Competency International

Shifting the performance curve, worldwide

AN ROI BASED APPROACH TO HUMAN CAPITAL MANAGEMENT

- making HR investment pay

Introduction

At times it seems as though investments in HR interventions lie outside the normal business criteria applied to any other investment decision.

This may be because it is felt that such criteria cannot be applied due to an inability to accurately measure/quantify human performance. Or, that by their very nature human assets should not be subjected to the normal commercial forms of measurement/evaluation.

For whatever the reason, there is a risk of missing valuable opportunities, e.g. to demonstrate HR's added value, strategic contribution etc.

Alternatively adopting a ROI based approach[1] provides the opportunity to:

1) demonstrate conclusively in economic terms the value added by investment in HR interventions;

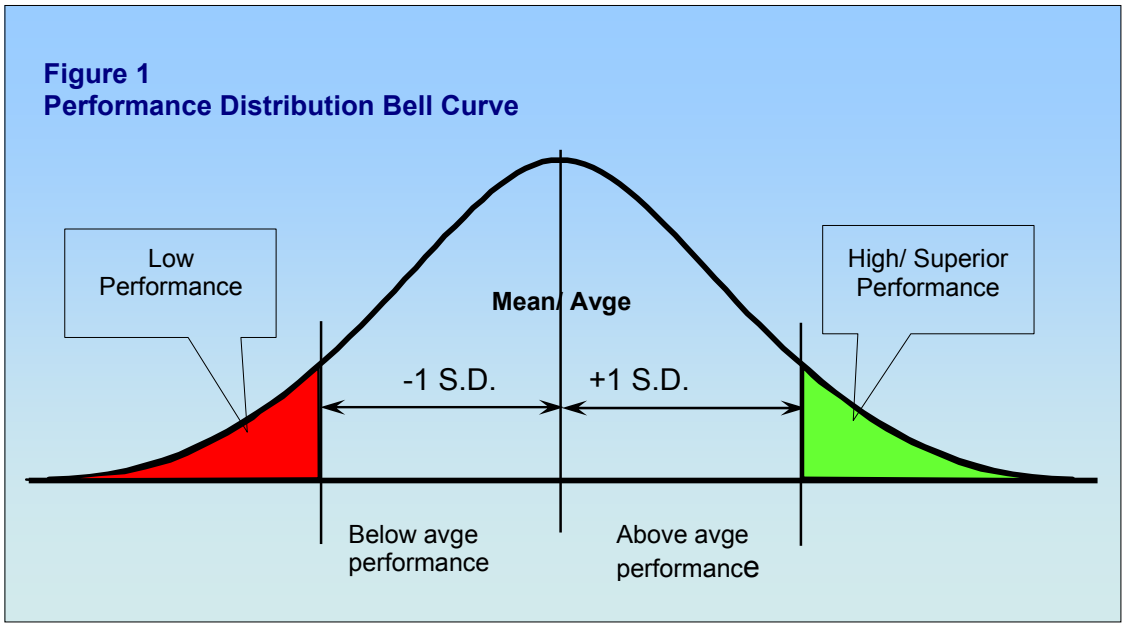
2) uplift HR interventions to a strategic level so as to run over longer terms based on their accepted economic contribution - rather than 'quick fix' solutions;

3) evaluate people's performance in a fair, objective manner and provide them with access to the methodologies and behavioural approaches that underlie superior performance so that they may develop themselves appropriately.

