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Achieving Competitive Advantage Through an Engagement-Based Talent Management Strategy: Expert Q&A with Pearl Meyer's Aalap Shah and Lianne Richardson

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An expert Q&A with Aalap Shah and Lianne Richardson from Pearl Meyer on how companies can gain competitive advantage by adopting an engagement-based talent management strategy. Aalap and Lianne address the biggest talent-related challenges facing companies today, the hallmarks of an effective talent management process, strategies for cultivating a cohesive culture, understanding the strong correlation between engagement and performance, measuring engagement, using engagement data to inform compensation design, and more.

In our current dynamic environment, the talent and skills companies need to execute their business strategies are constantly changing. To remain competitive, companies must:

- Establish and maintain an effective talent management process that spans the whole organization. Managing talent risk is no longer just about ensuring that the company's chief executive officer (CEO) is engaged. It involves effectively managing talent across multiple layers within the organization.
- Develop a "talent map" that aligns and supports the company's multi-year business strategy. The company must have a clear picture, at all times, of the extent to which its workforce has the skills required for the company to achieve its long-term goals.
- Relentlessly focus on identifying, developing, and engaging high-potential employees. To innovate and address future challenges, companies must engage the right talent.

But for companies that want to differentiate themselves and gain a true competitive advantage, this is only the beginning. Another key driver of business success is a cohesive culture that connects employees' work to the company's larger purpose. While improving a company's culture is a long-term, sustained endeavor, creating a positive culture that connects people to purpose is a powerful way to ignite engagement and attract and retain future leaders.

Research consistently shows a strong correlation between engagement and both individual and company performance. However, most employees worldwide are disengaged:

- Some are "quiet quitting" or doing the bare minimum that is required of them.
- Some are "quiet searching" or biding their time until the market improves and they can move on to their next role.
- Others have completely lost trust in their employer and are directly harming the company's reputation.

For various reasons, including in some cases a desire to find greater meaning from their work than their employers provide, many highly skilled employees today are not interested in pursuing traditional leadership roles. Instead, they are content serving as individual contributors, thereby leaving more time for side hustles or other activities that bring them the fulfillment they seek. This creates additional challenges for companies seeking to fill top leadership positions with first-rate talent.

In its State of the Global Workplace 2023 Report (the 2023 Gallup Report), Gallup estimates that low engagement costs the global economy $8.8 trillion. But Gallup also emphasizes the immense opportunity for productivity gains, as many employees who are currently quiet quitting are waiting to be inspired and motivated.

Practical Law Senior Specialist Legal Editor Jessica Cherry asked senior compensation consultants Aalap Shah and Lianne Richardson from Pearl Meyer to address how companies can gain a competitive advantage by:

- Understanding the factors that impact engagement within their organizations.
- Adopting an engagement-based talent management strategy.

What are the biggest talent-related challenges facing companies today?

Aalap Shah:

There are two primary and interrelated talent challenges facing companies today:

- Establishing and maintaining an effective talent management process.
- Cultivating a cohesive culture.

To keep up with the dizzying pace of change, and to drive engagement, companies must continuously re-assess whether:

- Their talent management process ensures that the company has access to the talent and skills it needs to achieve its business goals.
- Their culture is what the company desires and proclaims it to be.

What are the hallmarks of an effective talent management strategy?

Aalap:

Successful companies map their talent management strategy to their business strategy by asking themselves:

- Given our business strategy, what talent and skills do we need?
- How do we get there?

Companies can best support their business strategy by taking a holistic approach to talent management, that is, considering their talent needs across the entire organization, rather than focusing solely on the C-suite. When it comes to succession planning, for example, the process starts at the top of the house with the CEO, but many companies stop there. A company that adopts a more expansive approach is better situated to replenish its talent map at any given time.

Once the company has a good talent management process in place at the C-suite and senior executive level, it should take steps to ensure that the process permeates the rest of the organization. Otherwise, the company can end up with holes in its talent map, which can lead to situations where the company is forced to slot someone in quickly because it is in dire straits rather than because the person is the best fit for the role and the organization.

An additional benefit of consistently revisiting its talent map is that it encourages the company to focus on developing its talent by inviting them to ask questions such as "What training or other investment is required to ensure that employees achieve their full potential?" By focusing on employee growth and development, the company can fill holes in its talent map while fueling employee engagement and morale throughout the organization.

Unfortunately, most companies are at only the nascent stages of thinking about talent management as a holistic process that spans the entire company.

