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TOOL KIT

Maximizing Your Return on People

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by Laurie Bassi and Daniel McMurrer

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Managers are fond of the maxim "Employees are our most important asset." Yet beneath the rhetoric, too many executives still regard—and manage—employees as costs. That's dangerous because, for many companies, people are the only source of long-term competitive advantage. Companies that fail to invest in employees jeopardize their own success and even survival. In part, this practice has lingered for lack of alternatives. Until recently, there simply weren't robust methods for measuring the bottom-line contributions of investments in human capital management (HCM)—things like leadership development, job design, and knowledge sharing. That's changed. Over the past decade, we have worked with colleagues worldwide to develop a system for assessing HCM, predicting organizational performance, and guiding organizations' investments in people.

Using the framework we describe here has the obvious and immediate practical benefit of improving organizational performance. More broadly, though, as the links between people and performance come into focus, organizations will also begin to appreciate the long-term value of investments in human capital—and the folly of dwelling on narrow, near-term goals.

Measuring Management

When we researched the key HCM drivers of organizational performance, we found that most traditional HR metrics—such as employee turnover rate, average time to fill open positions, and total hours of training provided—don't predict organizational performance. (One important exception is training expenditure per employee, as we described in our Forethought article "How's Your Return on People?" HBR March 2004.)

After selecting the HCM best practices that had been previously identified in organizational-development, HR, and economics research literature as determinants of organizational performance, we developed employee and management surveys to measure their use by organizations. Collectively, the survey ques-

tions helped us assess overall HCM activity in dozens of organizations—ranging from service firms to manufacturers to schools—and identify which measures were most strongly associated with various aspects of organizational performance.

This empirical research has revealed a core set of HCM drivers that predict performance across a broad array of organizations and operations. These drivers fall into five major categories: leadership practices, employee engagement, knowledge accessibility, workforce optimization, and organizational learning capacity. In each of those categories, HCM practices are subdivided into at least four groups. Leadership practices, for example, include those related to managerial communication, inclusiveness, supervisory skills, executive skills, leadership development, and succession planning systems. (For more on HCM categories and practices, see the exhibit "Human Capital Drivers.")

By using rigorously designed surveys to score the organization on the range of HCM practices across the five major categories, it's possible to benchmark organizational HCM capabilities, identify HCM strengths and weakness, and link improvements or backsliding in specific HCM practices with improvements or shortcomings in organizational performance.

This process requires determining a 1 to 5 "maturity" score for each practice. A score of 1 on executive skills, for example, indicates poor performance (low maturity); a score of 5 indicates strong performance (high maturity). (For more on the HCM scoring system, see the exhibit "Your HCM Maturity Level.") Thus, with multiple surveys over time, evolving maturity scores can reveal progress or regression in each of the HCM practices and help a company decide where to focus improvement efforts that will have a direct impact on performance.

We've used this tool to analyze and improve the performance of 42 organizations over the past five years. Our work shows that although organizations should generally strive toward superior HCM across the board, the practices that have the greatest effect can vary within and across organizations and change with time.

Like Six Sigma techniques, which reduce defects by managing manufacturing process variations, our HCM methodology can be used to identify and manage process variations in human capital management that negatively affect organizational performance. It's time for HR departments to move beyond their usual focus on activities and process efficiency, such as the number of training courses offered or how long it takes to fill a vacant position. With HCM measurement tools, HR can start gauging how well people are managed and developed throughout the organization. In this role, HR departments can take on strategic responsibility, acting as coaching, mentoring, and monitoring agencies to ensure that superior management of human capital becomes a central part of the organization's culture.

Proof in the Performance

The power of HCM improvements to drive performance can be seen in a diverse array of organizations. Consider the following cases, involving a large manufacturer, a public school system, and a group of financial services firms. In each case, HCM maturity scores are directly linked to a range of performance outcomes.

