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# Human Capital Measurement:

## Approaches, issues and case studies

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D Robinson, H Hooker, M Mercer



REPORT 454

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# Human Capital Measurement: Approaches, Issues and Case Studies

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This report is the product of a study supported by the IES HR Network, through which members finance, and often participate in, applied research on employment issues. Full information on Network membership is available from IES on request, or at [www.employment-studies.co.uk/network](http://www.employment-studies.co.uk/network).

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# Contents

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<b>1</b>	<b>Introduction</b>	<b>1</b>
1.1	The study	1
1.2	Background	1
1.3	Approach	2
1.4	The report	2
1.5	Thanks	2
<b>2</b>	<b>The Process</b>	<b>3</b>
2.1	Participating organisations	3
2.2	Aims	4
2.3	What we did	4
<b>3</b>	<b>Outcomes</b>	<b>5</b>
3.1	Terminology – what’s in a name?	5
3.2	Issues that arose (and were mostly tackled)	6
3.3	The emergence of a workable approach	9
3.4	Making an impact by making the links	10
3.5	The journey continues	11
3.6	Participants’ tips for success	11
<b>4</b>	<b>Case Studies</b>	<b>13</b>
4.1	Royal Bank of Scotland (RBS)	13
4.2	Civil Aviation Authority (CAA)	19
4.3	Standard Chartered Bank	24
4.4	Royal Navy	29
4.5	Ministry of Defence (MoD)	32
4.6	Centrica	36
4.7	East Sussex County Council (ESCC)	40
4.8	Haringey Council	45
4.9	Medway NHS Foundation Trust	50

<b>5</b>	<b>Scan of Human Capital Measurement Activity</b>	<b>53</b>
5.1	Human capital – how it came about	54
5.2	Measures that followed ....	55
5.3	International activities	56
5.4	Human Capital valuation in HR	60
5.5	HR consultancies working on HC	62
5.6	What are the most frequently used HC measures/metrics on scorecards?	63
5.7	Suggestions for success from a leading consultancy in this area	64
5.8	Towards a set of standard measures?	67
	<b>Appendix 1: Questionnaire</b>	<b>68</b>
	<b>Appendix 2: Report Summary of ‘People and the Bottom Line’</b>	<b>70</b>



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# 1 Introduction

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## 1.1 The study

This study was funded by IES's HR Network, to which more than 40 large private and public sector organisations belong. IES carries out research every year on behalf of its member companies, selecting areas for investigation that are topical and of interest and relevance to the membership. Almost all the participating organisations in the study were from IES member companies. Funding for the study was initially provided for the financial year 2006 to 2007, and continued into 2007 to 2008.

## 1.2 Background

The backdrop to the study was the report of the Accounting for People DTI Task Force (2003), often called the 'Kingsmill Report'. The report recommended that information about human capital and the way in which it is managed should be included in company reports. The exact vehicle for conveying this information was not prescribed by Kingsmill, although the Operating and Financial Review was strongly suggested as the most appropriate. The report also did not recommend the format for reporting on human capital, instead giving some examples from industry and leaving more precise details to be worked out by a future working group. In the year or two following Kingsmill, despite a degree of disappointment that former recommendations had not emerged from the Task Force, there was considerable interest in the idea of measuring human capital. The interest centred on two main areas – firstly, how to do it, and secondly, how to prove that good human capital management made an impact on bottom-line organisational performance.

As time went on, however, the hope that guidance would be produced showing companies how to present the worth of their human capital faded. The most recent attempt – an Investors in People Human Capital Standards Group, set up in 2006, which aimed to arrive at a set of standard measures that could be used by all organisations – has not yet achieved this aim. Instead, there has been increased interest in the idea of developing context-dependent measures of human capital. This approach allows for the differences that exist among organisations in terms of their

purpose, customer base, areas of activity and definition of 'bottom line'. Its underlying premise is that it is not possible to arrive at a single set of measures that are appropriate to all, even to the extent that one organisation's set of key people performance indicators could be completely irrelevant to another organisation.

IES carried out its own follow-up of Kingsmill during 2004 and 2005 (Hartley V, Robey D, 2005) and has also continued to be active in the debate about the impact of people on organisational performance (eg Tamkin P, Cowling M, Hunt W, 2008).

### 1.3 Approach

In 2006, preparatory to launching this study, we surveyed our membership to find out more about the types of human capital measures in current use. The survey included questions about whether any particular measures were considered key, how people measures were presented to the organisation, and any attempts the organisation had made to link people measures with performance data. The questionnaire is included as Appendix 1.

Results from the survey were used to identify two sets of IES member organisations. Firstly, some companies were already advanced in their attempts to develop a coherent set of human capital measures, in some instances relating these to organisational performance, and we termed these companies our 'experts'. Secondly, other companies acknowledged that they were in the early stages of this journey and might welcome working with others to develop their approach. We invited these organisations to take part in an action learning group, and termed those who accepted the invitation our 'participants'. In the event, this distinction became blurred, with some 'expert' organisations asking if they could be part of the learning group, and some 'participants' demonstrating that they were further ahead in progressing their human capital measurement activity than they had previously believed.

### 1.4 The report

This report has three main sections. The first section describes the process and outcomes of the research study, with particular emphasis on the approach felt by several participants to be particularly effective in devising human capital measures for their own organisations. The second section contains case studies of nine of the organisations involved in the study as either experts or participants. Finally, the third section contains the results of a scan of human capital measurement in the UK and abroad. Further material is provided in the appendices.

### 1.5 Thanks

Thanks are due to all the participating organisations in the study, particularly those that consented to being case studies, to IES staff who presented the results of relevant research on related topics to the learning group, and to the HR Network for funding the study.

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## 2 The Process

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### 2.1 Participating organisations

A total of 14 organisations took part in the study, either as experts who presented their own organisation's approach to devising and using human capital measures, or as participants in the learning group who attended at least two of the five workshops. The organisations were:

- Royal Bank of Scotland (RBS)
- Civil Aviation Authority (CAA)
- Standard Chartered Bank
- Royal Navy (RN)
- Ministry of Defence (MoD)
- Centrica
- HBOS
- London Councils
- Haringey Council
- East Sussex County Council
- Medway NHS Foundation Trust
- Lloyds TSB
- BBC
- Department for Children, Schools and Families (DCSF).

### 2.2 Aims

At the first meeting, the learning group spent some time discussing what they wanted to achieve from participating in the study. **Terms of reference** were agreed, as detailed below.

The group offers participants an opportunity to:

- learn from expert organisations and from each other
- share the human capital measures they currently have, and discuss their appropriateness and usefulness
- discuss ways of using and communicating human capital measurement better within their organisations
- share any problems or barriers they encounter, and offer advice about overcoming these
- use IES to provide support and information.

Individual members should endeavour to:

- review the human capital measures their organisation currently uses
- focus on developing an improved set of measures **or** on communicating and using better the measures that exist
- explore possible ways of linking human capital measures to organisational performance data.

### 2.3 What we did

Five workshops were held during the course of the study, which lasted for a little over a year. The original planned series of four workshops – held in February, April, June and October 2007 – was supplemented by a final workshop in March 2008. The first two workshops each consisted of two presentations from expert organisations and one presentation on a relevant theme by an IES researcher, followed by discussions about the issues and the way forward. At the third and fourth workshops, only one expert presentation was given, as the balance started to shift towards participants giving progress reports and presentations. Final progress reports were given at the last workshop, at which the format of the report, and feedback on the draft, was also discussed.

In between workshops, participants worked (with varying degrees of success and speed) on devising, presenting and disseminating their own sets of human capital measures.

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## 3 Outcomes

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### 3.1 Terminology – what’s in a name?

Although this research study had, throughout its life, the working title of ‘Human Capital Measurement’, discussions with participating organisations revealed that most were not using the term at all, while others used it in some circumstances or to some individuals (such as the Finance Director) only. A variety of definitions exist for ‘human capital’, some examples of which are given below.

- *‘The stock of accumulated knowledge, skills, experience, creativity, and other relevant workforce attributes.’* (Nalbantian et al.)<sup>1</sup>
- *‘The knowledge, skills, competencies and attributes embodied in individuals that facilitate the creation of personal, social and economic well-being.’* (OECD)<sup>2</sup>
- The Kingsmill report described human capital management as *‘a strategic approach to people management that focuses on the issues that are critical to an organisation’s success’*.<sup>3</sup>

The reasons why the term was not in common use tended to revolve around its unfamiliarity (*‘It wouldn’t mean anything to managers here’*) and unsuitability (*‘It’s a bit insulting to people, it implies they’re stock or assets to be owned’*). Instead, a variety of terms were employed, sometimes interchangeably, sometimes according to circumstances or the audience: ‘key people indicators (or KPIs)’, ‘people metrics’, ‘workforce data’, ‘success factors’, ‘employee indicators’, ‘balanced scorecard indicators’ etc. In discussions, the prevailing view was that it did not really matter

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<sup>1</sup> Nalbantian H R, Guzzo R A, Kieffer D, Doherty J (2004), *Play to Your Strengths: Managing Your Company’s Internal Labor Markets for Lasting Competitive Advantage*, McGraw-Hill

<sup>2</sup> Healy T, Cote S (2001), *The Well-Being of Nations: The role of human and social capital*, Centre for Educational Research and Innovation, OECD

<sup>3</sup> Kingsmill D (2003), *Accounting for People*, DTI

what terminology was used – the important thing was for HR to demonstrate a good understanding of the business by delivering high quality, relevant, usable, clearly interpreted people measures.

### 3.2 Issues that arose (and were mostly tackled)

#### 3.2.1 Early anxieties

Early issues arising during the discussion about terms of reference included the following:

- Learning group members, and our experts, were at different stages in their journey towards developing human capital measures. It was unclear, at the outset of the study, whether or not this would matter. In the event, this proved not to be a problem. Some of the organisations that had done very little before the start of the study made rapid progress, while others, who had started a lot further ahead, found themselves revisiting their human capital measures during the course of the year. This meant that the majority of participating organisations were able to learn from each others' experiences.
- Each organisation was felt to be different, even those in similar sectors, and had its own set of strategic priorities and objectives. One issue that the group felt it should address was whether this meant that every set of human capital measures should be different, or whether there was a core set that every organisation should use. If the latter, a further issue was what the core set of measures should comprise. A related issue was how important benchmarking might be. In fact, it soon became apparent that a core set of measures was not particularly relevant to participating companies, as all felt that the really important thing was to develop a set of measures that would be useful to, and make an impact on, their own organisation. The only exception to this general rule was that organisations in a similar sector (such as local government) sometimes needed to include a few people indicators that were required for national or regional benchmarking initiatives.
- Data quality worried several participants at the outset of the study. How important was it, therefore, to have a good and reliable computerised HR information system? As time went on, it became apparent that very poor data quality would hamper the effective dissemination and use of people measures within the organisation; however, it was also inadvisable to wait until completely satisfied with data quality, as this was unlikely to ever happen. Generally speaking, organisations felt it was important to make a start, as increasing dissemination of people measures – especially internal comparison between different parts of the organisation – was in itself likely to lead to a willingness to co-operate in improving accuracy.

- The last major concern of participating organisations in the early stages of the study was how HR could achieve senior management buy-in for the use of human capital measurement. This was a particular worry after hearing an early presentation from RBS, a company that has, with top management support, invested considerable money, time and effort into measuring its people and comparing human capital measures with financial, customer, business and performance data. For some, these anxieties lessened as the study progressed. These organisations were able to make a start at developing their set of people measures with a minimum of outlay, and gain senior management interest and support at a later stage, once it was apparent that this was an initiative by HR that demonstrated an understanding of the link between people and the bottom line. For other participating organisations, however, the lack of buy-in caused major problems. Two of the private sector companies that signed up to participate had to withdraw – one at the outset, another part way through the study – because their small teams were disbanded and moved to other roles within the company.

### 3.2.2 Later thoughts

#### Status of HR

As the year progressed, one issue that arose was whether or not getting involved in developing a robust set of people measures would enhance the status of HR. In general, the answer appeared to be yes, as long as the following held true:

- The information disseminated internally was genuinely useful to managers and (especially for senior managers) was succinct, well presented and easy to follow.
- There was a link with performance, or at least an understanding and explanation of how people inputs might lead to variations on organisational output.
- There was a logic and coherence to the set of chosen measures.
- HR could demonstrate a business awareness in its interpretation of key people indicators.
- HR could respond to the queries and requests for further information that inevitably started to occur once managers' interest was aroused.
- HR information specialists had the required skills to produce, analyse and interpret the data. This implies an analytical mind-set and a degree of comfort with numbers, percentages, ratios, trends etc. which does not always come easily to HR practitioners.
- Everyone in HR, particularly HR business partners, was briefed about the initiative so that they understood the data and could answer questions about it.

The view of expert organisations was that HR, in demonstrating a thorough understanding of people – for example, demographics, employee attitude data, turnover and absence levels, ‘hot spot’ skills shortages, the links between these, and preferably further links to organisational performance data – proved its worth as a function and that demands for HR to ‘justify its existence’ were far less likely to happen as a result. One participating organisation found during the course of the research that, as a result of presenting good quality information to the Board that was perceived as highly relevant, information about people had started to attract the same degree of interest and discussion as financial information. This was a significant step forward for HR.

### Presentation

The format of any reporting of people measures was felt to be very important. One question to be answered was, who is the customer? Team or divisional managers were likely to want to know a reasonable amount of detail about their employees, but senior managers – particularly the Board – would need a summary, clearly presented, with key trends identified. The former would therefore be likely to require access to the detail beneath the headlines, for example, presented as both pictures and tables of figures, while the latter would probably prefer an approach that pulled together all key data, such as a balanced scorecard. Examples can be found in the case studies in Section 2 of this report.

The medium for conveying information about people was also thought to require consideration. Some of the expert companies in our study had developed their intranet access so that managers could access an impressive array of key data and people reports. Others were more cautious (or perhaps less well endowed with resources) and would allow HR access only, while some preferred to avoid any possible misunderstanding of people data by retaining central control of all reporting, interpreting and disseminating.

### What about measuring the difficult things?

Although all the participants in our research study appreciated the value of what they were doing, some felt that it was an uphill struggle to persuade their organisations to take notice. One problem was the difficulty of measuring some of the more important, but intangible, aspects of people – such as organisational know-how and the capacity of managers and leader to motivate their staff.

Discussions about these issues demonstrated that, although not everything can be defined and measured, it is worth making an effort to develop indicators for some of the softer aspects of organisational life. Employee engagement, for example, was a key indicator for several participating organisations, and was reasonably easy to obtain from the employee attitude survey, albeit only once a year for those who did not have in-between ‘pulse’ or ‘taking the temperature’ smaller sample surveys. Some



companies also measured engagement at team or departmental level, so were able to identify managers who appeared to be inspiring their teams to perform well. Indices of managerial or leadership capability were also starting to emerge, comprising measures such as competency or skills profile, appraisal rating, 360 degree feedback scores, team performance and team engagement levels.

### 3.3 The emergence of a workable approach

The approach that seemed to work best for the majority of participants was that developed by CAA.

- **Step 1:** CAA's first step was to ask itself a series of questions related to what it wanted to know about firstly the success of its policies and practices, and secondly the value created by its people. Examples include, '*Are we retaining key employees?*' and '*Are we continually raising the bar on performance?*'
- **Step 2:** The second step was to attach relevant measures to each question. Sometimes, these measures were already available, but others had to be devised. For the two questions asked above, the measures were firstly a quality of leaver indicator, and secondly the performance management index.
- **Step 3:** Having arrived at a set of measures, CAA then arranged them into a hierarchy.
  - At the base of the triangle are level 1 measures, which are the basic underpinning data about employees – headcount, demographics such as age, length of service, job role etc., details about joiners and leavers.
  - Then came level 2 measures, which are operational measures, largely related to the success of HR in recruiting, developing and retaining people, and the success of the organisation in managing its employees. Examples include recruitment costs, training days and the incidence of grievances.
  - Level 3 measures focus on outcome measures – such as employee turnover, absence, and engagement levels.
  - Finally, level 4 measures sit at the top of the triangle, and are still in development. It is at level 4 where the links are made – for example, between absence and engagement, or between engagement and performance.

Further detail about CAA's approach can be found Section 4 of this report. This approach appealed to participants because it was a logical, coherent way of tackling people measurement that was easy to explain to the rest of the organisation, and that made use of existing measures without dodging the need, where necessary, to develop new indicators.

### 3.4 Making an impact by making the links

A major issue for some was 'proving' the links between people inputs and performance, within participants' own organisations. There was acceptance that this can be difficult but that evidence in the public domain was mounting. Back in 1998, for example, IES's work on the service-profit chain showed that employee commitment leads to improved customer satisfaction, lower absence rates and increased sales (Barber L, Hayday S, Bevan S, 1998). A variety of academics and others have contributed research to show that there is a causal link between management and performance, that learning and skills makes a difference, and that high performance work practices lead to better productivity. Examples include:

- Bloom and Van Reenen (2005): Measures of management practice are related to productivity and profitability.<sup>4</sup>
- Green et al., 2003: There is a relationship between skills and product sophistication.<sup>5</sup>
- Dearden et al. (2000): There is a relationship between training and labour productivity.<sup>6</sup>
- Huselid and Becker (1997): One standard deviation shift in the High Performance Work Practices index is associated with a \$40,000 increase in shareholder value per employee.<sup>7</sup>

IES's recent work (Tamkin et al., 2008) has added to the body of evidence by showing that organisations that adopt an integrated range of HR practices (ie organisations that invest in their people) are likely to perform better on key indicators such as profit and sales growth. The report summary of 'People and the Bottom Line', can be found in Appendix 2.

Several of our participating organisations were experimenting with correlations, for example, between different people measures (absence rates and employee turnover, employee engagement and benefits scheme buy-in, vacancy rates and agency staff costs etc.). Some were also trying out correlations between people measures and performance (for example, engagement and performance ratings, absence or vacancy rates and customer satisfaction). While correlation does not prove causality, it does

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<sup>4</sup> Bloom N, Van Reenen J (2006), *Measuring and Explaining Management Practices Across Firms and Countries*, LSE

<sup>5</sup> Green F, Mayhew K, Molloy E (2003), *Employer Perspectives Survey*, DfES

<sup>6</sup> Dearden L, Reed H, Van Reenen J (2000), *Who Gains when Workers Train? Training and Corporate Productivity in a Panel of British Industries*, CEPR Discussion Paper

<sup>7</sup> Huselid M, Becker B (1997), *The Impact of High Performance Work Systems, Implementation Effectiveness, and Alignment with Strategy on Shareholder Wealth*, Academy of Management Best Papers Proceedings

show where clear links exist and can therefore be very persuasive in encouraging senior management to take notice.

One of our expert companies, RBS, has carried out a considerable amount of work in exploring employee engagement, and is able to demonstrate many links between engagement and performance. RBS has proved to its own satisfaction that employee engagement is a driver of performance and because of this has invested considerable resources in measuring, fostering and monitoring engagement levels. The example encouraged several of our participating companies to explore making links, as this seems to be a particularly effective way for HR to make an impact.

