Topgrading the organization

*Because **of** its impact on shareholder value, building a talent advantage over your competitors must be the number-one priority **of** board members and senior management.*

BY BRADFORD D. SMART AND GEOFFREY H. SMART

IN THE FACE of increasing international and domestic competition, two CEOs attempt to improve their company's performance. Both have read all of the books on the latest management trends. Both have worked with their boards to craft a winning strategy. One CEO succeeds and receives accolades from shareholders and customers. However, the other one feels the intense frustration of failing to implement the strategy because of a lack of employee horsepower. Shareholder value continues to rise in the first case, and continues to be destroyed in the second.

After witnessing literally thousands of successful and failed executive careers, we have one question to ask directors and senior managers who want to improve their company's short-term and long-term performance: "Is your company's talent creating or destroying shareholder value?" The fundamental driver of shareholder value is the talent of everyone in the organization on whom you rely to implement your business strategies. This conclusion is based on a large-scale research base of 4,204 executives in 123 companies.

We coin the term "topgrading" to describe the practice we observe of not only finding, hiring, and promoting better people at all levels (that would be upgrading) – but proactively hiring and promoting only the most talented people available, while sensitively but aggressively removing chronic underperformers. This helps companies build a talent advantage over their competitors. It is as if these organizations can boast, "Our sales people are more motivated and effective than your sales people. Our engineers are smarter than your engineers. Our officers are better leaders than your officers."

Paradoxically, organizations that topgrade do not necessarily pay more for talent. Companies that topgrade tend to look harder to find talent, screen harder to select the right people, and act more quickly to confront nonperformance. In relation to their competitors, these companies get disproportionately better talent for the compensation dollars they spend.

Building a talent advantage over your competitors does not happen without a high degree of focus and energy. Topgrading the organization must be a top priority of board members and senior management. If it is not a priority, then hiring the best and brightest is just given lip service. We estimate that less than 5% of U.S. companies are topgrading. As Peter Drucker said to us one time, "The toughest decisions in organizations are people decisions – hiring, promoting, firing, etc. The ability to make good decisions regarding people represents one of the last reliable sources of competitive advantage since very few organizations are very good at it."

We wince every time an undertalented company tries to implement TQM or some other initiative and push decisionmaking responsibility down in the organization. Underskilled or undertalented employees are given decisionmaking authority and end up making bad decisions. Performance inevitably suffers.

In contrast, organizations that topgrade are able to drive improvements or changes in strategic value drivers such as productivity, innovation, quality, customer service, and time to market. They experience greater success in these areas because they have the most competent employees on whom to rely. Having consistently strong operational performance can be a powerful force in building shareholder value. Of course, other factors such as macroeconomic trends, currency fluctuations, industry changes, and customer preferences can all affect

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shareholder value as well.

We are not saying talent is the only driver of shareholder value, but that it is a key one – and one of the only ones that senior managers can directly control. Ratcheting up the talent level of a company is a lot easier than trying to affect the strength of the U.S. dollar.

The idea behind topgrading is so simple, we are often shocked that so few companies do it. We have found that far too often, managers at all levels make the costly mistake of trying to "manage their way" to excellence with low-performers on their team.

This article provides a framework for illustrating how topgrading is a primary driver of shareholder value. In addition, the six most common organizational obstacles to implementing the practice of topgrading are identified. Finally, several brief case examples illustrate how some of this nation's most successful companies develop and maintain this powerful competitive advantage.

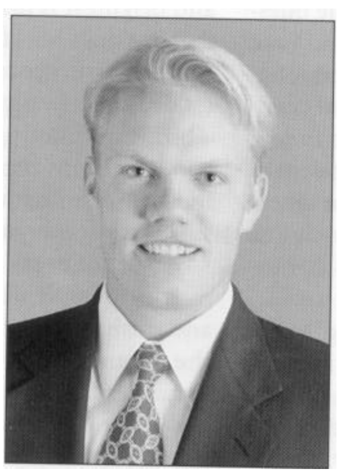
Talent counts

In the 1992 and 1996 Olympic Games, the American basketball Dream Team had no problem crushing its competitors. What was the primary source of its competitive advantage? Better strategic thinking? Better business processes? Was the team a learning organization? Was it the team's commitment to embrace change and innovation?

