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Employee Returns:

Linking HR Performance Indicators to Business Strategy

A Carter
D Robinson

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Contents

1. Introduction

1.1 Introduction

Human Resource professionals are increasingly feeling forced to justify in a systematic way the costs of their activities. They also have to make comparisons of their performance measures with those of other organisations. The evaluation of HR practices, in so far as they add value to an organisation's outputs or processes, has been going on since the late 1980s. Today's business environment is increasingly competitive, with a growing emphasis on cost reduction, innovation and quality/excellence. Development and monitoring of relevant HR performance indicators is becoming increasingly important.

But what are HR practitioners measuring? Our recent experience is that many are still primarily concerned with their own activities. That is, they are only examining the operational efficiency of the HR function itself. However, HR can be defined as the range of activities, practices and approaches that allow an organisation to attract, retain and successfully utilise a critical mass of human knowledge and talent. The key aim of HR management should be to ensure that these support business strategy and lead to committed employee behaviour. Increasingly, in devolved organisations, it is line managers or non-HR specialists whose practices have the greatest impact on strategy and employee commitment. This implies that examining the effectiveness of management and employee performance across the organisation is just as crucial as examining the HR function.

In the late 1990s interest in the use of balanced scorecards has grown in organisations. HR's contribution to balanced scorecards is varied, from responsibility for collecting or 'owning' data on the effectiveness across the organisation of people-related items on a corporate scorecard, to responsibility for developing and measuring data on a separate scorecard for HR. Either way the main struggles seem to be knowing what should be in a balanced scorecard and how the items that do go in should be monitored.

1.2 Purpose of this report

This document is a guide for HR practitioners. It provides some ideas and help for those who need to get to grips with measuring the performance of human resources across their organisations. It examines:

- why measures can be helpful
- the strategic context of measurement
- choosing the most appropriate measures
- the effective use of measures.

Throughout, we stress that one of the biggest problems in HR measurement is the temptation to measure everything and create a multiplicity of performance indicators. A focus on key issues and key staff is recommended.

We begin by offering some ideas in Chapter 2 on how HR practitioners can get a better understanding of the business strategy of organisations. This is vital to ensuring that HR measures have relevance and add value.

Chapter 3 aims to explode some of the myths surrounding financial indicators. It encourages HR professionals to contribute with more confidence to the development of a balanced portfolio of performance measures for their organisations.

In Chapter 4 we present a possible framework for presenting, calculating and analysing people indicators. The chapter also addresses some of the nitty-gritty of the sources of data that are needed.

Chapter 5 looks at the specific issue of the measurement of the HR function itself and aims to help HR practitioners to develop a set of measures for their own function which can be used to demonstrate worth and added value to others working in the organisation.

Chapter 6 focuses on benchmarking activities and emphasises how, in order to make successful comparisons using performance indicators, HR professionals can pay attention to ensuring that like is being compared with like.

In the conclusion we draw together all the various strands in recommending three broad steps to developing people measures.

2. Strategic Context of Measurement

2.1 Introduction

Measurement can be a resource intensive and laborious activity. The list of things you could measure is extensive. Being focused on the areas on which your organisation's business needs centre can save you much effort, and maximise your return in terms of usefulness to the organisation. Therefore, in this section we encourage you to step back from your current measurement activities, and indeed from your current HR activities, to consider the key issue of clarity of purpose.

We believe the first place to start is to consider the business strategy of your organisation and then to consider its HR strategy. That simply means understanding what is important in your organisation's business and what needs to be improved in terms of the people. Once you are clear on the overall purpose of people practices in your organisation (*ie* the outcomes needed) this should give you are good sense of the areas into which you need to put the most effort in terms of measurement. You will then be able to consider sensibly about what you might measure.

2.2 What is business strategy?

In essence, business strategy is merely the direction and scope of an organisation over the long term which it sets itself. In the private sector this is done from the belief that it will help achieve sustainable advantages over competitors. Ideally, its strategy needs to match its internal resources to the changing external environment, and in particular to the expectations of its markets and customers.

You may be fortunate in already having a handle on your organisation's strategy, especially if it has expressed it simply and in writing or if you have been involved in creating it. Companies that see strategy as an analytical, systematic, deliberate and rigorous process may well be willing and able to publicise their strategy openly. However, for many companies the reality is that their strategy can emerge in response to changing situations and so they just take a view on the general direction in which they intend to go. This is especially so in the context of industries where there is currently high growth or a changing marketplace, and mergers and acquisitions may be the order of the day. We recognise this makes anticipating what is important to the business quite hard. For the public sector too, it can sometimes be difficult to keep track of what is important to the government or a newly appointed Secretary of State. But these changing environments just go to emphasise how out of date performance indicators can get if you are not measuring the things that matter now, or are likely to matter in the future.

There are many different theories around about developing and interpreting strategy and we do not propose to put any of them forward in detail here. Rather we aim to put forward just two particular classic ways of looking at strategy in order to help you step back and consider your own organisation's situation. Both theories and different ways of looking at issues can be important. They can challenge our basic assumptions about the relationships in business life. They can suggest what to look out for and what to expect as a result of actions taken.

Many top managers in organisations today are avid followers of Michael Porter's approach to business strategy, which he proposed originally in the 1980s, and developed throughout the 1990s. His view was that an organisation's policies — finance, marketing, operations and HR — should all be derived from its business strategy and should fit together in a way that is mutually re-enforcing. Other strategists too tell us that strategic integration is necessary so that HR strategy supports the accomplishment of business strategy and indeed helps to define it. The aim is to provide a strategic fit and consistency between the policy goals of HRM and the business.

2.3 The role behaviour approach

There are three classic generic strategies businesses can pursue. These are often described as those of:

- innovation
- cost reduction
- quality enhancement.

The following three tables outline in more detail the theoretical relationship between these strategies and the types of employee behaviour companies with these strategies will be looking for, together with the HR policies they are likely to be pursuing. We then describe the kinds of measurement areas likely to be important.

An example of a company that could be said to primarily adopting a strategy of innovation is a high technology manufacturing company we shall call Organisation 1. It believes the way to succeed in its particular niche market is through

Table 1: The role behaviour model —Organisation 1

Strategy	Employee Role Behaviour	HRM Policies
Innovation	A high degree of creative behaviour Longer-term focus A moderate concern for quantity An equal degree of concern for process and results A greater degree of risk taking A higher tolerance of ambiguity and unpredictability	Jobs that require close interaction and co-ordination among groups of individuals Performance appraisals that are more likely to reflect longer term and group-based achievements Jobs that allow employees to develop skills that can be used in other positions in the firm Compensation systems that emphasise internal equality rather than external or market-based equity Broad career paths to reinforce the development of a broad range of skills

Source: Shuler and Jackson, 1987

continuously bringing better products or better applications of existing products or better after sales packages to its customers. This means it needs its product development, servicing, marketing and other key staff to be innovative. The theory goes that the type of environment conducive to producing innovative results, is one that harnesses cross functional team working, is tolerant of ambiguity, and encourages risk taking and creative behaviour. That is what Organisation 1 is striving to create. The type of HR policies believed likely to best support such an environment are those which emphasise team based achievements, rather than individual achievements, so their performance management and appraisal systems reflect team objectives and outcomes. In order to attract the top talent in their industry to stay with the organisation, Organisation 1 chooses to pay above market pay rates. However, it is careful to ensure team members from different disciplines are paid similarly.

What does this mean for the HR issues that Organisation 1 may wish to measure? In this example there are two priority areas. Firstly, it needs to check on the attitude and experience of its staff towards the organisation's climate and context to make sure the required behaviours of creativity *etc.* have the best chance of thriving. Questions inserted in a regular employee attitude survey can be very helpful here. Secondly, since it believes internal equity in its pay and compensations systems and the development of transferable skills are critical to high performance in innovation, it will want to monitor both equity across teams and breadth of skills.

Organisation 2 is an example of one that can be said to be adopting a strategy primarily of cost reduction. It is a Civil Service Department, which aims to significantly reduce the cost of providing its existing services year on year. Risk taking by employees can consume resources, so for the majority of its staff involved in service delivery, this organisation will not want to

Table 2: The role behaviour model —Organisation 2

Strategy	Employee Role Behaviour	HRM Policies
Cost reduction	Relatively repetitive and predictable behaviour A rather short-term focus Primarily autonomous or individual activity Moderate concern for quality Primary concern for results Low risk-taking activity Relatively high degree of comfort with stability	Relatively fixed and explicit job descriptions that allow little room for ambiguity Narrowly designed jobs and narrowly defined career paths that encourage specialist, expertise and efficiency Short-term result oriented performance appraisals Close monitoring of market pay levels for use in making compensation decisions

Source: Shuler and Jackson, 1987

encourage risk taking or creativity. Rather it seeks an environment in which there is a clear focus on short term results, and where every individual has a clear role to play which they understand and can be relied on to perform consistently and predictably. The HR policies likely to support the desired behaviours of Organisation 2 are an individual performance management system and narrowly defined job descriptions. Pay is a significant proportion of costs, so it is considered important in this organisation that pay rates are the minimum consistent with the external market.

So what does this tell us about the things Organisation 2 chooses to measure? A regular analysis of external pay rates for equivalent staff groups is very important if, broadly speaking, you want to make sure you are not paying more than you need to. An attitude survey gives indication of whether line managers are creating a working environment that is resulting in a focus on efficiency and results.

Quality enhancement is the primary strategy of our third example, Organisation 3, a major food retail company. Organisation 3

Table 3: The role behaviour model —Organisation 3

Strategy	Employee Role Behaviour	HRM Policies
Quality enhancement	Relatively repetitive and predictable behaviours A more long-term or intermediate focus A moderate amount of co-operative, interdependent behaviour A high concern for quality of output Low risk-taking activity Commitment to the goals of the organisation	Relatively fixed and explicit job descriptions High levels of employee participation in decisions relevant to immediate work conditions and the job itself A mix of individual and group criteria for performance appraisal that is mostly short-term and results orientated Extensive and continuous training and development of employees

Source: Shuler and Jackson, 1987

believes the route to success is through achieving continuous improvements in the quality of its services to customers. It wants its staff to exhibit a high degree of concern for the quality of output and the processes that lead to it. In order to achieve quality the company believes services have to be supplied to a consistent and high standard, which means there is lots of staff training, although within tightly defined job boundaries. However, they do want to engage staff in identifying areas where improvements to their store and services to customers could be made.