Starting point - the standard deviation of performance

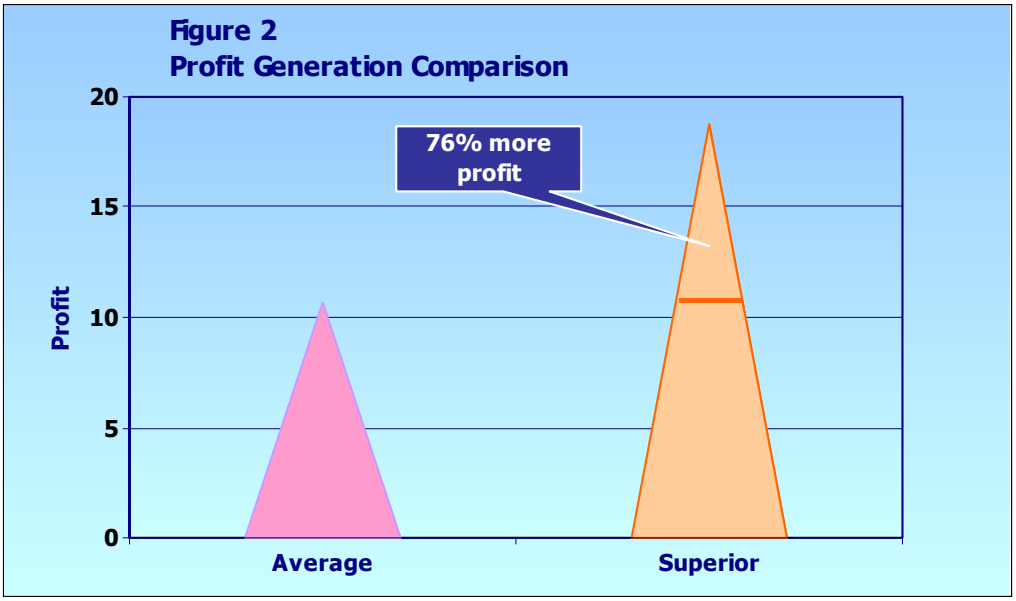
Research[2] has established that the performance (however measured) of people doing the same type of job can vary considerably. Further, this variation typically follows the bell curve as shown in Figure 1.

[1] As developed by Lyle M. Spencer.
[2] In particular, the work of Hunter, J.E., Schmidt, F.L. and Judiesch, M.K.

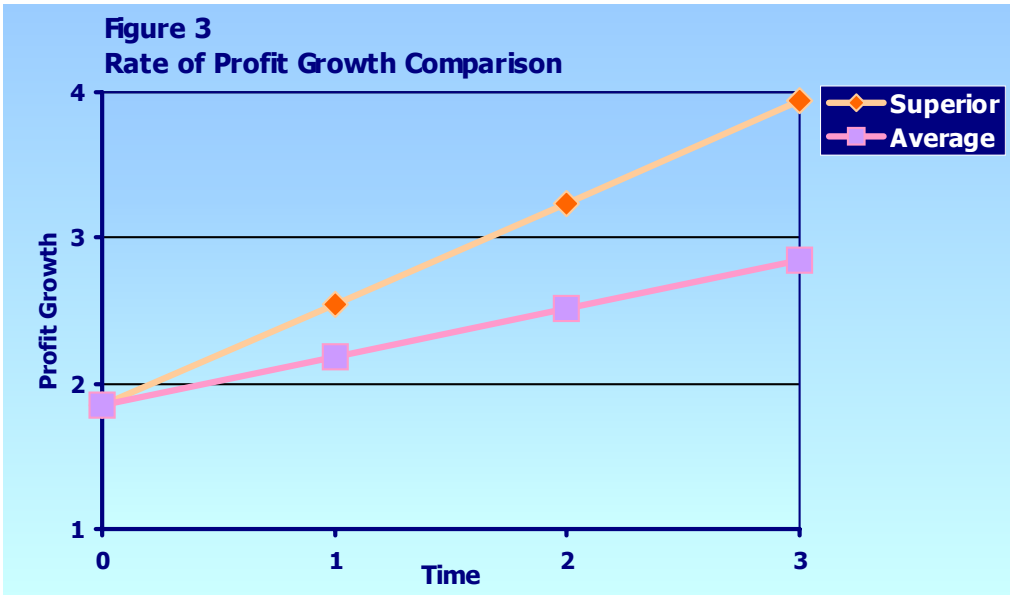


In those jobs where performance can be measured in economic terms, e.g. profit or sales, the added value provided by a person whose performance is 1 S.D. above the mean can be quite substantial.

As an illustration in one recent case it was found that over a measured period that superior performing managers generated 76% more profit than the mean, as shown in Figure 2.



Additionally, using rate of profit growth as a measure, superior managers (1 S.D. above the mean) grew their profits ***twice as fast*** as the average. The effect of this is quite dramatic. Over time superior performers put even more distance between themselves and the average. This is illustrated in Figure 3.



Where there is felt to be sufficient variation in performance to justify an intervention (as there clearly is in the case illustrated), then a programme may be designed/developed to close/narrow the gap between average performance and superior performance.

