The Financial Impact of Strategic Development and High Potential Programs

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We examined the talent management practices and financial performance of 300 organizations across 31 countries. Results demonstrated that organizations investing in strategic development and high potential programs financially outperformed their competitors over the course of seven years. Further, organizations' ability to make effective succession decisions was one likely explanation (mediator) for this relationship. We discuss surprising findings regarding the combination of strategic development and high potential programs on succession effectiveness. Finally, we offer theoretical explanations towards why and when high potential programs may not provide additional value and provide practical recommendations regarding strategic talent management or high potential programs.

STRATEGIC TALENT MANAGEMENT AND HIGH POTENTIAL PROGRAMS

Talent management (TM) practices have gained significant attention from both academics and practitioners (Al Ariss, Cascio, & Paauwe, 2014; Dries, 2013a; Garavan, O'Brien, & Watson, 2015; PricewaterhouseCoopers, 2012). Drawing from research in the area, talent management can be described as a value-creating strategy (Barney, 1991, 1995), in which organizations implement strategically aligned developmental practices in order to prepare employees to effectively perform in critical roles within the organization or roles that may become critical in the future. (Lewis & Heckman, 2006; Garavan, O'Brien, & Watson, 2015; Michaels, Hadfield-Jones, & Axelrod, 2001; SHRM, 2010).

Research has distinguished two distinct approaches (or *philosophies*) within the umbrella of TM (Husilid, Beatty, & Becker, 2005; Meyers & Woerkom, 2014). First, strategic development (or *strategic positions*; Collings, 2015), identifies critical roles within the firm that significantly impact—or will impact—the firm's ability to gain or maintain competitive advantage. After identification, firms then cater their developmental programs to ensure employees gain the competencies required by these critical roles (Husilid et al., 2005; Lepak, Takeuchi, & Swart, 2011).

In contrast, high potential (HiPo) programs—rather than identifying critical roles—focus on attracting and identifying unique and highly talented employees (i.e., high potentials; Collings & Mellahi, 2009). After identification, firms then focus on developing and retaining HiPo employees so that they can fill strategic roles within the organization (Bourdreau & Ramstad, 2007). While these two approaches are distinct, it is important to note they are not mutually exclusive (Meyers & van Woerkom, 2014). In fact, this study hypothesized that the optimal talent strategy likely involves blending the two approaches into an overall TM program.

The War for Talent

Researchers and practitioners suggest TM is essential to organizational performance and sustained competitive advantage (Mabey, 2013; Nyberg, Moliterno, Hale, & Lepak, 2013; PWC, 2012). This idea is closely related to the "War for Talent" (Michaels, et al., 2001), which refers to the new strategic focus of developing and retaining internal talent (i.e., TM) to maintain or gain competitive advantage (Collings & Scullion, 2007). In the business environment of the 21st century, corporate barriers are at an all-time low, business demands change rapidly, and many firms now automate or outsource production tasks (Barney, 1995). As a result, firms recognized effective TM, rather than mass marketing, specialization, or economies of scale, is essential to maintaining competitive advantage (Barney, 1991; McDonnell, 2013; Michaels et al., 2001).

As a result, corporate investment in TM has skyrocketed (Bersin, 2013; Day, 2000; Silzer & Church, 2009). In PricewaterhouseCoopers's (PWC) 2012 annual survey, 66% of CEOs identified TM as a key priority (see also Wright, Stewart, & Moore, 2011). Lockwood (2006) estimated total corporate investment into TM exceeded $50 billion dollars and suggested this number would only increase.

As organizations invested more and more into the war for talent, some research began to ask whether such initiatives created additional value (Avolio, Avey, & Quisenberry, 2010; Barney, 1995; Cascio, 1991; Collins & Holton, 2004). More simply, do these practices actually improve organizational performance? Most research has suggested yes (Black & Earnest, 2009; Cascio & Boudreau, 2008; Mabey & Ramirez, 2005; Russell, Terborg, & Powers, 1985). For example, Collins and Holton (2004) conducted a meta-analysis of 83 studies on managerial training and reported positive leadership outcomes. Avolio, Avey, & Quisenberry (2010) suggested the average return on investment of talent HR practices was 44 to 87%. Ernst and Young (2010) reported that strategic TM programs resulted in 20% higher return on investment than practices strategically unaligned.

