2

Human capital management

Human capital management (HCM) has been described as 'a paradigm shift' from the traditional approach to human resource management (Kearns, 2005b) – a large claim. It is considered in this chapter initially by defining the concept of human capital management and its relationship to the concept of human resource management. To understand HCM it is necessary to know about the concept of human capital, which is the next section heading. The chapter is completed with an analysis of the processes involved in HCM including a discussion of human capital measurement and reporting.

HUMAN CAPITAL MANAGEMENT DEFINED

Human capital management (HCM) is concerned with obtaining, analysing and reporting on data that informs the direction of value-adding people management, strategic investment and operational decisions at corporate level and at the level of front line management. The defining characteristic of HCM is this use of metrics to guide an approach to managing people that regards them as assets and emphasizes that competitive advantage is achieved by strategic investments in those assets through employee engagement and retention, talent management and learning and development programmes.

The Accounting for People Task Force Report (2003) stated that HCM involves the systematic analysis, measurement and evaluation of how people policies and practices create value. The report defined HCM as 'an approach to people management that treats it as a high level strategic issue rather than an operational matter "to be left to the HR people" '. The Task Force expressed the view that HCM 'has been under-exploited as a way of gaining competitive edge'. As John Sunderland, Task Force member and Executive Chairman of Cadbury Schweppes plc commented: 'An organization's success is the product of its people's competence. That link between people and performance should be made visible and available to all stakeholders.'

Nalbantian *et al* (2004) emphasize the measurement aspect of HCM. They define human capital as, 'The stock of accumulated knowledge, skills, experience, creativity and other relevant workforce attributes' and suggest that human capital management involves 'putting into place the metrics to measure the value of these attributes and using that knowledge to effectively manage the organization'. HCM is defined by Kearns (2005b) as 'The total development of human potential expressed as organizational value.' He believes that 'HCM is about creating value through people' and that it is 'a people development philosophy, but the only development that means anything is that which is translated into value'.

HUMAN CAPITAL MANAGEMENT AND HUMAN RESOURCE MANAGEMENT

In the opinion of Mayo (2001) the essential difference between HCM and HRM is that the former treats people as assets while the latter treats them as costs. Kearns (2005b) believes that in HCM 'people are value adders, not overheads' while in HRM 'people are (treated as) a significant cost and should be managed accordingly'. According to Kearns, in HRM 'the HR team is seen as a support service to the line' – HR is based around the function and the HR team performs 'a distinct and separate role from other functions'. Conversely, 'HCM is clearly seen and respected as an equal business partner at senior levels' and is 'holistic, organization-wide and systems-based' as well as being strategic and concerned with adding value.

The claim that in HRM employees are treated as costs is not supported by the descriptions of the *concept* of HRM produced by American writers such as Beer *et al* (1984). In one of the seminal texts on human resource management, they emphasized the need for: 'a longer-term perspective in managing people and consideration of people as potential assets rather than merely a variable cost'. Fombrun *et al* (1984), in the other seminal text, quite explicitly presented workers as a key resource that

managers use to achieve competitive advantage for their companies. Grant (1991) lists the main characteristics of human resources in his general classification of a firm's potential resources as follows:

- The training and expertise of employees determines the skills available to the firm.
- The adaptability of employees determines the strategic flexibility of the firm.
- The commitment and loyalty of employees determine the firm's ability to maintain competitive advantage.

Cappelli and Singh (1992) propose that competitive advantage arises from firm-specific, valuable resources that are difficult to imitate, and stress 'the role of human resource policies in the creation of valuable, firm-specific skills'.

Other writers confirmed this view. For example:

> HRM is an 'approach to labour management which treats labour as a valued *asset* rather than a variable cost and which consequently counsels investment in the labour resource through training and development and through measures designed to attract and retain a committed workforce'. (Storey, 1989)

> Human resource management is a distinctive approach to employment management that seeks to obtain competitive advantage through the strategic deployment of a highly committed and capable workforce, using an integrated array of cultural, structural and personnel techniques. (Storey, 1995)

The HRM argument is that people… are not to be seen as a cost, but as an *asset* in which to invest, so adding to their inherent value. (Torrington, 1989, emphasis in the original)

Of course, all these commentators are writing about HRM as a belief system, not about how it works in practice. The almost universal replacement of the term 'personnel management' with HR or HRM does not mean that everyone with the job title of HR director or manager is basing their approach on the HRM philosophy. Guest commented in 1991 that HRM was 'all hype and hope'.

A survey conducted by Caldwell (2004) provided some support to this view by establishing that the five most important HR policy areas identified by respondents were also the five in which the least progress had been made. For example, while 89 per cent of respondents said the most important HR policy was 'managing people as assets which are fundamental to the competitive advantage of the organization', only 37 per cent stated that they had made any progress in implementing it.

However, research conducted by Hoque and Moon (2001) found that there were significant differences between the activities of those described as HR specialists and those described as personnel specialists. For example, workplace-level strategic plans are more likely to emphasize employee development in workplaces with an HR specialist rather than a personnel specialist, and HR specialists are more likely to be involved in the development of strategic plans than are personnel specialists.

Both HRM in its proper sense and HCM as defined above treat people as assets. Although, as William Scott-Jackson, Director of the Centre for Applied HR Research at Oxford Brookes University argues (Oracle, 2005), 'You can't simply treat people as assets, because that depersonalizes them and leads to the danger that they are viewed in purely financial terms, which does little for all-important engagement.'