Improving sales and safety at American Standard Companies. Over the past four years, we have worked with American Standard—a manufacturer of global air-conditioning systems, bath and kitchen products, and vehicle control systems—to track and improve its HCM performance across business units. Our analysis has enabled us to pinpoint the HCM practices that most consistently predict sales productivity and factory safety.

In the exhibit "Improved HCM Scores at American Standard Companies…" the top chart shows a comparison between the average three-year compound annual growth rate in income for the 50% of sales offices in the major business unit that boasted the largest maturity-score improvements with the income growth rate for the 50% of offices that had the smallest. In four out of the five categories, the growth rate for the higher-scoring offices ranged between about 60% and 130% above the growth rate for the offices with smaller improvements (or declines) in HCM maturity.

Further analysis identified several specific HCM factors for which high maturity scores were most closely associated with high sales performance, including executive and supervisory skills (both in the leadership practices category), information sharing (in the knowledge accessibility category), and innovation (in the

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learning capacity category). Interestingly, in the employee engagement category, higher maturity scores were associated with a *lower* sales growth rate. This counterintuitive result highlights how idiosyncratic the relation between HCM practices and organizational performance can be; there is no one-size-fits-all HCM approach. In American Standard's case, it seems clear that an excessive focus on employee engagement at the expense of the other four categories would have been a mistake.

Armed with this analysis and the specific measures of HCM strengths and weaknesses for more than 300 locations, American Standard's HR staff developed prioritized action plans to close the most critical gaps in HCM maturity at each location, resulting in overall improvement in sales growth rates.

A similar study in American Standard manufacturing plants revealed a strong relationship between HCM practices and accident rates. One year after our initial analysis, we compared the mean accident rates of plants with HCM maturity scores in the top 50% of each of

Human Capital Drivers

Organizations' strengths and weaknesses in human capital management (HCM) can be assessed by monitoring the performance of each of 23 HCM practices that fall within five broad HCM driver categories. In general, improvements or declines in organizational performance can be tied directly to improvements or declines in HCM practices.

HCM Drivers	Leadership Practices	Employee Engagement	Knowledge Accessibility	Workforce Optimization	Learning Capacity
HCM Practices	*Communication* Management's communication is open and effective.	*Job Design* Work is well organized and taps employees' skills.	*Availability* Job-related information and training are readily available.	*Processes* Work processes are well defined, and training is effective.	*Innovation* New ideas are welcome.
	Inclusiveness Management collaborates with employees and invites input.	*Commitment* Jobs are secure, employees are recognized, and advancement is possible.	*Collaboration* Teamwork is encouraged and enabled.	*Conditions* Working conditions support high performance.	*Training* Training is practical and supports organizational goals.
	Supervisory skills Managers eliminate barriers, provide feedback, and inspire confidence.	*Time* Workload allows employees to do jobs well and enables good work/life balance.	*Information sharing* Best practices are shared and improved.	*Accountability* High performance is expected and rewarded.	*Development* Employees have formal career development plans.
	Executive skills Senior executives eliminate barriers, provide feedback, and inspire confidence.	*Systems* Employee engagement is continually evaluated.	*Systems* Collection systems make information easily available.	*Hiring* Hires are chosen on the basis of skill; new hires complete a thorough orientation.	*Value and support* Leaders demonstrate that learning is valued.
	Systems Leadership-development and transition systems are effective.			*Systems* Employee performance management systems are effective.	*Systems* A learning management system automates aspects of training.

the five major categories with those of plants whose scores were in the bottom 50% (see the bottom chart in the exhibit "Improved HCM Scores at American Standard Companies…"). As the exhibit shows, the mean accident rates for plants with high HCM maturity scores were between about 10% and 30% lower than the rates for plants with low scores. Thus, high HCM maturity scores in plants, indicating above average human capital management practices, predicted low accident rates the following year.

An analysis of which HCM practices were most closely associated with low accident rates found that the safer plants excelled in three areas: supervisory skills (in the leadership practices category), information sharing (in the knowledge accessibility category) and supporting employee skill development (in the learning capacity category).