However, considering firms' massive volume of spending into TM programs, empirical research investigating the actual financial impact of TM is staggeringly sparse (Day, Harrison, & Halpin, 2008). Indeed, Avolio and Luthens (2006) reviewed the leadership literature and found less than 100 articles investigated TM and firm performance. Of those 100, only a few evaluated performance using objective, financial, or organization-level measures (e.g., Cascio & Boudreau, 2008; Husilid, 1995).

The purpose of this study is to bridge this gap by evaluating the relationship between investment in TM practices and financial, objective firm performance. We also propose one reason TM practices may add value to firms: more effective succession decisions. Further, we investigated the individual and combined effects of strategic development and HiPo programs.

Talent Management and the Effectiveness of Succession Decisions

To fully explore the organizational benefit of TM, it is important to investigate why TM practices improve firm performance. To do so we investigated an organization-level antecedent of TM with a logical link to firm performance: effectiveness of succession decisions (Garman & Glawe, 2004; Meyers & Woerkom, 2013). In an evidence-based review, Groves (2007) claimed simple *replacement* approaches to succession planning are myopic and may cause more harm than good. Rather, research demonstrates organizations that effectively overcome succession challenges and succeed in the "war for talent" (e.g., Dow Chemical, Bank of America) do so by implementing strategic TM programs (Conger & Fulmer, 2003; Groves, 2007). Through these future-oriented programs, development starts long before succession and is designed to instill competencies identified as strategically critical to effective succession (Boudreau & Ramstad, 2007; McDonnell, 2013; Patton & Pratt, 2002; Rothwell, 2002).

Hypothesis 1: Strategic development implementation will positively relate to succession effectiveness.

Hypothesis 2: Organizations implementing formal HiPo programs will demonstrate higher rates of effective succession decisions than organizations without HiPo programs.

Succession effectiveness refers to the ease of transition, retention, and performance of the employee in the succeeded role. Research suggests organizations implementing strategic TM programs expedite transition times, facilitate talent retention and performance, and those that make effective succession decisions demonstrate sustained competitive advantage (Axelrod, Handfield-Jones, & Welsh, 2000; Barnett & Davis, 2008; Garman & Glawe, 2004; Gelens, et al., 2013; Husilid, 1995). Therefore, we suggest succession effectiveness is likely one mechanism through which TM improves firm performance.

Hypothesis 3: Strategic development implementation will positively relate to firm financial performance.

Hypothesis 4: Organizations implementing formal HiPo programs will demonstrate higher financial performance than organizations without HiPo programs.

Hypothesis 5: Succession effectiveness will positively relate to firm financial performance in subsequent years.

Hypothesis 6: Succession effectiveness will mediate the relationship between strategic development implementation and firm financial performance.

Strategic Development vs. High Potential Programs

Some researchers have pointed out HiPo programs typically involve investing a disproportionate amount of resources into less than 20% of the workforce (Dries, 2009; Lewis & Heckman, 2006; Malik & Singh, 2014). While some argue that this practice leverages strengths (e.g., Boudreau & Ramstad, 2007; Illes, Chuai, & Preece, 2010; Swailes, 2013), others contend overreliance on a few individuals may expose firms to significant risk because a large pool of capable employees is necessary to fill the ever-increasing number of skilled jobs left vacant by baby boomer retirees and new roles created by today's rapidly changing market (e.g., Collings, 2015; Dries & De Gieter, 2014; Gelens, et al., 2015; Malik & Singh, 2014; PWC, 2012).

Despite attention on the controversy, to our knowledge, research has yet to empirically compare the 'bottom up' HiPo approach to 'top down' strategic development or investigate the outcomes of using both (Becker & Husilid, 2006; Collings, 2015). Strategic development programs often focus on preparing many employees for critical or potentially critical positions (Lewis & Heckman, 2006; Cascio & Aguinis, 2008). This practice facilitates strategic succession planning and preparedness for shifts in job demands (Kransdorff, 1996). HiPo programs may facilitate this strategy because they maintain a pool of elite individuals capable of taking on many different roles (Smart, 1999; Groves, 2007). As the firm can trust these individuals to quickly acclimate to the newest or most difficult roles, HiPo employees can serve as fail-safes to fill critical positions when the general workforce is yet unprepared (Church, 2006; Michaels et al., 2001, Silzer & Church, 2009). From this idea, I suggest optimal TM approaches utilize both TM approaches as they strategically complement each other, thereby facilitating effective succession decisions and, thus, firm performance (see Figure 1 for conceptual model).

