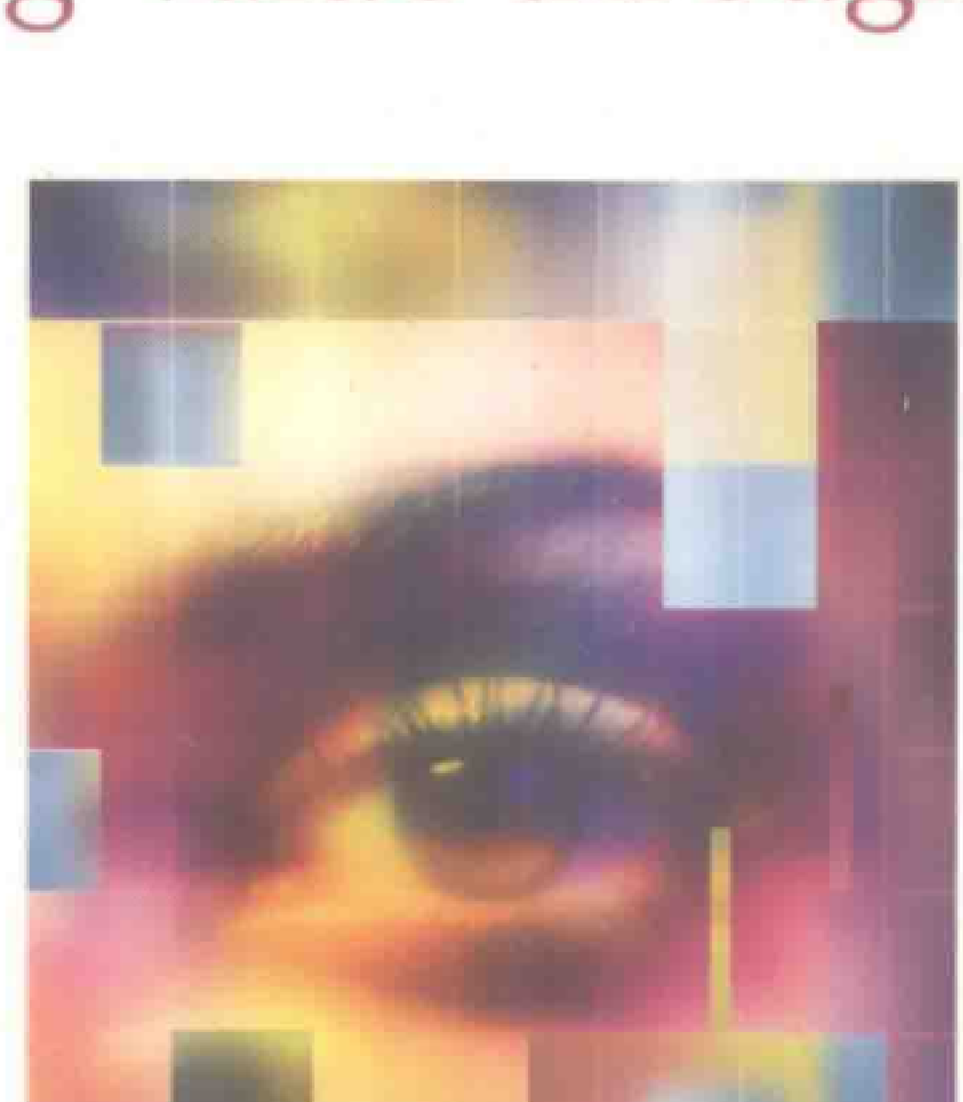
STRATEGIC HUMAN CAPITAL MANAGEMENT

Creating Value through People



Jon Ingham

A blueprint for managing people and organizations in the 21st century.

Human capital management (HCM) provides the key to unlocking great business performance. It focuses an organization's people management and development practices on maximizing the capability and engagement of all the people working for the organization. This creates valuable intangible capability, human capital, which enables the organization to take full advantage of potential business opportunities.

