

# Journal of Applied Human Capital Management

INAUGURAL ISSUE

*'Organisation performance through a human capital lens'*

www.ISHCM.com



INTERNATIONAL SCHOOL  
OF  
HUMAN CAPITAL MANAGEMENT

Volume 1 Number 1 2007

## Feature article



Focus on the first issue.....

- 13 **THOUGHT LEADERSHIP**  
Competitive Advantage through Strategic Human Capital Management  
Nicholas J Higgins
- 34 Devising an HCM Strategy: The Strategic HCM Toolkit  
Nicholas J Higgins
- 43 Employee Engagement  
Graeme Cohen & Nicholas J Higgins
- 59 Human Capital Measurement: A retrospective viewpoint  
Maurice Phelps
- 64 Brave New HR World - Part I  
Nicholas J Higgins
- 73 **SPOTLIGHT**  
THE VB-HR™ Rating HCM100 Study
- 91 **PRACTITIONER FOCUS**  
Employee Engagement – A review of the recent London conference  
Eric Welburn
- 99 View from the frontline:  
Management matters at the British Library:  
An interview with Mary Canavan
- 102 **INDUSTRY FOCUS: PUBLIC SECTOR**  
People management in Local Government:  
The VB-HR™ Rating consortium

Thought  
leadership

# Competitive Advantage through Strategic Human Capital Management



By Nicholas J Higgins

DrHCMI MSc Fin (LBS) MBA (OBS) MCFI

Dean, International School of Human Capital Management, London & CEO, VaLUENTiS

Sustained competitive advantage is often talked about, often strived for but for many organisations it remains an elusive goal. Organisations are increasingly realising that the only real differentiator in performance terms is people, since finance, IT/systems, marketing, supply chains and global reach can all be replicated. Public sector organisations are also increasingly exposed to the rules of market dynamics. As such, strategic human capital management is becoming the 'new science', with its focus on employer branding, employee engagement, talent management, human capital reporting and other emerging disciplines.

This paper, taken from the forthcoming publication 'The Human Capital Management Manifesto' provides a ground-breaking framework for HR leaders to analyse their external and internal environments to provide a truly strategic view of human capital, its management and contribution to an organisation's competitive advantage (whether public or private), drawing on existing concepts. Of particular importance is the existence of generic human capital strategies and their influence on deriving a HR strategy. The article goes on to describe the components of a strategic HCM toolkit which senior executives and HR leaders will find of prime importance in applying to their particular organisational context. The article is divided into two parts, part I sets out the underpinning framework and observations – the Why? Part II looks at the What? and the How? through the strategic HCM toolkit.

## Part I

# All organisations employ people.

All organisations have some form of strategy. Thus logic dictates that all organisations should have some form of people strategy, whether it is implicit or explicit, which provides a means for the said organisation to carry out its strategy. But is HR strategy as we know it the same as strategic human capital management (HCM)? The answer is actually no. HR strategy is in fact a derivative of strategic HCM, an output of a simple yet robust framework for which this article puts forward.

### The limitations of current HR strategies

All organisations, whether public, private or NFP, operate within a given 'industry' or subset of an 'industry', each having its own operating model (or models) with which people form a central component. Thus, strategic human capital management must take into consideration the prevailing 'industry' context for providing any ensuing organisational strategy with regard to people.

Rewinding for a moment, to allow ourselves to form a picture of what HR strategy currently looks like, we can see that, for many, HR strategy is really a collection of objectives/tasks that have been assembled from interaction with the 'line', (though some are still done in isolation). This HR strategy is really a collection of operational objectives, reflecting the roots of HR as an operationally focused function. This has served many well to the point of its limitations. For others, HR strategy has been nothing more than an inarticulated phrase of intention.

increasing focus on human capital measurement & reporting, and the search for an intangible model of how human capital relates to organisation value or organisational service delivery (in place of value).

Suddenly the world of people management has got 'complex'. Actually, that's not true. Managing people and optimising their performance in an organisational context has always been complex, it's just that we have preferred to treat it too simply, too often. In the whirl of organisational and industry dynamics, organisations and their HR functions need to make sense of all the competing elements – never has the concept of spinning plates had such a metaphorical reality.

### The importance of human capital

For the real reason that organisations, and their C-class executives need to 'get it', is that, in our increasingly knowledge-based economies, competitive advantage is increasingly derived

*Suddenly the world of people management has got 'complex'. Actually, that's not true. Managing people and optimising their performance in an organisational context has always been complex, it's just that we have preferred to treat it too simply, too often.*

Until recent times, these manifestations of HR strategy have served their, albeit, limited purpose providing HR functions with a certain *raison d'être*. However, lately, there have been a number of developments which have the inexorable mark of becoming mainstay elements of human capital management going forward.

For example, these include such concepts as employee engagement, talent, employer brand, human capital management architecture, workforce intelligence and human capital itself; all becoming everyday items in the lexicon of people management. Added to this, has been the

through people and their respective talents, and in a number of cases it is the only reason, for example in professional service firms, such as law or accounting, and many public sector organisations.

A few further examples would serve to illustrate the point. Ask any organisation which has invested in CRM technology, and they will tell you that ultimately it is the reliance on employees to leverage it to best effect, in B2C models like retail banking - in terms of cross-selling products at branch level; or in B2B models such as that employed in pharmaceuticals where getting sales

teams to input knowledge through client management is a key challenge.

On a wider note, staying on the pharmaceuticals theme, drugs are developed by R&D teams, not by computers. Car design still requires human input, even though manufacturing can be done by robots. Robots are both designed and maintained by human input.

Computer mainframes themselves require human monitoring. Similarly, no matter what technology is brought into health services, it still requires people to know when and how to use it and, more importantly, to interpret the data. And so on. The differentiating point is people. All organisations can access finance, acquire the same technology and software, route the different channels to market, the same lean supply chains, and access buildings and transport. No - what makes the difference is people and organisational leadership – which is itself a collective people interaction, and the execution of all of these organisational assets.

It is easy to forget that in the mega-trillion dollar industries that are business unit structured, multiple systems and technology-platformed; performance indicator-driven organisations, that human capital is the core element.

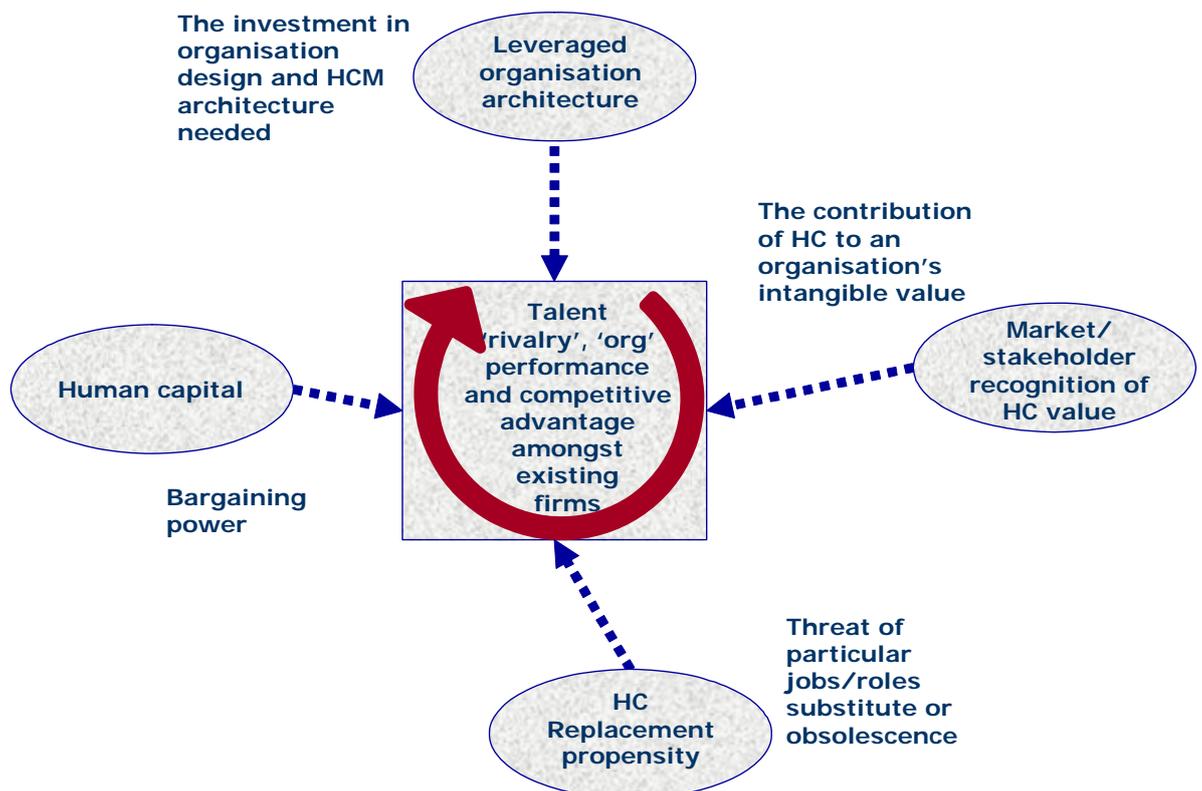
Somehow, collectively, we seem to have undergone selective memory loss when understanding human capital's contribution. Therefore organisations need to be reminded that strategy, innovation and creativity, product development, customer service/delivery, financial market trading, goods distribution, call centre response, hospital care, social care, teaching all have one thing in common – human capital.

Thus acquisition and retention of talent, both locally and globally, and developing capability whilst stretching individual performance, is of paramount importance, whether the organisation is a global billion dollar S&P500 striving to attain higher shareholder value or a local government department meeting citizen-based delivery expectations. From a human capital management perspective, private and public sector organisations face many similar challenges.

### Strategic HCM

Each industry (and sub-industry) has its operating signatures, pressures and outputs. Each organisation within that industry has its unique set of capabilities and performance history and with it the requisite talent necessary for achieving

## Strategic HCM Industry Analysis



both current and future expectations. Each competing cluster of organisations adds to the intensity of managing people well or risks the consequences.

Thus the strategic HCM framework proposes to acknowledge this constant 'push-pull' of existing forces that determine the top performing organisations from the also-rans, whilst at the same time providing the 'operating constraints' with which organisations have to negotiate.

As such, it incorporates and adapts previous knowledge from social science disciplines. In particular, I wish to acknowledge the pioneering work of Michael Porter on his industry analysis and competitive strategy/value chain frameworks<sup>1</sup>. Thus, I present for the first time, what I believe to be a truly encompassing framework for deriving human capital management strategy for any organisation to use.

These 'five HCM forces' dictate the parameters of organisation performance through a human capital lens, providing a battleground over which organisations 'fight' for and manage talent, and determine the optimal trade-off on human capital leverage as against human capital investment, and its ensuing impact on overall organisation performance.

Those organisations getting it right ultimately gain sustainable competitive advantage, i.e. a higher rate of return from their human capital, no matter the other pieces of an organisation's value proposition to its market-place/environment.

## The five HCM forces

To recap the 'five HCM forces' identified with strategic human capital management are:

- ❑ Talent rivalry
- ❑ Human Capital
- ❑ Leveraged organisation architecture
- ❑ Market/stakeholder recognition (of HC derived intangible value)
- ❑ Human capital replacement propensity

In effect, 'Talent rivalry' is impacted upon by the interaction of the other four forces. It also, in turn, acts as the 'primary' force impacting on organisation performance and ensuing competitive intensity. To help understand the effect of these forces, each contains a set of Premises<sup>2</sup>. Supporting comment is provided, together with appropriate observations on what organisations and HR functions should focus their attention in relation to the Premise. These

premises also provide insight and explanation into observed market behaviour. It is important to note that in undertaking an HC industry analysis, the emphasis can be threefold:

- The analysis can be at industry or subset industry level as defined
- The analysis can be focused from the human capital perspective which may be multi-industry dependent upon the context
- The analysis can be undertaken from the job role/family cluster perspective

All of these analyses will provide the necessary context for an organisation's human capital management strategy where appropriate, though it is to be acknowledged that the job family/role analysis will normally be undertaken as a subsidiary exercise; providing deeper context on specific areas such as critical (core) roles to the organisation.

## 1 Talent rivalry and competitive intensity



Starting with the core, the intensity created by competing organisations and their predilection for talent; this force encapsulates the competing operational strategies, i.e. their individual human capital management (HCM) strategies and market positioning, their employer brand (EB), their employee value proposition (EVP) and subsequent delivery on EVP expectation - through measures such as employee and organisation engagement and human capital related performance. This force is split into six sections:

- Competitive rivalry
- Human capital utilisation
- Employee engagement
- Employer brand
- Organisation performance
- Talent rivalry and retention.

<sup>1</sup> See Competitive Strategy (1980) and Competitive Advantage (1985), Michael E. Porter, Free Press

<sup>2</sup> There are a total of 34 premises spread across the five HCM forces. A list is provided at the end of this article for reference. Comment under each premise has been shortened for this particular article - for full version see The Human Capital Management Manifesto, forthcoming

**(a) Competitive rivalry**

**Premise [1]: That the number and size of competing firms in an industry will impact the intensity of human capital rivalry and ultimately competitive advantage.**

Competition in any industry or subset of industry will continually work to drive up human capital costs, whilst at the same time, driving down the potential returns on human capital similar to that as determined in the market – i.e. down to the free market rate.