Hypothesis 7: The use of HiPo programs will moderate the relationship between strategic development and succession effectiveness such that firms implementing HiPo *programs will demonstrate a stronger relationship between strategic development and succession effectiveness.*

METHOD

In 2007, a large consulting company sent a TM-oriented survey to over 1,500 organizations worldwide that used this consulting company's service. The survey was to be completed by high-ranking HR employees. Only publically traded organizations completing at least 75% of the survey were included in the final analysis. The remaining survey responses came from 300 organizations across 31 countries.

Talent Management Measures

Strategic Development Implementation was measured by a composite score of 8 items entitled: "how well does your organization implement its overall strategy for developing leaders?" Examples include "The skills being developed are aligned with business priorities and related leadership competencies" and "There are well-defined requirements and competencies for success in positions under consideration." Respondents indicated the extent to which they agree with the statements on a 5-point Likert scale where 1 indicates, "strongly disagree" and 5 indicates, "strongly agree." These 8 items emerged from exploratory and confirmatory factor analysis from a 16-item survey, $\chi^2(20) = 74.36$, $p < .001$.

Succession Effectiveness was measured with a single item on a 0-100 scale. The item asked respondents: "Using the following scale, 100% (completely effective) to 0% (completely ineffective), indicate the overall effectiveness of your organization's current approach to making succession decisions."

High Potential Employee Program was assessed on the survey by asking respondents "Does your organization have a formal process to accelerate the development of high-potential employees?" Participants answered either "Yes", "No", or "I don't know". Responses were then recoded to be score 1 if the respondent answered "Yes" and 2 if "No". Respondents answering "I don't know" were removed from HiPo-related analyses.

2007-2014 Competitive Financial Performance. Financial ratios were obtained using the *Mergent Online* database, which contains extensive financial data for over 25,000 active corporations. Using Mergent, we collected two financial ratios, revenue per employee (RPE) and return on equity (ROE), from year 2007 to 2014 for each public company that answered the survey (2007) along with 20-45 of the selected companies' competitors. RPE (i.e., *employee* or *labor productivity*) is calculated through dividing total revenue by the number of active employees. RPE is a widely used proxy measure for the amount of value the average employee contributes to the organization (Al-Matari, Al-Swidi, & Fadzil, 2014; Husilid, 1995; Ichniowski, 1990). In PWC's annual CEO survey, (2012) 98% reported staff productivity is important/very important to evaluate TM practices. ROE is calculated by dividing total stockholder's equity by net income. ROE is a popular proxy measure for return on investment (i.e., profitability) at the organization level (Al-Matari et al., 2014; Darwish, Singh, & Mohamed, 2013). In fact, Earnst and Young's (2010) study on TM measured business performance using ROE over five years.

Next, an excel macro standardized RPE and ROE values against the organizations' competitors for each year and combined them to make a single financial performance variable. Standardizing organizations against their competitors eliminates systematic differences between industries and served to indicate competitive advantage (March & Sutton, 1997). In the end, the 2007-2014, competitive financial performance variable resembled a normal curve around zero with approximately 99% of scores falling between -20 and 21.

RESULTS

Table 1 presents descriptive statistics and intercorrelations for the variables used. Strategic development was positively associated with succession effectiveness, *b* = 1.04, t(252) = 4.68, $p < .001$, and firm financial performance, *b* = 1.52, t(287) = 2.44, p = .015, supporting hypotheses 1 and 3. Succession effectiveness was positively associated with firm financial performance, *b* = 0.60, t(245) = 3.18, p = .002, and explained a significant portion of its variance, F(1, 245) = 10.13, $R^2 = .04$. Thus, hypothesis 5 was supported.