As continuous training is so crucial to the achievement of Organisation 3's strategy of quality enhancement, the company is likely to be keen to measure the effectiveness of the training supplied. It is also concerned to know the extent to which employees are demonstrating a concern for processes, the quality of outputs, and customer satisfaction; these will therefore also be areas to consider measuring.

These three tables and examples are presented as extreme positions of strategy to demonstrate how different the HR response can be to support different strategies. This therefore offers some clues as to what it might be more or less important to measure, given these different strategies or responses.

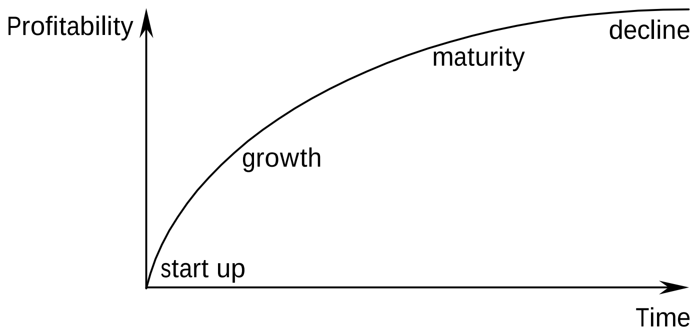
However, a company's overall strategy may not necessarily be the same as the business aims needed throughout all its operating units or departments to the same extent. For example, in Organisation 1, the production area was set up to pursue cost-containment, so different goals were set to its managers and different behaviours wanted from staff every day than for the other areas of the company where innovative behaviours were considered key. So to be meaningful, any measures introduced need to take into account that they may not always be applicable for all parts of an organisation. A mixture of indicators may be more meaningful in terms of reporting on progress against overall strategy.

2.4 The business cycle approach

An alternative way of looking at the strategic context of your organisation is to consider the well established and popular business life cycle model, outlined in Figure 1 and Table 4 below, which uses the stage that an organisation has reached in its development to assess what policies are most likely to fit its culture.

If a company or one of its subsidiaries is in a start up phase, such as British Airways' low cost airline GO in 1999, the model suggests its focus will be on attracting the best talent whether from inside or outside the parent company. Success in resourcing professional talent will be critical to its ability to quickly progress out of the resource-hungry start-up and growth stages.

Figure 1: Alignment with the corporate life cycle



Source: Adapted from Kimberley and Miles, 1980

Different HR activity is likely to be more important in organisations experiencing major growth, who may be the darlings of the stock-market, but like amazon.com may be yet to reach the point of profitability. Such companies, the model suggests, will still be recruiting, starting to design career structures and actively developing their own managers.

Mature organisations have few opportunities to expand their market share within their industry but nevertheless are often highly profitable. This is partly because in HR terms they typically focus on controlling their labour costs and managing their internal labour markets successfully.

Table 4: Business cycle model

	Life-cycle Stages			
HR Functions	**Start-up**	**Growth**	**Maturity**	**Decline**
Recruitment, selection & staffing	Attract best technical/ professional talent	Recruit adequate numbers and mix of qualified workers Manage rapid internal labour market movements	Encourage sufficient turnover to minimise lay-offs and provide new openings Encourage mobility as re-organisation shifts jobs around	Plan and implement workforce reductions and reallocation
Compensation & benefits	Meet or exceed labour market rates to attract needed talent	Meet external market but consider internal equity effects Establish formal compensation structures	Control compensation	Tighter cost control
Employee training and development	Define future skill requirements and begin establishing career ladders	Mould effective management team through management development and organisational development	Maintain flexibility and skills of an ageing workforce	Implement retraining and career consulting services
Labour/employee relations	Set basic employee relations philosophy and organisation	Maintain labour peace and employee motivation and morale	Control labour costs and maintain labour peace Improve productivity	Achieve flexibility in work rules. Negotiate employment adjustment policies

Source: Kochan and Barocci, 1985

Organisations in declining sectors are more likely to be interested in planning workforce reductions and maintaining employee relations through investing in career management and outplacement services.

Looking at your organisation in this way provides some clues as to what it is important to measure. If HR practitioners want to give their Board members something they will be interested in, they need to ensure it relates to the organisation's ability to achieve strategic goals. For instance, being able to define future skill needs and how you know whether or not you are being successful at recruiting 'the best', may be valuable in a start-up phase company or subsidiary. However, measures of labour flexibility and overall labour costs may be much more valuable for a mature company.

Bear in mind when thinking about a business life cycle model that, as presented here, the graph implies an end point or withdrawal from the market after decline. In reality the challenge for organisations is to re-invent themselves and start a new graph by making radical changes/adjustments or to have sufficiently focused on growing new areas of businesses to replace those ageing ones. This also implies that different companies within a group who are at different stages of the corporate life-cycle may find different measures helpful.

2.5 Organisation-specific approaches

There will be clues within your own organisation as to what is of strategic importance. If the organisation is committed to any particular model or external award, such as Investors in People or the EFQM Business Excellence Model, or a Balanced Scorecard, measures which align with processes or outcomes required are likely to be useful in helping the organisation monitor its progress against desired targets. One organisation known to IES had already developed its HR strategy and objectives from its corporate strategy and used these objectives to derive areas for measurement. Table 5, overleaf, is their approach.

2.6 Summary

There is now considerable research evidence (outlined later in Chapter 5) that good HR practices really do help organisations to outperform their competitors. This chapter aims to show that investing in innovative HR practices is only helpful if you can show it contributes to the business needs of your own organisation. This requires you to use measures your organisation understands. The purpose of HR in your organisation may be clearly defined and HR may be included as a strategic partner. If so, HR may well have developed policies and practices that are aligned to business strategy already and that add value rather than unwanted complexity.

Table 5: An example of attaching measures to HR's strategic objectives

HR's Strategic Objectives	Relevant Measures
Ensure our investment in people is prudent and good value	Paybill as percentage of total revenue Efficiency savings achieved
Achieve high productivity levels in all activities	Employment cost per unit of production Employment cost per unit of production Proportion of support function costs
Streamline support activities and business processes to achieve efficiencies and deliver an efficient, cost-effective HR service to the organisation	HR costs as proportion of total support function costs HR budget vs. actual HR costs benchmarked externally
Continually attract a diverse group of talented people and match them with the tasks to be achieved	Labour turnover rates, reasons for leaving, not joining Achievement of (progress towards) diversity targets and profile Difficulty in filling vacancies internally and quality of candidates available Skill and capability gaps
Constantly enrich and improve the organisation's knowledge and capabilities Influence culture, behaviour and management practice so that they support creativity and high performance	Level of involvement and training in-house and for the industry Staff perceptions of organisation as an employer Staff knowledge and commitment to the corporate strategy
Effectively develop HR strategy, policies and resource plans which are aligned to business strategy	HR strategy and policies in place, agreed and communicated Annual resource plans produced to include training and development plans linked to business strategy Customer satisfaction survey results Earnings level maintained with budget parameters set
Operate effective recruitment and selection processes	Recruitment survey data Time taken to fill vacancies and costs involved Percentage of jobs filled by internal promotion Career progression of staff recruited to key trainee schemes
Maintain safe systems of work	Accident and sickness records
Design attractive but affordable compensation, benefit and incentive systems and manage earnings growth in line with performance	Reward and benefit packages maintained at market median
Negotiate effectively with trade unions	Time taken to negotiate changes Number of days of industrial action
Build understanding and commitment to the organisation's role, purpose and objectives	Staff survey and communication survey results
Effectively market the organisation as a good employer	Customer perceptions of organisation as employer
Provide access to the information people need to do their jobs	Usage of Gateway sites and Learning Networks Proportion of HR staff who have the information they need
Develop the competency of the HR community	Skill and competency profile of HR staff

Source: IES

In this case it should be relatively straightforward to determine what needs to be measured, and bring this value to the attention of a wider audience. If this is not the case, you may have to search for the strategic clues to determine those areas related to people practices that are most likely to be considered relevant by your Board to your organisation's success.

3. A Question of Balance

3.1 Introduction

As recently as a decade ago, an organisation's performance would have been judged largely on its financial out-turn. For private sector companies, this meant a focus on declared profit, together with ratios such as earnings per share (EPS) and return on capital employed (ROCE). Public sector organisations were judged on their ability to manage their budget — in particular, the extent to which they avoided an overspend or underspend at the end of the financial year.

Today, the need for a balanced portfolio of measures representing organisational performance is more widely accepted, although there is still a tendency to treat financial indicators with particular respect, as if only they represent the true 'bottom line'. This chapter aims to explode some of the myths surrounding financial indicators. It also explores the concept of the balanced approach to presenting organisational performance, in which people indicators have a vital role to play.

3.2 Debunking the myth of financial indicators

Financial statements, and financial indicators of performance, are often treated with reverence within organisations. They are perceived as solid, hard data, relating to the 'real' world — and have the added benefit that they are usually expressed in monetary terms, giving that reassuring, 'bottom line' feel. In comparison, any figures produced by HR, and relating to people, seem somehow soft, woolly and insubstantial — not worthy of the same weight of consideration.