How often should companies re-assess their talent management strategy?

Aalap:

Starting with the fundamental principle that a company's talent management strategy supports the execution of the organization's business strategy and the organization's culture, the talent management strategy should be flexible enough to:

- Evolve with the ever-changing human capital landscape.
- Remain grounded in the vision for the business.

Therefore, the best talent management strategies are continuous. Consider that the critical talent a company needs today may be very different from the talent it will need in just two or three years. For some high-growth companies, talent needs may change within six to nine months.

This means that the company should be continuously:

- Identifying critical positions and potential vacancies and whether there are internal employees it wants to slot into those roles.

- Assessing the key competencies and skills it needs to achieve its business objectives over various time horizons.
- Developing the skills of individuals at all levels within the organization so that they:
  - are equipped to tackle new or unforeseen challenges as they arise; and
  - feel that the company is invested in their growth.

  Significantly, given the pace of change today, giving individuals the right development opportunities may mean preparing them not only for a specific next role, but also for an undefined role beyond that.
- Building and maintaining relationships with potential future hires.

Companies that are not considering these issues regularly may find themselves scrambling to find people with the requisite skills at the eleventh hour. In some cases, current employees eager to build their skillset may be sitting in plain sight, but never given the right development opportunities. This is not only a missed opportunity, but it also fuels disengagement. Astute companies recognize the direct link between developing talent, creating value, and managing future organizational risk.

If an external hire is the best option to fill a hole in the company's talent map, that process typically takes considerable time. Waiting until a vacancy exists and then beginning a search to fill it can result in significant opportunity costs. And many poor hiring decisions derive from a rushed hiring process.

A company that stays ahead of the curve on talent management is much more likely to find the talent and skills they need when they need them, either within or outside the organization, which is critical in today's fast-paced, competitive environment.

How does culture intersect with talent management and how does a company create and maintain a positive, cohesive culture?

Aalap:

Culture is widely recognized as a key driver of business success and has a reciprocal relationship with talent management, meaning that how people behave impacts culture and the company's culture impacts how people behave. Very generally, culture means how people at all levels within the organization think, act, and interact with each other. A company's culture is tied to how well people understand and connect with the company's purpose, the transparency of the company's core values, and whether people feel empowered to live those values.

In a cohesive culture, employees:

- Feel a sense of belonging.
- Feel that they are valued.
- Are empowered to utilize their strengths to drive their own and the company's growth.
- Are committed to the goals of the organization.

While culture is multidimensional, one fundamental way to create a cohesive culture is by clearly communicating the company's purpose and ensuring that people understand the connection between the company's purpose and their day-to-day work. This infuses their work with greater meaning, a key driver of engagement. Strong core values that are clearly communicated and consistently modeled by leadership also play an important role and can guide behavior across the organization.

While a positive, cohesive culture can ignite engagement, performance, and retention, a negative or fragmented culture often breeds disengagement and dissatisfaction, and can lead to quiet quitting and high turnover.

Common culture-related problems that can diminish engagement and impede performance include:

- Leaders acting inconsistently with the company's stated values or purpose, thereby fueling cynicism by sending the message that these are merely public relations gimmicks.
- A disjointed culture, meaning one that is based on individual personalities. This can mean that there are many disconnected sub-cultures within the organization, and no overarching sense of the company's values or purpose for employees to connect with.
- Difficulties adapting, that is, failing to ensure that the company's culture evolves with the speed of change. A company's culture should adapt to what employees need and want, but this is not static. For example, employee expectations regarding flexibility changed significantly due to the extended period of remote work during the COVID-19 pandemic. Generational employers, or employers that withstand the test of time, are good at evolving their culture to adapt to change, while maintaining their core values.

- Companies basing their understanding of what employees need or want on inaccurate data, such as the opinions of a handful of senior leaders, or information provided by managers about what they believe employees need or want. Of course, the most reliable method for uncovering what employees need or want is to ask them directly.

Companies must be intentional about cultivating a cohesive culture by continuously assessing:

- Employee perception of the company's culture based on their experiences and whether it aligns with what the company desires and proclaims its culture to be.
- Whether the characteristics of current employees align with the aspirational culture of the organization.
- Whether the company's compensation programs are informed by, and align with, the company's culture. For example, if the company's culture is intended to promote innovation, risk-taking, and collaboration, how do those themes present within the company's compensation programs? Do they incentivize desired behaviors?

