AN INVESTMENT PERSPECTIVE OF HUMAN RESOURCE MANAGEMENT

The Strategic View of Human Resources

- Employees are human assets
  - Increase in value to organization and marketplace when investments of appropriate policies & programs are applied
- Effective organizations recognize that employees have value
  - Much as organization’s physical & capital assets have value
- Employees are valuable source of sustainable competitive advantage

Exhibit 1.1
Sources of Employee Value

- Technical Knowledge
  - Markets, processes, customers, environment
- Ability to Learn and Grow
  - Openness to new ideas
  - Acquisition of knowledge & skills
- Decision Making Capabilities
- Motivation
- Commitment
- Teamwork
  - Interpersonal skills, leadership ability
Adopting an Investment Perspective

- Determines how to best invest in people
- Costs
  - Out-of-pocket
  - Opportunity
- Human assets become competitive advantage
- Required skills become less manual, more knowledge-based
- Appropriate, integrated, strategy-consistent approach is needed

A Dilemma

- Failure to invest in employees causes
  - Inefficiency
  - Weakening of organization’s competitive position
- Human assets are risky investment
  - Require extra effort to ensure that they are not lost

Exhibit 1.2 Types of Organizational Assets/Capital

<table>
<thead>
<tr>
<th>Type of Asset</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial</td>
<td>Investments, securities, loans</td>
</tr>
<tr>
<td>Physical</td>
<td>Plants, equipment, raw materials</td>
</tr>
<tr>
<td>Human</td>
<td>Knowledge, skills, reputation</td>
</tr>
<tr>
<td>Market</td>
<td>Customer relationships, trademarks</td>
</tr>
<tr>
<td>Operational</td>
<td>Management practices, processes</td>
</tr>
</tbody>
</table>

Research Findings

- HR practices directly related to profitability & market value
- Primary reason for profitability:
  - Effective management of human capital
- Integrated management of human capital can result in 47% increase in market value
- Top 10% of organizations studied experienced 391% return on investment in management of human capital
Wall Street analysts still generally fail to acknowledge human capital in assessing the value of an organization and the effect that human resources can have on stock price. This is rooted in the fact that there are no “standard” metrics or measures of human capital, much as there are for other organizational assets. Exhibit 1.4 lists some Common HR Metrics while Exhibit 1.5 displays the means of calculating five common metrics. However, the appropriate metrics for any given organization will be dependant on that organization’s strategy.
Exhibit 1.5 (cont.)
Calculation of Human Capital Metrics

<table>
<thead>
<tr>
<th>Metric</th>
<th>Formula</th>
<th>Value Use</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human Capital Value Added</td>
<td>Revenue - (Operating Expenses - Compensation - Benefits Costs) / Total number of FTE employees</td>
<td>Shows the value of employee knowledge, skills and performance and how human capital adds value to an organization.</td>
</tr>
<tr>
<td>Turnover Rate</td>
<td>[Number of employee separations during a given time period] / [number of employees]</td>
<td>Provides a measure of workplace retention efforts which can impact direct costs, stability, profitability, morale, and productivity; can be used as a measure of success for retention and reward programs.</td>
</tr>
</tbody>
</table>

HR Metrics Are Complex

- 90% of Fortune 500 organizations evaluate HR operations on basis of three metrics:
  - Employee retention and turnover
  - Corporate morale
  - Employee satisfaction

- These metrics do not necessarily illustrate how HR impacts:
  - Profits
  - Shareholder value

Mercer Model of Measuring HR Impact

- Identify problem HR can impact
- Calculate actual cost of problem
- Choose HR solution that addresses problem
- Calculate cost of solution
- Calculate value of improvement 6 to 24 months after implementation
- Calculate specific return on investment
- ROI in human assets often not realized until some time in future

Factors Influencing Investment Orientation

<table>
<thead>
<tr>
<th>Management Values</th>
<th>Utilitymight</th>
</tr>
</thead>
<tbody>
<tr>
<td>Attitude Toward Risk</td>
<td>Availability of Outsourcing</td>
</tr>
<tr>
<td>Nature of Employee Skills</td>
<td></td>
</tr>
</tbody>
</table>
### Investment-Oriented Organization
- Sees people as central to mission & strategy
- Mission statement & strategic objectives espouse value of human assets in achieving goals
- Management philosophy encouraging development & retention of human assets
- Does not treat human assets in same ways as physical assets

