feature

Talent Arbitrage

From the Outside in: Shaping HR and Workforce Strategy

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Introduction

For most organizations, human capital is both the single largest expense and most valuable asset. However, the composition of today's workforce is shifting rapidly, seemingly overnight, due to changing technology, increasing competition and growing availability of global and virtual resources. The labor market we once knew has flattened, and getting top talent at the best price is critical. Given this seemingly constant state of change, rather than undermining the validity of planning for the workforce, the unpredictable nature of business means planning for and executing on talent strategy is more important than ever.

But, how do HR and business leaders position themselves to win this war for talent?

Understanding how talent management fits as part of the overall business strategy is a good start. Once a talent management, or workforce strategy has been defined, HR and business leaders have the difficult task of finding top talent at a reasonable cost. This is where talent arbitrage comes into play, an integral component of a successful organization's overall workforce planning methodology and toolkit.

Talent arbitrage describes the process of an organization shifting resources, relocating, or expanding into new locations to take advantage of better, more plentiful talent and sometimes lower cost talent. If done right, organizations can get better talent at a lower price, and ultimately improve workforce productivity in the process.

What if there was a specific location, city, or region in which an organization could focus their recruiting efforts to get superior talent, education, skills, capabilities, and experience at a lower cost? The answer for many organizations is that there's not only one, but often several such superior talent rich locations.

While it might sound similar, talent arbitrage should not be confused with outsourcing or offshoring, which have been historically driven primarily by direct labor cost savings, as well as real estate and tax savings. For example, offshoring generally means acquiring talent in another lower cost country at a substantial wage cost savings, yet the quality, capability, and experience of such lower cost talent is typically well below that of the incumbent workforce. However, talent arbitrage hinges on labor supply analytics to optimize not just cost, but also availability and depth of talent.

For example, an organization might relocate a portion of their business to a specific metro area, shift their recruiting efforts to focus on specific jobs in selected regions, or use talent supply analysis to determine the best place to open a new office or location. Probably the best example in the world of talent supply analytics is that of Google, which has a large dedicated staff devoted to finding the best talent anywhere in the world. Upon finding a location or city with a significant amount of the key talent and skills Google is looking for, they generally proceed to open a new office location in that area, and siphon off top talent from various local or multinational employers.

Talent arbitrage enables organizations to leverage innovative and predictive workforce analytics, improving workforce productivity while controlling their total cost of workforce.

Another excellent example of talent arbitrage in practice is the application of analytics in Major League Baseball, pioneered by Billy Beane, former general manager of the Oakland Athletics. The bestselling book *Moneyball: The Art of Winning an Unfair Game*, by Michael Lewis, outlines how Beane and a young analytics guru, Paul DePodesta,

were able to recruit overlooked talent with the potential to be future stars on a very limited budget. Ultimately, their approach revolutionized professional baseball player selection through the use of superior talent metrics, a practice that has become widespread in professional sports today.

By implementing talent arbitrage for the workforce, organizations can achieve similar results to Google, hiring dramatically better talent at equal, or even lower, costs. Using analysis of global, regional, and local talent supply data – increasingly available online through sites such as the Bureau of Labor Statistics – organizations can integrate talent analytics into their workforce recruiting and planning efforts, filling the jobs they need most, with top talent at the best price.

Today, most organizations are still at the beginning of their workforce planning journeys. While a few have had great success, far more are still searching for a place to start. Originally referred to as manpower planning, the practice of workforce planning is not a new concept. During the 1950s, and up to the early 1970s, when unemployment ranged from a low of 3.5 percent to a high of 6.7 percent, and the economy was relatively stable, workforce planning was a necessity due to labor supply shortages.

It remained a significant practice in many large organizations until the economic downturns in the 1980s, when, as a part of restructuring, most planning departments were scaled back and ultimately eliminated. Furthermore, the increasingly unpredictable economic environment caused many organizations to question if workforce planning was a sustainable practice. In the late 1990s, the focus on workforce planning and talent arbitrage began to re-emerge. While a few companies such as Hewlett-Packard (HP) have had success in recent years, using scorecards to measure what HP coined *Total Cost of Workforce* (TCOW), most other organizations had no such advanced metrics. As the financial crisis of 2008 showed, organizations fell into a fear-based binge and purge approach to talent management, and layoffs were plentiful. However, the workforce cuts were too deep, resulting in significant talent gaps and the need to quickly rehire talent, only to repeat the process again in the next round of restructuring changes.