Using this information, American Standard's safety staff prioritized its efforts, addressing the specific HCM issues that were creating the greatest safety risks at the locations with the lowest HCM scores. In particular, the staff provided additional targeted training to thousands of workers on safety issues, focused on improving the organization's overall safety processes, and conducted more than a dozen global workshops that emphasized the importance of leadership at all levels in reducing accidents.

Your HCM Maturity Level

Level 1
Organization makes little or no attempt to address the stated HCM area or factor.

Level 2
Organization makes cursory, nonsystematic attempts to address at least some component of the stated HCM area or factor.

Level 3
Organization demonstrates adequate, or baseline, capability that forms a good foundation for improvement in the stated HCM area or factor.

Level 4
Organization is beginning to systematically extend capability in the stated HCM area or factor.

Level 5
Organization consistently demonstrates superior capability in optimizing its human capital management in the stated HCM area or factor.

Raising test scores in South Carolina schools. South Carolina's Beaufort County School District (BCSD) is the largest employer in its county, providing jobs for more than 1,500 instructional staff members and 1,200 other staff members to serve a growing, economically and racially diverse, student population of 19,000. Located in one of the wealthiest counties in the state (albeit one with pockets of high poverty), the district has not been lacking for funds. Yet, for years, the average scores of BCSD's student state achievement tests lagged behind the averages for similar school districts in the state.

To the great annoyance of many parents, teachers, and school district leaders, the students' lackluster performance often was attributed to the students themselves: Many come from low-income families, and the district serves a large number of Latino and African-American youngsters. As a result, some educators suggested in interviews that the county's schools were doing as well as they could, given the population they served.

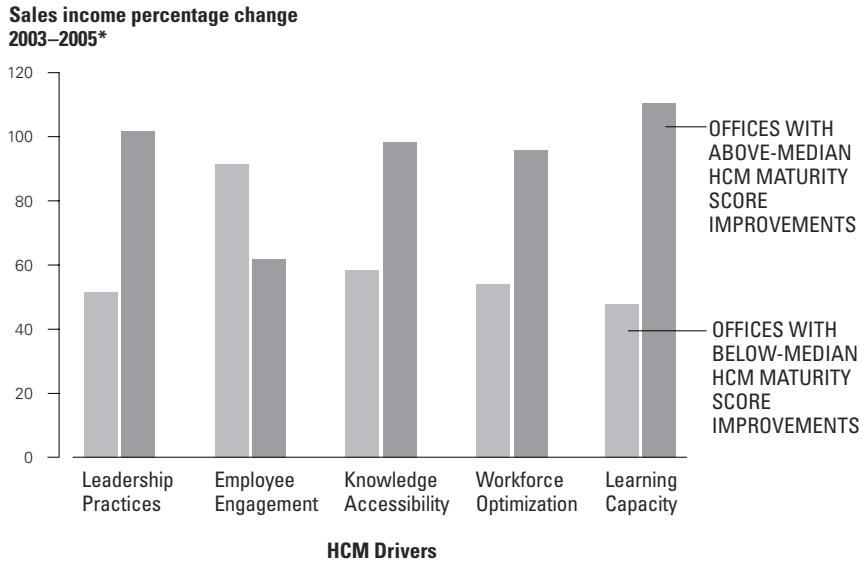
Getting past the excuses and improving students' performance became a priority for BCSD leaders. To that end, we have worked with BCSD for the past four years to help its schools identify and manage the HCM practices that created the biggest impact on student achievement. Our initial audit in 2002 revealed wide disparities on the HCM maturity scale among schools, although, when combined, the schools received a disappointing average maturity score of 2. On some measures, such as team leadership and leadership capability, many schools received a score of 1, indicating wholly inadequate HCM practices. It was difficult for district leaders to acknowledge these results and even harder for school leaders to accept them. But they couldn't ignore the correlations we found between HCM maturity scores and scores for individual schools on South Carolina's mandatory Palmetto Achievement Challenge Tests (PACT).

