

EXPLORE THE ARCHIVE

A few years ago, I was asked to help find a new CEO for a family-owned electronics retailer that wanted to professionalize its management and expand its operations. I worked closely with the outgoing chief executive and the board to pinpoint the relevant competencies for the job and then seek out and assess candidates. The man we hired had all the right credentials: He'd attended top professional schools and worked for some of the best organizations in the industry, and he was a successful country manager in one of the world's most admired companies. Even more important, he'd scored above the target level for each of the competencies we'd identified. But none of that mattered. Despite his impressive background and great fit, he could not adjust to the massive technological, competitive, and regulatory changes occurring in the market at the time. Following three years of lackluster performance, he was asked to leave.

Compare that story with one from the start of my executive search career. My task was to fill a project manager role at a small brewery owned by Quinsa, which then dominated the beer market in the southern cone of Latin America. In those days, I hadn't yet heard the term "competency." I was working in a new office without research support (in the pre-internet era), and Quinsa was the only serious beverage industry player in the region, so I was simply unable to identify a large pool of people with the right industry and functional background. Ultimately, I contacted Pedro Algorta, an executive I'd met in 1981, while we were both studying at Stanford University. A survivor of the infamous 1972 plane crash in the Andes, which has been chronicled in several books and the movie *Alive*, Algorta was certainly an interesting choice. But he had no experience in the consumer goods business; was unfamiliar with Corrientes, the province where the brewery was located; and had never worked in marketing or sales, key areas of expertise. Still, I had a feeling he would be successful, and Quinsa agreed to hire him. That decision proved to be a smart one. Algorta was rapidly promoted to general manager of the Corrientes brewery and then CEO of Quinsa's flagship Quilmes brewery. He also became a key member of the team that transformed Quinsa from a family-owned enterprise to a large, respected conglomerate with a management team considered at the time to be among the best in Latin America.

Why did the CEO of the electronics business, who seemed so right for the position, fail so miserably? And why did Algorta, so clearly unqualified, succeed so spectacularly? The answer is *potential*: the ability to adapt to and grow into increasingly complex roles and environments. Algorta had it; the first CEO did not.

Having spent 30 years evaluating and tracking executives and studying the factors in their performance, I now consider potential to be the most important predictor of success at all levels, from junior management to the C-suite and the board. I've learned how to identify people who have it and to help companies develop and deploy them. With this article, I share those lessons. As business becomes more volatile and complex, and the global market for top professionals gets tighter, I am convinced that organizations and their leaders must transition to what I think of as a new era of talent spotting—one in which our evaluations of one another are based not on brawn, brains, experience, or competencies, but on potential.

A New Era

The first era of talent spotting lasted millennia. For thousands of years, humans made choices about one another on the basis of physical attributes. If you wanted to erect a pyramid, dig a canal, fight a war, or harvest a crop, you chose the fittest, healthiest, strongest people you could find. Those attributes were easy to assess, and, despite their growing irrelevance, we still unconsciously look for them: *Fortune* 500 CEOs are on average 2.5 inches taller than the average American, and the statistics on military leaders and country presidents are similar.

I was born and raised during the second era, which emphasized intelligence, experience, and past performance. Throughout much of the 20th century, IQ—verbal, analytical, mathematical, and logical cleverness—was justifiably seen as an important factor in hiring processes (particularly for white-collar roles), with educational pedigrees and tests used as proxies. Much work also became standardized and professionalized. Many kinds of workers could be certified with reliability and transparency, and since most roles were relatively similar across companies and industries, and from year to year, past performance was considered a fine indicator. If you were looking for an engineer, accountant, lawyer, designer, or CEO, you would scout out, interview, and hire the smartest, most experienced engineer, accountant, lawyer, designer, or CEO.

I joined the executive search profession in the 1980s, at the beginning of the third era of talent spotting, which was driven by the competency movement still prevalent today. David McClelland's 1973 paper "Testing for Competence Rather than for 'Intelligence'" proposed that workers, especially managers, be evaluated on specific characteristics and skills that helped predict outstanding performance in the roles for which they were being hired. The time was right for such thinking, because technological evolution and industry convergence had made jobs much more complex, often rendering experience and performance in previous positions irrelevant. So, instead, we decomposed jobs into competencies and looked for candidates with the right combination of them. For leadership roles, we also began to rely on research showing that emotional intelligence was even more important than IQ.