As with the main economic theory of deriving economic profit, the more intense the competition, the more difficult to sustain adequate returns and this is the same for human capital. However, intense rivalry will also tend to drive up the costs of employing human capital as organisations jockey for premium employer value propositions (EVPs). Thus organisations potentially suffer a 'double whammy' in terms of human capital return.

However, more macroeconomic factors can influence the degree of intensity. For example, an industry which is experiencing market growth will mean that required talent (skill-sets) may become 'scarce' for organisations to acquisition thus further driving up costs of employment.

Conversely, organisations in a maturing or declining industry will potentially have human capital over-supply which has implications for costs of employment. Talent may well be in good supply but individuals may require further benefits to compensate (i.e. guaranteed pension or large pay-off entitlement should termination ensue).

Given the increasing sophistication of reward-benefits packages, organisations (through their HR functions) are increasingly turning towards optimisation analysis as a means of optimising reward profiles, i.e. the cost-efficiency of reward-benefit costs relative to best individual choice<sup>3</sup>. (Note this is from a reward perspective rather than the whole employee engagement perspective).

**Premise [2]: The degree to which human capital is paramount to an organisation's operating model (HCI) will determine the intensity of talent rivalry.**

Organisations utilise human capital to differing degrees<sup>4</sup> with some organisations more heavily dependent than others. Industries whose organisations have higher HCI ratios will, on average, incur more intense talent rivalry, than

firms who have much lower HCIs. That is not to say that human capital is not important in these organisations, merely the degree of intensity to which talent rivalry will occur.

Increasingly, organisations view their human capital population in a segmented fashion in terms of how human capital is viewed and categorised as either 'core', 'support' or 'contracted' (with further potential sub-classifications where appropriate). This assists in deriving specific strategies around areas such as employer branding, talent management and reward.

For HR functions, understanding how employee and management populations can be segmented is important. Traditionally this has been limited to demographic segmentation such as role, age and/or ethnicity categorisations. Increasingly, human capital segmentation needs to be viewed in further ways, i.e. role criticality, employee value proposition, development curve, communication network, degree of HR support etc. This provides far more insight to the perplexities of the organisation's human capital operating models and in particular defining HR's delivery and value contribution.

**Premise [3]: Given the underlying industry profit/return signatures, organisations will gain competitive advantage through the most effective utilisation and management of human capital.**

It is logical to reason that given any two identical organisations, the only difference being their human capital – then the organisation which gains higher productivity through the engagement of their employees and leadership of local and senior management will win out every time. Its return-cost ratio will always be higher and therefore overall performance also. To achieve competitive advantage, organisations need to ensure 'core' roles (these are not just in management) are matched with 'best fit' individuals and teams who are highly engaged (alphas).

It is important to remember that industry cost structures dictate the degree of profit signatures. Do organisations generate above market returns and therefore have higher HC return curves or are margins wafer-thin and/or indeed loss-making which accentuates cost-containment and lower HC return curves?

On a similar note, in industries where 'barriers to exit' are high, it is difficult for incumbent firms to exit with the HC performance-cost curve becoming particularly acute.

<sup>3</sup> Trade-off is achieved using conjoint analysis and then plotting against an efficiency frontier means that changes can be made in reward-benefit allocation, in terms of either reduced cost for same employee value proposition, or same cost for increased value proposition (maximising individual utility)

<sup>4</sup> The correct term is HCI – Human Capital Intensity and is a measure of relativity between operating costs which are HC related versus non-HC treated – see 'Cracking The Human Capital Code' –downloadable at [www.valuentis.com](http://www.valuentis.com) for further reference

If so then pressure on costs will increase due to fact that the majority of incumbent human capital will tend towards 'continuance commitment' (with its associated productivity challenges). Thus, employee benefits will become a prominent issue as individual employment switching costs (being re-employed outside of industry and the issues of retraining/relocation) are higher. In these instances, individuals look to maximise future benefit utility rather than undergo the uncertainty inherent in switching. The UK and US car industries give good examples of this.

For organisations, understanding where and how, and to what degree human capital adds value in relation to the unique profit signature(s) is of primary importance. HR functions need to go further and provide modelling analytics<sup>5</sup> to demonstrate this value derivation/contribution. Thus, the degree to which HR functions can display or access competence in this area, the greater their explicitised contribution to an organisation's competitive advantage (see also premise [30]).

#### ***(b) Human capital utilisation***

**Premise [4]: *That the organisation's utilisation of human capital is dependent upon the organisation's (or sub-unit's) operating model.***

The utilisation of human capital will always be dependent upon an organisation's operating model and performance, i.e. the degree to which an organisation uses various 'assets' together and the degree to which an organisation can generate higher revenues/profits (or alternative output measures). Thus, there will always be a natural limit to the productivity leverage of human capital.

Organisations need to have an understanding of where this 'HC leverage point' is, as potential over-investment in HC initiatives may occur as much as under-investment.<sup>6</sup> Again, as stated in Premise [3] HR functions have a core role, in conjunction with finance, in deriving the necessary analytics<sup>7</sup> to establish this type of organisational intelligence.

**Premise [5]: *Organisations deploy differing resourcing strategies either recruiting in before market and developing or purchasing required skill-sets but at market cost.***

Organisations operate hiring strategies that can be represented spread across a continuum with two generic strategies occupying each end from 'hiring in and developing human capital' through

to purchasing-in specific human capital. In practice, organisations choose a 'mix' dependent upon roles being filled. However, this model serves the purpose for understanding differing HC investment curves and thus pay-offs, particularly given the use of part-time or reduced-time staff.

Quite often, the changing external environment subtly changes resourcing options and organisations, from a human capital resourcing standpoint, need to understand their operating model requirements, particularly given the investment. This is quite marked in the small to medium sized business segments.

For example, an organisation's resourcing model is revealing in the potential transitory nature that employment may occur for individuals. This is the same for professional services firms as it is for leisure organisations. Understanding the resourcing model provides insight that may make certain reported HC metrics meaningless (i.e. turnover). The concept of HC return-cost curves for specific roles is still in its infancy with regard to industry practice.

This is a core fundamental for HR functions. Thus, understanding the operating model(s) in existence, evaluating current HC utilisation strategy and its implications for the organisation is paramount. Use of analytics is again helpful here in identifying any 'disconnecting' operational issues which are incurring unnecessary cost or vice versa – areas of under-investment.

**Premise [6]: *Human capital management is a key component to best utilising human capital.***

Human capital management is the collective term for optimising the capabilities and performance of management (as a separate subset) and employees<sup>8</sup>. Organisations can set the agenda for how high the 'bar' is in terms of managing human capital within their boundaries.

Thus, an integrated approach to human capital support mechanisms such as resourcing, training and development, organisation design, performance management, reward, employee communications, health and safety, payroll and HRIS can significantly leverage collective human capital productivity (through differing aspects of engagement).

However, for leverage to happen, all levels of organisational management need to execute to standards set. This is where effective HR functional expertise can have such an impact. Managers need to be reminded that they are 'agents' of many of the HC support processes.

<sup>5</sup> For example refer to [www.valuentis.com](http://www.valuentis.com) and [www.vbhr.com](http://www.vbhr.com); See also 'Competing on Analytics', Davenport T H & Harris J G, HBS Press (2007)

<sup>6</sup> For further insight on the HC leverage model see 'The VB-HR Rating HCM100 Report, VaLUENTIS, 2005

<sup>7</sup> The term used to describe the methods of combining various people metrics and data together with other operational and financial data to provide insight

<sup>8</sup> Extracted from the definition by The International School of Human Capital Management 2006

**(c) Employee engagement**

**Premise [7]: Employee and management engagement is a core platform to differentiated organisational performance.**

The term employee engagement has been defined<sup>9</sup> as:

“Employee (and management) engagement<sup>10</sup> is an ‘outcome-based’ concept. It is the term used to describe the degree to which employees can be ascribed as ‘aligned’ and ‘committed’ to an organisation such that they are at their most productive.”

Given human capital's prominence in organisation performance and that this is a result of the collective effort of all employees within the said organisation; then it is logical to deduce that given two organisations with identical operating models and outputs, an organisation with higher engagement as defined will be more productive and thus higher performing.

Engagement is the main driver for individual productivity. There are a number of studies that have looked at the linkage between employee engagement and organisation performance. One such meta-analysis showed certain positive relationships between employee engagement and certain business outcomes<sup>11</sup>.

Organisations are only just beginning to see the importance of engagement as a construct and, more importantly, as a driver of competitive advantage. As such defining and measuring engagement, to the technical standard required, is still very much in its infancy. Two organisations that are using engagement as a core driver in management terms are RBS and Standard Chartered, both coincidentally banking institutions.

Though a number of definitions are in existence in the market-place, many are specifically contextual or insufficient in terms of rigour. The International School of HCM having developed a universal definition, has since developed Standards<sup>12</sup> with associated measurement constructs.

HR functions need to understand that employee engagement is core to their existence and thus sufficient grasping of the concept, its measurement and application are of paramount importance in the workplace.

**Premise [8]: The degree to which the workforce is engaged (relating to both critical and support positions) within an organisation contributes to high performance.**

The key principle contained within this premise is that whilst organisations may find collectively that engagement is high or relatively high, a key differential is the degree to which the core roles as identified are populated by highly engaged individuals.

For example, in financial services, branch managers may be termed ‘core’ staff. A less engaged manager will have a less positive (more negative) impact on the team than a highly engaged manager. In industries employing call centres, highly engaged supervisors can have a big impact on team performance. Similarly, in hospitals, highly engaged core staff have a much more positive impact on patients than those less so. This is indeed a crucial element to many public sector services which have predominantly high human capital intensity.

Thus, apart from any corrective action required to eradicate poor engagement, HR functions need to utilise modelling analytics in which to express the differentials in productivity terms for management decision making and subsequent action. The education of the line is a critical component. Also, functions need to enhance their current organisational structure format into a ‘role value map’ emphasising the key roles and varying support roles that exist.

**Premise [9]: Organisations which suffer from lower employee engagement will conversely suffer a disadvantage from a productivity perspective to organisations with higher engaged workforces (other things being equal).**

Lower employee engagement will result in an increase in the number of employees who display ‘continuance commitment’,<sup>13</sup> i.e. those that remain with their employer because switching costs are too high (e.g. better reward/benefits than perceived for similar role in the market-place, location/mobility etc). The danger for organisations is that their productivity-cost ratio will reduce with a corresponding deterioration in overall organisational performance, as derived by their operating model. Similar to premise [8], HR

<sup>9</sup> As defined by The International School of Human Capital Management – see also article in this issue on Employee Engagement for a more detailed treatise

<sup>10</sup> I differentiate here the distinction between employees and people managers for purposes of analysis

<sup>11</sup> Business unit level relationship between employee satisfaction, employee engagement and business outcomes: a meta-analysis, Harter, JK, Schmidt, FL & Hayes TL (2002) Journal of Applied Psychology. I would stress that the research is not conclusive and is open to interpretation, nevertheless there does appear certain positive outcome relationships

<sup>12</sup> Refer to the ‘Employee Engagement’ paper in this Journal for more information

<sup>13</sup> For an insight into levels of engagement see ISHCM Employee Engagement presentation downloadable at <http://www.ishcm.com/events.htm> or see the ‘Employee Engagement’ paper in this journal

functions need to utilise modelling analytics to express the differentials in productivity terms caused by lower engagement for management decision making and subsequent action.

#### **(d) Employer brand**

**Premise [10]:** *To differentiate in the market-place, organisations need to develop employer brands with associated employee value propositions.*

In order to attract the talent that organisations have identified they require, each organisation needs to communicate to the market its particular message regarding its 'treatment' of human capital and therefore 'brand'. This is synonymous with the way in which organisations explicitise their brand to customers/clients. The term that is used to encapsulate this brand is employee value proposition (EVP)<sup>14</sup>, what is essentially a 'bundled' promise to potential employees on a range of people items (e.g. specific reward/benefits, opportunities, policies etc).

Organisations, both large and small, are increasingly looking for a means of differentiating themselves. One method has been to be granted awards. Many of these are of dubious quality<sup>15</sup> in both design and output but they at least provide some differentiation (or illusion thereof), however meaningless the award construct. 'Employer of Choice' (EOC) initiatives are another manifestation of this with many company websites proclaiming an 'Employer of Choice' monicker. Again, the term is open to many interpretations though attempts to define its properties and how to implement a strategy are in existence<sup>16</sup>. Diversity of job roles presents more challenges for the organisation particularly around branding in terms of what is deemed core and support, and the ensuing expectation differences with regard to employee value propositions. HR should be in a position to identify these.

One other key way for organisations to differentiate themselves is through human capital reporting which seems to have been greatly overlooked – (see Premise [29]).

HR functions are instinctively the guardians to drive this approach and thus need to have a good understanding of HC Reporting and the way in which it can enhance the employer brand. This may also provide a challenge as HC Reporting is viewed as separate to CSR reporting, where a number of HR functions have decided to pitch the organisation's 'HC wares'.

**Premise [11]:** *Organisations, however, need to execute on the employee value proposition (EVP) to match the 'experience' to the 'expectation'.*

The previous premise put forward the case for an employer brand with associated employee value proposition(s) that is successful in attracting the right/appropriate calibre of talent to an organisation. However, once within the organisation, the value proposition and 'brand' is open to challenge if subsequent experience does not match to individual expectation.

