



Chartered Institute
of Personnel and
Development

Human capital reporting An internal perspective

a guide

MERCER

Human Resource Consulting

Human capital reporting: an internal perspective

– a CIPD guide for personnel professionals to help them identify, collate, analyse and communicate data on human capital

Written by Jim Matthewman and Floriane Matignon of Mercer Human Resource Consulting

Acknowledgements

The document draws on the perspectives, experience and measurement methods set out in the recent book by Haig R. Nalbantian, Richard A. Guzzo, Dave Kieffer and Jay Doherty, *Play to Your Strengths: Managing your internal labour markets for lasting competitive advantage* (New York: McGraw Hill, 2004).

We are grateful to members of the CIPD Human Capital Working Party who provided input and advice:

Greg Aitken, Head of Employee Research and Measurement, Royal Bank of Scotland Group

Ron Collard, Partner, PricewaterhouseCoopers

Andrew Mayo, Director, Mayo Learning International

Tim Miller, Group Head of Human Resources, Standard Chartered Bank

Tony Palmer, Head of the Marple Partnership

Vicky Wright, Partner, Human Capital, Ernst & Young

Contents

Preface	4
Introduction	6
Step 1 – Setting human capital management in context	10
Step 2 – Getting started: gathering and collating the data	21
Step 3 – Measuring human capital: tools and methodologies	27
Step 4 – Reporting the data: from internal to external reporting	34
Step 5 – Developing a route map to human capital reporting	40
Case Studies	
1 Engaging employees to drive business performance – Standard Chartered	44
2 The service–profit chain – Nationwide	48
3 Reporting a 'People P & L' – RAC	51
4 Building a people strategy – MultiCo	54
5 Linking people to business results – Royal Bank of Scotland	57
6 Measuring the ROI on training – National City	60
7 The link between human resource management and patient mortality – NHS	63
8 Managing diversity – TechnoCo	67
9 What gets measured gets managed – Tesco	70
References	73

Preface

The issue of human capital reporting has risen up the management agenda in recent years. The debate on intangible value has concluded that people and their collective skills, knowledge and experience are a significant source of wealth and competitiveness in a majority of organisations. Yet the people side of the business is still often ignored in major decisions and doesn't feature prominently as a factor for potential investors when determining the likely future performance of a business.

We believe this is not because it doesn't matter or that directors and shareholders are blind to these realities, but because businesses find the people contribution hard to identify and measure. We are not alone. We are witnessing a shift in the business community towards developing their understanding of the value of people. We believe this must happen – and quickly. In the fast-paced knowledge economy, businesses that have the greatest understanding of their people and are able to tap into their collective assets, motivating them to apply their abilities in the interests of the business, will be those that get ahead in the competitive stakes and deliver high levels of service and performance.

The Chartered Institute of Personnel and Development (CIPD) has been committed for some years to raising awareness and developing knowledge on human capital. We've already published research and a practical Guide on the external reporting of human capital information. With this Guide, we aim to help personnel and development practitioners develop systems to capture, analyse and communicate information relating to their human capital in order to articulate its worth and contribution to the business. Our research demonstrates that improved business measures that demonstrate the value added by both people and people management practices will improve management decisions. In turn, managers equipped with better information, enabling them to understand what motivates their people to perform or exhibit positive behaviour, will be able to manage better and deploy their people assets more effectively.

We are also convinced that good-quality internal reporting on human capital is the cornerstone of good-quality external reporting. The ability to communicate the value and contribution of people to key stakeholders in the business has already been recognised as critical to understanding the true worth of organisations. Recommendations from the Department of Trade and Industry's *Accounting for People* report and proposals for operating and financial reviews stress the importance of meaningful external reporting on people.

It's apparent that many organisations are already moving towards a measurement-oriented human capital approach to managing their people. In doing so, they are strengthening the link between HR and business strategy because by recognising people as the owners of assets they become an integral part of strategies designed to maximise the return on assets. But it's also true that many organisations are still struggling to find ways of effectively evaluating the contribution of their people.

This Guide recognises that HR practitioners may find themselves at any point along the road to human capital management. And our research shows that there's no single measurement formula or set of measures of human capital effectiveness that can be used. Reporting has to be tailored to the goals, needs and character of each organisation. But, in all cases, without robust data informing decisions-makers of the real impact people make to the business, organisations can't improve and move on to effectively manage and motivate their human capital for business success.

This Guide is not therefore designed to be the universal 'magic' solution to human capital management and measurement. It's designed to offer practical support to HR managers actively seeking to develop a better understanding and hence more effective mobilisation of their human capital, and to set them on a route to better internal measurement and reporting and thereby improved management of their most important assets.

Angela Baron
Adviser, Organisation and Resourcing
Chartered Institute of Personnel and Development

Introduction

It's common for chief executives to claim that their employees are their greatest assets. The truth is they're right – and the investor community and Government are now, at last, recognising that how organisations develop and manage their workforce has become a priority in assessing corporate value. But CIPD research has shown that without a clear basis of measurement, this phrase is little more than empty rhetoric.

In recent years, increasing attention has been paid to what creates value or delivers excellence in a more service- and knowledge-based economy. Maximising productivity or efficiency from financial or fixed capital assets is becoming harder. Increasingly, the focus is on what is termed 'intangible assets' – this covers brands, customer goodwill, intellectual property and human capital.

The impending requirement for UK quoted companies from 2005 to report on their human capital in annual reports is galvanising attention and provides the HR function with an extraordinary opportunity to become the catalyst for action. There is clear impetus for more reliable information to be made available on workforce management – to help investors assess both short- and medium-term prospects. The Company Law Review and the introduction of operating and financial reviews (OFRs) present a major opportunity to make this sort of information an integral part of annual reports and accounts. The Accounting for People (AfP) task force established by the Department of Trade and Industry (DTI) confirmed this approach.

The message is that people can add huge potential value to your organisation, but tapping this source of value requires both measurement and management. The value added can only be shown externally if human capital is effectively measured and managed internally. HR professionals should, and must, play a leading role, but they need to be proactive rather than waiting on the legislation and positioning this purely as a response to an external requirement.

Research studies have shown that business context is critical. No single metric or basket of measures can capture the contribution of an organisation's human capital. What's required is agreement on a broad framework for reporting human capital and tailoring the measures and uses to suit the goals and character of individual organisations and their employees. The aim of this Guide is to help practitioners consider and develop the right internal measures and methods for reporting on the human capital and human capital management in their own organisation.

This is not a theoretical or conceptual guide but a practical 'how to', based on effective practice from a range of UK and international organisations in the private, public and not-for-profit sectors.

Professor Harry Scarbrough and Juanita Elias's CIPD study, *Evaluating Human Capital* (2002), investigated the human capital management and reporting practices of 12 organisations. It drew four conclusions:

- 1 Human capital should be viewed as a bridging concept linking business strategy and HR practices.
- 2 It is a precarious asset – the potential mobility of individual employees could and can undermine an organisation's ability to deliver.
- 3 It is a paradoxical asset – the qualities that individuals bring, notably flexibility, mobility and personal commitment, the very same factors that create competitive value, are some of the most difficult to measure.
- 4 Human capital measurement is context-dependent.

Scarbrough and Elias concluded from their investigations that the specific set of measures or metrics organisations reported were less important than the process of measuring and the uses for the information gathered. The research also demonstrated a focus on internal rather than external reporting, as the latter is impossible without solid and robust internal information regarding the effectiveness of the workforce and the people management practices within a given organisation.

This Guide therefore concentrates on the 'what', 'why' and 'how' of measuring human capital internally rather than on providing specific HR measures or cross-company benchmarks. For more details and guidance on external reporting in annual reports, see the CIPD's Change Agenda, *Human Capital: external reporting framework* (2003).

Previous research commissioned by the CIPD, reported in *Understanding the People and Performance Link* (Purcell et al 2003) and the *Impact of People Management Practices on Business Performance* (West et al 1997), examined the link between increases in people management and organisational performance.

These studies showed a clear association between business performance and the quality of people management. Internal measures and data are critical to developing these relationships, acting as the means to: set standards and objectives; identify and address problems; monitor progress; and link all aspects of HR policies and practices to the business strategy.

Three keys to success

The research and case experience presented in Mercer Human Resource Consulting's book, *Play to Your Strengths*, indicate that there are three core principles behind effective human capital management:

- insist on systems thinking
- get the 'right' facts
- focus on value.

Why holistic systems thinking? Because business models and human capital strategies must match. Decisions about each are intertwined, so if elements of people management, for example, learning and development, are developed in a piecemeal way and without reference to the other components such as resourcing, reward, work organisation and the overall business context, they will almost certainly fail.

The second principle is to get the right information and facts. Going beyond external benchmarking and internal perceptions, organisations can tap into the running record of people management to get firm-specific insights. These facts will provide a firm basis for action and help to explode any prevailing myths: like the organisation that thought it paid for performance when the evidence clearly showed it really paid for length of service; or another that claimed it grew its own talent, yet the data showed it actually bought in a large proportion of its senior managers.

Third, focus on value. For too long, line managers and executives have viewed people management as a variable cost to be minimised, reduced or reined in. Human capital should be viewed as a value-generating asset. Through measurement and analysis, organisations can identify the human capital drivers of productivity, service and performance. Human capital drivers can both create and destroy value. Disciplined measurement of the actual drivers of performance in an organisation can help prioritise interventions and improve the return on human capital investments.

What's in this Guide?

The purpose of this Guide is to help organisations move forward with their internal human capital measurement and reporting, by providing practical information and setting out a clear process to follow. This process has five key stages, and each subsequent section of the Guide will cover each of these stages in turn.

Step 1 – Setting human capital management in context

This section defines what human capital is and its links to the business strategy, and provides an overview of the frameworks and models necessary for human capital management and measurement.

Step 2 – Getting started: gathering and collating the data

We provide guidance on the nature and sources of relevant information for human capital reporting, what measures and categories might be reported on, and how this information can be collated to build a human capital measurement platform.

Step 3 – Measuring human capital: tools and methodologies

This section presents the spectrum of measurement techniques for human capital, introduces statistical methodologies which can be deployed to leverage the measurement platform, shows how to communicate results internally and select key metrics to guide human capital decisions.

Step 4 – Reporting the data: from internal to external reporting

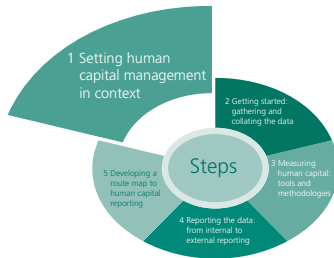
We address the links to the related issues of external reporting requirements, what kind of information investors are expecting, and propose a framework for external reporting.

Step 5 – Developing a route map to human capital reporting

This final step covers developing your own route map, identifying who in your organisation should be involved, determining stakeholders' expectations, and embarking on the human capital measurement journey.

The Guide describes each of these steps in detail, and contains summary action checklists at the end of each section. A series of case studies illustrates what human capital measurement and reporting looks like in practice. The cases address specific business challenges, indicate the nature of the data collected, the measurement methodologies and process implemented, and the business impact or value created through human capital measurement.





Step 1 – Setting human capital management in context

Defining human capital

There are many definitions of human capital, some of which unfortunately refer just to the efficiency of the HR function. As a result, associated metrics have often been used as a means of justifying human resource costs, for example the size of the HR team as a ratio of the overall workforce, or specific HR activities such as the average number of training days per employee. Such measures give no indication of the effectiveness with which the human capital of the organisation is being developed and deployed.

In fact, the term 'human capital' isn't new. Economists have used it widely, even as far back as Adam Smith in the eighteenth century. Most academics and writers agree that it's best expressed as the sum of knowledge, skills, experience and other relevant workforce attributes that reside in an organisation's workforce and drive productivity, performance and the achievement of strategic goals.

The DTI's AfP task force defined human capital management as a 'strategic approach to people management that focuses on the issues that are critical to an organisation's success'. Human capital strategy is defined by Mercer Human Resource Consulting as 'a form of asset management: a plan for securing, managing and motivating the workforce capable of achieving business goals'. The important distinction being made here is that human capital extends well beyond the HR function to encompass the total people strategy of the organisation and the management practices needed to optimise performance and drive value creation. Human capital is therefore owned by all of the business leaders and resides in everyone within the organisation.

Strategies for managing human capital need to be viewed as a holistic system of practices – with many interdependencies – that reflects the unique business goals and character of the organisation. Human capital is a dynamic, shifting asset because the organisation, its managers and individuals make choices daily that help to create, or potentially destroy, value.

Of course, human capital is different from other assets such as money, plant, materials or property. Companies can never own human capital any more than they can wholly control employee motivation or productivity. Still, substantial value can accrue to organisations bringing more of the discipline of asset management to decisions about the workforce.

A recent research study, *Human Capital Management: The CFO's perspective* (CFO Research Services 2003), estimated that the value of human capital represented over 36 per cent of total revenue in a typical organisation. It's not surprising, then, that there's a growing demand to apply more rigour in defining and measuring its contribution and the return on investment in it. Accounting methodologies have enabled companies to reflect

tangible assets in corporate balance sheets, but they have been less successful in capturing the value of specific intangible assets such as brand, corporate image, research and development, customer loyalty and intellectual property. With the growing realisation of the importance of intangibles, financial analysts and investors are calling for more transparency and fuelling interest in methods to measure their value. Calculating the true value remains a puzzle for many employers, and at present, annual reports rarely provide quantitative data on human capital and what is provided is often so general as to be of little value.

With fuller disclosure on its way, chief executives will need to explain their human capital investment and will be looking to their HR function to provide the lead in collation and measurement. The CIPD's research, reported in *Evaluating Human Capital* (Scarborough and Elias 2002) found that there is widespread acceptance across all industrial sectors that the know-how, imagination and creativity of employees is becoming at least as critical to business success as other, 'hard' assets.

Linking to the business strategy

The CIPD's research has demonstrated that HR plans, policies and practices can be in danger of becoming misaligned to changing business strategies and the requirements of the organisation. Historically, the various aspects – from compensation to talent management, learning and development to organisation design, have sometimes been built up in isolation and from 'best' professional practice rather than being developed as an integrated support for business needs. The HR function can be so involved in the day-to-day transactions of hiring, rewarding or dealing with leavers that it lacks sufficient time to proactively shape the workforce strategy for adding value.

Human capital strategy seeks to address this by placing the investment and development of the workforce as a key component of business strategy. This implies that people management should be clearly set out in a framework that allows for a strategic 'fit' and for flexibility in matching changing business requirements.

It's well worth producing a human capital business plan with a summary of the organisation's human capital strategy. This must be directly related to the delivery of the organisation's overall business strategy through the effective deployment and development of the organisation's human capital. It should highlight the organisation's overall approach to the acquisition, development, management and performance of human capital. The strategy statement allows the organisation to outline its vision for the contribution of human capital in relation to future opportunities and challenges, and the role of its HR and management policies in securing that contribution.

Human capital measurement frameworks and models

One of the principal recommendations from the AfP task force is that human capital management reporting should demonstrate the link between people management and business performance. There are many models and approaches to developing an HR strategy and linking it to the needs of the organisation, and the task force didn't set specific guidance as to which methodology to use or which framework to adopt.

Below we present a number of the most commonly used models and frameworks for human capital measurement. There are organisations that use each one to help structure their thinking on HR strategy, though in many cases the models are adapted and tailored to suit the organisation's particular needs. The key is to develop and/or adapt an approach that best suits the thinking and management style of the organisation in order to create a framework to link how people are managed with the delivery of business strategy. The models we profile are:

- the human resource benchmarking model
- the balanced scorecard
- the Human Capital Monitor®
- the Human Capital Index®
- the engagement model
- the organisational performance model.

The human resource benchmarking model

Benchmarking key data on HR policies, practices and costs within and between organisations has expanded considerably in quantity and quality in the last decade. One of the most popular methods is the approach developed by EP-first & Saratoga presented in *Human Resources Benchmarking* (Phelps 2002). It defines benchmarking as an organised method for collecting data that can be used to improve organisational performance, rather than simply gathering a mass of statistics that add little or no value. This method begins with a simple question:

'What are the issues we need to address to survive and succeed?'

People benchmarking is about providing a direct relationship between how people behave and the organisation's goals by focusing on the measures for selected people practices that drive and reflect those goals.

EP-first & Saratoga maintain a comprehensive database of people performance indicators, but stress that it's critical to transform this benchmarking data into useful, value-adding information. They propose the following methodology to transform benchmarking data into impact:

1 Decide where improvement is essential.

Use data to provide important indications as to where your performance may not be competitive.

2 Establish the parameters you're seeking.

Decide what type of improvement you're targeting, what level of improvement is realistic, what resources it will require and what the time span is.

3 Establish your benchmarking team.

People must be drawn from disciplines relevant to the selected project.

4 Specify the data.

Benchmarking relies on data and organisations must be clear about the data they intend to collect and the definition of the terms they use.

5 Undertake collection of data.

Establish the process, eg through a questionnaire or discussion.

6 Locate suitable benchmarking partners.

Select organisations that appear to be performing better than your organisation in the improvement activity selected.

7 Analyse the results.

Only a limited amount of data will be relevant. Focus on that. Produce action recommendations that clearly demonstrate the value of changes – preferably in hard, measurable terms.

8 Implement.

Data alone will not improve anything. Only action can do that.