Now we're at the dawn of a fourth era, in which the focus must shift to potential. In a volatile, uncertain, complex, and ambiguous environment (VUCA is the military-acronym-turned-corporate-buzzword), competency-based appraisals and appointments are increasingly insufficient. What makes someone successful in a particular role today might not tomorrow if the competitive environment shifts, the company's strategy changes, or he or she must collaborate with or manage a different group of colleagues. So the question is not whether your company's employees and leaders have the right skills; it's whether they have the potential to learn new ones.

The Scarcity of Top Talent

Unfortunately, potential is much harder to discern than competence (though not impossible, as I'll describe later). Moreover, your organization will be looking for it in what will soon be one of the toughest employment markets in history—for employers, not job seekers. The recent noise about high unemployment rates in the United States and Europe hides important signals: Three forces—globalization, demographics, and pipelines—will make senior talent ever scarcer in the years to come.

Back in 2006, I worked with Nitin Nohria, the current dean of Harvard Business School, and my Egon Zehnder colleagues to study this issue, gathering detailed data and interviewing CEOs from 47 companies with a combined market capitalization of \$2 trillion, revenue of over \$1 trillion, and more than 3 million employees. Representing all major sectors and geographies, these firms were successful, with strong reputations and solid people practices. Yet we found that all were about to face a massive talent crunch. Eight years later, the situation for companies is just as bad, if not worse.

Let's examine the three factors in turn. *Globalization* compels companies to reach beyond their home markets and to compete for the people who can help them do so. The major global firms in our 2006 study anticipated an 88% increase in their proportion of revenue from developing regions by 2012. Not only did that happen, but the International Monetary Fund and other groups are currently predicting that some 70% of the world's growth between now and 2016 will come from emerging markets. At the same time, firms in developing nations are themselves vying for talent, as well as customers, around the world. Take China, which now has 88 companies in the global *Fortune* 500, up from just eight in 2003, thanks in part to foreign growth. Huawei, the leading Chinese telecommunications company, employs more than 70,000 people, 45% of whom work in R&D centers in countries including Germany, Sweden, the U.S., France, Italy, Russia, and India. Similar examples can be found in companies based in markets such as India and Brazil.

The impact of *demographics* on hiring pools is also undeniable. The sweet spot for rising senior executives is the 35-to-44-year-old age bracket, but the percentage of people in that range is shrinking dramatically. In our 2006 study, we calculated that a projected 30% decline in the ranks of young leaders, combined with anticipated business growth, would cut in half the pool of senior leader candidates in that critical age group. Whereas a decade ago this demographic shift was affecting mostly the United States and Europe, by 2020 many other countries, including Russia, Canada, South Korea, and China, will have more people at retirement age than entering the workforce.



Insight Center Leading Innovation

**New and counterintuitive ideas
about generating innovation,
drawing on viewpoints from top
management thinkers.**

The third phenomenon is related and equally powerful, but much less well known: Companies are not properly developing their *pipelines* of future leaders. In PricewaterhouseCoopers's 2014 survey of CEOs in 68 countries, 63% of respondents said they were concerned about the future availability of key skills at all levels. The Boston Consulting Group cites proprietary research showing that 56% of executives see critical gaps in their ability to fill senior managerial roles in coming years. HBS professor Boris Groysberg found similar concerns in his 2013 survey of executive program participants: Respondents gave their companies' leadership pipelines an average rating of 3.2 out of 5, compared with an average score of 4 for current CEOs and 3.8 for current top teams. Equally troubling were responses to other kinds of questions in the survey: No talent management function was rated higher than 3.3, and critical employee development activities, such as job rotations, were scored as low as 2.6. In other words, few executives think their companies are doing a good job identifying and developing qualified leaders. Recent executive panel interviews conducted by my colleagues confirm that this view is widespread. Only 22% of the 823 leaders who participated consider their pipelines promising, and only 19% said they find it easy to attract the best talent.

In many companies, particularly those based in developed markets, I've found that half of senior leaders will be eligible for retirement within the next two years, and half of them don't have a successor ready or able to take over. As Groysberg puts it, "Companies may not be feeling pain today, but in five or 10 years, as people retire or move on, where will the next generation of leaders come from?"