### 3.5 The journey continues

None of our participating organisations felt that they had arrived at a definitive set of measures that fully represented the contribution made by people to organisational performance. Our experts were still working on defining their high level indicators, on presentation and interpretation, and on understanding the links between people and performance. Even RBS has not yet exhausted all its possibilities. Our participants are mostly happy with the progress they have made so far and the impact they have made, but feel they are still on a journey towards achieving a full understanding. It is heartening to hear, however, that taking part in the study has been worthwhile:

*'It has made us think about what is success, and how can it be linked with people measures?'*

*'It helped to confirm that we had the right approach.'*

*'It was especially helpful to hear from companies that were reaping the benefits.'*

*'It sparked some ideas and gave reassurance.'*

*'Everyone was very open and honest. I liked the format – everyone sharing, learning, and being on a journey.'*

*'It gave us focus to develop our balanced scorecard and to start to think about linkages and targeting our resources where we can make a difference.'*

### 3.6 Participants' tips for success

- Don't wait for perfect data quality – go with what you have and it should improve with use.
- Be prepared (and prepare your HR colleagues) for the onslaught of queries, comments, disagreements and request for further information that will gather momentum as you disseminate information about people.
- Try to measure what matters rather than what's convenient – but continue to use existing measures if they're useful and well understood.

- Use the same definitions throughout the organisation, especially for things that can be measured in a lot of different ways (eg absence, employee turnover, employee engagement).
- Involve managers wherever possible, rather than assuming you know what they want.
- Experiment with different report formats, and get customer feedback on what they prefer.
- Interpret the information for the audience – don't assume they will spot what you think is obvious.
- Talk to your colleagues in Finance, Business Development, Marketing, PR etc. – they could have performance data you could make links with, skills you could borrow, or ideas about presentation you could use.
- Focus on what is absolutely key for the Board, and present it so the messages are unmistakable. Ideally, have some solutions to hand for any problems revealed by the data.
- Make the links wherever you can – between different people measures, and between people and activity/financial/productivity/performance data.

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## 4 Case Studies

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### 4.1 Royal Bank of Scotland (RBS)

The Royal Bank of Scotland Group (RBS) is one of the world's leading financial services providers and one of the oldest banks in the UK. The takeover of National Westminster Bank in 2000, followed by a series of approximately 30 smaller acquisitions, marked a period of significant growth for the Group, increasing its strong UK presence with operations across Europe, the USA and Asia.

By the end of 2002, it was the second largest bank in Europe and the fifth largest in the world by market capitalisation.

In the UK the RBS Group's branch network spans the nation and boasts a pedigree of great variety and distinction. Its history is very much the history of banking in the British Isles over the past four centuries, as the Royal Bank can trace its roots back to the sixteenth century through the amalgamation of more than 200 private and joint stock banks which comprise its past and present constituents.

Following the recent acquisition of ABN Amro, the Group now serves more than 40 million customers in 53 countries with around 170,000 staff.

#### 4.1.1 The approach RBS took to human capital measurement (HCM)

The move to an HCM approach began for RBS with the recognition that, to outperform its peers, the contribution and performance of its people would be key. With a very supportive HR Director and Chief Executive, and a 'make it happen' culture within RBS, the development of HCM has aimed to keep ahead of the information needs of the company.

As other organisations have also done, RBS considered what it could already do and data it could already provide – wishing to get the basics right and focusing on three to four main measures around engagement, absence, turnover and short-term tenure (leaving within 12 months).

RBS brought in a range of people to develop the HCM framework to supplement the skills of the HR team. The organisation was keen to bring in the very best people available to ensure the most robust and 'joined-up' approach. Skills included market research, technology and finance.

It was key for RBS that:

- HCM was on its business (and not just HR) agenda
- it built a compelling employee proposition that attracted, engaged and retained the best talent
- the effectiveness of the people strategy was assessed through the impact on business performance.

Underpinning the HCM approach was the RBS strategy summarised in the diagram below.

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Figure 1: RBS strategy



Source: RBS

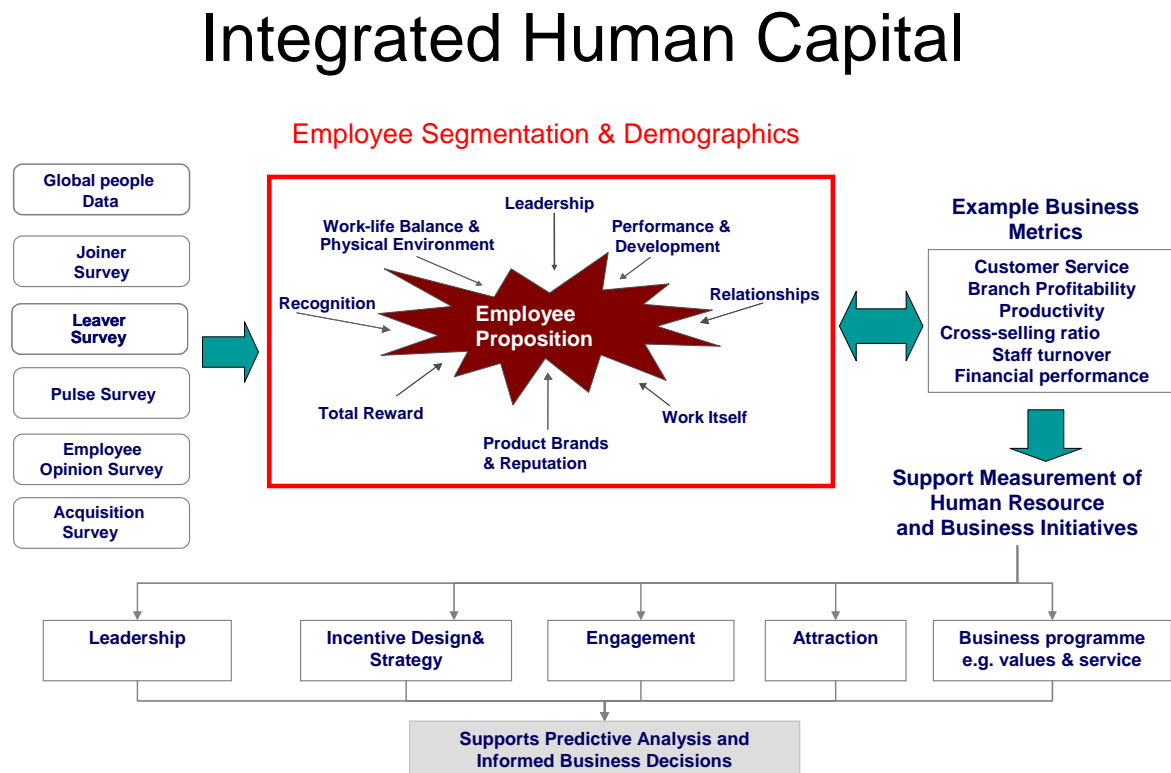
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This strategy reflects that RBS generates superior sustainable value for shareholders through adding value for both customers and the Bank's own people.

#### 4.1.2 Measures and outcomes

RBS has spent time, effort and resources on developing and gathering data from its staff. One employee survey was sent to all employees, containing over 100 questions. RBS has analysed this data against both employees' characteristics and against business outcomes and initiatives. The diagram below outlines how the survey data, the employee segmentation and the business metrics (of which there are 400) and outcomes work together.

Figure 2: Human capital measurement: An integrated approach



Source: RBS

In terms of the inputs to the model, RBS has been able to adjust the employee proposition and assess the impact on staff and on the business outcomes, and to assess the links between the two. Key findings for RBS have been:

- the impact of engagement on business outcomes
- the links between reward and engagement
- the life stage of the employee, and that the proposition needs to reflect differing needs at differing times.

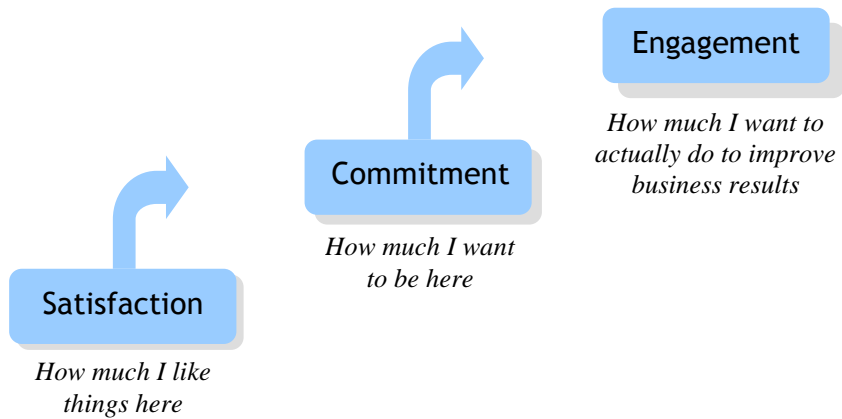
In terms of outputs, RBS has identified seven areas of employee performance that show a significant, consistent positive link with business and customer performance metrics. These measures are:

1. leadership index
2. engagement index
3. customer focus
4. image and competitive position
5. managing people and change
6. efficiency and innovation
7. performance management and development.

### 4.1.3 Dissemination and use of measures

The extensive analysis that RBS has done linking its employee survey data, through its benefits proposition, to business outcomes, has shown that engagement is a key indicator in human capital terms. Engaged employees perform well and contribute directly to business success. The benefits are shown below.

**Figure 3: Steps to engagement**



Employees who are engaged:

**Say:** Consistently speak positively about the RBS Group to colleagues, potential employees, and customers.

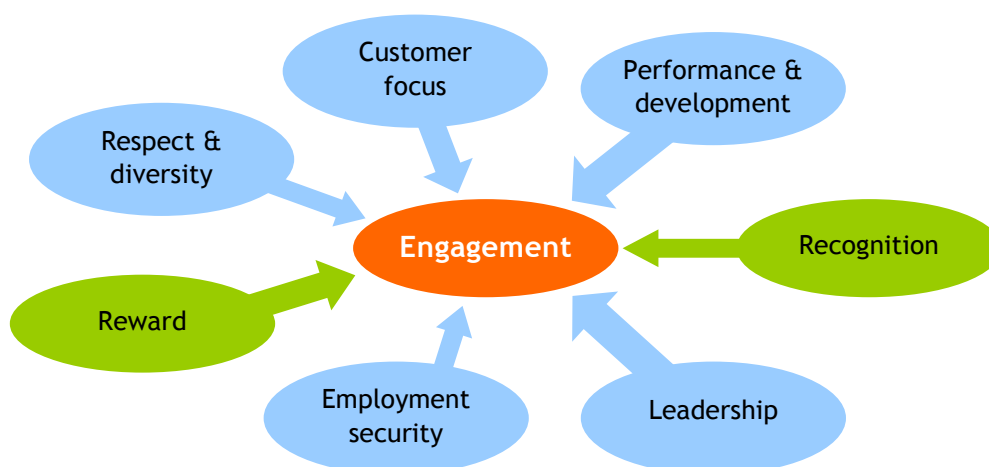
**Stay:** Have an intense desire to be a member of the RBS Group.

**Strive:** Exert extra effort and engage in behaviours that contribute to business success.

*Source: RBS*

A key activity has been work to identify drivers of engagement, as shown below.

**Figure 4: Engagement drivers**



*Source: RBS*



The Drivers to Engagement is a recognised toolkit used Europe-wide in RBS to reward the best performers and to motivate through engagement. The links between financial reward and engagement are not exact and non-financial recognition has been found to be more important in engagement terms. 'Reward' also covers hygiene issues which need to be put right rather than just paying more. However, while the link is not exact, RBS points out that reward can be organised from the centre and can be sorted out quickly for everyone and therefore have a wide impact as follows:

- Reward is not the number one driver of engagement, for example, the impact of a good manager is significantly greater.
- However, the organisational impact of good managers is limited by narrow spans of control ie they can have a very positive impact but only on a relatively small number of people.
- In contrast, reward done well can drive engagement across the whole organisation.
- Investment in the design of effective reward programmes can therefore deliver significant enterprise-wide returns.

Therefore, a focus on getting reward right has enabled RBS to impact on engagement and consequently on business performance.

RBS offers flexible reward through its *RBSselect* programme to ensure all employees can be engaged through being able to choose the rewards that best meet their circumstances at that time. Some 105,000 employees are eligible for the programme and administration of it has been outsourced. RBS carefully targets its rewards, having found that engagement levels increase by up to 20 per cent where three or more *RBSselect* options are taken up. This approach also makes financial sense for RBS. The bank has calculated that, on average, it takes ten months to repay the recruitment and onboarding costs of a new recruit. Therefore, knowing the engagement criteria is important for the new recruitment and retention strategy.

RBS has developed a human capital toolkit to enable its HR professionals worldwide to access the data and resources around HCM. The toolkit has five workstreams:

1. survey toolkit
2. reporting toolkit
3. benchmarking toolkit
4. research toolkit
5. measurement toolkit.

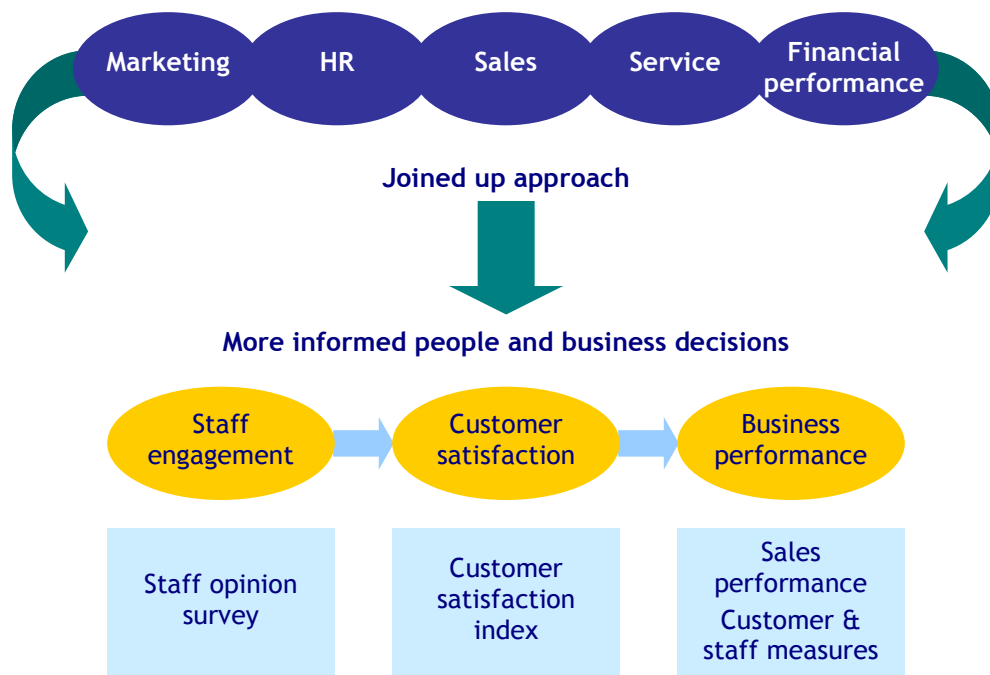
RBS has also produced material on the external reporting of human capital.

#### 4.1.4 The impact of HCM – challenges and lessons learnt

For RBS, the key to success has been the identification of the impact of engagement on their business performance and the links between engagement and reward. Coupled with this has been RBS's linkage of HCM with business performance. The bank has attempted to turn as much HR data into bottom line impact as possible, which has helped with organisation-wide buy in. For example, RBS has demonstrated that a one percentage point reduction in turnover is estimated to save the business £30 million a year; while a 0.2 percentage point reduction in employee absence can lead to annual savings of £6 million. RBS HR staff have had to learn 'business language' to communicate with their colleagues and RBS found, as other organisations have, that this was not always easy for the HR team.

RBS has supported the HCM approach with senior management buy-in and has ensured senior people from all elements of the business are involved in getting HCM right, as shown below.

Figure 5: A joined-up approach to HCM



Source: RBS

Next steps for RBS are to continue to pursue business excellence through people as it plans to 'see HR data through the lens of business performance'. The bank's interactive tool enables HR and line managers to see the links and the drivers for key measures such as engagement, leadership, sales and customer service, ie to see the impacts of people strategy on business performance.

## 4.2 Civil Aviation Authority (CAA)

The Civil Aviation Authority (CAA) is the UK's aviation regulator. An independent organisation, funded entirely from its charges to the aviation industry, the CAA is responsible for all civil aviation regulatory functions which include: economic regulation; airspace policy; safety regulation; and consumer protection. A not-for-profit organisation, the CAA employs approximately 1100 employees across the UK with main offices in London and at Gatwick.

Although independent, the CAA must report to and work closely with the Department for Transport, as well as reporting to the aviation industry. The CAA is currently subject to an independent review by Sir Joseph Pilling to ensure that the UK's arrangements for aviation regulation and policy making are fit for purpose and able to meet current and future challenges. This review is due to report in 2008.

### 4.2.1 The approach CAA took to Human Capital Measurement (HCM)

The CAA began by considering why it was important to them to measure human capital. One of the key drivers was that the Authority's success relies on the expertise and effectiveness of its people. As 60 per cent of the CAA's total costs are the costs of employment, it was hoped that human capital measurement would allow the CAA to quantify the value of their staff and to examine the relationship between staff performance and business outcomes.

Measurement of human capital also enabled the CAA's corporate objectives of continuous improvement, improved efficiency and cost effectiveness to be quantified more fully.

With the HR function responsible for the measurement of human capital, a supplementary benefit for HR was an opportunity to develop some meaningful measures which could be communicated to the rest of the business. This has improved the image of HR and enabled communication in a way that was readily understood by the rest of the business. This was not without challenge for the HR team.

Having established that measuring human capital was a worthwhile task, the CAA then considered how measures might be developed. How would success be measured when, as a not-for-profit service organisation, productivity and profit are not primary drivers? Many different performance measures were tracked throughout the business but none related to the success of the CAA overall. In addition, each business group within the CAA has non-comparable strategic objectives, although they all contribute to the organisation's corporate plan. There could not, therefore, be one overall measure but rather a combination of measures which combined would give an overall picture of the value of human capital.

The CAA set about developing a Balanced Scorecard approach to measuring human capital based on what constitutes their ‘bottom line’ which was translated as:

- external customer perception of CAA performance
- achievement of objectives
- assessment of staff expertise.