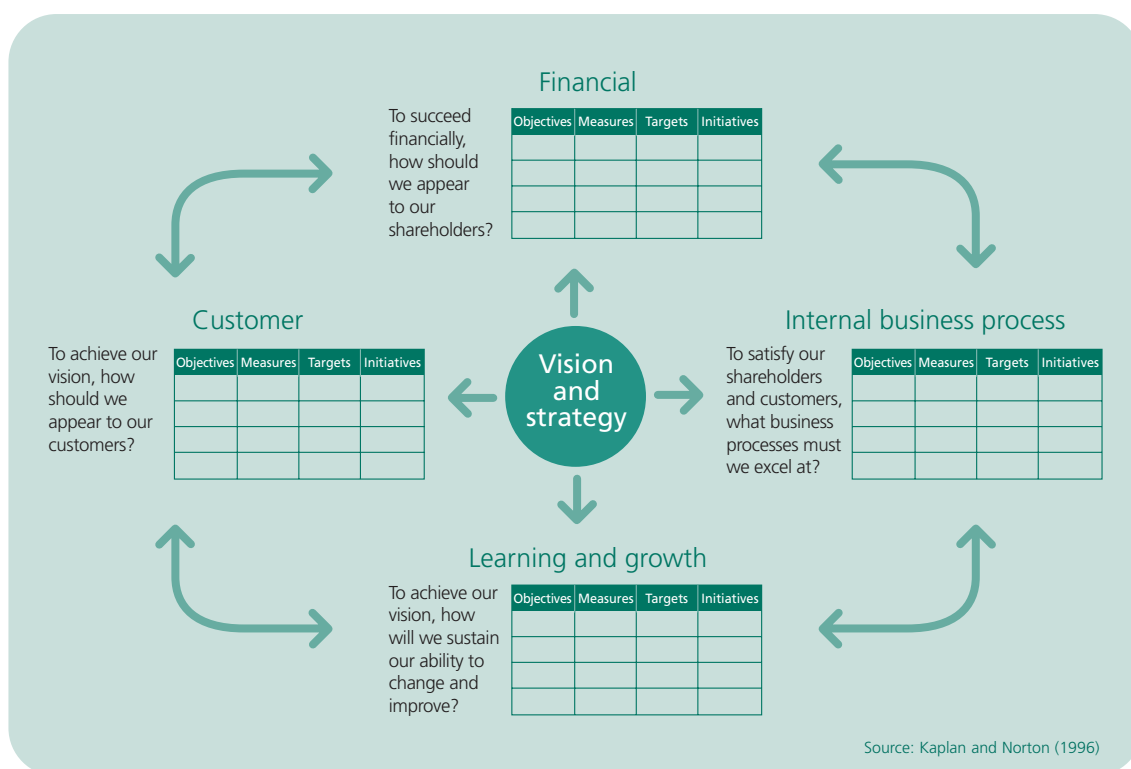
Balanced scorecard

This is one of the best-known methodologies. It aligns the evaluation of the people dimension to a company's strategic aims through a balanced scorecard. *The Balanced Scorecard* (Kaplan and Norton 1996) was developed to counter the tendency of companies to focus on short-term financial reporting. The scorecard originally had four elements – financial, customer, the internal business process, and learning and growth. The research

presented in *Measuring Human Capital Value* (Deloitte & Touche and *Personnel Today* 2002) reveal that as many as 32 per cent of large UK companies are using the balanced scorecard methodology.

The model presents each element within a system representing multiple objectives as a basis for setting targets. For example, under the financial element, the scorecard asks, 'To succeed financially, how should we appear to our shareholders?'; and under the customer element, it asks, 'To achieve the vision, how should we appear to our customers?' Some organisations have replaced the learning and growth element with a broader 'people' quadrant. In doing so, organisations using the scorecard as a basis for target-setting and strategy alignment have applied a wider perspective to judging their performance.

Figure 1: The balanced scorecard framework



One of the main benefits of the scorecard approach is that it provides a simple communication tool for internal and external stakeholders that can be cascaded down from corporate to department and individual levels. One of the difficulties has been that some organisations have over-engineered the number of metrics so individuals feel swamped by measures and targets and doomed to fail. Given its focus on target-setting, it is by definition context-driven and a useful internal reporting tool, but it has had little relevance for external or industry reporting.

Much has also been written about the HR scorecard. In particular, the book by Becker, Huselid and Ulrich (2001) makes the case for HR measurement to be linked to an organisation's strategic aims and values.

Their argument focuses on the need to create clear alignment between HR's own functional organisation, the supporting HR systems and employee behaviours. This suggests a strong link between HR activity and the development of a firm's human capital. While the authors stressed the need for strategic HR measurement, use of the HR scorecard has been focused on the HR function rather than on the wider concept of human capital. However, the idea of an HR scorecard has reinforced the need for business measurement of HR activities, and it is also a relatively popular tool which many HR functions use to assess their own effectiveness.

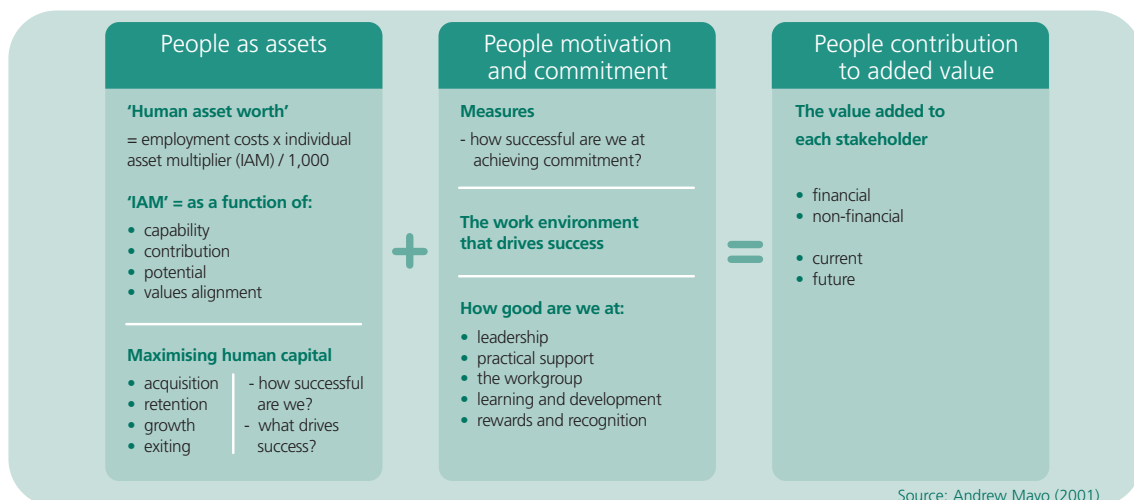
The Human Capital Monitor®

Andrew Mayo, a member of the CIPD's steering group, has sought to identify the human value of the enterprise or 'human asset worth' (Mayo 2001). He emphasises that people should be viewed as an asset rather than a cost. The main challenges are:

- how an organisation should recognise the intrinsic diversity in the worth of its people and value it
- how to create a framework of people-related metrics as part of an organisation's overall performance
- how to quantify both the financial and non-financial value to stakeholders.

He stresses the need to obtain relevant and reliable data on these assets within the organisation before attempting to publish it externally. The Human Capital Monitor provides a formula for calculating the human asset worth of individual employees.

Figure 2: The Human Capital Monitor



The human asset worth is defined as being equal to 'employment cost x individual asset multiplier (IAM)/1,000'. This is a weighted average assessment of capability, potential to grow, personal performance (contribution) and alignment to the organisation's values set in the context of the workforce environment (ie how leadership, culture, motivation and learning are driving success).

As with many of the models described in this section, this is a tailored approach where an absolute figure is not important. The process of measurement leads you to consider whether human capital is sufficient, increasing or decreasing and highlights issues to address. Mayo is cautious in stressing the need to be careful by not using too many measures and the need, instead, to focus on a few relevant enterprise-wide measures that are critical in creating shareholder value or achieving current and future organisational goals.

The Human Capital Index®

Watson Wyatt Worldwide have constructed a survey of companies linking their key management practices to their market value. Initially based on US research and then extended to Europe, the survey linked shareholder value creation with evidence of critical HR practices. The findings, presented in *Human Capital Index®: human capital as a lead indicator of shareholder value* (Watson Wyatt Worldwide 2002), concluded that four major categories of HR practice could be linked to a 30 per cent increase in shareholder value, as detailed in Table 1:

Table 1: The Human Capital Index

Practice	Impact on market value
Total rewards and accountability	16.5%
Collegial, flexible workplace	9.0%
Recruiting and retention excellence	7.9%
Communication integrity	7.1%

Source: Watson Wyatt Worldwide (2002)

The four critical practices are:

- **clear rewards and accountability** that differentiate between high and poor performers
- a **collegial and flexible workplace** environment encouraging teamwork and co-operation
- a **commitment to hiring and retaining the best people** and development of recruitment practices to support the firm's strategic aims

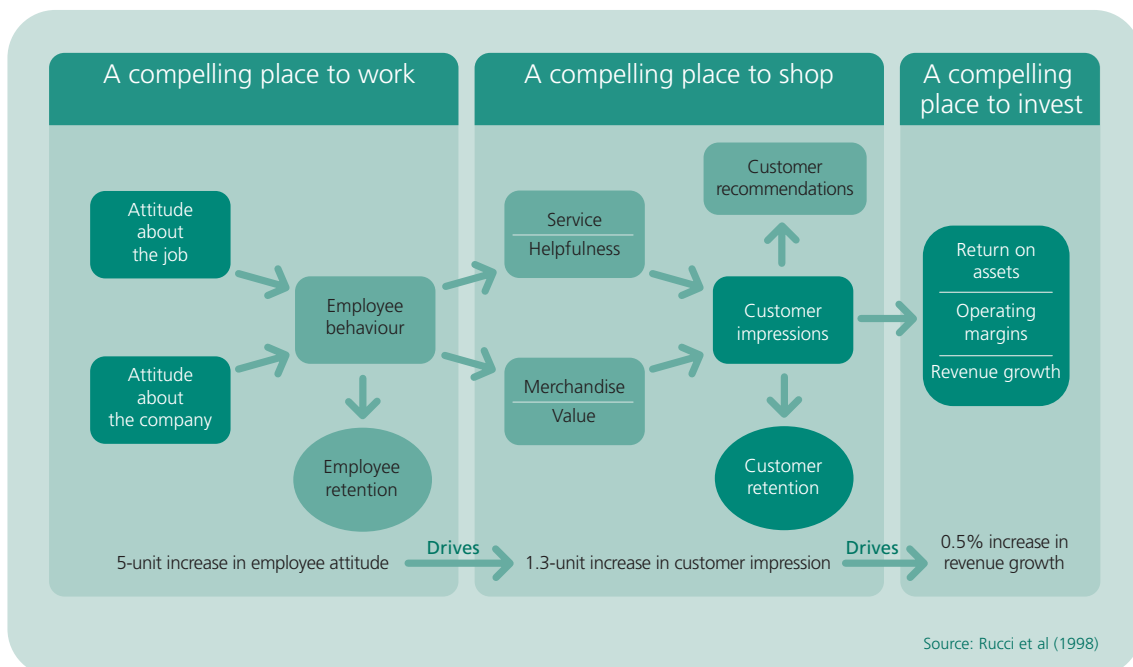
- a level of **integrity in communication strategy** where goals are clearly stated and business processes have a high level of transparency.

The methodology focuses more on a 'best practice' concept of value-adding HR policies than the 'best fit' approach applied in the models presented thereafter. The survey, based on broad correlations and aggregated data, doesn't provide the firm-specific context to assess a given organisation's human capital. Nor is it clear whether high-performing organisations adopt these best practices or that these best practices lead to high performance (ie demonstrating causality and direction).

The engagement model

The application of the engagement model that has been most widely publicised relates to research at Sears Roebuck (Rucci et al 1998) which looked at the employee–customer–profit chain. In essence, the theory states that if you keep your employees satisfied, they will help ensure that your customers remain satisfied, and your customers in turn will ensure and improve your corporate profits. Sears' demonstration of these relationships have been replicated in the UK in a number of organisations, including Nationwide (see case study on page 48).

Figure 3: The employee–customer–profit chain



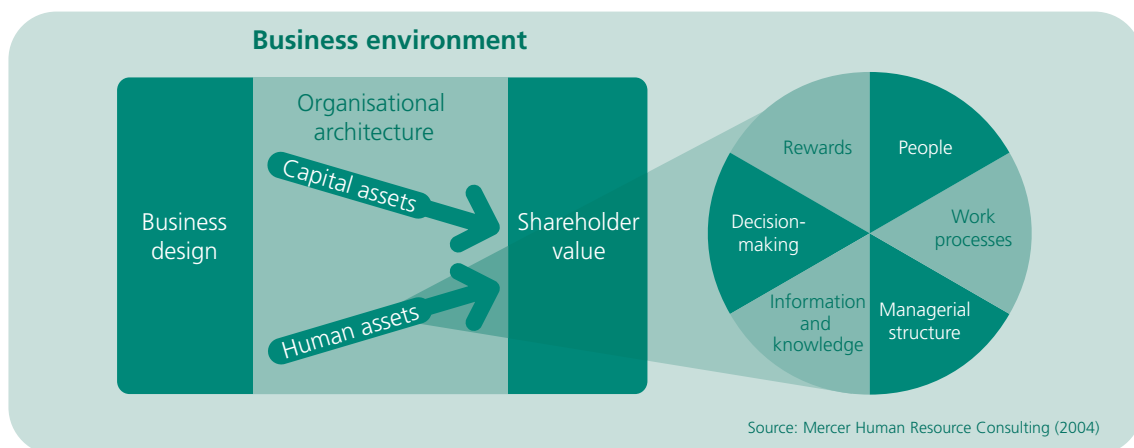
The result of this, as discussed by Paul Kearns in *Measuring and Managing Employee Performance* (2002), is that the pursuit of employee satisfaction has become interlinked with the concept of HR strategy and business alignment. Measuring and improving employee satisfaction for some companies, particularly in the retailing and service sectors, has therefore become an important basis of organisational improvement. Employee attitude or climate surveys have become a key measure of human capital, with a strong emphasis being placed on them in companies such as Marks & Spencer and Asda.

Other organisations, such as Standard Chartered, Tesco (see case studies on pages 44 and 70) and B&Q (see Matthewman 2003), have shown demonstrable links between employee morale and business metrics, particularly at the business unit performance level (including shrinkage, absenteeism, employee theft and customer profitability). More recently, Royal Bank of Scotland (see case study on page 57) has completed innovative analyses of employee attitudes and business results.

The organisational performance model

In the early 1990s, Mercer HR Consulting assembled a research group of labour/organisational economists and work psychologists to develop methods to measure the business impact of human capital practices in organisations. As a start, the group conducted a review and assessment of documented empirical research on the workforce drivers of organisational productivity. The review encompassed hundreds of studies in economics, psychology, communications and general management, covering more than 1,000 organisations. The work led to a model that explicitly linked human capital management to organisational performance and, ultimately, shareholder value.

Figure 4: The organisational performance model



According to the model, which has been applied and tested in numerous organisations since 1994, a firm's human capital strategy consists of six interconnected factors:

- **people** – who is in the organisation; their skills and competencies on hiring; what skills and competences they develop through training and experience; their level of qualification; and the extent to which they apply firm-specific or generalised human capital
- **work processes** – how work gets done; the degree of teamwork and interdependence among organisational units; and the role of technology
- **managerial structure** – the degree of employee discretion, management direction and control; spans of control, performance management and work procedures
- **information and knowledge** – how information is shared and exchanged among employees and with suppliers and customers through formal or informal means
- **decision-making** – how important decisions are made and who makes them; the degree of decentralisation, participation and timeliness of decisions
- **rewards** – how monetary and non-monetary incentives are used; how much pay is at risk; individual versus group rewards; current versus longer-term 'career rewards'.

Each of these factors plays out differently within the context of each organisation, creating a unique corporate 'DNA'. In practice, for many organisations these elements have been developed piecemeal, so there is no explicit human capital strategy. Lacking explicit co-ordination, the potential for serious misalignment is strong. As such, it is likely that human capital is not being optimised – creating real opportunities for substantial improvement in returns. Identifying those opportunities requires disciplined measurement of the organisation's human capital assets and the management practices that affect their performance. Mercer's statistical tools, including Internal Labour Market Analysis® (ILM) and Business Impact Modelling®, allow detailed review and identification of the unique drivers for a given organisation (Nalbantian et al 2004).

The ILM draws on the running record of employee and labour market data to analyse the actual experience of employees, rather than stated HR programmes and policies. Specifically, the ILM maps the flow of individuals into, through and out of an organisation over time and estimates the drivers of these movements. It addresses such questions as who gets hired; who advances; how is talent developed and how are rewards distributed. It draws a quantitative picture of what workforce capabilities, behaviours and attitudes are most valued within the company and are being retained. So it can help identify gaps between what is required in the workforce to support business goals and what is actually being delivered.

Business Impact Modelling focuses explicitly on the business rather than workforce outcomes. It involves a family of statistical tools to link workforce characteristics and management practices directly to performance measures. In its richest form, it can be applied to quantify the performance model above and estimate specific weights on the human capital drivers of performance. In doing so, it seeks to highlight those that will have the greatest impact and therefore the best returns on investment.

Section summary

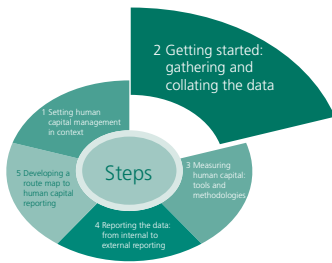
In this section, we've presented a number of theoretical frameworks that organisations use to help them define and measure their human capital. These frameworks help to classify and communicate what can be a complex set of issues, concepts and measures. The choice of framework very much depends on circumstances and preferences.