Jon Ingham is encouraged by the new thinking that has emerged in the area of human capital management. However, he believes that there is too much focus on the measurement of value created by HCM rather than the creation of that value. This book rebalances the agenda and brings a new, more strategic and more people-centred perspective to this increasingly important area.

Strategic Human Capital Management:

- outlines the key attributes of a strategic approach to HCM and captures these within a scorecard (the HCM Value Matrix).
- provides a process for managing human capital using the scorecard (the Strategic HCM Planning Cycle).
- includes case studies from leading organizations and commentary from HR practitioners and academics.

The book provides senior HR professionals, organizational development practitioners and business leaders with a thought-provoking review of the territory in HCM as well as a clear route map to support their own exploration.

"HCM is a much used and often misused term. The challenge for HR teams for some time has been to deliver integrated business strategies that optimize employees' capability and engage the discretionary effort they can choose to invest in the organization. This book, while acknowledging the importance of measurement, rightly focuses attention on what HCM approaches deliver increased business performance. It provides the reader with all the necessary thinking and rationale for setting the HCM agenda with their business along with practical case study material for moving to action. For business leaders it confirms the correlation between increased market value and applying best fit HCM practice. For HR professionals it will give confidence that they do have a unique and critical contribution to make which they are being expected to step up to."

Malcolm Hurrell, Vice-President Human Resources UK
AstraZeneca plc

"That people's capacity to unlock the performance of organizations is far from a simplistic and causal model is hardly new. A book offering a new way of explaining how such complexity can be managed and harnessed for the good of organizations certainly is. This is a book to address HR's continuing inability to think outside the box of how people influence performance. Read, reflect and act."

Dr Anthony Hesketh, Director
Centre for Performance-Led HR, Lancaster University Management School

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Strategic Human Capital Management

'Human, not financial, capital must be the starting point and ongoing foundation of a successful strategy.'

Christopher A. Bartlett and Sumantra Ghoshal
MIT Sloan Management Review
Winter 2002

Foreword

Tim Miller
Director, People, Property and
Assurance, Standard Chartered Bank

At Standard Chartered Bank, we've long recognized the importance of human capital management (HCM). Before sharing our philosophy, first a few words about who we are; why HCM is so important to us and why we welcome this book.

Standard Chartered is a long-established international bank, listed on both the London and Hong Kong Stock Exchanges and currently in the top 20 FTSE 100 companies. With 44 000 people, we're naturally a diverse organization, representing 89 nationalities in 54 countries in the Asia Pacific Region, South Asia, the Middle East, Africa, the United Kingdom and the Americas. Our core businesses are wholesale and retail banking. The wholesale bank provides services to multinational, regional and domestic corporate and institutional clients in trade finance, cash management, custody, lending, foreign exchange, interest rate management and debt capital markets. Our retail banking business provides credit cards, personal loans, mortgages, deposit-taking activity and wealth management services to individuals and medium-sized to small businesses. We've performed well over the last three years, doubling our revenue. Our goal is to continue this momentum, both through organic growth and selective acquisitions in our key growth markets. Market expectations of us are high and we're operating in an increasingly competitive and unpredictable environment. During this time, we've focused heavily on building a performance culture through building employee engagement.

So why is human capital management and measurement important to us? Partly this stems from the need to anticipate and respond to the changing world in which we operate. It's also to do with our fundamental belief that to take human resource management to the next level, we need to better understand our people predictors of future business performance and how we're building our people capabilities.

The world is changing quickly. Customer profiles are changing, so too are their needs and expectations. Growth of the middle classes in India and China and increasing female economic participation are obvious examples. Demographic trends indicate we're going to face tougher competition for talent in our key markets. All this means that we've got to be better than ever at attracting and retaining the best talent that reflects our customer profiles and builds our people capabilities. This is one argument for making sure we configure our people HR processes and policies to ensure we meet these challenges.

