Paying More to Get Less

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Most of us have had to deal with the situation where a leader is promoted or decides to leave the organization to pursue other opportunities. Either way, the question becomes who should be the replacement. Is it better to promote from within (build talent) or hire from the outside (buy talent)? Does it matter? What are the consequences of this choice?

Many managers believe it is better to buy (hire) talent than build (promote) talent. In fact, a large number of firms prefer to hire from the outside whenever possible. Outside hiring does have a certain intuitive appeal. For example, it enables a firm to set high expectations for the desired competencies. The broader labor market will usually have a more diverse array of talent with new/different/better skillsets than exist within one’s own company. Poaching talent from a competitor is a favored approach because not only can one hire a person with impressive credentials, but it also allows one to weaken the competitor’s talent and learn the competitor’s strategy and processes.

Hiring from the outside is also frequently expected to bring positive change. We see this when sports teams decide to hire a head coach from a different team rather than promote an assistant coach into the position. It also happens frequently in industry, where there is a preference to hire leaders from other organizations to be the new CEO. The thinking is that a new vision and fresh leadership will be more effective ways to change culture or grow business.

Most research suggests these expectations are wrong. Sadly, firms that hire from the outside (buy talent) will most likely pay more to get lower performance. In research that spans fast food restaurants to financial analysts, the following findings are very robust:
• **It costs more money to hire talent from the outside.** Hiring top candidates from competitors forces a firm to do more than pay competitively—it must pay *significantly better* than the competition to entice prospective hires to leave their existing firm (and quite frequently, uproot their family to a new location).

• **External hires usually perform worse than internal candidates.** Nearly all research suggests that, relative to internal candidates, external hires perform worse. External hires perform worse regardless of whether performance is based on objective data (such as individual or business unit sales), ratings from supervisors, or customer satisfaction.

• **The performance differences between external and internal hires last a long time.** One might assume that external hires perform worse than internal candidates because they are new to the firm; once they understand the company they will be more effective. In our research, we have found that internal hires outperform external hires for at least three years. It is true that the performance of external hires improves at a rate faster than internal hires, but it will take years for externals to catch up.

• **External hires are more likely to quit.** There are a few strikes against external hires that make them a flight risk. First, they are joining a company they don’t know much about. The new hire may have unmet expectations or may not fit the company culture. Second, they have already expressed a willingness to switch employers, which means they likely have a propensity for doing it again. Third, the external hire may look better on paper than on-the-job. In contrast, internal hires are more likely to remain with the firm because they already fit the culture. They have also already demonstrated sustained performance to be considered for the promotion. Hence, internal hires are likely to fit and require less adaptation to the new role.

• **External hires may positively change the culture—or they may not.** Employers who go outside with the intention of using an external hire to change culture are often disappointed. Culture change is difficult and it is fairly naive to believe a new hire with both learn the firm’s culture, and then learn how to change it in a *positive* manner (even when the new hire is able to choose his/her own key people).

The “build versus buy” choice is a perennial one in talent management. Fortunately, the choice is pretty clear: hire (promote) internally whenever feasible. Hire externally only when you lack the necessary internal talent (which is a different problem!), you want to make a conscious change and are willing to live with the risks of the change, or there is an intentional effort to infuse a small percentage of talent from outside the firm to keep things fresh. Ironically, a side benefit of aggressively promoting from within is that more external candidates will want to work for the company, because of its reputation as a firm that develops top talent!
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