When there is a lack of alignment in any of these areas, the company must quickly make adjustments to narrow the divide.

Why is employee engagement so crucial to achieving competitive advantage? What factors impact employee engagement?

Aalap:

Employee engagement is the degree to which an employee is:

- Involved and passionate about their work.
- Committed to the values of the organization.
- Going beyond their basic duties to propel the business forward.

Research consistently shows a strong correlation between engagement and a host of performance outcomes, including:

- Profitability.
- Productivity.
- Well-being.
- Turnover.
- Customer loyalty.

(The Benefits of Employee Engagement, Gallup, June 20, 2013, updated January 7, 2023.)

Unfortunately, most employees worldwide are disengaged, which has an enormous adverse effect on:

- The disengaged employees who are not thriving at work and relatedly, in many cases, outside of work.
- Employers that are failing to tap into the full potential of their most valuable asset—their talent.
- The global economy.

Many engagement problems can be traced back to problems with a company's talent management process. For example, there are huge opportunity costs related to:

- **Hiring someone who is not the right fit culturally**. This can happen when someone is hired for a leadership position based on their substantive expertise, but with no regard for whether their values align with the company's purpose or mission, or whether they are adept at inspiring and motivating people. A single bad hire can poison an entire subculture.
- **Leaving a position unfilled despite a need**. This can happen if the company is not consistently monitoring its talent map and anticipating vacancies. This can result in important work not getting done, or others within the organization being forced to take on additional responsibilities, often without adequate recognition or an increase in compensation.

With respect to the current employee population, engagement often hinges on issues such as:

- **How people are feeling about their own talent development opportunities**. For example, are they given opportunities to grow or left to languish? Are they encouraged to participate in educational programs about issues they care about? Do they feel like everyone has equal advancement opportunities?
- **Whether their managers or supervisors are effective in their roles**. For example, do their managers or supervisors effectively connect each individual's work to the company's purpose? Do they genuinely care about the members of their team as human beings and take their concerns seriously? Do they treat people with respect?
- **Whether people feel that their compensation adequately reflects the value they add to the organization and their benefits support their health and well-being**. For example, is extraordinary performance rewarded? Does the company's benefits program provide what they need and want throughout their career lifecycle?

To understand what factors are impacting engagement within their corridors, companies must measure it. One way to obtain valuable engagement data directly from employees is by periodically sending out engagement surveys, which may include questions such as:

- Are you motivated to give your best effort at work each day?
- Are you satisfied with the company's culture?
- Do you feel a connection between your work and the company's purpose or mission?

To obtain competitive advantage, companies can leverage engagement survey data in numerous ways, one of which is to use the data to inform their compensation strategy.

How can companies structure their compensation programs to drive engagement?

Lianne Richardson:

Many companies make compensation decisions based on:

- Market data, for example, information about what their peers are doing, with many companies ensuring that pay levels fall at or around the median of their peer group.
- The guidelines of proxy advisers such as Institutional Shareholder Services (ISS), with an emphasis on ensuring that none of their compensation practices are deemed problematic pay practices that could cause an adverse say on pay vote recommendation.

While compensation should be informed by market practice, it should not only be tied to that.

Engagement surveys can shed light on the different perspectives and needs of people throughout the organization. Companies are increasingly recognizing that they can obtain much more valuable information if they slice their population across a host of different classifications, such as, executives, employees, members of underrepresented groups, and so on. For example, a company may design its engagement survey to assess:

- What are the greatest needs of our junior employees?
- What are the greatest needs of employees with families?
- What are the greatest needs of employees who are nearing retirement?
- What do our high-performing future leaders want?

When designing their compensation programs, companies can differentiate themselves by using market data as a reference point, but also considering customized internal information, such as the company's culture, and the expressed needs and wants of their employee population.

Aalap:

Most companies design their compensation strategy from the perspective of "how do we attract, retain, and motivate employees?" These ARM goals reflect the tenet that a company's compensation strategy should focus on meeting employees' basic needs. Companies then adopt a traditional compensation model that bases compensation decisions solely on an individual's level or job band.

There are two rationales for maintaining the traditional model:

- **Administrative ease**. This is not a compelling rationale given how much technology has expanded our ability to get more granular data about people.
- **Fairness and pay parity**. This is a legitimate concern. An individualized model must be thoughtfully developed and implemented or it runs the risk of perpetuating inequality and unfairness. An effective way to protect against this is by using one model based on level or job band and alternative models based on pre-defined profiles derived from engagement survey results.