This presents a very difficult challenge to the organisation, particularly where the brand may have been 'stretched' for recruiting purposes. Over-promising rarely works, but the chase for talent inevitably pulls organisations into this type of 'lowballing' practice. A number of organisations do appear to manage expectation well and this positively reinforces the employer brand which provides further differentiation, and is particularly noticeable in graduate recruitment scenarios. I would expect organisations, and particularly their HR functions, to continue to develop more sophisticated and scientific approaches to both employer branding and employee value propositions in future.

**Premise [12]:** *Failure to match experience with expectation will erode the employer brand.*

If an organisation cannot match 'rhetoric' with reality, then over time its brand in the market-place will erode as 'experience' leaks out amongst potential recruits (the concept of efficient markets with regard to information).

For organisations, warning signs of the 'expectation gap' show up in a variety of ways. A common example is high voluntary turnover in employees with less than two years tenure. Employee engagement is one way to provide overarching 'evidence' of expectation matching or not as the case may be.

One of the challenges for organisations, going forward, is externally reporting engagement data that provides a reality check in reinforcing the brand, whether positive or negative. This is a very significant management driver and one that again has been overlooked in external (or internal) HC reporting. The fact that the employer brand can be eroded through poor engagement data should ensure that organisational management is pro-actively engaged in good execution rather than waiting to put right what has gone wrong through poor practice.

<sup>14</sup> There may be more than one EVP in existence targeted at differing employee segments

<sup>15</sup> See 'Employer Branding – the good, the bad and the downright ugly', VaLUENTIS white paper, forthcoming

<sup>16</sup> See for example VaLUENTIS white paper 'A Structured Approach to implementing an Employer of Choice strategy' 2007

Too many organisations still treat employee engagement (a.k.a. 'surveys') as a reactive event rather than as a scheduled proactive mechanism for evaluating and maintaining good management practice. As further evidence on the matter of employer brand, and one to which employer organisations need to be aware, there are a number of dedicated websites<sup>17</sup> (and blogs) that provide market information on employer experience. For the organisation, any 'expectation gap' will pose a serious challenge to correct, and in many cases what would be 'damage limitation'.

Another key role here for HR functions is in terms of their governance objective. The constant requirement of measuring and monitoring of employee engagement and its relation to employer brand experience, completely changes the traditional one-off positioning with which organisations and HR functions have viewed surveys and branding initiatives.

#### ***(e) Organisation performance***

***Premise [13]: That the organisation performance attributed to human capital, as defined by HCIR and HCIR/HCC measures, can be positively influenced by good management practice and high employee engagement.***

No organisation can view human capital in isolation of performance. Over the last decade there has been a significant amount of effort in determining meaningful and reliable measures of organisation performance relating to human capital. Despite a number of advances<sup>18</sup> in the 'science' of human capital measurement, debate continues today as to the best measures<sup>19</sup>. For the purposes of this exercise I shall refer to those metrics generated under the Human Capital Composite Index (see inset overleaf).

As proposed under premise [4] the return on human capital is subject to the limitations of an organisation's operating model. Organisations and HR functions need to be familiar with the various measurement approaches and standards in existence, in order to gauge the impact of good human capital management practice.

***Premise [14]: Competitive advantage is, to differing degrees, derived through employing and maintaining superior human capital performance across the organisation.***

Employing the right and diverse<sup>20</sup> talent relies

upon a good employer brand and effective resourcing practice, coupled with effective management practice. However, again using the analogy of the two identical organisations, the differentiation at this point (the margin) is the degree to which the core (critical) roles identified are staffed with highly engaged (HE) high performers (HP), and the percentage of 'fit' of supporting talent, i.e. the right people, in the right position at the right time, for the right reasons.

Thus, whatever the generator of competitive advantage, whether it is innovation, product quality, more efficient cost containment, higher profits per head etc., the critical people role inputs are HE-HP. In a similar vein, to support the critical roles, supporting roles need at least engaged performers (E-P), to avoid any unnecessary incurring of cost.

This presents the real challenge for organisations (and their HR functions) given their complexity of structures, roles and the organisational dynamics which are ever present. Talent management has different market interpretations but as an organisation there are three key challenges:

1. The degree of strength in depth ('benchstrength') to which core positions are covered - ,i.e. in other words there is always a 'talent pool' for any incumbent core role.
2. Core role vacancies should always be looked to be internally filled wherever possible given this strength. To ensure comparability with external individual capability, 'competency mark to market' should be used - i.e. organisations should always utilise external candidates through assessment centres to provide a comparison for any 'core' position.
3. To employ the innate talent of people in the best way possible through 'individual-role 'fit' to guard against potential skill/knowledge atrophy (see also premise [32]) and ensure optimal engagement, allowing for other engagement factors.

***Premise [15]: A well defined human capital strategy which is executed accordingly contributes to overall organisational success***

This is achieved through bringing the various strands of human capital management architecture and supporting HR capability into a cohesive and integrated whole which contributes

<sup>17</sup> See for example <http://www.vault.com/index.jsp>

<sup>18</sup> See for example [www.HCCindex.com](http://www.HCCindex.com) and VaLUENTIS report 'Cracking The Human Capital Code' (2006) - [www.valuentis.com](http://www.valuentis.com)

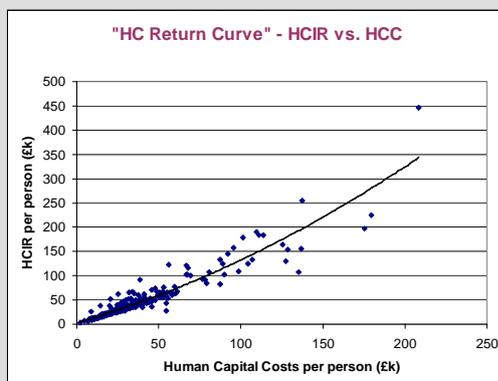
<sup>19</sup> See IRS report no 859, p20-21

<sup>20</sup> The meaning of diverse here is 'balance' of teams, from differing experience and competency perspectives, rather than any 'quota representation' driven interpretation. For insight into the advantages of diversity from this viewpoint see for example 'The Difference' Scott E Page, Princeton University Press (2007)

to superior human capital performance – (also refer to premise [6]). Again, using the ‘two identical organisations’ hypothesis, the organisation with a clear business focused and executed strategy (or collection of strategies) will result in higher organisational performance, given the preceding premises, than an organisation which poorly executes or which possesses an unfocused HCM strategy. There are several studies<sup>21</sup> which have provided empirical evidence to support this premise.

#### The problem with Revenue per FTE

*Revenue per FTE* has been commonly used as an ‘output’ marker for human capital productivity. The equation is simple enough, but fundamentally flawed. Unless all organisations exhibit the same operating model with the same people cost to operating cost ratio, then this equation will be of little relevance. The **HCIR metric** however, can be calculated to better represent revenue generation attributed to people (or output based for public sector). It provides the most practical and accurate representation as using asset-based or shareholder value based calculations are far trickier operations fraught with complications and inconsistencies. In the Human Capital Operating Statement (HCOS), the revenue metric is adjusted to take account of the people contribution factor (i.e. percentage applied equal to people cost percentage of total operating costs – referred to as human capital intensity or ‘HCI’). The resulting metric is referred to as HCIR per FTE. (and similarly HC costs and HC return performance betas). This provides much more accurate performance comparison, taking account of organisational operating models. The use of HCIR/HCC and HC betas provides businesses with far greater comparative insight with linkage to HR functional and human capital management priorities. (see [www.HCCIndex.com](http://www.HCCIndex.com)).



<sup>21</sup> See for example, ‘The Impact of Human Resource Management Practices on Turnover, Productivity, and Corporate Financial Performance, Huselid, M, Academy of Management Journal Vol 38 No 3, pp635-672, 1995. Also see ‘The Impact of Human Resource Management Practices on Perceptions of Organizational Performance, Delaney J & Huselid M, Academy of Management Journal Vol 39 No 4, pp949-969 1996.

#### (f) Talent rivalry and retention

**Premise [16]: That organisations will devise retention strategies to protect their core human ‘assets’ against being targeted by competing organisations.**

Talent rivalry, requires organisations to devise defensive barriers around their ‘core’ human assets in terms of retention strategies, just as they do with key clients/customers. Organisations have, in the past, used loyalty-type bases for retention but there are issues, not least the unintended situation of employees displaying continuance commitment (i.e. switching costs are too high to move so employees do enough rather than be engaged/highly engaged). Pensions were (and still are) seen as a core component of retention strategy - even if unarticulated – but whose present day costs are increasingly prohibitive. Given the probability of ‘continuance commitment’ amongst the workforce, this can prove to be an expensive option without ensuring other retention elements (leaving aside the current legislative enforcement of pension provision).

Previous investment in talent development and/or disruption caused by loss of key talent provides the necessary rationale for appropriate retention strategies in place. In high intensity industries populated with identifiable talent, organisations are particularly vulnerable to ‘poaching’ (itself a dangerous strategy given the propensity for ‘poaching’ to occur again).

It should not be forgotten, that this type of ‘poaching’ and ‘defensive retaining’ goes on within multi-united businesses (again particularly those with decentralised fiefdom-type cultures). HR functions need to be wise to this type of internal ‘gaming’.

Organisations and HR functions need to look beyond the ‘raise pay’ defence as the only viable retention strategy’ and look to more ‘exotic options’. – see also Premise [24].

**Premise [17]: That given an organisational choice (in equilibrium), talent retention strategies will always be pursued before acquisition strategies**

This is due to the increased market transaction costs associated with external acquisition. Thus, voluntary turnover of staff, particularly in any ‘core’ and/or ‘support’ roles which need to be replaced are costly and, also, of higher risk until a certain period of performance is observed – thus increasing internal opportunity cost of management time (excluding any training investment), i.e. retention strategies are of prime importance to organisations.

**Premise [18]: That organisations are likely to retain average or even poor performers if mechanisms are absent in the market-place which guarantee the fact that adequate replacements can be found.**

This may seem a counter-intuitive premise but evidence, in the main, bears out. The fact that the new hire market resembles a market for lemons (refer specifically to Premise [23]) bears out the fact that many organisations may countenance policies of ‘the devil you do’ as opposed to ‘the devil you don’t’ when it comes to exiting poor performers.

This prevailing attitude has perhaps been reinforced by the higher barrier put in place by various employment legislation in terms of due process which makes it more difficult to manage poor performance without corresponding rigour of process diligence (i.e. transaction/hassle costs are too high for local management unless in extreme cases).

The fact remains that many organisations still prefer poorly performing managers (at middle and junior levels) rather than replacement primarily because the ‘transaction costs’ of replacing are still seen as too high. One very much cited case of the forced exiting of poor performance has notably been GE who has routinely exited its bottom 10% performers. What isn’t evident from any published material is did their replacements fare any better? Or were they already above market average? It is an interesting question.

Senior executives have reportedly indicated that they would like to operate some form of annual quota for exiting poor performers but are concerned that skill shortages, a culture of fear and perceived damage to employer reputation would ensue<sup>22</sup>.

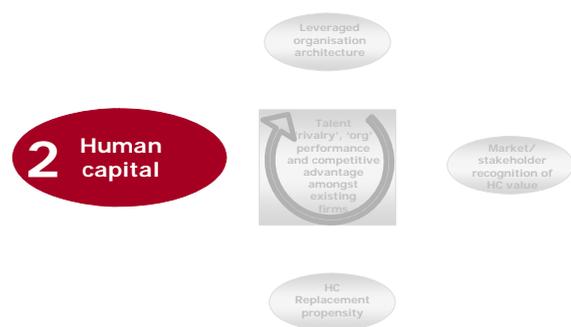
Of particular interest is the increasing frequency of C-class executive turnover. The market appears to have become more belligerent on poorly performing institutional performance, afforded by greater transparency of performance at individual level at the top of organisations.

Thus the challenge for HR functions is to provide a level of training and subsequent standards monitoring to negate the natural barriers to effective performance management and specifically the management of poor performance. Too often, where cases are escalated, HR’s involvement is back-ended rather than front-ended. Again smart HR functions are beginning to use analytics to identify drivers of poor performance in an effort to minimise their incidence. Pre-emption or effective pro-activity can significantly impact what is a collectively costly and wasteful use of time and resource.

### Comparative measures of talent & retention competitive advantage success

- HC performance metrics<sup>23</sup>
- Employee Engagement index
- Employer Brand index
- Talent Management index
- Execution of HCM strategy<sup>24</sup>
- Organisation performance metrics

## 2 Human capital



This force relates to the pool of talent, both local and global, that exists with each individual has certain bargaining power dependent upon his/her mix of education, experience, specificity of skills, location and relative role importance.

Hiring the right people who will be engaged rather than just committed to perform well, and who have innate talent to be developed rather than having threshold competency in order to just do the job in hand. This last point is an important point. To what end do organisations put stock on a job/role to be ‘filled’ versus the potential enrichment/enlargement of such roles and promotability outside of that?

The supply of human capital exerts a degree of ‘bargaining power’ on any hiring organisation though this is dependent upon a number of factors. Clearly, a prospective CEO who is headhunted has potentially more bargaining power than say a locally resourced contact centre staffed with hundreds of employees of similar role type.

