# Strategic HR Review

10 steps to successful human capital management

Dr Stephen Young,

by Dr Stephen Young
ISR, Europe



# 10 steps to successful human capital management

## How strategic people management can make companies successful

CEOs often talk about people being their best asset, but how good are they at measuring and managing it? Not very, according to Dr Stephen Young, deputy regional director of ISR Europe. Here, he offers a 10-point plan to reaching HR's "Holy Grail" – effective human capital measurement and management.

MOST PEOPLE IN THE HR profession can put together a lucid argument for why human capital management (HCM) is crucial to the survival of their organization. One example could be something like "with emerging economies winning business because they offer faster and equal quality service for half the price, the West must focus on the high-value end of the production chain, which is driven by the knowledge, expertise and creativity of its people. It's imperative that we manage our human capital effectively to drive optimum performance." Our 10-point plan will guide you through the human capital management learning curve, which will at some points be steeper than others. But one thing is guaranteed: if you don't do it, your competitors will.

In the UK, the government is concerned by the country's lagging productivity levels in comparison to the US, France and Germany. In 2003, the government appointed the "Accounting for People Task Force" to look at ways in which organizations could measure the quality and effectiveness of their HCM.

The task force called for company directors to include information about HCM within their Operating and Financial Reviews (OFRs) or explain its exclusion. The statutory OFR came into force in April 2005 and must be produced by a company alongside its annual report and accounts. The OFR is designed to convey a board's understanding of the factors that most affect the organization's performance.

Denise Kingsmill, the task force chairwoman, said: "Directors need to transform the airy cliché about people being their greatest asset into a guiding principle of business strategy."

### A different reality

ISR's own experience is that not many organizations are doing a good job of measuring, reporting on and managing their human capital. When it comes to the "what" and the "how" of HCM, the lucidity of the "why" seems to disappear. HCM's importance is clear, but what exactly is it that we are trying to achieve? The Accounting for People Task Force describes it like this: "Human capital management is an approach to people management that treats it as a high-level strategic issue and seeks to systematically measure how people policies and practices create value."

To understand the extent to which measurement and management of human capital is happening in organizations, ISR recently conducted a survey of senior executives, managers and HR professionals called "Measuring and managing human capital in today's organizations: A study of company practice." The sample of 100 respondents included a broad mix of industry sectors and countries across the world.

At first sight, the results suggested that a high degree of human capital management was taking place within organizations. Ninety-one percent of respondents said their organizations had some business performance measures that related to human capital. As many as 58 percent were including some kind of human capital measure in their organization's "Key Performance Indicators" (KPIs) or scorecards and 48 percent said they actively assessed human capital value and its impact on business performance.

On the face of it, these were quite high numbers, but a closer look at the findings, including the actual metrics respondents were using to measure human capital, failed to back up the initial positive numbers. Organizations may truly believe they are measuring and managing their human capital, but in reality, many have little idea of what HCM truly means and are consequently making a very poor attempt at it. With this in mind, based on what the world's best organizations do, we have devised a 10-point plan to help companies change their approach to human capital measurement and management.

## 1. Know where you are

Not all organizations have the same level of resources to implement human capital measurement and management systems. What a company like Royal Bank of Scotland is capable of will be very different to what a small- to medium-sized enterprise (SME) can manage. When speaking to organizations about their HCM capability, we're seeing a wide range in the sophistication of approach. There are four phases to human capital measurement (see Figure 1, above right):

*The early phase:*
At the beginning of the HCM journey, companies should develop a few simple measures that relate to their business strategy. For example, a company pursuing a customer-focused strategy could measure how customer-focused employees feel the company is.

*The benchmarking phase:*
At the next level, organizations need to benchmark the scores their HC metrics are giving them against the same metrics in other organizations. Without benchmarking, it's impossible to know whether those scores are good or bad.

*The linkage phase:*
This level begins to link a number of your HC metrics together to develop an understanding of how the organization performs. For example, you might start to see a relationship between employee views on leadership in the company and business performance.

*The mature phase:*
At this stage, organizations are developing metrics that can predict business performance and are integrating those metrics into the strategic management decision-making process.