Are these financial figures really so sound? What, for example, is 'profit'? It can be affected hugely by different accounting conventions, which are often carefully chosen to present the company in the best light. Stock valuation methods can be selected to deflate profit (the last in, first out method) or inflate it (first in, first out). Depreciation choices (method, length of time) can also significantly affect asset valuation, and therefore the bottom line of the balance sheet. Conventions and practices also differ greatly between countries, as Table 6 illustrates. The details

Table 6: Profit calculations

	ECU millions						
	Belgium	Germany	Spain	France	Italy	Netherlands	UK
Maximum	193	140	192	160	193	156	194
Most likely	135	133	131	149	174	140	192
Minimum	90	27	121	121	167	76	171

Source: Simmons and Azières, 1989

of a series of transactions were given to accountants in seven countries, and they were asked to prepare the accounts based on their own domestic practices. The results, in Table 6, show big differences, not only in the most likely figures, but also in the range between likely minima and maxima. Profit, then, can be seen as little more than an expression of opinion —and that is *before* the more dubious practices known as 'creative accounting' are introduced.

What this means is that most financial indicators, which use measures such as profit, net asset value, capital, *etc*., are not built on such solid foundations as first appears. ROCE, for example, is a widely used indicator of business performance. ROCE aims to show how good the organisation has been at using the financial resources invested in the business to produce a profit. However, it is calculated by dividing profit before interest and tax by total capital (*ie* the bottom line of the balance sheet). If the profit figure is a matter of opinion, and the bottom line of the balance sheet has been affected by asset valuation practices, what does this say about ROCE?

Accounting professionals will justify their use of financial indicators by pointing out that, if organisations are consistent in their approach, it is fair to make comparisons over time, or between business units. We certainly do not wish to denigrate the accountancy profession, or imply that financial ratios have no value to the business. We agree that they are very important to senior managers and external analysts —but as one of a set of measures, rather than the only figures that are ever taken seriously. HR professionals should not be shy of presenting indicators that relate to people and their performance, and defending their use to senior managers. People indicators have as much validity as their financial counterparts, and can be put forward by HR professionals as their contribution towards the measurement of how well the organisation is doing in relation to its strategic goals.

3.3 Why is balance important?

In the early 1990s, a 'portfolio' approach (Eccles, 1991) to the measurement of an organisation's performance began to gain ground. Organisations were encouraged to look beyond financial ratios, towards other measures that represented success, such as customer satisfaction scores and quality indicators. These non-financial measures are usually forward-looking, in that they aim to meet and exceed customer expectation by means of continuous product or service improvement. By contrast, financial indicators have often been criticised for their backward-facing stance.

The movement towards non-financial measures has been given further impetus by two important strands of strategic thinking:

- the need for organisations to be able to adapt to their environments if they are to ensure survival into the future (Chakravarthy, 1986)
- the idea of organisational core competence (Prahalad and Hamel, 1990) —key capabilities that give the organisation its competitive edge or distinctive characteristics, and must therefore be nurtured.

Both of these concepts, by emphasising long-term adaptability, development and growth, encourage organisations to look beyond traditional financial measures. These have frequently been criticised for discouraging investment by focusing too much on short time horizons.

Finally, the stakeholder approach to organisational performance gives a further push towards a balanced portfolio by recognising that shareholders are not the only important group of people with an interest in the organisation. Several other groups — notably employees and customers — also have a stake in the organisation's performance, but will judge its success in different ways. The portfolio approach enables the inclusion of measures that have particular relevance to different stakeholder groups.

3.4 The balanced scorecard

The balanced scorecard approach (Kaplan and Norton, 1993) formalises the portfolio approach to organisational measurement by linking together measures in four key areas.

- Traditional financial measures (such as ROCE, EPS and cash flow) are presented primarily for shareholders.
- Customer measures (customer satisfaction ratings, delivery times, defect and failure rates) represent the ways in which customers see the organisation.
- Internal business processes (productivity, quality and cost measures) show how efficient and effective the organisation is.
- Innovation, growth and learning indicators (for example, employee commitment and involvement, new product cycles, technological leadership, employee skills) represent organisational investment for future survival and development.

Possibly the most important aspect of the balanced scorecard is that the measures must be internally consistent in two ways. Firstly, the measures in all four areas of the scorecard must complement each other and not set potentially conflicting targets. Secondly, the measures must be capable of being cascaded downwards — from organisational level to business unit, and from there to departmental, functional, team and even individual level. The precise measures contained in each part of the scorecard are not laid down, as they are contingent upon the organisation. The three organisations described in Chapter 2 would have very different scorecards, as their generic strategies and the nature of their businesses vary widely.

3.5 The IES scorecard

IES has developed a different form of scorecard, which retains the notion of balance and internal consistency, but builds in warning and action levels. For simplicity of presentation, a 'status' system highlights areas where performance is good (ticks), adequate but needing to be watched (question marks), and failing to reach required standards (crosses). An example of the IES scorecard developed for a large retail company can be seen in Figure 2 (overleaf). Of course, the exact indicators chosen to represent performance are dependent upon the organisation concerned and its strategy, as are the warning and action levels. The IES scorecard is a useful monitoring tool, which enables organisations to track their progress towards objectives and see at a glance how they are doing.

3.6 Summary

This chapter has looked at the importance of developing a balanced portfolio of performance measures for the organisation. Increasingly, traditional financial measures are being perceived as inadequate, due to their short-term focus, backward-facing perspective and inability to reflect the interests of all stakeholders. Many organisations are now using tools such as the balanced scorecard to ensure that all their activities and all their stakeholders are represented. These tools must be adapted to fit the circumstances of each individual organisation, and should be checked for internal consistency every time a new measure is added or an old measure removed.

The following chapter goes on to examine in detail the range of people indicators from which those that might appropriately be included in an organisation's balanced scorecard can be identified.

Figure 2: IES Balanced Scorecard: Service Profit Chain

Report Date: July 2000		Units	Period	Actual	Target	Status
Financial	Sales Volume	£	March	675k	900k	✗
	Value Added	£	March	120k	150k	?
	Net Income	£	YTD	176k	265k	✗
	Contribution to Overheads	%	March	135.3	137	✓
	Gross Margin	%	March	23.6	29	✓
	Net Profit/(Loss)	£	March	42k	57k	?
	Percentage of products contributing to profit	%	YTD	46	50	✓
	Direct Costs	£	March	356k	294k	✗
	Contribution: Gross Salary Costs	C:G	March	2.43:1	3.8:1	✗
	Turnover per square foot	£	YTD	545	623	✗
Customer	Number of Customers	No.	March	75k	82k	?
	% Margin per Customer	%	YTD	15	13	✓
	% Repeat Business	%	YTD	34	45	?
	Customer Satisfaction Index	%	YTD	85	90	✓
	Customer Loyalty Index	%	YTD	65	60	✓
	Spend per Customer	£	YTD	85	105	✗
	Percentage of Customers Spending £150 plus	%	YTD	28	40	✗
	Customer Complaints	No.	YTD	1.2k	0.9k	✗
	% Customer Complaints Resolved	%	YTD	78	80	✓
	Recommendation Index	%	YTD	43	40	✓
Employees	Added Value per Employee	£	March	95k	115k	?
	% Vacancies Unfilled for 10 weeks plus	%	YTD	5	7	✓
	Voluntary Resignation Rate	%	YTD	3	11	?
	2 year Stability Rate	%	YTD	87	90	✓
	Job Offers Accepted	%	YTD	60	74	✗
	Employee Satisfaction Index	%	YTD	65	70	?
	Employee Commitment Index	%	YTD	72	70	✓
	Service Intention Index	%	YTD	62	75	?
	Product Pride Index	%	YTD	76	70	✓
	% Staff with less than 2 days Sickness	%	March	83	90	?
Innovation	% of Communications Plan Implemented	%	March	90	95	?
	No. days OTJ Training per Employee	No.	March	3	5	?
	% Staff Suggestions Implemented	%	YTD	32	35	✓
	% In-house Projects Completed	%	YTD	87	90	✓
	% Mngrs members of cross-functional teams	%	YTD	40	50	✗
	% Managers completed leadership module	%	YTD	65	70	?
	% Take-up of Paid Carer Leave	%	YTD	43	50	✓
	% Maternity Leavers Returning	%	YTD	86	90	?
	% New Products Launched within deadline	%	YTD	86	90	✓
TOTALS	**✗ —10**		**? —13**		**✓ —16**	

Source: IES

4. People Measures

4.1 Introduction

Most organisations monitor employee performance in some form, typically at individual and aggregate level. However, the attention paid to people indicators is sometimes little more than minimal. Despite the rhetoric that ‘people are our greatest asset’, many companies lose people indicators somewhere in the mass of labour cost and productivity statistics. The resource-based approach to strategy formulation has given a great boost to measures relating to employee performance, by stressing the importance of people — their skills, competences, commitment and attitudes — to the organisation’s competitive success. It seems that the time is right to develop a comprehensive set of people indicators, which can take their place alongside existing key performance measures.

This chapter suggests a possible framework for presenting, calculating and analysing people indicators. It also discusses the sources of the data that will be needed. The framework should not be considered prescriptive, as all organisations are different; it can be adapted to suit varied organisational styles and circumstances.

4.2 Levels of analysis

Before rushing into the calculation of people indicators, it is worth spending some time considering appropriate breakdowns and ways of presenting them. Calculating indicators for the organisation as a whole is unlikely to be adequate for any but very small companies. Most organisations will need to consider, separately for each indicator, the following possible levels:

- organisation wide
- business unit
- geographical location
- site
- department
- function

- employee type (*eg* professional group, occupation, job family)
- team
- individual.

It will also be necessary to consider employee characteristics, such as:

- gender
- age group
- length of service group
- full time or part time
- nature of contract (permanent, fixed term, temporary *etc.*)
- shift pattern
- operational or support.

The Board will not, of course, want to wade through pages of detailed reports for each indicator. However, it will want to know where the **significant differences** are to be found in the organisation — which department, employee grouping, *etc.*, is performing particularly well or the reverse. It will also want know **trends over time**, and whether these are getting better or worse. Finally, Board members will want to understand, at least in general terms, the **implications** of the indicators. For example, will costs go up if the absence rate increases? Will quality suffer if turnover is high? Are there likely to be constraints on production if the vacancy factor does not decrease? HR practitioners have traditionally had a poor reputation for 'hard talking', which in practice usually means attaching £ signs to everything. Some people indicators can be quantified and costed, others cannot — but they can all be measured and compared over time and place. The resulting comparative and trend data are as robust as most indicators that any other function will provide, and have the added benefit that most can be analysed at different levels, using many different breakdowns.