Of the 275 valid cases, 55% of surveys indicated their organization used a formal HiPo program. Strategic development and HiPo program usage accounted for a significant portion of the variance in succession effectiveness, F(1, 233) = 16.94, $R^2 = .13$. Next, two independent-samples t-tests were conducted. Results showed, when compared with organizations that did not use HiPo programs (N = 118, $M_{Fin} = .14$, $M_{Succ} = 53\%$), organizations using HiPo programs ((N = 149, $M_{Fin} = 1.89$, $M_{Succ} = 66\%$) demonstrated significantly higher percentages of effective succession decisions, t(265) = 3.92, $p < .001$, and financial performance, t(265) = 2.00, p = .047. Overall, hypotheses 1-5 were supported.

To test the proposed moderated mediation model, we used the bootstrapping method with the "PROCESS" macro to create bias corrected confidence intervals (Hayes, 2013; Preacher, Rucker, & Hayes, 2007). Table 2 displays the results of 5000 bootstrap samples on the tests of mediation, moderation, and the overall moderated mediation model. Of note, the results demonstrate succession effectiveness as a significant mediator (indirect effect *b* = 0.55, CI: [0.13, 1.20]; direct effect *b* = 1.04, CI: [-0.40, 2.48]; Preacher & Hayes, 2004). Further use of HiPo program (yes or no) was a significant moderator (conditional effects: $b_{yes} = 0.70$, CI: [0.11, 1.29]; $b_{no} = 1.50$, CI: [0.74, 2.26]; $b_{yes} - b_{no} = b_{diff} = .81$). Therefore, hypothesis 6 was supported, and hypothesis 7 was partially supported since the moderation effect was somewhat different than proposed (see Figure 2).

Finally, bootstrapping results revealed the indirect effect of strategic development on financial performance through succession effectiveness was conditional, depending on use of a HiPo program ($b_{yes} = .38$, CI: [0.03, 1.06]; $b_{no} = .93$, CI: [0.18, 2.01]; $b_{diff} = .55$, CI: [0.52, 1.67]). Thus, the model of moderated mediation was supported (Figure 1).

DISCUSSION

First and foremost, this study provides evidence that talent management initiatives, such as strategic development and high potential programs, relate to sustained competitive advantage and financial performance. One reason is firms who invest more into TM systems likely make more effective succession decisions.

The relationship between strategic development and high potential programs is more complex. It does appear organizations with poor strategic development implementation made more effective succession decisions when they also utilized a high potential program. However, organizations with strong strategic development and a high potential program only made slightly more effective succession decisions than those without a HiPo program (Figure 2).

While not the proposed effect, this relationship complies well with the philosophy of many researchers who argue that the static conceptualization of human capital is an anachronism in today's rapidly changing work environment (Cappelli, 2008; Cascio & Aguinis, 2008; Lepak et al., 2011; Meyers & Woerkom, 2014). High potential programs may enable firms to place talented individuals in critical roles where they will likely do well, but the critical roles of today are so dynamic and complex that high performance in one role may not guarantee success in another. A more optimal method scans the entire talent pool and identifies individuals with characteristics and interests that fit those critical roles and then facilitates development accordingly (Collings, 2015; Lewis & Heckman, 2006). Perhaps then the reason HiPo programs increase effectiveness at low levels of strategic development is that selecting HiPo employees ensures talented individuals enter into high-level roles rather than employees promoted due to less strategically relevant criteria, such as seniority or politics.

Alternatively, perhaps merely informing individuals that they are considered “high potentials” motivates them to pursue their own development opportunities when not formally available, or HiPo employees may be more likely to receive informal training by their supervisors and/or senior management. Along these lines, when there are more formal development opportunities, high potentials may not independently pursue informal development putting them on the same playing field as general staff.

Overall, results suggest a few practical recommendations to organizations. First, strategic talent management programs appear to relate to higher firm performance suggesting these practices are worth the investment due to their potential impact on succession effectiveness and the bottom line. Second, if your organization’s strategic development implementation is lacking—perhaps due to limited resources—the identification and development of the elite few (i.e., HiPo employees) in your organization may be one cost effective method to improve succession decisions and sustained competitive advantage. However, if your organization is already effectively implementing a strategic development program, the addition of a high potential program is not likely to result better outcomes.