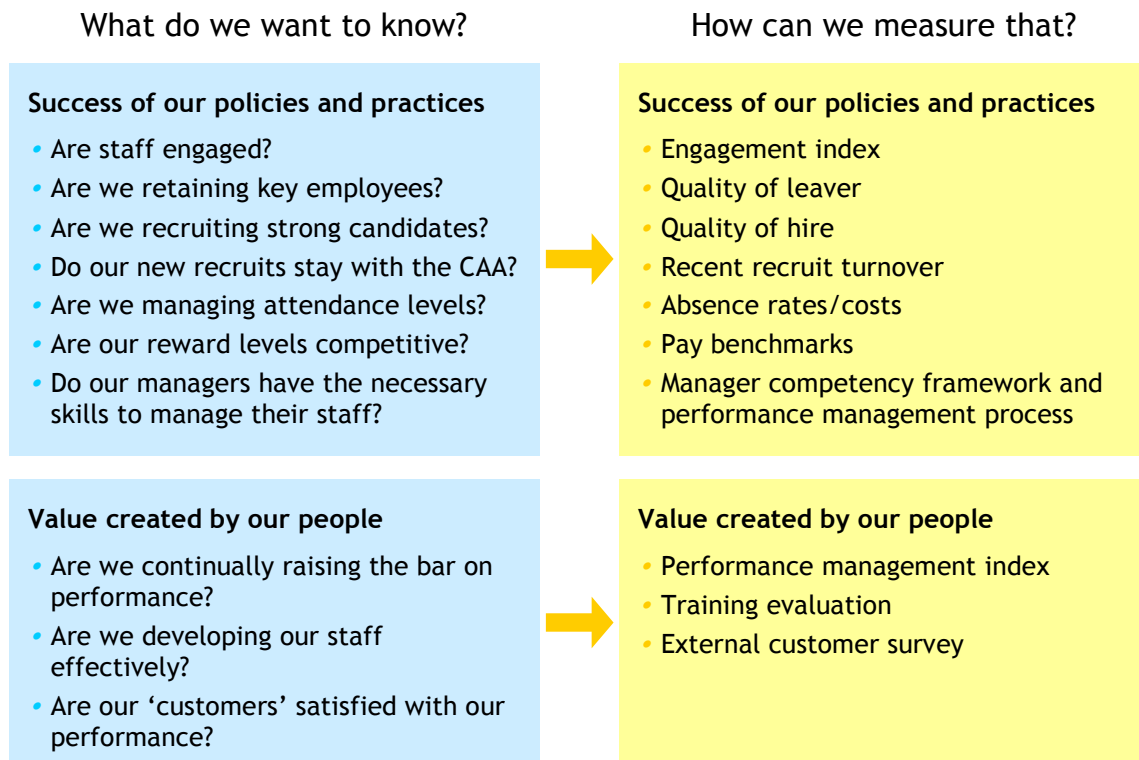
#### 4.2.2 Measures and outcomes

In order to develop usable, practical measures the CAA used an abridged version of the Accounting for People Taskforce’s definition of HCM:

*‘Measuring the value created by our **people, policies and practices.**’*

CAA defined their measures through considering what they wanted to know within these three prongs of the HCM definition, ensuring the constituents of their ‘bottom line’ were included. It was important to CAA that policies and practices should not be limited to initiatives driven by HR but should also recognise work carried out organisation-wide by line managers, senior managers and other functions. From outlining what they wanted to know CAA were able to consider where they might get the answers ie what they might measure. This process is presented in Figure 6.

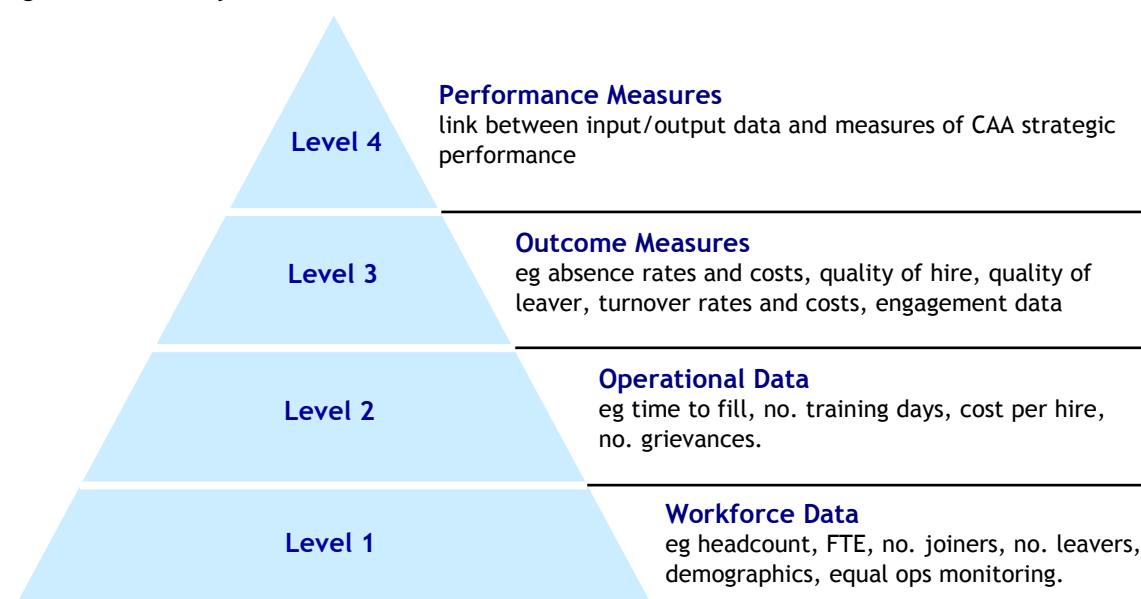
**Figure 6: Questions and measures**



Source: CAA

This first cut definition of measures identified, for CAA, that measures for human capital should be arranged into a virtual 'hierarchy of needs' with the basic workforce data leading onto measures of efficiency measured through operational data, leading to measures of effectiveness or outcomes, with the ultimate pinnacle of measuring organisational performance through linking the other levels of measurement to CAA strategic performance. This is shown in Figure 7, below.

**Figure 7: Hierarchy of measures**



Source: CAA

Like most organisations, CAA have found the fourth level of performance the hardest to define and measure. They are examining correlations between output measures such as engagement, and inputs such as absence, turnover, length of service and training. They are also aiming to identify links between engagement and performance management outcomes such as achievements of objectives and competencies. However, linking individual levels of performance to individual levels of engagement is a work in progress while attempts are made to improve the quality of data coming from performance management where currently there are too many 'ticks in boxes'.

### 4.2.3 Dissemination and use of measures

For CAA, there would be no point in carrying out the measurement of human capital without reporting it to those who are the subject of the measurement. To date, most of the reporting has been internal with consideration being given to external reporting and some progress.

Internal reporting mechanisms have included:

- HR Quarterly Report – delivered to the Board, Managers and HR. The Report contains the HR scorecard and analyses of absence, turnover, learning and

development, resourcing and demographics. The HR Quarterly report is available on the CAA intranet for all staff to access if they wish.

- HR Advisers have access to monthly drill-down reports using specialist software (Cognos Powerplay).
- Drill-down analyses and reporting in response to ad hoc requests, carried out by a central team, is available on all HR metrics as required.

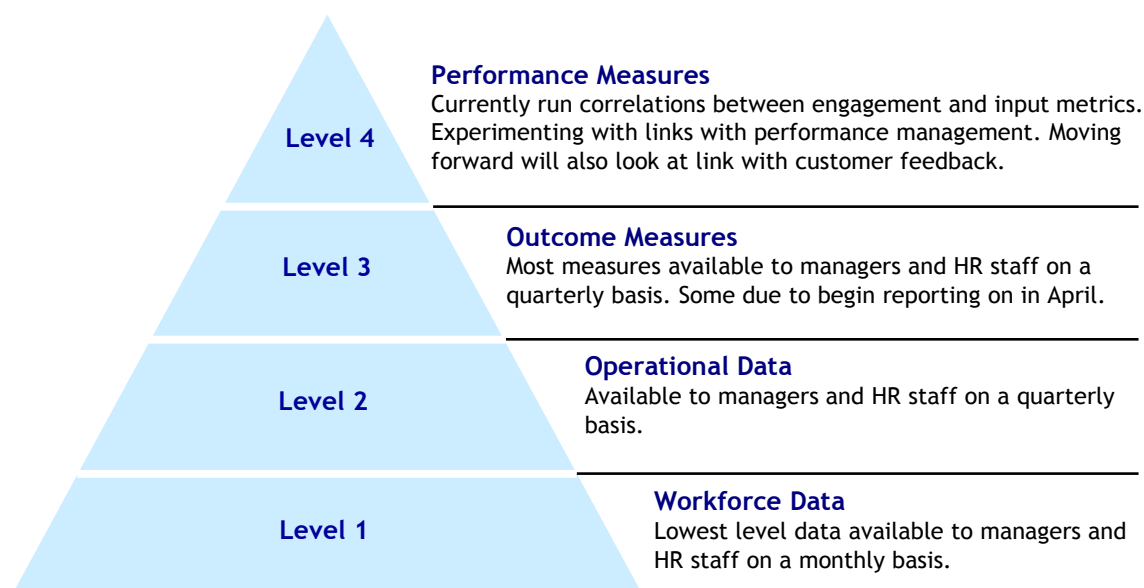
For the future:

- Manager self-service access to reports at group, department and team levels is planned as the next step.

Progress on measurement and dissemination so far is summarised in Figure 8.

Managers' responses to the data were slow to get going but they are now starting to act on the data that is disseminated. HR staff, too, have increased in confidence in using the data in their conversations and dealings with the rest of the business. Amongst managers, this has increased the respect felt for the HR function.

**Figure 8: Measurement progress**



Source: CAA

The external reporting mechanism is currently:

- a selection of HR metrics in the Annual Report.

For the future:

- Publication of human capital data externally, to include:
  - Staff movement report – a staff-focused ‘profit and loss’ style report that tracks joiners and leavers year on year.

- Human capital leverage report – identifies the proportion of CAA costs attributable to staff and the HR department year on year.
- Human capital productivity report – identifies total number of days available to the CAA and how many were worked year on year.

The HR function is starting to work with the finance function in the development and measurement of these reports.

#### 4.2.4 The impact of HCM: challenges and lessons learnt

The CAA spent time up front identifying what they wanted to know, what would impact on the bottom line and therefore what they wanted to measure. This is an important step and puts a focus on what is required rather than what is simply easy to measure. In spite of this, CAA report that data collection and collation still takes time and recommend working with data you have where you can and working towards data that you would like to have.

Introducing HCM is not a quick process. For CAA it took a while for HR to embrace the approach, let alone the rest of the business. HR were also faced with the prospects of capturing, analysing and researching data and with using IT which represented some challenges for both mindset and skill.

While it took managers a while to use and embrace the data, once they did they wanted more of it and CAA warn to be prepared for this increasing desire and capacity to use data once the approach to HCM kicks off.

To get initial buy in from the Chief Executive and the Board, HCM was presented in terms of supporting being a 'high performing organisation' and contributing to the ability to measure strategic success. This enabled HCM to be presented as an enabler of strategic objectives, facilitating buy-in.

## 4.3 Standard Chartered Bank

Standard Chartered Bank is one of the world's most international banks, employing 74,000 people in more than 70 countries across Asia, Africa and the Middle East. With a history of more than 150 years, Standard Chartered operates in many of the world's fastest growing markets. Listed on both the London and Hong Kong Stock Exchange, Standard Chartered is consistently ranked in the top 25 FTSE 100 companies by market capitalisation in the UK. The Bank's headcount has more than doubled in the last three years through both organic growth and acquisition.

### 4.3.1 The approach Standard Chartered took to human capital measurement (HCM)

Rigorous and robust human capital measurement (HCM) and management allows the Bank to build people capability to deliver financial performance and achieve the Bank's growth aspirations. People may be the most important asset of an organisation, but they are also the least predictable. Therefore, it is critical to know that resources are appropriately allocated and that investment is made in the areas which will make a tangible impact on performance.

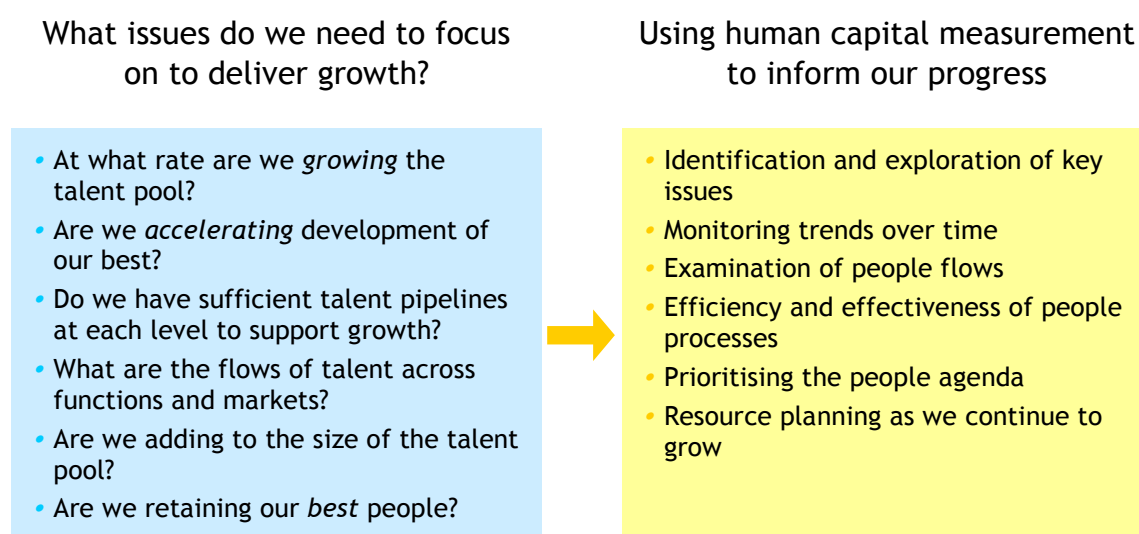
Using comparable, standardised, and robust data provided through the global management information system and HR Shared Service Centre in India, the Bank are able to provide deep insights into people issues to enhance business decision-making through the Human Capital Scorecard. Introduced in 2005, Scorecards are produced for each business unit and country and provide consistent people measures to help each area of the Bank to:

- plan resourcing to meet growth aspirations
- identify and explore key issues, eg attrition
- inform business decisions by evaluating risks and prioritising focus
- monitor progress on strategic imperatives, eg Diversity and Inclusion
- track trends over time.

In determining what data to report on, the Bank focused on what measures answer key questions about the effectiveness of people processes and their impact on business performance. This goes beyond what could be measured, to what would provide the most insight into strategic priorities, challenges and opportunities (Figure 9):



Figure 9: How measurement can help monitor and inform



Source: Standard Chartered Bank

### 4.3.2 Measures and outcomes

Standard Chartered's Human Capital Scorecard contains key measures of people-related data, eg capacity for growth, talent mobility and retention of talented employees. An internally-developed automated software process enables the Bank to produce dynamic slides from raw employee data in less than 40 seconds, implemented at no cost. At the Scorecard's inception, it took 1.5 days to produce each scorecard.

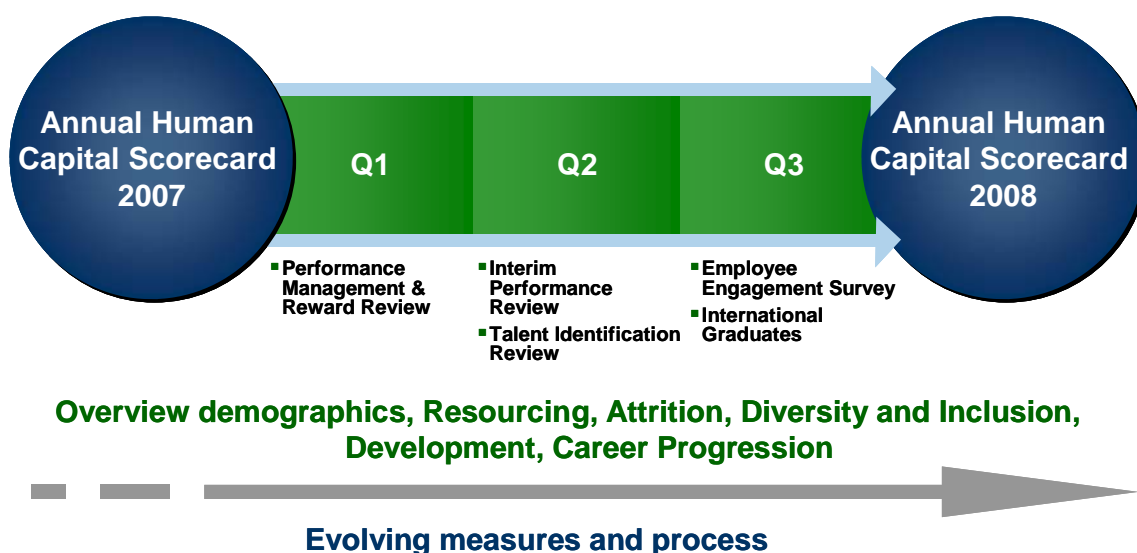
In addition, the Bank has developed an online portal to distribute the scorecards to country CEOs, global business heads and senior management teams. The portal was also developed internally at no cost and is accessible through a secure online website accessible from any of the Bank's markets. It has a user-friendly interface and enables access to all scorecards (including for previous quarters/years) and other business unit and country scorecards for internal benchmarking purposes. Also held on the link are definitions and calculations of each of the measures and a survey to collate regular feedback from users. Further drill-downs of the data can be received immediately from the human capital team where required.

The small team are responsible for designing, automating and distributing the Scorecards, as well as providing ongoing analysis, education/support in interpreting and applying the data and best practice sharing between HR teams across the Bank of how to use the data. Scorecard data is analysed in each country or business context by global organisation effectiveness teams providing strategic support to global businesses and local HR teams who support managers in each market.

The Human Capital Scorecard is produced quarterly and the measures differ by quarter to ensure they are aligned to the HR calendar, eg performance management

and reward in Quarter 1, interim performance management and talent identification data in Quarter 2, and employee engagement survey data in Quarter 3. Key measures such as resourcing, attrition and diversity and inclusion data feature in every scorecard (Figure 10, below):

Figure 10: Human Capital Scorecard



Source: Standard Chartered Bank

#### 4.3.3 Dissemination and use of measures

The Human Capital Scorecard provides detailed insights into how well the Bank is managing people capability and provides early warning signals of areas that need to be improved before they become major challenges. The scorecard enables the business and HR together to make better decisions, such as how quickly talent should be moved around the business and whether or not the Bank is accelerating the development of employees classed as high potential.

There are numerous examples of how the Human Capital Scorecard and analysis have provided rigor and data quality to processes and interventions which have made a quantifiable difference to business performance. For example:

- **Strategic Planning Agenda (SPA)** – The SPA is an in-depth annual review by each business and function head with the group chief executive to review their respective people plans and how these plans support the delivery of business strategy. The SPA is underpinned by the data and analytics in the Human Capital Scorecard which bestows rigor to the people discussions enabling the Bank to better optimise its investment in people. The discussions form the people agenda for the following year for which they are all accountable.
- **Induction** – The Human Capital Scorecard identified an issue of a relatively high rate of employees leaving within a year of joining the Bank. As a result, induction

became a priority for HR and a group-wide induction process was launched. New hire turnover has now decreased by 18% since first reported in the scorecards.

- **Retention Management** – The Bank’s key growth markets are susceptible to comparatively high rates of attrition leading to increased costs, operational risk, customer impact and strain on remaining team members. The Bank has combined attrition data with qualitative data analysis to understand the root causes of attrition and drivers of retention in order to develop a retention strategy and track the results. This work is being implemented in India, United Arab Emirates (UAE) and China.
- **Employee engagement** – The Bank has measured employee engagement for the last eight years using the Gallup Organization’s Q12 survey. Internal research has established that employee engagement is a lead indicator of a range of business performance outcomes, including higher profit margin and deposit growth, higher transactions per teller, and lower employee attrition.