However, our role in HR goes way beyond a simple 'best fit' approach of aligning people strategy to business goals. We need to build people capabilities and a workplace climate that gives us the competitive edge in responding to market changes and evolving business strategies. This is critical in an unpredictable world. Who'd ever have predicted 9/11, the 2003 SARs endemic or the 2004 tsunami? And yet all these had an impact on our business, calling for new and different types of responses.

Standard Chartered Bank's approach to human capital management is different to many organizations. We adopt a 'strengths-based' philosophy. In practice, this means we help employees to understand their individual talents using numerous tools, and then focus on leveraging these talents at work so they can be the best they can be. What do I mean by talents? Put simply, these are recurring patterns of thought, feelings and behaviours that distinguish each of us. These are normally hardwired in us in our mid-teens after which we can't do that much to change them. This strengths-based approach is woven into everything we do, with three fundamental principles guiding our approach to human capital management:

- Focus on talent for the job at all levels, by building tools and processes that identify, reward and retain high performing employees.
- Help individual employees know and focus on their strengths and, where necessary, manage their limitations.
- The development of exceptional managers and leaders who can identify and develop talent and build employee engagement.

We believe in positioning people for success by putting them in roles which naturally use their talents – play to their strengths as we call it – and then provide them with the knowledge and skills to be successful. Take salespeople for example. We know from our talent research that the very best salespeople are highly competitive and establish rapport quickly. You can't train people to be competitive – they either naturally want to beat their rivals to the point of being very poor losers, or they don't. You can't train them to be competitive. You can give them the basic product knowledge and sales skills through training, such as how to overcome objections or knowing when to close the deal. But without the right talents they're never going to be more than mediocre performers. What company wants mediocre salespeople? And yet, many companies take a remedial approach to training. They identify what a person's poor at, spend all their time trying to remedy the weakness, say through training, and pay scant regard to whether the weakness lies in an area of talent, knowledge or skill. They may end up getting the employees to be an OK performer, but they'll be demoralized in the process. They'll certainly never be world class. So, you need to know what talents your top quartile performers have and select more people like them.

Does this mean we ignore weaknesses? Absolutely not. We help employees identify their non-strengths, but the focus is on helping people build support systems to manage round them, partly through building complementary and diverse teams. A great example is one of our FX markets salespeople. A sales genius, but poor at planning and administration. Sounds familiar? He added more value to the company through selling and this is what he was paid to do. But his manager didn't get the talent equation. He still judged him on his administration, his Achilles heel. So our sales guy just made sure that he had a team member who could sort out the detail for him. He continued to deliver exceptional results, while dealing painlessly with the admin.

Employee engagement also sits at the heart of our strengths-based approach. We've been using Gallup's Q12 to measure and improve employee engagement across all our markets since 2000. It gives us powerful insights into our culture and how well our managers are managing. Within a single country, with the same national culture, the same economic conditions, and the same HR policies, there are wide variations in engagement of our employees. This is mainly down to the manager, the way they manage their teams. This picture somewhat debunks the school of thought that there is one best bundle of HR practices, or a silver bullet for high performance.

Knowing that managers have the biggest impact on engagement wasn't enough for us. We wanted to know *how* they do it and get inside the 'black box' of performance. So we studied our very best managers, those who create highly engaged teams and deliver business results. We found that great management is about ensuring each person has clarity about their deliverables, using the person's unique strengths to position them for success, and providing positive reinforcement for doing the right things through praise and recognition. Our best managers are also great storytellers. They create meaning for their people and a connection between what they do and the bigger organizational goals simply by telling stories that bring it alive in vivid language. For example, a branch manager in Ghana will talk about growing the business in terms of farming analogies. We've woven our findings into our management development programmes, how we communicate within the Bank, and we're starting to translate this into how we select managers.