However, there is more to both HRM and HCM than simply treating people as assets. Each of them also focuses on the importance of adopting an integrated and strategic approach to managing people, which is the concern of all the stakeholders in an organization, not just the people management function. So how does the concept of HCM reinforce or add to the concept of HRM? The answers to that question are that HCM:

- draws attention to the importance of what Kearns (2005b) calls 'management through measurement', the aim being to establish a clear line of sight between HR interventions and organizational success;
- strengthens the HRM belief that people are assets rather than costs;
- focuses attention on the need to base HRM strategies and processes on the requirement to create value through people and thus further the achievement of organizational goals;
- reinforces the need to be strategic;
- emphasizes the role of HR specialists as business partners;
- provides guidance on what to measure and how to measure;
- underlines the importance of using the measurements to prove that superior people management is delivering superior results and to indicate the direction in which HR strategy needs to go.

The concept of HCM complements and strengthens the concept of HRM. It does not replace it. Both HCM and HRM can be regarded as vital components in the process of people management.

THE CONCEPT OF HUMAN CAPITAL

Individuals generate, retain and use knowledge and skill (human capital) and create intellectual capital. Their knowledge is enhanced by the interactions between them (social capital) and generates the institutionalized knowledge possessed by an organization (organizational capital). These concepts of human, intellectual, social and organizational capital are explained below.

Human capital

The term 'human capital' was originated by Schultz (1961) who elaborated his concept in 1981 as follows: 'Consider all human abilities to be either innate or acquired. Attributes… which are valuable and can be augmented by appropriate investment will be human capital.'

A more detailed definition was put forward by Bontis *et al* (1999) as follows:

> Human capital represents the human factor in the organization; the combined intelligence, skills and expertise that gives the organization its distinctive character. The human elements of the organization are those that are capable of learning, changing, innovating and providing the creative thrust which if properly motivated can ensure the long-term survival of the organization.

Scarborough and Elias (2002) believe that: 'The concept of human capital is most usefully viewed as a bridging concept – that is, it defines the link between HR practices and business performance in terms of assets rather than business processes.' They point out that human capital is to a large extent 'non-standardized, tacit, dynamic, context dependent and embodied in people'. These characteristics make it difficult to evaluate human capital bearing in mind that the 'features of human capital that are so crucial to firm performance are the flexibility and creativity of individuals, their ability to develop skills over time and to respond in a motivated way to different contexts'.

It is indeed the knowledge, skills and abilities of individuals that create value, which is why the focus has to be on means of attracting, retaining, developing and maintaining the human capital they represent. Davenport (1999) comments that:

> People possess innate abilities, behaviours and personal energy and these elements make up the human capital they bring to their work. And it is they, not their employers, who own this capital and decide when, how and where they will contribute it. In other words, they can make choices. Work is a two-way exchange of value, not a one-way exploitation of an asset by its owner.

The choices they make include how much discretionary behaviour they are prepared to exercise in carrying out their role (discretionary behaviour refers to the discretion people at work can exercise about the way they do their job and the amount of effort, care, innovation and productive behaviour they display). They can also choose whether or not to remain with the organization.

Intellectual capital

The concept of human capital is associated with the overarching concept of intellectual capital, which is defined as the stocks and flows of knowledge available to an organization. These can be regarded as the intangible resources associated with people who, together with tangible resources (money and physical assets), comprise the market or total value of a business. Bontis (1996, 1998) defines intangible resources as the factors other than financial and physical assets that contribute to the value-generating processes of a firm and are under its control.

Social capital

Social capital is another element of intellectual capital. It consists of the knowledge derived from networks of relationships within and outside the organization. The concept of social capital has been defined by Putnam (1996) as 'the features of social life – networks, norms and trust – that enable participants to act together more effectively to pursue shared objectives'. The World Bank (2000) offers the following definition:

> Social capital refers to the institutions, relationships and norms that shape the quality and quantity of a society's social interactions... Social capital is not just the sum of the institutions that underpin a society – it is the glue that holds them together.

It is necessary to capture individual knowledge through knowledge management processes, as described in Chapter 12, but it is equally important to take into account social capital considerations, that is, the ways in which knowledge is developed through interaction between people. Bontis *et al* (1999) point out that it is flows as well as stocks that matter. Intellectual capital develops and changes over time and a significant part is played in these processes by people acting together.

Organizational capital

Organizational capital is the institutionalized knowledge possessed by an organization, which is stored in databases, manuals, etc (Youndt, 2000). It is often called

structural capital (Edvinson and Malone, 1997), but the term 'organizational capital' is preferred by Youndt because, he argues, it conveys more clearly that this is the knowledge that the organization actually *owns*.

The significance of human capital theory

The added value that people can contribute to an organization is emphasized by human capital theory. It regards people as assets and stresses that investment by organizations in people will generate worthwhile returns. The theory therefore underpins the philosophies of human resource management and human capital management.

Human capital theory is associated with the resource-based view of the firm as developed by Barney (1991). This proposes that sustainable competitive advantage is attained when the firm has a human resource pool that cannot be imitated or substituted by its rivals. Boxall (1996) refers to this situation as one that confers 'human capital advantage'. But he also notes (1996 and 1999), that a distinction should be made between 'human capital advantage' and 'human process advantage'. The former results from employing people with competitively valuable knowledge and skills, much of it tacit. The latter, however, follows from the establishment of:

> difficult to imitate, highly evolved processes within the firm, such as cross-departmental co-operation and executive development. Accordingly, 'human resource advantage', the superiority of one firm's labour management over another's, can be thought of as the product of its human capital and human process advantages.