Figure 1. The four phases of the human capital measurement journey

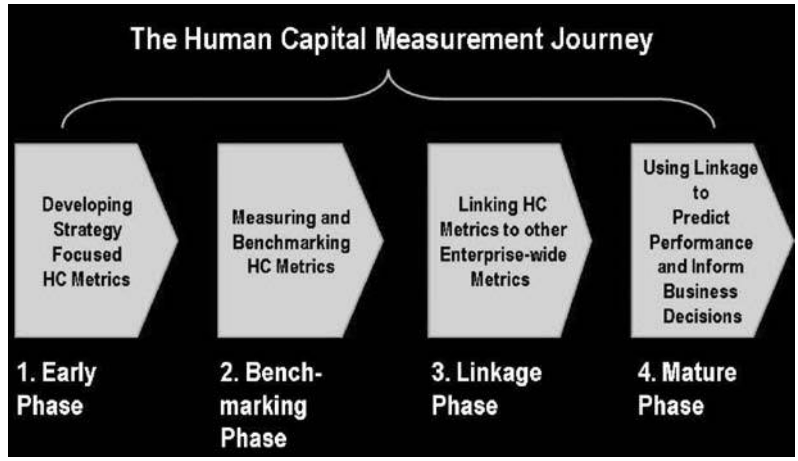
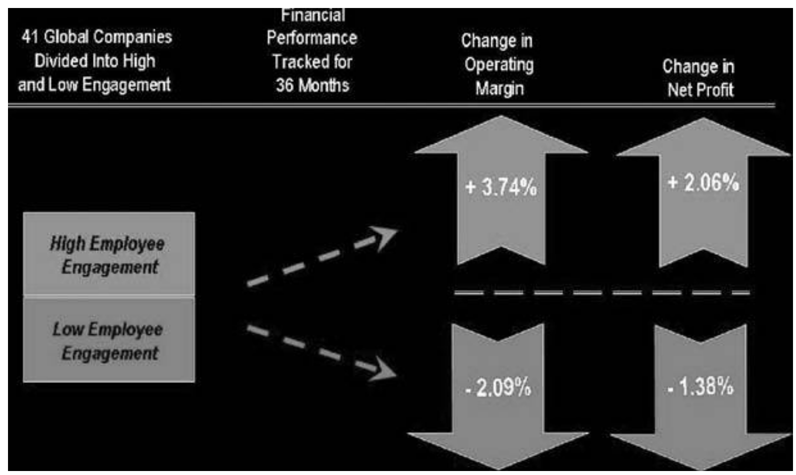



Figure 2. How employee engagement impacts financial performance




You must know where you are on the HCM journey and aim for what's achievable. A lot of the debate about HCM focuses on the mature phase, where it's highly sophisticated, integrated and dynamic. That just won't be appropriate for many smaller organizations and it can put them off from making any contribution at all.

## 2. Make the business case

Making the business case is absolutely fundamental to any attempt at managing the human capital within your organization. The evidence to back the business case is there, both internally and externally – you just need to find it.

In a study that tracked companies over a three-year period, we showed that companies with very high levels of employee engagement showed an increase in net profit, whereas companies with a low level of employee engagement showed a decline in net profit (see Figure 2, above). This sort of evidence can be very powerful in helping the HR community get the buy-in of the executive team.

**Stephen Young** is deputy regional executive director, ISR, Europe. He is a chartered psychologist and has been working in the field of organizational research and consultancy for 10 years. During this time he has managed successful organization development programs in major UK industries.

Figure 3. The characteristics of high-performing organizations

The center line is average % favorable of employees in over 40 countries. The bars show difference in % favorable in ISR's Global High Performance Norm.


Unless that can be done, HR will go round in circles.

### 3. Plan how to get there

If you observe companies that are successful at HCM, you'll see that they don't just try to introduce one or two metrics and leave it at that. They are canny and strategic about getting support from within the organization and embedding the idea of HCM throughout the company.

The ISR survey revealed that 43 percent of organizations included human capital measures within senior executive appraisals and 30 percent included them as part of their senior executive bonus system. In these cases, typically around five to 10 percent of the total amount of senior executive bonuses was linked to HCM. For some companies, human capital is clearly being factored into performance and reward for senior people, but the numbers suggest this is a token effort, with limited emphasis on the value of human capital and how to manage it for improved performance. For success in this area, you need to be able to answer "yes" to questions such as:

- Do you have the buy-in and commitment of senior leadership?
- Do you have an HCM strategy to implement?
- Have you demonstrated the business value of HC to your organization? Have you made the business case?
- Is your HCM strategy sponsored by the business?
- Is HC an integral part of your company's business performance metrics?
- Is the importance of HCM embedded into your executive coaching programs?
- Are you working with other non-HR internal stakeholders, such as marketing, to ensure an integrated strategy?

In our survey, very few HR directors were able to answer these questions positively. My guess is that very few were being successful.

### 4. Remove the barriers

Anyone who understands organizational change knows that they need to remove the barriers to that change. Many organizations aren't doing that because they just don't know how to get from A to B. In our survey, a couple of the reasons respondents gave to why they are not measuring human capital were:

- "We lack systems to measure performance despite the fact that measurement is absolutely essential."
- "The primary reason is a lack of understanding, more than a lack of desire or will."