While Standard Chartered have chosen not to rely on external benchmarking because of the Bank’s unique position, HCM has enabled comparison and benchmarking between internal business units and between countries. External visibility of HCM is increasing and the Bank reports key data in the Annual Report and Sustainability Review each year which attracts increasing interest from investors.

#### 4.3.4 The impact of HCM – challenges and lessons learnt

Like other organisations, Standard Chartered have attracted the interest of senior managers through a focus on tying HCM to the organisation’s bottom line. Of course, people vary in their interest in data and numerical analysis in both HR function and the organisation as a whole.

Other challenges Standard Chartered have faced while implementing the approach to human capital include:

- **Measures** – The Bank has strongly resisted reporting what is easy to measure but adds little value. The same applies to measures where the validity of the data cannot be guaranteed, as this would cast doubt on the validity of the scorecard overall.
- **Accuracy** – As the data on the Bank’s management information system data relies on employee and manager self-service, there are sometimes challenges with the accuracy of the data. However, the Bank made the decision to use the Scorecard as a catalyst and incentive to encourage managers and employees to ensure their data is up-to-date.
- **Technology** – The Bank has automated the production of the Human Capital Scorecard. However, the ultimate aim is to deliver the capability to line managers’ desktops to allow them to drill-down within trends. The ability to compare data

trends, such as attrition, at a micro level will help to make managers more accountable for key people measures.

- **HR skills** – A final challenge relates to the skills and inclination of HR practitioners to apply human capital metrics. Measurement capability requires skills not usually associated with HR – analytical, evaluative, and data-rational with knowledge of statistical techniques. The Bank allocated a great deal of time to helping HR managers to interpret the data trends and highlight key issues within the context of their business area.

## 4.4 Royal Navy

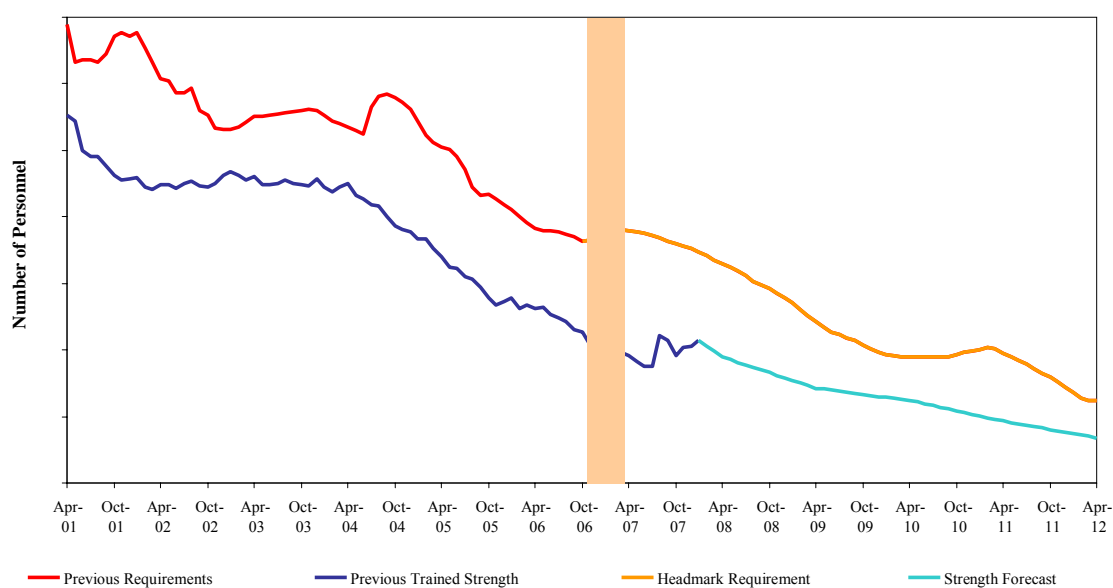
The Ministry of Defence employs 190,000 military personnel and 98,000 civilians, 35,000 of whom are trained regulars in the Naval Service (ie the Royal Navy and Royal Marines). The Royal Navy continues to experience major advances in technology which have resulted in a steady decline in numbers, particularly in the lower ranks. Some of this decline can be managed with the technological changes but some is causing real concern about future human capital resourcing, not least because most Naval Service personnel need to start at the bottom of the organisational pyramid rather than being able to be sideways recruited.

### 4.4.1 The approach the Royal Navy took to human capital measurement

The Royal Navy has taken a specific approach to human capital measurement (HCM), which differs from the other case studies, focusing in particular on the personnel contribution to operational capability (OC) and associated concerns about workforce planning. Within an overall Service personnel liability of 36,400, the current strength is 35,000 which is a headline deficit of four per cent. Although the Service may not be able to afford staffing at full strength, this deficit causes concern, particularly within Specialisations where deficits are far higher than four per cent with a correspondingly high impact on OC. The Royal Navy has therefore focused on the reasons why people are not joining, or more importantly, why they might leave the Service, together with ways of encouraging them to stay.

In addition to this, the Royal Navy endeavours to forecast future liability and strength to enable workforce numbers to be correctly adjusted. This latter approach includes planning ahead for ten years using the ‘headmark requirement’ worked out for every branch/specialisation, rank and rate as shown in example Figure 11, below.

**Figure 11: Royal Navy: Historic and forecast trained strength and requirement: 2001-2012**



Source: DASA(Navy)

Workforce planners then need to work out how to manage the strength to match the requirement within the Royal Navy through:

- gains to trained strength (ie numbers in)
- promotion numbers (ie numbers up)
- longer commission/engagement targets (ie longer contracts)
- extensions of service/acting higher rank/reserves (ie short-term extra manpower).

In parallel with this, the Royal Navy uses a range of mechanisms to best use, encourage and retain its workforce. These range from the ways in which ships can be efficiently manned to specialist pay and financial retention initiatives.

#### 4.4.2 Measures and outcomes

The metrics used by the Royal Navy in their approach to HCM have two purposes. Firstly, they have been measuring the size of the issue – the numbers of personnel required compared to numbers expected. The challenges include managing what has been described as a ‘black hole’ caused by a big reduction in recruitment as the Services downsized due to the ‘peace dividend’ in the 1990s; the corresponding demographic damage is now at the 12 to 13 year length of service point. This, together with wastage and increasingly steep personnel structures caused by the relative loss of more junior posts, becomes even more serious at more senior levels as the pool to feed the senior roles is depleted.

Secondly, the Navy has been ‘taking the temperature’ of their personnel, examining and assessing morale and expectation through a range of mechanisms including continuous attitude surveys and leavers’ surveys. These indicate why people are leaving or why others might not join the Navy.

The impacts of both strands have been recorded by means such as a risk register, or against a range of key performance indicators in a balanced scorecard.

#### 4.4.3 Dissemination and use of measures

Past attitude surveys have found a number of issues which cause both satisfaction:

- security of employment
- the variety of tasks in current role
- adequacy of the training for service job
- current level of job satisfaction

and, dissatisfaction:

- the quality of equipment
- the amount of fun in the service

- ability to plan own life
- effect of Service life on your immediate family.

These have been corroborated by leavers' surveys. Conditions of Service are laid down within personnel functional standards; these are policies and practices such as leave, harmony and fitness, sport and adventure training to ensure they are applied correctly and that they can enhance satisfaction and diminish dissatisfaction as far as possible. Conditions of Service also include financial reward which is kept under constant scrutiny.

#### 4.4.4 The impact of HCM: challenges and lessons learnt

The challenge for the Royal Navy is to deliver the desired manpower component of operational capability while meeting the needs of Service personnel. By fully understanding workforce numbers and future requirement in terms of level and specialisation, and by looking at the impacts of Conditions of Service, the Royal Navy is attempting to fully grasp and address the issues. The balanced scorecard, with its traffic light system, has been one effective approach to keeping the issues visible in quarterly strategic management reports. In addition, the workforce planning team has found presenting data in pictures/graphs and using colours (thereby aligning reporting of HCM to commonly-used capability/effectiveness grades across the Royal Navy) has been popular and effective with busy senior managers.

## 4.5 Ministry of Defence (MoD)

The Armed Forces employ 190,000 military personnel and 98,000 civilians. The civilian workforce comprises 84,000 civil servants and 14,000 locally employed people abroad, across a huge variety of roles from aircraft engineers to accountants, from schoolteachers to policemen, from merchant seamen to media specialists, from nuclear scientists to procurement experts – indeed, almost all categories of employment exist within the Ministry of Defence (MoD).

A complex and federal organisation, the MoD spends around £3 billion per year on civilians. Like most other large organisations the MoD is facing demographic staffing challenges, with an ageing workforce and fewer young people in the labour market. It also faces the challenge of usefully segmenting such a large and diverse workforce.

### 4.5.1 The approach MoD took to human capital measurement (HCM)

The Defence Vision of the MoD is *'Defending the UK and its interests, strengthening international peace and stability: a force for good in the world'*. To that end the MoD wants its staff to be:

- fit for the challenge of today
- ready for the tasks of tomorrow
- capable of building for the future.

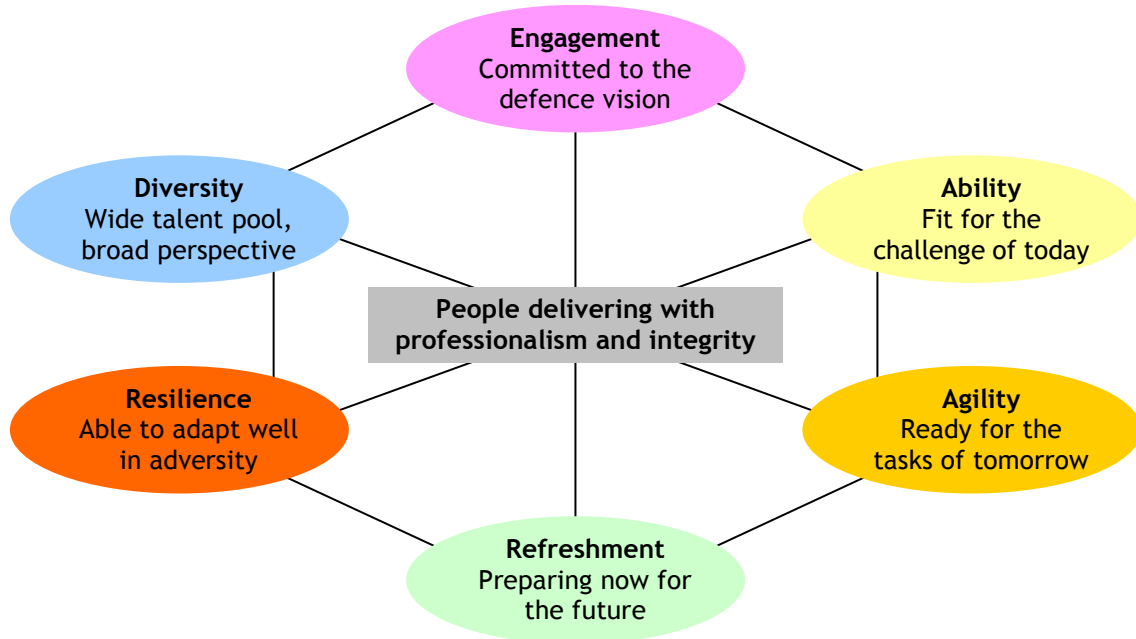
The challenge for HR is *'to ensure that the organisation obtains the maximum return on its investment in people'*. Also key is to ensure that business challenges are supported through people processes. Examples of business challenges are:

- support to operations
- buying and supporting equipment
- the efficiency and change programme (new roles/processes, relocations/mergers, restructuring, partnering).

In 2006, MoD published its Civilian Workforce Strategy which outlined priorities for developing the civilian workforce and priorities for developing civilian HR. This was the first time that MoD had consciously taken an approach of overtly defining and agreeing key workforce capabilities which are shown in Figure 12.



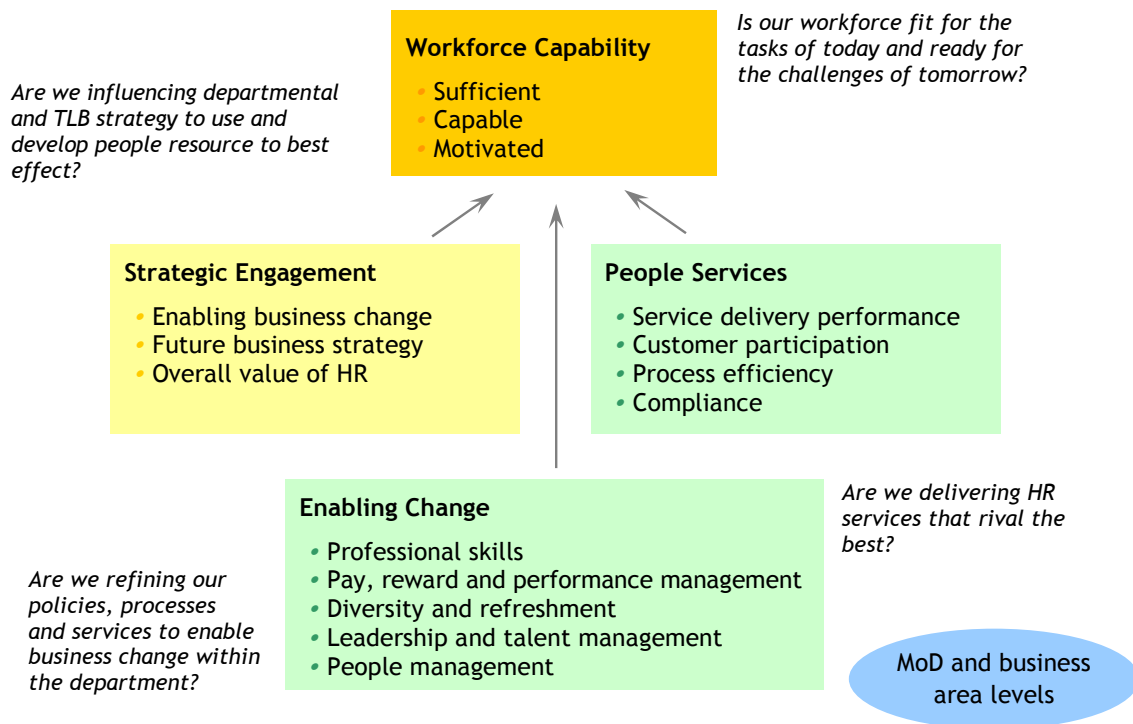
Figure 12: Workforce capabilities



Source: MoD

Also within the Civilian Workforce Strategy was the Civilian Workforce Scorecard which aims to set up a framework for measuring the efficiency and effectiveness of the investment in civilian staff and to monitor these capabilities. The Scorecard blended well with the culture at the MoD which is used to using scorecards and having a red, amber, green traffic light approach. The scorecard is shown in Figure 13.

Figure 13: Civilian Workforce Scorecard



Source: MoD

## 4.5.2 Measures and outcomes

MoD is still developing and refining its measures and its workforce planning and analytics capability. An early approach was to develop a framework showing the Scorecard areas, indicators within those areas and actual measures. Progress against the measures will be shown in a traffic light system, as demonstrated in Table 1, below.

**Table 1: Monitoring Scorecard progress**

	<b>People services</b>	<b>Are we delivering HR services that rival the best?</b>	<b>Y</b>	<b>Overall assessment</b>
	Service delivery (PPPA)		Y	
		SLA KPI 1 – Customer satisfaction	G	SLA % (av over qtr) (customer survey)
		SLA KPI 2 – Responsiveness and availability	A	SLA % (av over qtr) (data and survey)
		SLA KPI 3 – Accuracy of services and advice	G	Ditto
		SLA KPI – Business critical services	Y	Ditto
Example data only	Customer participation		A	
		% line managers completing sift, sift eval, interview, interview eval feedback within 12 days of closure of the advert	R	SLA report
		% staff opting in and out of providing personal info and emergency contacts every two years		MIS report
		% staff with no PDTP		MIS report
	Process efficiency	(under development)		SLA/evaluation against policy
	Compliance		Y	
		Progress towards (PPPA) ISO9001	Y	Design Board – flash

Source: MoD

## 4.5.3 Dissemination and use of measures

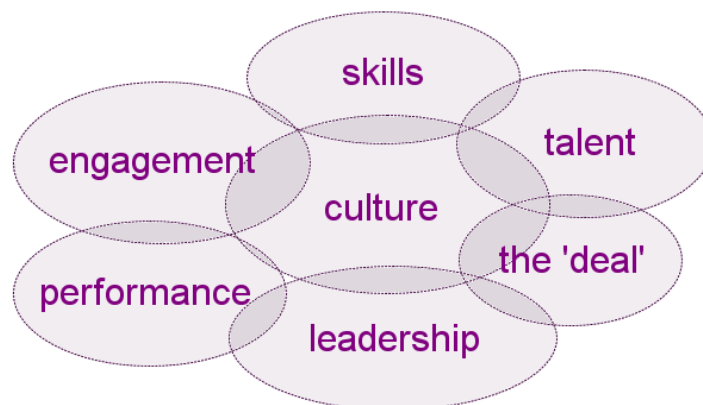
A range of data sources feed the Civilian Workforce Scorecard, including:

- management systems
- service level agreements between MoD Corporate Civilian HR and the People, Pay and Pensions Agency (PPPA)
- management information
- the Civilian Continuous Attitude Survey (last conducted summer 2007).

This continuous process ensures that evidence-based assessment, business-focused improvement and a strong performance regime underpin the measurement approach.

MoD is aiming to extract the human capital elements and demonstrate links between them, from the scorecard. These elements are shown in Figure 14, below.

Figure 14: HC elements



Source: MoD

#### 4.5.4 The impact of HCM – challenges and lessons learnt

MoD has developed a solid framework for HCM and is now preparing to populate it and make it a usable tool. The steps so far have attracted the attention of senior staff which has helped with visibility and acceptance of the approach.

For HCM to have an impact in MoD, the effects and improvements have to be felt by those whom the civilian staff supports, ie the frontline. In order for this to happen, the next steps are to gain a greater understanding of:

- the current workforce – its make up, key elements and capabilities
- planning effectively for future workforce and skill requirements
- the changing/changed world
- the new 'deal' and how to adjust to the individual
- 'talent' – what it is and whose talent is it anyway
- leadership and its role in the link between people and performance
- engagement with the MoD brand
- performance in terms of performance being offered not driven
- the 'value chain' at MoD, given that it is a complex organisation
- possible new operating models.

In terms of lessons learnt, MoD has found it important to use language that chimes with military colleagues, and advises that it is necessary to be prepared to discuss HCM with those who may be challenging or sceptical.

## 4.6 Centrica

Centrica is a top 30 FTSE100 company with growing energy businesses in the UK, North America and Western Europe. Centrica secures and supplies gas and electricity for millions of homes and businesses and offers a distinctive range of home energy solutions and low carbon products and services.

Centrica was demerged from the former British Gas plc in February 1997. The organisation has established itself and continued to invest in a successful energy and related home services business in the UK. Overseas it is building businesses in liberalising energy markets. Centrica employs nearly 34,000 people.

Centrica operates under the British Gas name in England, Nwy Prydain and British Gas in Wales, and Scottish Gas in Scotland, supplying gas and electricity to residential customers. As well as energy, it offers millions of customers an increasing choice of home services. British Gas remains the largest residential supplier of gas and electricity in the UK, and British Gas Business is the number one supplier of energy to the commercial sector in Britain.