Designing and developing a ROI based HR intervention

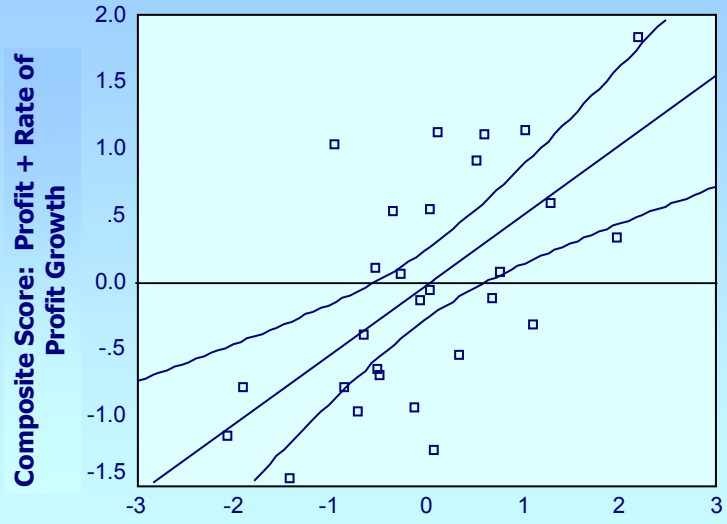
The first question to be asked (assuming sufficient variation in measured performance) is:

How realistic is it to expect to close/narrow gaps between superior performance and the mean? Surely much of the variation is due to factors outside our immediate control, e.g. variations in local economic conditions, extent of competitor activity, rapidly changing market conditions, etc.?

The answer is that while there are undoubtedly many factors affecting performance, research indicates that a considerable amount of the variation is due to managerial behaviour and organisational practises which are to a great extent under an organisation's control.

As an example, in the case referred to previously ***38% of the variation in a combined measure of profit and rate of profit growth over a 3 year period was explained or accounted for by a combination of 7 managerial competencies and 4 organisational climate dimensions as perceived by employees.***

Figure 4
Regression Analysis of Competencies and Organisational Climate on Composite Profit + Rate of Profit Growth Measure