4.3 Approaches to measurement

There are three broad types of measure.

- **Hard measures** lend themselves easily to quantification. They are typically ratios, percentages or costs. They can — at least on a superficial level — be easily understood; they also lend themselves to comparison over time or place.
- A subset of hard measures is **process measures**. Process measures typically involve counting, in relation to an activity — for example, the number of job applications processed by the HR department every year, or the number of calls answered by the customer services centre.

- Finally, s**oft measures** deal with attitudes, perceptions and shades of opinion. They can be quantified, but only by imposing some sort of measurable scale and asking people to indicate where, on the scale, their opinions lie.

Hard measures

Some examples of hard indicators that are in common use are contained in Appendix A. They are an illustration rather than a recommendation, as there is no ‘best practice’ standard to follow and no ‘compulsory’ indicators that *every* organisation should be using.

As already stated, hard measures are usually reasonably easy to calculate, as they use data that are — or should be — readily available in the organisation. A difficulty with hard and process measures, however, is that they tell the organisation nothing about the *quality* or *effectiveness* of the activities being measured.

Soft measures

Soft measures require the collection and analysis of perceptions, opinions and attitudes. The usual tool used for this purpose is the **survey**. The advantage of the survey approach is that it enables measurable indicators to be derived from the analysis of the data. Appendix B describes how this can be done. These indicators can then be used to compare perceptions in a variety of ways, such as by department, gender, grade, employee group *etc.* The problem with surveys is that they are time-consuming and expensive, so cannot be carried out too often. They also raise expectations that something will be done. Doing nothing as a result of the survey can be far more damaging than not carrying it out in the first place.

Another way of gathering ‘soft’ data in a reasonably systematic way is via workshops or discussion groups. These are excellent vehicles for allowing people to express and share opinions, and for generating ideas. However, they require careful handling by experienced, preferably independent, facilitators; they are also time-consuming and labour-intensive. They generate a wealth of qualitative data, but quantifiable indicators are harder to derive. Bear in mind that peer pressure can result in discussion groups tending to pass on negative aspects, so keeping numbers of attendees small is helpful.

4.4 Calculating measures: some examples

The following examples show how hard measures can be calculated and used in practice, and illustrate some of the complexities that may arise.

Table 7: Turnover problems

High wastage	Low wastage
High recruitment costs	Promotion blockages
High induction and training costs	Lack of fresh ideas from newcomers
Pressure on experienced employees	Resistance to change
Low productivity due to inexperience	Higher paybill due to preponderance of long-serving employees
Possible turnover spiral, as newer employees are more likely to leave	Low motivation

Source: Bevan, Barber and Robinson, 1997

Employee turnover

Turnover is not completely under the organisation's control, since it is affected by external factors — in particular, the buoyancy of the labour market. However, it is a crucially important indicator, as turnover rates that are either too high or too low can have damaging results (see Table 7). What constitutes high and low wastage is, of course, dependent upon the organisation and type of employee. An annual wastage rate of 40 per cent might be acceptable for catering assistants in a fast food chain, but unacceptable for senior qualified nurses in an intensive care ward.

The most common method of calculating turnover is to use the following wastage rate formula:

$$\frac{\text{number of leavers}}{\text{average number of employees}} \times 100$$

This will express the number of leavers over a given period as a percentage of the average employees in post over the same period. The period is usually a year, but could be adapted to suit the organisation or particular employee group. The 'average employees in post' can be surprisingly hard to calculate, even with sophisticated computerised HR systems. An adequate proxy is to add together the employees in post at the beginning and end of the period, then divide by two.

Most organisations omit certain types of leaver, such as those departing due to retirement, redundancy or dismissals, from the analysis and this is generally regarded as best practice. These departures are considered unavoidable, whereas voluntary resignation is much more within the organisation's control. However, unavoidable turnover also has consequences (leaver costs, need for new recruits, loss of expertise and productivity *etc.*), so it is recommended that turnover due to retirements and other unavoidable reasons is monitored separately from voluntary wastage.

Vacancy factor

Employee shortages can be a serious constraint to organisations, particularly in key posts or key groups. The vacancy factor can be calculated as follows:

$$\frac{\text{number of vacancies}}{\text{number of posts}} \times 100$$

This formula gives vacancies as a percentage of the total number of posts, or jobs. Calculating this indicator globally may, of course, mask a vacancy in key posts. Because of this shortcoming, it is recommended that key posts are identified as such, and are monitored separately.

Absence rate

Two main indicators are important here. The first is the overall absence rate, which shows the percentage of time lost through employee absence. Approved absence, such as holidays, study leave and compassionate leave, should not normally be included in the calculation. What is of interest to most organisations is absence that may be avoidable, such as sickness, industrial injury and unauthorised absence. A common formula is:

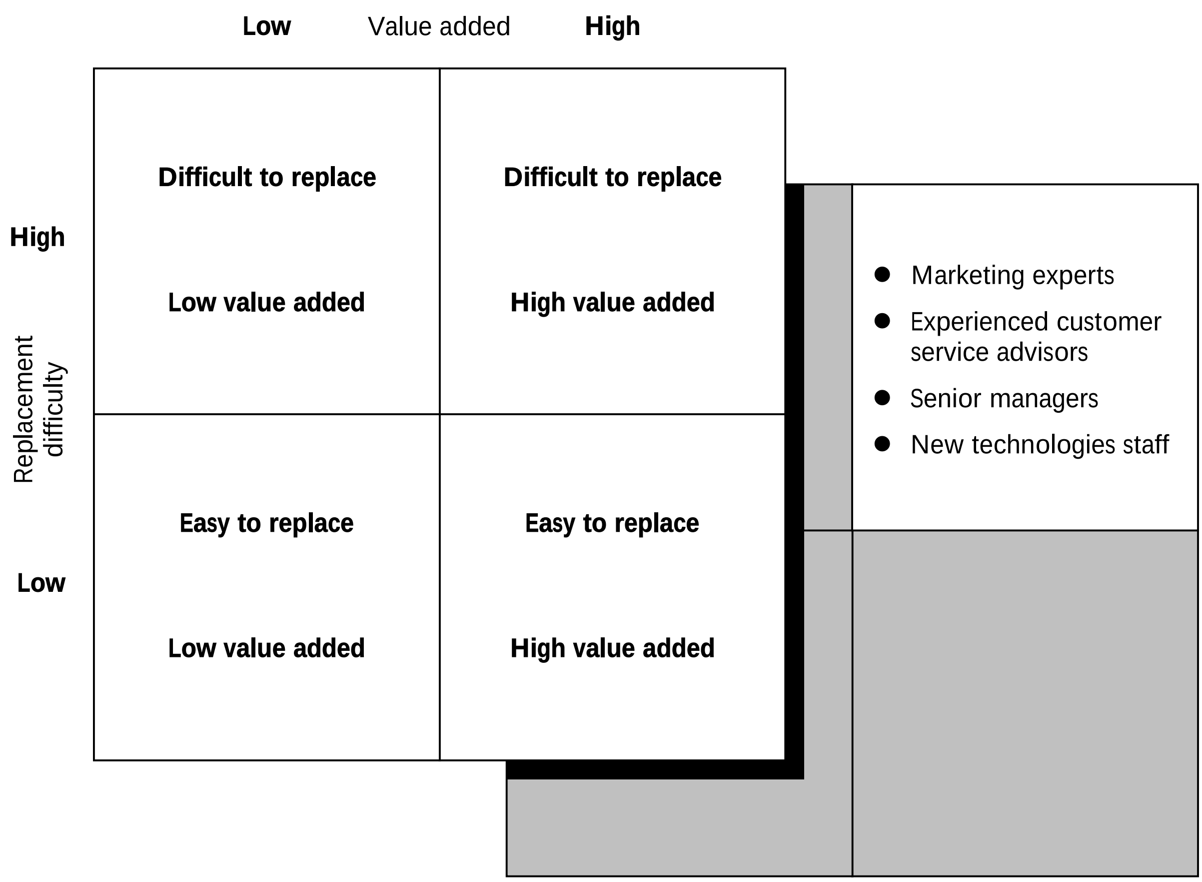
$$\frac{\text{number of days absent}}{\text{number of planned work days}} \times 100$$

If shift working is the norm, the number of shifts can be substituted for the number of days. Like the turnover rate, this indicator can be measured over different periods of time. Absence rates can therefore be calculated for a particular shift, day, week, month or year —or whatever time periods are most appropriate to the particular organisation.

The overall absence rate will hide different absence behaviours, so it is also important to measure absence patterns. The incidence of absence on certain days or shifts, for example, could prove higher than average. Repeated, unpredictable short periods of absence tend to be more damaging to productivity and smooth running of operations than one long period, as the latter can be planned around. Analyses of absence patterns should, therefore, include:

- lengths of absences
- frequency of absences
- regularity in patterns of absence.

Figure 3: Focusing PI attention on key people: identifying the key people



Source: IES

4.5 Deciding what is really important

One of the big problems in measurement is the temptation to measure everything and create a multiplicity of performance indicators. As well as being time-consuming, this approach can lead to serious problems not being spotted in a mass of data; it also causes information overload or even paralysis. A focus on key issues can help here. For example, when looking at vacancy, recruitment, retention and turnover levels, it would make sense to concentrate on those groups of staff that are particularly important to the organisation, especially if they are also difficult to replace. The quadrant shown in Figure 3 could help with the focusing process; it helps identify groups of staff that are critical in terms of retention efforts.

