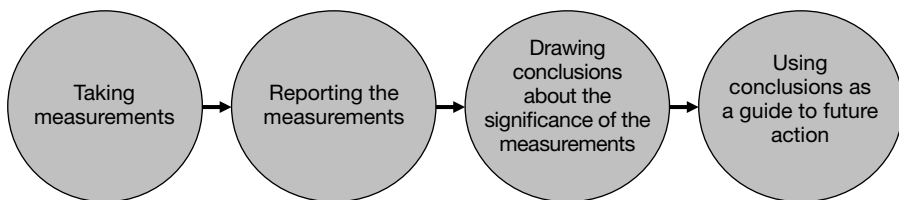


## The process of HCM

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The aim of this chapter is to provide an overview of the process of HCM which, as shown in Figure 3.1, is a journey in which the key stages are measurement, reporting, drawing conclusions from the data and action.



**Figure 3.1** The process of HCM

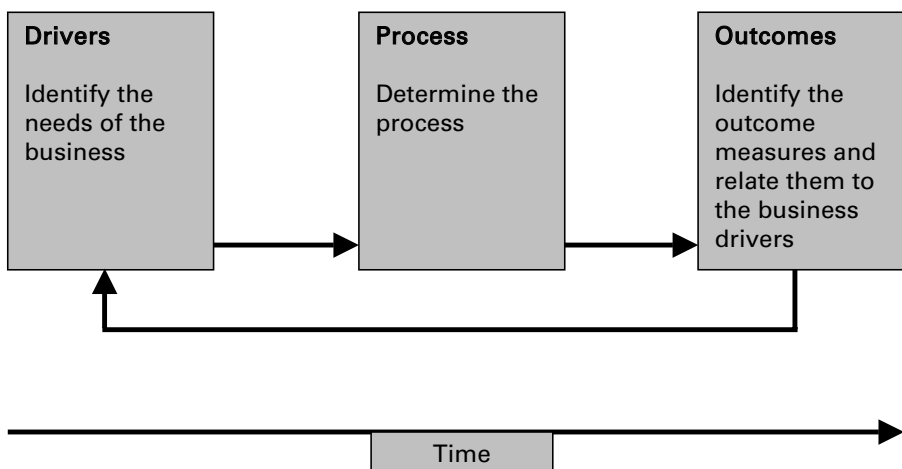
The chapter starts with an assessment of the drivers of HCM and continues with a description of the human capital journey. The processes of measurement and reporting are then examined in more detail and the chapter ends with discussions on drawing conclusions and introducing HCM.

## HCM DRIVERS

The question of what drives HCM needs to be answered before looking at the processes involved. The key drivers are:

- the need to achieve the strategic goals of the organization;
- the recognition that these goals can only be attained by the effective use of resources and that the key resource is people, whose knowledge, skills and abilities create value and produce human capital and therefore competitive advantage;
- an appreciation of the importance of understanding the factors that will create value through people;
- the realization that to understand and apply these factors it is necessary to measure and assess the actual or potential impact of HR processes and to base HR and business strategy on the outcomes of these measurements;
- the need to ensure that HR processes provide value for money.

The focus of HCM is illustrated in Figure 3.2.