**Premise [19]: That all individuals will look to maximise their job/role utility function.**

This is the propensity for individuals to choose what they perceive to be their best employment strategy which in simple terms is to find the most ‘rewarding’ job. For example, this includes the

<sup>22</sup> A study by Hudson consultants as reported in the Financial Times, ‘Directors want staff cull every year’ January 12 2007

<sup>23</sup> For example through GHCRS2006/HCCI portfolio

<sup>24</sup> The EE,EB and TM indices can be calculated by quantitative and qualitative assessment, for example, through the VB-HR™ Rating organisation indicator portfolio

trade-off between reward, opportunities, work environment, immediate personal needs and longer term aspirations for the highest reward given their individual proposition to prospective employers and market conditions.

An individual's proposition is interpreted here as a combination of skills, qualifications and experience together with knowledge specificity, mobility/flexibility and whether professional vocation or job based.

HR functions need to supply line management with an understanding of the reasons why individuals join organisations. A key challenge is the various trade-offs between the various utility drivers and HR possessing this type of intelligence, i.e. have access to modelling data that provides insight into future engagement outcomes.

**Premise [20]: That the 'market' for talent in terms of reward follows an 'efficiency frontier' based on perceived worth.**

There is evidence that an efficiency frontier exists for a number of job roles. Collectively, at macro level, organisational human capital costs do follow an 'efficiency frontier', of which there is evidence<sup>25</sup>. However, this frontier remains subject to distortions. The existing gender inequality has been a distortion for far too long and has only recently been the subject of corrective action due in the main to legislation. The fact that legislation has been required and that this has been endemic across both public and private sectors asks poses some serious societal attitude questions (in the name of saving costs?).

There are a number of macro-industry factors that (temporarily) distort this 'efficiency frontier'

1. Hiring immediacy/skills shortage – is hiring required within a very short time-frame or is it part of a planned future event? Is there a talent shortage in particular skill-sets? Immediacy and or perceived talent shortages will put pressure on both hiring quality and employment costs.
2. Concentration of specialisation - is hiring focused on a small population of specialised roles or a large population of relatively lower skilled jobs? Again, a small population of specialisation will put upward pressure on costs, whereas a large population of lower skilled will keep downward pressure on costs, (subject to any national minimum wage thresholds).
3. Monopsony<sup>26</sup> (the existence of a single large employer in a location) – gives rise to potentially negative impacts on

individual reward in the immediate locality, though organisations may benefit. However, this may be short-lived if any other competing organisation locates within the catchment area.

The CEO market would neatly fit into the 'concentration of specialisation' category as debate rages over the issue of executive pay. There are a number of factors involved in this scenario. It does seem odd however, that given the 'war for talent' beneath CEO level, there seems to be an apparent small pool of talented CEOs. Is that true or is there some other 'dark force' at work?

Whatever, the role, whatever the location, organisations need market intelligence to set appropriate reward based packages to avoid paying 'over the top'. Inappropriate reward strategies can have two main outcomes: (i) provide competitive disadvantage through higher costs if not matched with performance expectations, or (ii) inability to hire requisite talent or indeed lose talent over-time.

For organisations and their HR functions, the analysis and design of reward propositions is key particularly where any of the above distorting circumstances are in existence.

**Premise [21]: That the market in terms of matching capability to role is efficient.**

The evidence suggests the market for human capital is less than efficient in terms of 'fit'. This is down to a variety of reasons (one of which is discussed in Premise [23]). There are a number of differentiated 'resourcing' channels which include recruitment firms, headhunting, press advertisements, events, personal network, each with its own advantages and disadvantages from an effectiveness and cost perspective. The advent of e-recruitment has seen both advantages and disadvantages from an organisational perspective.

The greater degree of available information for matching potential employees with potential employers has become more transparent and more 'efficient' as a result.

The downside is that the inherent recruitment channels still act as potential barriers due to the inefficiencies caused by the differing agendas of selection bias. Also, some of the transaction cost advantages of e-advertising have been negated due to the higher volume of prospective applications and screening required. Recent regulation has also placed further burdens in terms of being able to differentiate potential applicants.

<sup>25</sup> See 'Cracking The Human Capital Code' report, VaLUENTIS-ISHCM 2006

<sup>26</sup> For more on the monopsony topic see Labor Economics, Cahuc P & Zylberberg, (2004) MIT or for an extensive treatment see 'Monopsony in motion: Imperfect competition in labor markets', Manning A, (2003), Princeton University Press

For HR functions, gaining access to the right talent in the market place is key. Thus resourcing strategies need to identify the various requirements of the organisation, the most effective channels, or combination of channels and the degree to which any of the recruitment processes are outsourced (intelligence and brand implications).

**Premise [22]: That the 'internal market' relating to an organisation's talent 'fit' in terms of individual performance and capability is efficient.**

Evidence here suggests that organisation's internal markets are at best patchy in terms of efficiency, and as a result, organisations incur increased costs and/or reduced productivity collectively. It is an area of increasing attention as evidenced by the increase in organisations' documented talent strategies, succession planning and focus on management developmental options.

As stated under premise [14] employing talent optimally is a big challenge. Organisations need to spend more time focusing on this aspect. To illustrate the point, I refer to 'the two identical teams' hypothesis and the relation to performance given that one team employs talent to the full correctly, whilst the other misallocates resource in a variety of ways. The team performance is highly divergent. If we view organisations as a collection of teams, it is easier to see the prospective value destruction that takes place if the simple premise is not adhered to.

For HR functions, ensuring that performance (and development) management systems are effective is paramount. Organisations who view this process as 'task' rather than 'value-adding' with corresponding HR focus on completion rates rather than quality of assessment and feedback will suffer accordingly. HR needs to assess the degree to which individuals at an aggregate level feel 'matched' in terms of current capability, allowing for individual over-estimation (blindspots). This is easy to put in place if using some kind of survey instrument, allowing for cultural impediments.

**Premise [23]: That the human capital market displays similar characteristics to that as for 'The Market for Lemons'<sup>27</sup>.**

That is, the 'recruitment market', in terms of organisations looking to hire the requisite individual capability/performance<sup>28</sup>, suffers from what is termed adverse selection problems caused by imperfect (asymmetrical) information, in most circumstances.

- No organisation can accurately assess the value or actual performance of a potential candidate through examination before contract offer is made (internship is a means of negating this)
- Competent individuals are more likely to have more knowledge/assessment of their value prior to contract offer rather than organisations
- Incentives exist for the individual to exaggerate their individual human capital (or pass off a lower skillset as a higher one)
- Organisations are limited in having reliable and credible disclosure (it is difficult for individuals to differentiate with sufficient credibility)
- There are no guaranteed individual quality assurances (even with qualifications).

However, to compensate for this, organisations use a number of mechanisms. There are no guarantees and educational qualifications are only partly informative as an indicator of performance.

The use of assessment centres is one way that organisations look to redress this asymmetrical information in providing evidence of capability, though again assessment centres and psychometrics only provide partially accurate insight. Personal recommendation/ headhunting is no real guarantee and still comes with risk attached, even in a CEO position. Some organisations use a process driven by multi-interviewing which may uncover more information but is costly in terms of management resource.

Thus organisations rely on an individual's organisational experience and in particular, well-known organisations act as a 'quality' proxy even though they do not, in itself, provide any real guarantee. Reference checks are really just 'rubber-stamping' compliance exercises rather than as measures of selection. Also, organisational politics can play a part in the process which may work against the most appropriate selection.

**Premise [24]: Incumbent organisations will evoke defence/retaliation strategies through targeted retention and/or counter-targeting competitive organisation talent which in turn drives up HC costs.**

Organisations are continually vulnerable to 'poaching' or 'luring away' of top talent in a variety of roles. Sales and/or senior management type roles appear to come under constant threat, where particular skill-set/knowledge and/or perceived high performance is required (reference to Premise [20] is particularly apt).

<sup>27</sup> 'The Market for Lemons: Quality Uncertainty and the Market Mechanism, G Akerlof, 1970

<sup>28</sup> The reverse can also be argued in that individuals seeking organisations suffer, to some degree, the same adverse selection issue

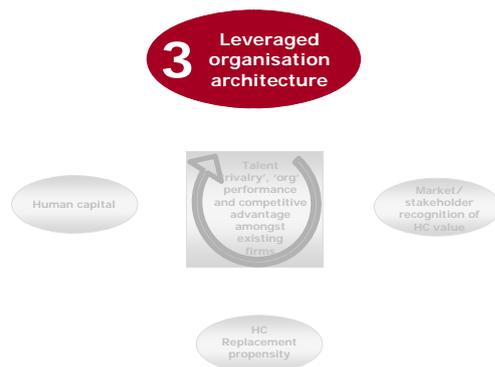
Quite often there is an immediacy aspect which is itself caused by previous loss of talent. Thus the market can take on the appearance of a 'domino effect' in relation to a series of appointments across competing organisations. The end result is higher human capital costs for all.

Organisations, subject to 'talent poaching', will quite often look to acquisition any 'high performing' talent from rivals, as a retaliatory strike. Either way, this type of scenario will often lead to cost escalation. Some observers may say that this is just a 'market mechanism'. However, if these actions are symptomatic of distortive factors, then this raises a serious question regarding 'market efficiency' in reward terms. (Note Premise [24] is based on a reactive strategy which differs to Premise [16] pro-active strategy).

### **Comparative measures of human capital competitive advantage**

- ❑ Employee value proposition (EVP) in terms of percentage of selected candidates who accept offers
- ❑ Brand – degree of differentiation (see talent rivalry)
- ❑ Talent 'fit' index (external and internal)
- ❑ Overall resource effectiveness/efficiency ratio (relating cost to minimising risk of poor hire vs maximising likelihood of good hire)
- ❑ Resourcing index<sup>29</sup>.

### **3 Leveraged organisation architecture**



The degree to which an organisation structures itself can directly impact on human capital and thus organisational performance.

**Premise [25]: That an organisation which displays effective organisation design in terms of efficient structure, role definition, process and decision rights allocation will produce higher organisation performance.**

This premise essentially uses the baseline concept of internal efficiency to derive optimum output.

Organisations can structure themselves in many ways through business units/directorates for example, along product or country lines or increasingly, in hybrid matrix-type structures. These all present challenges in optimising output and promoting supporting behaviours rather than value destroying behaviours. The sub-structures around teams and functions, together with the appropriateness of decision rights (i.e. the allocation, trade-off and control of decision-making) and reporting channels should support and optimise the organisation's value proposition to the market<sup>30</sup>. The referred to 'architecture' can also incorporate the use of supporting systems and platforms in this endeavour.

From a human capital perspective, the sophistication of human capital management architecture and organisation design and its effective execution enhances individual, team and middle management performance. To recap there is specific 'architecture', representing a collection of systems/processes and tasks (referred to as HCM architecture) that organisations invest in, and HR functions look to maintain, to optimise human capital performance and minimise operational risk.

**Premise [26]: That appropriately designed and integrated HR processes/systems, supported with 'expert' HR capability when executed well, enhances both individual and the collective organisational performance.**

We have already stated that getting the best from people requires appropriate supporting mechanisms and effective management (refer to premise [6]).

Investment in HCM architecture, such as, payroll systems, training & development allocation, performance management, job design, resourcing reward, and case management provide the environment for optimal productivity (given any satisfactory standard of management practice), whilst minimising the risk of transgressing legal requirements demanded by employment legislation. This investment can also act as a 'barrier to entry' to organisations who wish to compete in the same talent space – what can be described as 'needed to play' requirement. To this

<sup>29</sup> The Resourcing index can be calculated by quantitative and qualitative assessment, for example, through the VB-HR™ Rating organisation indicator portfolio

<sup>30</sup> For more on this topic see 'Managerial Economics and Organizational Architecture' 4<sup>th</sup> Ed, Brickley, Smith & Zimmerman, McGrawHill (2007) and 'Designing Organizations to Create Value' by the same authors. Also 'Designing Effective Organizations', Goold and Campbell, Jossey Bass (2002).

extent organisations will have normally sunk investment and will incur certain maintenance or upgrading costs (normally monitored by the HR function) to ensure effectiveness.

An important precursor is the 'integration' of the architecture, i.e. the propensity for each HCM process component to link and mutually reinforce as opposed to non-linkage and the potential for unintended consequences, resulting in barriers to performance optimisation. An important cog in the HCM architecture is the HR function in terms of its expertise and capability, the procurement with which the function undertakes to maintain effectiveness and the degree to which management perceive HR 's contribution'<sup>31</sup>.

This last point is of considerable importance. Organisations display different HCM architecture maturity, partly driven by industry context, partly through legacy and to a greater extent, the degree to which management views the importance of human capital performance. HR functions which are engaged primarily as 'compliance units' will be limited in both scope and contribution, and most likely the organisation is not deriving 'best value' from its people contribution.

Organisations that see the potential of human capital performance and its contribution to organisation performance will see HR function's primary role as performance enhancing (with the compliance role as a subset) and will see management competence and capability as the key target<sup>32</sup>. Thus the HR function will be staffed with the requisite expertise and knowledge and their roles are regarded as 'core' rather than 'support' to the organisation.

For example, a performance management system can be used as both an enhancer of individual contribution and productivity with its emphasis on achieving objectives and individual developmental opportunities; whilst at the same time protecting the organisation through due diligence of the process by managers to address poor performance.

The problem for many organisations is that despite sunk investment in 'automated PM systems', the real investment needs to be made in those conducting assessments from a quality and accuracy perspective.

Further, for a 'system'<sup>33</sup> like performance management to work well, as its original intention, requires constant attention to protect against unwanted behaviours or outcomes such as 'poor

framework design', 'gaming for reward', 'rating blindness' 'misappropriate allocation of training & development', 'poor performance avoidance', and 'inattention to individual recognition' to name but a few of the inherent dangers lurking within such a 'system'.