4.6 Summary

The people indicators described in this chapter and in the accompanying appendices are not the only indicators that can be calculated; many organisations will be able to produce examples of useful indicators not described here. It is also not prescriptive, in that it would be an enormous task for some organisations, particularly those without good quality computerised HR systems, to calculate and monitor *all* the indicators described. The chapter is intended primarily to encourage HR practitioners to develop performance indicators across a range of ‘people’ measures in the organisation, which can integrate with more traditional indicators of finance and productivity and form part of a balanced portfolio. A focus on key issues and groups of staff is recommended.

Having established that measuring people activities is both important and beneficial, the focus now turns to the specific issue of the measurement of the HR function itself. The following chapter suggests approaches to this traditionally difficult area of measurement.

5. Measuring HR

5.1 Introduction

Perhaps more than most functions, HR tends to suffer from role ambiguity. Is HR a strategic shaper, or the provider of an employee service? Is its main focus employee well-being, or managing productivity targets? Is HR mainly a line activity, or a specialist service that only trained, central practitioners can provide? Is it a core function, or a peripheral activity that can be outsourced? Should it be part of the business, or deliberately separated from day to day operations? The confusion over HR's role may go some way towards explaining why it is a function that, from time to time, is called upon to justify its existence — and why it is often difficult to produce measures that prove HR is adding value. There is now considerable evidence to show that good HR practices really do help organisations to outperform their competitors, but this may not be enough. HR needs departments themselves to show that they add value to their organisation, using measures that the organisation understands; research carried out elsewhere may not be perceived as relevant. This chapter aims to help HR practitioners to develop a set of measures for the HR function which can be used to demonstrate worth and added value to the rest of the organisation.

5.2 The evidence

As a background, the following short summary may be helpful. It outlines recent research into the relationship between investment in HR practices and business outcomes.

- **Fox and McLeay** (1991) examined the recruitment and selection, management development, performance appraisal, rewards and recognition, and career planning processes of 49 companies operating in the engineering and electronics sectors. A clear positive relationship emerged between financial performance and the degree of integration between corporate strategy and HR management functions in practice.
- **Pfeffer** (1994) identified the five top-performing firms between 1972 and 1992 and looked for common features. The companies did not owe their success to being in attractive industries, nor to being market leaders. They were found to

share a set of high commitment work practices, such as employment security, selectivity in recruiting, good reward schemes, employee ownership, information sharing, participation, empowerment, team working and job redesign.

- **Arthur** (1994) conducted research in 30 US steel mini-mills. Two HR configurations were identified, namely control and commitment systems. Control systems enforced employee compliance with specified rules and procedures, whereas commitment systems aimed to shape desired employee behaviours and attitudes by creating psychological links between organisational and employee goals. The mills with commitment systems had higher productivity, lower scrap rates and lower employee turnover than those with control systems.
- **Huselid** (1995) found, in a study of nearly 1,000 US firms, that if companies increase their high performance work practices, there are significant reductions in employee turnover and increases in productivity. High performance work practices meant participation in quality circles, access to profit sharing, formal appraisal systems and access to training.
- **Ostroff** (1995) developed an overall HR Quality Index. Companies that score higher in the HR Quality Index consistently out-perform companies with a lower index in four key financial measures.
- **Patterson** *et al*. (1997) researched medium-sized manufacturing firms in the UK. They found that HR practices explained nearly one-fifth of the variation between companies in productivity and profitability. HR practices relating to the acquisition of skills and job design were particularly important.
- Most recently, **IES research** (Barber, Hayday and Bevan, 1999) has demonstrated strong links between employee attitudes, customer satisfaction and business performance in almost one hundred stores of a major UK retailer. Employee commitment to the organisation's values and culture was shown to be a key factor driving the service profit chain. HR has an important role to play in communicating organisational values.

5.3 The dilemmas

Taking the decision to 'measure HR' involves facing up to various dilemmas.

- There is a temptation to concentrate on those aspects of HR that are easy to measure, in the sense that the data are readily available and can be converted easily into indicators. While this may be helpful in getting the ball rolling, it can also help to trap HR into following certain paths and prevent it from participating in the setting of organisational objectives at a high level. Measuring processes, for example, shows how hard people are working in HR —but does the function wish to be perceived as an efficient processor of low status tasks?

- High-level HR objectives are rarely phrased in easy-to-measure terminology. An objective such as 'Ensure the recruitment of high quality people', for example, begs a lot of questions. What does a 'high quality person' look like? Does he or she have to possess certain qualifications or skills, or have a particular type of experience? Or is attitude (for example, a willingness to learn) more important? Even if the organisation concedes that its people are of high quality, can HR show that it has contributed significantly towards attracting them?
- Some initiatives are perceived to 'belong' in some way to HR, even if they operate across the whole organisation. Performance review, for example, is often assumed to be a system that has been imposed upon the organisation by HR. Measuring these initiatives may, therefore, cause problems; if they are not perceived to be beneficial to the organisation, HR's reputation may suffer.

5.4 Perceptions of HR

One way of finding out what the organisation thinks of its HR function is, of course, to ask people. Opinions, attitudes and perceptions are in the 'soft indicator' arena, but can be analysed and measured very effectively. One possible instrument for collecting such views is illustrated in Figure 4. The continuum approach deliberately does not ask respondents to use a rating scale; they are free to mark the line at a point they feel to be

Figure 4: Perceptions of HR

Ineffective	Effective
Inefficient	Efficient
Unaware	Responsive
Remote	Friendly
Irrelevant	Essential
Self-contained	Aware of business
Separate	Integrated with business
Adds nothing	Contributes to business
Pace follower	Pace-setter

Source: IES

appropriate. A scale can, however, be imposed afterwards, enabling the results to be measured and analysed. An alternative questionnaire, developed by Hiltrop and Despres (1994) is presented in Appendix C.

It is recommended that several different groups of people are asked to assess the HR function, so that the results can be compared for similarities and differences. Important groups are:

- senior managers (Board level if possible)
- line managers
- employees
- HR itself.

It would also be helpful to make other comparisons to try to tease out differences in perception, such as:

- HQ and business units
- different locations
- different business units
- operational and support functions.

If the organisation already carries out regular employee attitude surveys, it might be possible to avoid the need for a special exercise by incorporating a special HR section. It will then be possible to monitor changes in perception over time. Some organisations might prefer a discussion group approach rather than a formal survey; the results will be harder to quantify, but the method will yield copious amounts of qualitative data. The use of external researchers or consultants can sometimes be helpful in undertaking and analysing perceptions.

Analysing the results of the survey will take time, and interpreting them may be confusing. There may be several areas, for example, where differences in perception are difficult to explain and might require further investigation. However, the survey should enable HR to gain an overall picture of its strengths and weaknesses as perceived by its own organisation. It should also show HR where its supporters are located, and where, on the other hand, the function is perceived to be lacking.

In interim periods, HR is usually reliant on praise or criticism given by individual employees or managers, to individual people in the HR function. Regular monitoring of such feedback will at least help towards the identification of areas of most and least dissatisfaction, and may help to indicate whether things are getting better or worse generally.

5.5 An HR value chain

The value chain concept is usually used to identify specific processes or functions that make up an organisation's activity, with particular reference to those that give the organisation a competitive edge. The concept can also be used by functions within an organisation, to help the function identify where it is adding value to the organisation. An example of an HR value chain is illustrated at Figure 5. The value chain is one way of approaching measurement, in that performance targets and indicators can be attached to each area of key HR activity.

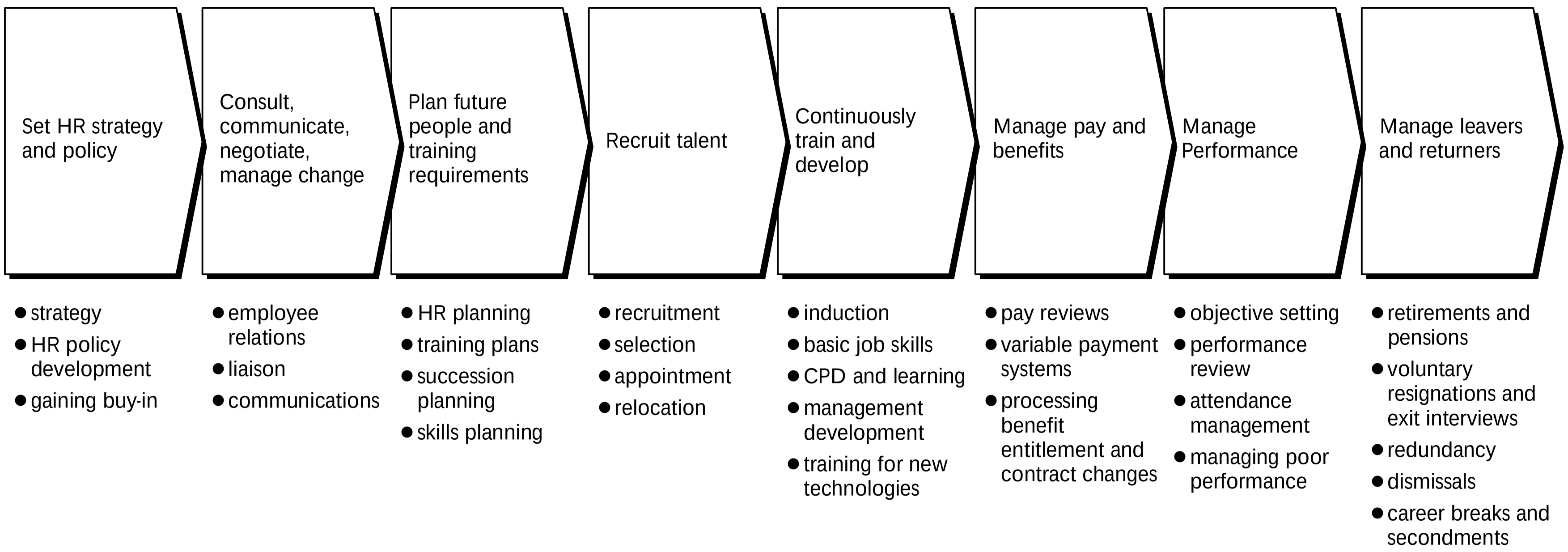
5.6 Defining key indicators

The definition of key indicators from key objectives is not always easy. The first challenge is that many organisations do not have an HR strategy at all, while others have a strategy, but have not linked it with the organisation's business strategy. Even when a strategy is in place, it is not necessarily accompanied by a set of key strategic objectives. The final problem is the translation of these objectives into activities, or processes, or opinions, that can be measured. Objectives are often couched in terminology that is impressive, but begs many questions. To take an example, many HR functions are probably familiar with statements along the lines of: 'It is HR's aim to ensure the recruitment of high quality people,' or: 'HR will introduce initiatives to retain key people'. But what constitutes high quality? What does a key person look like? Where are the key people to be found in the organisation?