The traditional approach unnecessarily slots people into structures that fail to account for their individual circumstances and contributions. For example, it fails to consider that many individuals are largely intrinsically motivated, and therefore carrots and sticks may not be particularly incentivizing. It also fails to consider that two individuals in the same job band could have vastly different needs and wants.

A more individualized, engagement-centered model takes into account the amount and type of compensation but also other factors that are not traditionally part of the compensation conversation, but that are valuable to employees in the context of their overall lives, such as:

- Growth and development opportunities.
- Educational opportunities.
- The benefits that best support people at different points in their lives and careers.

Viewing compensation through a more personalized lens, and seeking input directly from employees, a company may find that:

- Employees who have just graduated from college are often most worried about paying off their student loans and therefore motivated by cash compensation.
- Those starting families are frequently concerned about being able to pay for their children's education, and therefore programs such as qualified tuition programs, or other programs that directly reduce monthly expenses, such as programs that provide discounted mortgage rates, may be particularly attractive.
- Someone who is in a stable financial position but who is responsible for an ailing parent or other family member may be less concerned about salary and more concerned about having the flexibility they need to properly care for their loved one.
- Someone who is primarily concerned about career advancement may be motivated by stretch assignments and opportunities to work with the company's senior leaders rather than dollars and cents.

Taking care of each individual's evolving needs is both the laudable thing to do and it enables workers to focus on higher order thinking and output.

During the pandemic, when the global mental health crisis and heightened levels of employee disengagement started garnering significant attention, many companies started thinking of compensation more holistically and offering more human-centric benefits designed to support employee well-being, such as greater access to childcare and more robust mental health benefits. However, as market volatility increased, companies became increasingly focused on profitability and expense management, and many backed away from these initiatives.

What role should pay equity, DE&I, and commitment to all stakeholders play in compensation design?

Aalap:

Every conversation about compensation design should be informed by an assessment of the company's stakeholder community. Conversations should address certain baseline questions, such as:

- Does the program appropriately address fairness concerns and promote pay equity?
- What is being "left on the table" and who is being "left behind?"
- Does the program enable the company to achieve its growth goals while adhering to its cultural values?

Companies should be prepared to make adjustments that are guided by their core values and their business strategy rather than the pendulum swings of public opinion. For example, recently there has been considerable backlash against several companies' diversity, equity and inclusion (DE&I) programs. That does not mean that a company must necessarily avoid incorporating DE&I metrics into their compensation programs. Rather, subject to the advice of their employment counsel, companies should carefully assess their programs, manage their risk, and ensure that they make decisions that align with the fundamental questions posed above.

Stakeholders care deeply about these issues. Companies that do not demonstrate a commitment to pay equity and that do not thoughtfully address the social and cultural issues that matter most to their stakeholders will find it increasingly difficult to attract and retain sought-after talent. Investors and other stakeholders also take these issues into consideration when evaluating whether a company has the right workforce in place to meet future business challenges, as evidenced by:

- The SEC's renewed focus on human capital disclosure.
- The increasing demand for companies to publish sustainability reports.

The charged political environment around terms such as environmental, social and governance (ESG) and DE&I notwithstanding, there continues to be considerable interest in understanding how companies are:

- Addressing these challenges.
- Moving the conversation forward with respect to these issues.

Finally, among other responsibilities, boards of directors must oversee the company's exposure to risk. Failing to create and maintain a diverse, inclusive, and equitable workplace creates significant organizational risk, especially over the long-term. And when contemplating their company's risk profile, boards that focus solely on financial and audit risks and ignore human capital risks do so at their peril, as these issues are not going away.

Boards can mitigate risk by holding their executive team accountable to the company by:

- Requiring the executive team to evaluate and report on the social impact of the company's compensation and benefit programs (analogous to the type of evaluation they would request in connection with a proposed business strategy pivot).

- Making a member of the leadership team directly responsible for reporting to the board on:
  - human capital issues generally; and
  - the social and cultural issues that are of paramount importance to the company's stakeholders.

What role do a company's internal communications play in the success of its compensation strategy or individual compensation programs?

Lianne:

A company must have a good communications strategy in place for its overall compensation strategy and each of its compensation programs, bearing in mind that employees typically want more information about how their employers make decisions.

A company can have an impressive strategy or design an excellent program, but if the roll-out is poor, it can nonetheless fail. We have seen this with many post-pandemic return-to-office policies. By poorly executing the communications piece, some companies inadvertently undercut all of the careful thought and planning that went into designing a strong policy.