All of these human capital support 'mechanisms' (there are ten 'domains' identified as core containing 93 discrete activities<sup>34</sup>) require appropriate 'linkage' i.e. each of these supporting 'systems' need to fit and reinforce each other rather than be disconnected and/or conflicting with unintended consequences.

For example, the links between performance management and reward, and performance management and development are important yet organisational practice invariably ends up with 'muddled' outcomes, an obvious one being a misalignment of timing. Good and effective organisation architecture and particularly HCM architecture can add significant employer performance/branding differentiation.

However, up until recently<sup>35</sup>, it has been difficult for organisations to measure or quantify this in any meaningful comparison.

**Premise [27]: That appropriately designed and integrated HR processes/systems with supporting policies and 'expert' HR capability minimise operational and reputational organisation risk.**

In a similar vein to the previous premise good HCM architecture can help to minimise operational risk or organisational reputation risk.

Certain industries can be prone to more operational and reputational risk than others. The oil industry has a prime focus on health and safety. Good health and safety policies and a management culture that does not compromise on business expediency will ensure its business reputation. Those that don't will be subject to increased risk and potential catastrophic fall-out<sup>36</sup>. The transport industry faces similar issues.

In financial services, the competency and subsequent performance of individuals is paramount to minimise the risk of mis-selling and reputational damage (plus the heavy penalties that can ensue). Thus induction, training, management, management control, performance assessment and incentivisation are all key inputs. There have been a number of recent 'scandals' with perhaps the most famous still being that of Barings.

<sup>31</sup> For a more detailed analysis of HCM architecture and the HR Function's contribution and structure see 'Brave New HR World Part I' in this Journal

<sup>32</sup> For more on HR's performance role also see the 'Brave New HR World Part I' paper in this journal

<sup>33</sup> The use of the apostrophised term 'system' here is to denote that this is a collection of processes, activities and tasks as distinct from an actual IT system

<sup>34</sup> Refer to Valuentis VB-HR™ Global Profiler. The ten core domains are HR governance, Organisation design, Resourcing, Training & Development, Performance (talent) management, Reward/benefits, Employee relations & communications, Health & Safety, HRIS & Payroll.

<sup>35</sup> That has changed since the arrival of the VB-HR™ Rating and its HCM evaluator engine which allows for deep and insightful analysis of HCM architecture.

<sup>36</sup> Witness the recent events at BP's Texan refinery – so long a company held up as a champion of industry. For an excellent commentary, see for example 'BP - In their own words....' The Economist March 2007.

The fairly recent demise of Arthur Andersen in professional services also shows the extent to which an organisation can just disappear. Here the endemic culture was to ignore ethical considerations of the profession itself, and a breakdown in management control with the implied 'complicity' of partners to cover up rather than to exit what was, essentially, poor performance from a professional standpoint.

HR functions have a challenge in this area which ranges from ensuring 'controls' are in place for even the most basic of tasks which carry a degree of operational risk; whilst at the same time assuming the mantle of ethical considerations that are embedded within the operating culture which goes right to the top of the management pyramid.

**Comparative measures of leveraged organisation architecture competitive advantage**

- Effectiveness of HCM architecture
- Workforce intelligence
- HR capability & effectiveness
- Management capability & performance
- HCM risk index
- HR spend analysis/return<sup>37</sup>.

**4 Market /stakeholder recognition (of HC derived intangible value)**



With regard to human capital, organisations will be subject to the force generated by the general market and particular stakeholder recognition of human capital's contribution to organisation performance as well as a potentially forward looking insight into future value creation.

The reporting of both internal and external measurement has a number of related outcomes including:

- Comparative analysis of organisational

performance from a human capital perspective

- Potential contribution to future value
- Communication of HC related information
- Education of management and other stakeholders regarding the importance of human capital and human capital management)
- The ability to communicate (and encapsulate) the employer brand

**Premise [28]: That organisations report human capital based information to inform the market and relevant stakeholders for comparative purposes and for insight into potential future performance (intangible value).**

The current state of financial reporting has, for some time now, been viewed as limiting in its reflection of an organisation's actual and potential future performance. There have been a number of attempts at providing intangible models and more specific human capital based models, which have met with limited success.

The Human Capital Reporting Standards (GHCRS2006) released in 2006<sup>38</sup> went some way to standardising the performance dynamics from a human capital perspective with its HC Operating, Peopleflow™ and Productivity statements.

However, fundamentally, potential investors or stakeholders should be as interested on current performance, and a means of comparative analysis, as much as any future performance (the two are linked), though the latter has tended to dominate the drive towards greater transparency of reporting. Intangible value attributed/derived by the contribution of human capital is a more complicated challenge; it is dependent upon the business model and the subsequent identity of 'HC contribution streams' and operational role specificity. The elements of operational and reputational risks are also included here, given their propensity for value destruction.

However, for organisations (both public and private) there is a trade-off between externally reporting these types of insights and releasing what can be termed 'sensitive' or confidential data to competitors.

For organisations, a key question regarding reporting is the ability to influence the decision-making of potential investors and/or stakeholders, i.e. would I invest/transact with this organisation from a human capital perspective?

Again, HR functions should be the natural guardians of this reporting premise, though the advent of CSR has provided an alternative

<sup>37</sup> HCM architecture effectiveness can be calculated by quantitative and qualitative assessment, for example, through the VB-HR™ Rating strategic indicator portfolio

<sup>38</sup> See original white paper on Human Capital Reporting, VaLUENTIS 2006. A new publication on the HCR Standards (GHCRS2006) is forthcoming.

(though contentious) vehicle for the organisation to report human capital related information<sup>39</sup>.

**Premise [29]: Reporting human capital related information externally helps to differentiate the overall brand and specifically the employer brand of an organisation.**

Organisations are increasingly looking to differentiate themselves in the market-place from an employer brand perspective given the importance this has from both a corporate and a prospective recruitment platform.

As such, in the absence of definitive standards, organisations have engaged in seeking a cost-effective solution to 'award mania'. Thus the market has produced a number of products that promote supposed differentiation from a human capital perspective.

For example, in the UK, Investors in People Standard has often become unwittingly used as a 'badging' exercise rather than as a bona fide human capital management Standard of Practice (which was its original intent). There is evidence that certain organisations have 'gamed' the accreditation<sup>40</sup> exercise as a means of gaining the award, coupled with inconsistencies in the qualification process.

A number of HR awards are shown, indeed known to be unscientific and spurious in design<sup>41</sup>. However the market, does show, whatever the unsophistication, the 'pull' to differentiate through these awards.

The problem with spurious awards, or misapplication of Standards is that they both undermine the market-place, rendering differentiation by these channels meaningless, unless (a) a robust award construct is used, or (b) a Standard becomes more rigorous.

As an alternative, a well constructed human capital report can provide a differentiated employer brand message<sup>42</sup>.

Thus, for organisations, focus on effective human capital reporting may provide a far more cost-effective approach to differentiation in the external environment.

For HR Functions, the decision to follow a particular branding channel, whether by award, reporting or combination of both, is of prime importance, from both a professional and political standpoint. HR Functions, through their 'governance hat' should critically evaluate the

various options and choose appropriately, resisting the temptation to go with the 'easy route' if analysis deems this to be sub-optimal.

**Premise [30]: That organisations who report good internal human capital intelligence focus more on good human capital management practice.**

Essentially 'what gets measured gets managed' and the focus on internal reporting of human capital related measures, ensures that an organisation's management applies a certain due diligence to executing effective people management practice. The preceding premises have provided a particularly robust case for the reason as to why this is important to most organisations, as if executed to the extent possible, they will benefit from superior competitive advantage.

Again the call for human capital reporting has been primarily driven from an external perspective. However, organisations should, to a great extent, focus on internal reporting and communication to its main target within, i.e. management.

Organisations and their HR functions should not underestimate the educative process that internal HC reporting can provide. The more management understand the potential pay-offs of good human capital management, particularly at the 'margin', the more likely the derived benefits of greater productivity, ensuing organisation performance, and ultimately, competitive advantage.

### **Comparative measures of market and stakeholder recognition competitive advantage**

- Human capital reporting quality and differentiation<sup>43</sup>
- Comparative HC related performance metrics<sup>44</sup>
- HCM performance metrics portfolio
- HCM modelling analytics.

<sup>39</sup> See comments re CSR/HR in VaLUENTIS white paper 'Human Capital Reporting' (2006)

<sup>40</sup> See and example Saturday Guardian - Work Dear Jeremy: 'Should I blow the whistle on an Investors in People scam?' as reported 17 June 2006.....Also for a more detailed assessment see 'Investors in People: Emperor with no clothes' study, ISHCM (2006)

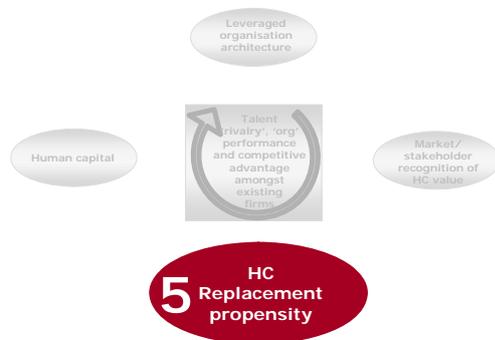
<sup>41</sup> see for example 'Best Companies' [www.bestcompany.com](http://www.bestcompany.com) and for more insight, see 'Employer Branding – the good, the bad and the downright ugly - a summary evaluation', ISHCM forthcoming

<sup>42</sup> See for example, the Human Capital Reporting template, VaLUENTIS/ISHCM

<sup>43</sup> For example, as that evaluated under VaLUENTIS GHCRS2006 assessment as evaluated in HCC Index ([www.HCCIndex.com](http://www.HCCIndex.com))

<sup>44</sup> For example see HC Operating Statement (GHCRS2006)

## 5 Human capital replacement propensity



The degree to which market forces impact on organisation jobs/roles through potential replacement by technology or redundancy caused by obsolescence or considered 'at risk' through adverse organisation performance

- Potential likelihood of jobs being replaced through technology/ reengineering
- Redundancy nature of role through potential skill and knowledge atrophy
- Redundancy nature of role through potential skill obsolescence
- Risk of role redundancy given adverse organisation performance

**Premise [31]:** *There is a countervailing market force to the bargaining power of human capital and the intensity of talent rivalry in the form of potential replaceability by technology.*

Basically any human capital role is subject to market forces in terms of potential replaceability by technology. This replaceability can be viewed as the threat of 'substitute' assets – the potential for a particular role or cluster of roles that can be replaced by technology. Normally, low manual skill roles are more at risk of replacement, though this is not exclusive. Increasingly higher knowledge-based roles are at risk through knowledge codification or automated human intelligence. Two particular examples from finance and entertainment include fund management 'trackers', and the use of CGI to replace actors in movies.

**Premise [32]:** *There is a countervailing market force to the bargaining power of human capital and the intensity of talent rivalry in the form of skill and knowledge atrophy.*

All individuals possess innate talent in the form of special skills or knowledge. As a result in fulfilling a role, individuals are subject to skill or knowledge atrophy, i.e. the natural wasting of talent if actions are not taken to maintain. This is particularly acute in knowledge based professions or roles. The concept of lifelong learning is deemed to be the antidote to individual maintenance of human capital talent.

Other potential ways in which atrophy may occur is through long-term unemployment, career interruptions, or not using an individual's skills set (i.e. in a role that doesn't require the level of educational or experience attained). This last point is in the context of organisational talent management as previously identified.

**Premise [33]:** *There is a countervailing market force to the bargaining power of human capital and the intensity of talent rivalry in the form of skill obsolescence.*

Many human capital roles are subject to market forces in terms of potential skill obsolescence<sup>45</sup>. This premise is different to [31] in that it does not have to be technology driven, and different to [32] in that obsolescence is market or organisation driven whereas, skill atrophy, to a great extent is individually driven. They are not the same (though in certain instances they are linked).

Skill obsolescence can come about through specific industry or profession/vocation decline or potential reengineering of role design. They are subject to external forces of which organisations can run foul of if they are executing a poor business strategy or conducting inadequate workforce analyses (a.k.a. 'planning'). History is unfortunately littered with many examples. In effect the skills 'market' operates like an efficient market in seeking out human capital skill inefficiencies.

Another example can be an organisational over-reliance on an individual's skill specificity. This degree of skill specificity of an individual can distort perceived role value (i.e. mark-to-market finds over-value from an alternate use perspective).

Individuals in these circumstances will be of heightened value to organisations due to unique attributes (such as an 'expert' knowledge of internal bespoke system, or protecting particular organisational knowledge). However, should circumstances change, i.e. a change of system, or

<sup>45</sup> For an insight into the types of skill atrophy and obsolescence, see for example 'Evaluating Human Capital Obsolescence', Andries de Grip, Research Centre for Education and the Labour Market, Maastricht University (2006)

the specific organisational knowledge deemed to be no longer of value, the individual may find their 'talent' seriously impaired and no longer of value to the organisation with a risk of substantial decrease in market worth (i.e. alternate use of specificity of skills of little value).

HR functions, through the course of their various analyses, should note the incidence of these 'unique' roles.

