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Human Capital: Leveraging Your Company's Greatest Asset

The real fuel and energy behind a company's growth and success comes from its people, yet managing human capital can be a real challenge for the board.

Following the sale of several operational units in 2008, ConAgra Foods Inc. looked to measure the impact of a new leadership initiative the company had launched to cultivate talent and align it with the corporate vision. ConAgra—maker of American treats such as Reddi-wip, Orville Redenbacher popcorn, and Hebrew National hot dogs—studied the performance of 600 trained and 1,600 untrained supervisors across 65 U.S.-based plants to determine the effect of training on leader retention.

By measuring the performance of the two groups, consultants working on the project determined the overall 12-month turnover of trained supervisors was just 5.3%, compared with 11.4% for untrained supervisors, translating to a savings of $2.3 million in the first year of the leadership initiative. ConAgra, based in Omaha, Nebraska, suddenly had raw numbers to justify management training going forward.

ConAgra represents a growing trend in recent years of companies placing more value on human capital, starting with basic measurement of the effectiveness of everything from training programs to employee engagement. From the board level on down, these companies place a premium on analytics to help them make decisions on grooming talent, finding ways to keep it, and using methods to recruit it.

At the highest levels, there are signs of human capital gaining emphasis. Board charters have been expanded at many companies to focus on human capital, and more organizations are using quantitative analysis to gauge their efforts, including strategic risks and rewards. These companies are giving more emphasis to measuring the effectiveness of the workforce, while increasing the role of monitoring the risk of human capital at the board level.

To be sure, there is still work to be done. While many chief executives would say human capital is a vital asset, experts say most companies fail to give it the attention it deserves. Only 31% of companies said they effectively assess human capital risk and 24% said they do an ineffective job, according to a 2011 survey of executives by The Conference Board. Nevertheless, human capital risk is viewed as important. It ranks fourth on a list of 11 risk categories in terms of impact on business results, according to the survey. While trailing regulatory, operational, and strategic risks, it was ahead of financial, reputation, supply chain, and information technology risks.

Several trends point to a need for more analysis of human capital as a risk and asset. One is demographics, with experts predicting a labor shortage for qualified workers down the road. As baby boomers begin to retire, companies will need to fill the gap with Gen-Xers and Millennials. There are expected to be 55 million job openings from 2010 to 2020, according the Bureau of Labor Statistics, with 62% of them coming from the need to replace workers who retire or permanently leave an occupation.

Meanwhile, as companies become ever more service oriented, they will increasingly depend on the intellectual capital of their own workers. Major workplace changes are taking place, too. Technology has made workers more able to work virtually, with the help of video conferencing and an increasing reliance on outsourcing. Bottom line, companies need to have a handle on their own workforces more than ever before.

"You are talking about a very different world, one that is highly ambiguous and that brings new levels of risk around talent," says Jody Miller, a director at TRW Automotive Holdings Corp. and Capella Education Co. and chief executive officer of Business Talent Group, a Los Angeles-based company that places professionals for temporary project and executive assignments. "Every board should be asking whether it fully understands and has thought through the overall challenges that will hit the talent market. Boards should be thinking of that as a high-level strategic issue on an annual basis."

And the shifts in the world economy are playing a role in workforce trends as well. With costs rising in overseas labor markets, Korn/Ferry International CEO Gary Burnison noted in a Fox News interview that he expects a rise in "insourcing" versus global outsourcing. However, right now, many companies are putting their efforts on building the need to hire, rather than hiring to grow. "CEOs are not looking to hire, then innovate," Burnison said in the interview. "They are looking to innovate, then hire." All these dynamics play a major role in how companies are viewing their human capital needs, and the risks of embarking on the wrong strategy.

The definition of human capital varies by industry and company, but simply put, it's "the abilities and skills of any individual, especially those acquired through investment in education and training, that enhance potential income earning," according to Collins English Dictionary. Economist Adam Smith once wrote human capital is the "acquired and useful abilities of all the inhabitants or members" of a society. He noted "the acquisition of such talents, by the maintenance of the acquirer during his education, study, or apprenticeship, always costs a real expense, which is a capital fixed and realized, as it were, in his person." It's just that getting a handle on the expense has been easier said than done.
When it comes to human capital, boards lack both knowledge and data, says Edward E. Lawler III, a professor at the University of Southern California Marshall School of Business and founder and director of USC's Center for Effective Organizations in Los Angeles. "Boards might have HR executives sit in on meetings, but not consistently at the typical company," he says. "Basically, they go by the seat of their pants when it comes to human capital decisions."