Even now, in 2015, with an improving economy, many organizations have amnesia with regards to sustaining their talent planning efforts. Going forward, with competition for top talent rapidly accelerating and five million open unfilled jobs[1] in the U.S. alone, talent arbitrage and strategic workforce planning must become a priority in order to succeed. The ability to recruit top talent from an increasingly competitive and shrinking labor market is imperative for organizations to execute on their business strategy.

1 http://www.bls.gov/news.release/jolts.nr0.htm, BLS.gov, May 2015

The Shrinking Global Talent Supply: Why Should We Care?

A key component of successful planning and talent analytics is understanding labor supply and implementing strategies to address gaps, both locally and globally. Talent arbitrage is not just about getting the best price, but also about maximizing the quality and availability of talent.

Whether organizations know it or not, the global supply of talent is not growing fast enough, and industries and even entire countries are experiencing acute talent shortages. In its article, The Hard Facts: Acute Shortages, Unrelenting Surpluses (2015) the Boston Consulting Group (BCG) listed some of the crippling labor shortages and slowly evaporating labor surpluses the world faces:

- Germany will see a shortage of up to 2.4 million workers by 2020, and a shortage of 10 million by 2030.
- Brazil will have a shortage of up to 8.5 million workers in 2020; by 2030, that figure could increase nearly fivefold to 40.9 million people.
- Italy will see a surplus of 2 million workers in 2020, but by 2030, it will face a labor deficit of up to 0.9 million.
- Canada's labor surplus of between 700,000 and 1.1 million people in 2020 will become a deficit of up to 2.3 million by 2030.
- China's surplus of 55.2 million to 75.3

- million workers in 2020 could reverse sharply, turning into a shortage of up to 24.5 million people by 2030.
- The U.S., with a surplus of between 17.1 million and 22 million people in 2020, will still face a surplus—at minimum 7.4 million—by 2030.

By 2030, the only major advanced economy with a skills surplus will be the U.S., and yet some industries are already experiencing increasing skill shortages for selected jobs, particularly in certain U.S. cities and geo-metro areas.

What does this mean? Historically, companies have been able to get away with a shortsighted approach to talent management; however, that is changing. When times are tough, cost-cutting is the common practice and layoffs are plentiful. Conversely, when times are good, companies hire from the outside and pay whatever the market demands without much thought to long-term impacts.

So, what happens in good times when organizations cannot fill their demand for workers at any reasonable price?

The oil and gas industry is a prime example. With over 70 percent of the workforce approaching retirement, and approximately 50 percent of all geophysicists and engineers estimated to retire by 2018, the industry is facing a critical shortage of key jobs. In addition, increasing job complexity and a declining number of new petroleum engineering graduates are only making matters worse.

While oil and gas industry leaders openly identify the looming talent shortage as their greatest corporate challenge, a reactionary approach to talent management still appears to prevail. According to *Fortune* magazine, job cuts soared to a near two-year high in the first quarter of 2015 as the energy sector in the U.S., particularly in Texas, trimmed its payrolls due to a sharp drop in oil prices.

In order to learn from past mistakes, organizations in the oil and gas industry could be buying talent, while others are discarding it, using local labor market analysis and talent arbitrage to focus on specific regions or competitors. In addition, increasing investment in education, training, and internship programs would allow them to grow better talent, faster and cheaper, ultimately outperforming competitors through superior talent management.

Regardless of industry, it is critical to understand how the shrinking supply of talent will drive changes in workforce strategy going forward. Finding the top talent and skills of tomorrow needs to become a priority today. For example, organizations should be able to answer questions such as the following:

Successful workforce planning combines insightful analysis and modeling with implementation and execution.

- What jobs and skills are becoming obsolete?
- What roles will have more pronounced shortages in the future?
- Where is the largest supply of talent for those roles?
- How do labor prices vary from our current locations?
- Should we focus on buying or building talent?
- What jobs have a defined career path?
- What is the impact of turnover and retirements?

What Does Success Look Like?