Taken independently, globalization, demographics, and pipelines would each create unprecedented demand for talent over the next decade. The pace of globalization has never been faster; the imbalance between old and young has never been so dramatic; views on the pipelines of qualified successors have never been more negative; and the survey ratings of development practices are the lowest I've seen. Combine all those factors, and you get a war for talent that will present a huge, perhaps insurmountable, challenge for most organizations. But for those that learn how to spot potential, effectively retain people who have it, and create development programs to help the best get better, the situation will instead offer an extraordinary opportunity.

Better Hiring

The first step is to get the right people into your organization. As Amazon CEO Jeff Bezos, one of the most impressive corporate value creators in recent history, put it in 1998, "Setting the bar high in our approach to hiring has been, and will continue to be, the single most important element of [our] success." So, when evaluating job candidates (and reevaluating current employees), how do you gauge potential?

Potential at the Top

A focus on potential can improve talent spotting at every level of the organization—especially the very top. When choosing a CEO or board member, as opposed to a young manager, you’ll often find that several candidates have the right credentials, experience, and competencies. That’s why an accurate assessment of their motivation, curiosity, insight, engagement, and determination is all the more important.

For CEO roles, succession planning must start very early, ideally when a new leader takes charge but no later than three to four years before he or she expects to leave. At Egon Zehnder, even when a much longer tenure is expected, we help companies assess potential two to four layers below the C-suite, identifying people to retain and develop so that some can become contenders for the top job.

I know one outstanding corporate director who twice orchestrated the dismissal of fully competent C-suite executives because they didn’t have enough potential and she wanted to make their roles—key development opportunities—available to people who did. Board appointments require the same discipline. Our firm’s UK office recently helped a highly respected retail group, the John Lewis Partnership, evaluate a long list of candidates for two nonexecutive director positions, using all the indicators of potential—curiosity, in particular—as key metrics. After all, if a company’s leaders don’t have the potential to learn, grow, and adapt to new environments, how can they attract up-and-coming employees and managers who do?

Many companies have well-established “high potential” programs, through which they fast-track promising managers for development and promotions. But most of these are actually “high performer” programs, full of people who have done well in the past and are therefore assumed to have the best shot of doing well in the future—but given VUCA conditions, that is no longer a safe prediction. About 80% of the participants in the executive programs I teach consistently report that their companies don’t use an empirically validated model for assessing potential. I’ll admit, this kind of evaluation is much more difficult than measuring IQ, past performance, and even various competencies. But it can be done—with a predictive accuracy around 85%, according to data on the careers of thousands of executives we assessed at Egon Zehnder using a model developed and refined over the past two decades.

The first indicator of potential we look for is the right kind of *motivation*: a fierce commitment to excel in the pursuit of unselfish goals. High potentials have great ambition and want to leave their mark, but they also aspire to big, collective goals, show deep personal humility, and invest in getting better at everything they do. We consider motivation first because it is a stable—and usually unconscious—quality. If someone is driven purely by selfish motives, that probably won’t change.

We then consider four other qualities that are hallmarks of potential, according to our research:

Curiosity: a penchant for seeking out new experiences, knowledge, and candid feedback and an openness to learning and change.

Insight: the ability to gather and make sense of information that suggests new possibilities

Engagement: a knack for using emotion and logic to communicate a persuasive vision and connect with people

Determination: the wherewithal to fight for difficult goals despite challenges and to bounce back from adversity

In retrospect, I can see that Pedro Algorta succeeded at Quinsa because he had all those qualities, not because he possessed a specific set of skills and competencies. And those qualities were in high relief during his harrowing ordeal in the Andes. He demonstrated his motivation by playing a critical yet humble role—providing sustenance for the explorers who would eventually march out to save the group. He melted snow for them to drink and cut and dried small pieces of flesh from the dead bodies of fellow victims to serve as food. Instead of succumbing to despair, Algorta became curious about the environment around him, taking an interest in the water coming off the ice. It flowed east, leading him, and only him, to the insight that the dying pilot had misreported their position; they were on the Argentine side of the mountain range, not on the Chilean side. His engagement and determination were also clear over those 72 days. He faithfully tended to his dying friend, Arturo Nogueira, who had suffered multiple leg fractures, trying to distract the young man from his pain. He encouraged his fellow survivors to maintain hope and persuaded them all to condone the consumption of their own bodies, should they die, describing it as “an act of love.”