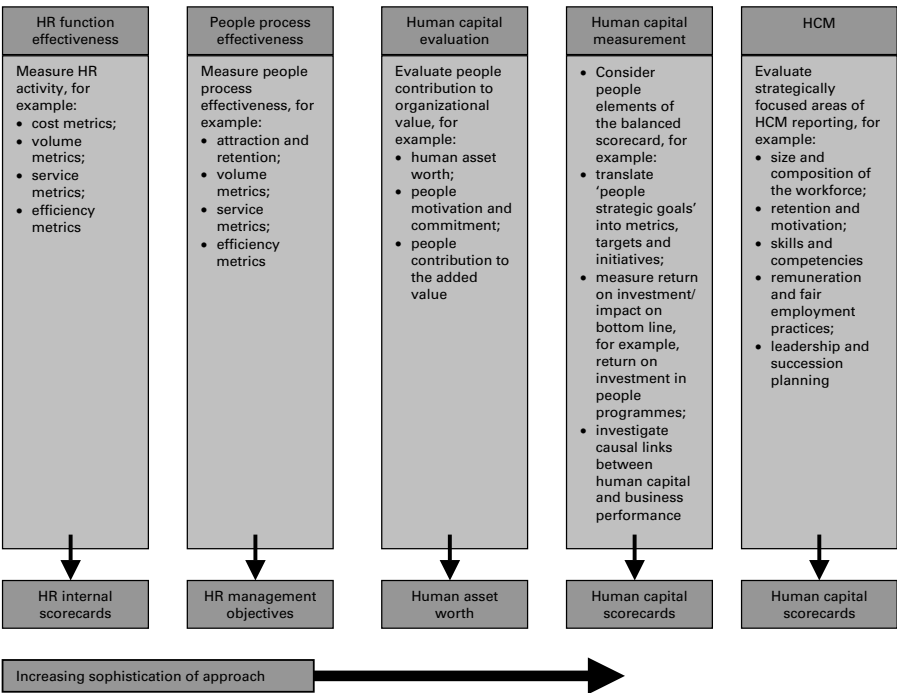


**Figure 3.2** Human capital focus

## THE HCM JOURNEY

The drivers influence how the process is used to generate particular outcomes and this means as our research has shown, that approaches will differ between organizations depending on their planned outcomes. So, for example, when the driver is internal to HR and about demonstrating value for money, the approach is very different to when it's about determining the impact of people on the business and the contribution to shareholder value.

Moreover, HCM is a dynamic and evolutionary process, as shown in Figure 3.3, which describes how the human capital journey produced by the drivers develops over time as organizations generate new needs and drivers.



Source: CIPD (2004) *Human Capital Reporting: An internal perspective*, CIPD

**Figure 3.3** The human capital pathway

It is important to emphasize the notion of HCM as a journey. It is not an all or nothing affair. It does not have to depend on a state of the art HR database or the possession of advanced expertise in statistical analysis. It is not all that difficult to record and report on basic data and, although some degree of analytical ability is required, it is to be hoped, nay expected, that any self-respecting HR professional will have that skill. At the beginning of the journey an organization may do no more than collect basic HR data on, for instance, employee turnover and absence. But anyone who goes a little bit further and analyses that data in order to draw conclusions on trends and causation leading to proposals on the action required that are supported by that analysis, is into HCM. Not in a big way perhaps, but it is a beginning. At the other end of the scale there are the highly sophisticated approaches to HCM operated by such organizations as the Nationwide Building Society and the Royal Bank of Scotland. This might be the ultimate destination of HCM but it can be approached on a step-by-step basis.

## HUMAN CAPITAL MEASUREMENT

As Becker *et al* (2001) emphasize: 'The most potent action HR managers can take to ensure their strategic contribution is to develop a measurement system that convincingly showcases HR's impact on business performance.' They must 'understand how the firm creates value and how to measure the value creation process'. This means getting involved in human capital measurement as defined and described below bearing in mind that, as pointed out by Scarborough and Elias (2002) that the process of measurement can be just as important as the measurements themselves.

### ***Definition***

Human capital measurement has been defined by IDS (2004) as being 'about finding links, correlations and, ideally, causation, between different sets of (HR) data, using statistical techniques'. The CIPD (2004) emphasizes that it deals with the analysis of 'the actual experience of employees, rather than stated HR programmes and policies'.

Human capital measurement is based on human capital data comprising the numbers or quantities that describe human resources in an organization, represent particular aspects of the behaviour of people, or indicate the scale of different people management activities.

For example, the data may refer to demographic figures on the size and composition of the workforce, or the numbers of leavers, or absence figures, or the amount of training that has been carried out, or the number of vacancies that have been filled.