A possible approach to defining key HR indicators has the following steps:

- Identify HR's key objectives — the really important things HR exists to do for the organisation. The HR value chain may help here.
- Brainstorm the meaning of each objective in turn. Does it make sense? What does in mean in practice? What are its implications?
- When there is a reasonable consensus, move on to considering how, if at all, the objective can be measured. This may involve breaking down the main statement into more manageable parts.
- In the unlikely event of a particular objective proving immeasurable, it may be worth questioning its purpose. Is there any point stating an aim, if it is not possible to assess whether or not the aim is being met?
- Do not try to attach an indicator to every part of every objective. Focus on those that will contribute most to the organisation's strategic aims, and therefore raise HR's credibility.

Figure 5: Building up indicators from processes attached to main HR functions



Source: IES

5.7 An 'HR scorecard'

The concept of the balanced scorecard has been adopted by different functions within organisations, including HR. It is a potential approach that can be taken towards the presentation of measures of the HR function. An 'HR balanced scorecard' might bring together a set of hard, soft and process measures in an attempt to demonstrate HR's purpose and function. This approach is attractive in two main ways:

- it enables the contribution of people at all levels of HR to be recognised
- many people are more comfortable with an approach that acknowledges the importance of different types of measurement.

One caveat, however, is that the desire to create a balance of types of measurement might result in a 'scorecard hotchpotch', which lacks overall coherence. Because of this danger, many HR functions are attempting to relate their performance measures to their key objectives. As the expression of HR objectives often incorporates hard, soft and process terminology, the end result should be a scorecard that is balanced, relevant and coherent.

5.8 Evaluating initiatives

The HR function is often seen as being good at introducing new initiatives, but poor at monitoring and evaluating them. This makes the investment in the new initiative hard to justify in quantifiable terms, which in turn can lead to loss of credibility. Whether or not this view is justified is not particularly relevant, since the difference between perception and reality is usually blurred indistinguishably. The important issue, for HR, is that some form of evaluation and monitoring of important initiatives is seen to take place, and produces some form of measurable output. It is difficult to be prescriptive about the format of such output, as every new initiative has its own unique objectives and content. The following two examples may help, however.

- **The fast track graduate trainee programme**. Typically, this is an area that consumes huge resources, but has a questionable outcome. Possible measures are: numbers of applicants, percentage of applicants who are successful, cost of recruitment, percentage remaining after each complete year of the programme, percentage still remaining (for example) one, two, three and five years after completing the programme, organisational level attained (for example) two, five and ten years after completion. These indicators should be capable of analysis separately for man and women, by age group and by ethnic group.

- **Equal opportunities and diversity programmes**. These require monitoring at various stages in the employee cycle, to compare the performance of the different groups identified in the equal opportunities or diversity policy. For example, recruitment (applications, shortlisting, selection), training and development (attendance at training events, selection for development programmes, support for further qualifications), appraisal (ratings and assessments) and career progression (internal competition, promotions).

5.9 Summary

This chapter has explored the issues and dilemmas that HR professionals will encounter when tackling the thorny problem of measuring the HR function. It has presented a variety of different approaches that could be taken towards the measurement of HR. There is no one recommended approach, and the different approaches are not mutually exclusive.

The next chapter focuses on benchmarking activities.

6. Benchmarking

6.1 Introduction

Much published research reveals that by the mid-1990s the practice of benchmarking HR functions against those in other organisations, as a way of measuring the relative performance of their own function, was a common management practice. The primary use, however, was internally focused, *ie* to examine and improve the operational efficiency of the HR function itself. The drivers for this were varied and included (as a response by HR) managers to quality programmes: cost-cutting, operational efficiency targets or business process re-engineering, the threat of the function being outsourced and, in some cases, jumping on the 'flavour of the month' bandwagon. But many found that the numbers didn't necessarily tell the whole story of cause and effect and that like-with-like comparisons were not always easy to make. However, a survey by the Industrial Society in 1998 found that over one-third of all organisations used external benchmarking as their primary tool for comparing the performance/effectiveness of their HR function and informing HR management activities.

This chapter is designed to help you think through the issues related to benchmarking activities. In particular, it addresses:

- understanding what a benchmarking process actually is about and what the aim is of undertaking it
- judging to what extent HR Performance Indicators are really comparable with those calculated in another organisation, and how you might judge which other organisations are appropriate to compare with
- implementing changes from benchmarking activities
- how, if undertaken properly and with purpose, benchmarking can greatly assist HR managers in justifying in a positive and systematic way the cost of their activities.

6.2 What is benchmarking?

Benchmarking is an outward looking evaluation technique for reviewing one's own processes and practices, assessing how they compare with the way in which they are addressed in other organisations, and learning how they can be improved. To this extent, benchmarking is merely an enabler to achieving something else and not an end in itself. Benchmarking involves a systematic, analytical process of questioning and analysing one's own activities and company, and learning from others. So in essence the main aim is to raise your own performance standards. Through benchmarking, you can decide whether your organisation's performance is in some way falling short of the standard against which you compare yourself. This standard is the 'benchmark'. The numbers involved in benchmarking are known as 'metrics'.

There are two main types of benchmarking:

- **Internal Benchmarking** —comparison of the same or similar HR activities/working practices/services provided, being undertaken by departments within the organisation or by closely related organisations in the same group. Usually an explicit target and detailed specific key indicators are set.
- **External Benchmarking** —three different approaches:
  - Competitive Benchmarking —direct comparison of the full range of HR performance indicators with those of external competitor organisations.
  - Parallel Benchmarking —selectively comparing different HR policies/practices/processes, usually in considerable detail, each with different non-competing comparator organisations who are undertaking the same or similar specific HR activity. Examples would be comparing Financial Participation Schemes for Employees with Company A, 360 degree feedback with Company B and costs of outsourced Training function with Company C.
  - Generic Benchmarking — comparison with partner organisations of HR activities or indicators which are common to all or most organisations, such as payroll or recruitment.

These types and approaches are not mutually exclusive and it is possible to 'mix and match', using different approaches to address different problems.

Many HR functions find it easier to benchmark subsections of their function, such as recruitment, pay or training, and use their Key Performance Indicators or other internal data as a basis for comparison. According to the Industrial Society Survey (1998) it is most common for those using benchmarking in HR to make comparisons with five or more other organisations.

The emphasis in a benchmarking exercise is placed on understanding the processes and practices which influence higher levels of performance. So, while comparing internal data on, say, absence rates or employee turnover rates, is interesting, it is the questioning and self-reflection that follows in order to identify the reasons for the differences, which is most important. Benchmarking therefore essentially involves:

- being able to articulate what you are trying to achieve
- a comparison of internal data
- understanding the reasons for any differences and identifying 'how' others achieve higher levels of performance
- ability and commitment to adapting one's own HR practices to seek to improve one's own performance.

Of course you do not have to be doing a benchmarking exercise to be focussing on improving. There are other options. Assessing performance against an external standard, such as the EFQM 'Model for Business Excellence' or 'Investors in People', can be very valuable.

6.3 Being clear about why you are benchmarking

Benchmarking can be a time-consuming and expensive activity unless it is well focused on specific areas of priority in need of improvement or development. The process of benchmarking can be an effective way to review both the efficiency of the HR function itself in meeting its own service delivery standards, and its effectiveness in delivering outcomes or facilitating change across the whole organisation. It can help with operational and strategic outcomes in support of a once-off improvement or a sustained programme of continuous improvement. The costs in terms of the staff time of those engaged in managing the whole benchmarking process and those collecting internal data not routinely collected, should not be underestimated. It is therefore important to clearly identify the scope and focus of your benchmarking initiatives to ensure they are addressing your priority needs.

The dilemmas and issues raised in the previous chapters should have already alerted you to some areas of possible concern within your HR activities. Before you launch into benchmarking, however, it is important to 'step back' enough from your current activities to consider the key issues: clarity of purpose, and a focus for the improvement you really need to seek. Consider the following questions:

Do you understand what is important in your organisation's business?

1. Do you understand what needs to be improved within the HR function in order to support what is important to the organisation?

2. Do others share your diagnosis of what is important? (You will need the support and commitment of others to change or sustain the benchmarking process.)
3. Are you clear whether your aim is to improve a specific situation/process/activity, or is it part of a rolling programme of continuous improvement?

Clarity on the overall purpose of a benchmarking process for HR in an organisation gives a sense of the general 'territory' to be looked at. If this 'territory' is very different from the current benchmarking initiatives, this does not necessarily mean the current initiative was a waste of effort. It could be that it addressed needs of the past, which are no longer priority areas because the previously desired improvements have now been made. It is time to refocus and start again. Or it may be that the competitive climate within which the organisation is operating has changed very fast and the original benchmarking purpose is no longer as important as it once seemed. Of course, it could just be that you or your predecessors weren't very selective about what to benchmark!

Table 8 provides some examples of common target areas for benchmarking, together with one or two commonly associated pieces of data that could be collected. The list is extensive, so being focused and selective at this early stage, about which bit of the territory your organisation's business needs are on, can save much effort for limited organisational learning later on. If you are already really good at something, such as recruitment, you may achieve some small incremental improvements, but if you already know you have problems with management development or absence, then you could achieve a major step change improvement by focusing your benchmarking efforts here. The choice is yours!