**Premise [34]: There is the potential risk of redundancy of any individual role through duplication (which is not caused by technology) and structural reorganisation caused by poor organisation performance, and/or a change of organisational strategy.**

In addition to the market forces, there is an organisation-specific risk of potential job overlap caused by ineffectual organisation design, which can be exacerbated by merger and acquisition type transactions. For example, two HQs are superfluous from a corporate function perspective.

It must be remembered that any major organisational change initiative is costly to the organisation and should be viewed as such. In many ways, it is corrective action to a current faulty position (allowing for the fact that organisations should be aware of their external environment). Therefore, this can be viewed as an internal transaction cost.

Good human capital management therefore requires effective workforce planning, taking into account likely changes on the organisational horizon. Workforce planning is not a term to describe some large document for shelving. Rather it is an active means of reviewing current organisation design, matching the demands of the organisation, and in that respect has a dual focus – both short term and longer term, utilising modelling analytics where necessary.

On a final note, the onset of offshoring has made a big impact at the time of writing. The economic argument behind offshoring is really one of 'arbitrage', i.e. a specific human capital skillset has been replaced by the same skillset only at a cheaper cost. The market for human capital like any other market will move towards an equilibrium, with lower costs eventually rising to a point (the question is whether it is as high as the previously arbitrated level).

Organisations can only game this strategy so many times as the arbitrage advantage of offshoring is counterbalanced by the transaction costs of offshoring (especially when risk is taken into account). In a global economy, and from a localised country standpoint offshoring is really the reverse of labour importing to which the Western economies have historically benefited.

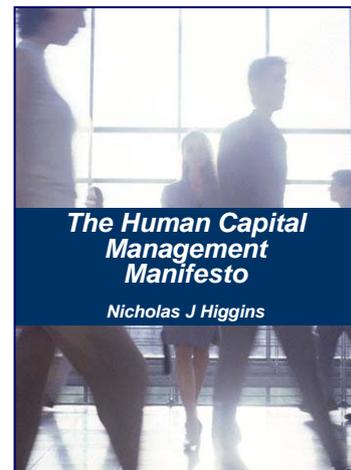
What is significant is the increasing supply of skilled human capital from around the world which

may cause certain temporary/permanent 'reward dips' in traditionally high rewarding roles in localised environments (this relates back to classical supply-demand theory).

From HR's point of view, the Function needs to be aware of the commercial environment and pressures which may already be or will impact. HR of course, in this instance has two roles, (i) with regard to the organisational focus re any specific restructure/reengineering and (ii) the HR function itself which may need to undergo transition or transformation as a result.

**Comparative measures of HC replacement propensity competitive advantage**

- ❑ Organisational role risk Index
- ❑ Job evaluation index (incidence and cost implications of 'red spots')
- ❑ People managers/people ratio (cross-compared with effective HCM evaluation).



**'A management tour de force'**

**'Putting human capital at the heart of the business agenda'**

Due out: 2<sup>nd</sup> Quarter 2007

ISHCM Publications

Pre-order your copy on +44 (0) 20 7887 6121  
and quoting reference: JAHCM001

## Deriving HC brand strategy and differing employee value propositions

We have seen from the HC industry analysis that employer brand and employee value propositions form key components of an organisation's approach to acquisition of talent. Given the differing employee segmentation in terms of 'core', 'support', 'contracted' and further sub-divisions, it is useful to draw up a model that provides a set of generic strategies open to organisations.

The generic strategies are based on two competing axes: the intensity of human capital related to the organisation's operating model (defined as the ratio of people costs to overall operating costs); and the categorisation of staff in terms of whether they are deemed core (critical), supporting, and/or those under various contracted arrangements.

Organisations whose human capital can be described as 'dominant' in their operating model (i.e. HCI is over 50%) will look to differentiate across both their 'core' and 'support' human capital in a clear branding exercise to the market. The advent of a 'premium' on certain aspects of the brand will be marketed. Those organisations whose human capital can be described as having 'parity' typically have human capital intensity of between 20 and 50%. Here full differentiation across the various role families/types is difficult to achieve, thus specific targeting of roles for differentiation is key, providing the necessary market differentiation.

Organisations whose human capital typically make-up less than 20% of the operating model or whose job design is limited to a large number of similar type roles will view human capital from a cost-containment perspective. It is important to note that this strategy does not preclude sophisticated reward/benefits packages or indeed investment in good working environments.

It is simply the prevailing philosophy of where organisations interpret and position human capital management importance.

Organisations need to be clear which branding strategy they are following. Of significant note is that a 'one size fits all' strategy may be inappropriate. This may not fit comfortably with certain pro-employee representatives but as we have seen employer branding is an extremely important input into recruiting the right talent and, it should not be forgotten, the continuing proposition to the organisation's existing employees (refer to Premises [10] & [11]).

This internal aspect of the employer brand is often overlooked in favour of the external aspect but is in fact the more important in terms of the fact that internal brand is tested everyday and needs to meet expectation or suffer erosion over time that will eventually 'leak' into the market. Employer brand maintenance (EBM) effectively requires more effort to maintain.

For many organisations, the lack of appropriate reporting vehicles and/or channels has provided difficulties in differentiating their employer brand. In order to solve this, a number of organisations have invested in various (and questionable) awards relating to human capital management as a means of differentiating, as previously stated.

However, these are very much focused on the EVP (reward/benefits/work environment) rather than any specific talent requirements. A much more meaningful way that any organisation can differentiate itself is by producing a meaningful human capital report as part of its natural financial reporting cycle. Prospective employees can garner a real insight into the organisation they wish to pursue. This aspect was explained in the Premise [29].

The categorisation of an organisation's human capital

		'Core' human capital	'Supporting' human capital	'Contracted' human capital
The 'intensity' of human capital related to the organisation's operating model	Human Capital 'Dominant'	DIFFERENTIATION	DIFFERENTIATION	FOCUSED DIFFERENTIATION
	Human Capital 'Parity'	FOCUSED DIFFERENTIATION	FOCUSED DIFFERENTIATION/ COST CONTAINMENT (TRANSACTIONAL)	COST CONTAINMENT (TRANSACTIONAL)
	'Human Resource'	COST CONTAINMENT (TRANSACTIONAL)		

## Summary to Part I

Thus, the 'five HCM forces' contain a total of 34 premises (see table below) on which organisations should consult when looking to analyse an industry from a human capital perspective or investigating specific role(s) analysis prior to deriving HCM strategy.

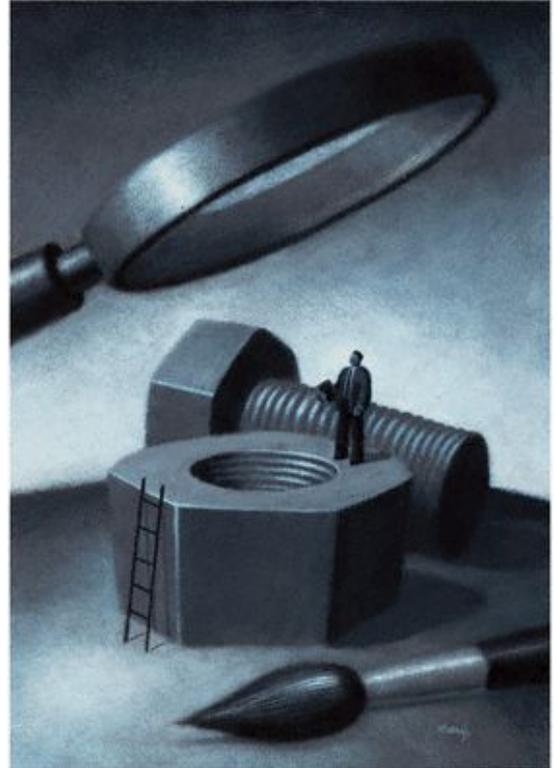
In this part I have provided a framework that explains the fundamentals, i.e. the **Why** of human capital and human capital management. Part II now looks at the **What** and the **How** through the use of a strategic HCM toolkit.

### The 34 Human Capital Premises

1	<i>That the number and size of competing firms will impact the intensity of human capital rivalry and ultimately competitive advantage.</i>
2	<i>The degree to which human capital is paramount to an organisation's operating model (HC1) will determine the intensity of talent rivalry.</i>
3	<i>Given the underlying industry profit/return signatures, organisations will gain competitive advantage though the most effective utilisation and management of human capital.</i>
4	<i>That the organisation's utilisation of human capital is dependent upon the organisation's (or sub-unit's) operating model.</i>
5	<i>Organisations deploy differing resourcing strategies either recruiting in before market and developing or purchasing required skill-sets but at market cost.</i>
6	<i>Human capital management is a key component to best utilising human capital.</i>
7	<i>Employee and management engagement is a core platform to differentiated organisational performance.</i>
8	<i>The degree to which the workforce is engaged (relating to both critical and support positions) within an organisation contributes to high performance.</i>
9	<i>Organisations which suffer from lower employee engagement will conversely suffer a disadvantage from a productivity perspective to organisations with higher engaged workforces (other things being equal).</i>
10	<i>To differentiate in the market-place, organisations develop employer brands with associated employee value propositions.</i>
11	<i>Organisations, however, need to execute on the employee value proposition (EVP) to match the 'experience' to the 'expectation'.</i>
12	<i>Failure to match experience with expectation will erode the employer brand.</i>
13	<i>That the organisation performance attributed to human capital, as defined by HCIR and HCIR/HCC measures, can be positively influenced by good management practice and high employee engagement.</i>
14	<i>Competitive advantage is, to differing degrees, derived through employing and maintaining superior human capital performance across the organisation.</i>
15	<i>A well defined human capital strategy which is executed accordingly contributes to overall organisational success.</i>
16	<i>That organisations will devise retention strategies to protect their core human 'assets' against being targeted by competing organisations.</i>
17	<i>That given an organisational choice (in equilibrium), talent retention strategies will always be pursued before acquisition strategies.</i>
18	<i>That organisations are likely to retain average or even poor performers if mechanisms are absent in the market-place which guarantee the fact that adequate replacements can be found.</i>
19	<i>That all individuals will look to maximise their job/role utility function.</i>
20	<i>That the 'market' for talent in terms of reward follows an 'efficiency frontier' based on perceived worth.</i>
21	<i>That the market in terms of matching capability to role is efficient.</i>
22	<i>That the 'internal market' relating to an organisation's talent 'fit' in terms of individual performance and capability is efficient.</i>
23	<i>That the human capital market displays similar characteristics to that as for 'The Market for Lemons'.</i>
24	<i>Incumbent organisations will evoke defence/retaliation strategies through targeted retention and/or counter-targeting competitive organisation talent which in turn drives up HC costs.</i>
25	<i>That an organisation which displays effective organisation design in terms of efficient structure, role definition, process and decision rights allocation will produce higher organisation performance.</i>
26	<i>That appropriately designed and integrated HR processes/systems, supported with 'expert' HR capability when executed well, enhances both individual and the collective organisational performance.</i>
27	<i>That appropriately designed and integrated HR processes/systems with supporting policies and 'expert' HR capability minimise operational and reputational organisation risk.</i>
28	<i>That organisations report human capital based information to inform the market and relevant stakeholders for comparative purposes and for insight into potential future performance (intangible value).</i>
29	<i>Reporting human capital related information externally helps to differentiate the overall brand and specifically the employer brand of an organisation</i>
30	<i>That organisations who report good internal human capital intelligence focus more on good human capital management practice</i>
31	<i>There is a countervailing market force to the bargaining power of human capital and the intensity of talent rivalry in the form of potential replaceability by technology.</i>
32	<i>There is a countervailing market force to the bargaining power of human capital and the intensity of talent rivalry in the form of skill and knowledge atrophy.</i>
33	<i>There is a countervailing market force to the bargaining power of human capital and the intensity of talent rivalry in the form of skill obsolescence.</i>
34	<i>There is the potential risk of redundancy of any individual role through duplication (which is not caused by technology) and structural reorganisation caused by poor organisation performance, and/or a change of organisational strategy.</i>

Thought  
leadership

# Devising an HCM Strategy: The Strategic HCM Toolkit (Part II)



By Nicholas J Higgins  
DrHCMI MSc Fin (LBS) MBA (OBS) MCFI  
Dean, International School of Human Capital Management, London & CEO, VaLUENTiS

Part I explained the underlying HCM industry analysis and the 34 premises that were subsequently derived to explain current industry developments and to set a current agenda for strategic human capital management.

Part II describes the components of a strategic HCM toolkit which senior executives and HR leaders will find of prime importance in applying to their particular organisational context. Of particular importance is the existence of generic human capital strategies and their influence on deriving a HCM strategy. The toolkit provides a development process (*'the ten commandments'*) and examples of measurement. An introductory exercise entitled *'Human Capital Management: How strategic are you?'* is also provided to complete and provide a quick means of assessing current organisational/HR function status.

## Part II - Devising an HCM strategy: the strategic HCM toolkit

The strategic HCM toolkit is designed to be used in conjunction with the framework and subsequent analysis presented in Part I. The rationale is to deliver a workable and comprehensive human capital management strategy that comprises a portfolio of integrated operational strategies that utilise evaluative measurement and which incorporates the HR function's value proposition(s). A white paper published by the School and VaLUENTIS<sup>46</sup> articulated the main strategies organisations use in engaging employees and enhancing organisational performance.

There are sixteen such strategies which are:

- Employee engagement
- Diversity
- Employee centricity
- Employer brand
- Leadership
- Organisation climate
- Organisation communications
- Organisation design
- Performance orientation
- Resourcing
- Retention
- Reward
- Talent management
- Training & development
- HR governance
- HR operational excellence.