Many organisations have also developed and implemented their own models for human capital measurement. The final section of this Guide presents case studies and includes some company-specific models, as well as applications of some of the frameworks presented in this section.

Once you've set human capital management in context within your organisation and selected and developed an appropriate framework for measurement, you can get started with Step 2.

Step 1: Checklist Setting human capital management in context

- Define human capital management in the organisation.
- Articulate a human capital strategy to support your business objectives.
- Produce a human capital plan.
- Select a human capital management and measurement framework to demonstrate the links between people and performance.



Step 2 – Getting started: gathering and collating the data

Gathering and collating human capital data requires an understanding of type, analysis and use. This section provides guidance on the different categories that might be reported on, the sources of the data and relevant timelines. Once the relevant data have been identified, you can build a measurement platform and start to interpret the information. And when this has been achieved, you'll be ready to demonstrate the connection between human capital management practices and business objectives and performance.

1 Gather the right facts

Many decisions about human capital management rely on common sense, perceptions, assumptions or so-called 'best' practice. Those decisions can involve thousands of pounds invested in implementing a new training programme, or the move towards using more part-time employees to reduce staff expenses. But evidence is mounting to show that these types of facts will not consistently help you, nor will they – or should they – convince senior management that this is the right thing to do. High-quality and high-impact decisions need to be based on reliable and relevant facts, the 'right facts' (Nalbantian et al 2004).

Gathering the right facts entails looking beyond what people 'say', and considering what they actually 'do'. Attitude surveys or executive interviews are a rich vein of information, providing data around employee engagement, motivation and development needs, but this must be matched by observation of what happens in practice. Often, there's a discrepancy between perceptions/intentions and reality. Employees' stated preferences in attitude surveys about, say, benefits or their intention to leave or stay with the company don't always reflect how those employees will behave when faced with real situations. It's essential to look at the actual behaviours of employees over time to inform your human capital decisions.

Facts about your workforce can be drawn from multiple sources of data and their value will vary depending on how they're used. There are two basic types of employee data:

- **perceptual** – attitudinal or qualitative information, typically collected via interviews or surveys
- **archival** – based on historical records; this includes employee history, financial or operational data, customer records.

Time is another critical element. Data can be captured as snapshots at a particular point in time or can be assembled as a running record over time – so-called longitudinal data. Only by looking at data over time are you able to answer questions about, for example, the pace of career progression or pay increases, or measure the impact of a new programme on employee added value. The approach that should be taken depends on the

particular purpose for which the data will be used. But, as a platform to support management decision-making and human capital reporting, there is greater power in using longitudinal data.

Several criteria can be considered to determine what data an organisation should collect. It's important to recognise whether the data collated is adding information and value or whether they are simply creating overload or 'noise'. The following sections will guide you through the process of assessing and collecting the right data.

Many organisations will form a project team to carry out this process. As well as HR professionals, the input of line managers and those with IT and finance expertise will help to ensure a robust measurement platform is developed.

2 Assess the data sources and information systems

Many organisations have serious concerns about the quality of their existing employee data and are unsure of its suitability for undertaking human capital measurement and reporting. But existing HR information systems are often an under-utilised resource and can contain a wealth of readily available data, capturing facts about the employees over time. Advances in modern technology and workforce analytics now enable companies to use their existing HR information and databases more effectively.

In the process of gathering and reviewing information, you'll need to work closely with your human resource information system (HRIS) experts. You need to start by asking basic questions:

- What are the software packages or vendors currently used?
- Over what period of time have existing systems been in place?
- Do they differ by geography, by business unit, by division?
- What amount and type of historical employee data is available?
- Have there been any major organisational changes, such as acquisitions, that might affect the consistency, comparability and continuity of data captured?
- Is the measurement initiative enterprise-wide or does it have a specific focus, eg key employee segments, line of business, function, geography?

Answering those questions early on will help you to determine your critical elements. You need to assess the feasibility of the measurement study you're contemplating. Unless data is still on paper files, you should feel confident you can move ahead. The amount of historical data is also critical. Experience suggests that a minimum of three years and at most five years of employee data is optimal.

It's important in this phase to define the scope of the study. You might want to conduct human capital measurement throughout the whole organisation and for all employees – although for most global or even national companies, you're likely to discover that systems are not identical across locations or units. In that case you might want to start with a specific country or unit. A pilot will enable you to test the analysis, demonstrate the results – and value – and will provide a template that you'll be able to extend to other parts of the company.

You could decide to focus your analysis on specific people or business issues that will affect the nature of the data you need. It might be the promotion of equal employment opportunities, identifying the cause of employee turnover or improving the productivity of your sales force.

Once you've clarified the feasibility, scope and focus of your analysis, you can identify and collect the relevant data.

3 Identify and collect the relevant data

The list below presents the examples of sources and the types of data that might be collected to support human capital reporting. There are two caveats. First, depending on the scope and the issue you're trying to address, you'll need to select which data is relevant for your organisation. Second, very few organisations – if any – will have all of those data sources and categories available. So you'll need to focus on collecting relevant and reliable data today and identify those areas you will need to capture or harmonise in the future.

Three broad categories of data can be used for human capital measurement:

- HR practices and workforce data
- performance data
- external data.

We describe the data sources, recommend timelines and provide examples for each category below.

HR practices and workforce data

HR and workforce data is the 'must have' for human capital reporting. Compiling and analysing this data will enable the organisation to understand the characteristics of its workforce, measure the effectiveness of its people policies and assess the value of its human capital assets. It will provide a fact-based platform for making many essential human capital management decisions.

- **Data sources:** HRIS (eg PeopleSoft, SAP, custom system), payroll systems, ancillary systems (eg training and development, performance management), employee surveys.

- **Data elements:**

HRIS and payroll data on the workforce:

- **demographics**, eg age, race, gender
- **status**, eg full-time vs part-time, fixed vs temporary
- **job history**, eg length of service, job title, job level
- **availability**, eg sickness days, absence, holidays
- **compensation**, eg base salary, bonus, benefits
- **mobility**, eg transfers, international assignments
- **organisation and management**, eg business unit/function/structure.

Complementary workforce data:

- **performance management**, eg performance ratings, promotions, high-potentials
- **training and development**, eg training courses, training assessments
- **skills and competencies**, eg skills, languages, assessment centre ratings
- **education**, eg academic level, graduate/postgraduate qualifications
- **pre-employment**, eg recruitment source, years of prior experience
- **succession planning**, eg number of replacements identified.

Perceptual data:

- **employee survey**, eg satisfaction, engagement, attitudes, intention to quit
- **exit interviews**
- **executive interviews**.

Performance data

The second type of data relates to business performance, ie a mixture of financial, operational and customer information. By connecting workforce information to performance outcomes, you'll be able to assess the impact of your human capital management practices on the business and provide a basis for making human capital investment decisions.

- Data elements: While the actual performance data and measures tracked will be specific for each industry, company and even for each of its business lines, there are three categories of performance outcomes to consider:
 - **financial data**, eg revenues, net income, economic profit, profit margins
 - **operational data**, eg calls abandoned (call centres), customer waiting times (retail), new accounts opened (financial services), patient care (healthcare)
 - **customer data**, eg customer satisfaction, customer retention, customer service ratings.

External data

External data can also provide valuable insights to help determine how successful your policies and practices are likely to be in the face of competitive market conditions.

Labour market data, such as local unemployment rates and/or industry salaries, will influence both the availability of skills and the ability to buy necessary talent.

Industry or market data, such as market share or industry volatility, will allow you to control for external influences that might mask the impact of human capital management practices.

External data can be gathered through public sources or private providers, which encompass national statistics, labour force surveys, industry reports or compensation data.

We would distinguish between the use of external data as inputs to the analysis and benchmarking the outcomes of the analysis across organisations. There's more detail on benchmarking in Step 3 – Measuring human capital: tools and methodologies.

Once you've identified the relevant categories of data, you're ready to move on to the collection phase. Based on your preliminary audit, you should now be able to specify the list of the data elements you require.

4 Build the human capital measurement database

The building process involves the data acquisition, data 'cleaning' and the transformation of data. This is a rigorous process which will call on the skills and close collaboration between your information systems experts and HR professionals.

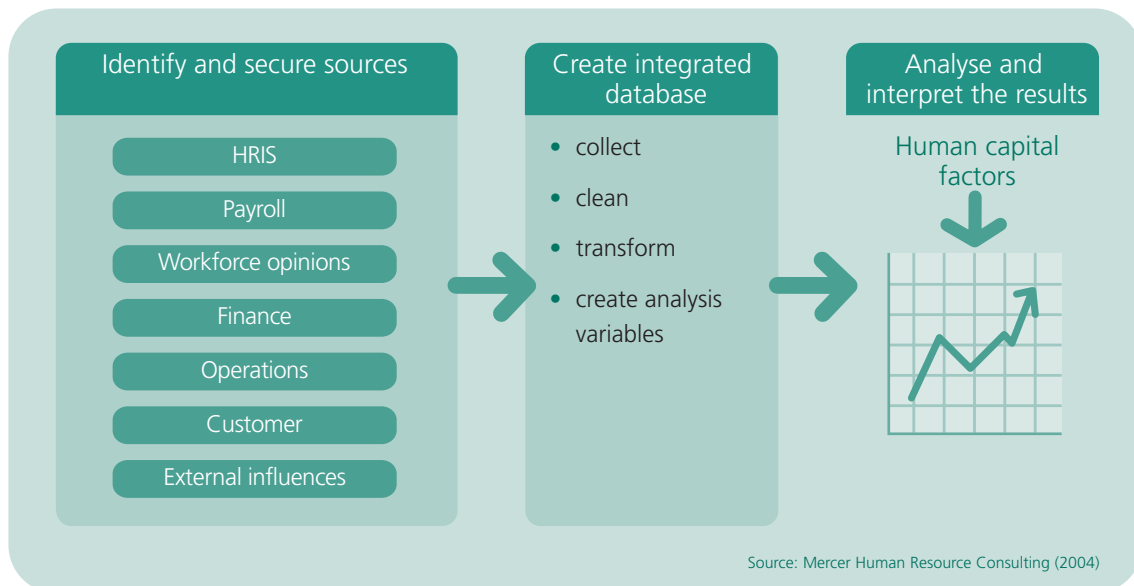
The 'cleaning' of data will ensure that the format of the data you've received is:

- **consistent**, eg are the date formats similar across files?
- **reliable**, eg do business-unit headcounts add up to the total company headcount?
- **complete**, eg are there any 'holes' in the education data?

The data you receive will also come in a variety of formats and will use a variety of applications. They might be in numeric files, in text files, or stored in databases. You'll need to convert them to a similar format to enable the integration to a single data platform. There is a variety of software you can use for this, including programming and statistical applications such as SPSS® or SAS®.

How the data collection, acquisition and build come together is illustrated in Figure 5.

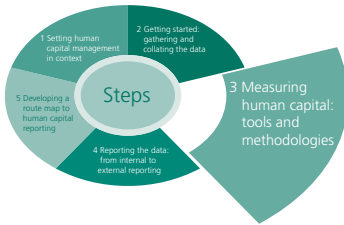
Figure 5: Building a human capital measurement database



Once the data has been integrated and checked for reliability, you can get started with the analysis. Larger organisations are increasingly setting up a project 'workforce analytics' unit or 'HR metrics' team. Step 3 describes workforce analysis and measurement techniques in detail.

Step 2: Checklist Getting started: gathering and collating the data

- Gather the right facts.
- Assess data sources and information systems.
- Identify and collect the relevant data.
- Build the human capital database.



Step 3 – Measuring human capital: tools and methodologies

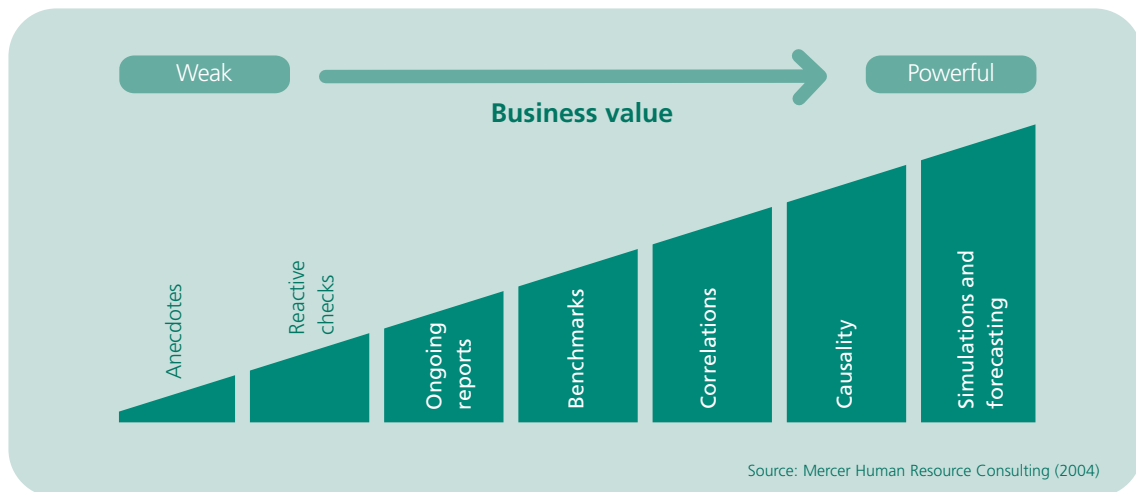
Once you've identified and integrated the various sorts and sources of human capital data, the next thing is to bring the relevant pieces of disparate data together for analysis and forecasting. This section goes beyond presenting statistical methodologies to help you interpret and communicate the results internally and, most importantly, select the few, key metrics to guide your people management decisions.

Where are you in the spectrum of measurements?

There's a broad spectrum of assessment and measurement techniques and sources of information available to organisations today, ranging from anecdotes to more complex efforts at determining causality and forecasting outcomes, as illustrated in Figure 6. The technique you currently – or will decide to – use will influence the value and business impact of human capital reporting in your organisation and its reliability for making essential people and business decisions.

Very few organisations are able to immediately introduce the type of sophisticated data and analysis required to simulate and forecast the business returns on human capital investments on the right of Figure 6. But many organisations are now progressing in that direction, from fairly ad hoc and disjointed data to producing a more integrated platform for effective human capital reporting and decision-making.

Figure 6: The human capital measurement spectrum



The weakest sources of information are corridor anecdotes: 'She's really good!' or 'That initiative worked well in XYZ division.' These can generate an initial interest in human capital data, but there is generally little or no objective assessment. They are highly subjective and potentially biased and unlikely to form a reliable basis for action.

The next level, **reactive checks**, includes one-off studies, typically immediate reactions to potential or real issues. An equal pay audit might fall into this category. While informative and useful to address the issue at stake, such measurement rapidly falls out of date and loses its context, given its 'snapshot' type of analysis. So, if an organisation finds that average female pay is 20 per cent below average male pay, this tells the organisation little about the causes of the gap and how it can be addressed.

The third level, **ongoing reports**, such as on performance and absence monitoring, provide internal benchmarks and some basis for human capital measurement. Yet, typically, reports are dependent on consistency, agreed common criteria, effective implementation and application. They often don't capture underlying relationships within the data and can be administered with little control or quality assurance, so this can also create inaccurate or potentially biased information.

The fourth level – **benchmarking** – can be applied both externally and internally. **External benchmarking** is typically used to compare HR and management practices across companies, either within industries or against recognised 'high performance companies'. The motivation of external benchmarking is to establish 'best practice' standards that companies will aim to match or replicate within their own organisational environment. External facts can alert you to innovative practices which benefit your organisation.

They certainly provide a sense of direction and a guide to how well your organisation stacks up against the competition.

But copying the practices of one organisation might not deliver the same results for your own company. For one, your business context might be very different and almost certainly there is no guarantee that your management and employees will respond and behave in the same way as another organisation. For example what does it mean if an organisation has a staff turnover rate of 10 per cent. Is this good or bad? Depending on the context, a company might want a higher turnover rate to bring new blood and new ideas while for another company this might highlight a problem in retaining labour.

In many cases relying on industry or external benchmarks can be misleading. Benchmarking studies rely on normative datasets, based on self-reporting and aggregated conclusions. There is a danger that self-reported data may be erroneous and that aggregation may blur differences – and hence the value of the information for your own organisation.

When focusing internally, benchmarking can be particularly useful to analyse activity costs where a given function or operation is conducted across many locations or geographies. **Internal benchmarking** can provide insights into how effectively the workforce is managed and deployed. By using activity cost analysis, the cost of labour can be directly linked to operational outcomes such as business performance or customer value. However, it's often difficult to maintain the currency of the data and for local management to accept common definitions and findings. Care is needed to ensure both sample size and sample matching are effective.

The fifth level – **correlation** – sets out to show statistical links between two or more given variables, for example, employee morale and customer service and satisfaction.

The difficulty with correlations is that they reflect association rather than causation but are often mistaken for the latter. For example, it has been noted in the US that there are higher crime levels in areas with more churches. One might conclude, therefore, that religion creates more crime but the reality is that more churches were erected in deprived urban areas in the last century. Simple correlation doesn't distinguish between these two explanations.

The most powerful reporting methodologies look to determine **causality** in order to identify the key human capital drivers of performance and predict and **forecast** the impact of people strategy interventions. This then allows modelling of potential changes and their likely results. While this is relatively new for HR, many other management disciplines already do this.