For the employer, investments in training and developing people is a means of attracting and retaining human capital as well as getting better returns from those investments. These returns are expected to be improvements in performance, productivity, flexibility and the capacity to innovate that should result from enlarging the skill base and increasing levels of knowledge and competence. Schuller (2000) suggests that: 'The general message is persuasive: skills, knowledge and competences are key factors in determining whether organizations and nations will prosper.' This point is also made powerfully by Reich (1991).

But Davenport (1999) has some cautionary words about the asset-based content of human capital theory. He argues that workers should not be treated as passive assets to be bought, sold and replaced at the whim of their owners – increasingly, they actively control their own working lives. Workers, especially knowledge workers, may regard themselves as free agents who can choose how and where they invest their talents, time and energy. He suggests that the notion that companies own human assets as they own machines is unacceptable in principle and inapplicable in

practice; it short-changes people by placing them in the same category as plant and equipment.

Important though human capital theory may be, interest in it should not divert attention from the other aspects of intellectual capital – social and organizational capital – which are concerned with developing and embedding the knowledge possessed by the human capital of an organization. Schuller (2000) contends that:

> The focus on human capital as an individual attribute may lead – arguably has already led – to a very unbalanced emphasis on the acquisition by individuals of skills and competences which ignores the way in which such knowledge is embedded in a complex web of social relationships.

HUMAN CAPITAL MANAGEMENT: PRACTICE AND STRATEGY

Practice

Human capital management is concerned with measurement, reporting measurements and drawing conclusions about the significance of the outcomes of measurement as a guide to future action. This is the process of human capital measurement and reporting that is considered separately in the next two sections of this chapter. But it is not the sole purpose. There is more to HCM than measurement. Human capital management focuses the attention of an organization's leadership team on the strategies it should adopt as outlined below to increase the added value they obtain from people. It identifies those aspects of people management that demonstrably have the greatest bearing on business performance. It clarifies the returns that can be obtained in terms of increased profitability, productivity and overall effectiveness arising from the deployment, development and engagement of the people the organization needs to achieve its goals. HCM points the way to achieving human capital advantage by highlighting where and how investments in people generate the highest returns. It ensures that HRM policies and practices are developed to attain this end. These policies include knowledge management, resourcing, talent management, performance management, learning and development programmes, and reward and recognition processes.

From an organizational perspective, an HCM approach generates the following practical questions:

- What are the key performance drivers that create value?
- What skills have we got?

- What skills do we need now and in the future to meet our strategic aims?
- How are we going to attract, develop and retain these skills?
- How can we develop a culture and environment in which organizational and individual learning takes place that meets both our needs and the needs of our employees?
- How can we provide for both the explicit and tacit knowledge created in our organization to be captured, recorded and used effectively?

Strategy

To provide guidelines for action a human capital strategy can be developed making use of the data provided by human capital measurement and reporting. The Mercer HR consulting organizational performance model (CIPD, 2004a) describes a firm's human capital strategy as consisting of six interconnected factors:

1. *People* – who is in the organization, their skills and competencies on hiring; what skills competences they develop through training and experience; their level of qualification; and the extent to which they apply firm-specific or generalized human capital.
2. *Work processes* – how work gets done; the degree of teamwork and interdependence amongst organizational units; and the role of technology.
3. *Managerial structure* – the degree of employee discretion, management direction and control; spans of control; performance management and work procedures.
4. *Information and knowledge* – how information is shared and interchanged between employees and with suppliers and customers through formal or informal means.
5. *Decision-making* – how important decisions are made and who makes them; the degree of decentralization, participation and timeliness of decisions.
6. *Rewards* – how monetary and non-monetary incentives are used; how much pay is at risk; individual versus group rewards; current versus longer-term 'career rewards'.

The human capital strategy of an organization can be regarded as complementary to its human resource strategy, as discussed in Chapters 7 and 8.

HUMAN CAPITAL MEASUREMENT

As Becker *et al* (2001) emphasize: 'The most potent action HR managers can take to ensure their strategic contribution is to develop a measurement system that convincingly showcases HR's impact on business performance.' They must 'understand how

the firm creates value and how to measure the value creation process'. This means getting involved in human capital measurement as defined and described below.

Human capital measurement defined

Human capital measurement has been defined by IDS (2004) as being 'about finding links, correlations and, ideally, causation, between different sets of (HR) data, using statistical techniques'. The CIPD (2004a) emphasizes that it deals with the analysis of 'the actual experience of employees, rather than stated HR programmes and policies'.

The need for human capital measurement

There is an overwhelming case for evolving methods of valuing human capital as an aid to decision-making. This may mean identifying the key people management drivers and modelling the effect of varying them. The issue is to develop a framework within which reliable information can be collected and analysed such as added value per employee, productivity and measures of employee behaviour (attrition and absenteeism rates, the frequency/severity rate of accidents, and cost savings resulting from suggestion schemes).

Becker *et al* (2001) refer to the need to develop a 'high-performance perspective' in which HR and other executives view HR as a system embedded within the larger system of the firm's strategy implementation. They state that: 'The firm manages and measures the relationship between these two systems and firm performance.' A high-performance work system is a crucial part of this approach in that it:

- links the firm's selection and promotion decisions to validated competency models;
- develops strategies that provide timely and effective support for the skills demanded by the firm's strategy implementation;
- enacts compensation and performance management policies that attract, retain and motivate high-performance employees.

Reasons for the interest in measurement

The recognized importance of achieving human capital advantage has led to an interest in the development of methods of measuring the value of that capital for the following reasons:

- Human capital constitutes a key element of the market worth of a company. A research study conducted in 2003 (CFO Research Studies) estimated that the

value of human capital represented over 36 per cent of total revenue in a typical organization.