Human capital data can be necessary in itself for record keeping and to comply with various legal and regulatory requirements such as to ensure recruitment practices are not discriminatory or to comply with health and safety legislation. However, the data that is collected for these purposes is not always sufficient to inform on human capital. It can provide a useful starting point but needs to be considered in the light of what organizations need to know to understand their human capital and how it can be manipulated and analysed in order to provide this.

Data, therefore, needs to be distinguished from measures, as considered in the next chapter. Data is raw material; measures assemble and analyse that raw material so that conclusions can be reached on its value and significance.

Thus data may be available on the number of people leaving an organization over a certain period, but this will be interpreted as a measure of employee turnover – the number leaving as a percentage of the number employed. Data comes first, but establishing the need for a certain measure or metric may indicate what data is required to enable the measurement to take place. A metric is simply another word for a measure, although it has the connotation of being somehow more sophisticated.

Data as analysed and interpreted through measures provide *information* on human capital in order to provide the basis for evaluation, planning and action. In turn, the measures an organization uses to provide the information it needs on human capital may have implications not only for the type of data it collects but also for how this data is collected. Many organizations rely on data from computerized HR information systems that were designed for very different purposes. As a result they are experiencing difficulty with interpreting the data and ensuring that it is comparable with data collected by other means.

The next part of this book (Part 2) starts with Chapter 4, which explores the meaning and significance of human capital data. This provides the lead in to Chapter 5, which carries on with a description of how that data is turned into measures or, conversely, how the need for measures establishes the need for data. In turn, this leads to Chapter 6, which examines how the information provided by the

data and measures is converted into reports as the basis for greater understanding and action.

### ***The need for human capital measurement***

There is an overwhelming case for evolving methods of valuing human capital as an aid to decision making. This may mean identifying the key people management drivers and modelling the effect of varying them. The issue is to develop a framework within which reliable information can be collected and analysed such as added value per employee, productivity and measures of employee behaviour (attrition and absenteeism rates, the frequency/severity rate of accidents, and cost savings resulting from suggestion schemes).

Becker *et al* (2001) refer to the need to develop a 'high-performance perspective' in which HR and other executives view HR as a system embedded within the larger system of an organization's strategy implementation. They state that: 'The firm manages and measures the relationship between these two systems and firm performance.' A high-performance work system is a crucial part of this approach in that it:

- links the firm's selection and promotion decisions to validated competency models;
- develops strategies that provide timely and effective support for the skills demanded by the firm's strategy implementation;
- enacts compensation and performance management policies that attract, retain and motivate high-performance employees.

### ***Reasons for the interest in measurement***

Human capital is a vital intangible asset in an organization that is as critical to business success as 'hard' assets', if not more so. The recognized importance of achieving human capital advantage has led to an interest in the development of methods of measuring the value of this intangible asset for the following reasons:

- Human capital constitutes a key element of the market worth of a company. A research study conducted in 2003 (CFO Research Services) estimated that the value of human capital represented over 36 per cent of total revenue in a typical organization.

- People in organizations add value and there is a case for assessing this value to provide a basis for HR planning and for monitoring the effectiveness and impact of HR policies and practices.
- The process of identifying measures and collecting and analysing information relating to them will focus the attention of the organization on what needs to be done to find, keep, develop and make the best use of its human capital.
- Measurements can be used to monitor progress in achieving strategic HR goals and generally to evaluate the effectiveness of HR practices.
- You cannot manage unless you measure.

However, a number of voices have advised caution about measurement. Leadbeater (2000) observed that measuring can 'result in cumbersome inventories which allow managers to manipulate perceptions of intangible values to the detriment of investors. The fact is that too few of these measures are focused on the way companies create value and make money'. Scarborough and Elias (2002) concluded from their investigations that the specific set of measures or metrics organizations reported were less important than the process of measuring and the uses for the information gathered. The Institute of Employment Studies (Hartley and Robey, 2005) emphasized that reporting on human capital is not simply about measurement. Measures on their own such as those resulting from benchmarking are not enough; they must be clearly linked to business performance 'materiality' – ie, the relevance of the measures is important. And Donkin (2005) emphasized that:

It is not the measuring itself that is the key to successful HCM, but the intentions behind the measuring and the resulting practices that emerge. The effectiveness of these practices is heavily dependent on how they are perceived and understood by frontline employees and the kind of workplace behaviours they encourage. Measuring is not a good in itself. Adopted without any rationale it will achieve little. Its prime uses are to evaluate cost and to test the effectiveness of a strategy, pointing the way to further improvement.