Establishing causality and testing hypotheses

At the heart of this process is the need to test hypotheses to establish causal relationships. As Nalbantian et al (2004) note in *Play to Your Strengths*, establishing causality is always a challenge – for example, how do you know that your reward system will drive better business performance? At a minimum, three conditions must be met:

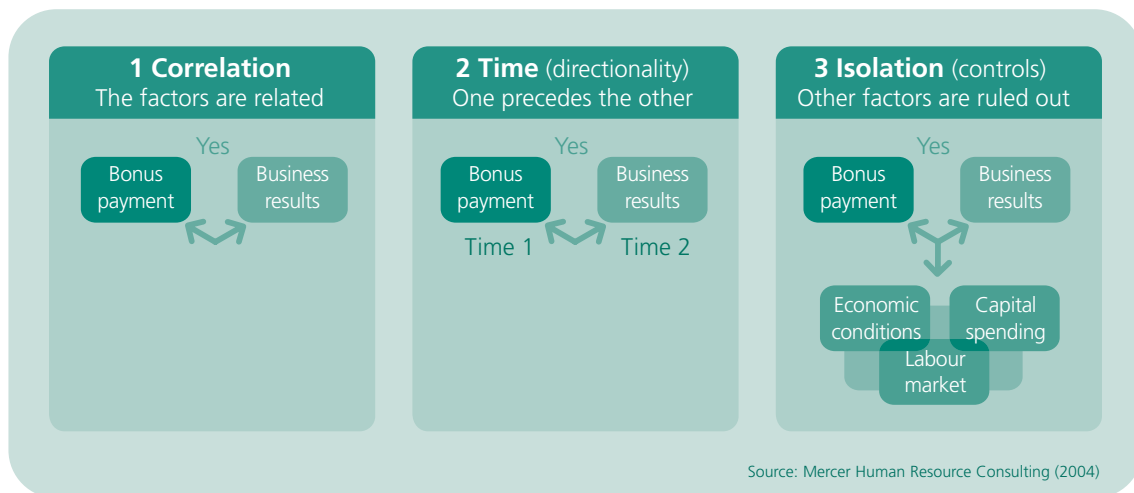
- 1 **A simple correlation must first be found**, ie two or more variables are linked. This might be, for example, that higher business unit results are linked to staff bonus payouts.
- 2 **Any change must precede the outcome**. In our example, this means that the increase (or decrease) in bonus payments must precede the increase (or decrease) in business results. This is why historical data is more valuable than snapshot surveys. Time matters, since many of the most important drivers of employee behaviour and their relation to performance can't be understood unless they are measured over time. The good news is that your employees are creating this running record of critical events every day.
- 3 **This concerns statistical controls**. Multiple factors may be influencing the variable of interest, so it's important to account for their effects when assessing the effect of any one factor. A rise in business performance might be linked to more favourable economic conditions rather than solely reflecting the

impact of a new bonus scheme. This is where external data comes into play. Good statistical models can draw on both experience and research in relevant disciplines to determine the appropriate control variables and to specify how the variables relate to one another.

Once such models are specified, they can be used to test hypotheses about these relationships and determine the magnitude of impact. The direction of causation is important, but not enough to make good decisions. Your analysis might reveal that spending more money on bonus programmes improves business results. But, unless you know how large the return on investment is, you won't be able to decide between the competing human capital investments that you can make.

The following example illustrates the three fundamental steps in establishing causality and in demonstrating, for example, that staff bonuses drive corporate performance.

Figure 7: Hypothesis testing: do bonus payments drive business results?



Analysing the data, both qualitative and quantitative, will allow you to review scenarios and test hypotheses. This means going beyond producing data to providing 'what if?' calculations for particular people management practices and their potential return on investments. But collating and crunching a mass of workforce data will be of little use if insufficient time and focus is spent on their interpretation.

Interpreting and communicating the results internally

We've emphasised the importance of relying on facts to make essential human capital decisions. At the same time, we'd stress that no decision should be made on the analysis of results alone. 'Reality checks' need to

confirm that the human capital data and measurement reflect what is really happening inside your organisation. If results are at odds with what you were expecting, it will be critical to understand why. The juxtaposition from myths and realities will be in many cases revealing. Uncovering the root causes of this gap will help you take the right decisions.

Consultation and involvement, ie of line managers and employees, in scoping, gathering and using data is critical to ensure it reflects the reality of day-to-day operations and value-creation in your organisation.

Once you're comfortable with the reliability of the results, spend some time with your project team to discuss the findings, the outcomes from the hypothesis-testing and your first read of the implications for the business. You generally need to gather the inputs from business leaders at some stage during the project and we strongly encourage you to involve them early on in the process, highlighting key issues to address and building understanding and ownership of the outcomes.

Presenting the results of your human capital analysis is also an important aspect of gaining the support of your business managers. As we see in the Royal Bank of Scotland case study on page 57, instead of just pages of detailed statistical analysis, they needed answers to a few basic questions:

- What does the data tell me?
- What do I need to improve?
- What are the issues to watch?
- Are there any major challenges I will have that will prejudice the performance of my business unit?
- What investments in my human capital will generate the best returns?

In response to these concerns, Royal Bank of Scotland and other leading organisations have found that presenting their results as a graphic diagram, scorecard or measurement dashboard targeting the key areas to improve, is very effective. The case study section provides illustrations of a number of possible internal reporting formats.

Once you have a record of data and areas for improvement have been identified, quantify your key targets wherever possible. For example, these might be to reach a specific level of employee engagement, to decrease the ratio of full-time to part-time employees or to hire a specific number of technical specialists to meet business needs over a given period of time. Quantitative results, measurable targets and 'high-impact' recommendations are most likely to convince your line managers, finance director or chief executive, win their buy-in and encourage them to take action or unlock the necessary budgets. We recommend that you track and report your

progress against objectives on a regular basis, monthly or quarterly, to ensure that you keep your internal stakeholders engaged and to show that you deliver on your promises.

Selecting, monitoring and reporting the key metrics

Research proves, and case studies illustrate, that there is no 'best-practice' set of measures that are relevant for all organisations' internal reporting. There are several reasons for this. An organisation's context is unique and so are its human capital strategies, business needs and therefore its people management priorities and practices. Depending on its strategy or the issues an organisation seeks to address, the corresponding metrics and targets for success will differ.

There may well be differences in application in different parts of the organisation. If companies merge to maximise economies of scales, and/or diversify the business or geographical portfolio, this will have an impact on human capital management and measurement. Such companies need to strike the balance between common people management practices and specific local practices that will reflect the unique nature of each business and its people dynamics. Likewise, some measures may be more significant or critical to given groups of employees than others. Metrics and targets will need to reflect those differences.

As we've emphasised so far, your internal reporting should present the few most appropriate metrics to drive human capital management. In deciding which of these measures to use and report, you should assess them in the context of your own organisation and its objectives. Ask yourself:

- Are the measures relevant? Do they respond to business needs and seek to maximise the people contribution to the business?
- Are they useful to managers? Reporting the frequency of employee transfers might be irrelevant for the day-to-day management of a call centre, for example.
- Which measures are common across the organisation? Which are specific to each business, geography or employee segment?
- Are they associated with measurable targets that can be tracked and reported on a regular basis? How often should they be reported and to whom?
- What's the expected trend (direction) and required change (magnitude) over what period of time (strategic vs tactical)?
- Are the high-impact human capital priorities accompanied by tangible recommendations and clear guidance on the 'how to'?
- Can I provide a return of investment figure for a specific human capital programme/initiative?

Answering these questions will help you select the most appropriate measures for internal reporting. However, the metrics you report to external shareholders might differ. Your HR and business leaders need targets and tactical steps to enhance the contribution from people to the business. Your shareholders want to see evidence of how well you're managing your workforce to support your business strategic objectives and what value is delivered to the business.

In Step 4 – Reporting the data: from internal to external reporting, we highlight the rise of external reporting requirements, what type of information investors expect, and recommend a framework for external human capital reporting.

Step 3: Checklist Measuring human capital: tools and methodologies

- Identify the measurement technique to apply to the human capital analysis.
- Formulate and test hypotheses by establishing causality.
- Interpret the analysis and communicate the results.
- Monitor and report the key metrics.



Step 4 – Reporting the data: from internal to external reporting

The rise of external reporting requirements

The AfP task force, headed by Denise Kingsmill, was set up by the DTI in January 2003 to look at human capital management and external reporting. More specifically, the task force's mission was to review the performance measures currently used to assess investment in human capital, consider best practice in human capital reporting and champion the business case for producing such reports.

The task force released its report in October 2003, and represented a significant step on the road towards the legal requirement for employers to report on human capital management in their OFRs. The express purpose of the reviews is the provision of information to shareholders that will allow an informed assessment of the company's operations, financial position, future business strategies and prospects. The AfP task force's view – and recommendation – was that human capital management has a direct impact on performance and should therefore be included within this main reporting vehicle.

Many private sector organisations already prepare OFRs to accompany their annual reports, while in the public sector, government departments and agencies have been doing so for the past two years. The independent OFR Working Group, led by Rosemary Radcliffe, was set up to develop guidance on information directors should disclose in their OFRs. Its consultation paper was issued in June 2004.

The response from the DTI to the AfP recommendations, the Company Law Review and the OFR Working Group was announced in May 2004. The Government published its Consultation Paper on Regulations for Company Reporting, aimed to 'strengthen corporate Britain and boost confidence in the UK business'. Under draft Regulations, it will be mandatory for all quoted companies to produce an OFR for their shareholders from January 2005 onwards.

What should OFRs include?

The Government proposes that OFRs should provide shareholders with details of the company's objectives, strategy, past performance and future prospects, including:

- its policy towards employees, customers and suppliers
- its impact on the environment
- its social impact
- its impact on the wider community.

The OFRs will have to consider information about employment policies and practices which, the Regulations recommended, should be evaluated using the AfP task force's report on measuring human capital management. But it will be left to directors to decide what specifics should be included, using the more detailed recommendations of the AfP task force as a guide.

The Government plans to review how effectively OFRs are working – including human capital management reporting – in five years' time.

The AfP recommendations

As most organisations are at an early stage with human capital management and reporting, the AfP team has opted for an evolutionary approach. Indeed, the task force explicitly rejected any specific measurement approach. Rather, it recommended a broad framework that companies should use in drawing up their reports:

- **Present a strategic focus**, spelling out the alignment and 'fit' of the people strategy with the business objectives, showing the link between human capital management practices and business performance, and specifying the key themes and priorities in the HR strategy for generating value through people.
- **Provide information on workforce practices in five areas:**
 - **the size and composition of the workforce** – this might cover the size of the workforce and the strategic trends; its profile in terms of age, gender and ethnicity; the balance between part-time and full-time employees; and the extent to which the organisation is dependent on external labour.
 - **the retention and motivation of employees** – this might review levels of staff turnover; the level of employee engagement; and buy-in to the strategic direction, aims and values.
 - **skills and competencies necessary for success, and training to achieve these** – this might indicate whether the organisation is nurturing and developing the skills it needs to support the strategy. For example: How does its skill base match current and future business needs? Is the skill set changing? How does training and development contribute? Does the organisation have a talent strategy? How successful is the programme?
 - **remuneration and fair employment practices** – for example: How successful is the remuneration policy in contributing to business performance? Do incentives support the business strategy? How is non-financial performance rewarded? How does the organisation satisfy itself that it doesn't discriminate unfairly in pay or employment?
 - **leadership and succession planning** – this might address the sustainability of performance through leadership and succession planning; the necessary leadership skills and characteristics needed to implement the business strategy; whether existing managers have these skills and characteristics; the

initiatives in place to develop future leaders; the role of external recruitment; and the current state of succession planning.

- **Human capital management should be balanced and objective, following a process that is susceptible to review by auditors** – this implies:
 - breadth, in applying to the whole workforce, not just one segment
 - balance, in looking at various human capital factors at play
 - covering historical and future trends
 - being accurate, robust and verifiable.
- **Reporting should provide information in a form that enables comparison over time:**
 - using commonly accepted definitions where available and appropriate.
- **Directors of companies producing OFRs should include information on human capital management or should explain why it is not material.**

In terms of actual metrics to report on, the task force recommends that individual organisations determine which measures are appropriate for them, as any prescribed indicators or metrics might fail to capture the links between human capital management and performance that are critical in individual organisations. At the same time, the task force is hoping that the emerging consistency of approach could improve comparability and reliability and provide a common framework that companies might find helpful, for example, on an industry basis.

What kind of information are investors or external agencies expecting?

The CIPD has been working with a number of professional bodies to develop guidelines on the relevant issues. Our understanding is that investors and financial analysts are looking for a range of information that integrates human capital into their assessment of an organisation's performance and hence its valuation. More specifically, they reported they would like to see information on:

- the profile of the workforce and its diversity
- senior executive remuneration
- the quality of leadership and management strength
- how well labour costs have been managed over time
- evidence of a coherent, robust people strategy which is mapped to the stated business strategy for the next three years

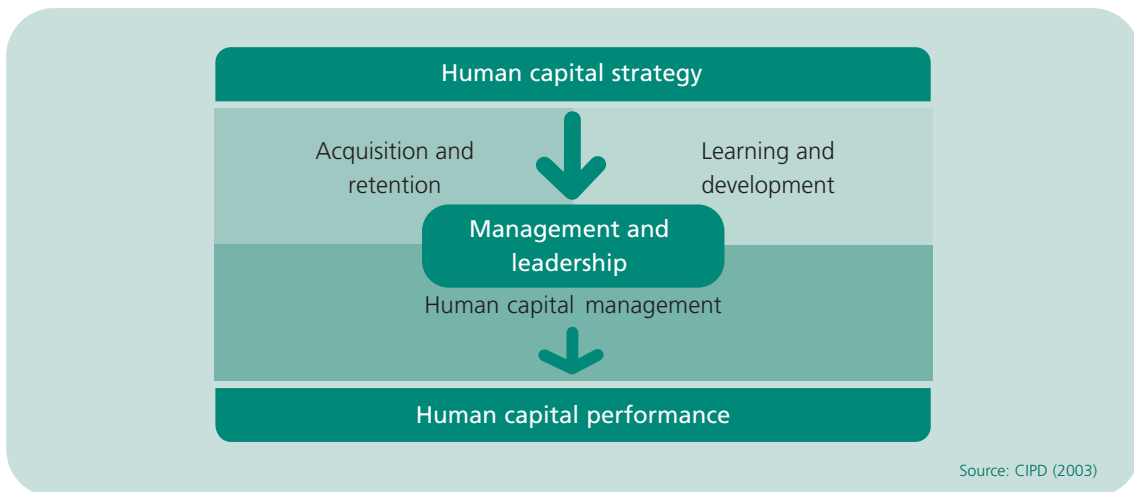
- evidence that current people management practices (especially regarding acquisition, motivation and retention) are affecting organisational and business performance
- current and forecasted returns on people investments for the next three to five years
- the valuation of current human capital assets and future investments, especially in major corporate decisions such as mergers and acquisitions
- comparator listings in financial league tables – such as industry, FTSE or analyst ratings (eg Standard & Poor ratings).

The CIPD external reporting framework

The recommendations from the AfP task force, combined with investors' expectations, provide a multitude of choices as what to report and how to organise and structure your report on human capital management.

The CIPD has set out a framework to help organisations with their reports. The proposed external reporting framework shown in Figure 8 draws on extensive research and evidence from companies investigating the impact of people management practices on business performance to demonstrate that human capital is at least as important as financial capital in generating success.

Figure 8: Proposed external reporting framework



The CIPD stresses the importance for external reporting to provide a holistic, future-oriented account of human capital management that is supported with reliable facts and robust analysis. More specifically, we recommend that organisations report on the following components:

1 Human capital strategy

Reporting should start with the firm's strategy statement, highlighting its approach to the acquisition, development, management and performance of human capital. It should outline its vision for the contribution of human capital in relation to future opportunities and challenges.

2 Sections on acquisition and retention, learning and development, and human capital management

These three sections should provide evidence on how organisations acquire, develop, manage and retain human capital, which will be specific to each organisation. The evidence should be supported by a balance of qualitative and quantitative data, accompanied by adequate explanations.

3 Information on human capital performance

The organisation should provide details of the effectiveness and performance of their human capital and human capital management policies and practices, to indicate how well their strategic objectives are being achieved. This information should be drawn from a mix of qualitative and quantitative data.

Each category should include both a narrative plus a menu of key and discretionary indicators, explaining the organisation's approach to the area of activity, any difficulty they need to overcome specific to their operating circumstances, and the strategy for the development of the policy. Although such a framework provides only snapshots, a succession of reports would provide an indication of trends and changes over time.

The CIPD's Change Agenda (2003) provides further details of the recommended framework for external reporting and includes examples of possible measures as well as practical guidance on how and what to report. It also provides a list of indicators which organisations might decide to include in their reports.

Comparability and flexibility of external reporting

The question of the comparability and flexibility of human capital reporting has been one of the most debated issues in task force discussions and consultation. Most recognise that the more comparable human capital management information becomes, the greater the utility for shareholders in assessing trends over time and across organisations. At the same time, measures that are relevant for one sector and organisation may be much less useful in another. In fact, they may not even be comparable between sectors.

The CIPD has addressed this issue by developing a set of primary and secondary indicators. Primary indicators could be indicative of the investment and return on human capital in all or most circumstances, while secondary

indicators might be used to explain key data or be indicative of particular operating and environment circumstances.

Forthcoming requirements to report on human capital management in OFRs present a serious challenge to the UK HR profession and its capability. Clearly those in HR need to take up this challenge. If they don't, others such as those in finance or corporate strategy will. And external reporting will be impossible without an effective internal reporting procedure. Step 5 sets out a route map of the journey towards human capital reporting.