Put simply, the students who attended schools with high HCM maturity scores in key areas (such as employees' learning culture and work design) performed better, on average, on state achievement tests than their peers in other schools, even after controlling for socioeconomic status. What's more, a high maturity score on "teaching to standards"—a customized set of questions that we created for BCSD to respond to its initial interest in that issue—

Improved HCM Scores at American Standard Companies…

Drive Sales Income Growth

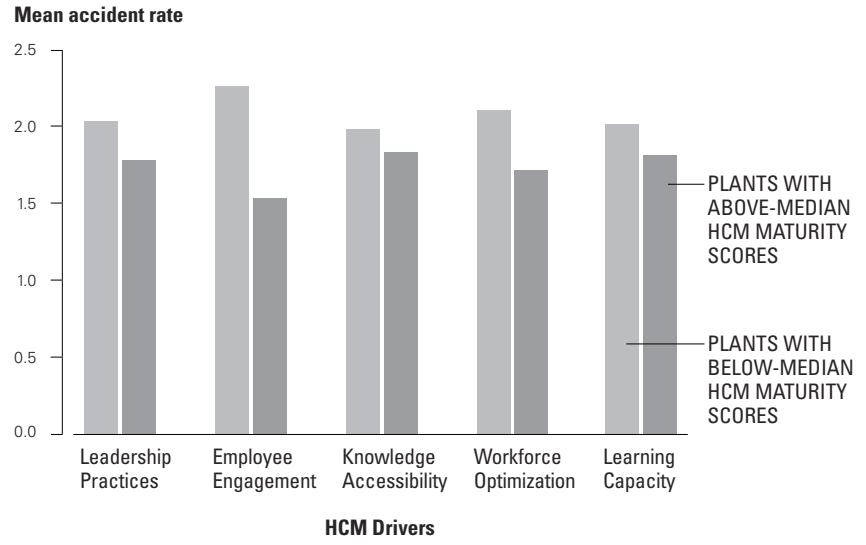
In four of five human capital management (HCM) driver categories, American Standard sales offices whose HCM score improvements were above the median had greater income growth rates than offices whose scores were below the median.



*Mean 3-year compounded annual growth rate (%) in segment income, by sales office, January 2003 to December 2005.

Reduce Plant Accidents

American Standard plants with above-median HCM scores in each of the five HCM driver categories on initial assessment had lower accident rates a year later than plants with below-median scores. (The accident rate reflects the number of recordable safety incidents per 100 employees over a given period.)



had a lower correlation to student achievement than did high scores in any of the five standard human capital management categories. Schools with the biggest gains in HCM maturity scores have, on average, experienced the greatest increases in student achievement. The exhibit "Higher HCM Scores Improve Students' Test Performance" shows the relationship between those schools' HCM maturity scores and growth in students' achievement in math.

Our results revealed that the school district's traditional emphasis on teaching to state standards had less to do with student performance than did the teachers' overall work and learning culture, the schools' ability to reinforce and retain talent, and other factors relating to human capital processes. This finding challenged most people's assumptions about the way to improve achievement, the impact of student socioeconomic status, and the role of leadership in creating successful work and learning environments.

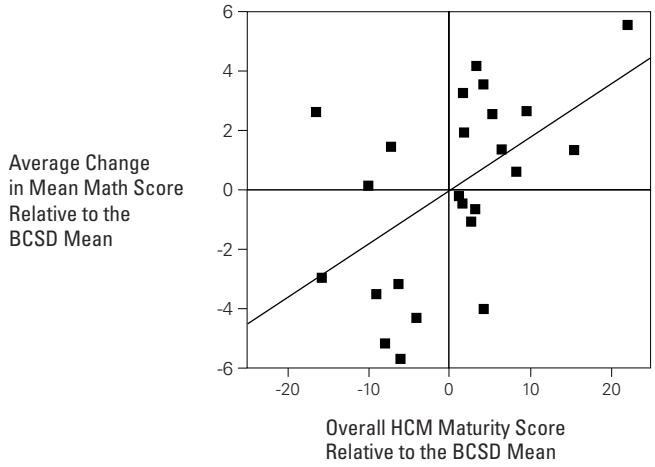
Based on this analysis, BCSD has restructured its approach to teachers' professional development, making it more centralized (as opposed to site based) and introducing greater consistency in teachers' use of proven instructional approaches. In addition, the district has expanded its focus on leadership development, restructured its HR department, and incorporated the results of the annual HCM assessment at each school into biannual performance reviews of the schools' leaders.