6.4 Identifying comparator organisations for benchmarking

There is a school of thought that suggests that companies should only compare themselves with, or seek information from, 'world-class' benchmarks —seeking out the best and striving to match them. But these organisations are often over-benchmarked and their 'world class' position often transitory. Others believe that companies do not need a direct relationship with comparator(s) or partner organisations.

There are a number of sources of published metrics. One of the commonly used ones in the UK is the APAC/ATAC National Database of Human Resource Effectiveness which has been compiled by MCG Consulting Group since 1989. It includes information from 150 employing organisations and allows the comparison of typical ratios of activities with organisations in the same or different sectors (extracts are published monthly in *Personnel Today*).

Table 8: Example of Target Areas for Benchmarking

A: Internal efficiency of the HR function itself	Examples
Recruitment	*eg* Time spent and costs per recruit
Training	*eg* Costs per employee and hours/days training per in-house trainer
Compensation and Benefits	*eg* Costs per employee
HR staffing	*eg* HR staff per employee and skills/ competency.
Major HR policies and procedures	
Turnover and Absence levels	

B: Effectiveness of organisation-wide operational HR issues	Examples
Absence and Turnover	*eg* Absence cost per employee and voluntary termination rate
Productivity levels	
Profit impact	*eg* Sales revenue and profit per employee
Sickness levels	

C: Effectiveness of organisation-wide strategic HR issues
Culture
Approaches to Performance Management
Management Development
Value Systems

Source: Adapted from Branham, 1997

Another common source of metrics worldwide is the Human Resource Effectiveness Reports, published regularly for its database of some 800 or subscribing organisations, by Saratoga. But just making use of externally published metrics from databases limits your ability to interrogate what lies behind the headline figures. This is the main reason why many organisations choose to identify partner or comparator organisations in addition to using published metrics.

It takes time to establish realistic partners who have an interest in benchmarking. There is no point beginning or continuing with another organisation if it no longer has similar activities or if trying to get data out of them is very hard indeed. Benchmarking depends on measuring performance against agreed criteria. If you want to find a partner or think it might be time to find a new partner, there are various ways you can make a start by using a ready-made common interest forum to signal your interest:

- a formal benchmarking club
- local interest groups, such as chamber of commerce or a local employers federation
- sector-specific groups, such as pay and benefits or training specialists in your industry.

It may be very difficult for some organisations to find a good match. But, ideally, you do need them to possess at least some of the same essential characteristics you have chosen — whether these are industry, organisation size, employment practices or some other characteristics.

Some of the issues to consider when reviewing the appropriateness of current comparator organisations(s) are:

1. Do you know on what basis the comparator(s) were originally selected? (*ie* best practice, similar stage of organisational maturity, facing similar challenges, same sector, *etc.*). Does that basis still hold true?
2. Are you clear you are still gaining from the relationship? What are you getting in return for what you are offering?
3. Does the relationship focus on 'how' things are done and not just on 'what' is done? Is it a focused exchange of information which is still leading to improvements for your organisation?

6.5 Data collection and understanding benchmarking results

A common failure in benchmarking is to allocate insufficient resources to collecting data. It is a resource intensive business. A second common failure is to get so absorbed in the process and detail of collecting the data that you spend too much time on collection and not enough on understanding what the results actually mean.

It is important that you are planning properly the information that you wish to collect. It is likely that it comprises a range of hard, process and soft data (as discussed in the previous chapter on performance indicators). It is likely that you are currently collecting key ratios of quantitative data as a baseline to enable your organisation to identify any potential or apparent 'performance gaps' between the figures other organisations seem to be performing. It is likely that you are also currently collecting qualitative data or attitudinal information, and you may be using this to get a broader picture of the context within which you and your comparator(s) are operating.

It is very difficult to be sure that you are comparing like with like. The problems of calculating and data collection that apply to PIs within your own organisation, are merely expanded when it comes to comparisons with other organisations. The same problems of formulae, data sources, validity and reliability apply. They key is, if you're not sure whether a difference in ratios is significant or not, the first question to ask should always be '*how did you work that one out*?'. At least you will then have a better idea whether you are comparing like with like.

Common differences to watch for are:

- Staff numbers. Are they using full-time staff equivalents or absolute numbers of staff?
- Terminations. How have they differentiated voluntary and non-voluntary leavers? Also, if the data was collected from line managers or operating units, check whether everyone who 'left' that unit has been included, even if they went to another unit within the same company?

You need to be confident that you understand the results of the comparisons you have made with the other organisation(s). Ask yourself the following questions:

- Do we fully understand how others have achieved the results they have?
- Have we been sufficiently innovative and creative in identifying exactly what it is that we could do differently?
- Do we fully understand the implications of how others do things in terms of the possible implications for the way we organise, our information flows, and our existing staff capabilities/skills/competences?
- Have we identified any relevant differences in culture or management style which could make what others have done difficult for us to achieve without customising to fit?

6.6 Adapting for improvement from benchmarking

Once data has been collected and analysed, you should be ready to take decisions and to draw up an action plan for the improvements you want to make. Unless decisions are taken on what to do with the insights or ideas you have obtained, the detailed benchmarking work will, to a large degree, be forgotten and wasted. An opportunity will also have been missed to respond either more effectively or efficiently to customer or corporate needs.

Planning to adapt for improvements can be thought of as a similar process to planning and managing any projects which involve change. The following questions need to be addressed to maximise your chances of achieving improvements in the best possible way:

1. Are the improvement targets clear? Are they realistically achievable in the set timeframe? Do they focus on the key issues that can be expected to make the most substantial contribution to improved performance?

2. Is there a proper project plan and sufficient associated resources to implement the changes or adaptations identified? Is it sufficiently detailed, including who is responsible for doing what and when? And does it include goals and milestones along the way?
3. Does the process for implementing the adaptations include gaining the support and commitment from those affected by the changes? And is there sufficient patronage and commitment from senior managers?

The importance of focussing on the implementation of change cannot be underestimated. Frequently, benchmarking exercises have proved less satisfactory than they might, by organisations:

- spending too long on analysis
- collecting more data than they needed to
- failing to involve those people affected by the adaptations identified.

Benchmarking is a powerful analytical tool, but it needs to be focussed on the achievement of beneficial and desirable change, so introducing and sustaining adaptations needs to be constantly at the forefront of your thinking throughout a benchmarking exercise.

6.7 Summary

Benchmarking is a popular management tool, but there are pitfalls to be aware of in using it, particularly in the field of people management. In this chapter we have tried to emphasise that in order to make successful comparisons using HR performance indicators, you need to ensure that like is being compared with like.

7. Conclusion: Measurement in Context

7.1 Key points

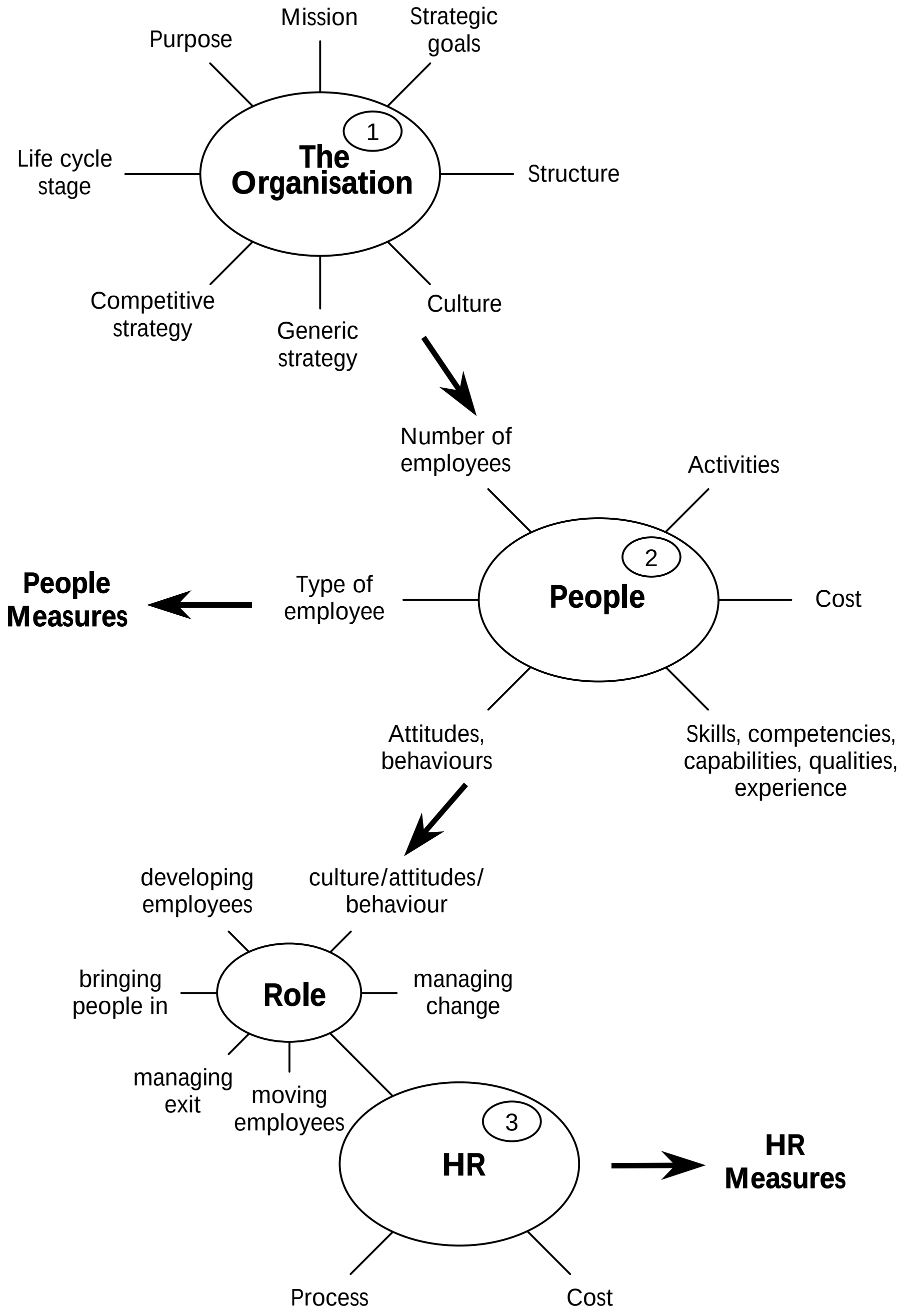
This publication contains several key messages to HR practitioners who wish to measure both people activities in their organisations, and the HR function itself.