## **HUMAN CAPITAL REPORTING**

Human capital reporting is concerned with providing information on how well the human capital of an organization is managed. There

are two aspects: first, external reporting to stakeholders. The second aspect is internal reporting which informs the leadership team and stakeholders about how human capital is being managed but extends this with statements of how the information will be used to guide future action. The purpose is to inform decision making about HCM not just to record the figures.

### ***External reporting***

The Accounting for People Task Force (2003) recommended that:

The (external) report should clearly represent the Board's understanding of the links between HCM policies and practices and its business strategy and performance. This means that it should normally include details on the size and composition of the workforce, employee retention and motivation, skills, competencies and training, remuneration and fair employment practice, and leadership and succession planning. The report should follow a process that is susceptible to review by auditors, provide information in a form that enables comparison over time, and use commonly accepted terms and definitions.

### ***Internal reporting***

Internal reporting should be linked to the external reporting framework but will focus more on the practical implications of the data that has been assembled and analysed. The information and the headings of the internal report have to be tailored to the context and needs of the organization but it could:

- set out the quantitative and qualitative information – this might include data on the size and composition of the workforce, attraction and retention, absence, motivation, skills and competencies, learning and development activities, remuneration and fair employment practices, leadership and succession planning and the outcomes of opinion or job satisfaction surveys;
- analyse measures of employee satisfaction and engagement, compare them with data on business performance and demonstrate the links between them;
- analyse the outcomes of external benchmarking;
- identify the key performance drivers in the organization and indicate how HCM is contributing to adding value in each of these areas;



- review the extent to which people management strategy, policies and practices are contributing to the achievement of business goals;
- set out the returns on investments in people management and development projects and evaluate the effectiveness of the investments;
- draw conclusions on the implications of the data for future people management strategy, policy and practice.

## DRAWING CONCLUSIONS

The conclusions drawn from the data can lead to three areas of strategic decision making: (1) the formulation and implementation of HR and business strategy; (2) the improvement of the capability of line managers in handling HR issues; (3) the overall organization of HR effort.

### ***HR and business strategy***

The importance of 'strategic relevance' is stressed by Donkin (2005). He believes that the key issue is how the information delivered by employment metrics is going to create value in the company. He suggests that 'the response must be to interpret the analysis of any body of measurement in a meaningful way set against qualitative considerations and existing management perspectives'.

To provide guidelines for action a human capital strategy can be developed making use of the data provided by human capital measurement and reporting. This will reinforce or redirect any existing HR strategies. The aim of the human capital strategy should be to inform business decisions to achieve human capital and therefore competitive advantage.

The key is to make operational the concept of 'fit' – the fit of HRM with the strategic thrust of the organization. The development of operational linkages is an important characteristic of strategic HRM. Tyson and Witcher (1994) consider that 'human resource strategies can only be studied in the context of corporate and business strategies'. HCM provides the means to create these operational linkages through fostering a resource-based strategy as described in Chapter 2.

### ***Improving the capability of line managers in handling HR issues***

The data produced by HCM can be used to provide information to line managers on how well they are handling HR issues which can initiate guidance on any improvements necessary.