Increasing returns in financial services. The final case, in financial services, illustrates the power of HCM to drive stock performance.

In late 2004, we gathered HCM maturity data on 11 publicly traded financial-services firms. A year later, we took a look at the stock performance for each one of those firms. As the exhibit "Higher HCM Scores Predict Stock Returns for Financial Firms" demonstrates, half of the firms—which are represented by the five light gray data points clustered around the center of the chart—had average HCM practice scores and subsequent stock appreciation. As a group, the three firms that scored below average on HCM maturity (the data points in dark gray) had significantly lower subsequent stock appreciation than the three firms that measured above average on HCM maturity (the data points in medium gray).

Higher HCM Scores Improve Students' Test Performance

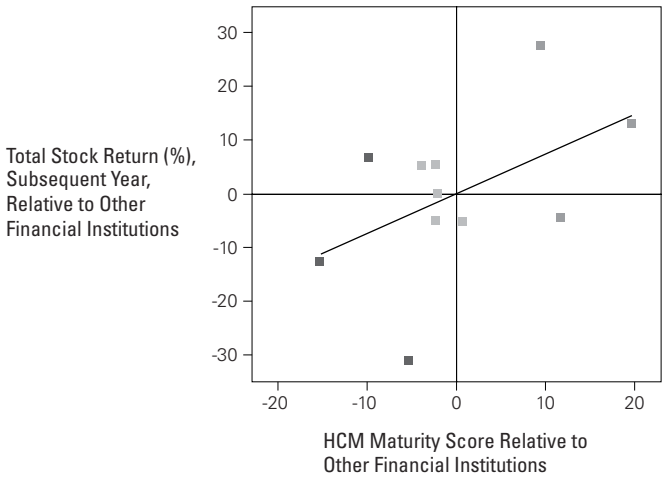
In South Carolina's Beaufort County School District, the higher a given school's human capital management (HCM) score, the greater the students' improvement on a standardized math test. (Each data point shows a single school's overall HCM maturity score on a 100-point scale and academic-year change in mean math score[1] relative to the average maturity score and change in math score for all schools in the district.)



1. Math score as assessed by the Northwest Evaluation Association's Measures of Academic Progress (MAP) in fall 2005 and spring 2006.

Higher HCM Scores Predict Stock Returns for Financial Firms

Financial services firms with higher human capital management (HCM) scores in an initial assessment trended toward higher stock-market returns a year later than firms with lower HCM scores. (Each data point represents one firm. HCM maturity scores on a 100-point scale and stock returns for each are calculated relative to the average for all 11 firms.)



Though this is a small sample, and though the relationship between HCM and stock appreciation is imprecise, the case aligns with our broad findings linking HCM and performance over many years and many different types of organizations.

Assessing Yourself

Just as Six Sigma techniques involve continuous refinement of processes based on feedback, the HCM evaluation approach is used iteratively: An initial assessment indicates the HCM changes that should positively affect performance; performance responds to the changes; HCM practices are reevaluated, leading to further rounds of suggested changes; and so on. Note that as organizations and their environments evolve, the key HCM factors that drive performance may shift. Thus, it's important to regularly measure and adjust HCM practices and correlate them with organizational outcomes.