- People in organizations add value and there is a case for assessing this value to provide a basis for HR planning and for monitoring the effectiveness and impact of HR policies and practices.
- The process of identifying measures and collecting and analysing information relating to them will focus the attention of the organization on what needs to be done to find, keep, develop and make the best use of its human capital.
- Measurements can be used to monitor progress in achieving strategic HR goals and generally to evaluate the effectiveness of HR practices.
- You cannot manage unless you measure.

However, three voices have advised caution about measurement. Leadbeater (2000) observed that measuring can 'result in cumbersome inventories which allow managers to manipulate perceptions of intangible values to the detriment of investors. The fact is that too few of these measures are focused on the way companies create value and make money'. The Institute of Employment Studies (Hartley, 2005) emphasized that reporting on human capital is not simply about measurement. Measures on their own such as those resulting from benchmarking are not enough; they must be clearly linked to business performance. And Scarborough and Elias (2002) concluded from their investigations that the specific set of measures or metrics organizations reported were less important than the process of measuring and the uses for the information gathered.

Approaches to measurement

Six of the main approaches to measurement are described below.

The human capital index – Watson Wyatt

On the basis of a survey of companies that have linked together HR management practices and market value, Watson Wyatt (2001) identified four major categories of HR practice that could be linked to a 30 per cent increase in shareholder value creation. These are:

Practice	Impact on market value (per cent)
total rewards and accountability	16.5
collegial, flexible workforce	9.0
recruiting and retention excellence	7.9
communication integrity	7.1

The organizational performance model – Mercer HR Consulting

As described by Nalbantian *et al* (2004) the Organizational Performance Model developed by Mercer HR Consulting is based on the following elements: people, work processes, management structure, information and knowledge, decision-making and rewards, each of which plays out differently within the context of the organization, creating a unique DNA. If these elements have been developed piecemeal, as often happens, the potential for misalignment is strong and it is likely that human capital is not being optimised, creating opportunities for substantial improvement in returns. Identifying these opportunities requires disciplined measurement of the organization's human capital assets and the management practices that affect their performance. The statistical tool, 'Internal Labour Market Analysis' used by Mercer draws on the running record of employee and labour market data to analyse the actual experience of employees rather than stated HR programmes and policies. Thus gaps can be identified between what is required in the workforce to support business goals and what is actually being delivered.

The human capital monitor – Andrew Mayo

Mayo (2001) has developed the 'human capital monitor' to identify the human value of the enterprise or 'human asset worth', which is equal to 'employment cost × individual asset multiplier'. The latter is a weighted average assessment of capability, potential to grow, personal performance (contribution) and alignment to the organization's values set in the context of the workforce environment (ie how leadership, culture, motivation and learning are driving success). The absolute figure is not important. What does matter is that the process of measurement leads you to consider whether human capital is sufficient, increasing, or decreasing, and highlights issues to address. Mayo advises against using too many measures and instead to concentrate on a few organization-wide measures that are critical in creating shareholder value or achieving current and future organizational goals.

A number of other areas for measurement and methods of doing so have been identified by Mayo (1999, 2001). He believes that value added per person is a good measure of the effectiveness of human capital, especially for making inter-firm comparisons. But he considers that the most critical indicator for the value of human capital is the level of expertise possessed by an organization. He suggests that this could be analysed under the headings of identified organizational core competencies. The other criteria he mentions are measures of satisfaction derived from employee opinion surveys and levels of attrition and absenteeism.

The Sears Roebuck model

The Sears Roebuck model (Rucci *et al*, 1998) defines the employee-customer-profit chain. It is sometimes called the 'engagement model'. It explains that if you keep employees satisfied in terms of their attitude to the company and their job you will create a '*compelling place to work*', which will encourage retention and lead to service helpfulness and merchandize value, which leads to customer satisfaction, retention and recommendations, thus creating '*a compelling place to shop*'. This in turn creates '*a compelling place to invest*', because of its impact on return on assets, operating margins and revenue growth (Figure 2.1).

