

# Whatever happened to human capital measurement?

When they first came to prominence in the late 1990s, models of human capital measurement and HR analytics seemed to offer HR an ideal path to the strategic role it has long been seeking. By creating a clear 'line of sight' between HR interventions and bottom-line profitability, such models can potentially provide a link between people management and business results – paving the way for HR to feed into business strategy. Yet despite their promise, very few organisations make full use of these techniques and the insights they can offer.

Ten years ago, human capital measurement (HCM) seemed to be the next 'big thing' in HR. In 1998, Harvard Business Review published an article describing how Sears, Roebuck and Company had transformed its fortunes using an evidence-based approach to HR management that drew a causal link between employee satisfaction, customer behaviour and the company's bottom line performance. Soon after, several large employers – most notably Nationwide Building Society and The Royal Bank of Scotland Group in the UK – followed suit, developing their own models of human capital measurement along similar lines. And in 2003, the UK government established a taskforce on HCM to 'consider best practice in human capital reporting, and the performance measures that are most valuable to stakeholders'. One of the key recommendations of its *Accounting for People* report was that:

'Directors of companies producing operating and financial reports (OFRs) ... should include within them information on HCM within the organisation, or explain why it is not material.'

At this time, it seemed that HCM offered the 'holy grail' that HR had been searching for – a way of linking HR interventions and bottom-line profitability, with the potential to transform the profession from an administrative function, often seen as a cost centre for organisations, into a strategic partner that could put a value on what it was adding to the business.

But rather than building from these firm foundations, HCM instead began to falter. The Department of Trade and Industry did not adopt the taskforce's recommendation in its 2005 draft OFR regulations – in fact, it completely ignored the term HCM – and just a few months later the Chancellor, Gordon Brown, effectively withdrew the regulations altogether. Support for HCM among employers also seemed to dry up, with many of the most established models and frameworks falling out of use at their respective organisations.

And the picture has not greatly improved in the last few years. In a KPMG survey published last month (*Rethinking Human Resources in a Changing World*, October 2012), just 15 per cent of the 418 executives questioned thought HR was able to 'provide insightful

and predictive workforce analytics that provide understanding of the people agenda in businesses' and just 17 per cent said HR was able to 'measurably prove the value of HR to the business'.

So why has the HR profession failed to take advantage of all that HCM appears to offer?

## The current state of HCM

HR data continues to be collected. Most employers maintain at least some basic HR metrics, whether it is workforce demographics, staff turnover rates, absence levels, training spend or cost-per-hire. Many organisations also carry out a basic analysis of these figures. They may be compared to the figures from previous years to assess progress or decline, for example, or they may be benchmarked against the performance of other organisations in the same industry or region.

But human capital measurement – or HR analytics, as it is now increasingly referred to – is about more than simply collecting data and carrying out basic benchmarking. It is about finding connections, correlations and, ideally, causal links, between HR metrics and other business measures – and then using this knowledge to inform HR strategy and actions. For example, while it is good to know that absence levels have fallen year-on-year, if HR could also show that this decline correlated with an improvement in sales, the business would be more likely to sit up and take notice. And if HR was able to show that the decline in absence was a causal factor in the improved sales figures, it may find itself being asked to feed into the overall business strategy.

Despite the apparent promise of HCM, very few HR departments attempt to use their data this way, preferring instead to stick to their basic analyses. It appears there are a number of barriers standing between HCM and its acceptance into mainstream HR.

## The data is too fragmented or dispersed

For many employers, the fundamental problems are those of data quality and access – the HR information they hold is simply too inconsistent or it is stored in

too many different places to be used in any meaningful way. It is not unusual, for instance, for sickness absence data to be maintained on an online database, while performance management records are held on a separate, standalone spreadsheet and individual training records are kept on paper files in a line manager's drawer. It is crucial to have datasets in an accurate, consistent and accessible format before making any attempt to try and find links or correlations between them.

Paulette Welsing, Leader of KPMG's Global HR Transformation Centre of Excellence, believes this is a real problem. 'There is a tremendous amount of data available regarding employees today,' she says. 'But the data is very hard to get at. Often what we see is that the data is resident in various systems, so it may not all be sitting in one place. I think that's a big issue.'

'A lot of organisations have data on their recruiting system, their workforce management system, their training system – and instead of these one-off solutions they want to combine the data into one set of dashboards and reports,' adds Todd Randolph, Managing Director, Advisory Services at KPMG.

These problems can not be addressed overnight – bringing together and standardising data in such disparate forms is an expensive and time-consuming process. It could take months to clean up the HR data held by a large, multinational organisation, so senior managers would need to be convinced of the value of the exercise before giving the go ahead to proceed. However, new technology – particularly the introduction of HR management systems – is making it easier for organisations to maintain all of their HR data in a single, standard format. For many employers, this could mean an end to the problem of inconsistent, dispersed data.

### **Businesses are not asking the right questions**

But data management is not the only issue that needs to be addressed. Even among organisations that store all of their HR data in an accurate and consistent format on a single system, few tend to carry out more than routine analyses of their information. According to Paul Kearns, a member of the council at The Institute for HR Maturity, this is because on its own, the data that most organisations collect holds little value. 'Organisations have used data for a long time in HR, but it's all very basic – like measures of absenteeism and staff turnover. And that doesn't tell you very much,' he says. 'If you take absenteeism, for example – it doesn't tell you whether good performers are absent or poor performers are absent; whether the performance of the business has gone down; or what it's actually costing the business. So it's all very limited.'