### 4.6.1 The approach Centrica took to human capital measurement (HCM)

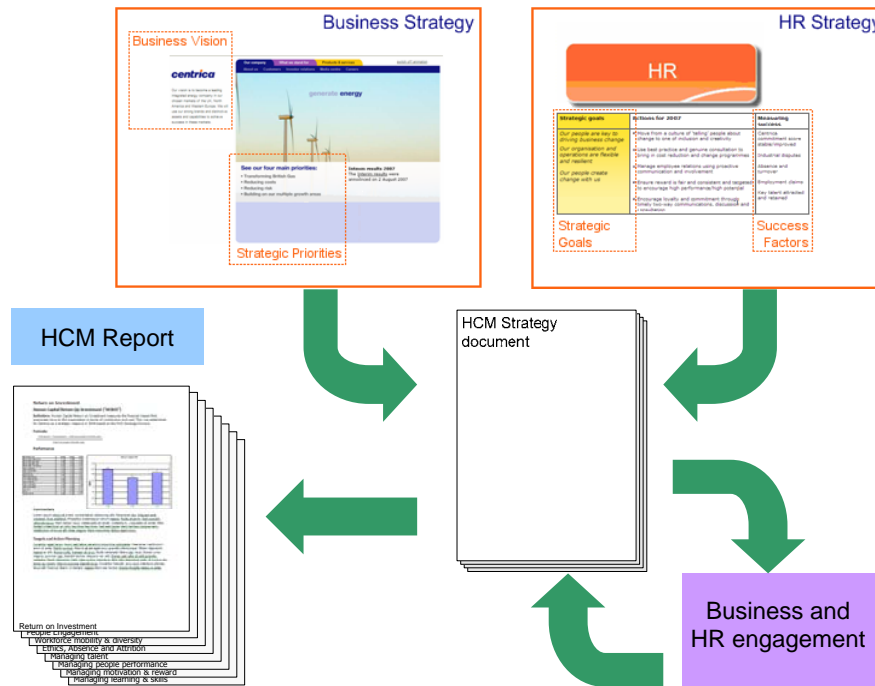
To Centrica, HCM is about:

- the value people bring to the organisation
- the way that people are managed
- the alignment between performance of people and the organisation as a whole
- measuring what is important, not what is convenient.

The Centrica HCM programme began in 2005 as a project forming part of its HR Transformation programme. The first deliverables were produced later that year internally with 'Centrica People Measures', and externally within the Corporate Responsibility report. The HCM programme is now managed by the HR SMO and supported by an outsourced HR services provider.

Centrica's approach to implementing HCM is documented in Figure 15. The company has aligned its business strategy and HR strategy and from those have distilled the HCM strategy document. The HCM strategy, once implemented, should generate both business and staff engagement which in turn will re-inform the HCM strategy moving forward. The measured outcomes from the HCM strategy are documented in the 'HCM Report'.

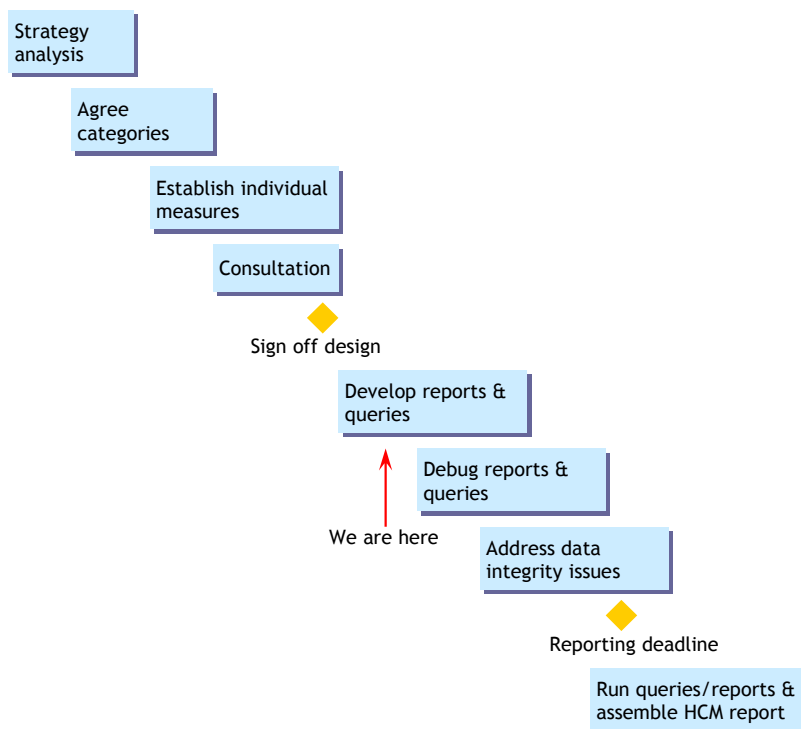
Figure 15: Alignment of HCM with strategy



Source: Centrica

Centrica developed a process for developing its HCM programme which took the company from developing its strategy, through agreeing the individual measures to running reports and queries. The process, and Centrica’s progress through it, are shown in Figure 16.

Figure 16: HCM development programme: progress



Source: Centrica

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## 4.6.2 Measures and outcomes

For Centrica, like many other organisations, the HCM measures were set into a hierarchy with 'hygiene factors' at the base and strategic performance measured at the apex, as shown in Figure 17.

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Figure 17: Hierarchy of HCM measures



Source: Centrica

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The measures themselves were then organised into the following categories:

- return on and skills investment
- people engagement
- workforce movement and diversity
- ethics, absence and attrition
- managing talent
- managing people performance
- managing motivation and reward
- managing learning and skills.

A range of 33 measures was introduced in 2007, with a further seven in 2008.

## 4.6.3 The impact of HCM – challenges and lessons learnt

Centrica recommends a couple of tools that the company found useful in implementing HCM. Firstly, Centrica found it vital to test for strategic fit – checking that each element of strategy had a related measure and that each measure supported

a strategic element. Secondly, it is really important to consider the context and complexity of the measures – ie did the measure exist, had it been used before, how complex was it and what were the resource implications of collection? Finally, Centrica considered data source planning: how accurate or precise did the data need to be, where would the data come from and how good (complete, accurate, timely) would the data be? These considerations helped with planning and refining the measures and facilitated the collection process.

Centrica also identified some key HCM project features which worked well, in addition to highlighting some potential pitfalls.

Working well were:

- high level sponsorship – challenge, support and commitment
- collaboration between HR and Finance
- sound strategic foundation
- focusing on what adds value
- wide engagement
- realistic expectations
- agreement is as important as accuracy.

Pitfalls were:

- temptation to use what is easily available and ‘spray it as HCM’
- data integrity:
  - as an excuse not to think strategically
  - as a potential undermining factor
- paying too much attention to ‘we’ll never achieve this’ players
- limiting scope of thinking to what people think is useful now.

Centrica has two key recommendations:

1. Start simple, but do start.
2. Agreement is as important as accuracy.

## 4.7 East Sussex County Council (ESCC)

East Sussex County Council (ESCC), a two tier Council located in the south east of England, provides services for the region along with the five district councils of Hastings, Rother, Eastbourne, Lewes and Wealden. ESCC delivers services to a population of 500,000 and employs around 16,000 people. There are five departments within the Council, supporting and delivering key services, including more than 190 schools. Within these departments, major staff groups include teachers, administrative staff and social care staff. The job roles within these groups vary widely as well, from social workers to care officers, engineers to rights-of-way rangers, teaching assistants to nursery nurses and librarians to solicitors.

### 4.7.1 The approach ESCC took to human capital measurement (HCM)

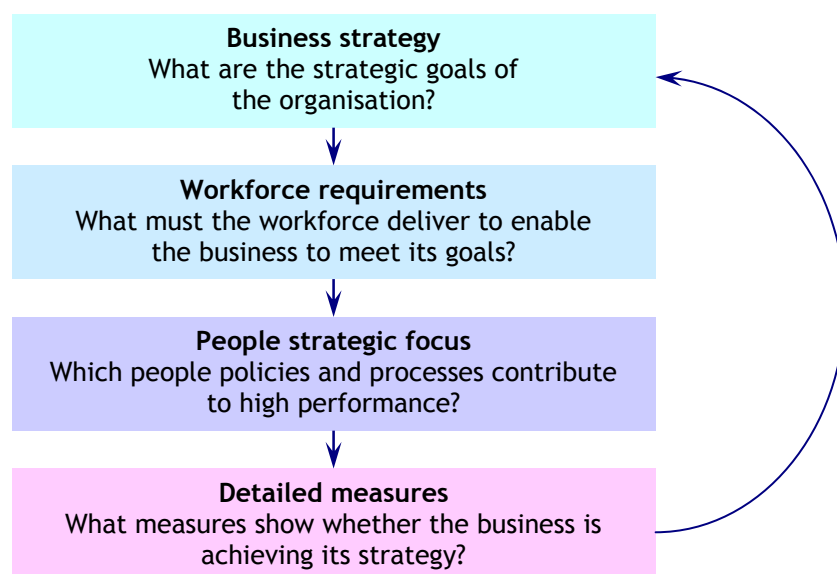
ESCC began by outlining what the organisation wanted to achieve from the introduction of HCM and decided on the following:

- **Aim:** to develop a range of measurements which inform actions that improve the quality of core services linked to high performance during 2007/2008.
- **Desired outcome:** success demonstrated by a measurable improvement in quality of core services and performance as a direct result of using appropriate measures.
- **Planned benefits:** target resources correctly, better management decision-making, measurable link between initiatives and performance, possible cost savings, improved customer service.

Like other organisations, ESCC began by contemplating its strategic objectives, which for ESCC are to make a positive difference to local people's lives, create a prosperous and safe county, and provide affordable, high quality services at the lowest possible council tax. Achievement of these is via corporate monitoring using Best Value Performance Indicators (BVPIs) and local indicators. ESCC then considered how the workforce should deliver in order for these objectives to be achieved, and which people, policies and processes needed to be in place for this to happen. Finally, the organisation discussed the detailed workforce measures which would demonstrate that their objectives were being achieved. The process is shown in Figure 18.



Figure 18: Measurement linked to strategy



Source: Adapted from the Corporate Leadership Council (CIPD Human Capital Panel Report 2006)

#### 4.7.2 Measures and outcomes

ESCC first looked at other organisations to see whether there were standard sets of human capital measures that had already been identified and that would be of use to them. However, although they found that the Audit Commission were developing measures for a range of functions, including HR, finance and ICT, no complete sets were currently available. ESCC did look at data that they provide to a range of bodies, such as:

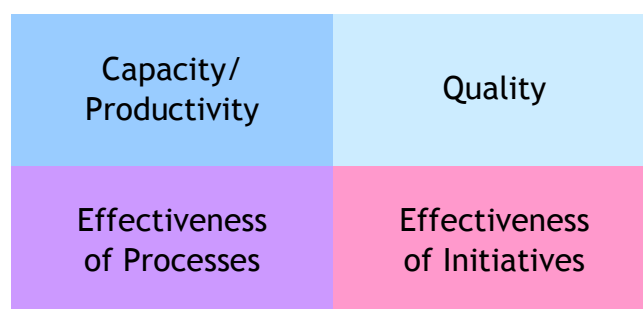
- Personnel Today awards
- Institute of IT training awards
- Best Councils to Work For award
- CIPD benchmarking of recruitment, retention and turnover
- CBI absence survey
- CIPFA benchmark data provision
- data provided to the Audit Commission
- informal contacts with other local authorities where pay and workforce surveys are compared, to see where linkages could be made and where existing data could be used.

The Council also looked to the existing BVPIs used internally throughout the organisation where departments set their own targets through their performance teams. These measures were very useful because they had already been well thought

through, were already being measured and were already being paid a lot of attention through a 'traffic light' system of performance monitoring. A biannual staff survey also provided useful data and ESCC set about trying to link the data to identify correlations and impacts.

ESCC grouped measures under a balanced scorecard, shown in Figure 19, below.

**Figure 19: ESCC balanced scorecard**



*Source: East Sussex County Council*

ESCC decided to pilot their approach on their HR and training function. Personnel and Training became a centralised team in 2003 in the Chief Executive's Department, with around 132 employees. The team comprised six main functions including HR strategy, workforce planning, occupational health/safety and training, professional services and the personnel support unit. Personnel and training applied the principles of human capital measurement to their strategic objectives with the intention of applying experience gained to the development of a set of measures related to the objectives of the organisation, in due course.

The Personnel and Training team developed the following internal HC measures:

- Capacity/productivity:
  - sickness absence by team (days lost and reason)
  - vacancies – no. of days and length of time vacant
  - wastage by team (rate), wastage amongst recruits <1yrs service, total leavers x length of service and grade, high performers x length of service.
- Quality:
  - compliments/complaints
  - key performance indicators
  - exit and engagement questionnaires.

- Effectiveness of processes:
  - recruitment – new process of ‘open day’ and costs
  - new induction process including training.
- Effectiveness of initiatives:
  - HR Academy
  - stress intervention and monitoring.

### 4.7.3 Dissemination and use of measures

Although the full HCM approach has only been trialled in the Personnel and Training function so far, the rest of the organisation has been receiving information for their BVPIs for some time. An annual workforce plan is published and a Council Plan which contains the BVPIs that relate directly to achievement of objectives. Every six months, a workforce profile is distributed to departmental representatives who are on the HR management Board, for use by the departmental management teams.

Some departments are using the data more effectively than others. For example, Adult Social Care and Children’s Services are identifying recruitment issues and ‘hot spots’ and looking at their own development and skills and workforce plans.

Within the Personnel and Training function, the data generated by the HCM approach is being used to calculate outcomes and the bottom line impact – for example, absence and attendance data is being analysed against productivity levels and the costs of providing cover. The team are finding it helpful to begin to be able to ‘prove the value of HR’ in this way. Figure 20 provides a selection of the sort of data that Personnel and Training are producing.

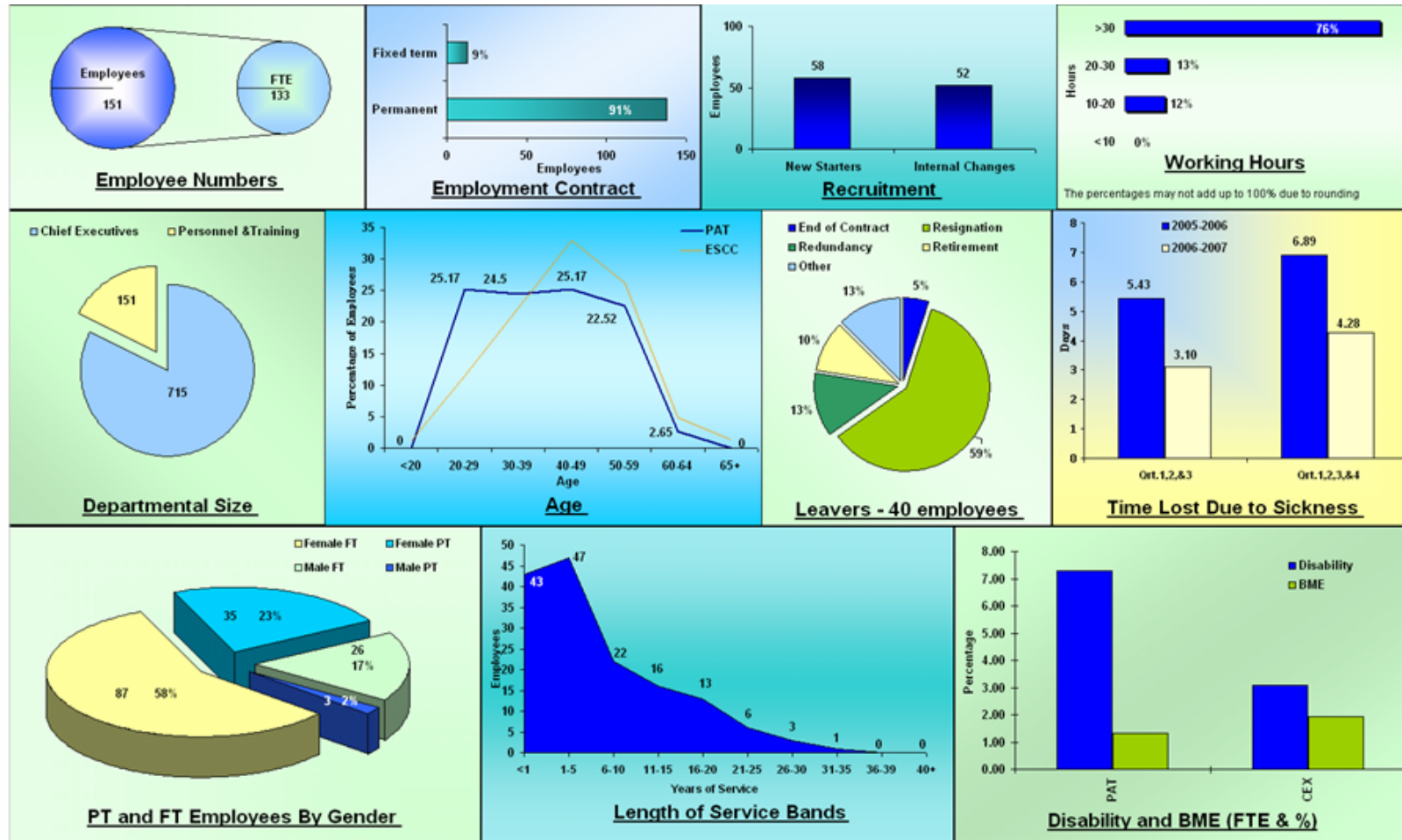
### 4.7.4 The impact of HCM: challenges and lessons learnt

The staff at ESCC have been relatively geared up for the messages of HCM as they have been measuring their BVPIs for some time and are used to looking at data and assessing its implications. For the Personnel and Training team who have piloted the full HCM approach it has been valuable to begin to take the data a step further and to look specifically at the costs and organisational implications of HR measures. The next step is to roll out the approach to other functions.

Like other organisations ESCC have found that, once used to data, managers’ capacity for it and their desire for detail increases, so it is important to anticipate that.

Another advantage for ESCC and the Personnel and Training function in particular, is that people (including HR people) are IT literate. SAP has been used since 2005 and good databases have been in place since the 1980s. Employee and manager self-service to update data will shortly be introduced.

Figure 20: Personnel and training workforce profile summary (2006/2007)



The charts illustrate a range of data relating to PAT, taken as a snapshot at 31 March 2007 with recruitment and leaver information for 2006/07. Employee numbers increased by ten from the start to end of the year although this is due to filling of vacancies rather than growth. The 52 internal changes were promotions, transfers, redeployment, secondments and acting up arrangements. The majority of staff are full time, unlike the Council as a whole, with 81% being women, higher than the council at 78%. The level of sickness absence has decreased over the year by 38%, from 6.89 days lost to 4.28 days lost per fte, a very good reduction. PAT employs 7% disabled staff, almost as high as ASC, the top department, recording over 7%. The age profile shows a workforce spread fairly evenly across the age bands, with more younger staff than for the Council as a whole. The average age is 40 compared to 44 in the Council. The average length of service is 6 years compared to 7.5 years in the Council. The majority of employees (74%) have 10 years' service or less with very few employees having more than 20 years' service.