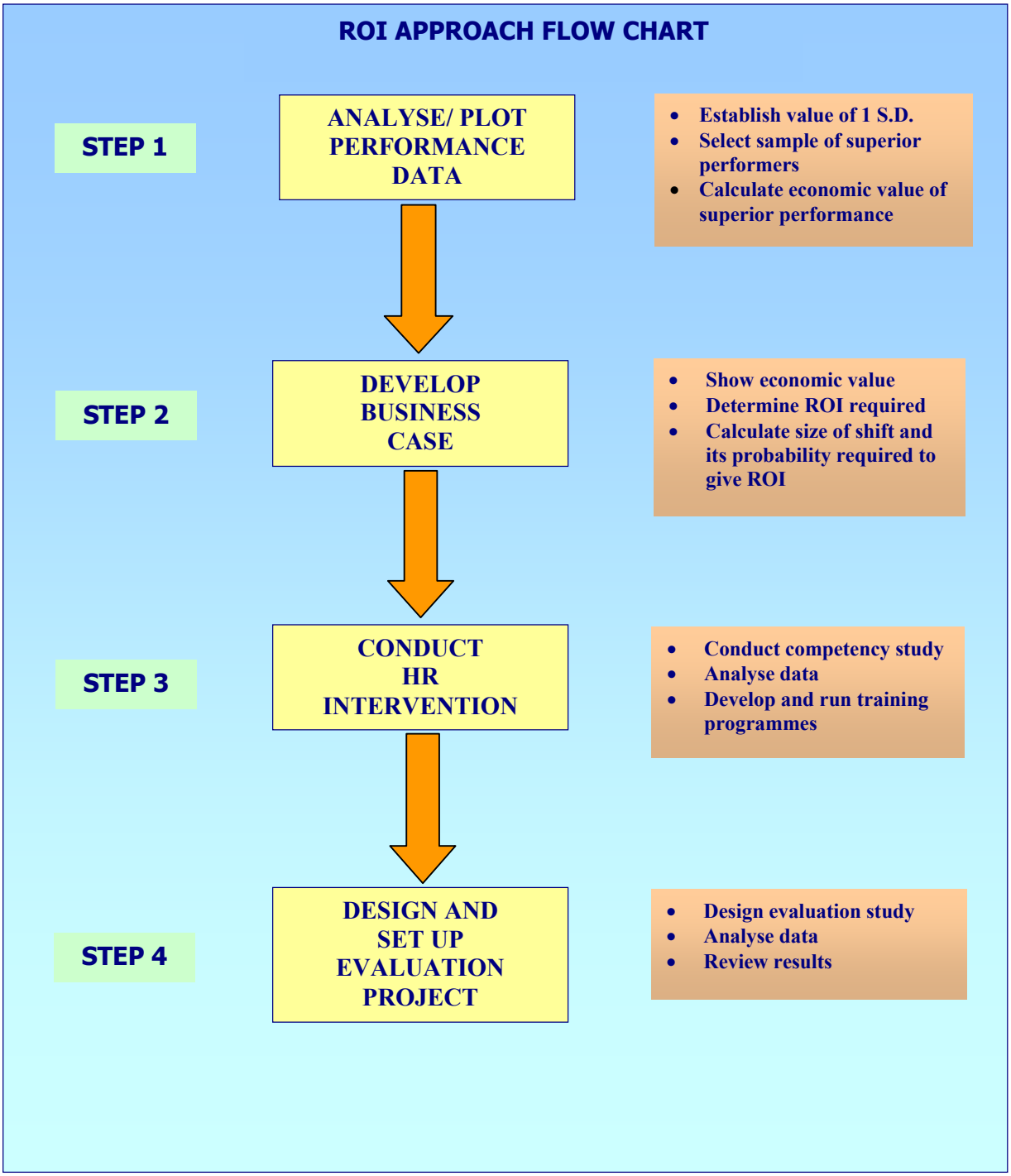


38% of the variance in the composite score (Profit + Profit Growth), is due to 7 Competencies and 4 Climate Scales.

r^2=0.3786

Regression: 7 Competencies + 4 Climate Scales

While this leaves a substantial amount of variance to be accounted for by other factors, it still provides a major opportunity for a meaningful HR intervention as outlined in the steps below.


ROI APPROACH FLOW CHART
STEP 1
ANALYSE/ PLOT PERFORMANCE DATA
Establish value of 1 S.D.
Select sample of superior performers
Calculate economic value of superior performance
STEP 2
DEVELOP BUSINESS CASE
Show economic value
Determine ROI required
Calculate size of shift and its probability required to give ROI
STEP 3
CONDUCT HR INTERVENTION
Conduct competency study
Analyse data
Develop and run training programmes
STEP 4
DESIGN AND SET UP EVALUATION PROJECT
Design evaluation study
Analyse data
Review results

Step 1 Analyse/ plot performance data

In this step all the performance measurement data available for the target job are collected and analysed to determine the respective means and S.D.s.

Next, a sample of people who are 1 S.D. above the mean on one or more key measures are identified so as to form a superior performer sample. The economic value of superior performance is calculated at this time also.

Step 2 Develop business case

Once the economic value of 1 S.D. is known, a business case is prepared. The objective is to present an investment proposal as follows:

a) Show economic value of 1 S.D. above the mean on the performance measures of most interest to management, e.g. revenues, profits, customer loyalty etc.

b) Determine ROI required on proposed HR investment. Most organisations have already established a ROI figure for new investment.

c) Calculate size of performance shift along bell curve needed to give required ROI and the probability of this happening

This information is readily calculated using a formula which includes cost of proposed HR intervention, ROI required and estimated (based on previous studies) or actual value added by competencies as well as data on the expected effect of training on performance, i.e. effect size shift.

The formula then calculates the percentage shift needed to give the ROI required and its probability which forms the business case to be presented to management.

As an illustration in our example case a 4% effect size shift in performance (as a result of the proposed HR intervention) was needed to give the required ROI and the probability of achieving this was 87%.

Step 3 Conduct HR intervention

Assuming the business case has been accepted/approved the intervention may proceed as follows:

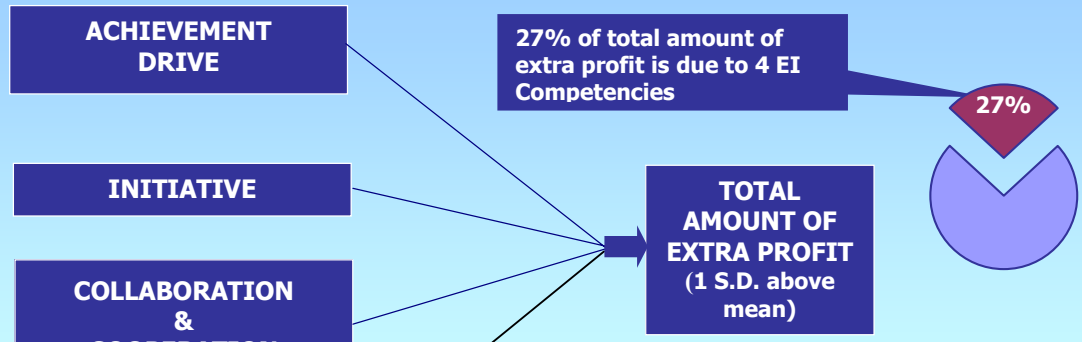
a) ***Conduct competency study including motivational style and organisational climate***. Preferably interviews should be conducted with 12 superior performers (as identified in Step 1) and 8 typical/average performers so as to permit statistical analysis. Questionnaire data are also gathered from a sample of subordinates re perceptions of motivational style and organisational climate.