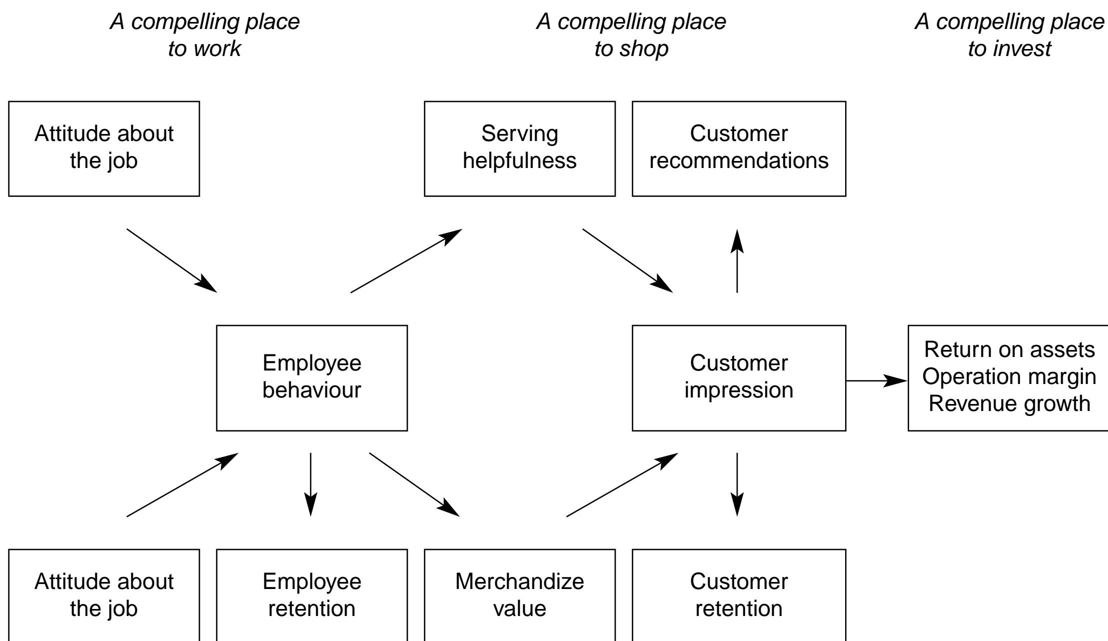

Figure 2.1 The Sears Roebuck Model: Employee-Customer-Profit chain

This model encourages the use of attitude surveys to measure job satisfaction and engagement and has been used in a number of organizations in the UK.

Nationwide has developed its 'Genome' human capital investment model to quantify the impact that employee commitment has on customer satisfaction and business performance. The model uses data from existing sources such as employee opinion surveys, customer satisfaction indices, business performance statistics and employee metrics covering turnover, length of service and absence. Use of the model enabled

Nationwide to prove statistically that the more committed the employee the happier the customer. It is possible to use data modelling to predict the impact that a change in one factor affecting employee commitment would have on customer satisfaction and ultimately on business performance. For example, increasing employee satisfaction with basic pay by 5 per cent would produce an overall rise in customer satisfaction of 0.5 per cent and an increase in personal loan sales of 2.3 per cent.

The balanced scorecard

The balanced scorecard as originally developed by Kaplan and Norton (1992, 1996) is frequently used as the basis for measurement. Their aim was to counter the tendency of companies to concentrate on short-term financial reporting. They take the view that 'what you measure is what you get', and they emphasize that 'no single measure can provide a clear performance target or focus attention on the critical areas of the business. Managers want a balanced presentation of both financial and operational measures'. Their original concept of the scorecard required managers to answer four basic questions, which means looking at the business from four related perspectives, as shown in Figure 2.2.

Some organizations have replaced the innovation and learning perspective with a broader people or human capital element.

Kaplan and Norton emphasize that the balanced scorecard approach 'puts strategy and vision, not control at the centre'. They suggest that while it defines goals, it assumes that people will adopt whatever behaviours and take whatever actions are required to achieve those goals: 'Senior managers may know what the end result should be, but they cannot tell employees exactly how to achieve that result, if only because the conditions in which employees operate are constantly changing.'

They suggest that the balanced scorecard can help to align employees' individual performance with the overall strategy: 'Scorecard users generally engage in three activities: communicating and educating, setting goals, and linking rewards to performance measures'. They comment that:

> Many people think of measurement as a tool to control behaviour and to evaluate past performance. The measures on a Balanced Scorecard, however, should be used as the cornerstone of a management system that communicates strategy, aligns individuals and teams to the strategy, establishes long-term strategic targets, aligns initiatives, allocates long- and short-term resources and, finally, provides feedback and learning about the strategy.

Research by Deloitte & Touche and *Personnel Today* (2002) found that 32 per cent of large UK companies are using the balanced scorecard methodology, although the