Step 4: Checklist Reporting the data: from internal to external reporting

- Be prepared to report on human capital management in your OFRs from 2005 (applies to quoted UK companies).
- Refer to the recommendations on human capital management reporting from the Accounting for People task force.
- Take investors' expectations into consideration.
- Establish data-gathering systems to populate this framework, linked to your internal human capital information.



Step 5: Developing a route map to human capital reporting

Who should be involved?

One of your first tasks is to get a clear understanding of who 'owns' human capital and its reporting in your organisation. In other corporate disciplines such as finance, marketing or production, it's clear who is accountable for what. This is not the case with human capital. Human capital and the people strategy encompass the whole organisation – the chief executive, the senior management team, line managers, staff and all the various functions.

While the HR function may be the likely catalyst in human capital reporting and most certainly needs to take up the challenge, the most successful examples of human capital management and reporting are those involving cross-functional human capital teams combining HR, finance, line managers and corporate communications. A recent Conference Board research report (Gates 2003) also points out that this wider community not only has the required mix of skills, but also that engaging other managers in the collation and analysis will help to ensure more likely acceptance of meaningful metrics by line managers.

The AfP task force makes it clear that ultimately the chief executive should be held to account as investors and stakeholders seek the assurance that their organisation's human capital is being effectively deployed and nurtured for the future. This is why board-level commitment and involvement is so important.

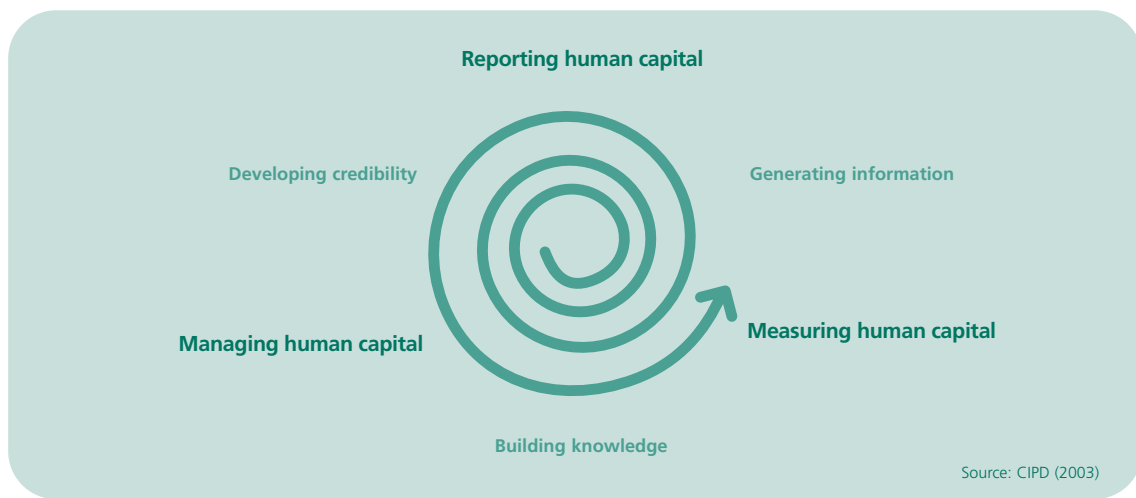
What is beginning to emerge is a new science of human capital management, with practitioners versed in analysis and measurement to complement traditional HR skills. These individuals are combining skills and knowledge from labour economics, work psychology, corporate strategy, financial and statistical modelling. A number of them have been providing input and expertise to the CIPD group that has helped to develop this Guide.

All of this is producing a 'harder' side to people management. HR professionals should take advantage of these changes to become more strategic and to develop into true business partners, aligning human capital interventions to future business objectives. But, for these changes to take place, we face a major education and communication task. HR needs to take the lead in explaining to stakeholders – both inside and outside the organisation – what human capital is, how it affects business results and how its return on investment can be calculated.

Research published by the CIPD in *Evaluating Human Capital* (Scarborough and Elias 2002) has shown that a virtuous circle (Figure 9) is generated by organisations committed to effective measurement. The research shows that the measures are in some ways less important than the activity of measuring and of continuously developing and refining the understanding of human capital and its links to business performance. By linking

management to measures, measures to reporting, reporting to management, these companies are beginning to build the credibility, information flows and knowledge necessary to embed a human capital perspective in management and measurement practices both at HR and top management level.

Figure 9: The virtuous human capital circle

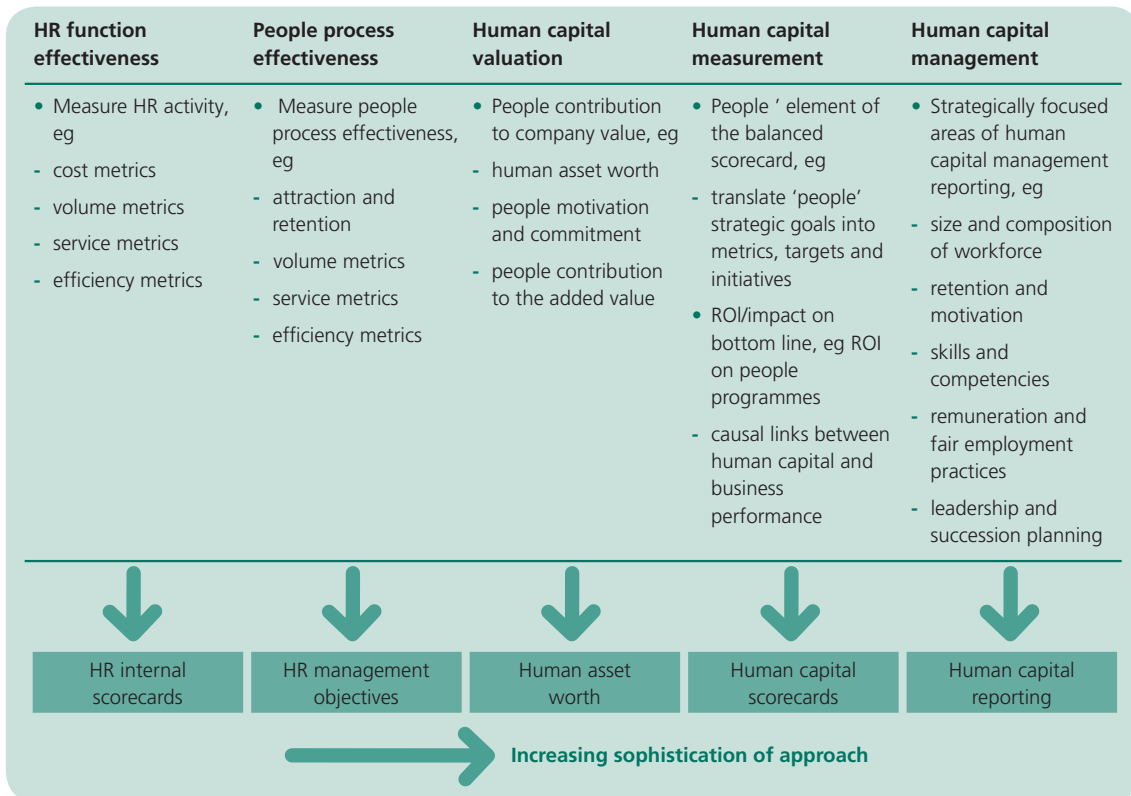


Embarking on the human capital measurement and reporting journey

Organisations often refer to human capital measurement as a 'journey'. Some companies have developed sophisticated human capital models measuring the return on human capital investments, while others are assessing the added value from HR by tracking measures of the HR function's effectiveness.

This journey can be seen as a continuum from HR effectiveness towards full human capital management, as shown in Table 2.

Table 2: The human capital measurement journey



The column on the left illustrates the metrics HR managers use as a means of justifying the effectiveness of the function. In the main, these tend to be activity measures – the number of calls handled by the HR service centre; the length of time to respond to requests; or the satisfaction from internal customers. HR effectiveness is defined as the balance between the service expected and received versus the cost of delivery. This approach helps build appropriate service-level standards. However, using HR effectiveness as a proxy for human capital measurement is misleading, as it implies human capital is inwardly focused on the HR function.

A more useful positioning in the second column is to consider the wider people strategy and to what extent the people processes in place are effective in meeting key HR and business objectives. If the talent management strategy places an emphasis on building rather than buying talent, what is the ratio of external vs internal hires? So the second window in the journey reflects organisations actively tracking the effectiveness of key people processes and their alignment to business objectives.

The third column introduces the concept of valuing human capital, a function of people capability, potential, contribution and alignment to organisational values. This step on the measurement journey enables organisations to quantify the value added by their human capital assets and the true costs of issues such as excessive labour turnover and absenteeism.

The fourth column sees human capital being measured and reviewed alongside other strategic measures to ensure a focus and balance in consideration. For many organisations, the use of balanced scorecards has provided a useful reporting and communication tool to address financial, customer, innovation and people management in an integrated way. Scorecard reporting, in the main, is a historical reporting mechanism, although it can be used to set future, usually short-term, goals.

Effective human capital measurement should enable organisations to: demonstrate causal links between people practices and business performance; differentiate the return on investment of specific projects; and ultimately, predict the value-added impact of the change programmes. At this point, human capital measurement begins to pinpoint key drivers that are currently adding (or destroying) value, identifying those necessary to deliver the future strategic goals of the organisation.

Equipped with robust measurement techniques, organisations can move towards full human capital reporting, illustrated in the fifth column. The reporting should present the organisation's human capital management strategy and practices in key areas, and be supported by quantitative and qualitative information. Measures reported should reflect past performance and incorporate a future dynamic.

Obviously, we recognise that organisations are at various stages on this journey. The guidance we have set out in the Guide, from human capital frameworks to data collection and analysis and to human capital measurement techniques and reporting will hopefully help you to move on along this continuum. Yet are ready to embark on the journey!

Strategic summary

Step 5: Checklist Developing a route map to human capital reporting

- Identify who should be involved in the human capital team.
- Review your current position in the human capital management journey and plan what is required for you to move on to the next stage.
- Review the Guide, take each step, and tick off all the checklist's items.
- Embark on the journey to human capital measurement and reporting!

Case studies

The following case studies present some good examples in the area of human capital measurement and reporting. More particularly, they show how organisations have used their people and performance data to drive business performance.

Case study 1

Standard Chartered Bank: Engaging employees to drive business performance

Business challenge

Standard Chartered is one of the world's most international banks, employing 31,000 people from 79 nationalities in over 500 locations spread in 56 countries across Asia, Africa and the Middle East as well as the UK and the Americas. The bank serves both consumer and wholesale banking customers and aims to be the 'right partner' for its customers.

E. Mervyn Davies, the Group Chief Executive, recognises the importance of effective people management as a key source of strategic strength and competitive advantage: 'In the banking industry, our customers are ever more demanding. We will develop a competitive edge through our people – through their relationships with our customers in working together to deliver superior service and by applying their wealth of talent and skills to add value to customers in complex markets across borders. That's why Standard Chartered Bank has long recognised the importance of effective human capital management. Our ability to attract the best talent, position people to make a difference to our business each day and engage them to give their best performance drives shareholder value and long-term growth' (cited in Accounting for People Task Force, 2003).

Standard Chartered has established a range of processes and benchmarks to measure and enhance the contribution of its employees. Considerable work on human capital measurement allows a greater understanding of the difference that talented and motivated employees make to the business.

Human capital measurement in practice

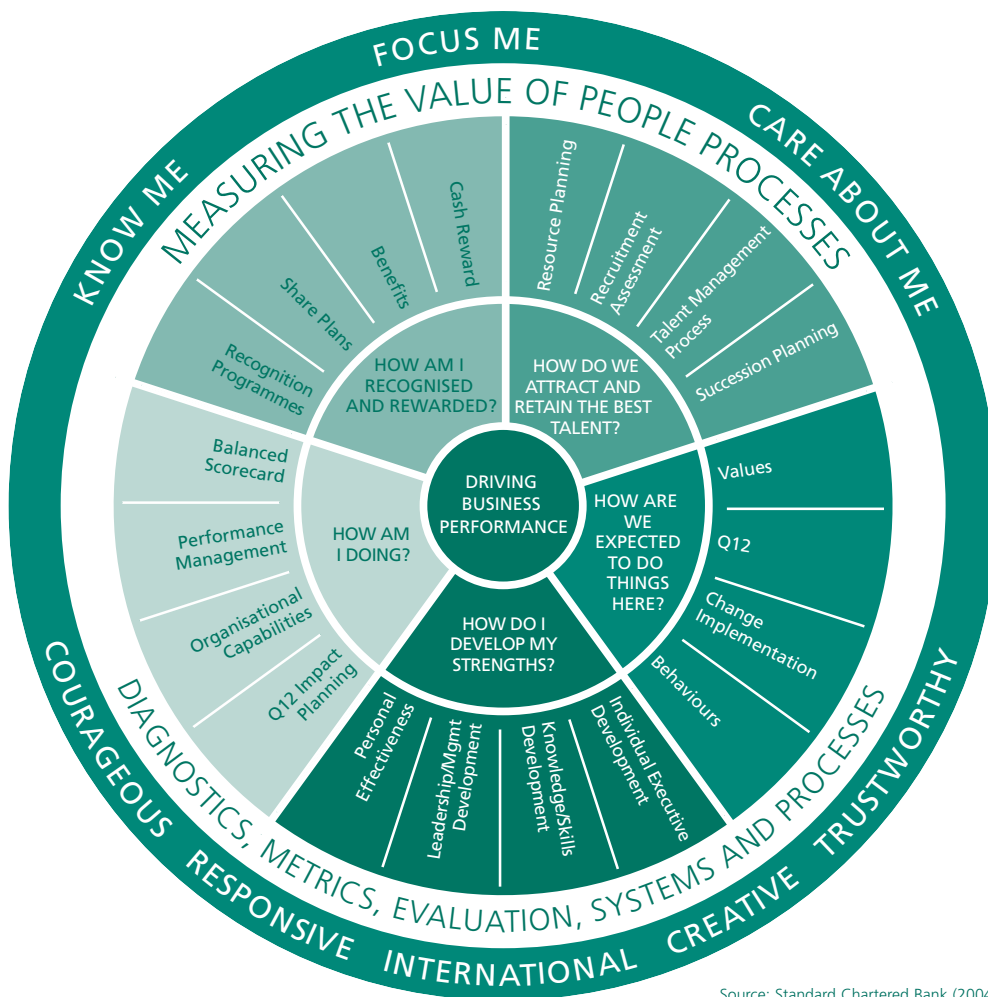
Standard Chartered's Human Capital Roadmap

The bank has developed a clear people agenda, set out in the Human Capital Roadmap (Figure 10).

The core of the roadmap has five areas of focus to drive business performance, which are supported by key people processes and interventions. This ensures an integrated approach to human capital management.

These areas are then applied appropriately to ensure the alignment with specific business objectives. Standard Chartered's Human Capital Roadmap provides a common and consistent framework for people management policies and practices across the group.

Figure 10: Standard Chartered's Human Capital Roadmap



Source: Standard Chartered Bank (2004)

Engaging employees to build business performance

Employee engagement is an integral part of Standard Chartered's approach to building a strong culture to drive business performance. In 2000, the bank introduced the Q12 engagement survey (developed by the Gallup Organisation) covering 12 factors that underpin a productive and stimulating place to work. In 2002, the bank researched and introduced an additional ten questions to assess the work climate within the organisation and three questions to ensure effective follow-through on action plans. In 2003, the survey covered 53 countries, with 95 per cent of employees responding.

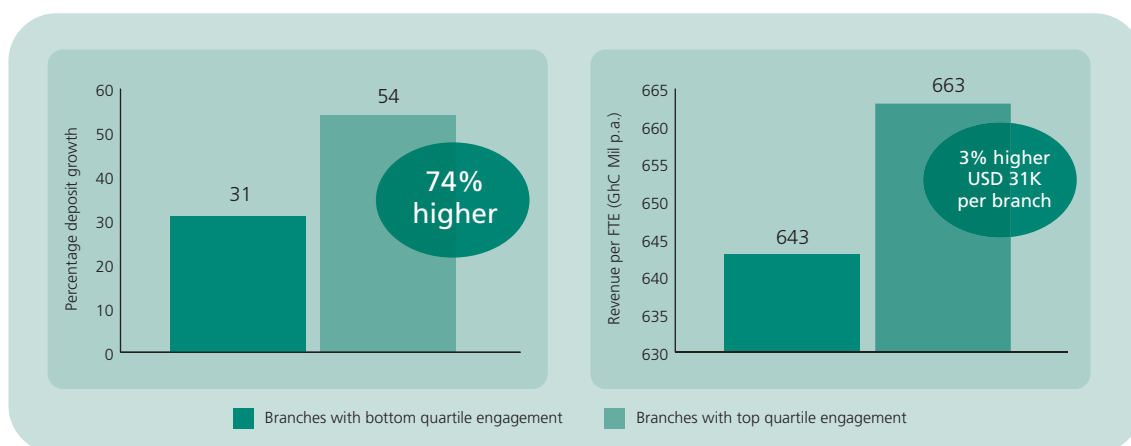
Business impact and value creation

Established research has demonstrated a powerful link between engagement (Q12 scores) and business outcomes. From 2001 to 2003, Standard Chartered conducted an internal study across several markets to understand the business impact of engagement within the bank's branches. The study was a collaborative effort between the HR and the consumer banking functions.

Consumer bank branches with highly engaged employees experience:

- greater deposits growth
- greater profit margin growth
- greater revenue growth
- greater productivity
- less 'shrinkage'
- greater employee loyalty
- greater likelihood of achieving above-average customer satisfaction ratings.