Limitations and Future Research Directions

While we examined this financial performance over the seven years following the survey, it is unable to claim a cause-and-effect relationship. Further, while the performance variable was objective, the implementation of TM practices was measured through survey items. Future research should adopt experimental and longitudinal methodology that also considers the cost of TM implementation (i.e., ROI; Avolio et al., 2010). Next, while succession effectiveness was found to be a significant mediator, it is not likely the only mechanism through which strategic development impacts financial performance. Future research should investigate additional explanations. Lastly, we offered some explanations towards the unexpected moderation of HiPo programs (Figure 2). However, as these theories are merely speculative, TM research would benefit from a more in-depth investigation.

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APPENDIX

FIGURE 1
CONCEPTUAL MODEL OF MODERATED MEDIATION

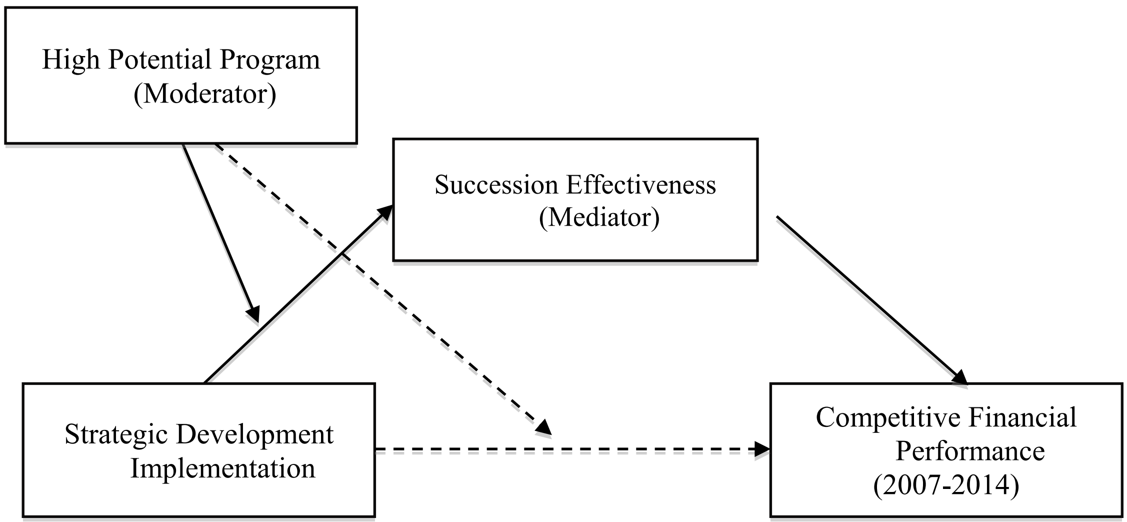

Figure 1. Solid lines indicate proposed direct effects or moderation of direct effect. Dotted lines indicate indirect effect or moderation of indirect effect (Preacher, Rucker, & Hayes, 2007)

TABLE 1
VARIABLE DESCRIPTIVE STATISTICS AND INTERCORRELATIONS

Variables	N	M	SD	1	2	3	4
1. Strategic Development	297	23.48	7.11	(.85)			
2. High Potential Program	275	(NA)	(NA)	.34***	(1)		
3. Succession Effectiveness	284	5.96	2.43	.29***	.25***	(1)	
4. Financial Performance	292	0.94	7.11	.17**	.12*	.20**	(.91)

Note: High potential variable is dichotomous (“yes” = 0, “no” = 1). Reliability estimates are in the diagonal. *p < .05. **p < .01. ***p < .001.

TABLE 2
BOOTSTRAPPING TESTS OF MEDIATION, MODERATION, AND MODERATED MEDIATION

Test	N	Level of W	Effect	SE	LLCI	ULCI
Mediation	247					
Direct Effect (x-y)			1.04	.73	-.40	2.48
Indirect Effect (x-m-y)			.55	.265	.13	1.20
Moderation	236				.	
Conditional direct effect on x-m		0 (yes)	.70	.30	.11	1.29
Conditional direct effect on x-m		1 (no)	1.51	.39	.75	2.27
Moderated Mediation	229					
Conditional Indirect Effect on x-m-y		0 (yes)	.38	.25	.03	1.06
Conditional Indirect Effect on x-m-y		1 (no)	.93	.45	.18	2.01
Index of Moderated Mediation			.55	.36	.052	1.57

Note: All effects were significant except for direct effect (x-y) (Hayes, 2013)
x = Strategic Development
y = Financial Performance
m = Succession Effectiveness
w = High Potential Program Use (coded 0 if yes,1 if no)

FIGURE 2
HIGH POTENTIAL PROGRAM USAGE MODERATING THE EFFECT OF STRATEGIC DEVELOPMENT IMPLEMENTATION ON SUCCESSION EFFECTIVENESS.