### Investment Orientation Factors
- Senior Management Values & Actions
  - Managers need “investment orientation” toward people
- Attitude Toward Risk
  - Investment in human resources inherently riskier
  - Human assets never absolutely “owned”
- Nature of Skills Needed by Employees
  - The more marketable employee skills, the riskier the firm’s investment in skill development

### Investment Orientation Factors
- Utilitarian (“Bottom Line”) Mentality
  - Attempt made to quantify employee worth through cost-benefit analysis
  - “Soft” benefits of HR programs difficult to objectively quantify
- Availability of Outsourcing
  - Given availability of cost-effective outsourcing, investments in HR should produce highest returns & sustainable competitive advantages

### Reading 1.1: The Hidden Leverage of Human Capital
- Model for Management Success
  - Strengthen key relationships
    - Customers
    - Employees
    - Shareholders
  - Leverage downtime
    - Use variable-pay
    - Address neglected areas:
      - Infrastructure
      - Marketing
      - Operations
**Reading 1.1**

**Model for Management Success**

- Refocusing staff on what’s important
  - Performance management as disciplined, strategic, value-added process
  - Clearly define, differentiate & balance between core competencies & results

- Building return on compensation
  - Link base-pay progression to competency achievement
  - Link incentive pay to annual, semiannual, or quarterly results

**Reading 1.2**

**Seven Common Misconceptions**

1. Conscientiousness is a better predictor of performance than intelligence.
2. Companies that screen job applicants for values have higher performance than those that screen for intelligence.
3. Integrity tests don’t work well in practice because so many people lie on them.
4. Integrity tests have adverse impact on racial minorities.

**Reading 1.2**

**Seven Common Misconceptions: Implications**

1. Select new employees on both intelligence and conscientiousness.
2. Assess intelligence and conscientiousness before values.
3. Define the values that are important and assess them through carefully developed, valid procedures.
4. Use integrity tests with ability tests for high predictability.

5. Encouraging employee participation is more effective for improving organizational performance than setting performance goals.
6. Most errors in performance appraisal can be eliminated by providing training to managers on how to avoid them.
7. If employees are asked how important pay is to them, they are likely to overestimate its true importance.
Reading 1.2
Seven Common Misconceptions: Implications

5. Develop compelling goals; enlist participation and support it through rewards.
6. Training and feedback are important, but errors are difficult to eliminate. Top managers should serve as role models in quality of performance reviews.
7. Attitude surveys are subject to biases; study behaviors as well as attitudes.

Reading 1.3
Maximizing Human Capital

• Human capital is defined as the collective knowledge, skills and abilities of people that contribute to organizational success
• Human capital is influenced by corporate culture, organizational values and strategic business goals and objectives and indicates the health of an organization
• Human capital can be assessed via key performance indicators (KPIs) which are quantifiable, specific measures of an organization’s performance in critical areas of its business

The HR scorecard is a key management tool which can strengthen HR’s strategic influence in an organization. The scorecard has four perspectives: strategic, operational, financial and customer. These four perspectives organize and track areas in which HR adds value:
• The strategic perspective focuses on measurements of effectiveness or major strategy-aligned people goals.
• The operational perspective reflects the effectiveness of HR processes.
• The financial perspective relates to financial measures of HR value to the organization.
• The customer perspective focuses on the effectiveness of HR from the internal customer viewpoint. Specific measures for each of these perspectives are provided in Figure 3. KPIs can also be effectively utilized in the global HR function as indicated in Figure 4.

Four recommendations are provided for developing specific KPIs tailored to a given organization’s strategy
1) qualitative measurement is one path to assess qualitative characteristics of the workforce, such as engagement
2) employee feedback provides useful perspectives on HR efficiency
3) whenever possible, the impact of recruiting is best described in terms of financial gains
4) retaining older workers for future leadership roles depends on what the employer values