No. The dream team's fundamental competitive advantage was clearly the talent. All other advantages flowed from this primary driver of performance. The team was comprised of high-performers, or A players. There were almost no B players and certainly no C players to drag the organization's talent level down.

AlliedSignal's Chairman and CEO Larry Bossidy is a believer that nothing his company does is more important than hiring and developing the right people. He contends that strategies are intellectually simple but the success of strategy implementation depends on who is doing the implementing.

Proactively seeking out and employing the most talented people can have a multiplier effect on the creation of other competitive advantages. High-performers, the A players, contribute more, innovate more, work smarter, earn more trust, display more resourcefulness, take more initiative, develop better business strategies, implement change more effectively, deliver higher quality work, demonstrate greater teamwork, and find ways to get the job done in less time with less cost. Across our sample of companies, only 25% of their employees were A players, 55% were B players, and 20% were C players.



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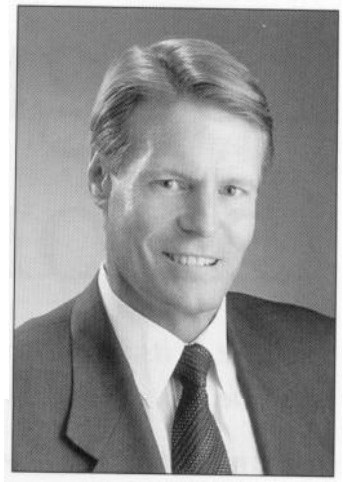
— Geoffrey Smart

What is topgrading?

Topgrading simply means proactively seeking out and employing the most talented people available, while redeploying (internally or externally) those of lesser ability or performance. More specifically, we view topgrading as employing only A players. These folks are in the top 10% of the talent available. "Available" is defined as the total number of people in the pool of talent who are willing to work for a given compensation level, in a given company, in a given town. Whether the number of available people is 20 or 20,000, topgrading means inserting only the most talented ones available into every job. B players fall in the next lower 25%, and C players drop below the 65th percentile. The accompanying exhibit is a brief summary of behavioral competencies for a division president. In fact, dozens of competencies should be included, and they should be carefully tailored to the specific job.



Unlike so many factors that also affect shareholder value, the board and senior management can directly control the talent level of the company.

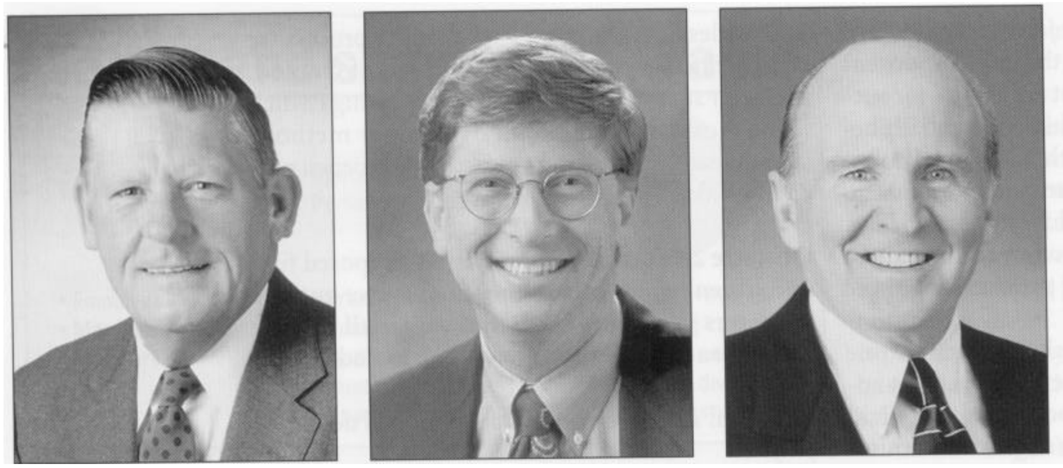
-Bradford Smart

Another way of thinking about topgrading is making a commitment to realizing the most "bang for one's buck" with respect to the total cost to employ people.

The process of topgrading should start with the board's decision to topgrade the CEO position. An A-player CEO will then make topgrading a top priority for all levels of the organization. Specifically, the most successful companies we encounter simultaneously execute the four elements of topgrading:

1) Proactively searching out and identifying A players (from within or outside of the firm).