Two types of data are necessary in order to perform such an analysis: measures collected through employee and management surveys that can be used to quantify HCM performance and measures of organizational performance. Typically, the latter comprise key business outcomes across units—either financial (such as sales productivity, profit margins, or revenue per employee) or nonfinancial (such as safety, customer satisfaction and loyalty, or employee retention)—and are usually tracked by the office of the CFO or COO. As part of the employee survey, measures of employee commitment (such as a willingness to contribute discretionary effort or to recommend the company to friends as a great place to work) may also be collected.

HCM data capture and analysis proceeds in three steps:

Step 1. Employees and managers are surveyed to quantify variations in HCM maturity across functions, business units, regions, and job categories and also to document organizational HCM strengths and weaknesses.

Step 2. Variations in HCM maturity are linked to variations in key organizational outcomes, either financial or nonfinancial. This step identifies which HCM factors are most critical to organizational performance. (For more on this process, see the sidebar "Linking HCM Scores and Outcomes.")

Step 3. Findings from the first two steps are

HCM Survey

Rate your organization on each statement, using a 1-to-5 scale (1, strongly disagree; 2, disagree; 3, neutral; 4, agree; 5, strongly agree). Offer your best guess for any item that you are uncertain about, and make sure to check the "Not Sure/Don't Know" box that corresponds to it. Then, follow the instructions at the end of the survey to estimate your organization's HCM effectiveness.

	Score (1 to 5)	Not Sure/ Don't Know
Leadership Practices		
Communication. Senior executives and managers are open and honest in their communications; have an effective process in place for communicating news, strategies, and goals to employees; and ensure that employees know what is expected of them.		
Inclusiveness. Senior executives and managers seek and use employee input, work in partnership with employees, and treat them with respect.		
Supervisory skills. Managers demonstrate organizational values, eliminate unnecessary barriers to getting work done, offer constructive feedback, provide employees with performance appraisals, and inspire confidence.		
Executive skills. Senior executives demonstrate organizational values, eliminate unnecessary barriers to getting work done, offer constructive feedback, and inspire confidence.		
Systems. Highly effective systems and processes are in place to identify and develop the next generation of leaders and ensure smooth leadership transitions.		
Add items in above section, then multiply by 0.8 for **Subtotal**		
Employee Engagement		
Job design. Work is effectively organized, makes good use of employees' talents and skills, and is interesting and meaningful. Employees have appropriate responsibility to determine how best to do their work, and creative job designs help make jobs fit employees' needs.		
Commitment to employees. Employees are secure in their jobs, recognized for their accomplishments, and provided with opportunities for advancement.		
Time. The workload allows employees to do their jobs well, make thoughtful decisions, and achieve an appropriate balance between work and home.		
Systems. Systems help retain good performers by continually evaluating trends in employee engagement and providing information that can be used to determine the key drivers of productivity and customer satisfaction.		
Add items in above section for **Subtotal**		
Knowledge Accessibility		
Availability. People have the necessary manuals, tools, and information they need to do their jobs, and there are procedures in place that enable employees to access training when they need it.		
Collaboration and teamwork. Teamwork is encouraged and facilitated; there are places for people to meet informally; and time is set aside for people to share with and learn from one another.		
Information sharing. Best practices and tips are shared, improved, and circulated across departments.		
Systems. Effective systems are in place to collect and store information and make it available to all employees.		
Add items in above section for **Subtotal**		