Boards are so focused on financial performance, strategy, and operations that human capital gets less airtime. "It's about share of mind," says Ron Lumbra, co-head of the board and CEO practice at search firm Russell Reynolds in New York. "The whole issue of human capital strategy needs to become an increasingly important topic on board agendas."
"If you believe talent is a key opportunity for difference making, then it follows logically that the board should be very much concerned about it and on top if it," Lawler adds. "Not just at the CEO level—where they are involved—but deeper into the organization."

Management succession: a starting point

When it comes to human capital, management succession is a big element. Replacement plans for the top echelon are integrated into board protocol, but less so when it comes to succession on a companywide basis. Here, boards on the whole are not probing enough, says Theodore L. Dysart, a vice chairman and leader in the Global Board of Directors practice at Chicago-based Heidrick & Struggles, an executive search and consulting firm. Dysert says boards need to rigorously drive through that culture of talent throughout the organization and recognize their fiduciary responsibility to monitor succession planning at all levels of the company.

Such rigor includes asking questions of management, says Barbara Adachi, a national managing director for the human capital practice at Deloitte Consulting in San Francisco. "They need to dig deeper, beyond the first layer of the positions that are opening up," she says, and ask questions such as how far down do we want to go into the organization to look at the pipeline? What are the future critical talent needs? How do we promote and drive succession in the organization? How do we retain high performers to make sure they are going to be here in five to 10 years? Should we have a committee on talent?

Of course, the types of questions asked depends on the type of company. For example, boards of fast-growing companies must make sure the infrastructure of a business is scaling as quickly as the top line. Dysart says directors must be vigilant on the topic of talent. “Board members need to ask those questions early and often,” he says.

It doesn’t matter so much where the function of human capital analysis resides on the board; rather, the important thing is having a protocol in place that has HR leadership reporting to the board on a regular basis, says Claudia Lacy Kelly, the global practice leader of Spencer Stuart’s human resources practice in Stamford, Connecticut. Depending on the size of an organization, directors should have a good idea of the company’s talent one or two layers down in the management tiers.

“A committee of the board should be charged with interacting with the HR leadership of the organization to make sure there is talent development and planning process in place,” Kelly advises. Talent should also be benchmarked to peers: “Your CFO might be a great guy. But is he as great as your competitor’s CFO? You don’t want to fool yourself that you have such great talent without looking at competitors,” she adds.

Digging deeper into data

Boards should also have a good handle on how their companies measure human capital. In the quest to better manage this asset, Fortune 500 companies have been using increasingly sophisticated analysis to measure workforce efficiency. Companies such as Google Inc., Procter & Gamble Co., Lowe’s Cos., Marriott International Inc., and Intel Corp. have all established HR analytics groups to get a clearer understanding of the behavior, potential, and risks inherent with their workforces. Thanks in part to lower technology costs, these companies have taken advantage of more accessible data and software, such as statistical modeling products.

Not surprisingly, companies leading the way in HR analytics are sometimes reluctant to talk about their work, lest it give away those competitive advantages. For this article, more than a dozen companies cited as leaders in the practice of HR analytics declined to participate or ignored interview requests.

But anecdotally, it’s clear many companies are digging into their own data. For example, Starbucks Corp., Limited Brands Inc., and Best Buy Co. can identify the value of a 0.1% increase in engagement among employees at a particular store, cites the Harvard Business Review. PNC Financial Services group used its HR and marketing analytics teams to show that internal hires outperformed external ones in terms of sales performance, according to McKinsey Quarterly.