2) Using the most advanced and rigorous selection methods to make fewer



Masters at topgrading: Accordmg to the authors, AlliedSignal's **Larry Bossidy** is a believer that nothing his company does is more important than hiring and developing the right people; **Bill Gates** himself makes calls to talented undergrads to recruit them to join Microsoft ("Imagine that — a college senior picks up the phone in the dorm room one night and Bill Gates is on the line asking him or her to join the company!"); and GE's **Jack Welch** frequently says that his job is to get the right players on the field and to occasionally call the big plays, and calls himself the "top personnel guy around here."

mistakes and hire and promote only A players.

3) Improving the existing "human capital" by providing employees with developmental training, and/or redeploying low performers into roles in which they can excel.

4) Requiring subordinate managers at all levels to embrace the topgrading approach for the creation of their teams.

In high-performing companies, this process is ongoing and is not a one-time strategic initiative or program.

Who is topgrading

McKinsey & Co. is known for its commitment to seeking out and employing the best people available at every level. This philosophy comprises one of the points in its mission statement. 3M, Procter & Gamble, General Electric, and AlliedSignal attract and retain A players and quickly redeploy C players. These organizations topgrade as a way of life.

However, there are plenty of smaller companies that also topgrade. You may recognize them as the grocery store with uncommonly friendly employees, the dry cleaner that goes out of its way to serve you, or the restaurant where every member of the staff seems competent, responsive, and enthusiastic. The most successful organizations in our database tended to have at least 75% of their people in the A-player range and have almost no C players.

Obstacles to topgrading

Many managers are committed to the idea of employing highly talented people, but find its implementation challenging. We have asked thousands of senior managers to describe what they have done to increase the talent levels of their teams. Drawing from the myriad of successes and failures, we have distilled the most troubling obstacles that managers face in ratcheting-up the organization's talent level. Following each description of the obstacles is the best solution to overcome the barrier.

Obstacle 1: "We think we are hiring high performers, but they turn out to be C players once they are on the job."
Solution: *Your organization will* make *fewer hiring mistakes if it adopts the most advanced* assessment *methods available (described below).*

Making hiring mistakes is a very common problem. It is due primarily to using ineffective methods for assessing candidates. Many companies in our sample put candidates through a series of brief "tell me about yourself" interviews which result in a typical hiring success rate of only around 50% (half of the new hires work out). This disappointing result may even happen when eight of your people interviewed the candidate for an hour each. In comparison, organizations that use better methods typically are successful at hiring the right people 90% of the time. It is impossible to topgrade if your organization cannot accurately assess who is walking in the door.

So what is the most accurate and reliable way to assess people? Our recommendations in the next few paragraphs are based on over 30 years of combined experience in this area. In addition, we compared notes with other experts in the field, and reviewed several hundred scientific studies on "best practices" for assessment.

There are two critical components in the most effective assessment processes: the job analysis, and the chronological, in-depth interview. The job analysis at senior levels is too often "delegated" to the executive search firm, which too often results in a "boilerplate" job description. Error-free hiring begins with the hiring manager's rigorous analysis of the job in relation to corporate strategy and the desired organization culture. The job description will also include what it takes to do the job – the dozens of behavioral competencies that are critical for success or failure in the position. This list essentially becomes a "blank scorecard" with all of the dimensions against which the candidates will be evaluated. These competencies should include any knowledge, skills, abilities, operating style, or any other factors that will affect the behavior and performance of the person in the position.

Next, the screening process should include one chronological, in-depth interview. This format appears to be the most accurate tool for gaining vivid insights into the candidate's strengths and limitations in the dimensions that were identified on the scorecard. The point of this interview format is to make sure one gets sufficient data to make an informed judgment on each of the critical dimensions. Failing to get a clear reading on even one dimension can result in a hiring mistake.

Such an interview typically last 3-4 hours and chronologically covers the candidate's entire career history with a fine-toothed comb. It does not rely on asking candidates hypothetical questions because these questions are too easy to fake and their responses often do not reflect what people actually do. Instead, this type of interview focuses on their actual experiences over the course of their entire career. Clear patterns surface that make it easy to see what their strengths and weaker areas are and allow your people to accurately predict how they would do on the job.

Across each job or relevant experience in the person's career, we ask a core group of six questions:

1) Their expectations coming into that job;
2) Responsibilities in that job;
3) Accomplishments and other high points;
4) Failures and low points;
5) TORC; and
6) Reasons for leaving.