Although Algorta’s tenure as CEO bears no resemblance to what he experienced on that mountain, the same characteristics served him in his career at Quinsa. Perhaps the best example of the purity of his motives came at the end of his 10-year stint with the company, when, for sound strategic reasons, he recommended that it abandon the agribusiness project he was leading, thus voting himself out of a job. He was also a curious executive, always going out of his way to meet customers, clients, and workers at all levels, and to listen to voices that usually went unheard. As a result, he accepted and supported some revolutionary marketing initiatives, which allowed Quilmes to multiply its sales eightfold while achieving record profitability. He displayed great insight both in his hiring decisions—the future CEOs of both Quilmes and Nestlé were among his best hires—and in his strategic ones: for example, his bold move to divest all noncore assets so that the company could use the proceeds to expand the regional brewery business. His engagement transformed an ineffective and even vicious culture at Quilmes; his insistence that bosses and subordinates come together in open meetings set a precedent that was later rolled out to the whole group. Finally, Algorta showed amazing determination at Quinsa. When the project he’d been hired to lead—the construction of a new brewery—ran out of funds just after he took over, he didn’t consider quitting; instead, he pushed to get the necessary financing. And when Argentina was shaken by devaluation and hyperinflation a few months later, he pressed on; the facility was up and running in 15 months. How can you tell if a candidate you’ve just met—or a current employee—has potential? By mining his or her personal and professional history, as I’ve just done with Algorta’s. Conduct in-depth interviews or career discussions, and do thorough reference checks to uncover stories that demonstrate whether the person has (or lacks) these qualities. For instance, to assess curiosity, don’t just ask, “Are you curious?” Instead, look for signs that the person believes in self-improvement, truly enjoys learning, and is able to recalibrate after missteps. Questions like the following can help:

- *How do you react when someone challenges you?*
- *How do you invite input from others on your team?*

- *What do you do to broaden your thinking, experience, or personal development?*
- *How do you foster learning in your organization?*
- *What steps do you take to seek out the unknown?*

Always ask for concrete examples, and go just as deep in your exploration of motivation, insight, engagement, and determination. Your conversations with managers, colleagues, and direct reports who know the person well should be just as detailed.

As a leader, you must also work to spread these interviewing techniques through the organization. Researchers have found that while the best interviewers' assessments have a very high positive correlation with the candidates' ultimate performance, some interviewers' opinions are worse than flipping a coin. Still, few managers learn proper assessment techniques from their business schools or their employers; in my surveys of participants in executive talent management programs, I've found that only about 30% think that their companies provide adequate training. Most organizations, it seems, are filled with people who have the power to endorse bad candidates and kill off good ones.

By contrast, companies that emphasize the right kind of hiring vastly improve their odds. Amazon has, for example, hundreds of dedicated internal recruiters, great training programs in assessment, and even a legion of certified “bar raisers”: skilled evaluators who hold full-time jobs in a range of departments but are also empowered to participate in assessing—and vetoing—candidates for other areas.

The Brazilian mining group Companhia Vale do Rio Doce, known as Vale, took a similarly disciplined approach, working with Egon Zehnder, during the 2001 to 2011 tenure of CEO Roger Agnelli. On his watch, not one senior role was filled without an objective, independent, and professional assessment of all internal and external candidates. Managers were encouraged to favor motivated, curious, insightful, engaging, and determined prospects even when they had no specific experience in the field or function to which they had applied. “We would never choose someone who was not passionate and committed to our long-term strategy and demanding objectives,” Agnelli explains. Some 250 executives were hired or promoted in this way, all over the world, and the strategy paid off. Vale became a global player in the mining industry, dramatically outperforming others in the country and the region.

Smart Retention

Once you've hired true high potentials and identified the ones you already have, you'll need to focus on keeping them. After all, competitors grappling with the same tight talent market will be more than happy to tempt them away. Agnelli says his proudest achievement at Vale was not the huge revenue, profit, and share price growth over which he presided but the improved quality of the leaders rising through the company's ranks. “After five or six years, everyone appointed at the highest levels came from inside,” he says, adding that the capacity to build and retain great teams is “*the key*” to any leader's or organization's success.