'It's the same with cost-per-hire,' he continues. 'If you were to ask me if you could use general cost-per-hire data for analysis, I would say no, you can't, because the cost of hiring somebody is not really what you need to know. It's the performance and the quality of the person that you've hired that really matters – and only then is it really worth asking how much it cost to hire them.'

It is a view shared by Anthony Bruce, HR consulting partner at PwC. 'HCM has not yet fulfilled its promise as there is still too much focus on basic workforce metrics and data, such as the number of people, where they are located and how much they are paid, and not enough focus on understanding the link to business outcomes,' he says. 'Many organisations now possess a wide range of relevant quantitative and qualitative information within and outside the HR arena, but this is not being connected or effectively mined or analysed to create deeper business insight.'

The view among the consultants we spoke to is that organisations are starting from the wrong place. They are starting with the data and hoping it will give them some answers. They should instead be starting with a question: 'What is it that we want to know?'

Bruce suggests that HCM should 'be less about the individual metrics and more about combining a range of measurements and using analytical methods to test hypotheses relevant to the business. For example, does higher engagement lead to higher profits? Do compensation plans or mobility drive retention? Does diversity contribute to improved business results? Companies that are able to interpret data and create insight that helps drive what the business is trying to achieve will emerge in a stronger position.'

### **HR does not have the required skills**

Once the question has been set, however, a further obstacle presents itself. Does HR have the skills required to carry out the sort of complex statistical analysis required to find the answer? Historically, statistics has not been a requirement of most HR roles. 'HR people are known for not liking numbers,' says Kearns. 'A lot of HR people don't even want numbers – they take the view that you can't attach numbers to what they do.'

Welsing, however, believes this situation is beginning to change. 'Over the last couple of years we have seen a shift in the skillset of HR professionals,' she says. 'Having real quantitative analysis skills and really strong business acumen is becoming much more important – and you need those skillsets in order to look at analytics.'

For Kearns, meanwhile, the lack of statistical knowledge within HR is not a problem – HR may provide most of the data, but it does not actually have to get involved in its analysis. ‘If you asked a CEO today to tell you if they are getting the best value from their human capital, they wouldn’t immediately turn to the HR department for an answer – they’d turn to the COO or the CFO,’ he says. ‘Somewhere down the line, HR would get involved. But I don’t see HR as being the main driver of this.’

### People are resistant to being measured

Finally, even if an organisation has excellent data, a well-defined question to answer and employees skilled enough to carry out the analysis, there is one more – often unacknowledged – hurdle to overcome: people’s resistance to being measured – especially where their people management skills are being assessed. And all HR metrics provide a measure, whether direct or indirect, of the performance of an organisation’s managers.

‘Managers are very sensitive to any criticism of the way they manage people,’ says Kearns. ‘Somebody who’s managing machinery or procurement, for example, may make mistakes and they’d probably take it on the chin. But the same people would get very funny if you suggested that they didn’t know how to manage people.’

He believes it will take a radical change of mindset from the CEO and other senior managers to overcome this natural resistance. ‘One of the barriers to getting better data and better analysis is organisations being prepared to admit that they don’t measure their people very well,’ he says. ‘If you want to take HCM seriously, you need an executive committee who are going to take it seriously and who are actually prepared to stand up and be counted on how well they manage people – and there aren’t many of those around.’

For Welsing, it is HR’s job to convince the CEO of the value of HCM and get them to buy in to its principles. ‘I actually think HCM is almost one of the best kept secrets in HR. I think if the CEOs understood what this data could tell them – if they could get at it and mine it – they would be extremely interested. I think it’s HR’s responsibility to bring it to their attention,’ she says.

This requires HR to have a relationship with the board. According to Bruce, the only way it will achieve this is by becoming more connected to the business and by making its data more accessible to leaders. ‘HR

needs to become more confident, assertive and business-focused,’ he says. ‘HR data needs to be presented simply and clearly and it is critical it links to business issues and focuses on what the business is trying to do.’

### A brighter future for HCM?

Despite all of these barriers, there is some evidence that in the next few years HCM may finally come of age. Improved technology should certainly have an impact. The widespread adoption of HR management systems and the advent of cloud storage have made it easier than ever for organisations to maintain all of their HR data in one place, while the software needed to carry out complex statistical analysis is now affordable and freely available. And employers seem ready to take advantage – KPMG’s survey of executives found that 31 per cent of organisations plan to make HR technology investment in data analytics in the next three years.

More importantly, however, HR as a profession appears to have finally latched onto the potential of HCM. In the US, the Society for Human Resource Management (SHRM) has started to draft guidelines for standardising common HR metrics, such as cost-per-hire and staff turnover, with the aim of establishing professional standards both in the US and around the world. Critics within the HR field have questioned whether it is appropriate to prescribe the metrics that different organisations should use and how they should be applied, given the huge variations between different businesses. Supporters of the movement, however, believe that having a common framework will make HR metrics more objective, understandable and comparable between organisations. If nothing else, it has brought HCM back into the limelight.

In the UK, meanwhile, the coalition government has fulfilled its commitment to review the previously withdrawn OFR regulations. In October 2012, the Department for Business Information & Skills published new draft regulations for strategic reporting. These contain a requirement for quoted companies to ‘include information about the company’s employees, including information about any policies of the company in relation to [employees] and the effectiveness of those policies’. However, whether the required information will include HR metrics, such as measures of absenteeism or training spend, remains to be seen.