TORC stands for "Threat of Reference Check." This is asking candidates, "If we call that former supervisor, what will he or she tell us were your specific strengths and weaker areas in that job at that time?" These questions yield extremely valuable information. This is not a bluff. Finalist candidates are asked to set up those reference calls.

This interview takes 3-4 hours, whereas a typical informal interview lasts less than one hour. However, the total hiring process we are describing should not take any more time or money than the typical ineffective assessment methods. Your company saves time by identifying C players earlier in the process before they advance to later rounds of interviews and waste your people's time.

Decades of research suggest that the process we describe is the most accurate assessment method, and is far superior to informal interviewing (which is the most common method) or other methods such as assessment centers or paper-and-pencil psychological testing.

Obstacle 2: "Our HR department is supposed find and screen top talent, but they do not give our line managers what they need. And we are all so busy putting out fires, we don't have time to find A players."

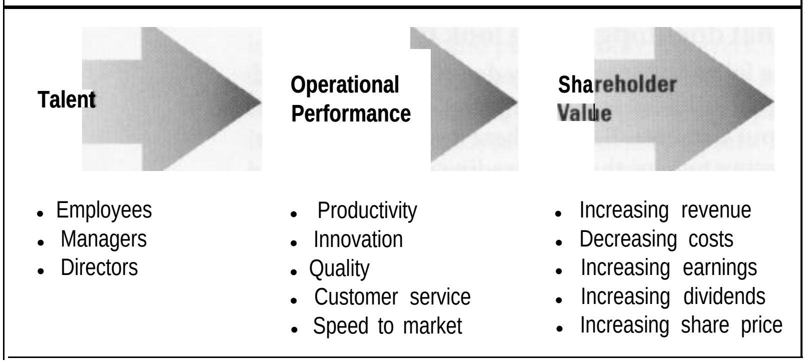
Solution: *Do more yourself to recruit and develop A players.*

AlliedSignal's Larry Bossidy said that the responsibility to recruit superior managerial talent at all levels is a role the CEO cannot delegate. The CEO must own the topgrading process if the organization is to understand that it is a key priority. That means a visible, systematic, and persistent commitment of the CEO. Bossidy is personally involved in hiring decisions for the top 150 executives and tracks their progress in semiannual management resources review meetings. Bill Gates himself makes calls to talented undergrads to recruit them to join Microsoft. Imagine that. A college senior picks up the phone in the dorm room one night and Bill Gates is on the line asking him or her to join the company!

Procter & Gamble, 3M, General Electric, and AlliedSignal topgrade as a way of life. However, there are plenty of smaller companies that also topgrade.

Successful leaders find that they are in the "recruitment business" for life. They are constantly on the lookout for talented people – at professional gatherings, university programs, community service boards, etc. They keep a "network file" so when a position opens up, they can immediately tap their network for candidates or referrals. This way, they save the cost and time of a search, and their finalist candidates have been personally pre-screened.

At William M. Mercer Inc., Managing Partner Charles Hartwig occasionally has breakfast or lunch with prospective recruits two or three times per week. He once spent half a Sunday interviewing a candidate for a position three levels down in the organization. Not surprisingly, his division is packed with talented people. Contrast this example with the countless examples in which managers rely exclusively on the HR department for candidates and do



Talent and shareholder value

not get involved in the recruitment process at all.

If your senior managers think that they do not have time to topgrade because they are too busy putting out fires, ask them how much time they waste addressing problems that the C players in the company should have prevented or fixed. Skimping on the talent search leads to more C players being hired, which means more fires, which means less time. Stop the downward spiral by replacing the C players with A players.

Obstacle 3: "We want to change the organization's culture and raise the performance bar... but almost every talented person I bring in from the outside is rejected by the current culture and ends up quitting."
Solution: *Provide "air cover"* for *your new change agents.*

This was a common problem for the organizations in our dataset. An executive realizes that his or her company, unit, or department is far from world-class. The low-performance culture – often characterized by low accountability, fear of change, autocracy, low innovation, poor communication, slow pace, and/or lots of excuses – reinforces itself because of an incestuous promote-from-within policy.

> ***Successful leaders find that they are in the 'recruitment business' for life.***

In this case, it is critical to seek out and employ A players who will help drive the culture-change process. It is often essential to hire those A players that have the competencies, skills, and attitudes consistent with the desired culture. Additionally, they will not be rejected by the old culture if senior managers provide them with air cover by making it clear to the others that the new hires have their full support.