Pushing your high potentials up a straight ladder won't accelerate their growth—uncomfortable assignments will.

Indeed, when the Brazilian government used its 61% stake in Vale's controlling shares to precipitate Agnelli's departure, in 2011, prompting the voluntary resignations of seven out of eight executive committee members within a year, the company soon lost almost half its value. Growing disenchantment with Brazilian and commodity stocks played a role, to be sure. But given that Vale's closest competitors, Rio Tinto and BHP Billiton, saw much less dramatic declines over the same period, it seems clear that investors were also reacting to the loss of an outstanding leadership team.

How can you emulate Vale under Agnelli and avoid the company's subsequent fate? By considering what your high potentials want most from you. As Daniel H. Pink explains in *Drive*, most of us (especially knowledge workers) are energized by three fundamental things: *autonomy*—the freedom to direct our lives; *mastery*—our craving to excel; and *purpose*—the yearning for our work to serve something larger than ourselves.

Pay does matter, of course. All employees, especially rising stars, expect their compensation to reflect their contribution or effort and to be comparable to that of others doing similar jobs. However, in my experience, while unfair pay can surely demotivate, compensation beyond a certain level is much less important than most people think. In my examination of candidates hired through our firm who were successful in their new jobs but moved on within three years, I found that 85% of them were hired away into a more senior position, confirming that they were competent people with potential. But only 4% of them cited more money as the primary reason for their departures. More common reasons were bad bosses, limited support, and lack of opportunities for growth.

So do pay your stars fairly, ideally above the average. But also give them autonomy in four “I” dimensions: task (what they do), time (when they do it), team (whom they do it with), and technique (how they do it). Help them toward mastery by setting difficult but attainable challenges and eliminating distractions. And engage them in a greater team, organizational, or societal goal. Bezos and other leaders at Amazon are expert at this. Agnelli and his team at Vale were, too. But the conditions at the company following his departure failed to motivate the remaining leaders in the same way, and many of them chose to move on.

Stretch Development

Your final job is to make sure your stars live up to the high potential you've spotted in them by offering development opportunities that push them out of their comfort zones. Jonathan Harvey, a top HR executive at ANZ, an Australian bank that operates in 33 countries, puts it this way: “When it comes to developing executives for future leadership assignments, we're constantly striving to find the optimal level of discomfort in the next role or project, because that's where the most learning happens. We don't want people to be stretched beyond their limits. But we want well-rounded, values-focused leaders who see the world through a wide-angle lens, and the right stretch assignments are what helps people get there.”

To explain the consequences of *not* challenging your high potentials, I often point to Japan. In 2008 Kentaro Aramaki, from Egon Zehnder's Tokyo office, and I mapped the potential of senior

Japanese executives (that is, our consultants' objective assessments of the executives' ability to take on bigger roles and responsibilities, as measured by the indicators described above) against their competence (that is, our objective assessments of the eight leadership competencies listed in the sidebar "What Else Should You Look For?"). When we compared those scores with the average scores of all executives in our worldwide database, we found a great paradox. Japanese professionals had higher potential than the global average but lower competence. In spite of great raw material, there was a poor final product. The problem was, and still is, Japan's flawed development process. Although the country's educational institutions and the strong work ethic that is part of Japanese culture give managers a jump-start in their careers, their growth is stymied when they actually start working. A leader in Japan traditionally rises through the ranks of one division, in one company, waiting respectfully for promotions that usually come only when he's the most senior person in line for the spot.

What Else Should You Look For?

Although potential should be the defining measure of executives today, it would be a mistake to ignore other lessons we've learned over the years about how to evaluate people.

Intelligence

Although you probably won't administer an IQ test, it is important to assess a candidate's general intelligence (including analytical, verbal, mathematical, and logical reasoning) by considering educational background, early job experiences, and responses to interview questions. You don't need to look for geniuses; for most jobs anything above a certain level of intelligence has almost no impact on performance. However, you should still hire people clever enough for your requirements, because their general intelligence won't increase dramatically over time.