### ***The overall organization of HR effort***

As explained by Ulrich and Lake (1991) 'For organizations to utilise human capital strategically, they must be organized in a manner that enables them to do so.' The data created by HCM enables organizations to come to conclusions on what should be done to improve HR effectiveness. One of the aims of HCM is to achieve 'human capital advantage' but Boxall (1996 and 1999) notes that a distinction should be made between 'human capital advantage' and 'human process advantage'. The former results from employing people with competitively valuable knowledge and skills. The latter, however, follows from the establishment of:

... difficult to imitate, highly evolved processes within the firm, such as cross-departmental cooperation and executive development. Accordingly, 'human resource advantage', the superiority of one firm's labour management over another's, can be thought of as the product of its human capital and human process advantages.

Human process advantage is achieved by line managers in their day-to-day dealings with people, but HR has a key role to play both in developing the processes and providing guidance to managers on their implementation.

## **GETTING INTO ACTION**

The diagnostics provided by HCM as described above are meaningless if they do not result in action. When developing measures, reporting procedures and methods of drawing conclusions it is essential at each stage to answer the following questions:

- *Why* are we doing this?
- *Where* is it leading us to?

- *What* sort of action do we believe can and should flow from this process?
- *Who* takes the action?
- *How* are we going to ensure that action takes place?

There are no standard answers to those questions, which is why every organization's approach to HCM will differ according to its circumstances although the basic processes of measurement and reporting will always be present.

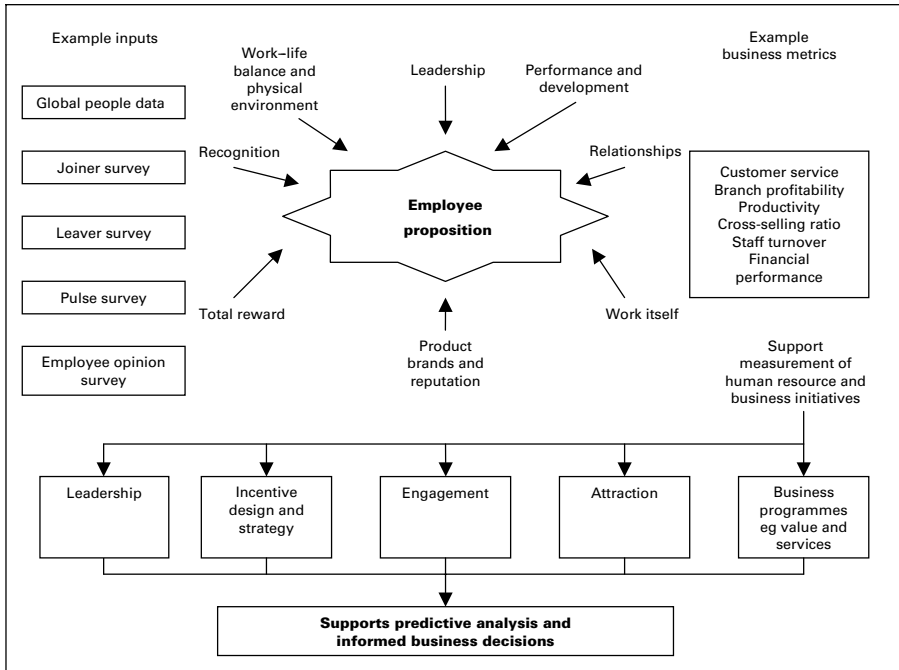
A critical evaluation approach is used. This involves six steps:

1. Determine from the analysis the critical elements that indicate where action may be required.
2. Define the action required and by reference to the analytical data identify alternative approaches to meeting the requirement.
3. Assess the advantages and disadvantages of each approach.
4. Summarize the data and other factors influencing choice of approach.
5. Define criteria for determining the success of the selected approach.
6. Prepare the business case for the approach using the HCM data to support the proposal.

## PUTTING IT ALL TOGETHER

Although the process of HCM can be described as a series of activities – measurement, reporting, analysis, evaluation, action – it can equally well be described as a holistic approach to proving the value of people and generating added value from them. Although the next part of this book describes the concept of data and the processes of measurement and reporting separately, they are all closely interrelated.

HCM could also be regarded as an attitude of mind rather than a series of techniques – a belief that investment in people is highly desirable but that it must be *considered* investment supported by evidence that a satisfactory return will be obtained from it. HCM functions as part of an integrated approach to the management of people.