Obstacle 4: "We can't afford to hire A players."
Solution: YOU *can't afford to not hire A players, so do it!*

This excuse does not make sense under our theoretical framework. A players are available at all compensation levels – they are people above the 90th percentile of overall talent of all potential candidates at any given compensation level. Organizations are always paying for A players, whether or not they get them. That means that a company that is paying its C player marketing director a $90,000 base salary could hire an A player for the same salary.

Another way to look at it is that your return on investment in A players is positive and big, and your return on investment in C players is negative and big.

Obstacle 5: "I do not want to fire loyal C players."
Solution: *Give Cplayers a chance to* become *A players.* If *they fail, then redeploy them into a role in which they can perform well (but if this also does not work* then you must *counsel them out* of *the company).*

C players are sometimes given a chance to become A players with extra training and a redefinition of their job responsibilities. A C player can be considered one who is overpaid and/or underperforming. By reducing pay (a "long-shot" solution) and/or improving performance, C players can become B players, or even A players.

Nobody is a C player all of the time. People are C players when they are mishired, mispromoted, or misdeployed within their company.

Theoretically, everyone can be an A player. The best organizations ask the question, "In what sort of role (and for what level of pay) can this person be an A player?" Such organizations systematically align individuals' responsibilities to be consistent with their strengths and weaknesses.

Former Dial Corp. Chairman John Teets, at a roundtable meeting of CEOs, said that the most common self-criticism was not moving fast enough to remove long-term underperforming executives. Just as A players provide an uplifting force to an organization, C players can sink the ship. In 1996 alone, 53,549 businesses declared bankruptcy. The best way to avoid firing C players is to not hire or promote them in the first place.

The next best alternative is to have a hard-hitting performance management system that generously rewards, retains, and develops A players: A players thrive in that environment, whereas C players may end up taking a less demanding job somewhere else.

Obstacle 6: "Our problems will soon clear up be-

cause we engaged a strategic management consulting firm, and its report looks great."
Solution: *Topgrade if you want to drive the successful implementation of the strategic recommendations.*

Great strategy combined with a team of high performers can reasonably be expected to increase a company's performance. However, expensive consulting engagements often fall flat when the company managers lack the talent to drive successful implementation. In chess, great strategy will not prevail if one player has nothing but a few pawns while the opponent enjoys a board full of royalty. Talent is a necessary ingredient to making strategy implementation possible.

What does topgrading look like?

The following cases briefly describe what topgrading looks like at several large and small companies in our database. Each of these executives gave permission to have their topgrading story told.

Reversing the Slide: Travelers Express Co. in 1991 (when it was a division of Dial Corp.) was a cash cow that was drying up. After years of flat earnings, the president was removed. The new president,

Summary of Critical Hiring Competencies

Position:	**President (base compensation level, $250,000)**		
	A PLAYER	**B PLAYER**	**C PLAYER**
Overall Talent Level	**Top 10% of those at this salary level**	**65th-89th percentile at this salary level**	**Below the 65th percentile at this salary level**
Intelligence	130 or higher IQ; a "quick study"; able to rapidly perform complex analyses	120-129 IQ; smart, but not as insightful as an A player	110-119 IQ; hasdifficulty coping with new, complex situations
Vision	Facilitates the creation and communication of a compelling and strategically sound vision	Vision lacks credibility; is somewhat unrealistic or strategically flawed	Embraces tradition over forward thinking
Leadership	Initiates needed change; highly adaptive and able to "sell" the organization on change	Favors modest, incremental change; lukewarm "followership"	Prefers the status quo; lacks credibility so people are hesitant to follow
Drive	Passionate; high energy level; fast pace; 55 (+) hour work weeks	Motivated; energetic at times; 50-54 hour weeks	Dedicated; inconsistent pace; 40-49 hour weeks
Resourcefulness	Impressive ability to find ways over, under, around, and through barriers; invents new paradigms	Open-minded and will occasionally find a new solution	Requires specific direction
Customer Focus	Extremely sensitive and adaptive to both stated and unstated customer needs	Knows that "customer is king" but does not act on it as often as A players	Too inwardly focused; perhaps misjudges the "inelasticity" of demand for the firm's products and services
Hiring	Hires A players and employees with A potential	Hires Bs and Cs; suffers from an occasional costly mis-hire	Hires C players; crises occur due to low talent level
Team-Building	Creates focused, results-driven teams; energizes others	Less adept team-builder	Drains energy from others
Track Record/ Experience	Exceeds expectations of employees, customers, and shareholders	Meets key constituency expectations	Sporadically meets expectations
Integrity	"Iron-clad"	Generally honest	"Bends the rules"
Communication	Excellent oral/written skills	Average oral/written skills	Mediocre