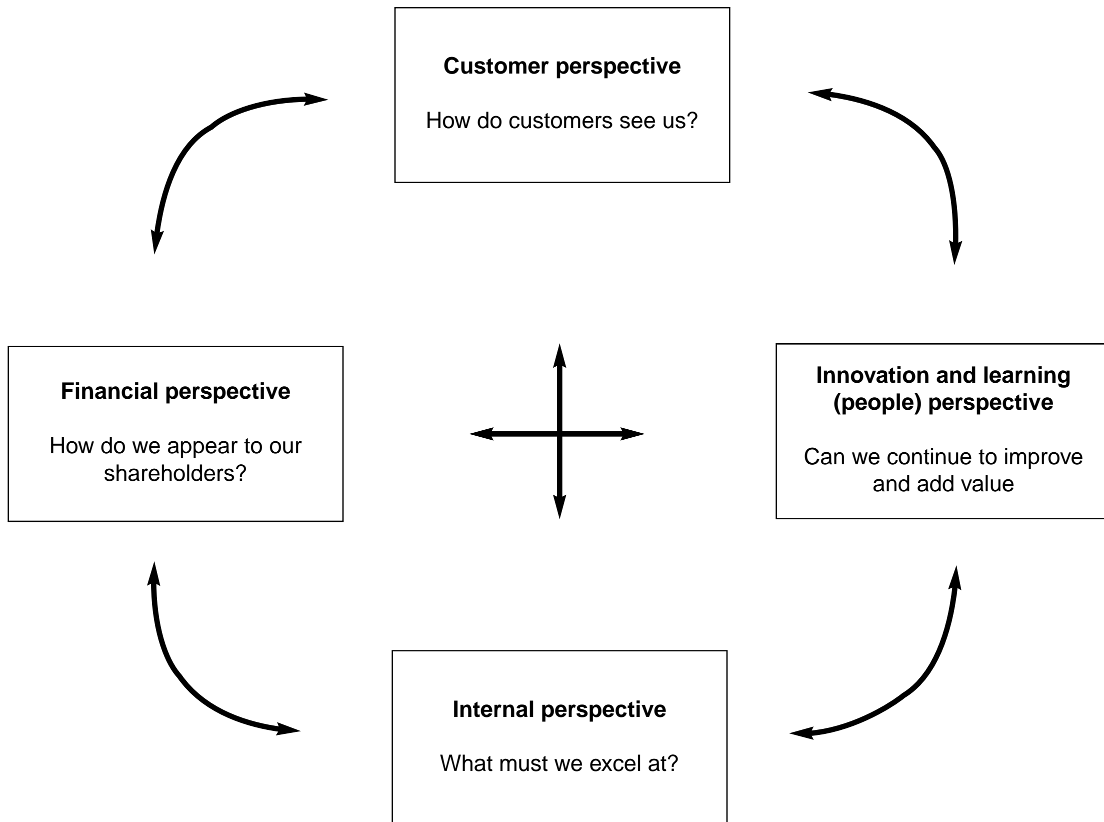

Figure 2.2 The balanced scorecard

methods adopted vary. At Lloyds TSB the balanced scorecard blends a mix of financial metrics and non-financial indicators to provide a single integrated measure of performance that focuses on key indicators, from which a true reflection of organization performance can be accomplished. The scorecard thus enables the organization to focus on a small number of critical measures that create value for the organization.

Norwich Union Insurance describes its balanced scorecard as a 'mechanism for implementing our strategy and measuring performance against our objectives and critical success factors to achieve the strategy'. The scorecard is cascaded throughout the organization to measure the operational activities that are contributing to the overall company strategy. The balanced scorecard changes from year to year. Most recently, it set out to achieve three goals: positive benefit, staff impacts and financial performance – in short, service, morale and profits. Previously, the emphasis was

predominantly on profit, in order to deliver the promises made to the City and shareholders, but the company feels that more focus is now needed on service and morale.

The EFQM model of quality

The European Foundation for Quality Management (EFQM) model of quality as shown in Figure 2.3 provides another framework for measuring and reporting on human capital management. It indicates that customer satisfaction, people (employee) satisfaction and impact on society are achieved through leadership. This drives the policy and strategy, people management, resources and processes required to produce excellence in business results.

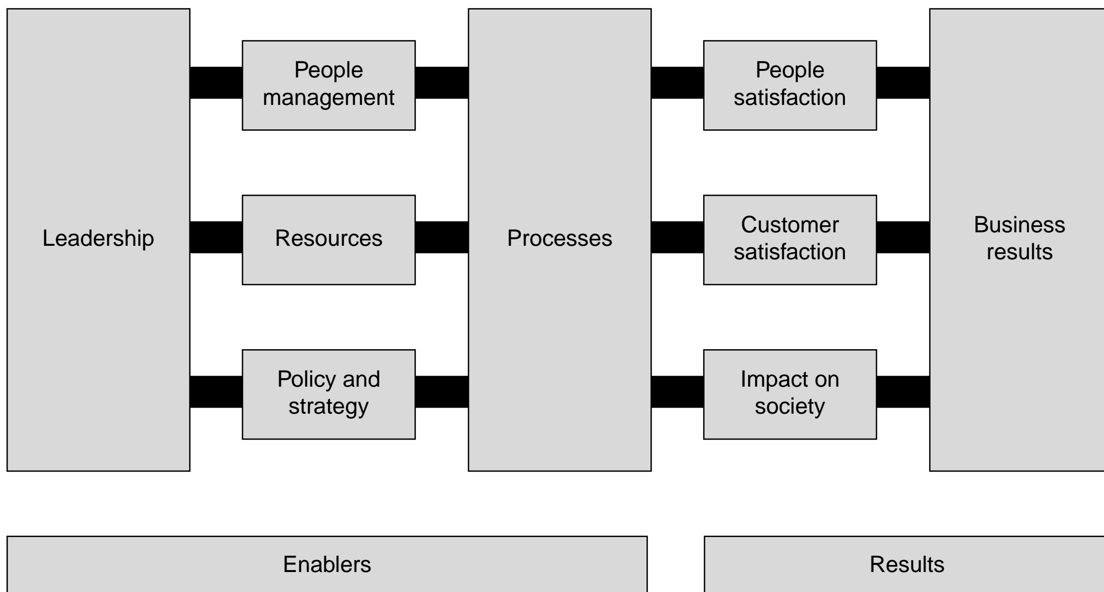

Figure 2.3 The EFQM model

The nine elements in the model are defined as follows:

1. *Leadership* – how the behaviour and actions of the executive team and all other leaders inspire, support and promote a high performance culture.
2. *Policy and strategy* – how the organization formulates, deploys and reviews its policy and strategy and turns them into plans and actions.
3. *People management* – how the organization realizes the full potential of its people.

4. *Resources* – how the organization manages resources effectively and efficiently.
5. *Processes* – how the organization identifies, manages, reviews and improves its processes.
6. *Customer satisfaction* – what the organization is achieving in relation to the satisfaction of its external customers.
7. *People satisfaction* – what the organization is achieving in relation to the satisfaction of its people.
8. *Impact on society* – what the organization is achieving in satisfying the needs and expectations of the local, national and international community at large.
9. *Business results* – what the organization is achieving in relation to its planned business objectives and in satisfying the needs and expectations of everyone with a financial interest or stake in the organization.

Organizations that adopt the EFQM model accept the importance of performance measurement and work all the time to improve the usefulness of their measures, but they also recognize that simply measuring a problem does not improve it. There is a risk that managers will exert their best energies to the analysis, leaving little left for the remedy.

