout the company. Our respondents rated their companies highly on designing and delivering learning programs – more than 75 percent said they were effective on both counts. But digitizing education effectively requires the additional, more technical capabilities that a wired-in world demands.

For make no mistake, it really is a new world, learning at the speed of business. Since there is less need to wait for scheduled training sessions, “pull” can complement “push,” as employees empowered to up-skill and reskill themselves log on to user-friendly learning platforms. Much as Amazon makes books instantly available anywhere, anytime, on its Kindle and other devices, the digitization of learning can provide unprecedented access to relevant knowledge, a lot of it at relatively low or even no cost.

The impact of today’s best systems and tools can be just as profound as Amazon’s, even if the results are not always precisely measurable. As an executive at one leading global company noted, investing in modern L&D platforms is so fundamental that it transcends simple metrics – akin to building a house and then trying to measure the ROI of the plumbing. Despite the ability of digital platforms to make the collection, analysis, and scoring of data more sophisticated, the full measure of impact cannot be captured to the decimal.

### **The enduring case for (at least some) bricks and mortar**

Similarly, for all of the notable advances that digitization promises, comprehensive learning cannot be based on the cloud alone. Companies still have compelling reasons to locate significant elements of corporate learning in tangible, specialized educational facilities – increasingly, with ergonomically designed furniture, plenty of light, and interior design geared specifically to learning. In our experience, any successful educational program allows employees to unplug and enjoy a respite from an always-on, 24/7 tempo.

The importance of this physical separation from the daily grind should not be underestimated. If employees have no opportunity to step away from their working environments, the same old behavior, for good and ill, is constantly reinforced, and the chance for more reflective,

committed learning is lost. Harvard professor Ronald Heifetz calls this a “balcony moment”: the imperative for leaders to leave the “dance floor” periodically and reflect on the patterns and movement below.

Dedicated learning facilities also befit the gravitas of a professional function. However virtual business may now seem, we still belong to a physical world; even Amazon recently established its own physical bookstores. It is worth noting, as well, that millennials benefit from high-touch learning no less than workers from previous generations do. Younger employees may spend more time online and be more comfortable with mobile apps. But they should not be forced – and, in our experience, do not desire – to engage solely with digital learning tools.

Indeed, corporate academies provide an unparalleled opportunity for employees to share experiences with fellow participants and to connect with company leaders.

Many best-practice corporate academies deploy their top executives as visiting faculty; GE, for instance, has long used its most senior leaders in many learning programs. A major Asian oil and gas company we know includes the number of days senior executives spend in such teaching capacities in their performance evaluations. The value of this interaction is particularly high for companies that operate across businesses and geographies.

That said, learning is an expertise, no less than disciplines such as marketing or finance. It is therefore critical to maintain a core L&D team with professionals in that field. We have observed that too many L&D organizations are led by employees from other company functions who “graduate” to managing L&D a few years short of retirement. Companies that are serious about modernizing their skill-building efforts as digitization transforms corporate learning must attract and develop leaders with deep experience in this unique function. Some global organizations are even sending senior personnel to a new executive doctoral program, launched by the University of Pennsylvania, designed specifically to prepare CLOs and other senior executives for success as educational and talent development leaders.

### **Tying it all together**

Ultimately, we believe, the future of corporate academies lies in blended learning, which combines classroom forums, in-field applications, personal and results-oriented feedback, and online engagement. There is no magic number for allocating time between digital and in-person learning; different industries, and different companies within them, must determine the mix that makes the most sense for their circumstances and capability development priorities. Connectivity allows organizations to meet many of the most important learning objectives: avoiding disruptions in day-to-day business, delivering content consistently (as opposed to in-person training with different facilitators), and sustaining learning for employees (who review the content after the end of each lesson and then update and share their new knowledge in real time).

It is critical, too, for an organization to express its commitment from the very highest levels. Just as the digital and physical elements of learning must fit together in a rational way, L&D should collaborate with the C-suite to ensure general agreement on educational priorities and the required funding. “If L&D is not a strategic partner for the important initiatives of the company,” noted the CLO of one European telecom we interviewed, “you’re just working reactively with the other businesses. In our company, there is a strong alignment between learning and our overall business strategy. But that’s because of a strong push from the CEO.”

Farsighted corporate leaders understand the value proposition. When critical training programs became mandatory, a leading financial institution we are familiar with boosted its level of engagement and morale and halved its absentee rate for key positions. Across many dimensions, the effects of corporate learning – especially in the digital age – will find their way to the bottom line.