Our strengths-based approach has had a bigger organizational and emotional impact than we'd even first anticipated. Managers across cultures and markets now have a common language where they talk about their strengths in the same way. It's also helped managers to manage their teams more effectively – many managers know the dominant talents of their team members through the tools we use. This means they can adapt their management style to each person to really get the best out of them. We call this individualization. Ever been managed by someone who treats you the same as your colleague sitting next to you, when you're fundamentally different people, with fundamentally different styles, needs and motivations? It's pretty frustrating. And it limits your potential. Our leadership development approach is based on a rigorous assessment of individual talents and development planning based on their strengths. The feedback is that it's had a huge impact on performance – while also being liberating compared to our old remedial approaches.

But the best part about our strengths-based approach is that it gives us greater capability than if we'd purely focused on strategic fit. Hiring for talent gives us a bigger gene pool to play in. This is critical in those growing markets where competition for people is tough. China's a great example. Many companies are expanding rapidly in China. We're no exception. But people with banking skills are in short supply. We're hiring people with the right talents and values for our roles – and just training them to give them the right skills and knowledge. Sounds obvious but few companies do it.

All this is woven together by a strong set of organizational values, what I call the DNA or glue of the company. Our HR and Brand people worked together on building a distinct brand, through developing a brand promise to our customers based on their needs and wants, but also by building the brand from within – focusing on the values behaviours that are at the core of our brand. Our values are all-pervasive now. They provide a strong sense of who we are and what we stand for.

So we've got a clear approach to people management. But we also need to know how well we're building the right sort of people capabilities to deliver. This is where rigorous and robust human capital measurement comes in.

There is a lot of talk about balanced scorecards, much of which makes a great deal of sense. Most companies are in good shape when it comes to reporting financials, customer satisfaction and loyalty, and measuring process efficiency. But the final quadrant of the balanced scorecard – people metrics – tends to be pretty poor. Human capital measurement is all about our ability to measure how well we're doing on the people measures that matter, both to help us understand how we've been doing but also to help predict how we'll be doing going forward on key business enablers.

So the first question is what should we be measuring? Sounds simple, but in reality it's quite complex. My advice is to be clear about the difference between HR efficiency metrics, such as the ratio of HR to employees, volume of recruitment and so forth, and human capital measures. Companies have to avoid the temptation of reporting on what's easy to measure as data for data's sake is unhelpful. Some companies who purport to do it well haven't yet got beyond 'gee whiz' metrics such as average training days per employee. What on earth does the number of training days tell you about how well you're building capability? It tells you nothing about the quality of training, or more importantly the impact on the bottom line. As bad are statistics that are so aggregated as to be little more than useless. You need to focus on what will add value to the business. And it has to be driven by strategy.

Our HCM philosophy is simple. We take an integrated approach to human capital management and measurement to ensure we measure and then develop the effectiveness of our processes in building strategic capability and the return on investment of key activities, such as engagement and training. So how do we do it? Our starting point is the strategic goals for each of our businesses. We then work out what people levers will help achieve these, and frame a series of questions that probe how well we're doing in pulling these levers. Our key questions are around how we are building resources to deliver future growth, both from a quality and quantity perspective. For example:

- Is our level of resourcing in line with future growth needs?
- Are we *growing* the talent pipeline through quality selection and development?
- Are we *accelerating* development of our best people so as to increase the succession pool of senior leaders?
- Are we retaining our best people?
- Are we rewarding disproportionately our best performers and high potential staff?

Our metrics are designed to provide deep insights into business questions like these. However, in practice, it's tough to deliver well. The second question is how to report people measures in a helpful and meaningful way and that have credibility with the business. It's difficult to get off first base if you haven't the system capability to do this. We're in a fortunate position to have established one global HR information system a few years ago where all our people data is held. This acts as the HCM engine for us.

One of the big prizes is that we now have common scorecards for our different business units and markets, with consistent measures calculated in a standard way, giving us the ability to compare across the business. It's like having a standard P&L but focused on people. It gives us confidence that we're all looking at the same thing.