This strategy configuration is normally referred to as the 15+1 OE framework<sup>47</sup>. Thus, deriving an HCM strategy will normally contain aspects of these operational strategies. Thus the derivation and formulation of these operational strategies will have been preceded by the analysis, which will have provided the following:

- ❑ The organisation (and sub-unit context)
- ❑ Key challenges facing the organisation and its sub-units
- ❑ The identifying of the different 'slices' of current employee segments
- ❑ A baseline evaluation of where the

organisation is performing from a human capital perspective, including employee engagement<sup>48</sup>

- ❑ A baseline evaluation of where the organisation is with regard to human capital management practice and organisation engagement (in the form of fifteen key operational areas)<sup>49</sup>
- ❑ A baseline on what the organisation currently reports internally and externally from a human capital perspective, incorporating workforce intelligence and metrics portfolio in use<sup>50</sup>
- ❑ Given the evidence, the identification (or not) of any current delivery or line perception gap
- ❑ An HR/HCM spend and activity analysis (i.e. HR function spend and organisational spend)
- ❑ HR policy risk assessment
- ❑ HR functional capability 'fit for purpose'

Thus obtaining an accurate view of where the organisation is in terms of people management is paramount for strategy derivation. This is important for two reasons:

- 1) HR has quite often confused organisational strategy relating to people with HR strategy relating to delivery (which is covered under HR operational excellence).
- 2) The HR function has not always had access to or received guidance on operational excellence matters, making it more prone to inefficiencies (given its wide ranging coverage).

As a consequence, HR strategies have tended to become overly inwards focused. The strategic HCM toolkit is designed to assist in reorienting HR to a more externally focused view (i.e. inside the organisation and beyond), following a structured yet interchangeable format starting with the 'Five HCM forces' framework introduced in part I. The following diagram maps the relationship between these operational strategies and the five HCM forces as shown overleaf. For reference a brief definition of each operational strategy is supplied.

<sup>46</sup> Key HC operating strategies: Operational indicators and the VB-HR™ Rating VaLUENTIS white paper (2006)

<sup>47</sup> OE = Organisation Engagement which are 15 in number. The +1 refers to Employee Engagement which is viewed separately owing to its concept and definition being viewed as an outcome of the interaction of the others.

<sup>48</sup> Such as that assessed through the HCM evaluator engine of the VB-HR™ Rating

<sup>49</sup> *ibid.*

<sup>50</sup> Such as that evaluated through the HCCI assessment process – see VaLUENTIS 'Cracking The Human Capital Code' study (2006)

**Definitions of HCM strategies**

**Diversity**  
The focus and effectiveness of diversity and diversity policies within the organisation

**Employee centricity**  
The degree to which the organisation has 'employee-centric' policies in place and delivers on them in terms of effectiveness

**Employer brand**  
The degree to which the organisation has an identifiable brand and its contribution and effectiveness in related organisational areas

**Leadership**  
The perceived effectiveness of overall management within the organisation

**Performance orientation**  
The degree to which the organisation is viewed as effective in terms of focus and actions regarding performance related areas

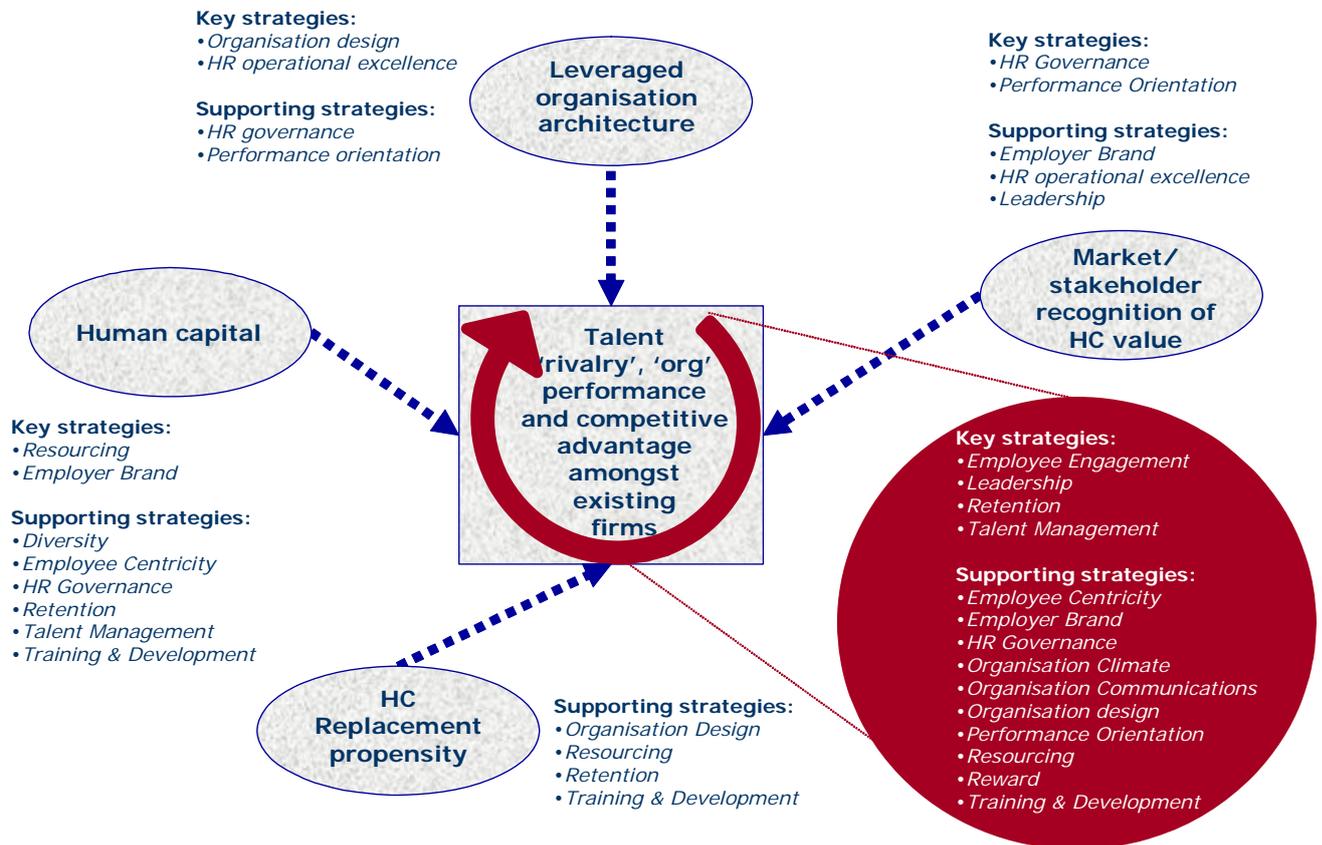
**Resourcing**  
The effectiveness of current resourcing policies, processes and activities in terms of organisation requirements

**Retention**  
The effectiveness of current organisational retention approaches and efforts

**Reward**  
The effectiveness of current reward policy and strategy

**Talent management**  
The effectiveness of current organisational approaches to talent, its scope and its management

# Strategic HCM – Key operational strategies



**Organisation climate**  
The degree to which the current operating environment within the organisation is seen to be a positive/negative factor

**Organisation communications**  
The current effectiveness of communications in the organisation as perceived by managers and employees

**Organisation design**  
The degree to which the overall organisation architecture, e.g. management structure, job/role design is effective

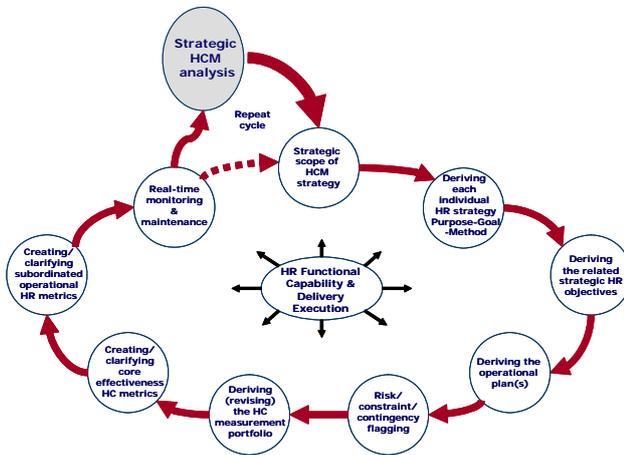
**Training & Development**  
The degree to which current approaches and application of training, learning and development are effective

**HR governance**  
The overarching management of HR as a function and governance of Human Capital Management and Reporting within the organisation

**HR operational excellence**  
The degree to which the HR function possesses the requisite competence and executes its delivery objectives in terms of quality and effectiveness

**Operational Strategy (OS) development: The ten 'commandments'**

For each of the fifteen 'operational strategies', a typical structured process incorporating 'ten' key steps ('commandments') can be followed as indicated in the diagram below:



The table opposite provides more detail of each step. In terms of format, each individual operational strategy should not be overly long, a page per strategy being sufficient, with depth added where necessary or alternatively maintained in softcopy format, expanding where necessary. The point is for HR directors/Business partners to be in control of a working template with a real-time iterative based 'due process'.

The complexity here comes in the form of aggregated 'strategising', i.e. those strategies constructed at Business/Country Unit or Directorate level and which need to undergo some form of consolidation to avoid duplication and/or resolution of conflicting priorities.

One important note is that HR Directors/business partners looking to use the '15+10E approach will be able to short-cut in terms of measurement as all of these operational strategies have already been defined with corresponding measurement indices<sup>51</sup>. Thus, they can be used for monitoring and benchmarking purposes (also even as guidelines to devising the individual strategies), saving considerable time and expense.

The various HC/HR measurement scorecard-type outputs can be generated by further metrics frameworks. An example 'radar' format is shown overleaf.

OS Parameter	Detail
1. <b>Strategic scope of operational strategies</b>	Definition of boundary levels and scope, i.e. business unit/region/country/directorate level and/or aggregate/ consolidated level
2. <b>Deriving the Purpose-Goal-Method of each strategy (reality check)</b>	Why are we utilising this strategy? (purpose) What is the strategy looking to achieve? (goal) How are we achieving it? (method)
3. <b>Deriving the related strategic objectives</b>	The derivation of objectives, their prioritisation and assignment. The application of SMART team/individual principles, extended to line where applicable is important.
4. <b>Deriving the operational plan(s)</b>	Ensuing related HCM actions and activities (again between HR function and line) with accountability and deliverables
5. <b>Risk, constraint, contingency flagging</b>	Elements of operational strategy, actions and measures may be subject to constraints and delivery risk which need to be explicitised. Also includes contingency planning.
6. <b>Deriving the measurement portfolio</b>	Derivation of core comparative KPIs as defined; Level and type of analysis: one-off/cross sectional and/or trend (longitudinal)?
7. <b>Creating/ clarifying core effectiveness HC metrics</b>	Derivation of objective/metric trees where appropriate; Selection to Value-based HC scorecard
8. <b>Creating/ clarifying subordinated operational metrics</b>	Derivation of objective/metric trees; Incorporation within HR operational scorecard
9. <b>Strategy-delivery monitoring and maintenance (real-time)</b>	Monitoring and maintenance protocol to ensure comprehensiveness and business reality, revising both operational strategy and plans where necessary
10. <b>Repeat cycle</b>	Updated as often as business/HR function requires

There are different aspects to measurement (excluding pure data) and metrics classifications can be used to differentiate the often confusing world of HC measurement. For example, they can be separated into four main categories:

- Metrics relating to the efficiency and effectiveness of the HR function/process, such as transaction/payroll costs, recruitment cycle time etc
- Metrics related to aspects of human capital/human capital management performance, such as employee engagement, turnover etc
- HC analytics that look to combine various metrics and data to provide further insight, for example, looking to find relationship between engagement and turnover, employer brand and recruitment success, talent index etc.

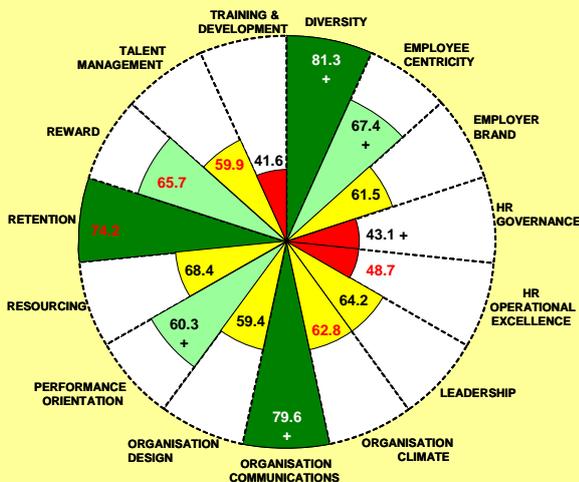
<sup>51</sup> All of these are contained within the derivative output of the VALUENTIS VB-HR™ Rating ([www.vbhr.com](http://www.vbhr.com))

- Enhanced (modelling) analytics that look to combine macro and micro organisational measures to provide 'performance models'.

The various human capital related scorecards can be (re)created with appropriate definition and level, thus providing the right metrics with the right communication to the right audience.

The final essential component is the governance aspect, ensuring that the requisite monitoring and maintenance of strategy and the measurement of its effectiveness. Progress of achievement is a vital cog in assessing HR's contribution as much as the individual operational strategies are vital to organisation performance. The reality for HR functions is that HCM strategy can have a far more scientific approach towards it even though in essence, very little additional effort is required once the basics are in place.