Identifying the barriers is simple. Talk to people in the business about why they don't want to go down this particular route. To remove these barriers, use your organizational development resources – that's what they're there for.

### 5. Establish the appropriate metrics

You need to understand what your organization's business strategy is in order to put in place the appropriate metrics. One standard set of metrics may not be appropriate for every organization. In our survey, the top five HC measures companies were using were:

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|---|---|---|
| 1. | Headcount | 56 % |
| 2. | Employee surveys | 47 % |
| 3. | Productivity | 44 % |
| 4. | Training hours | 40 % |
| 5. | Recruitment and selection costs | 37 % |

Are people using these because they are the most appropriate measures in understanding what supports their business strategy, or simply because they are the most convenient metrics? It's probably the latter because a lot of these measures are lagging indicators; they tell you how you're performing *after* the fact.

Measures that reflect business strategy need to be seen as standard HR metrics. For example, a company is competing by offering first-class service to its customers – what would the measures listed above tell its managers about the contribution its *people* are making to that objective? The answer is, very little.

At ISR, we are increasingly being asked to help our clients implement such strategy-related people measures, which can provide them with leading indicators of their strategy.

### 6. Understand your cultural context

Every country has its own unique national culture. If a multinational company develops one standard set of HC metrics, the scores for each country will vary depending on its culture. For example, employees that show deference may be valued in Asian countries, but perhaps not in the West.

If you're a multinational, you need to have different metrics for different countries based on what's culturally appropriate. So, benchmarking needs to be done on a country-by-country rather than global basis.

### 7. Know what it takes to become a high performer

When you look at the characteristics of what makes organizations financially successful in their particular sector, you find they have a particular profile (see Figure 3, left). The diagram lists, according to 30 years of ISR research, the characteristic employee opinion scores of high performing organizations, in order of importance, compared to "average" companies.

Companies that work to fix leading indicators such as leadership, strategic direction, communication or their focus on the customer tend to perform highly. Companies that primarily focus on soft measures such as morale or stress tend to perform less well because these measures do little to predict successful execution of strategy. Unfortunately, many organizations focus on these things because they are easier to measure. To be a high-performing organization, make sure you start with leading indicators.

### 8. Don't just measure it, integrate it

Once organizations are using the right HC metrics, it's important to be able to integrate them with other business metrics. Creating a "Human Capital Enterprise Scorecard" will help to show how levels of employee engagement in different divisions of a company can directly impact on sales, customer satisfaction, leadership and ultimately, the amount of money generated per employee.

A lot of what we see in successful organizations is the ability to integrate measures together in ways that are understandable to business people. To establish the link between HCM and the "bottom line" in your leadership team's minds, you need to speak their language.

### 9. Create a dynamic dashboard

The nirvana that many organizations are trying to achieve is a dynamic dashboard of business performance metrics that work in real time. For example, you have just seen a drop in your employees' views on how customer-focused you are as an organization. How will you know what impact that is likely to have on business performance? A dynamic dashboard will show you that if your employees believe that now, what you are likely to see in the future is less satisfied customers, a drop in sales performance, increased employee turnover and decreased profitability. The dashboard helps you avoid that scenario and buys you time to refocus the organization on the customer to avert those disastrous results.

The most impressive organizations in HCM are aiming for this. There are very few that have reached that point but many are working at it and this is what effective HCM is all about – it gives input into management decision making.

### 10. Give ownership to the business

Give ownership of this whole process back to the business. It can't be owned solely by HR because it's about things that impact business performance. If it remains the preserve of HR it will struggle to become something that informs decision making. So, how do you sell it back to the business?

- Inform and educate.
- Keep it simple, clear and actionable.
- Require all strategic decisions to incorporate HC impact analysis.
- Demonstrate that HC is no longer to be seen as a heavy cost to the business, but a worthwhile investment with great returns.

### Beating the competition

Companies are beginning to take human capital seriously as a driver of competitive business advantage. There are many different ways firms have approached this and many organizations clearly have the desire to put human capital at the core of how they operate.

The challenge is to find ways of reliably assessing human capital, aligning these metrics to business strategy, understanding the impact of human capital on business performance and embedding this into how the company is run.

It may seem like a mountain to climb but the mantra "people are our greatest asset" is in danger of wearing thin if we don't make it a living reality that delivers promised benefits. If you don't learn how to implement HCM properly, you'll be left behind. It's a source of significant competitive advantage and when done well, it demonstrates direct business impact.

### ISR

**ISR is an international employee research and consulting business. It helps organizations to improve employee engagement, retain key talent, increase productivity, enhance customer satisfaction and increase shareholder value. ISR has surveyed more than 35 million employees from over 3,000 companies in 106 countries. For more information, visit: www.isrinsight.com.**

CONTACT
Stephen Young
E-mail: stephen.young@isrinsight.com