The other element of our approach to HCM is measuring the business impact of what we do. Take employee engagement. Through our modelling we know that business units with high levels of engagement outperform others on a range of measures, including revenue growth, profit margin, employee retention and customer satisfaction. This is so much part of our DNA now that managers accept the business argument for engagement. We can tell you too about the revenue impact of our sales training – and we know we have a quick payback for the investment.

So what are the benefits of better HCM measurement? To start, it's given us granular insights into how well we're managing our people capability. It acts as an early warning signal for us about things we need to put right before they become major challenges. It gives HR the ability to challenge the business constructively in a way we haven't been able to do before. It also helps us make better decisions, for example, about how quickly we should be moving our talent around.

There's also the external reporting debate, a highly public one in the UK at present, especially given the history of the Operating and Financial Review (OFR). How and what do we report externally around people is a complex issue which involves regulators and governments alike. We also believe in greater transparency with our external stakeholders and helping analysts understand what people measures they should be looking for in assessing the value of companies, beyond the usual rather narrow question of top-team succession. For this reason, we're continuing to evolve what we report externally, whether through our Annual Report and Review or our Corporate Responsibility Report. Some companies are still squeamish about doing so, using the argument of commercial sensitivity to do nothing. However, this is a smokescreen; HCM reporting doesn't necessarily mean other companies can easily replicate what you're doing in managing people. It usually means they haven't got their act together on their metrics or what they're doing in HCM.

Given the growing interest in HCM I welcome this book. A lot of companies talk about it but few have yet to share their approach or how to do it in practice. The book will contribute enormously to raising the bar on the standards around HCM.

Preface

Unleashing the Chain Reaction

I initially became interested in human capital management (HCM) after having come across T.O. Davenport's book, *Human Capital* (1999) while working as an HR Director for Ernst & Young. Davenport explains that the 'employees are our biggest asset' metaphor is outdated and misguided. Instead, employees are more like investors of their own human capital. Organizations do not own this human capital but can rent it from their employees. Because of this, human capital is highly precarious and is in constant danger of being lost when an employee walks out of the door.

When I joined Penna Change Consulting (previously Crane Davies and subsequently, Penna Board Partnership) as Head of HR Consulting in 2001, I started to think more deeply about this area. I also worked with several clients to help them maximize the human capital that their people were investing. In 2002, Penna published its first report on HCM, explaining that:

> HCM leverages your most valuable asset – your people – to improve business performance and grow competitive advantage. Focusing you on the issues that attract, motivate and inspire the best talent, HCM mobilizes every aspect of your operations to achieve a single goal: sustained business success.
>
> (Finn, 2002)

Although this was still early days in our thinking, we had managed to capture two very important points:

HCM is about Leveraging Value from People

Human resource management (HRM) treats people as an organizational resource. The term 'human resource' implies an available supply that can be drawn on and used up to support or help in a particular task. And resources appear as costs in traditional accounting practices.

HCM recognizes that people are investors of their personal human capital and that this provides the main source of value for an organization. Of course, financial reporting standards will not allow us to account for human capital in the same way as financial capital, but with a nominal shift from the right-hand to the left-hand side of the balance sheet, the term 'human capital' at least implies the right level of importance. It describes an investment, not a cost. It indicates something that can appreciate if it is managed appropriately over time, rather than being utilized for short-term gain. It also recognizes that organizations do not have to own the capital to utilize it, but that it will only be made available for as long as investors (the people working for the organization) gain value in return for making their investment.

HCM is about Business Success and Competitive Advantage
HCM is about managing people in a way that leads to the optimal accumulation of human capital: for the individuals who are investing it; the organizations which are using it and also the financial investors who are funding it. In fact, HCM provides a way of reconciling the views of people in economic and in human terms. In this way, it supports the stance taken by Libby Sartain, previously Vice-President of People at Southwest Airlines and now at Yahoo!, that head and heart should not be considered mutually exclusive (Sartain and Finney, 2003).