The sophistication of analysis varies widely. About 90% of companies now use basic methods such as internal benchmarking, according to a Mercer 2012 survey of 500 North American organizations on metrics and analytics. Internal benchmarking generally involves cross-company comparisons. Yet more aggressive firms have embraced more complex methods: 43% said they deploy predictive modeling, using statistical analyses to uncover cause and effect relationships, allowing them to project outcomes of company policies.
Job websites also help tell the story, showing how some companies are putting an emphasis on human capital with regard to analytics. In early June, job descriptions posted on the job

search engine SimplyHired.com showed positions for “manager of learning measurement” at Lowe’s, and a “senior manager in HR change management” at Marriott for the company’s Change Management Center of Expertise, with a primary focus on “creating and implementing change management plans that minimize employee resistance and maximize employee engagement.” There was a posting by UniBanCal Corp. for a “strategic data analytics consultant,” and a listing for a “workforce management analyst” by Harley Davidson.

Many leading companies have also woven the concept of human capital into their board charters. ConAgra, for example, has a human resources committee that has traditional compensation committee functions but also handles tasks such as reviewing with the full board companywide talent management programs and processes.

The power of analytics

When it comes to measuring human capital, most companies are at the dashboard level, where they use software that has some analytics reporting capability, says Gene Pease, chief executive officer of Capital Analytics, a consulting firm based in Durham, North Carolina. But these tend to be more focused on descriptive factors, such as the number of people in training and the number that completed it, as opposed to calculating a return on investment.
Yet in the case of ConAgra, the ROI of training was easily calculated: The attrition for trained supervisors fell to 5.3%, down from a company average of 12.7% a year earlier. The analysis, done by Capital Analytics, also showed training increased safety audit scores at the company’s smaller plants to 8.9, up from 7.3, on a scale of 10. At the larger plants, training had little effect on scores, showing the company other types of safety interventions were needed. (ConAgra declined to comment.)

Pease likens human capital measurement to clinical drug trials, where pharmaceuticals use statistical techniques to measure pre- and post-trial observations. “This allows companies not only to show how their investments are doing but more importantly, how to optimize them,” he says.

From this camp of proponents, human capital expenditures should be treated as investments. It boils down to risk and reward principles generally used in investing, says Michael Echols, executive vice president of strategic initiatives and the Human Capital Lab at Bellevue University, in Bellevue, Nebraska. Yet costs of human capital get lost on the profit-and-loss statement. While a 10-K filing would show how much money was spent on plant and equipment, it won’t have a line item for training and development expenditures, Echols notes. These costs get spread out through operations units.

“The board would never approve a major capital investment without an ROI calculation associated with it,” Echols says. Yet “there is not a conversation between management and the board about expenditures on human capital.” However, he points out these types of investments are happening nonetheless, since in the aggregate, U.S. companies spent about $172 billion in 2010 on learning and development, according to the American Society for Training and Development.

Certainly companies have already used analytics in areas such as sales and customer service. In sales, it might be about how training could increase gross margins or shorten the time of selling a product. For a call center, it might be about how training can decrease average handling time of a call or decrease escalation of a call to a supervisor. When it comes to human resources, metrics would include measuring retention, reduction in sick time, and employee engagement.

Processes also must support analytics. Finance and HR need to work together to quantify some aspects of the workforce to get a sense of how it is trending, says Jeff Higgins, chief executive officer of the Human Capital Management Institute, which has done work for companies such as JetBlue Airways Corp., UniBanCal, and Penske Truck Leasing. Higgins has helped companies develop so-called human capital impact statements that measure workforce productivity and quantify workforce impact on financial performance. The statement uses calculations of traditional metrics such as revenue, profit, total expenses, and market capitalization on a per full-time equivalent (FTE) basis (see sidebar, "In Search of a Standard").

Another metric is total cost of workforce (TCOW), which includes the sum of compensation and benefits costs, plus HR costs such as training, recruiting, risk mitigation, and administration. From there, companies can calculate the TCOW as a percentage of revenue, expenses, and operating expenses. Companies can also calculate profit per FTE. Comparing those numbers year over year gives an idea of trends in workforce efficiency and allows for calculating a return on investment for human capital.

Bottom line, companies that place an emphasis on human capital, measuring it, and treating it as a pure asset will stand apart, experts say. "The workforce is the primary way to drive revenues," says Scott Pollak, a principal at PwC's Saratoga practice, its workforce analytics group. "Companies that do a proper job of making sure they have the right people at the right time at the right price are going to be in a position to have a sustainable competitive advantage."

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