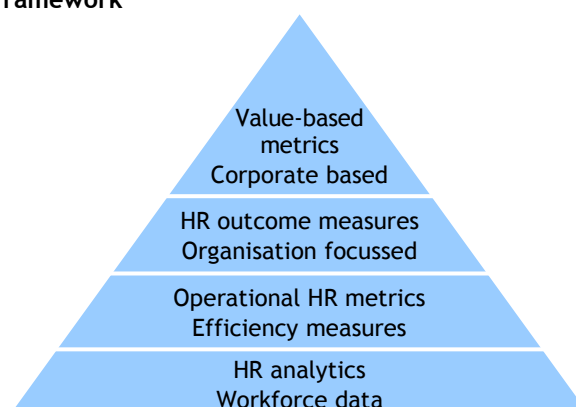
## 4.8 Haringey Council

Haringey Council is a north London Borough Council providing services for a population of 225,000 people over 11 square miles. The community is ethnically diverse with 160 languages being spoken. The Council itself employs 8,500 staff of whom 45 per cent are from a black or minority ethnic background. Described as an outer London Borough with an inner London challenge, Haringey ranks as one of the most deprived boroughs in the country with 7.7 per cent of the economically active population registered unemployed – more than twice the British average. However, the Borough is undergoing regeneration with a large injection of funding from Europe. Haringey is divided into two Parliamentary constituencies, Hornsey and Wood Green (Liberal Democrat) and Tottenham (Labour).

### 4.8.1 The approach Haringey Council took to human capital measurement

With an established history of collecting and distributing data and workforce metrics through the SAP system, Haringey is one of the leading London boroughs for workforce metrics. As such, the Council was approached by London Councils (the regional employer organisation representing all 32 London boroughs) to develop an HCM approach that might be shared with the other London boroughs. Haringey's participation in the IES HR Network project was via London Council's membership of IES. Haringey was keen to approach HCM using as many of its existing HR data sets and metrics as it could. Aiming to use an HCM approach to demonstrate organisational effectiveness in managing people and to provide evidence of value for money, Haringey was influenced by the approach to HCM taken by the CAA. The CAA had developed a framework whereby workforce data was built up through operational HR measures and HR outcome measures to demonstrate corporate achievement and Haringey utilised this approach as shown in Figure 21, below.

**Figure 21: Measurement framework**



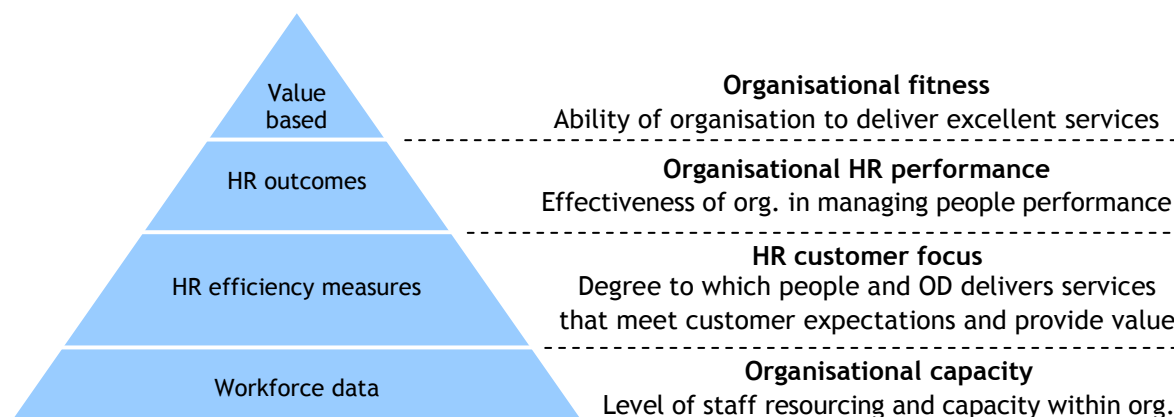
*Source: Haringey Council*

Haringey has a dedicated metrics team and uses SAP to gather data and monitor metrics on HR, payroll, finance and procurement. The HR team has full access to this and managers can access data about their own staff. Employee/manager self-service is currently being considered.

## 4.8.2 Measures and outcomes

For each stratum on the organisational pyramid – with workforce data at the base and organisational outcomes at the apex – Haringey developed a broad definition of what each level meant to it in an HCM context, as shown in Figure 22.

**Figure 22: Adding meaning to the framework**



*Source: Haringey Council*

From these definitions, the HR metrics team at Haringey found the actual HC measures easy to define and found that existing measures were sufficient in most instances with some additional measures (such as return on investment from training) identified as ‘would like to have’ but not critical, and possible to work towards. The measures developed by Haringey within each definition were:

### **Organisational fitness**

Measures include: customer satisfaction, ROI measures, staff performance levels/competency, resource/capacity measures indicating good employer.

### **Organisational HR performance**

Measures include: employee satisfaction, sickness absence reporting, disciplinary/sickness actions, number of days suspension, appraisals conducted, Employment Tribunal claims.

### **HR customer focus**

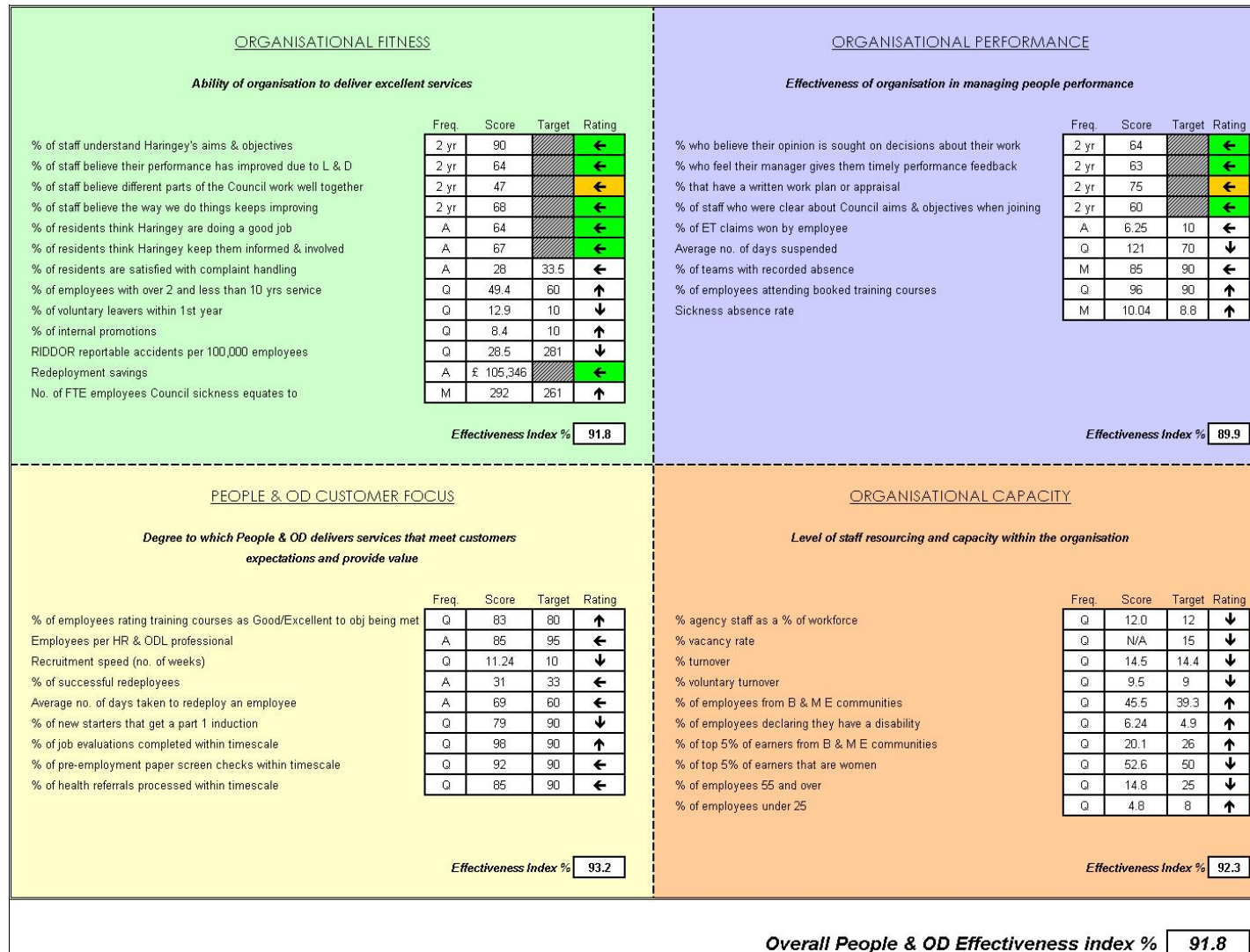
Measures include: HR Customer satisfaction surveys, HR costs/capacity, recruitment speed, HR performance measures, training programme success, redeployment success.

### **Organisational capacity**

Measures include: vacancy rates, turnover rates, workforce profile (ethnicity, disability, age, etc.), agency staff.

Haringey Council has organised the measures into a scorecard, with a traffic light system to indicate areas of success and areas of concern, as shown in Figure 23.

Figure 23: Haringey Council’s People and OD Scorecard



Source: Haringey Council

The Council is also converting the scorecard measures into management statistics showing, for example, sickness absence days by individual managers; and also staff turnover is being linked with grade and length of service to show some interesting patterns which HR can then consider and address.

### 4.8.3 Dissemination and use of measures

#### Internally

Managers have long been able to access data relating to their own staff from the SAP system and over time use has gone up and queries have gone down. HR staff have also become used to challenging and querying managers on the timeliness, quality and messages given by the data.

The scorecard data are reported periodically to lead councillors and the Chief Executive and annually to Council committee through the HR Strategy Update and the Annual Employee Profile reports.

Quarterly, key elements from the scorecard are circulated to key managers (eg heads of service) and HR business partners, and the metrics team are beginning to drill the data down to an individual level for reports, for example, on sickness absence. These reports are welcomed and appreciated by the managers concerned.

Using the scorecard as a platform, the HR team has continued to build on its success by producing other reports aimed at highlighting organisational goals and driving performance. The 'Haringey Manager Performance Rating', for example, uses additional measures, as well as those within the scorecard, to rate the top 100 managers. The intention is to create a league table for people management performance amongst managers, with the focus on improving those in the bottom quartile of performance.

In another example, the 'People Management Metrics report' was created, to track key business-related people-management measures over time, such as the number of agency staff, agency costs, sickness costs, suspension costs, number of staff on training etc., and to benchmark these against the directorates and Council performance. This report has been well received and is now used to challenge directors on the people management issues in their directorates at the same time as budgetary matters. Therefore this report has helped to put human resources on an equal footing with finance in the Council.

#### Externally

A range of benchmarking with other London boroughs is undertaken via London Councils, and the scorecard metrics have helped with this. A presentation of the scorecard was made to the London Councils Workforce Intelligence Group and was well received, with some boroughs indicating that they plan to adopt the framework



themselves. A further presentation is planned soon to Heads of HR in the London boroughs.

The scorecard has also been shared with the National Audit Office who is looking at it as a potential exemplar framework for use with the new value-for-money HR indicators within the local government Comprehensive Area Assessment, which is reported annually to the Government and reviewed regularly by the Audit Commission.

#### 4.8.4 The impact of HCM – challenges and lessons learnt

The HCM approach has, for Haringey, put a focus on developing links between data items. This is a natural next step for an organisation already comfortable with using and circulating data.

Like other organisations, Haringey has focused its development of HCM on data that were already being collected, and on identifying gaps and aspirational items to work towards. This has made the development of HCM more straightforward for the Council.

Haringey has been keen to identify terms and phrases that managers would relate to and feel comfortable with and have found 'workforce intelligence' and 'metrics' more useful than 'statistics'. Also, the term 'human capital measurement' is not popular so the Council has focused on 'management information' and 'HR metrics' to ensure managers will use the data, being comfortable with what it represents.

Being responsive to the needs of senior management, and 'pushing out' insightful metrics, has increased the organisation's focus on, and demand for, workforce intelligence.

## 4.9 Medway NHS Foundation Trust

The Medway NHS Foundation Trust (the Trust) is one of four hospital trusts in Kent and Medway. Employing over 3,550 staff, its main focus is to run the hospital in Gillingham. Medway is characterised by a highly populated urban area situated around the Medway estuary to the north, and to the west lie substantial rural areas. It is one of the largest urban conurbations in the South East outside London. The Trust is proud of its achievements in recent years and looks forward to providing further improvements. The hospital is continuing to expand and will become the centre for vascular surgery across West Kent. It is also developing a urology cancer centre across Medway and Dartford and last year, the Trust opened a new cardiac catheter suite so that local people can receive these services locally rather than having to travel to London.

### 4.9.1 The approach Medway NHS Foundation Trust took to human capital measurement (HCM)

Before 2001, the Trust provided its workforce data in its Annual Board Report. Workforce profile areas covered were:

- staff group
- ethnicity
- turnover
- age profile
- sickness absence
- workforce supply.

The Trust recognised that annual reporting was insufficient for close monitoring and, more importantly, that the profile was treated as a retrospective snapshot rather than proactive management information that could be acted upon.

The Trust therefore looked to redesign its Board Reports and have done so in two phases, which are explained below.

### 4.9.2 Measures and outcomes

From 2002 to 2006 the Trust developed a range of measures to inform the Board Report which was produced quarterly rather than annually as before. Measures were:

- recruitment and retention (turnover, vacancy rate, agency expenditure)
- sickness absence (by staff group/directorate, short-term and long-term, number of ill health retirements, reasons for sickness absence)

- appraisals (including consultant appraisal)
- induction and mandatory training
- hours compliance (junior doctors hours).

The quarterly reporting enabled comparison between quarters and proactive identification of trends.

The key performance indicators (KPIs) listed were chosen for a range of reasons, including:

- local need for HR reporting
- local need for information from clinical and non-clinical directorates
- local need for information from a performance perspective, and the ability to rate as 'red, amber or green' against Trust and national targets
- national need = 'The Intelligent Board'
- Foundation Trust status (business approach).

In 2004, the Trust further broke down the level of reporting for the KPIs. In addition to sickness absence, which was already reported on a directorate level, the other KPIs were also reported by directorate. Employee relations were added as a further area for reporting.

The Trust's detailed approach was submitted for a national award.

The second phase of the reporting redesign, from 2007, was prompted by both external and internal factors. Externally, new national pay scales were introduced, as was new national coding of staff groups and a new national HR/payroll system. Internally, Non-Executive Board members had become very enthusiastic about the production and use of HCM data. The Trust, like other organisations, found that once people got used to the data and understood it, their desire for more grew and grew. In addition, the Trust was aiming for Foundation Trust status and wanted to develop the most business-like approach possible.

From February 2007 HC measures have included:

- economic and external workforce data (now presented not to the Board, but to another committee)
- KPIs – headcount and salary bill, sickness absence, appraisal, turnover, statutory compliance; (quality of leadership and staff engagement indicators are being developed).

The new HR strategy and targets form 19 pages of the Board Reports.

In April 2007 the Trust took the performance reporting a stage further with exception reports for any KPI coded as red on the traffic light system.

### 4.9.3 The impact of HCM – challenges and lessons learnt

The HCM approach that the Trust has adopted has increased the confidence of managers in data quality and the role of the HR function. It has also linked HR, financial and activity data and brought HR into the centre of the organisation.

The data collected supports the Trust's plans of:

- first choice for patients and staff
- working to make a difference
- leadership scorecard.

The Trust is more competitive and cost effective with an enviable reputation.

For the future, the Trust is planning to continue to refine and validate the information and further link HR, financial and activity data through IT, which will lead to more improvements in management information.

In terms of challenges and lessons learnt, an initial challenge about the validity of data from directorates was resolved by debate and then getting the directorates themselves involved in the data collection. The Trust also recognised and accepted that performance against targets was not always fully within its control.

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## 5 Scan of Human Capital Measurement Activity

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As part of the workshops facilitated by IES, a brief review of the literature was also conducted on the activities taking place in the UK and abroad on the topic of Human Capital (HC) measurement. This chapter refers to the main findings from the review conducted for this project.

The following search terms were used for the review:

- human capital measures, HC indicators, HC metrics
- human capital measurement
- people metrics
- balanced scorecard people measures
- workforce measures
- key performance indicators for workforce.

The key findings of the search were that:

- Human capital is not a new but popular concept.
- There has been a wide range of interest on the concept from academics, consultants, politicians and business people.
- The general consensus among these groups is that although human capital is frequently discussed, it is poorly measured. However, there seems to be a lot of consistency in activities taken up in the measurement of HC.
- The main reason for its poor measurement is that HC encompasses attributes or variables which are *intangible*.

- What seems to add to the complexity of measuring human capital is that it has many dimensions and it is often difficult to decide what aspects of HC should be measured.
- Internationally, there has also been a great deal of research and consultancy-based activities on HC measurement, especially in America, Australia and New Zealand, and also in Sweden, Finland and Denmark.
- The Organisation for Economic Co-operation and Development (OECD) has been very active in this area and their definition of human capital (1996) as *'the knowledge that individuals acquire during their life and use to produce goods, services or ideas in market or non-market circumstances'* has been widely used in many studies concerning human capital.

## 5.1 Human capital – how it came about

Human capital (HC) is not a new concept, as economists have long recognised that people are an important component of the wealth of nations (Le et al., 2005 cited Smith, 1776)<sup>8</sup>. Interest in HC revolves around economic growth and who better to focus on this growth than economists. Le et al. (2005) point out that, traditionally, the focus on creating more economic growth was to give workers access to more physical sources, like land, factories and machines. However, modern theories of economic growth emphasise human capital in their explanation of growth so the focus has shifted from 'physical capital', which was no longer enough to explain economic growth, to 'human capital'.

Most of the academic reviews seem to point to Schultz' (1961)<sup>9</sup> paper as having the main influence in sparking the revival of interest in the notion of human capital. In his paper, Schultz classified skills and knowledge that people acquire as a form of human capital. There have been other definitions since then. For example, the Penguin Dictionary of Economics defines HC as *'the skills, capacities and abilities possessed by an individual which permit him to earn income'*. The OECD's definition extended HC to include non-market activities as *'the knowledge that individuals acquire during their life and use to produce goods, services or ideas in market or non-market circumstances'* (1996). Although this definition has been widely used by many academic as well as non-academic studies, there has also been a more recent version of the definition by the OECD (2001)<sup>10</sup>, which provides a broader definition of HC as *'the knowledge, skills,*

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<sup>8</sup> Le T, Gibson J, Oxley L (2005), 'Measures of human capital: a review of the literature', New Zealand Treasury, *Working Paper 05/10*, November.

<sup>9</sup> Schultz T W (1961), 'Investment in human capital', *American Economic Review*, Vol. 51(1), pp. 1–17.

<sup>10</sup> OECD (2001), *The Well-being of Nations: The Role of Human and Social Capital*, OECD, Paris.

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*competencies and attributes embodied in individuals that facilitate the creation of personal, social and economic well-being*'.