HCM's role in creating value for investors is highlighted by Brian Becker and Mark Huselid, the co-authors of books on the HR and workforce scorecards:

> HR can have an important influence on the shareholder value … To create this value, however, requires a fundamentally different perspective on HR; a perspective probably more accurately described as human capital management than as HRM. The concept of human capital management emphasizes the essential point that a firm's human resources and subsequently its HRM system can be more than a cost to be minimized.
>
> (Becker *et al.*, 1997)

Taking Measures of HCM

Shortly after Penna published its report on HCM, the UK government set up the Accounting for People taskforce to look at ways in which organizations could measure and report on the quality and effectiveness of their HCM practices. I still believe the review was a useful intervention as it highlighted the importance of people and put the value of people management firmly on the business agenda. However, as I explain further in Chapter 1, the review did not actually relate that closely to what I understand as HCM. Another HCM consultant, Paul Kearns (2004), has also explained that, in his view, the linking of HCM and the measurement and reporting of people management has really been quite accidental:

> It is really just coincidental that these developments have happened at a time when the term human capital has come to prominence. Hence, the people reporting requirements have now just become human capital reporting requirements.

I believe that this accidental connection, supported by the sales pushes of software vendors and benchmarking providers has led to a lot of poor thinking on HCM. For example, have a look at this comment from Leslie Weatherly (2003), HR Content Expert at the US Society for Human Resource Management (SHRM):

> Only by ensuring that HR metrics are recognized and valued on an equal footing with other business metrics routinely used by the CEO and management can the HR practice leader be assured an equitable position as a key member of the senior management team. These metrics must, of course, measure the value and return on investment in human capital to the organization.'

I believe that HCM does provide an opportunity for HR to take on a more strategic role, but improving recognition of metrics cannot be the only (or even a particularly important) way to do it. As David Longbottom (2005), previously HR Director at DSG International, explains:

> Playing the numbers game won't raise the profile or improve the performance of the HR profession; nor will it secure HR's place as a strategic business partner to the chief executive.

HCM as 'Managing the Measurement'

However, some of the linking of HCM with HRM measurement is a result of different, and I believe, wrong, rather than just poor thinking. Take this comment from Eric Flamholtz (2005), one of the founders of the field of human resource accounting, who proposes a version of HCM based on:

> The need to change the perspective of HRM from a behavioral field anchored in social and organizational psychology to a field rooted in measurement and analytical tools.

This is almost the complete opposite of the people-centred approach to HCM I described before. At its most extreme, this version of HCM is now being seen as a decision science (Boudreau and Ramstad, 2004) in which people management is focused on the financial worth of individual employees and the organization as a whole. Actions are only taken if it is predicted that the resulting increase in financial worth will provide an appropriate return on investment (ROI). This is an approach I describe as 'managing the measurement' because the financial measures become the main focus of decision-making. Some HR professionals believe that this approach will help them talk the language of Finance and that doing this will give HR more credibility in the business. However, it seems strange to me, particularly at a time when existing accounting methodologies are struggling to measure the tangible outputs of a business effectively, that HR should be trying to adopt these approaches and apply them in areas they were never even designed to cover.

HCM as 'Measuring the Management'

Of course, measurement is important. But I think the growing focus on measurement is based more on improvements in the supply of information than changes in demand. Better technology means that many businesses can generate lots of data and of course it is important that we respond to the new possibilities that more information gives us. But information only helps to the extent that it enables us to do something differently and the purpose of measurement is to support, not replace, the management of people. As the Penna report (Finn, 2002) explained:

> We believe organizations should measure success, and not people. Few businesses will benefit from extensive number crunching and searching futilely for a financially based evaluation system. Instead, decide the criteria for the success of your HCM programme – and monitor your progress in achieving them. What people issues feed through to the performance of your business? What are you going to do to address them?