Figure 11: Business impact of engagement



The key is dialogue and effective follow-through

The bank is committed to maximising the contribution of increased employee engagement on business performance. In order to achieve this, Standard Chartered goes beyond the survey results – improvement is rarely achieved through pure measurement! The bank has established a process by which teams agree and implement actions that help build a high-performing culture, supported by regular reviews. The bank emphasises that improvement is achieved by dialogue within teams to identify the areas that need focus in order to drive engagement and follow-through of action plans agreed at the team level. The teams that follow through on their action plans have been found to significantly increase engagement as well as achieving an increase in employee satisfaction and loyalty.

Continuing research

The internal research found that the line manager plays the most significant role in creating a workplace climate that engenders increased levels of engagement. In light of this, Standard Chartered has embarked on further research to identify the strengths and behaviours of the consumer banking branch managers who are successful in driving engagement and high business performance. The aim is to share best practice and to conceptualise a 'talent profile' of successful branch managers for the purpose of future recruitment and selection.

Standard Chartered is firmly committed to measuring key human capital processes, as these constitute leading indicators that will ensure delivery of sustainable business performance.

Case study 2

Nationwide Building Society: The service–profit chain

Business challenge

Established over 150 years ago, Nationwide is one of the UK's largest financial services organisations, providing a broad range of retail services and products to over 11 million members, including mortgages, savings, current accounts, life assurance, personal loans and household insurance. Nationwide is the largest building society in the world and employs 15,000 staff, mostly in its network of 700 branches spread across the UK.

In recent years, Nationwide has become well known for its commitment to mutuality, to best serve the long-term interests of its current and future members. As building societies have converted to plc status, this characteristic of ownership has come to distinguish them in the marketplace – enabling the organisation to perform strongly despite an increasingly competitive environment.

Human capital measurement in practice

Underpinning this ambition to perform, Nationwide has, since 2002, been investigating the links between employee commitment, customer commitment and business performance. Nationwide's Branch Network Director and Head of Corporate Personnel have been 'sponsoring' this initiative, working closely with a truly cross-functional team, involving retail operations, personnel operations, personnel and development planning and systems and area managers.

The team objectives were to:

- establish the key drivers of customer commitment
- measure the impact of improved employee commitment on customer commitment and business performance
- identify activities that can be undertaken, at corporate and local levels, to use this knowledge and bring about business improvements.

The Genome II model

This research, an application of the service–profit chain, is summed up in Figure 12:

Figure 12: The Genome II model



All data used within the model is Nationwide-specific and are collected from four main sources:

- **HR data** – from PeopleSoft
- **employee opinion data** – from the 'Viewpoint' survey
- **customer satisfaction and commitment data** – from the 'Member Perception' questionnaire
- **business performance data** – from the 'Operational Sales' database.

This data was then integrated into a platform for analysis. The statistical software 'SPSS' was used to run initial correlations. Due to the number of data items, factor analysis was conducted to bring out core themes. Finally, multiple regressions analysis was used to identify the strengths of relationships.

The model is updated annually when new employee, customer and business performance data becomes available and the relationships are revisited.

The drivers of employee commitment, customer satisfaction and business performance

The analysis revealed that employee commitment and length of service were the most critical factors driving customer commitment and sales. Modelling conducted across 34 retail areas demonstrated that areas generating the best performance were also those with the highest average length of service.

The Genome II model enabled the team to look further into the drivers of employee commitment and ways to increase employee tenure. Five key drivers were found to have the most effect on employee retention, which in turn affect positively customer satisfaction and business performance, as follows:

- employees' perceptions of pay levels
- average age of employees
- levels of resource during peak times
- understanding and promoting the values of Nationwide
- management behaviours emphasised in Nationwide's organisational development programme, PRIDE.

Those findings enabled Nationwide to refocus its HR strategy around these five key drivers.

From modelling to implementation

Moving forward, pilot schemes have been set up in multiple retail areas to translate the 'concept' into local practical applications. Champions for each pilot retail area are challenged with integrating the five key drivers into existing business plans – and any other operational practice where appropriate. Full support is given to these champions, including ideas or ways to stimulate action around the key drivers.

Operational/business dashboards are produced on a quarterly basis for area managers, enabling them to easily identify, and act on, areas for improvement.

Business impact and value creation

By taking actions to significantly improve employee commitment and length of service in retail areas where levels are lowest, the team forecasted:

- a 6 per cent increase in customer willingness to repurchase
- a 7 per cent improvement in customer overall satisfaction
- a 3 per cent rise in customer willingness to recommend Nationwide to others
- up to 18 per cent increased sales of certain products.

Case study 3

RAC: Reporting a 'People P&L'

Business challenge

RAC plc provides a comprehensive range of motor solutions to individuals and businesses through five interrelated business units, including roadside, other consumer services and vehicle leasing services. Employing 11,500 people, the vision of RAC plc is to make a 'good' company into a 'great' company through delivering inspirational service.

RAC was acquired in 1999 by Lex Service plc and the company was renamed RAC plc in 2001.

The acquisition brought together two different entities operating a range of different HR and payroll databases. To take advantage of economies of scale and efficiencies, an integrated approach to its HR practices was needed. A team was brought together with the objective of producing quantifiable measures of HR performance across the business.

Human capital measurement in practice

As a start, RAC sought to develop a common set of quantifiable HR measures it could track and report on on a quarterly basis. The ten core HR measures identified were:

- colleague satisfaction
- absence
- turnover
- stability
- new colleague retention
- reasons for leaving
- gender – full-time/part-time split
- ethnic profile
- length of service
- age profile.

Creating a common HR database

By the time the measures were consolidated, they were out of date and their accuracy was challenged. Rationalisation was required to enhance efficiency and effectiveness of the systems that reported the measures, in order to gain credence with line management.

A harmonisation programme began in 2000. By the end of 2002, one consolidated HR and payroll database with all 11,500 RAC employees had been created, enabling RAC to benchmark across the company and devise a set of uniform measures for reporting. Named the 'People P&L,' these measures were considered just as important as the financial profit and loss.

To test and refine the new measures, a six-month pilot study was carried out to address concerns about format and accuracy. Common definitions and processes were introduced to facilitate comparisons. Under the pilot study, RAC benchmarked and quantified the costs of turnover, new colleague retention and absence. The CIPD HR trends and prospects survey was used as a nationwide comparator.

Reporting a 'People P&L'

The People P&L was well received and quickly integrated into the various business units. Demonstrating a direct link to the business strategy, it gave line managers a clear picture of the impact of people on the bottom line.

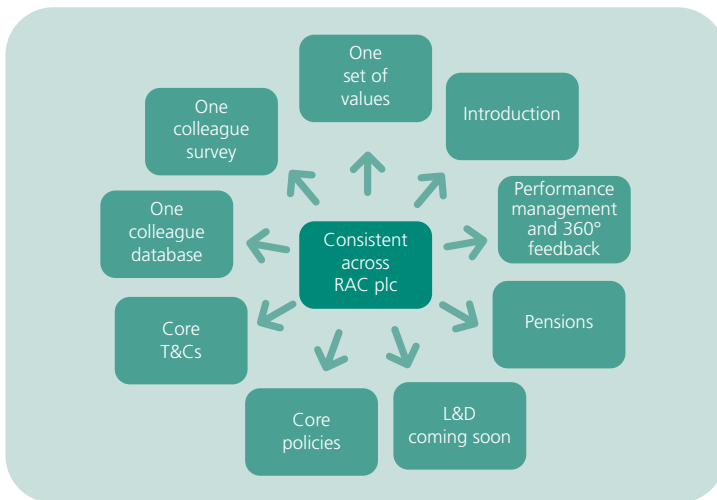
People P&Ls are now reported on a monthly basis, monitoring results and progress against targets within each business unit.

At the board level, RAC's board sets annual performance targets for colleague satisfaction, growth in revenue and growth in shareholder profit using a traffic-light system. These measures are particularly important to assess progress and success in delivering inspirational service. The target for colleague satisfaction is to achieve over 75 per cent.

Setting priorities for HR

For HR, key priorities have been focused on areas needing improvement. Figure 13 illustrates achievements in the 18 months after acquisition:

Figure 13: RAC after the merger: HR priorities



Business impact and value creation

As a result of these activities, colleague turnover has fallen by 3 per cent and absence is down 1.5 days per person per annum. These improvements translate into a quantifiable return on investment, which is reflected in bottom-line benefit.

Further, those investments in technology and a common HR database have enabled the company to deliver key consolidated people measures across the group with efficiency and to actively engage line management.

RAC has won a number of awards for the quality of its products and services. These include being ranked the top roadside rescue and recovery company in the annual J D Power and Associates independent customer satisfaction 2004 UK Roadside Assistance Study. As well as beating its rivals in overall customer satisfaction, RAC came top in 22 of 23 specific service-related performance areas. It attributes this success to the commitment of its people, underpinned by the company's investment in technology.

Case study 4

MultiCo: Building a people strategy

Business challenge

MultiCo is a US-based global services company, with more than 15,000 employees operating in diversified businesses and international markets. MultiCo was a highly successful company with well-developed brands. Yet its business leaders weren't content to rest on their success. They knew the company had to accelerate growth to preserve its market position in a highly competitive market and they knew that this challenge required some fundamental changes in the way they operated their businesses.

The service company had big plans for growth, but lacked an explicit strategy for securing, managing and motivating the people who would be needed to execute the business strategy. Leaders were asking:

- Is the workforce aligned with future business requirements?
- Which workforce practices should be maintained or changed?
- How do we maximise business results by adjusting people management?
- Which practices should be enterprise-wide vs specific to business unit?

The senior vice president of HR took on the challenge to address those critical business issues. With the support of Mercer Human Resource Consulting, MultiCo built a people strategy from the ground up, working with a team of HR leaders and business executives, comprising all the business units.

Human capital measurement in practice

MultiCo's approach to building its people strategy is based on a systemic comparison between the 'current state' and the 'desired state' of human capital management, combining the views from business leaders with the fact-based analysis of employees' experience over time.

Building the human capital database

The first step was to assess, collect and collate data from MultiCo's human resource information systems. The team compiled employee data over a four-year period, covering all of its business units.

Assessing the current state

The current state was assessed using a combination of quantitative and qualitative analytics. Mercer's Internal Labour Market AnalysisSM revealed, in hard quantitative terms, the kind of capabilities, behaviours and attitudes that were most valued within MultiCo, and the impact of specific practices on the workforce. For the qualitative analysis, Mercer's Human Capital ScanSM was deployed to elicit the perceptions of key HR and business leaders concerning the attributes of MultiCo's workforce and current management practices. Combining these sources of information, the team could test hypotheses about the workforce and create a consensus view of alignments and misalignments in the way MultiCo was managing its human capital.

Defining the desired state

The Human Capital Scan engaged top business and HR leaders to collaboratively think through the workforce implications of their strategic choices, and define what was required in the workforce to fulfill the company's strategic goals and growth targets.

Articulating MultiCo's people strategy

Assessing the gaps between the current and desired states enabled the team to articulate a coherent people strategy, which focused on three objectives:

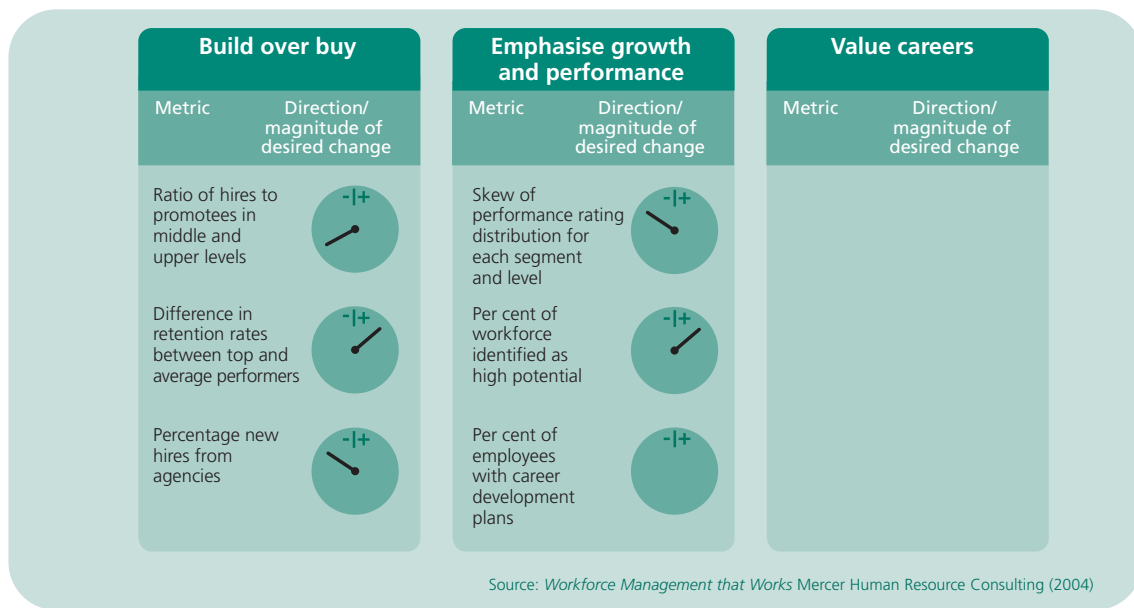
- **talent acquisition and development:** build over buy
Shift in hiring to lower levels and strengthen employee development plans to focus on requisite experience and capabilities.
- **performance management:** performance and growth
Emphasise employee development and growth, in addition to current performance, as basis of employee assessments.
- **Rewards:** value careers
Strengthen career components of rewards rather than pay and incentives to support development goals and reinforce retention among high performers.

Comprehensive three-year plans were developed, laying out action steps to achieve those objectives.

Monitoring the results

A human capital dashboard allows leaders to focus on and evaluate the success of the company's new people strategy, by reporting key metrics to improve, setting targets for desired change, and tracking progress.

Figure 14: MultiCo's human capital dashboard (selected metrics)



Business impact and value creation

Management understood that its workforce was key to engineering the strategic shifts it was aiming for. By engaging senior business leaders in the creation of the strategy – from the beginning – they created a common understanding of both the 'why' and the 'how' of specific policy choices. They transformed management's view of people from 'an expense to be controlled' to a 'value-producing' asset to be managed. And in the process, they transformed human capital management from an implicit HR function to an explicit business function.

This case study is drawn from Nalbantian and O'Neill (2003).

Case study 5

Royal Bank of Scotland: Linking people to business results

Business challenge

With more than 120,000 employees, the Royal Bank of Scotland Group (RBS) encompasses nine divisions with very different customers and employees. These range from the retail banking chains of the RBS and NatWest, and the Direct Line and Tesco Personal Finance brands to corporate banking and financial markets.

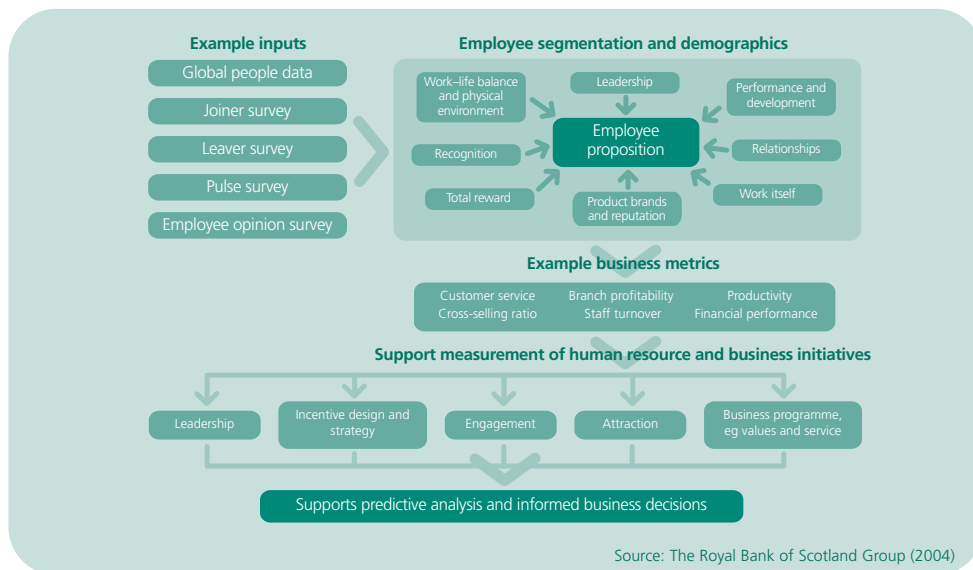
With staff costs of over £4.3 billion in 2003, the RBS group considers measuring the effectiveness of its investments in people and its impact on business performance to be a strategic imperative. Over the past 18 months, RBS HR has been building, validating and introducing a human capital model that both demonstrably links people strategies to performance and supports the improvement of those strategies in clear and manageable ways.

Human capital measurement in practice

Royal Bank of Scotland's human capital model

RBS created the Human Capital (HC) Model to assess the group's effectiveness at attracting, engaging and retaining employees. It also identifies the links between RBS's employee offering and business results. This model links the separate HR information in a consistent way, which is then analysed together with key business indicators. The outputs enable the business to understand how to influence the bank's results through its people.

Figure 15: The Human Capital (HC) Model



This approach won RBS the 2003 Innovation in Measuring Human Capital award from *Personnel Today*.

In order to test and validate the model, the RBS HR team reviewed all the survey instruments actually used in HR activities (joiner, leaver, 'pulse', employee opinion), along with the HR data available in HR's database over the 'life cycle' of an employee at RBS. The HC Model can be further analysed after the entire population is segmented by several criteria – such as tenure, location, gender or flexible benefits preference.