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Corporate academies are poised for change on the order of magnitude experienced a century ago, when they developed from low-level workshops into mature institutions. The disruption now underway is remarkable, representing a transformation even when compared to what had been standard practices at the end of the 20th century, when the focus was largely on classroom-based learning. Achieving the next level of change – akin to the revolution that Amazon brought to retailing – will require a nimble balance between digital and physical platforms, cultural messaging and technical content, and real-time and actively shared learning. The sudden emergence of a more digitally engaged generation and the stepped-up pace of technological change suggest that time is of the essence. Successfully navigating the coming transformation will require not just a shift in tools and approaches, but also an agile, engaged organization.

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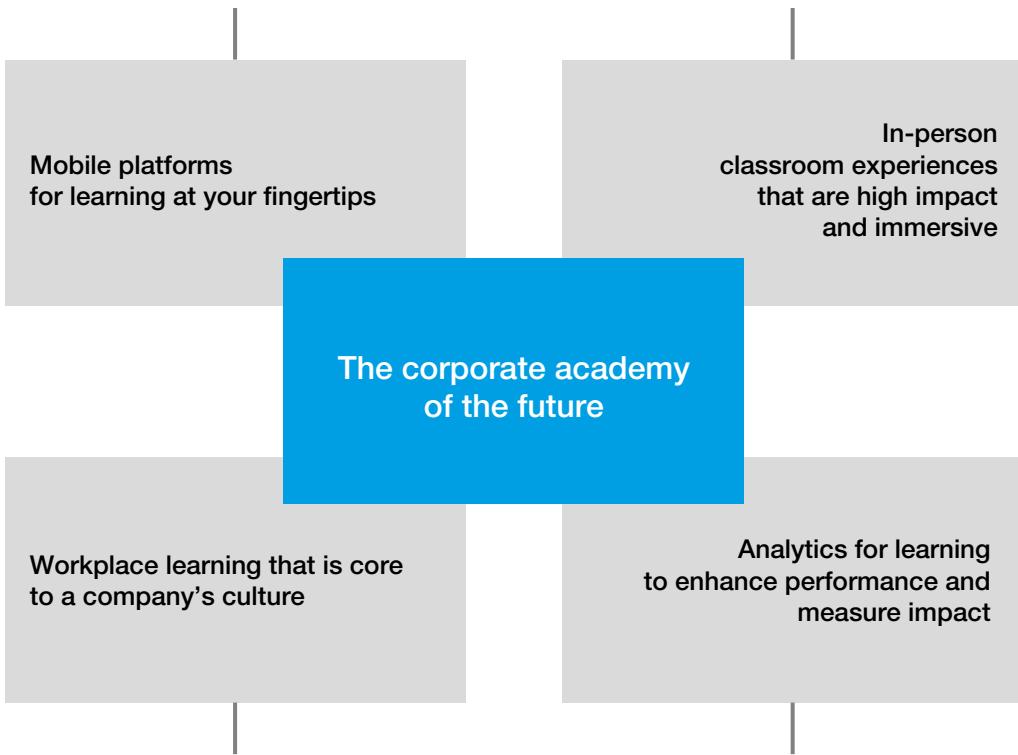
The authors wish to thank Jacqueline Brassey, Andy Moffit, Nicolai Nielsen, and Silke-Susann Otto for their contributions to this article.

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**Exhibit – The next generation of corporate academies supports learning at the speed of business.**

Cloud-based learning that is mobile and multiplatform

Physical separation from the “daily grind” to develop new skills and behavior



A culture of social learning, real-time feedback, sharing, and networking

Use of big data and predictive analytics to improve learning continually



# Decoding leadership: what really matters

By Claudio Feser, Fernanda Mayol, and Ramesh Srinivasan

New research suggests that the secret to developing effective leaders is to encourage four types of behavior.



Telling CEOs these days that leadership drives performance is a bit like saying that oxygen is necessary to breathe. Over 90 percent of CEOs are already planning to increase investment in leadership development because they see it as the single most important HC issue their organizations face.<sup>1</sup> And they are right to do so: McKinsey research has consistently shown that good leadership is a critical part of organizational health, which is an important driver of shareholder returns.<sup>2</sup>

A big, unresolved issue is what sort of leadership behavior organizations should encourage. Is leadership so contextual that it defies standard definitions or development approaches?<sup>3</sup> Should companies now concentrate their efforts on priorities such as role modeling, making decisions quickly, defining visions, and shaping leaders who are good at adapting? Should they stress the virtues of enthusiastic communication? In the absence of any academic or practitioner consensus on the answers, leadership development programs address an extraordinary range of issues, which may help explain why only 43 percent of CEOs are confident that their training investments will bear fruit.