Source: *IRS Employment Review 802*, 18 June 2004

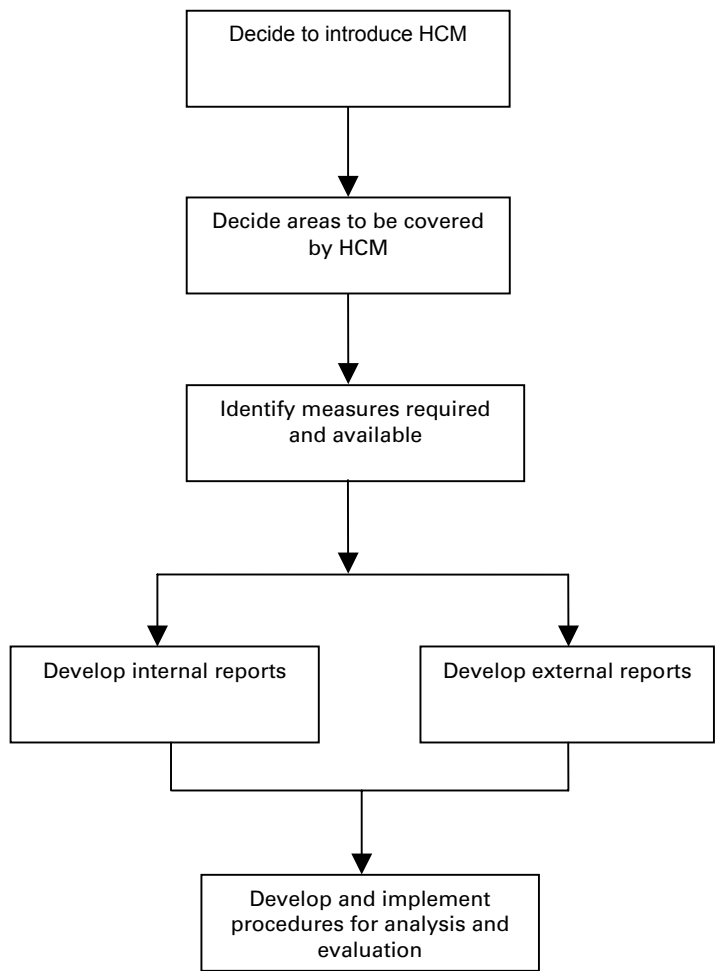
**Figure 3.4** The Royal Bank of Scotland's human capital model

An integrated model of HCM could look like the one developed by the Royal Bank of Scotland illustrated in Figure 3.4.

This is a highly sophisticated approach to HCM but the process of HCM can still make a significant contribution to business success even when it is conducted on a much more basic level as long as the principles of measurement, reporting, analysis, evaluation and action are followed.

## DEVELOPING HCM

The steps required to develop HCM are illustrated in Figure 3.5.



**Figure 3.5** Programme for introducing HCM

The checklist below, developed by Saratoga/Pricewaterhouse-Coopers (Saratoga, 2005) and cited by IRS (2005), can be used as a guide to the development process described in more detail in the toolkit (see the Appendix).

1. What are the priority business challenges facing your company in the next two years?
2. What human capital actions are required to maximize the opportunities required to guarantee business success?
3. How will you make those actions happen?
4. What are your KPIs [key performance indicators] and how are these related to the business challenges?
5. What data is required to measure human capital performance?
6. Are you fully informed and/or are involved in your company's OFR (now Business Review) plans?
7. What human capital information will be most useful to your shareholders and in what format?
8. What information gaps exist and how do you intend to fill them?
9. Are information systems advanced and flexible enough to respond to all recognized demands?
10. Are you satisfied that the information you produce is robust and can stand scrutiny?
11. Are you conversant with the key human capital subjects and major global trends that may be raised by shareholders?
12. Is there a direct link between what the HR function does and what the board wants it to do?