Measurement elements

The main data elements used for measurement are as follows:

- *Basic workforce data* – demographic data (numbers by job category, sex, race, age, disability, working arrangements, absence and sickness, turnover and pay).
- *People development and performance data* – learning and development programmes, performance management/potential assessments, skills and qualifications.
- *Perceptual data* – attitude/opinion surveys, focus groups, exit interviews.
- *Performance data* – financial, operational and customer.
- *Non-financial variables* – the top 10 as listed by Low and Siesfield (1998) are:
  - quality of corporate strategy;
  - execution of corporate strategy;
  - management credibility;
  - innovation;
  - research leadership;
  - ability to attract and retain talented people;
  - market share;
  - management expertise;
  - alignment of compensation with shareholders' interests;
  - quality of major business processes.

In more detail the Council for Excellence in Management and Leadership (2002) report listed the following measures:

A. *Morale*

1. Absenteeism.
2. Accidents.
3. Employee turnover.
4. Director and manager turnover.
5. Employee satisfaction (staff survey measure).
6. Sickness.

B. *Motivation*

1. Appraisal – completion rates.
2. Per cent of employees for whom documented annual appraisal has been agreed.
3. Per cent of jobs for which objectives have been documented.
4. Per cent of jobs for which job descriptions exist.
5. Employee understanding of strategy (staff survey measure).
6. Employee understanding of vision (staff survey measure).
7. Employee retention.
8. Director and manager retention.
9. Working hours.

C. *Investment*

1. Benchmarked remuneration levels.
2. Directors and managers' salaries as a percentage of total salaries.
3. Human resource spend per employee.
4. Training investment.

D. *Long-term development*

1. Current management and leadership capability.
2. Potential management and leadership capability.
3. Management and leadership skill gaps.
4. Per cent of job holders for whom a development plan has been agreed.
5. Per cent of jobs for which competencies have been audited.
6. Training days.

E. *External perception*

1. Job applications: vacancies.
2. Job offers: job acceptances.

Measuring human capital

The points that should be borne in mind when measuring human capital are:

- Identify sources of value including the competencies and abilities that drive business performance.
- Analyse the relationships between people management practices and outcomes and organizational effectiveness.
- Remember that human capital measurement is concerned with the impact of people management practices on performance so that steps can be taken to do better. It is not just about measuring the efficiency of the HR department in terms of activity levels. It needs to be value-focused rather than activity-based. For example, it is not enough just to record the number of training days or the expenditure on training; it is necessary to assess the return on investment generated by that training.
- Keep measurements simple – concentrate on key areas of outcomes and behaviour.
- Only measure activities if it is clear that such measurements will inform decision-making.
- Analyse and evaluate trends rather than simply record actuals – compare the present position with baseline data.
- Focus on readily available and reliable quantified information; however, although quantification is desirable it should not be based on huge, loose assumptions.
- Remember that measurement is a means to an end, not an end in itself. Do not get so mesmerized by the process of collecting data as to forget that the data is there to be used to support decision-making and generate action.

HUMAN CAPITAL REPORTING

Human capital reporting is concerned with providing information on how well the human capital of an organization is managed. There are two aspects: first, external reporting to stakeholders through, in the UK, the compulsory Operating and Financial Review (OFR). The second aspect is internal reporting, which also informs the leadership team and stakeholders generally about how human capital is being

managed, but extends this with statements of how the information will be used to guide future action. The purpose is to inform decision-making about human capital management, not just to record the figures.

External reporting

The Accounting for People Task Force Report (2003) recommended that operating and financial review reports (OFRs) should be made by companies which have a strategic focus, are balanced and objective and based on sound data'. The Task Force specified that:

> The report should clearly represent the Board's understanding of the links between HCM policies and practices and its business strategy and performance. This means that it should normally include details on the size and composition of the workforce, employee retention and motivation, skills, competencies and training, remuneration and fair employment practice, and leadership and succession planning. The report should follow a process that is susceptible to review by auditors, provide information in a form that enables comparison over time, and use commonly accepted terms and definitions.

The CIPD (2003b) has recommended that the OFR should provide information on:

- the profile of the workforce and its diversity;
- senior executive remuneration;
- the quality of leadership and management strength;
- how well labour costs have been managed over time;
- evidence of a coherent, robust people strategy that is mapped to the stated business strategy for the next three years;
- evidence that current people management practice (especially regarding acquisition, motivation and retention) are affecting organizational and business performance;
- current and forecasted returns on people investment in the next three to five years;
- the value of human capital assets and future investments, especially in major corporate decisions such as mergers and acquisitions;
- comparator listings in financial league tables – such as industry FTSE or analyst ratings.

The CIPD (2003b) also proposed the external reporting framework illustrated in Figure 2.4.

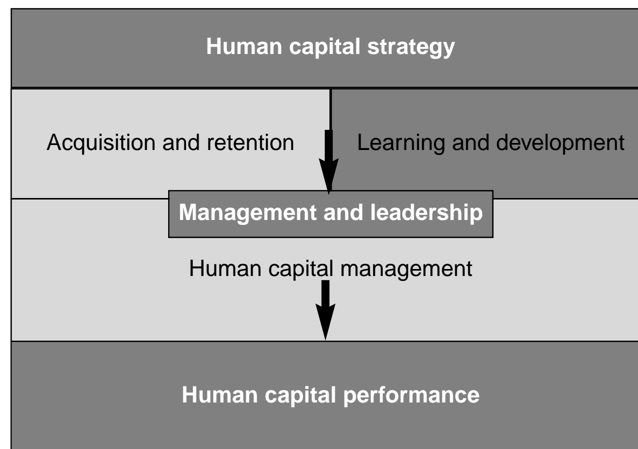

Figure 2.4 Human capital external reporting framework (CIPD, 2003b)