b) ***Analyse data obtained from competency study and questionnaires.*** In this step the relationships between the independent variables, i.e. behavioural competencies as measured/derived from the interviews as well as motivational style and organisational climate measured/derived from questionnaires, and the dependent variable/s of interest such as profit etc are calculated and plotted.

As an illustration of this, in our example case it was found that 4 key Emotional Intelligence competencies, which have been validated extensively in numerous studies could explain or account for 27% of the extra profit generated by superior performers as shown in Figure 5.

Figure 5

Simplified Structured Equation Model



c) ***Develop and run training programmes.*** Once it is known what is causing/leading to superior performance, appropriate development materials can be prepared, e.g. relevant case study materials are drawn from the interview data bank showing how superior performers actually demonstrate the competencies which predict performance.

Step 4 Design and set up evaluation project

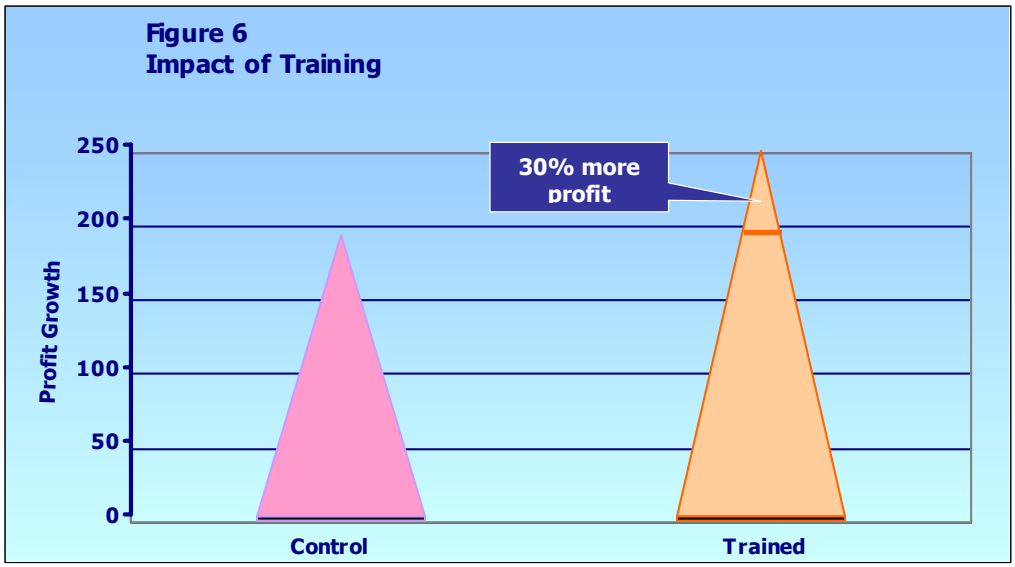
In order to assess the actual impact of the HR intervention, there is a need to set up some form of evaluation.

In our example case the total population of managers was trained over an extended period where those people waiting to be trained served as controls for those people trained earlier in the programme.

The performance of a trained group of 23 managers versus a group of 7 controls was assessed and then compared.

Results

- The comparison analysis showed that the trained managers generated 30% more profit than the untrained controls. The probability of this occurring by chance was 2%. (See Figure 6 below.)



- The effect size shift in performance was 12.5%, over 3 times greater than what was needed to justify the investment in analysis and training.

- The actual ROI figure was over 600%.

Conclusions

- Measuring the impact of HR interventions is a real possibility.
- However, it requires that relevant performance metrics be available for the job type in question.
- It also requires that the organisation be committed to an evaluation and follow up programme to get full value from an intervention.
- Further, it requires that management have a basic belief in the value of upgrading/improving the performance of what can perhaps be a more productive resource than technology or financial capital - the human capital of the organisation.