According to modern theories of economic growth (as explained in Le et al., 2005), HC can boost growth through stimulating technological creation, invention and innovation, as well as facilitating the uptake and imitation of new technologies. Empirical studies, mostly by economists, have sought to establish a link between HC and economic growth and although some reported a positive relationship, others have failed to validate this claim. Therefore, the hypothesis that HC plays a significant role in the growth process is not empirically validated.

## 5.2 Measures that followed ...

The definitions of HC indicate that HC is *intangible*, not directly observable as that of physical capital and therefore proxies have been used to capture key elements of HC. The mixed evidence on the positive relationship between HC and economic growth raised the concern that HC has been poorly measured.

The literature on HC measurement identifies three general approaches; cost-based, income-based and education-based (Le, Gibson and Oxley, 2003)<sup>11</sup>. The 'cost-based approach' very crudely estimates human capital based on child rearing costs to one's parents, while the 'income-based approach' estimates the money value of a human being by calculating the present value of the individual's future earnings net of personal living expenses. The 'education-based approach' is different from the 'conventional' approaches which measure capital by cost or by yield; this approach estimates HC by measuring educational output indicators, such as literacy rates, enrolment rates, dropout rates, repetition rates, average years of schooling in the population, and test scores. The underlying assumption in this approach is that these indicators are closely related to investment in education and that education is a key element in HC formation. Educational measures are therefore proxies for, not direct measures of, human capital.

HC encompasses more dimensions, but education has been the most crucial component, as education can enhance financial as well as personal well-being at both micro and macro levels. In education-based approach, 'years of schooling' and 'formal educational attainment levels' have been commonly used in the earlier cross-country studies, regardless of their actual productive capacity. But more recent studies emphasise that earlier studies made no allowance for the difference in quality of education over time and across countries. There have also been other criticisms which pointed out that average years of schooling completely ignores all the HC elements other than formal schooling, including health, on-the-job training, informal schooling

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<sup>11</sup> Le T, Gibson J, Oxley L (2003), 'Cost- and income-based measures of human capital', *Journal of Economic Surveys*, Vol. 17(3), pp. 271–307.

and work experience. Individuals acquire knowledge in various ways, including at home, at school, at work and so on and therefore using 'average years of schooling' treats uneducated individuals as having no HC, even though in practice they are economically valuable, as long as they participate in economic production.

On the whole, the education-based measures of HC have the advantage of being easy to quantify and of good international data coverage. These measures give a rough estimate of how much human capital a country has. However, they do not adequately reflect key aspects of human capital, as the quality aspect is overlooked.

Although the cost-, income- and education-based approaches to HC measurement seem different, they are not independent of each other. As Le et al. (2005) state,

*'... the inputs in the human capital production process, including the costs of rearing and educating people, form the basis for the cost method. The income method builds on individuals' earnings, whereas such indicators as literacy rates, school enrolment rates, and mean years of schooling have been widely used as education-based measures of human capital.'* (p. 30)

Le et al. (2005) also point out that there has been a radical change in the motivation behind HC valuation. Early measures of HC were more concerned with demonstrating the power of a nation, with estimating, in monetary terms, human loss from wars and plagues, and with developing accurate estimates of human wealth in national accounts. Recent focus in HC valuation has been switched to using HC as a tool to explain economic growth across countries. HC is believed to play a critical role in the growth process, as well as producing positive external effects, such as enhanced self-fulfilment, enjoyment and development of individual capabilities, reduction in poverty and delinquency, and increased participation in community, social and political affairs.

With such an ambitious agenda behind HC measurement, one could see how and why HC has become a common piece of jargon not only in academic circles but also among politicians, business people and the media. Employers recognise the importance of human capital in today's business and there is a strong desire among employers to improve their business by improving human capital management. More and more organisations acknowledge that their companies' poor performance may be due to poor management of their bottom line.

Taken together, the literature review on human capital measurement suggests that the concept of HC is rather complex and it encompasses attributes or variables that are intangible. Therefore, the measurement should take this into consideration.

### 5.3 International activities

There have been a great deal of academic, as well as consultancy-based research activities on human capital measurement in Australia, New Zealand and the USA.



These activities cover very similar discussion and literature grounds that have been discussed above, in terms of the definitional issues and the history of the concept.

There have also been high levels of interest in the concept of HC and the related measurement issues in Scandinavian countries, especially in Sweden, Finland and Denmark.

As an organisation which provides a setting where governments compare policy experiences, seek answers to common problems, identify good practice and coordinate domestic and international policies, the Organisation for Economic Co-operation and Development (OECD) has also been very active in the area of human capital. Their definitions (the 1996 and 2001 versions, given at the beginning of this chapter) have been used in many academic and policy-related studies.

### 5.3.1 European Human Capital Index (HCI)

In 2006, a study by two European think tanks<sup>12</sup> – the Lisbon Council and Deutschland Denken – sought to classify the European countries by measuring the knowledge capital and the increase and decrease in knowledge capital in 13 EU countries. Specifically, the study measures human capital stock, deployment, utilisation and evolution in these countries and ranks them by their ability to develop their HC to meet the challenge of globalisation. It predicts major challenges for key European countries, such as Germany and Italy that do too little to invest in and develop their HC. According to the findings of this study, if current trends are not reversed, citizens of Sweden and Ireland (which invest heavily in their HC) could enjoy a living standard up to twice as high as citizens of Germany and Italy, a trend which would turn the traditional economic hierarchy of Europe on its head.

In terms of its measurement methodology, the European HCI was created to rank the participating countries. The Index defines HC as the costs of formal and informal education expressed in euros and multiplied by the number of people living in each country. Then it accounts for some depreciation, deducting value due to the fact that some knowledge will become obsolete and that people will forget some of what they learn. It also adjusts for ongoing demographic developments, allowing for the loss of HC due to declining populations and shifting employment patterns across the EU countries.

The Index identifies and defines the following four types of HC and analyses the way they collectively contribute to the wealth of European citizens:

- Human capital endowment – measures the cost of all types of education and training in a particular country per person active in the labour force.

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<sup>12</sup> <http://www.urenio.org/2006/11/12/the-european-human-capital-index/>

- Human capital utilisation – looks at how much of a country’s HC stock is actually deployed.
- Human capital productivity – measures the productivity of HC. It is derived by dividing GDP by all of the human capital employed in that country.
- Demography and employment – looks at existing economic, demographic and migratory trends to estimate the number of people who will be employed (or not employed) in the year 2030 in each country.

Each of the four components measured for the European HCI represents one aspect of how HC contributes to the generation of economic activity. To compile the ranking, the researchers scored 13 EU countries in each of these four areas and then they compiled the four scores into a single composite score, giving each country a relative rank within Europe for its ability to develop and deploy its existing HC.

The results shown in Table 2 not only reflects today’s situation but also takes account of these countries’ ability to improve the quality and quantity of their HC in the future. In terms of interpretation of scores, the score of 4 is the best possible; 52 is the worst. As can be seen below, Sweden tops the HC Index in 2006 with a score of 8, while Germany and the Mediterranean countries mark the bottom.

**Table 2: The European Capital Index**

Rank	Country	Overall score
1	Sweden	8
2	Denmark	14
3	United Kingdom	19
4	Netherlands	21
5	Austria	23
6	Finland	29
7	Ireland	30
8	France	30
9	Belgium	31
10	Germany	36
11	Portugal	37
12	Spain	38
13	Italy	48

*Source: The European HCI Report*

### 5.3.2 Other HCM practices outside of the UK

At the request of the Accounting for People task force, PricewaterhouseCoopers (PwC) has undertaken a review of HC measurement and reporting practice in the following 13 countries:

- Australia
- Brazil
- Canada
- France
- Germany
- Japan
- Netherlands
- South Africa
- Spain
- Sweden
- Switzerland
- Thailand
- The US.

The data was collected from two sources: firstly a series of structured interviews was conducted, interviewing a PricewaterhouseCoopers expert from each of the countries (except in the case of Sweden where an external source was used). Secondly, this qualitative evidence was validated and contrasted against the quantitative findings of the Global Human Capital Survey 2002/2003 (GHCS). This survey had already been conducted by PricewaterhouseCoopers and has responses from more than 1000 companies based in 47 countries.

The findings showed that although Sweden is viewed as being forward thinking in human capital measurement, the practice does not live up to this reputation. Swedish companies tend only to report externally those people metrics that are legally required of them; only five per cent of the content in Swedish annual reports is related to HC.

Japan's employment practice has historically reflected a 'job for life' culture which had an implicit agreement where the companies invested in their staff in return for 100 per cent dedication and loyalty to the company. Therefore, in general, companies have neither measured nor reported workforce demographics. However, the Japanese government has recognised that society is changing and has recently started responding to the challenges of HC and reporting externally on issues such as corporate social responsibility.

There is relatively little HC measurement and reporting either internally or externally within Spanish companies. Good reporting practice is mostly lead by multinational companies who comply with global norms.

There are no legal requirements or public pressure to measure and report on HC in Thailand. Consequently, measuring and reporting practice is very limited, often just

covering workforce demographics, with the exception of multinational companies, which adopt global practice.

Although Germany was found to score rather low on the European HCI, German companies are required to report on specific HC metrics to their works council (which is a legally required body of employees for enterprises with above a minimum number of staff and represents the interests of the workforce and monitors the compliance with the working conditions).

Taken together, depending on which aspects of human capital they focus on, there also seem to be variations among the findings of international research activities in the area of HC.

The next section will look at how the concept of HC has become the focus of attention in HR and how the measurement issues have been addressed.

## 5.4 Human Capital valuation in HR

The Chartered Institute of Personnel and Development (CIPD) has been working in the area of human capital since 2000, when the concept was first identified as a significant issue facing the HR profession in the medium term. The HR literature shows that over the last decade the term Human Capital has become popular in HR language to describe people and their collective skills, abilities, experience and potential (CIPD, 2006).

HR professionals like the idea of having a model that shows the links between HR investments and organisational success. Financial and physical assets (physical capital) have been used extensively to explain the links between HR investments and organisational success and it seems that they no longer add to the debate on what contributes to organisational success. The HC measures have therefore become the focus of attention as they are perceived to have the potential to offer competitive edge to companies.

Measuring human capital has its complications, of course, some of which have been discussed above in broader context. CIPD's research work on HC discusses some of the measurement difficulties in detail:

*'Measurement is notoriously difficult because the things that human capital is likely to influence such as customer satisfaction, innovation and service delivery are at the mercy of numerous other contextual factors. Whereas it can be relatively easy to collect data to describe workforce and the prevalence of certain practices, particularly where sophisticated human resource information systems (HRIS) exist, it is more difficult to develop credible and reliable measures and decide what the measures will tell us.'* (CIPD, 2007)<sup>13</sup>

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<sup>13</sup> <http://www.cipd.co.uk/subjects/corpstrtg/hmncapital/humancap.htm>

One of the reasons why measurement is difficult, as pointed out by the CIPD's factsheet on human capital measurement, is that HC is not owned by the organisation but secured through the employment relationship.

*'Employees can decide how much effort above the absolute minimum required to retain their job they put into their work; this is sometimes called discretionary effort. To secure the extra effort from their employees which will really make a difference to their business, organisations must identify the triggers which will encourage this discretionary effort.'*

The debate on the measurement difficulties of HC almost always points to the 'context dependent quality' of the measures, which often deters organisations from moving towards a measurement-oriented HC approach to managing their people.

#### 5.4.1 What aspects in HC are being measured?

The HR literature on human capital indicates that there is no single measurement formula that can be used to identify human capital and give organisations the answers they are looking for. What seems to add to the complexity of measuring human capital is that it has many dimensions and it is often difficult to decide what aspects of HC should be measured.

So what aspects in HC have organisations been measuring? An international survey by ISR (2005)<sup>14</sup> polled 100 senior executives, managers, and HR professionals working in a variety of industries around the world to find out what the gap was between the active measurement of HC and the actual use of those metrics strategically. At first sight, the results suggested that a high degree of human capital management was taking place within organisations, as 91 per cent of respondents said their organisation had some business performance measures that related to human capital. As many as 58 per cent were including some form of HC measure in their organisation's 'Key Performance Indicators' (KPIs) or performance scorecards. Less than half (48 per cent) said they actively assessed HC value and its impact on business performance.

On the face of it, the reported numbers were quite high but a closer look at the findings, including the actual metrics respondents were using to measure HC, showed that the initial positive numbers could not be supported. The ISR survey concludes that organisations may truly believe that they are measuring and managing their HC, but, in reality, many have little idea of what HC really means and are consequently making a very poor attempt at it.

The results of the ISR survey indicated that organisations are using a broad range of HC measures, the top five being head count, employee survey indices (engagement,

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<sup>14</sup> A survey by ISR called 'Measuring and Managing Human Capital in Today's Organisations: A Study of Company Practice' cited in *Strategic HR Review*, Vol. 5, Issue 1, November/December 2005.

commitment, satisfaction), productivity, training hours and recruitment/selection costs. These are usually the most convenient metrics because a lot of these measures are lagging indicators; they tell organisations how they are performing 'after' the fact.

The Conference Board's survey results (2006) also indicated that companies are nowhere near where they ought to be in terms of using their HC measures strategically, as only 12 per cent of organisations who participated in the survey reported that they had made use of people measures to meet strategic targets or KPIs. However, in the next three years, 84 per cent of that same group expected to increase the application of human capital measures.

#### 5.4.2 Sectoral differences?

The results of our brief review suggest a notable difference between private and public sector organisations in terms of investing in the HC measures, as the private sector companies seem to be ahead of the game. However, one needs to bear in mind that once again we are referring to self-reported cases of the use of human capital measures. The majority of the companies that report using the HC measures/metrics and linking them to business performance seem to be from financial and manufacturing services, where the business context would be much easier to quantify and linkages easily made.

#### 5.4.3 What are the overall suggestions?

The general consensus among the HR professional on the HC measures/metrics used is that these measures should reflect the strategy of particular organisations. For example, staff turnover may be a central issue for some but less important for other organisations. Other suggestions include:

- There is no 'one size fits all' answer.
- The answer for each organisation will depend on the specific concerns or questions of that particular organisation.
- Those responsible for developing or using the measures need to be clear about what they would like to achieve.
- They should try to use HC measures that would answer their questions within the unique culture of their own organisation – what works for one company might not produce the same outcome for the other.

### 5.5 HR consultancies working on HC

There are global HR consultancy firms which specialise in human capital measurement. Most of these consultancies offer a balanced scorecard approach. Some examples of these include:

- Saratoga (which is part of PricewaterhouseCooper's HR Services practice offering international benchmarking) – assists organisations in quantifying and evaluating their human capital. It offers a range of quantitative and qualitative measurement tools enabling benchmarking versus peers in the marketplace, or those facing similar challenges.
- VaLUENTiS – another global firm in the field of human capital management and organisation performance, which specialises in providing clients with solutions to enhance enterprise performance, focusing on four core disciplines:
  - organisation effectiveness and measurement
  - strategic human capital management
  - human capital measurement; and
  - HR functional (transformation) effectiveness.
- McBassi and Company – an American firm with partners in other countries, it is a workforce strategy and benchmarking company that helps organizations improve their 'return on people (ROI)'
- Towers Perrin-ISR – the research practice of Towers Perrin HR Services, which is also a global company. They, too, offer global benchmarking on a wide range of HR subject areas, human capital being one of them. Towers Perrin-ISR has very large normative databases on organisational attitudes in more than 60 countries worldwide.
- FiSSInG – the HR Society's benchmarking club. Their subscribers are mainly from the financial sector organisations. They receive benchmarked scorecards for their business performance and the HR functional performance. They also get analyses of HR activities and accountabilities for people management.
- Infohrm Group – specialises in workforce planning, reporting, and human capital analysis. They have offices in the UK, Australia and the USA. They have 160 member organisations globally and represent every major industry from public, private and non-profit sectors.

## 5.6 What are the most frequently used HC measures/metrics on scorecards?

The following list includes items which are the most frequently suggested HC metrics but these not always measured or used, especially the aspects of human capital that include soft (subjective) measures, such as attitudes. The list contains:

- employee satisfaction/attitudes, including engagement and organisational commitment

- innovation and creativity (always mentioned as an important dimension of human capital but very hard to measure)
- relationship management
- talent management
- leadership
- work–life balance.

The following items are easier to measure, as they are mostly hard measures and have often been widely used in HC measurement:

- workforce demographics
- turnover/retention
- remuneration
- compensation/total operating costs
- absenteeism
- tenure
- educational level
- HR investment/training and development
- health and safety
- experience
- productivity (this is not always easy to measure as it is very sector/job-specific).

As can be seen, this is a long list but not all aspects would be relevant or useful for every organisation. As has been emphasised before, there is no ‘one size fits all’ answer.

## 5.7 Suggestions for success from a leading consultancy in this area

As a starting point, organisations need to know where they are in term of their resources and systems they have in place in order to implement HC measurement and management systems. What a large company with sophisticated systems can achieve will be very different to what smaller organisations can do. Therefore, one would come across large variations in organisations’ approach to HC measurement.

Stephen Young, who is Executive Director at Towers Perrin-ISR (London), points out that there are four phases to HC measurement:



1. **The early phase:** This is the beginning of the HC measurement journey when companies should develop a few simple measures that relate to their business strategy.
2. **The benchmarking phase:** At this stage, organisations need to benchmark their scores against the same HC metrics in other companies, as benchmarking will give them a sense of whether these scores are good or bad.
3. **The linkage phase:** This phase begins to link a number of company's HC metrics together to develop an understanding of how the organisation performs. For example, you may start to see a relationship between levels of employee engagement and company's financial performance.
4. **The mature phase:** This stage is about developing metrics that can predict business performance and integrating these metrics into the strategic management decision-making process. Organisations know where they are on their journey and what is achievable by this stage.

He adds that so much of the debate on HC measurement focuses on the 'mature phase', where it is highly sophisticated, integrated and dynamic. This phase may be totally inappropriate to many smaller organisations and it can deter them from making any contribution at all.

If organisations 'know where they are' as a first step, Stephen Young points out the following nine actions as part of his *Ten steps to successful human capital management*<sup>15</sup>:

- **Make the business case:** This is fundamental to any attempt at managing HC within an organisation. One needs to find the evidence to back the business case, as in the case of high levels of engagement showing an increase in net profit.
- **Plan how to get there:** Companies that are successful at HC measurement and management do not just try to introduce one or two metrics and leave it at that. They are strategic about getting support from within the organisation and embedding the idea throughout the organisation.
- **Remove the barriers:** Introduction of new measurements or a different way of doing things can often cause resistance and the ISR's global survey showed that many organisations simply did not know how to get from A to B. Identifying the barriers is, therefore, very important so that these barriers can be removed.
- **Establish the appropriate metrics:** One needs to understand what their organisation's business strategy is in order to decide on the most appropriate metrics to use. One standard set of metrics may not be appropriate for every organisation.