Robert Bohannon, immediately topgraded the company. In the first year, Bohannon replaced most of his executive team. He used in-depth chronological interviews to hire and promote only A players. The in-depth interview process led to zero hiring mistakes. The new team embraced topgrading, replacing 30% of all employees in the next two years. Bohannon and his vice presidents personally drove the process of identifying A players, B players, and C players. He gave each B and C player a fair chance of becoming an A player. Some C players were removed. Over one quarter of the C players were redeployed into roles in which they could perform as A players.

In chess, great strategy will not prevail if one player has nothing but a few pawns while the opponent enjoys a board full of royalty.

The results? Record revenues and profits were achieved during 1992-1996. Morale has been sky-high. The successful vision and strategy were created by the new "dream team" of high performers. Recently, Bohannon was named chairman and CEO of Viad Corp., the $2.6 billion publicly traded company created from a 1996 spinoff of the old Dial Corp.

Large-Scale Change and Growth: From 1991-1994, Nielsen International's CEO Christos Cotsakos reorganized the non-U.S. businesses of the world's largest marketing firm. Cotsakos found that too many C players were comfortable with slow growth. Cotsakos initiated a program that required everyone to reapply for his or her job. All but two of the top 50 executives changed jobs; some were promoted or reassigned, and many left voluntarily or were terminated. Cotsakos' topgraded organization achieved record financial performance in 1992-1995. Cotsakos, promoted to president of ACNielsen World-Wide, said, "We topgraded at a frenetic pace – hiring, assessing, coaching, firing, reorganizing."

Increasing Shareholder Value: Beginning in the mid-1980s, Chairman and CEO James DiMatteo of Dominick's Finer Foods, a $2.5 billion grocery retailer, initiated the topgrading process. The CEO and his officers were evaluated using the in-depth chronological interview plus co-worker evaluations, and received executive coaching every two years. No senior executives were removed, though several A players were added to the team. However, almost one-fourth of the store managers were deemed C players and were removed (most became department managers) after extensive feedback and job coaching. The topgrading process helped to identify and develop an internal executive, Robert Mariano, who was recently promoted to president. From 1985-1995, the firm's value grew by 15 times.

Being Premier at Everything You *Do:* General Electric benefits from its unusually thorough and effective systems to assure that its businesses are "packed" with A players. The firm accomplishes this by hiring A players, by developing its B players into A players, and by removing a few C players who do not improve and do not fit other positions. Chairman and CEO Jack Welch frequently says that his job is to get the right players on the field and to occasionally call the big plays. He calls himself the "top personnel guy around here," affirming his personal commitment to hire and promote the best people.

Officers at GE are periodically put through an extremely comprehensive tandem (two interviewers) assessment and development process. For each candidate, human resources professionals conduct an in-depth chronological interview and confidential co-worker interviews, and provide hard-hitting feedback to the individual in a 15-20-page report containing specific developmental action plans.

Twice per year, in what is called "Session C," Welch devotes a full day or more to the human resources issues of each of GE's businesses. After visiting the businesses, Welch himself evaluates each executive's strengths, weaker points, and progress on their developmental plans. Nothing impacts the topgrading process more powerfully than the CEO's personal commitment to make sure it happens.

Driving value upward

For those charged with the awesome responsibility of increasing shareholder value, topgrading provides a powerful tool. They can ask if the company has the top 10% of the talent available, and, if not, "Why are we paying for A players and not getting them?" They can ask if the hiring success rate is around 90%; if not, "Why are we not using the most advanced selection methods available to screen people?" They can ask why so many C players are causing problems when, for the same salaries, A players can drive shareholder value upward.

By increasing the talent level, you can expect to see key performance indicators go up. Unlike so many factors that also affect shareholder value such as customers, competitors, investors, and broad economic trends, the board and senior management can directly control the talent level of the company. Since so few companies topgrade, it represents a reliable source of competitive advantage. For now.