Internal reporting

Internal reporting should be linked to the external reporting framework but will focus more on the practical implications of the data that has been assembled and analysed. The information and the headings of the internal report have to be tailored to the context and needs of the organization, but it could:

- set out the quantitative and qualitative information – this could include data on the size and composition of the workforce, attraction and retention, absence, motivation, skills and competencies, learning and development activities, remuneration and fair employment practices, leadership and succession planning, and the outcomes of opinion or job satisfaction surveys;
- analyse measures of employee satisfaction and engagement, compare them with data on business performance and demonstrate the links between them;
- analyse the outcomes of external benchmarking;
- identify the key performance drivers in the organization and indicate how human capital management is contributing to adding value in each of these areas;
- review the extent to which people management strategy, policies and practices are contributing to the achievement of business goals;

- set out the returns on investments in people management and development projects and evaluate the effectiveness of the investments;
- draw conclusions on the implications of the data for future people management strategy, policy and practice.

An example of internal reporting is provided by Standard Chartered Bank. A range of processes and benchmarks has been established to measure and enhance the contribution of its employees. Work on human capital measurement has enabled the bank to understand the difference that talented and motivated employees can make to the business. A 'Human Capital Roadmap' has been developed to provide a clear people agenda. The core of the roadmap is the five areas of focus which drive business performance that are supported by key people processes and interventions. The latter form the framework for metrics and evaluations. These include an engagement survey (G12) developed by the Gallop Organization covering 12 factors that underpin a productive and stimulating place to work. Research has established a powerful link between engagement scores and business performance.

At Nationwide regular reports are made to area managers on key drivers. These are presented graphically on dashboards, as illustrated in Figure 2.5, enabling the manager to identify problem areas, investigate the circumstances and initiate action.

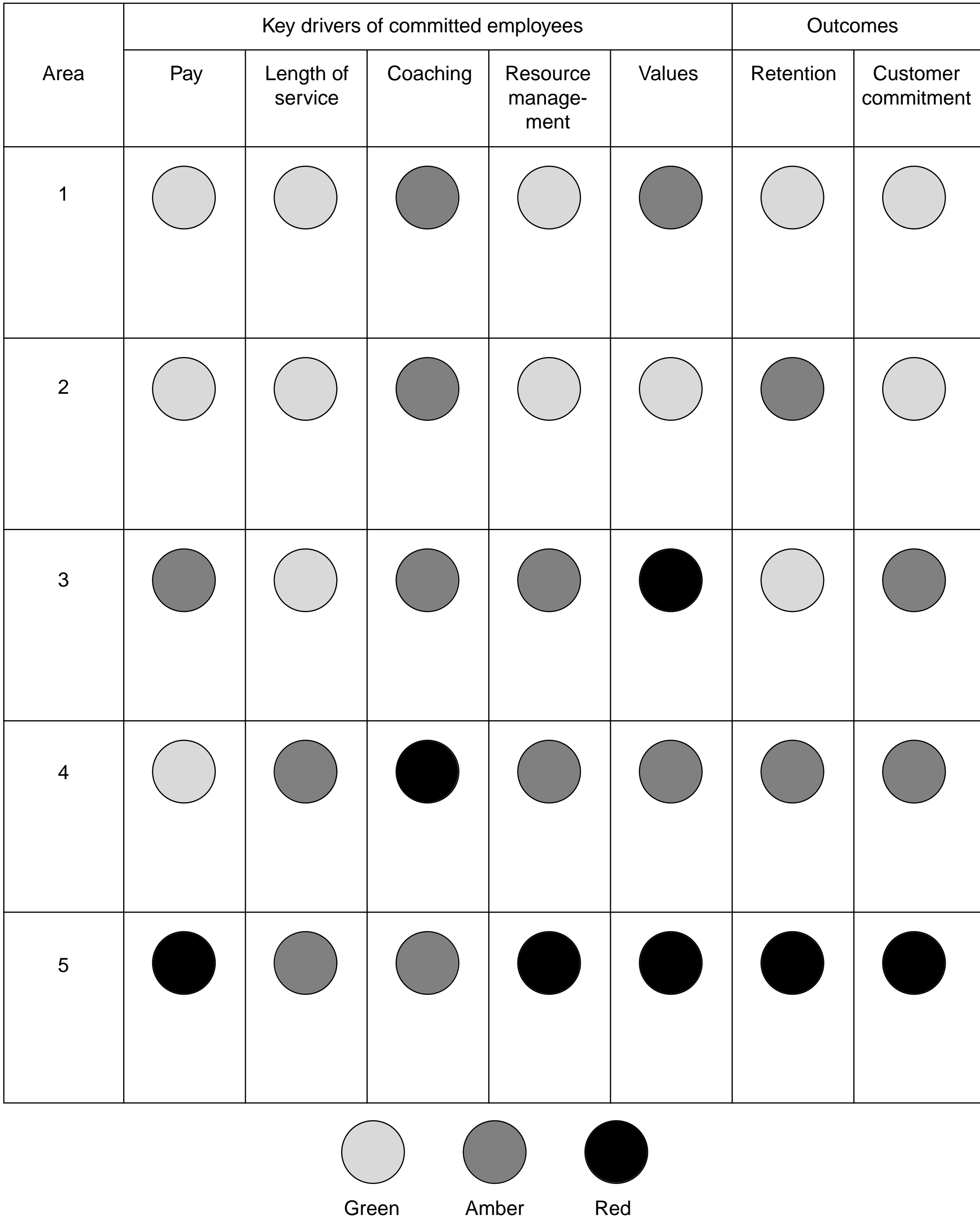

Figure 2.5 Human capital reporting dashboard for area managers: Nationwide