

INVESTING IN PEOPLE: CONVINCING THE CFO

There is compelling evidence of links between investments in human capital and performance and profit. Allan Schweyer reports.

The revolution in quality control and manufacturing techniques that has taken place in the last 15 years was data-driven and systems-driven and statistical-process-control-driven. The US economy has benefited incredibly over the last 15 years ... by seriously embracing the science of manufacturing and quality control. Figuring out what to do is important. But doing it and doing it well is equally important. And in the second category, the scientific, data-driven approach is absolutely well-placed."

When Andy Grove, Chairman and founder of Intel said these words in a Harvard Business School Press interview in 2003, he was talking about general business strategy and execution. Jeffrey Pfeffer, a professor of organisational behaviour at Stanford University, calls the data-driven approach "evidence-based management". He strongly advocates for its application in the field of human capital management.

In his book, *Dangerous Half-Truths & Total Nonsense*, Pfeffer writes: "There is compelling evidence that when companies use HR best practices based on the best research, they trump the competition. These findings are replicable in industry after industry, from automobiles to textiles, to computer software to baseball. Yet many companies still use inferior people management practices. The problem isn't just that HR managers know what to do but can't get their companies to do it. Like other leaders, many HR executives hold flawed and incomplete beliefs. They fall prey to second-rate evidence, logic and advice, which produce suspect practices, and in the end damages performance and people."

Despite the admonitions of Pfeffer and other luminaries, HR professionals have for years argued that their discipline is an art rather a science and that there is no way of precisely measuring the ROI in talent management initiatives. While it will always be more difficult to quantify the returns on an investment in a middle manager's leadership skills than in a machine that spits out a widget, for example, there are more and increasingly credible indicators available today that clearly demonstrate the link between human capital investment and profit.

Among the most compelling evidence comes from McBassi & Company, where founder Lauri Bassi and her colleagues have recorded human capital investment data for more than 10 years. Bassi's analysis, which cuts across industries and through business cycles, consistently demonstrates a high

positive correlation between firms that invest more than the average in human capital development and much higher sales per employee, far better gross profit margins and stocks that outperform bottom quartile firms by almost double. Recently, McBassi has expanded on its research to include the ROI in human capital investments in employee engagement, leadership and knowledge accessibility – says Bassi: “... managing human capital by instinct and intuition is not only inadequate, it’s reckless. It is high time to use measurement systems that drive business results through the management of people as assets, and not just costs.”

The Great Places to Work Institute (GPTWI) has developed *Fortune* magazine’s “100 Best Companies to Work For” list for the past nine years and has been evaluating employers since 1984. To make the list, hundreds of firms compete aggressively on a broad range of factors designed to determine whether employees trust the people they work for, have pride in what they do, and enjoy working with the people in their organisation.

These “measures” are as warm and fuzzy as they get, yet in 2004, Frank Russell Company compared a hypothetical portfolio of the publicly-traded “100 Best Companies to Work For” from 1997, to a Standard & Poor 500 (S&P 500) portfolio of publicly-traded companies in the same year. Through 2003, the stocks from the companies on the “Best Companies to Work For” list grew in value at almost three times the rate of those in the S&P 500 portfolio.

As if this weren’t convincing enough, consider the returns if the list had been updated, reflecting the new Best Companies to Work For list each year. In that case, a “Best Companies” investor would have seen a better than 500 per cent return compared to the S&P 500 list.

The Stanford Project on Emerging Companies (SPEC) studied more than 200 Silicon Valley high-technology start-ups between 1994 and 2002. Their purpose was to determine whether human resource management practices mattered in the “new economy”, particularly among the young, “built to flip” dot.coms of the era. The study compared the start-ups across three dimensions: the likelihood and speed of going public; the likelihood of surviving versus failing; and, for those that did go public, growth or decline in market capitalisation following the IPO.

SPEC’s results are just as clear as those from McBassi & Company and the GPTWI. Start-ups whose founder(s) created a best practice HCM blueprint from the outset were almost two and a half times less likely to fail and more than two and a half times as likely to go public than other firms, similar in every respect, whose founder(s) either had no HCM plan or were committed

to a command and control, "you work, you get paid", philosophy.

The findings from McBassi & Company, the GPTWI and SPEC constitute only a small portion of the available research in this arena. They and other studies offer compelling proof of a direct line between performance and profit, and investments in human capital. HR executives should use them to make their case for budgets and as a basis for their own measurement of human capital initiatives and investment.

By Allan Schweyer, President of The Human Capital Institute

Source: Human Resources, Australia

Tel: (02) 9422 2074

www.humanresourcesmagazine.com.au