A company must consider its audience and try to anticipate their questions. For example, when a reporting company adopts a new incentive compensation plan, it must disclose information about the plan in the compensation, discussion, and analysis (CD&A) section of its proxy statement. In addition to following the principles-based approach required by the proxy disclosure rules, the people designing the plan and writing the disclosure must ask themselves "How will this land with employees, investors, and other stakeholders when they read the CD&A?" Companies should think about their internal communications in the same way. They should ask themselves questions such as:

- How is the communication likely to land with our employee population? Putting ourselves in their shoes, what questions will it raise?
- What is the best way to deliver information about the strategy or program? For example:
  - Should they present the information to people when they are in small or larger groups?
  - How should they prepare managers to address questions?
  - What form of presentation will be most effective (for example, power point presentation versus frequently asked questions)?

Just as companies must be intentional about cultivating a cohesive culture and designing a talent management process that drives engagement, they must be intentional about how they communicate both the "what" and the "why" of their compensation arrangements.

Traditionally talent management has fallen largely within management's purview, with oversight by the board. Should these lines be drawn any differently today?

Aalap:

Historically, management has handled talent management matters and the board has largely rubber-stamped management's decisions. The boards did not (and many still do not) require management teams to report out to the board. However, to re-emphasize my prior point:

- The board must oversee the company's risk exposure.
- The risk that an inappropriate or ineffective human capital strategy presents is very real.

To fulfill its obligation to the company, the board should send a clear directive to management that they must spend time and resources on the company's talent management structure and pipeline, and engage in a very robust process.

There is, however, reluctance from both the board and management to change the status quo because:

- The board wants to give proper respect to management and does not want to step on management's toes.
- Management views the board's role as providing strategic direction, without becoming overly involved in internal matters.

While finding the right balance of responsibilities can be challenging, the resistance to change can be overcome if the company has the right directors in place who:

- Ask the right questions.
- Are restrained enough not to take over management's role.

Ultimately, given that one of the greatest drivers of shareholder value is the extent to which a company has an engaged and productive workforce, the board and management must:

- Jointly address human capital issues.
- Recognize that failing to do so creates risk that each is running afoul of their respective responsibilities.

Are there any special considerations regarding the relationship between the board and the CEO?

Aalap:

CEO succession planning should be a normal part of the governance process and there should be transparency between the board and the CEO. Consider that the average tenure of a CEO is three years, but finding a successor can take four to five years. A thoughtful process of looking for a successor should therefore start as soon as a new CEO is hired. This means that:

- Succession planning must always be part of the conversation.
- The current CEO should be transparently engaged in the process.

While there is some inherent tension in addressing succession-related matters, this tension can be mitigated by:

- Involving an objective third party in the process (for example, a consulting firm that has significant in-depth experience in leadership and organizational effectiveness).
- Institutionalizing succession planning conversations so that they become a normal part of the governance process.

To illustrate, I was at a board meeting recently where the CEO, who is in his early 50s, openly shared with the board, and the Head of Human Resources, that his aim is to serve in another CEO role for another company before he retires. While he was not signaling his imminent departure, he wanted to let the board know his intentions so they could plan for it. This level of transparency is mutually advantageous and can occur if both:

- Succession planning conversations are institutionalized.
- Trust exists between the CEO and the board.

* * *

While the labor market is not as competitive as it was in 2020-2021, a considered approach to talent management is crucial for companies to survive and thrive under any circumstances. It therefore transcends economic cycles. Companies should not take a laissez-faire approach to talent management. Looking at their raw data, many companies are seeing high job acceptance rates and low turnover, and assuming that employee satisfaction and engagement are also high. But as the 2023 Gallup Report confirms, that is generally not the case.

Today (as was the case pre-2020), many employees are biding their time in their current positions while actively searching for something new due to factors such as:

- Poor management.
- Lack of growth or educational opportunities.
- An undesirable culture.
- Inadequate compensation.
- Compensation that does not align with their lifecycle stage.
- Benefits that do not align with what they need or want.

Companies should not assume that being able to fill open roles and retain people is synonymous with a thriving employee population. And, regardless of market conditions, by continuously reassessing their talent management processes and their culture, and by providing a more individualized compensation program that is tuned into the specific issues that are impacting employee engagement, companies can unlock potential and spur growth while differentiating themselves in the talent market.