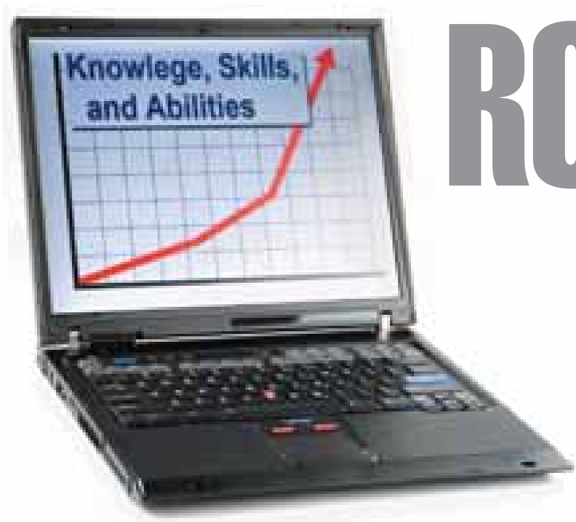


ROI: Measuring the Contribution of Human Capital

by Gail Evans, MBA, CHRP, The Wynford Group

Why Measure Human Capital Effectiveness?

We often hear that **people** (human capital) are the most important assets of any organization and the success of an organization largely depends on the management of its human capital. Yet, in today's organizations there is a strong focus on controlling the bottom line. Common financial metrics that are used to determine these financial results include:

- Net Income
- Gross Profit Margin
- ROI (Return on Investment)
- EBIT (Earnings Before Income Tax)

To gain and maintain credibility at the executive table, it is increasingly important for Human Resource management to present support for their Human Capital Management strategies in a manner that is similar to those used to support Financial and Structural Capital.

Progressive Human Resource Executives have recognized that using Human Capital Metrics, to support business decisions provides direct links to organizational results in quantitative terms that are readily understood by other executive decision-makers.

The attraction and retention of motivated, skilled employees has been identified as HR Executive's #1 priority (*Wynford IAT survey, 2006*), particularly in Alberta, where there have been extreme shortages of skilled workers. Therefore retention of employees as well as high levels of employee productivity have become increasingly important components of successful organizations. In fact, it has been demonstrated that Human Resources activities that are clearly aligned with business strategy can result in significant increases in return on investment (ROI) and organizational success.

A Watson Wyatt study (2003) found that *"Firms that carefully link HR activities to business strategy, measured by metrics have a 33% higher return on total capital than organizations that do not."*

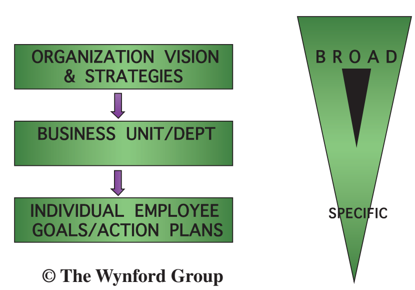
Further studies by Dr Nick Bontis of McMaster University, have shown that there appear to be causal relationships among training, employee engagement and effective leadership that support human resource effectiveness. These studies provide evidence that employees with on-going opportunities for learning with strong leadership are more highly motivated and engaged and therefore more productive and less likely to leave the organization. Both the productivity and retention factors can lead to increased ROI (Return on Investment). The causal model developed by Dr. Bontis can be used to predict which specific factors are most likely to increase Human Capital effectiveness within a specific organization.

A process that has been used successfully to determine Human Capital Value or ROI includes the following steps:

1. Strategic Goal Alignment
2. Identification of Value Drivers
3. Human Capital Benchmark Measurement
4. Development of Effective Human Resource Solutions

1. Goal Alignment

Clearly identifying organizational goals and measurable outcomes is critical to the development of effective Human Capital strategies. A cascaded approach at both the strategic and tactical levels provides clear line-of-sight that enables programs and activities to be focused.



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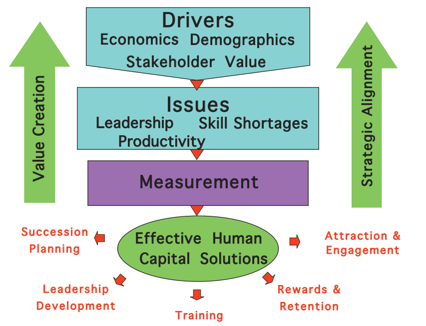
2. Identification of Value Drivers

An important component of Goal Alignment is the identification of Key Value Drivers for the organization that affects the success of Human Capital programs and value creation. The model below identifies the role and important of these drivers in the process of developing effective Human Resource solutions that fit a particular organization.

Human Capital Value Creation



For example relevant Human Capital value drivers include:

- Economic environment that affects the organization's core activities
- Impact of demographics and the available labour pool relevant to the organization's operations
- Stakeholder value, which could include shareholders, clients, members, employees and the public

Determining the specific Human Capital issues that affect the organization's Key Drivers provides focus for developing HR solutions that will use the organization's resources effectively.