Linking employee engagement to productivity

The credibility of the model depended on the ability to demonstrate how engagement helps employees add value using the same business metrics that managers employ. The HR team put the HC Model into practice in the processing and customer contact centres, where productivity measures are very important, as these affect service to the end customer. The analysis found that productivity increased in tandem with engagement levels. With this information, managers could see the connection between what they were doing to energise their staff and how those efforts were translating into improved business performance.

Figure 16: Productivity vs engagement in trial area A



Increasing manager buy-in for the human capital model

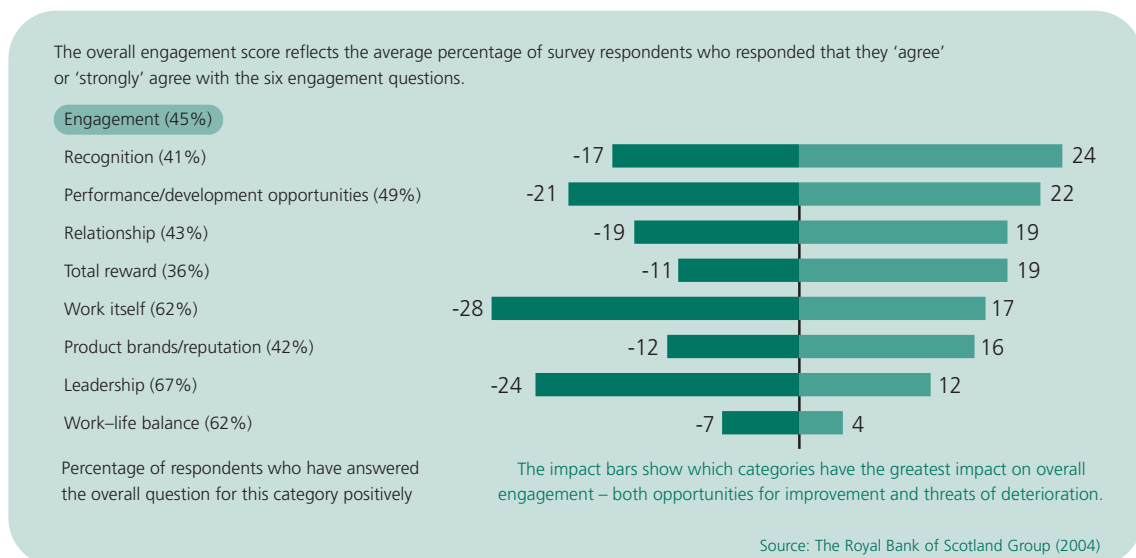
The HC Model project team was composed of representatives from group and business-facing HR and expert survey providers. The team also involved business managers. In some cases, the business managers, not HR, ultimately presented information back to the business division directly, enhancing the credibility of the process with those divisions.

Presenting the results of the HC Model analysis is an important aspect of gaining the support of managers. Instead of a detailed statistical analysis, they need answers to a few basic questions:

- What do the data tell me?
- What do I need to do to improve?
- What are the issues I need to watch?
- Are there any major challenges that will prejudice the performance of my business unit?

In response to these concerns, the model results can be presented as a one-page graphic engagement impact diagram (Figure 17) targeting the items that should be improved, and those that need to be protected to keep the engagement score rising.

Figure 17: Engagement impact diagram



Business impact and value creation

Six months after managers' action plans were implemented in one trial area, the HR group reported a 7 per cent increase in employee engagement. Managers have exhibited enthusiasm for this HC Model because it provides them with a road map and compass for raising their employees' contribution to the value of RBS. It also gives top management a strategic point of view about what could be done to improve employees' contributions to business performance.

Case study 6

National City: Measuring the ROI on training

Business challenge

National City, one of the ten largest retail banks in the US, with 33,000 employees, was threatened by strong industry consolidation. A shift in its corporate and banking strategy was needed to secure the loyalty of its customers. Two years ago, it launched a new brand promise to refocus on customer service: 'At National City, we care about doing what's right for our customers.'

Achieving this demanded enhanced employee skills sets, increased employee commitment and reduced turnover. Through the National City Institute, the company made a major investment in a training and induction programme designed to change the service culture. The investment was substantial, with start-up costs reaching \$2.5 million.

The National City Chairman and CEO addressed the challenge in his letter to stockholders in the company's annual report, citing the company's effort to change its value proposition to customers and the people practices that were being changed. He cautioned that these investments might hurt short-term earnings but were essential to longer-term success.

Human capital measurement in practice

Facing pressure to demonstrate the measurable benefits of the investments, the head of the institute worked with Mercer to establish a disciplined approach for assessing the impact of the programme and to quantify its return on investment.

Evaluating the impact of the training programme

Demonstrating the ROI for a 'soft' people programme – such as training – and its impact on key employee and business metrics required a fact-based, rigorous measurement approach. The evaluation of the training programme was rooted in Kirkpatrick's methodology (details about Kirkpatrick's methodology 'Evaluation in Training' can be found in Kirkpatrick (1987)), comprising four levels:

Reaction	Whether participants 'like' the training programme
Learning	The extent of participants' learning during training
On-the-job behaviours	The extent to which participants change their behaviours
Results	The extent to which training affects retention and financial performance

The fourth level has always been the most difficult to enact. Mercer's proprietary Business Impact Modelling™ using statistical modelling techniques to measure and predict the impact of HR initiatives on performance, provided the solution.

Data from multiple surveys, knowledge tests, and the company HRIS and financial systems were tracked 12 months after the training introduction and integrated to provide a comprehensive evaluation of the programme on all four levels. Using the Business Impact Modelling™, the analysis was able to:

- assess the business impact of the programme on the bottom line, while controlling for other factors (such as location, pay and changes in labour market conditions) that may affect financial performance
- determine the degree to which the programme changed employee behaviours in areas such as turnover and customer service.

Representatives from each of the businesses examined (retail, collections, item processing) were involved in the data collection and analysis phase.

Measuring the return on investment

The causal analysis revealed some compelling findings. The programme substantially improved employee commitment, customer service behaviours, turnover, absenteeism and financial performance.

New hires who participated in the training were 50 per cent less likely to quit in the first months of employment. This reduction in voluntary turnover alone could save the organisation at least \$1.35 million annually.

The programme was also found to reduce absenteeism by 25 per cent, representing an annual cost saving of \$306,000.

Figure 18: Impact of training on quit rates

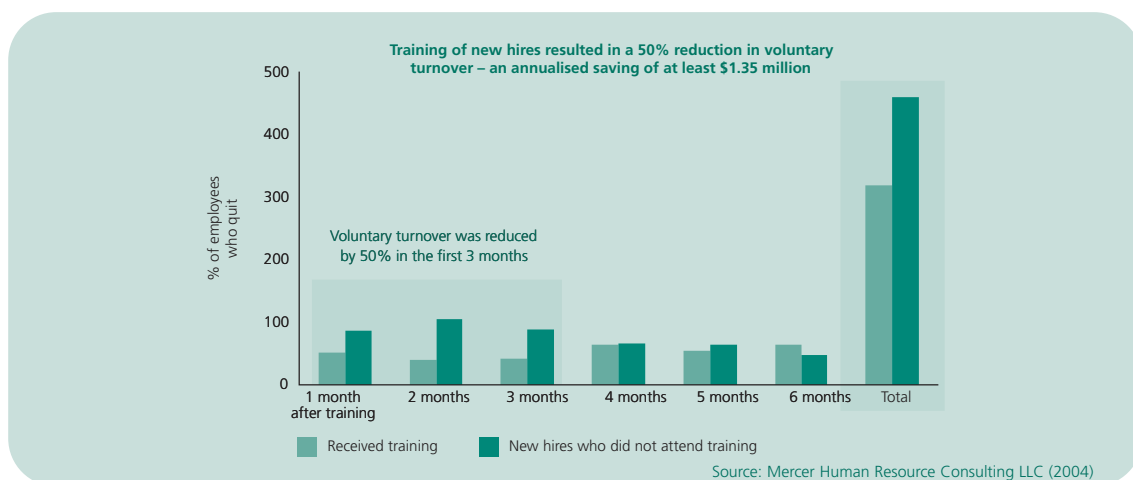
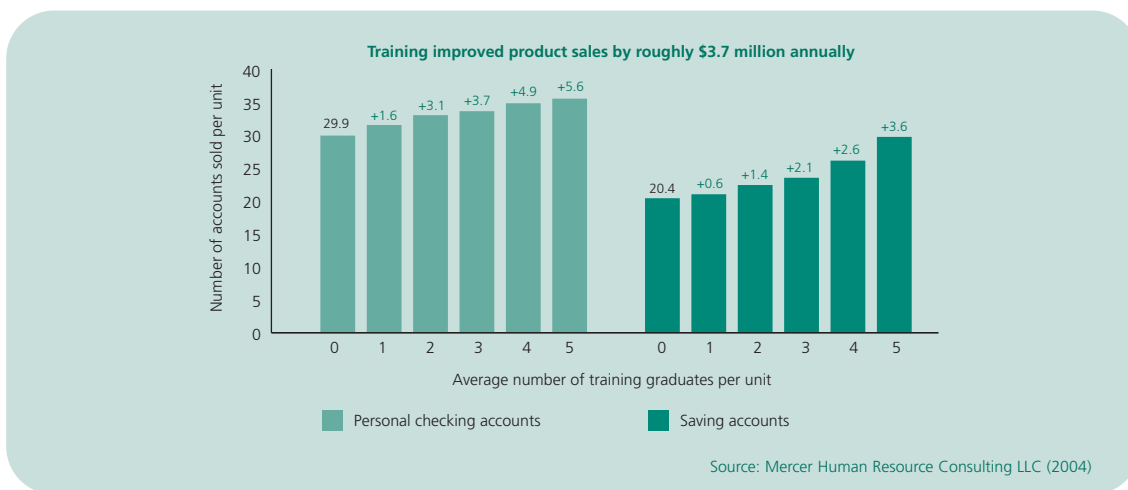


Figure 19: Impact of training on product sales



Most importantly, the analysis indicated that the programme improved sales of savings accounts, checking accounts and annuities and boosted the number of referrals. The greater the reach of the programme into organisational units, the greater the bottom-line payoff.

This represented an increase of \$3.7 million in annual revenue and \$1 million in net income for National City.

Business impact and value creation

Overall, the training programme combined cost savings and productivity gains representing, conservatively, an ROI of 6 per cent. This provided National City with tangible and measurable facts to report back to its shareholders.

National City's programme has won several awards, including a 2002 CUBIC (Corporate University Best in Class) Award for the programme's innovative measurement approach.) Additionally, *Workforce Magazine* awarded its Workforce Optimas Award in the Financial Impact category for HR initiatives that demonstrate positive business results.

For further information about this case study, see George et al (2004).

Case study 7

NHS: The link between human resource management and patient mortality

Business challenge

The NHS Plan set out a vision of what the NHS must become by 2012, with faster, more accessible services based on patients' needs. Delivering this depends crucially on the efforts of the biggest workforce in Europe – over 1.2 million people who are employed by the NHS.

Ensuring that these employees can deliver high-quality services requires the NHS to become an exemplary employer, creating a healthier workplace. HR in the NHS Plan states that, 'the delivery of high-quality, effective healthcare requires all executives, including professionals in management positions, to appreciate human resource management issues and the strategic role they play in enabling organisational excellence.

HR is everybody's business' (*HR in the NHS Plan: More staff working differently*, DoH, 2002).

Human capital measurement in practice

In 2002, the London Region NHS Executive funded a national study on the relationship between human resource management and patient mortality in hospitals, and commissioned Aston Business School to lead the research, with the aims of:

- determining whether there was a link between people management practices and hospital performance, specifically the quality of healthcare
- establishing which aspects of people management best predict levels of healthcare in hospitals
- offering prescriptions for hospital managers about people management in their hospital
- providing evidence of the likely impact of such changes on the quality of healthcare in the NHS.

The research process

Aston defines human resource management (HRM) as 'the practices of people management that aim to enhance organisational performance by improving the performance of individuals within the organisation'. The present study focused on ten main areas of HRM: trust strategy and HRM, recruitment and selection, training, harmonisation, job security, reward and flexibility, job design and teamworking, staff involvement and decision-making, and appraisal.

The research followed four stages:

Stage 1 – consultation exercise to develop a deeper understanding of the NHS organisational context, and to identify performance measures.

Stage 2 – survey completed by HR directors from 61 hospital trusts, including questions on the ten main areas of HRM.

Stage 3 – case study work examining examples of excellent HR practices in the NHS. The aim was to develop an understanding of the mechanisms by which employment and HRM practices contribute to enhancing hospital performance.

Stage 4 – collection of hospital performance data on health outcomes, using specific measures of mortality and an overall mortality index.

The link between HRM and hospital performance

Qualitative and quantitative data sources were integrated to analyse the link between each area of HRM and patient mortality. Statistical modelling enabled the researchers to account for local and hospital-specific factors that might have an effect on mortality, such as hospital size, local health needs and number of doctors per bed in hospitals.

The analysis revealed a strong relationship between HRM and patient mortality and found that each of the key HR practices was linked with mortality. The team tested which of these practices had the strongest links with mortality, and sought to quantify the magnitude of HR effects in real terms. Three HRM practices emerged as having the strongest association with lower patient mortality in NHS hospitals:

- the sophistication and extensiveness of appraisal
- the quality of and access to training
- the proportion of staff working in teams.

See Figures 20-23 on pages 65–66.

Figure 20: HRM and patient mortality



Figure 21: Appraisal and patient mortality

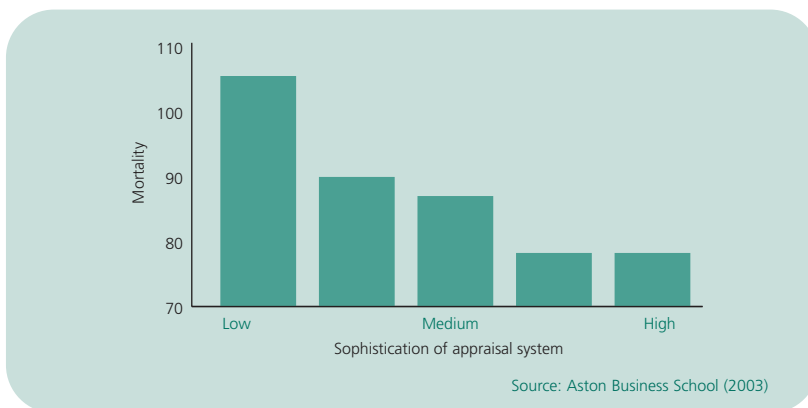


Figure 22: Training and patient mortality

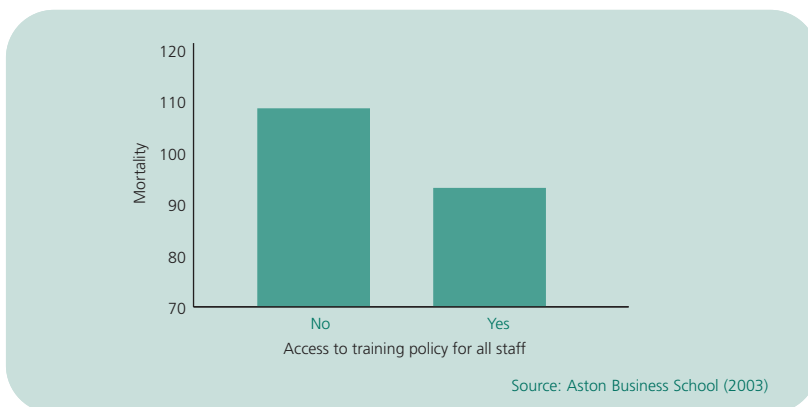
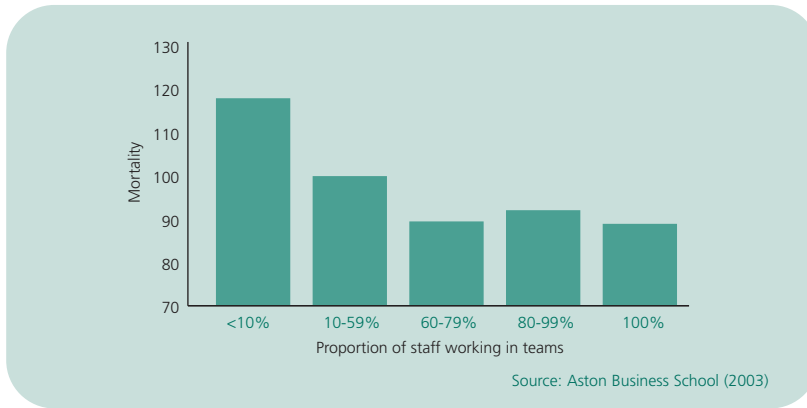


Figure 23: Teamworking and patient mortality



Business impact and value creation

Further, the research evaluated the likely impact of suggested changes in HRM practices on mortality, showing that, for hospitals of equal size and local population health needs:

- improving the sophistication and extensiveness of the appraisal system is associated with, on average, 1,090 fewer deaths per 100,000 admissions, or 12.3 per cent of the mean number of deaths.
- increasing teamworking – equivalent to approximately 25 per cent more staff working in teams – is associated, on average, with 275 fewer deaths per 100,000, or 7.1 per cent of the mean number of deaths.

The resource implications for the NHS are significant. Considerable benefits for patients' healthcare could be gained from investment in improving the sophistication and extensiveness of appraisal and training policies, and from increasing the percentage of staff working in teams within NHS hospitals.