Successful workforce planning combines insightful analysis and modeling with implementation and execution. Organizations must be able to leverage internal workforce and financial data, business and strategic forecasts, and external market factors to build robust scenarios for the future workforce. But, what examples can organizations use to model their workforce planning efforts? The following is a best-in-class case study of talent arbitrage in action, as part of a holistic workforce planning strategy.

Case Study: Talent Arbitrage in the Financial Services Industry

A regional bank with approximately 12,000 employees was looking to relocate IT opera-

Figure A: Market Differential Analysis:

tions outside of their primary markets in Northern and Southern California. Management had identified a target market, primarily based on estimated real estate savings and tax credits. In addition, top executives at the bank were positively predisposed to this market selection, as some had previously worked and lived in this area. Although some on the team were already convinced, such a big shift required a more rigorous talent arbitrage analysis, as initial projections did not include any real talent availability or detailed labor cost comparisons on jobs targeted for relocation.

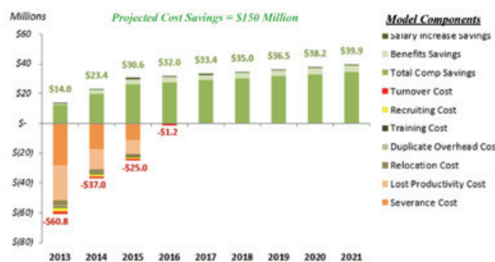

Figure B: Optimal Market Savings Forecast:

Management decided to invest the time and money for a highly detailed analysis, creating a talent arbitrage dynamic model that could evaluate talent variables across 12 separate metro areas chosen for comparison. In addition to real estate and tax considerations, a comprehensive research on wage differentials and talent availability was conducted for over 2,000 unique positions, including labor statistics for major job families, talent supply, concentration, skills availability, and projected growth of jobs in the future.

Leveraging the assistance of the Human Capital Management Institute (HCMI), a custom workforce planning model for talent arbitrage was developed to evaluate and compare labor markets. With the ability to dynamically update dozens of scenario variables, hundreds of scenarios were run to optimize the selection process. This enabled management to rapidly calculate the projected cost impact and savings differential for each market.

Figure A shows the cost savings comparison for two unique markets over time, the original target market identified by management, and an alternative optimal market identified using the labor arbitrage model. Unfortunately, any real estate and tax savings that management was expecting for the original target market were projected to be completely wiped away by an increase in labor costs. Furthermore, due to competition for talent in the original target market, it would be very difficult to replace talent and hire for growth, putting additional upward pressure on labor costs going forward.

Figure B outlines the costs and savings components included in the model, based on a three-year phased relocation approach. Under this scenario, the bank would recoup their costs by 2017. Furthermore, they were able to gain a detailed understanding of the relative size and distribution of each of the cost elements, and where they could expect savings in the future.

Leveraging this analysis, management was able to change course, and decided to move away from the initial market. Based on talent supply and labor arbitrage potential, management made a successful business case to the CFO and CEO for selecting the new market identified by the model, and ultimately delivered an opportunity for future workforce cost savings in excess of US$150 million.

Conclusion

Successful execution of talent arbitrage requires leveraging the right workforce data, interpreting the story, and utilizing those findings to make better workforce decisions. Organizations can start small by focusing on a specific region or critical segment of their workforce before expanding their efforts to a more comprehensive analysis of their overall workforce. The key is to look beyond just head count. The biggest value lies in forecasting costs, skills, roles, and talent availability.

As the market for talent continues to evolve, and labor shortages become more pronounced, organizations that are slow to embrace workforce planning and talent arbitrage won't be able to compete in the war for talent. Linking workforce and business strategy is critical, and will better prepare organizations to adapt in an uncertain future. With more workforce data available than ever before, investing in predictive talent analytics will yield perhaps one of the largest returns on investment that organizations will see in the coming years.

About the Author

Grant Cooperstein has more than 10 years of experience conducting advanced workforce analytics and planning projects. In his current role, he provides guidance to organizations across the globe, enabling rapid advancement in human capital management practices. Responsible for leading consulting engagements, deep content training and product development, he helps clients drive value and quantify the impact of workforce decisions. Previously, Cooperstein worked as a human capital consultant for the Infohrm Group, a global analytics and planning company. There he led clients from Fortune™ 500 companies and government agencies on their human capital journeys, delivering millions of dollars in cost savings and value creation. He can be reached at ***grant.cooperstein@hcminst.com***.