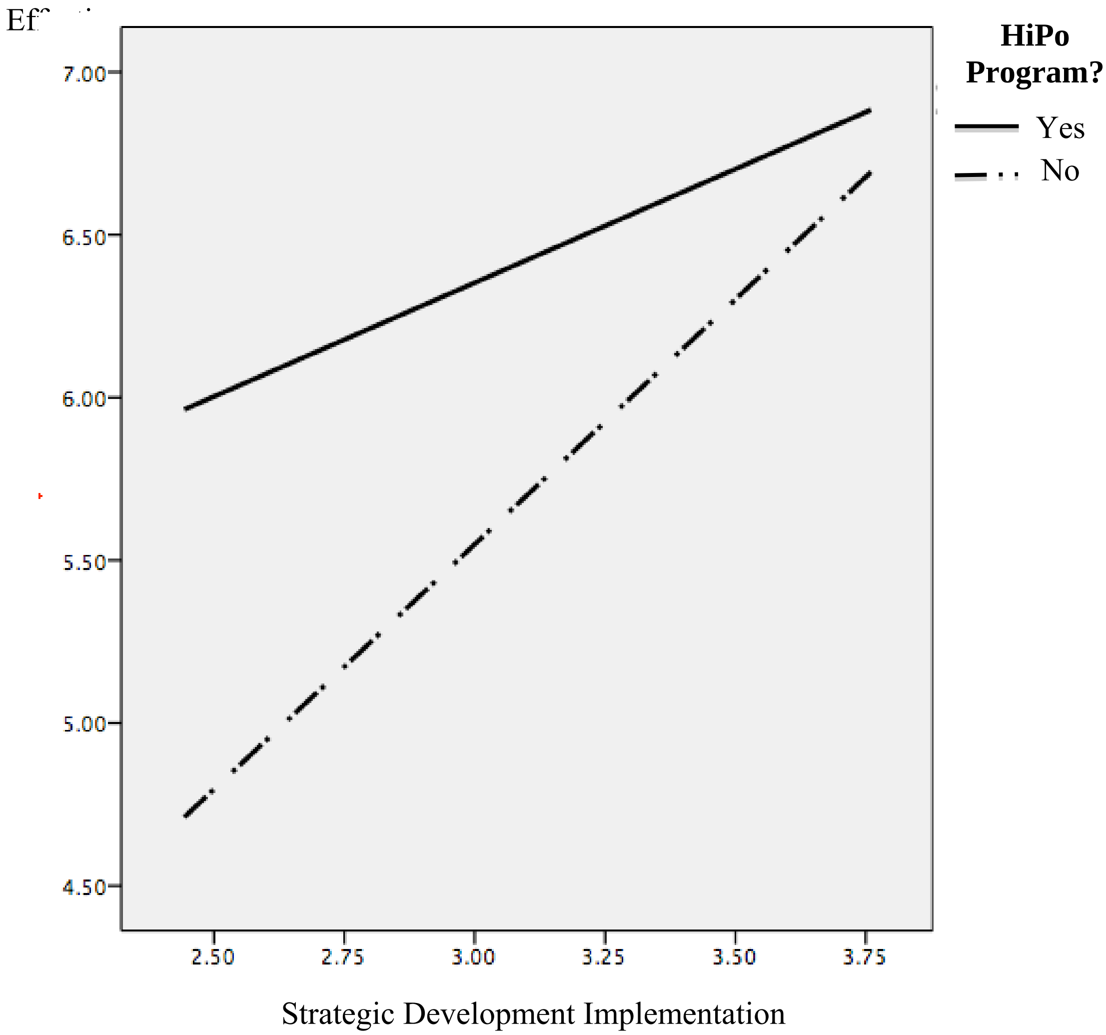

Figure 2. Succession effectiveness coded through dividing percentage of effective succession decisions by 10.