- There is research evidence to show that organisations with good HR practices perform better than their competitors. Good HR practices contribute to increased employee commitment to the organisation, which then leads to increased returns.
- By measuring both people activity and HR activity, the HR function can demonstrate what it does for the organisation.
- People measures are as robust as, and possibly more robust than, any other measure used within the organisation. This assertion applies to soft measures as well as hard.
- It is not necessary to measure *everything* — in fact, this approach leads to wasted effort and information overload. Instead, a focus on key measures, linked to key objectives, is recommended. This focus will demonstrate that HR is aware of what is relevant and important to the organisation, and is contributing to strategic goals.
- The key measures should be underpinned by comparative measures — headcount, wastage, absence, costs — showing trends over time and between main employee groups.
- A mixture of hard, process and soft measures will give a better balance than a focus on one type of measure alone.
- HR measures should be part of a balanced portfolio approach to measuring an organisation's performance.

7.2 Steps to success

Three broad steps are recommended, out of which people measures and HR measures should naturally fall. The steps are summarised in Figure 6.

Figure 6: Measurement in context



Source: IES

Step 1: The organisation

The fundamental question to pose here is, what does the organisation exist to do?

- What are its strategic aims?
- Does it have a mission statement? If so, what does the mission statement say about the organisation, in terms of its activities, aims and intent?

- What type of structure does it have — bureaucratic and hierarchical, or organic and flat? Or somewhere in between? Or do different parts have different structures?
- How about the organisation's culture? How easy is it to change attitudes and alter the way things are done? How receptive is the organisation to information, and in what form does the information have to be presented in order to make an impact?
- At what stage in the life cycle is the organisation? Is it a new company, or a mature organisation with many years of history? Are its products are services well established? Is it trying to do new things?
- What is the organisation's generic competitive strategy or ethos? Does it have a strategy of innovation, differentiation, quality or cost? Or a mixture of these?
- What are the organisation's core competencies?

Step 2: People implications

The answers to step 1 above will help identify the type of people required by the organisation.

- What sort of people should the organisation employ?
- How many people are needed?
- Where do they come from?
- What do the people working for the organisation actually do?
- What skills, competencies, capabilities, qualifications, experience, training do they require?
- What attitudes and behaviours are expected of them?
- How do they move around the organisation?
- How much do they cost?

People measures — particularly key measures — should be apparent from the answers to step 2. Most organisations will probably need to measure:

- headcount
- wastage
- absence
- grade mix
- skill mix
- attitudes, opinions and satisfaction
- commitment
- competencies
- cost.

Step 3: HR implications

Step 2 should help the organisation, and the HR function in particular, to define HR measures.

- What is HR's role in:
  - bringing people in to the organisation?
  - developing their skills/competencies/capabilities?
  - instilling culture/attitudes/behaviour?
  - moving people around the organisation?
  - managing change?
  - managing exit?
- What HR processes match these activities?
- How much does it cost?

As for step 2 above, **HR measures** should be apparent as a result of considering these questions. As a minimum, most HR functions will wish to consider:

- measuring key HR processes
- ensuring that workforce plans are in place
- costs of HR
- attitudes towards HR.

Appendix A: Defining Hard Indicators

Introduction

The measures and definitions described in this appendix are not exhaustive. Some may be appropriate for your organisation, while some may not; others may be useful for parts of the organisation only, such as particular businesses or employees groups. Many are suitable for using in internal or external benchmarking exercises — with the usual caveats about ensuring that the same definitions have been used, so that you really are comparing like with like.

People indicators

The organisation

- Revenue per full time equivalent (FTE) employee: divide total revenue by the total number of FTEs in the workforce.
- Costs per FTE: divide total costs by total FTEs.
- Profit per FTE: divide profit before interest and tax by total FTEs.

Recruitment

- Cost per new recruit: divide total recruitment costs by the number of new recruits. (This can be split between internal and external recruits.)
- Acceptance rate: percentage of offers made that are accepted.

Absence

- Total absence rate: days absent expressed as a percentage of total FTE working days.
- Unauthorised absence rate: days unauthorised absence expressed as a percentage of total FTE working days.
- Sickness absence: days sickness absence expressed as a percentage of total FTE working days. (This should be split into uncertified, self-certified and medically certified, or alternatively, long-term sickness and short-term sickness —

using an agreed definition of what constitutes long- and short-term absence).

Labour turnover

- Total wastage rate: number of leavers expressed as a percentage of average headcount.
- Voluntary wastage rate: number of resignations expressed as a percentage of average headcount. (This can be broken down into internal wastage, *ie* leavers who go to a new job elsewhere in the organisation, and external wastage, *ie* leavers who depart from the organisation altogether.)
- Involuntary wastage rate: number of retirements, dismissals and redundancies expressed as a percentage of average headcount.

Training and development

- Training cost per FTE: total training costs divided by total FTEs. (This can be divided into internal and external training costs, or into types of training.)
- Training days per FTE: total training days divided by total FTEs (can be divided as above).

Health and safety

- Health and safety costs per FTE: divide total health and safety costs by total FTEs.
- Lost time per incident: divide days lost by the number of incidents (*eg* in the past week/month/quarter/year).
- Incidents per 1,000 FTEs: divide number of incidents by total FTEs, then multiply by 1,000.

Reward

- Cost of compensation and benefits compared to total revenue: express compensation and benefits as a percentage of total revenue.
- Average remuneration: divide total compensation and benefits by total FTEs.

HR indicators

- Ratio of HR function FTEs to total FTEs: divide FTEs of people working in HR by total FTEs.
- HR costs per FTE: costs of providing HR divided by total FTEs.

- HR costs as a percentage of profit: HR costs expressed as a percentage of profit before interest and tax.
- HR costs as a percentage of total costs: HR costs expressed as a percentage of total costs.
- Average HR compensation: divide total HR compensation by FTEs working in HR.

Appendix B: Deriving Indicators of Satisfaction and Commitment

Introduction

Recent research indicates that there is a relationship between employee commitment and business performance. In broad terms, the research shows that if commitment to the organisation grows, business performance improves. Partly, the improvement is due to a direct relationship between employee commitment and business performance; there is also an indirect link, in that improved employee commitment leads to greater customer satisfaction and therefore a greater propensity to spend.

This link is encouraging organisations to be more aware of the attitudes and perceptions of their employees. There are two main ways of gathering employee attitude data, of which the most common is the survey. One of the difficulties of using 'soft' methodologies is that they tend to gather data on opinions, perceptions and attitudes — subtle, abstract concepts that do not, apparently, readily lend themselves to quantifiable and measurable indicators. But is this really the case?

Many organisations now conduct employee attitude surveys on a regular basis — usually every eighteen months to two years. Some have a rolling survey, which test the attitudes of a sample of employees even more frequently. The attitude survey is, despite appearances to the contrary, an extremely useful instrument for the development of **satisfaction and commitment indicators,** which can be derived from the statements and questions in the survey. The following example uses job satisfaction statements to show how this can be done.

An example: Job satisfaction

Respondents, typically, are asked to agree or disagree with various statements —often using a five point scale ranging from 'strongly disagree' to 'strongly agree'. Some statements often asked about **jobs** are given below:

- Most days I am enthusiastic about my job
- I am often bored with my job

- There is a lot of variety in my job
- I do interesting and challenging work
- I get a feeling of accomplishment from my work
- I enjoy my job
- I feel dissatisfied in my job.

These statements obviously have a common theme, that of job satisfaction. It will usually be possible to group the responses to such statements together, using statistical techniques such as factor analysis or scaling, to derive an overall 'job satisfaction' indicator. This indicator can then be used to compare different employee groups — by gender, age, department, function, location *etc.* Statistical tests can again be applied, to highlight any significant differences between groups.

Quality indicators

Organisations participating in initiatives such as the European Foundation for Quality Management (EFQM) have found that they can use the responses to statements in their employee attitude survey to derive and monitor many of the suggested indicators in the 'people's perception of the organisation' section of EFQM standards. Examples of derived indicators are:

- opportunities to learn and achieve
- empowerment
- equal opportunities
- career and personal development
- recognition
- communication
- organisational values and mission
- pay and benefits
- peer relationships
- management of change.

Even if not participating in a formally badged initiative like EFQM, deriving indicators like these is a very useful exercise, enabling a huge variety of comparisons and trends to be drawn.

Appendix C: Perceptions of the HR Function

The United Technologies HR practices survey, quoted in Hiltrop J M and Despres C (1994), 'Benchmarking the Performance of Human Resources Management'. *Long Range Planning*, Vol. 27, No. 6.

To what extent does the HR organisation...

Always: 1 Usually: 2 Sometimes: 3 Rarely: 4

1. understand where the business is headed and what management is trying to accomplish?
2. stand up for the human resource perspective on business issues?
3. staff the HR organisation with competent professionals?
4. participate actively in the business planning process?
5. take appropriate risks?
6. respond in a timely manner?
7. develop human resource objectives in the context of business priorities?
8. do its homework?
9. provide competent advice and support?
10. explore alternative solutions to problems?
11. find ways to balance its functional interests with the needs of the business?
12. react quickly to changes in the needs of the business?
13. anticipate business problems?
14. help more than hinder the organisation in attaining its business objectives?
15. have people seek its advice?
16. set high standards for evaluating its own effectiveness?
17. bring a competitive global perspective to the hr function?
18. design solutions to business problems that meet the needs of the business?

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