Values

Values are critical, and you can't expect to impart them on the job. Use interviews and reference checks not only to weigh the essentials, such as honesty and integrity, but also to discover if the candidate shares your organization's core values.

Leadership Abilities

Some competencies are relevant (though not sufficient) when evaluating senior manager candidates. While each job and organization is different, the best leaders have, in some measure, eight abilities.

- 1. Strategic Orientation** The capacity to engage in broad, complex analytical and conceptual thinking
- 2. Market Insight** A strong understanding of the market and how it affects the business
- 3. Results Orientation** A commitment to demonstrably improving key business metrics

4. Customer Impact A passion for serving the customer

5. Collaboration And Influence An ability to work effectively with peers or partners, including those not in the line of command

6. Organizational Development A drive to improve the company by attracting and developing top talent

7. Team Leadership Success in focusing, aligning, and building effective groups

8. Change Leadership The capacity to transform and align an organization around a new goal

You should assess these abilities through interviews and reference checks, in the same way you would evaluate potential, aiming to confirm that the candidate has displayed them in the past, under similar circumstances.

READ MORE

Recently a Tokyo-based global conglomerate asked our firm to assess its top dozen senior leaders, all in their mid- to late 50s. This company, which operates in multiple industries and markets, should have been an ideal training ground for executives. However, only one of the managers we evaluated had worked in more than a single business line. The time each had spent working outside Japan was just one year, on average. And their English language skills were quite limited. As a result, none were suitable candidates to succeed the CEO. The sad thing is that all had started off strong. They were engineers, with an average tenure of more than 20 years in R&D and product strategy and marketing—but that potential had been squandered.

Pushing your high potentials up a straight ladder toward bigger jobs, budgets, and staffs will continue their growth, but it won't accelerate it. Diverse, complex, challenging, uncomfortable roles will. When we recently asked 823 international executives to look back at their careers and tell us what had helped them unleash their potential, the most popular answer, cited by 71%, was stretch assignments. Job rotations and personal mentors, each mentioned by 49% of respondents, tied for second.

How do you make sure people in your organization are getting the stretch assignments and job rotations they need? Let's come back to ANZ. Following a 2007 to 2010 hiring spree as the company expanded across Asia, it decided to refine its leadership development processes. Its efforts center on what it calls business-critical roles: those that make a vital contribution to the strategic agenda; require a scarce set of skills; produce highly variable outcomes dependent on the incumbent; and, if vacant, pose a significant threat to business continuity and performance momentum.

ANZ makes a point of assessing all its managers for potential and then placing those who rate the highest in these business-critical roles. Other development initiatives include the Generalist Bankers Program, which each year offers 10 to 15 participants the opportunity to spend two years rotating

through wholesale, commercial, and retail banking, risk, and operations to build broad industry and corporate knowledge. Participants then move into permanent roles with a focus on gaining geographic, cultural, product, and client-facing experience, including a mandatory posting in internal audit to ensure that they understand the bank's control frameworks. The program commitment is 15 years, with the goal of a country CEO posting at the end.

This disciplined approach already seems to be bearing fruit. Whereas three years ago 70% of ANZ's senior executive roles were filled by external candidates, outside hiring is now below 20%. Internal surveys show that staff engagement has increased from 64% to 72%, while "same-period performance excellence" (a measure of employee commitment to customer service and product quality) has jumped from 68% to 78%. And the business has benefited in other ways. In 2013 the company was judged the number four international bank in the Asia Pacific region for the second consecutive year by the highly regarded Greenwich customer survey, up from number 12 in 2008. Geopolitics, business, industries, and jobs are changing so rapidly that we can't predict the competencies needed to succeed even a few years out. It is therefore imperative to identify and develop people with the highest potential. Look for those who have a strong motivation to excel in the pursuit of challenging goals, along with the humility to put the group ahead of individual needs; an insatiable curiosity that propels them to explore new ideas and avenues; keen insight that allows them to see connections where others don't; a strong engagement with their work and the people around them; and the determination to overcome setbacks and obstacles. That doesn't mean forgetting about factors like intelligence, experience, performance, and specific competencies, particularly the ones related to leadership. But hiring for potential and effectively retaining and developing those who have it—at every level of the organization—should now be your top priority.

Source-Harvard Business Review(June 2014 Issue)