Our most recent research, however, suggests that a small subset of leadership skills closely correlates with leadership success, particularly among frontline leaders. Using our own practical experience and searching the relevant academic literature, we came up with a comprehensive list of 20 distinct leadership traits. Next, we surveyed 189,000 people in 81 diverse organizations<sup>4</sup> around the world to assess how frequently certain kinds of leadership behavior are applied within their organizations. Finally, we divided the sample into organizations whose leadership performance was strong (the top quartile of leadership effectiveness as measured by McKinsey's Organizational Health Index) and those that were weak (bottom quartile).

What we found was that leaders in organizations with high-quality leadership teams typically displayed 4 of the 20 possible types of behavior; these 4, indeed, explained 89 percent of the variance between strong and weak organizations in terms of leadership effectiveness (see exhibit).

- **Solving problems effectively.** The process that precedes decision making is problem solving, when information is gathered, analyzed, and considered. This is deceptively difficult to get right, yet it is a key input into decision making for major issues (such as M&A) as well as daily ones (such as how to handle a team dispute).

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<sup>1</sup> The State of Human Capital 2012 – False Summit: Why the Human Capital Function Still Has Far to Go, a joint report from The Conference Board and McKinsey, October 2012, mckinsey.com.

<sup>2</sup> See Aaron De Smet, Bill Schaninger, and Matthew Smith, "The hidden value of organizational health – and how to capture it," McKinsey Quarterly, April 2014, mckinsey.com.

<sup>3</sup> See Ralph M. Stogdill, "Personal factors associated with leadership: A survey of the literature," *Journal of Psychology: Interdisciplinary and Applied*, 1948, Volume 25, Issue 1, pp. 35 - 71. Also, for more on our work with Egon Zehnder, notably the contrast between organizations growing organically and those growing through acquisition, see Katharina Hermann, Asmus Komm, and Sven Smit, "Do you have the right leaders for your growth strategies?," McKinsey Quarterly, July 2011, mckinsey.com.

<sup>4</sup> The 81 organizations are diverse in geography (e.g., Asia, Europe, Latin America, and North America), industry (e.g., agriculture, consulting, energy, government, insurance, mining, and real estate), and size (from about 7,500 to 300,000 employees).

- **Operating with a strong results orientation.** Leadership is about not only developing and communicating a vision and setting objectives, but also following through to achieve results. Leaders with a strong results orientation tend to emphasize the importance of efficiency and productivity and to prioritize the highest-value work.
- **Seeking different perspectives.** This trait is conspicuous in managers who monitor trends affecting organizations, grasp changes in the environment, encourage employees to contribute ideas that could improve performance, accurately differentiate between important and unimportant issues, and give the appropriate weight to stakeholder concerns. Leaders who do well on this dimension typically base their decisions on sound analysis and avoid the many biases to which decisions are prone.
- **Supporting others.** Leaders who are supportive understand and sense how other people feel. By showing authenticity and a sincere interest in those around them, they build trust and inspire and help colleagues to overcome challenges. They intervene in group work to promote organizational efficiency, allaying unwarranted fears about external threats, and preventing the energy of employees from dissipating into internal conflict.

We are not saying that the centuries-old debate about what distinguishes great leaders is over or that context is unimportant. Experience shows that different business situations often require different styles of leadership. We do believe, however, that our research points to a kind of core leadership behavior that will be relevant to most companies today, notably on the front line. For organizations investing in the development of their future leaders, prioritizing these four areas is a good place to start.

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**Exhibit – Four types of leadership behavior account for 89 percent of leadership effectiveness**

**Be supportive**

- Champion desired change
- Clarify objectives, rewards, and consequences
- Communicate prolifically and enthusiastically
- Develop others
- Develop and share a collective mission
- Differentiate among followers
- Facilitate group collaboration
- Foster mutual respect
- Give praise
- Keep group organized and on task
- Motivate and bring out best in others
- Make quality decisions
- Offer a critical perspective

**Operate with strong results orientation**

- Recover positively from failures
- Remain composed and confident in uncertainty
- Role model organizational values

**Seek different perspectives**

**Solve problems effectively**

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