### Organisation engagement (OEI) indicator (RADAR)



Indices are made up from constituent qualitative and quantitative measures and related across four comparative 'sets': world class, higher to peer, comparative to peer, and below peer. Further modelling analytics can provide deeper interpretation for assessment and strategy purposes.

### OEI benchmarking (extract)

HCM Operational indices	Rating Differential
	(based on collective percentile)
<b>Diversity</b> The focus and effectiveness of diversity and diversity policies within the organisation	Lowest Position Highest 10 <sup>th</sup> 20 <sup>th</sup> 30 <sup>th</sup> 40 <sup>th</sup> 50 <sup>th</sup> 60 <sup>th</sup> 70 <sup>th</sup> 80 <sup>th</sup> 90 <sup>th</sup> 100 <sup>th</sup> 82 <sup>nd</sup> -4.0% -14.0%
<b>Employee Centricity</b> The degree to which the organisation has employee-centric policies in place and delivers on them in terms of effectiveness	10 <sup>th</sup> 20 <sup>th</sup> 30 <sup>th</sup> 40 <sup>th</sup> 50 <sup>th</sup> 60 <sup>th</sup> 70 <sup>th</sup> 80 <sup>th</sup> 90 <sup>th</sup> 100 <sup>th</sup> 76 <sup>th</sup> -4.0% -14.0%
<b>Employee Engagement</b> The degree to which employees are currently engaged with the organisation (see level 2 main report)	10 <sup>th</sup> 20 <sup>th</sup> 30 <sup>th</sup> 40 <sup>th</sup> 50 <sup>th</sup> 60 <sup>th</sup> 70 <sup>th</sup> 80 <sup>th</sup> 90 <sup>th</sup> 100 <sup>th</sup> 81 <sup>st</sup> -7.0% -15.0%
<b>Employer Brand</b> The degree to which the organisation has an identifiable brand and its contribution/effectiveness in related organisational areas	10 <sup>th</sup> 20 <sup>th</sup> 30 <sup>th</sup> 40 <sup>th</sup> 50 <sup>th</sup> 60 <sup>th</sup> 70 <sup>th</sup> 80 <sup>th</sup> 90 <sup>th</sup> 100 <sup>th</sup> 77 <sup>th</sup> -9.0% -17.0%
<b>HR Governance</b> The overarching management of HR as a function/governance of Human Capital Management within the organisation	10 <sup>th</sup> 20 <sup>th</sup> 30 <sup>th</sup> 40 <sup>th</sup> 50 <sup>th</sup> 60 <sup>th</sup> 70 <sup>th</sup> 80 <sup>th</sup> 90 <sup>th</sup> 100 <sup>th</sup> 59 <sup>th</sup> +1.0% -10.0%
<b>HR Operational Excellence</b> The degree to which the HR function possesses the requisite competence and executes its delivery objectives in terms of quality and effectiveness	10 <sup>th</sup> 20 <sup>th</sup> 30 <sup>th</sup> 40 <sup>th</sup> 50 <sup>th</sup> 60 <sup>th</sup> 70 <sup>th</sup> 80 <sup>th</sup> 90 <sup>th</sup> 100 <sup>th</sup> 47 <sup>th</sup> -4.0% -14.0%
<b>Leadership</b> The perceived effectiveness of overall management within the organisation	10 <sup>th</sup> 20 <sup>th</sup> 30 <sup>th</sup> 40 <sup>th</sup> 50 <sup>th</sup> 60 <sup>th</sup> 70 <sup>th</sup> 80 <sup>th</sup> 90 <sup>th</sup> 100 <sup>th</sup> 60 <sup>th</sup> -7.0% -13.0%
<b>Organisation Climate</b> The degree to which the current operating environment within the organisation is seen to be a positive/negative factor	10 <sup>th</sup> 20 <sup>th</sup> 30 <sup>th</sup> 40 <sup>th</sup> 50 <sup>th</sup> 60 <sup>th</sup> 70 <sup>th</sup> 80 <sup>th</sup> 90 <sup>th</sup> 100 <sup>th</sup> 25 <sup>th</sup> +12.0% -4.0%

Percentage differences can be used to show the extent of over and/or under-performance and linked to HC analytics for further insight.

### Summary

The recent onset of outsourcing or partial outsourcing of HR has raised a number of interesting questions for HR functions. The main rationale used for outsourcing HR has been cited<sup>52</sup> as cost reduction, though this has quite often translated in to HR becoming more 'strategic'. Other reasons include: better quality of HR delivery/standardisation, access to better technology without capital investment, and/or requisite HR expertise (scale with regard to any of these may also be regarded as a reason). However, what is strategic?

Cost reduction implies that HR functions have not been operating efficiently or have failed to communicate their internal value proposition. Organisations would not outsource for cost reasons unless operational inefficiencies exist. Indeed transaction cost economics<sup>53</sup> would lead us to the same conclusion<sup>54</sup>. But cost reduction is not strategy. Thus the business case for HR outsourcing appears to be confused.

The 'five HCM forces' model and its link to competitive advantage addresses this confusion by defining what strategic human capital management is. The subsequent toolkit, as outlined here, assists in bringing the strategic HCM concepts alive in a practical applied manner.

The toolkit is equally applicable whether it's a small 20-person firm located on an out of town industrial park or a global firm operating in 200 countries with over 100,000 people. The only difference is scale and level of complexity.

HR Directors and business partners should be in no doubt as to the contribution the HR function plays in fulfilling the proposition that competitive advantage can be sustained through effective human capital management.

HR's value proposition has moved on. Instead

<sup>52</sup> There are a number of reports and studies – see for example 'European ways to HR transformation – survey highlights 2006' Hewitt p16

<sup>53</sup> For an understanding of transaction cost theory see Coase, R.H. (1937), 'The Nature of the Firm', *Economica* 4, pp386-405 or alternatively Williamson, Oliver E., *Markets and Hierarchies: Analysis and Antitrust Implications*, NY: The Free Press, 1975

<sup>54</sup> The business case for the other reasons stated would be acceptable as long as the cost of managing and monitoring the vendor relationships and the costed degree of risk caused by an external supplier(s) produces a net positive margin.

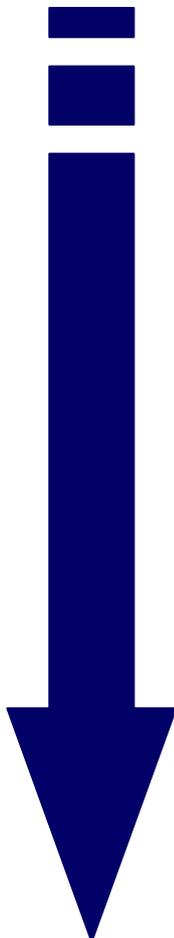
of justifying its existence, the positioning of strategic HCM redefines its potential contribution. HR professionals have a duty to become more transparent and not hide behind fuzzy and too often 'faddy' concepts. After all that is what being professional is all about.

For their part, organisations and their senior management must grasp the opportunity of achieving differentiation in human capital management terms, which doesn't default to the lowest common denominator, i.e. pay.

As stated at the beginning, it is people that largely make the difference. Their collective uniqueness outguns any other organisational investment due to the fact that inanimate assets are replicable. Its time for organisations and managers to embrace the human capital management manifesto.....

### Human Capital Management: How strategic are you?

The following 'quick test' (see overleaf) will help to determine the extent to which HR and (indirectly their organisations) are achieving strategic human capital management:



**INTERNATIONAL SCHOOL  
OF  
HUMAN CAPITAL MANAGEMENT**

## Human Capital Management Faculty

The HCM faculty is currently engaged in a number of leading research projects and white papers on people management including leadership, organisation design, talent and employer of choice and their link to superior competitive advantage.

Major publication for 2007:  
*Organisation Performance through a human capital lens*



<b>Berkeley Square Campus</b>	<b>Victoria Campus</b>
2nd Floor, Berkeley Square House	27 Floor, Portland House
Berkeley Square	Stag Place
London	London
W1J 6BD	SW1E 5RS

Tel: +44 20 7887 6121  
Fax: +44 20 7887 6100  
[www.ISHCM.com](http://www.ISHCM.com)



**INTERNATIONAL SCHOOL  
OF  
HUMAN CAPITAL MANAGEMENT**

## HR Strategy & Leadership Faculty

This leading faculty is preparing a number of related publications on HR strategy, governance and the role of the Chief Human Capital Officer.



Major publication for 2007:  
*The Human Capital Management Manifesto*  
*The chief Human Capital Officer*

<b>Berkeley Square Campus</b>	<b>Victoria Campus</b>
2nd Floor, Berkeley Square House	27 Floor, Portland House
Berkeley Square	Stag Place
London	London
W1J 6BD	SW1E 5RS

Tel: +44 20 7887 6121  
Fax: +44 20 7887 6100  
[www.ISHCM.com](http://www.ISHCM.com)

## Human Capital Management: How strategic are you?

Organisation related	YES	NO	DON'T KNOW		
Does the organisation know its overall performance from a human capital perspective?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
Does the organisation know its overall performance from a human capital management perspective?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
Do you know to what degree your employees and managers are engaged?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
Does the organisation know how its overall employer brand relates in the market?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
Does current focus on talent management match current/future organisation priorities?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
Does current HR resource activity match HR priorities?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
Can you provide a robust 'return on investment' chart for the current HR spend?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
Does the organisation know how much is spent on ancillary people costs (such as recruitment, training & development, certain HR initiatives)?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
Have you quantified operational risk through people related activities/competencies?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
Does the organisation utilise human capital reporting externally as a means of supporting its employer brand?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
HR function related	YES	NO	DON'T KNOW		
Are any HR processes working less than efficiently with incidence of (non-IT) system failures?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
Does the HR function spend a disproportionate amount of time on compliance issues?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
Does the HR function suffer from a lack of capability/resource?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
Do you constantly feel like you're on an HR 'business-as-usual' treadmill with no means of stopping?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
Have you tried HR benchmarking only to find it is of little value?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>		
HCM Strategy	Not at all	To some extent	To a reasonable extent	To a large extent	To a great extent
The degree to which the HR function plays a critical role in the development of the organisation's values, strategy and business planning?	<input type="checkbox"/>				
The degree to which the HCM strategy and its main programmes of work implementation are known, widely, to managers and employees?	<input type="checkbox"/>				
The degree to which there is a recognised process for reviewing performance against the objectives and targets contained in the HCM strategy?	<input type="checkbox"/>				
The degree to which the HR team understands the organisation and its associated value/cost drivers?	<input type="checkbox"/>				
That the HR function's duties and responsibilities are clear in relation to the corresponding management responsibility?	<input type="checkbox"/>				
The degree to which relevant stakeholders are involved in the review process for the development of the HCM strategy?	<input type="checkbox"/>				
That the organisation utilises employee metrics/analytics/performance data in its management decision-making?	<input type="checkbox"/>				
That the organisation is able to forecast accurately the future shape of the workforce and the available labour pool to determine resourcing needs?	<input type="checkbox"/>				
That the degree to which the organisation measures return-on-investment accurately for all significant HR interventions?	<input type="checkbox"/>				
That the work and job roles of the organisation are designed to optimise effort and enrich employee engagement?	<input type="checkbox"/>				
HR functional contribution legacy	Little effect	Some effect	Noticeable effect	Large effect	Serious effect
If the HR function was not there tomorrow, how, in your view, would it be missed by the organisation? (i.e. effect on employee engagement directly and indirectly through influence on management)	<input type="checkbox"/>				

Essentially, with regard to the organisation, the more responses of 'Yes' signifies that the more strategic HCM will be in place. With regard to the HR related questions, the more 'Yes's' signify barriers to strategic HCM. With regard to HCM strategy, the more 'To a great extent' is ticked the higher the probability that the HCM strategy is cohesive, relevant and executed. The HR functional contribution legacy question poses a challenge for all HR functions in terms of their perceived value, particularly when related to employee engagement.

• Performance • Compliance • Performance • Compliance  
Analysis • Evaluation • Assessment • Investigation • Insig  
Organisation • HR Function • Organisation • HR Function  
Innovative • Unique • Groundbreaking • Challenging • Tho

Financial services • Pharmaceutical • Retail • Healthcare •  
Manufacturing • Banking • Utilities • Business services • IT  
• Mining • Media • Transport • Construction • Telecomms  
Local Government • NHS • Higher Education • Agency •

*"From a client perspective the question isn't why, it's why not?"*

Human Capital Management

Human Capital Measurement

Organisation Performance

HR Functional ROI



**ADVISORY - AUDIT - ASSURANCE - ANALYTICS**



**Global Headquarters:**  
2<sup>nd</sup> Floor, Berkeley Square House  
Berkeley Square  
London  
W1J 6BD

Office: +44 (0) 20 7887 6108  
Fax: +44 (0) 20 7887 6100  
[www.valuentis.com](http://www.valuentis.com)

**International School of Human Capital Management**

**Berkeley Square Campus**

2<sup>nd</sup> Floor  
Berkeley Square House  
Berkeley Square  
London  
W1J 6BD

**Victoria Campus**

27 Floor  
Portland House  
Stag Place  
London  
SW1E 5RS

Tel: +44 20 7887 6121  
Fax: +44 20 7887 6100  
[www.ISHCM.com](http://www.ISHCM.com)