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<sup>15</sup> Young S (2005) 'Ten steps to successful human capital management', *Strategic HR Review*, Vol. 5, No. 1

- **Understand your cultural context:** This is especially relevant for multinational companies, as one would need to have different metrics for different countries based on what is culturally appropriate.
- **Know what it takes to become a high performer:** The Towers Perrin-ISR research in the area of HC measurement indicates that financially successful organisations have a particular profile; companies that work to fix leading indicators, such as leadership, strategic direction, communication or their focus on customers tend to perform highly. The suggestion is that to be a high performing organisation, one needs to start with leading indicators.
- **Do not just measure it, integrate it:** Once companies are using the right HC metrics, it is important to be able to integrate them with other business metrics. Successful organisations show higher ability to integrate measures together in ways that are understandable to business people.
- **Create a dynamic dashboard:** A dynamic dashboard of business performance metrics that work in real time is what many organisations are trying to achieve and this is what effective HC measurement is all about – it gives input into management decision making.
- **Give ownership to the business:** Rather than being owned by HR, ownership of the whole process should be given back to the business, because HC measurement is about things that impact business performance.

### 5.7.1 Success tips for putting together a scorecard from consultancies

The consultancies specialising in the area of human capital measurement agree that scorecards are the way to go because they are simple. However, it is imperative that they must be very carefully designed. PwC's Saratoga Institute suggests (and other consultancies also agree) that metrics on scorecards should be easy to understand and their numbers should be limited: 8 to 12 seem to be the optimal numbers given.

In line with Stephen Young's *Ten steps to successful human capital management*, it is also suggested by other consultancies that:

- All key players must agree on what exactly should be measured.
- The scorecards must be deeply relevant to organisation's specific needs.
- Metrics should measure the execution of organisation's strategy.
- Selecting metrics is a process, not a one-off event. The purpose is to track performance, not just to collect individual numbers.

## 5.8 Towards a set of standard measures?

Investors in People (IIP) put together the 'HCM standards group' in July 2006, with the aim of developing a generic set of measures for company reports. The group is made up of 15 HR experts from private industry, business groups and academic organisations.

According to Richard Donkin<sup>16</sup>, a Financial Times business journalist and the driving force behind the group, the purpose of the group is to establish a basic set of human capital measurement standards that are common to all businesses, and that would mean something to investors looking at an annual report. As Donkin says:

*'The final standards are likely to include some qualitative evidence alongside metrics such as, profit and turnover per employee and the percentage of vacancies unfilled within a month. If every employer asked employees the same standard question, such as: "would you recommend this company to a friend?" or "are you well managed?", the findings would give a useful measure of employees' well-being and attitudes to the organisation.'*

Donkin also points out that if organisations combine factual findings with qualitative information, they can build a rounded picture of an organisation's human capital. There was no progress report available on the activities of the group at the time of this review.

Elsewhere in the HR arena, the sponsor organisations of the Lancaster University Management School Centre for Performance-Led HR have teamed up with Rick Emslie of Emslie Analytics<sup>17</sup>. Their agenda is to provide *tangible* evidence of the member organisation's contribution to a performance-led focus on HR and its contribution to the business. They state that they could establish a solid UK example of best practice within three years. The sponsor members of the Centre have agreed on a short list of metrics for which they will collect data. The 'core metrics' are:

- Income per FTE (£)
- Human investment ratio
- Annual total cost of absence/total employment costs (percentage)
- Annual total cost of resignations/total employment costs (percentage)
- Resignations < 12 months service/total resignations (percentage)
- Employee engagement/commitment index
- Percentage women in 100 top positions (by remuneration).

<sup>16</sup> cited in *Personnel Today* magazine, 03 April 2007

<sup>17</sup> Human Capital Metrics Project, 2007, LUMS & Emslie Analytics

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## Appendix 1: Questionnaire

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### Human capital measures

1. Which people management metrics do you routinely collect?

Data	What is collected? Please tick those areas where you collect data	Please give details of how collected/held eg personal record on computerised HR system, annual employee survey	What key performance indicators do you use?
Employee demographics			
Leadership capability			
Management capability			
Training and development investment			
Training and development quality			
Staff motivation/engagement			
Absence			
Retention			
Recruitment			
Talent management			
Performance			
Reward			

2. What data do you currently collect to assess your management and leadership capability?

3. Have you attempted to make the link between people metrics and organisational performance? If yes, what have you found to have an effect? If no, what stops you doing so?
  
4. What data have you found to have greatest importance to understanding the people–performance link?
  
5. Do you have a single or very small number of key people indicators? If so, what do you use?
  
6. How do you incorporate key people indicators into your overall organisational performance monitoring, eg balanced scorecard, reports to the management board?

Thank you very much for your assistance. All responses will be treated in the strictest confidence and will not be attributed to any organisation or individual.

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## Appendix 2: Report Summary of ‘People and the Bottom Line’

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### Executive Summary

Does the way people are treated at work make a difference to the performance of the organisations that employ them? Are there returns to investment in human capital in a similar way to investments in physical capital? These seem straightforward enough questions but they have generated huge amounts of debate. On one side, there is plenty of evidence strongly suggesting that investment in people has important business performance benefits, and yet on the other hand, the research that arrived at this conclusion has been subject to detailed criticism.

And whilst academics gather and dispute the evidence, it would seem that practitioners are not completely convinced either. The take-up of what have been termed High Performance Working Practices (HPWPs) has been slow and many organisations do not adopt them. The doubts of practitioners reflect concerns over what it might mean for individual firms and sectors, and confusion over which people-management practices are likely to show the greatest link to performance. Many studies adopt complex measures which are outside the capabilities of most firms to replicate. In terms of a step change in employer behaviour what is needed are some measures that have been linked to performance, that employers can capture for themselves and which do not require considerable academic resource to make useful.

Against this background, this study takes into account concerns from both academics and practitioners, and provides a convincing argument that the investments firms make in their workforce make a difference.

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## Background to the research

This report presents findings and analysis from *People and the Bottom Line*, the third part of a research project exploring the link between the way employees are managed and organisational performance.

The project began in 2004, when Investors in People UK (IIP UK) – together with the Sector Skills Development Agency (SSDA), the Chartered Institute of Personnel and Development (CIPD) and the Department for Education and Skills (DfES) – began drawing together evidence of the links between skills and organisational performance. This work began with two phases:

- *Phase one* involved an extensive literature review which explored the relationship between skills investment, employee commitment, high performance workplaces, and organisational performance.
- *Phase two* drew on the literature to generate a framework of capability against which organisations could consider all aspects of people management, together with their own investment in people. It drew together a theoretical framework – the 4A Model – alongside a list of 40 measures (related to skills development and wider people-management practices) which employers could use in order to monitor performance in each of these areas.

This third phase of activity was developed to assess the link between the measures presented in the 4A model and organisational performance, and to determine which of the candidate 40 measures show the strongest association.

## Theoretical framework

The work conducted in phase two of the project<sup>18</sup> identified two key dimensions to the expression of and improvement of human capability in the workplace:

- The first dimension encompasses the development of capability at one end and its deployment at the other.
- The second dimension explores the roles of individuals at one end and organisations at the other and the way in which capability depends on an appropriate partnership.

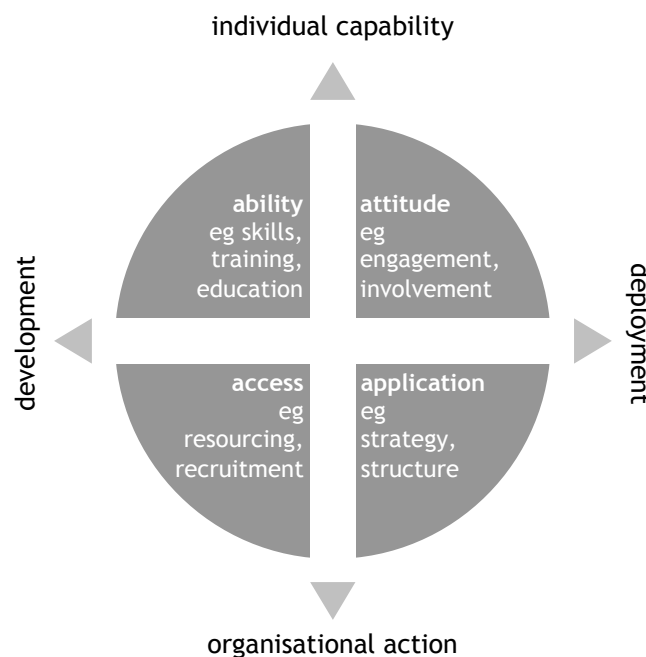
The resulting four quadrants of activity form the 4A model (see Figure 1A):

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<sup>18</sup> Tamkin P (2005), *Measuring the Contribution of Skills to Business Performance: A Summary for Employers*, Institute for Employment Studies

- **Access** — the effective resourcing of roles in the organisation in terms of initial recruitment, ongoing job moves and succession activity. The focus here is on deliberative organisational activity, including policy and practice.
- **Ability** — the skills and abilities of the workforce. In essence, the quality of people that the organisation has at its disposal, and the ongoing development activity of those individuals which maintains and further develops their capability.
- **Attitude** — it is clear that skills are not the totality of what makes people do an excellent job. There is also the engagement, motivation and morale of the workforce and the meaning they find in work, their beliefs about the workplace and their willingness to put in additional effort.
- **Application** — the opportunities made available to individuals to apply themselves. This recognises that people need an appropriate working environment to prosper provided through information, job design, organisational structure and business strategy.

Figure 1A: The 4A model of capability



Source: Tamkin P, Giles L, Campbell M, Hillage J (2004), *Skills Pay: The Contribution of Skills to Business Success*, SSDA Research Report 5

Each quadrant of the model was then populated with measures that had either been tested within the literature reviewed, were already used elsewhere (and were therefore accepted by organisations), or were new measures that had been developed to provide a reasonable test of investment by an organisation in that quadrant of activity. The criteria used to identify potential measures included resonance with employers (ie they should be meaningful to employers and align as far as possible with measures already in use); rigour and lack of ambiguity; and the capacity for



longitudinal study (ie the measures should be able to track organisational inputs, outputs and performance over time).

This analysis led to a set of 40 measures across the quadrants of the 4A model: a list of core and desirable measures of HR practice.

## Objectives and methodology

The main aim of this new research was to examine the link between the measures presented in the 4A model and organisational performance, and to determine which measures show the strongest association. In addition, it was to provide a method that will enable examination of a causal link in the future.

In doing so, the initial 40 measures underpinning the 4A framework were to be tested and reduced to a smaller set which show the greatest correlation with organisational performance.

More specifically, the objectives were:

- Using the framework of human capital, Human Resource Management (HRM) and organisational performance measures/indicators, identify a core set of indicators which show the most robust relationship with business performance and which organisations can feasibly collect.
- Test if this core set can be collected in a consistent way so that aggregate data can be generated.
- Explore how easily employers can identify the information required, and the feasibility of future data collection.
- Use the generated core set of indicators to test the association with business performance across a broad and representative cross sector of employers.

At a more detailed level it was hoped that the project would answer some key questions:

- Can the measures be collected in a consistent way so that aggregated data could be generated for analysis at organisational size, sectoral, regional and national levels?
- Can meaningful correlations be drawn?
- What methodology should be adopted to assess a causal link in the future?

To achieve these objectives, the researchers conducted a telephone survey across a wide range of employers. The survey was first piloted, in order to test the effectiveness of the questionnaire, and then rolled out to cover 2,905 organisations with 25 or more employees, of which 2,500 were private sector and 405 were public sector.

The questionnaire was designed to explore each element of the 4A model, collecting employers' views on how they invest in people and the processes they use to manage the capability and contribution of their staff. Questions were based on elements identified from the earlier phases of research plus additional questions requested by the IIP Human Capital working group. Responses allowed each of the four quadrants of the model to be populated, whilst additional information on organizational performance was also gathered which could be compared to performance information from an independent business database. This enabled the researchers to explore the link between the quadrants of the 4As model both separately and as an integrated model, and to assess which measures had the strongest relationship with organisational performance.

## Analysis: factors influencing index scores

Initial analysis of responses, involving frequencies and cross-tabulations, revealed that a number of characteristics affected an organisation's performance on measures that make up the 4A model. These included variations of size and sector, plus three elements of an organisation's strategy: its approach to innovation, its efforts to create a great working environment, and the emphasis placed on meeting the needs of external stakeholders. The impact of being IIP-recognised was also investigated and found to have a positive and significant effect across all 4A indices, and in each case the scale of this effect was substantial. The data demonstrate that IIP recognised organisations have greater investment in their workforces and more sophisticated processes and practices than non-IIP organisations.

## Analysis: relationship with business performance

Next the data were analysed in greater depth to explore the relationship between scores on the index and company performance, in order to understand whether the way in which employees are managed affects performance regardless of organisational characteristics.

To do this, regression techniques were used to help understand the correlations between the variables (ie questionnaire responses) in more depth. Regression enables us to hold constant all the factors we have identified as influencing index scores, including previous company performance. Initially, the focus was on whether specific clusters of HR practices are linked to organisational performance:

- Is it access policies (ie careful recruitment and resourcing) that have an effect?
- Is it the ways in which the firm looks to increase ability (ie through high levels of workforce training and development)?
- Is it attitudes that are important – the ways in which the workforce is motivated, engaged and aligned to the needs of the business?

- Is it the application of people in the workplace – the ways in which the organisation ensures that employees are given appropriate opportunities to apply their skills and motivation through job design, etc?

Statistical tests found only a weak relationship between these individual quadrants of the 4As model and performance, suggesting that no single sub-system of HR practices impacts on performance in isolation. However, if we combine our measures across all parts of access, ability, attitude and application, we find much more powerful statistical relationships between the degree to which firms invest in their people and a wide array of organisational performance measures.

These are clearly very significant findings. The size of the effects are also of note and provide, in tangible terms, a sense of the relationship between the index and the organisation's performance. The results imply that if a business increases its investment by the equivalent of increasing its combined index score by one (around 10 per cent), this would equate to<sup>19</sup>:

- an increase in gross profits per employee of between £1,083 and £1,568
- an increase in operating profit per employee of between £1,139 and £1,284
- an increase in profit margins per employee of between 1.19 per cent and 3.66 per cent (ie the ratio of profit over sales)
- a 0.09 per cent increase in sales growth per employee
- a 3.1 per cent increase in the probability of achieving sales from new technology.

These results are congruent with the literature reviewed within Tamkin et al<sup>20</sup>, which suggests that bundles of HR practice are more impactful than single HR practices. This makes intuitive sense as firms need to create a strategically consistent HR environment. It suggests, for example, that there will be limited benefits to firms creating great recruitment or succession practices if they do not attend to staff development or motivation. The results also show that as IIP recognition is strongly associated with higher index scores and higher index scores with better performance, achieving the Standard could provide the framework to improve policy and increase investment, which in turn is associated with better performance.

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<sup>19</sup> All figures are based on annual company accounts data.

<sup>20</sup> Tamkin P, Giles L, Campbell M, Hillage J (2004), *Skills Pay: The Contribution of Skills to Business Success*, SSDA Research Report 5.

## Analysis: comparing upper and lower quartile scores

Further analysis of the data was conducted to compare those organisations that were in the top 25% of index scores (the upper quartile) with those in the lowest 25% of scores (the lowest quartile). The results of this comparison showed that:

- Younger firms are significantly less likely to be located in the lowest quartile. This might suggest a degree of inertia in HR strategy development in older firms. It was also noted that large firms are more likely to be in the upper quartile and medium-sized firms in the third quartile.
- The most consistent differences between the lowest quartile firms and the highest quartile firms are in terms of their innovation strategy and positioning, and their overarching strategic objectives. Upper quartile firms are significantly more likely to develop their own new technologies or buy in up-to-date technologies. This contrasts with the lowest quartile firms who are more likely to use tried and tested technologies.
- Upper quartile firms are also much more strongly orientated towards creating a great working environment for their employees, meeting the needs of other external stakeholders and being innovation led.
- Finally, it was observed that multiple establishment firms are more likely to be located in the upper quartile of the index.

Taken together, such results show that – if factors such as size, sector, previous performance and the strategic objectives of the firm are held constant – then better scores on the index (and therefore greater investment in people) are associated with better financial performance. This suggests that there may be potential benefits to all firms of adopting a coherent range of HR practices and investments in their people, irrespective of their circumstance.

Even where firms are already investing in their workforce, there would seem to be benefits of doing more; there was no evidence that higher scores on the index show diminishing returns.

## Analysis: identifying key measures

In addition to exploring the link between people management and organisational performance, the project sought to distil the measures (76 in total including the 40 original measures and those added from the human capital group) which were tested to identify a core set which show a robust relationship to performance, and which organisations can feasibly collect.

This total was initially reduced, removing measures which:

- had achieved relatively low response rates in the survey (perhaps because employers found it difficult to provide data)
- had relatively little variation in responses (and therefore gave us little with which to differentiate organisations)
- did not help raise the reliability of the individual 4A indices.

This still left a relatively long list of measures (37), which form the basis of our regression analysis of the link to performance. For most organisations this would prove to be too many, and so to distil these further, the items which accounted for the greatest impact in terms of variability between responses from organisations were identified and studied. Each item within each quadrant of the 4A model was looked at, which then led to the identification of the items that had the greatest impact in each case.

This analysis gave a scaled down set of 12 measures, as captured in the table below.

**Table 1A: The key 12 measures**

Area	Measures
<b>Access</b>	<ol style="list-style-type: none"> <li>1. Proportion of new appointees tested on recruitment</li> <li>2. Proportion of new appointments for which there was a person specification</li> <li>3. Proportion of employees covered by a succession plan</li> </ol>
<b>Ability</b>	<ol style="list-style-type: none"> <li>4. Proportion of workforce that have a current personal development plan</li> <li>5. Proportion of the workforce that have a career development plan</li> <li>6. Proportion of employees qualified to degree level</li> </ol>
<b>Attitudes</b>	<ol style="list-style-type: none"> <li>7. Proportion of managers that left voluntarily over the last twelve months</li> <li>8. Proportion of staff that receive profit related pay</li> <li>9. Proportion of staff that have a regular appraisal</li> <li>10. The frequency with which staff have one-to-ones</li> </ol>
<b>Application</b>	<ol style="list-style-type: none"> <li>11. Who decides on the pace of work (1 = exclusively managers; 5 = exclusively workers)</li> <li>12. Who decides on task allocation (1 = exclusively managers; 5 = exclusively workers)</li> </ol>

*Source: IES, 2008*

These 12 measures provide a core set for organisations to use to measure their own investment in people within the organisation and which could be used to provide further evidence or the base for tracking research.

In addition, there are three items from the survey which have not been suggested as a measure as they do not test *degree* of adoption, rather they capture whether a process exists or not. As the presence or absence of the process is indicated as important in the regression analysis they are included and it is suggested that organisations ensure that these three processes are in place:

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**Table 2A: Key processes**

Area	Items
Ability	1. The organisation evaluates development in a systematic way 2. The organisation focuses on the long term development of its managers
Application	3. The organisation encourages and captures the suggestions of the workforce

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*Source: IES 2008*

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## Conclusion

Overall, the findings from this project demonstrate that organisations that adopt an integrated range of HR practices, captured by the 4A model, are likely to perform better on key indicators like profit and sales growth. The research has also demonstrated that employers of all types and sizes could benefit from this strategic investment in people.

Whilst this research was not intended to demonstrate causality, it has laid the ground for future work that could do so by providing a tested set of measures that were both acceptable to employers and shown to relate to performance.