Examples of issues that may affect key drivers include:

- Shortages of both workers and the required skills
- Leadership attraction, development and retention
- Productivity of employees and the implications for training
- Nature of turnover, such as tenure, positions and reasons

3. Human Capital Benchmark Measurement

Benchmarking is a quantitative method for measuring and improving processes, products and services that speaks to the language of business. Benchmarking requires:

- Effective performance measures and evaluation
- Internal diagnostics to identify high leverage activities and drivers

It is also important to use measurements or metrics that provide feedback on issues that are specific to your organization, so that they can provide some direction or factual basis for decisions on those issues. Here are a few examples:

Issue	Measurement
Productivity	ROI % Utilization
Turnover/Retention	Separations Demographics
Attraction	Time to Fill Offer Acceptance Rate
Employee Capability	% Employees Trained Training Investment
Leadership	Human Value Added Comp Revenue
Succession Planning	Internal vs External Replacement

Examples of specific Human Capital Metrics commonly used for benchmarking include:

1. ROI on Human Capital =

$$\frac{\text{Revenue} - (\text{Operating Expense less Costs for Human Capital})}{\text{Costs for Human Capital}}$$

- Value of investing in Human Assets
- Amount Returned for every $ spent on Human Capital

2. Training Investment Value =

$$\frac{\text{Total Training Investment}}{\text{Headcount}}$$

- Indicates training investment per employee

These metrics can be useful tools in diagnosing internal processes to:

- Assess the value and Return on Investment of Human Capital.
- Identify cost/performance drivers.
- Assess the effectiveness and contribution of internal programs and activities.
- Identify opportunities to improve alignment of Human Capital to corporate strategy.

To take the power of HR Metrics to the next level, they can be used to benchmark against industry-based metrics to identify competitive position in various areas and pinpoint areas of opportunity and improvement.

For example:

The *ROI* for public sector organizations are typically around 1.10 (or $1.10 returned for every $1.00 invested) where as financial organizations are typically closer to 2.00 (or $2.00 returned for every $1.00 spent). *Training Investment Value average for all industries is typically over $2000/employee [From Human Capital Benchmarking (HCB) Survey, The Wynford Group].*

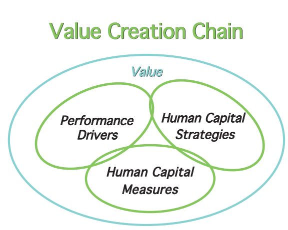
Examples of common HR Metrics are identified below. Using these metrics as benchmarks is particularly useful when used on a year over year basis, so that improvements can be identified and linked to specific strategies or programs. This is where the real value of can be seen, in employing systematic assessment using consistent metrics over several years. Often there is a lag effect, where the implementation of a new training program or succession planning program may take several years to see the actual results in metrics such as reduced turnover, increased employee engagement and ROI.

HR Metric	Definition
Human Capital ROI	*Shows the ratio of income to employment costs*
Revenue Factor	*Shows the revenue per employee (FTEs)*
Income Factor	*Shows income per employee (FTEs)*
Expense Factor	*Shows operating expenses per employee (FTEs)*
Human Added Value	*Shows income net of employment costs per head*
HR Expense %	*Shows HR expense as a % total operating expenses*
HR Headcount Ratio	*Shows ratio of employees served to HR employees (FTEs)*
HR investment Factor	*Shows HR operating expenses per employee (FTEs)*
HR Structure Breakdown	*% of HR resources applied to each key HR area*
Voluntary Separations (Turnover)	*Shows HR expense as a % total operating expenses*
Training Investment Value	*Shows $per person that is spent on training*
Internal Mobility Rate	*Shows % of employees who move internally within a year*
Time to Fill Vacancies	*Shows average number of days to fill a vacant position*

[From Human Capital Benchmarking (HCB) Survey, The Wynford Group]

4. Development of Effective Human Resource Solutions

The Human Capital Metrics provide a focused diagnostic to determine where new or improved human resources solutions need to be developed in the organization. Once new strategies are identified and implemented, the cycle of measurement starts again. The results of new initiatives are measured against the expected results as well as industry benchmarks and strategies are then further refined. This cycle can also be referred to as a Value Creation Chain as illustrated below:



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Hopefully this article has provided insight into the use of HR metrics can support decision-making on Human Capital management that is based on "facts" rather than "gut-feelings" can increase the Human Capital effectiveness and credibility as well as directly contributing to the success of the organization. As the field of HR metrics grows, we should be able to more accurately predict where resources should be deployed to further increase employee engagement and Human Capital productivity. ■

Gail Evans is President of The Wynford Group; a management consulting group specializing in Human Capital Benchmarking, Human Resource Infrastructure and Total Rewards and Performance. The Wynford Group conducts several annual national surveys including the IAT Compensation Survey, Construction Survey and the Human Capital Benchmarking Survey.

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