The research provides compelling evidence that managing staff is not an 'incidental function in the NHS'. The HR function in the NHS has a critical role to play in the successful delivery of quality patient care.

This case study is drawn from the White Paper by West and Borrill (2003).

For further information about the research, please see West et al (2002).

Case study 8

TechnoCo: Managing diversity

Business challenge

TechnoCo is a global technology leader with over 50,000 employees and operations worldwide. Legal counsel and HR executives were concerned that there might be areas where the company's commitment to diversity was not being realised, opening them up to claims of pay and promotion inequity. TechnoCo teamed with Mercer to proactively examine the true extent of pay and promotion differences, and to determine how the organisation might address any disparities.

Human capital measurement in practice

To understand how an organisation's diversity strategy is playing out on the ground, it is critical to analyse the data captured in its HRIS. Such analysis can reveal where unexplained reward and representation gaps exist, as well as the dimensions of the reward structure that might be working to exacerbate or mitigate disparities.

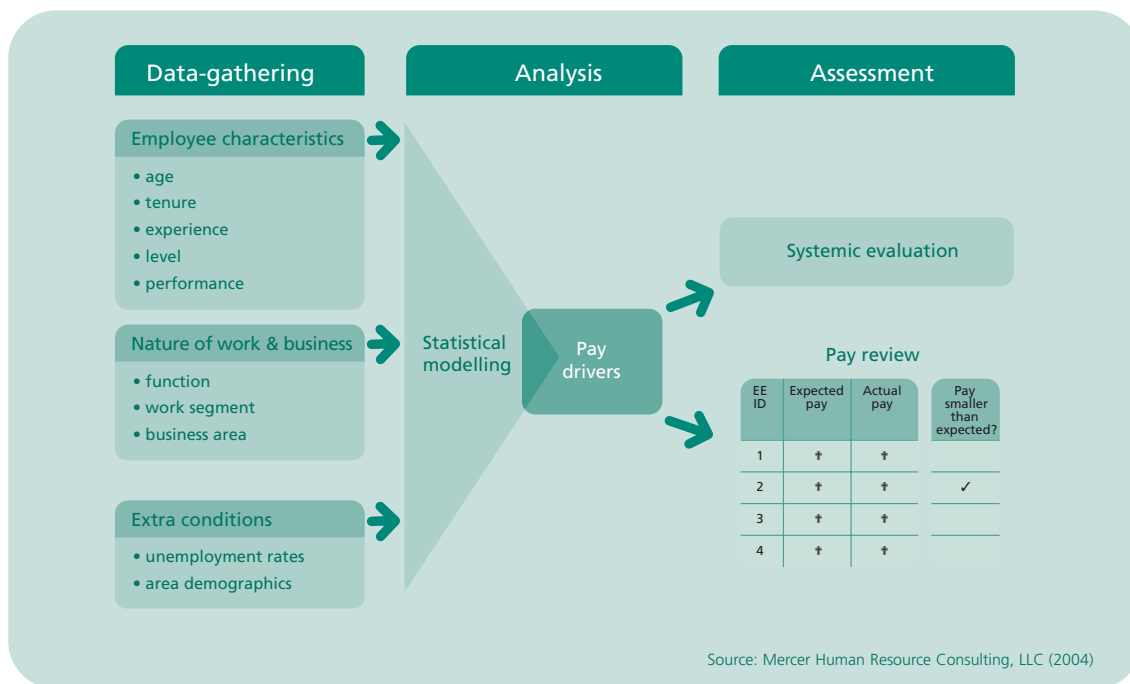
The process

TechnoCo's legal counsel requested an analysis covering the main components of reward equity: base pay rates, base pay growth, total compensation, and promotion. Using employee data covering multiple years and advanced statistical methodologies, TechnoCo was able to:

- assess disparities in pay and promotion, by gender and ethnicity, at organisation, division and employee levels
- identify potential adjustments that eliminated disparities for specific employees
- understand workforce dynamics causing disparities to emerge over time.

The process to assess pay rate equity followed three steps, as shown in Figure 24 overleaf.

Figure 24: Overview of the pay equity process



1 Data-gathering

- Data were collected from the organisation's HRIS and payroll systems and supplementary sources on employee characteristics, the nature of their jobs and businesses, external conditions and rewards. The measures of pay included base pay, total pay (bonus, commission, overtime, etc), and information on equity awards. Individuals were compared over four consecutive years to determine pay growth and promotion outcomes.

2 Analysis of the drivers of rewards

- Mercer's Internal Labour Market analysis™ enabled TechnoCo to go beyond a snapshot of its pay distribution practices. It identified the drivers of total rewards and career progress over time and, hence, the root causes of disparities. Statistical modelling was used to account for individual characteristics, job attributes, organisational factors and external influences that could otherwise legitimately result in differences in rewards.
- Since TechnoCo's multiple divisions and job types deployed different pay and reward determination mechanisms, several models were conducted to address differences in practices across segments.

3 Assessment of rewards equity

The analysis provided an objective review of any differences in compensation and career advancement by race and gender. The models identified parts of the organisation as well as specific employees for which reward gaps could not be explained by legitimate factors. The models also provided potential pay adjustments.

- TechnoCo went beyond the analysis to address disparities. In consultation with its legal counsel, it set up a systematic review process to examine, in each case, whether other factors not captured in its data systems could reasonably explain the difference.

Managing and monitoring equal opportunity

These cases were documented in a Mercer software tool that:

- represents disparities for individual employees and selected groups across gender and race categories, and tracks the cost of eliminating disparities
- enabled TechnoCo to focus on segments of the organisation facing gaps and, within each, systematically to review individual cases and document circumstances that justify differences.

Business impact and value creation

Preventing the emergence of gaps

The analysis also revealed practices responsible for gaps emerging over time. Using this information, TechnoCo could adopt a proactive approach to managing diversity, and take action to prevent future gaps. For example:

- While women and men were equally likely to progress and were hired into similar positions, they were concentrated in different jobs. TechnoCo needed to assess whether women were self-selected or channelled into different careers over time and to take action to increase the representation of women in opportune jobs – through revisiting qualification requirements and enhancing training opportunities.
- New hires were coming in at pay rates that were sensitive to external labour market conditions. As TechnoCo was striving to hire increasing numbers of women in soft labour markets, they were at risk of amplifying gaps. The company would work to ensure that women coming into the organisation were paid fairly in relation to incumbents.

Overall, the process enabled the HR and legal counsel teams to work together to better understand the extent to which they might be exposed to claims of unequal treatment and to take proactive steps to ensure that their reward practices fit with their corporate commitment to diversity.

Case study 9

Tesco: What gets measured gets managed

Business challenge

To sustain advantage in today's intensely competitive retail sector, Tesco's business focus is highly customer-driven as stated by its core purpose, 'to create value for our customers, to earn their lifetime loyalty'.

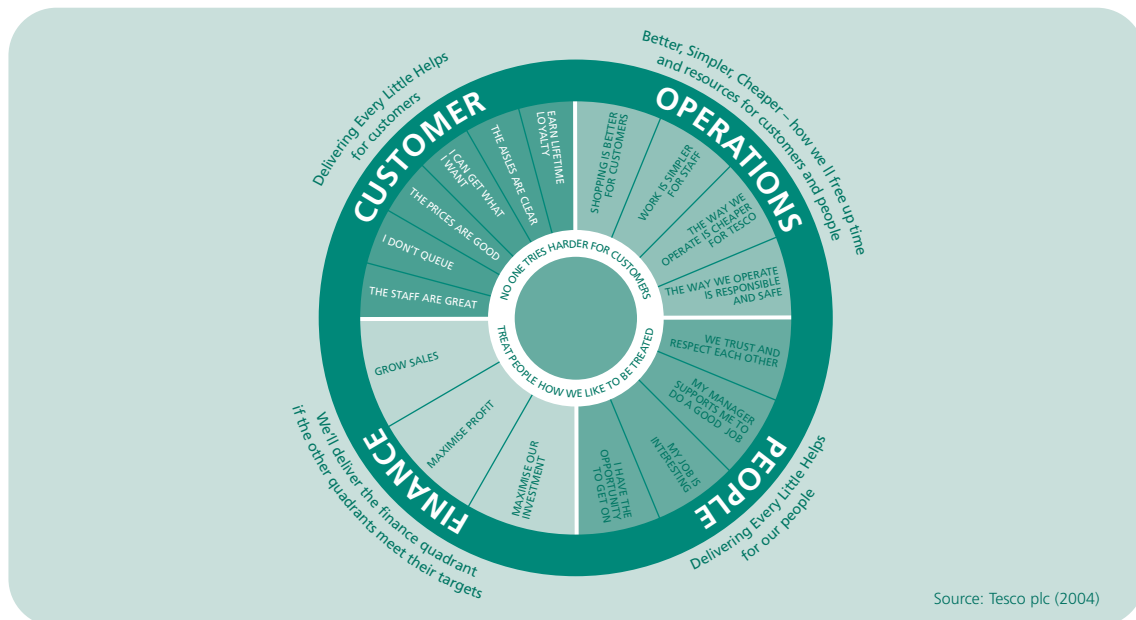
The competencies of its 250,000 employees are critical in fulfilling this challenge. A deep understanding of the different ways in which its people strengths can be channelled to generate customer value and contribute to business performance is paramount.

With this purpose in mind, Tesco has formed an Insight Unit within the marketing team to measure people issues across business functions.

Human capital measurement in practice

To manage its business strategy, Tesco has adopted the balanced scorecard, which it has renamed the Steering Wheel. The Steering Wheel is divided into four parts – Customer, Operations, People and Finance. The HR function delivers on its scorecard goals by producing 'hard' data linking the people quadrant and the rest of the wheel.

Figure 25: Tesco's Steering Wheel



'What gets measured gets managed'

To evaluate success effectively, quality people data is essential. Acknowledging the importance of data integrity in measuring progress against strategic goals, Tesco developed its Insight Unit to measure people issues across the scorecard. By developing a set of key performance indicators (KPIs) on people, Tesco has been able to demonstrate which people measures are most critical to meeting business objectives and how people policies can contribute.

Specifically, the Insight Unit analysed a combination of people data, research and employee opinion surveys, producing fact-based insights into the drivers of people commitment:

- Research into KPIs confirmed that workforce loyalty and commitment are crucial. While employee commitment is driven by functional and practical factors such as job stability, the emotional aspects of commitment play an extremely important part.
- Employee opinion surveys coupled with comprehensive analysis of feedback data revealed that the key drivers of emotional commitment include trust and respect, feeling supported, job interest, career development and opportunities.

Making effective use of data is key and human capital evaluation at Tesco works on the basis that 'what gets measured gets managed'. Already feeding employee competency data into strategic planning, Tesco now turns people data to advantage for monitoring performance against its strategic goals.

Relating strategy to day-to-day work

Every store also has its own individual Steering Wheel, which is linked to every person's objectives, relating strategy to day-to-day work. Individual managers are supplied with results from employee opinion surveys to incorporate into their action planning toolkits. These toolkits highlight development areas and further feedback requirements.

Performance is measured and reported to the board every quarter and a summary report is sent to the top 2,000 managers in the company to cascade to staff.

Ultimately, KPIs contribute to the way Tesco monitors and reports overall company performance to its shareholders. Proposals for addressing KPIs are outlined in Tesco's annual people plans, as illustrated in Figure 26 overleaf.

Figure 26: Sample key performance indicators (KPIs)

KPI	2003/04 target	How we performed	Below target	On target	Exceeded expectations	Target for 2004/05
Social: Employee retention	To retain loyal and experienced staff in the business and achieve a loyalty level of 80%, ie staff who have been with Tesco for more than 1 year.	We have exceeded our target. 82% of our experienced staff stayed with us throughout 2003/04.			✓	To exceed 80% retention of experienced staff.
Social: Employee training	95% of retail staff to be trained to bronze level.	96% of retail staff achieved bronze level.			✓	95% of retail staff to be trained to bronze level.
Social: Supply chain labour standards	To assess 10% of high-risk own-brand suppliers on labour standards.	We achieved our target for assessment of high-priority own-brand suppliers, carrying out audits at 83 high-risk sites.		✓		To carry out ethical assessments of 100% of our high-risk own-brand suppliers.
	To train 10% of high-risk own-brand suppliers on labour standard issues.	We exceeded our target, providing training to 450 suppliers to date.			✓	To train 100% of our ethical high-risk own-brand suppliers.

Source: Tesco Corporate Responsibility Review (2004)

Business impact and value creation

Application of the Insight Unit's findings, together with ongoing data generation and performance measurement, has had a significant impact on value creation by positioning the workforce to deliver on corporate goals.

Tesco also uses the Steering Wheel KPIs as a communication tool to report on corporate responsibility to the external community. With integrity at the centre of its responsibilities, the company carried out in 2003 the first internal audit of its corporate responsibility system, to ensure that it stands up to external scrutiny. Verification of the data used for the KPIs was carried out using independent sources where possible. Through disciplined human capital measurement, management and reporting, Tesco shows its commitment to delivering results and the highest standards of corporate governance.

References

- BECKER, B.E., HUSELID, M. and ULRICH, D. (2001) *The HR scorecard: linking people, strategy and performance*. Cambridge, Mass.: Harvard Business School Press.
- CFO RESEARCH SERVICES. (2003) *Human capital management: the CFO's perspective*. Boston: CFO Publishing Corp.
- CIPD. (2003) *Human capital: external reporting framework*. Change Agenda. London: CIPD.
- DELOITTE & TOUCHE and PERSONNEL TODAY. (2002) *Measuring human capital value 2002 survey*. London: Deloitte & Touche.
- FITZ-ENZ, J. (2000) *The ROI of human capital: measuring the economic value of employee performance*. New York: Amacom.
- GATES, S. (2003) *Research report: linking people measures to strategy*. USA: The Conference Board.
- GEORGE, G., HANNIBAL, M. and HIRSCH, W. (2004) Building the brand through people. *WorldatWork Journal*. First quarter.
- GUEST, D., MICHIE, J., SHEEHAN, (2000) *Effective people management*. London: CIPD.
- KIRKPATRICK, D.L. (1987) Evaluation in training. In: CRAIG, R.L. (ed) *Training and development handbook: a guide to human resource development*. 3rd ed. New York: McGraw Hill. pp301–319
- KAPLAN, S. and NORTON, D. (1996) *The balanced scorecard*. Boston: Harvard Business School Press.
- KEARNS, P. (2000) *Measuring and managing employee performance: a practical manual to maximise organisational performance through people*. London: Financial Times Prentice Hall.
- MATTHEWMAN, J. (2003) Strong divisions. *People Management*. 20 February.
- MAYO, A. (2001) *The human value of the enterprise: valuing people as assets – monitoring, measuring, managing*. London: Nicholas Brealey.
- MAYO, A. (2004) One-stop guide: understanding HR return on investment. *Personnel Today resources*. 23 February.
- MERCER HUMAN RESOURCE CONSULTING. (2004) *Human capital and business performance: measuring the links*. New York: Mercer Human Resource Consulting.
- NALBANTIAN, H.R. and O'NEILL, C. (2003) *Workforce management that works: new opportunities to leverage your human capital*. New York: Mercer Human Resource Consulting.

NALBANTIAN, H.R., GUZZO, R., KIEFFER, D. and DOHERTY, J. (2004) *Play to your strengths: managing your internal labour markets for lasting competitive advantage*. New York: McGraw-Hill.

PHELPS, M. (2002) *Human resources benchmarking*. London: Gee Publishing.

PURCELL, J., KINNIE, N. and HUTCHINSON, S. (2003) *Understanding the people and performance link: unlocking the black box*. London: CIPD.

RUCCI, A., KIRN, S. and QUIN, R.T. (1998) The employee–customer–profit chain at Sears. *Harvard Business Review*. January–February.

SCARBROUGH, H. and ELIAS, J. (2002) *Evaluating human capital*. London: CIPD.

WEST, M., PATTERSON, M. and LAWTHOM, R. (1997) *Impact of people management practices on business performance*. London: CIPD.

WEST, M. and BORRILL, C. (2003) *Effective human resource management and lower patient mortality*. Birmingham: Aston Business School.

WEST, M., BORRILL, C. and DAWSON, J. (2002) The link between the management of employees and patient mortality in acute hospitals. *International Journal of Human Resource Management*. Vol. 13, No. 8. pp1,299–1,310.

WATSON WYATT WORLDWIDE. (2002) *Human Capital Index®: human capital as a lead indicator of shareholder value*. Washington, D.C.: Watson Wyatt Worldwide.

Consultation papers on human capital reporting

ACCOUNTING FOR PEOPLE TASK FORCE. (2003) *Accounting for people: report of the task force on human capital management*.

COMPANY LAW REVIEW. (2002) *Modernising company law*. Cm 5553. London Stationery Office.

DEPARTMENT OF TRADE AND INDUSTRY. (2004) *Draft Regulations on the operating and financial review and directors' report: a consultative document*. London: Stationery Office.

OFR WORKING GROUP. (2004) *The operating and financial review: practical guidance for directors*.

OFR WORKING GROUP. (2003) *The operating and financial review working group on materiality*.

The CIPD explores leading-edge people management and development issues at a strategic level. Our aim is to share knowledge and to increase learning and understanding to improve practice. We produce surveys, think-pieces, research summaries and introductory guidance that all are available to download from our website.

Chartered Institute
of Personnel and
Development

CIPD House Camp Road London SW19 4UX
Tel: 020 8971 9000 Fax: 020 8263 3333
Email: cipd@cipd.co.uk Website: www.cipd.co.uk
Incorporated by Royal Charter Registered charity no.1079797