	Score (1 to 5)	Not Sure/ Don't Know
Workforce Optimization		
Processes. Processes for getting work done are well defined and continually improved, and employees are well trained in how to use them.		
Conditions. Employees have access to the materials and technologies they need, and working conditions contribute to good performance.		
Accountability. Employees are held accountable for producing high-quality work; promotion is based on competence; poor performers are terminated; and employees trust their coworkers to get the job done.		
Hiring decisions. Selection is based on skill requirements; new hires receive adequate orientation, induction, and description of required skills; and employees provide input into hiring decisions.		
Systems. Highly effective systems and processes are used to manage employees' performance and talents, view the overall proficiency of the workforce, help employees realize their full performance potential in their current jobs, identify development opportunities for those experiencing performance difficulties, and prepare motivated employees to progress in their careers.		
Add items in above section, then multiply by 0.8 for **Subtotal**		
Learning Capacity		
Innovation. New ideas are welcomed; employees are encouraged to find new and better ways to do work; and employees' input is sought in solving problems.		
Training. Training is practical, supports organizational goals, and is provided for employees on work-related technologies.		
Development. Employees have formal development plans in place, and they use those plans to achieve their career goals.		
Value and support. Leadership behavior consistently demonstrates that learning is valued, and managers consistently make learning a priority.		
Systems. A learning management system automates the administration of all aspects of training and learning events, provides reports to management, and includes features such as content management and skill or competency management.		
Add items in above section, then multiply by 0.8 for **Subtotal**		

TOTAL (Sum of five section subtotals above)

Scoring

Take the sum of the five subtotals from the sections above (note that the sections with five categories are multiplied by 0.8 in order to weight them equally with the sections that have four categories), then refer to the chart below for interpretation. The interpretation will be accurate only if your answers are honest and if others in the organization would agree with your assessment.

Total score	Your HCM is:
90 to 100	Superior
80 to 89	Adequate
70 to 79	Marginal
69 and below	Poor

Count how many times you checked the "Not Sure/Don't Know" box, and consult the chart below.

Number of times checked "Not Sure/Don't Know"	Your HCM measurement system is:
0 to 1	**Good.** You have a measurement system in place that you can use to optimize human capital management and organizational performance.
2 to 3	**Adequate.** There are likely to be some critical holes in your measurement system.
4 or more	**Poor.** You do not have the basic information you need to improve business results by effectively managing human capital.

Linking HCM Scores and Outcomes

Identifying which HCM practices are most important to organizational performance requires statistically linking variations in maturity scores over time or across units to variations in key outcomes (such as employee commitment or financial performance). There are several different statistical techniques for doing this, ranging from the simple (looking for statistically significant differences across two units) to the complex (nonlinear multiple regression analysis). In general, the greater the number of units of analysis (whether business units or individual employees) used for statistical analysis, the more reliable the results will be.

Once you've identified the practices that are most closely associated with performance, it's important to include measures of these practices in your organization's ongoing data collection and monitoring processes—and don't waste time by waiting for future business outcomes data to become available. Use the data available for recent or current outcomes, and refine your analysis later. It is better to use approximately correct, timely insights than to hold out for precise measurements until they're too late to be useful.

then used to identify the HCM factors that significantly drive organizational performance as well as those that also represent areas of relative weakness. The results of this analysis will highlight where the organization should concentrate its HCM development efforts.

Alas, there is no ready-made prescription that can substitute for a thorough HCM analysis of your own organization. As the American Standard cases demonstrated, an HCM strength, such as employee engagement, that might be critical in one firm may be less relevant in another. However, managers can use a shortened version of our own survey to quickly assess their organizations' HCM maturity and detect weak areas. See how your company measures up.

• • •

So, where does your organization stand? Did it score in the 90 to 100 range? Did you mark fewer than two items "Not Sure/Don't Know"? Are you consistently using the three-step process outlined here to focus your HCM development activities? If you can answer an honest "yes" to the last three questions, and others in your organization would agree, your company is well positioned to compete by using its human capital advantage. But if your answer to one or more of those questions is "no," then your organization is almost certainly at risk of failing to maximize its return on people and succumbing to the forces that cause short-sightedness and an excessive focus on narrow, near-term goals. This is not a sustainable strategy.

Globalization has left only one true path to profitability for firms operating in high-wage, developed nations: to base their competitive strategy on exceptional human capital management. Any benefits that, historically, have been associated with superior technology and access to capital (both financial and physical) are now too fleeting to provide sustainable advantage. As these former sources of advantage become less relevant, managing human capital by instinct and intuition becomes not only inadequate but reckless. The most competitive companies will be those that manage their employees like the assets they are.

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