

# Five steps to effective human capital measurement

**M**EASURING THE WAY AN organization manages its human capital is finally on the agenda. Board members, shareholders and/or stakeholders and analysts have a right to understand just how well organizations are managing their most costly investment – people.

Line managers need to know how well people are contributing. The board has to be assured that their people investment is not just in safe hands, but that its value is being maximized, and investors want to see evidence of this value creation. Analysts, meanwhile, and especially those who focus on intangible assets (Hermes now has 50 analysts researching intangibles) are especially interested in the way human capital on the board is being managed.

So, we're not just talking about measuring the quality of the HR function, although that may be one of the enablers of good human capital management (HCM). No, the people agenda has finally reached the board because HCM, unlike HR, is business critical. Through research that Penna has recently carried out with over 200 managing directors and HR directors, we have seen real evidence of an increasing appetite to measure human capital at board level for both internal and external use.

## Making measurement strategic

The research shows that, at last, business acknowledges the critical role HCM plays in success. Findings show that business leaders see human capital management as critical to the fundamental success of the business (82 percent of respondents) and 80 percent of business leaders think that measurement is key to the delivery of effective HCM. However, organizations are not focusing on the measures that can inform critical strategic decisions. For the most part, they are looking at basic operational and historical measures such as headcount changes (86 percent), hires and terminations (81 percent) and total compensation (61 percent).

However, many organizations do understand the value of more strategic HCM measures, such as employee motivation (77 percent), leadership team capability (76 percent) and employee competency (70 percent). Boards will want reports on these measures in the future. But, there is a large gap between this desire and current reality. Almost 90 percent of business leaders believe that companies should report on HCM, but only 29 percent of respondents currently report externally. Over 70 percent of business leaders (rising to 88 percent among MDs) are strongly against government legislation or

regulation that enforces external reporting on people management issues.

The problem is that although there's a demand for HCM reporting, there's little practice of it. The temptation is to measure "everything that moves," but this may only result in a huge amount of energy and time being wasted on measurement rather than business goals. Measuring HCM must be a strategic exercise.

## Five steps to success

At Penna we believe this can be a simple five-stage process:

1. First identify the key HCM programs or business critical people factors in the organization. An example of the first might be a talent management program aimed at ensuring the organization has the talent it requires to deliver its future.
2. Next identify measures that indicate progress or monitor the current state against a benchmark.
3. The bias in selecting measures should be on the results of programs that add value to the organization. If it's true that people are the most significant competitive differentiator in a business, then we should be able to measure this difference.
4. Next collect the data, report on trends to the board and agree which, if any, will be reported externally. The data should set the agenda for further HCM priorities.
5. Finally, identify correlations between HCM measures and fluctuations in key business objectives. For example, after 10 years of measuring staff satisfaction, Sears identified that movements in that measure were predictive of a profit increase or decrease. Over time it will be possible to reduce the number of measures as their significance to the quality of HCM is better understood.

Without a doubt HCM, and its measurement, is here to stay. Boards and investors will increasingly require reliable data to back up "soft words" about how important people are as evidence that the organization is in good hands. HR professionals have to get a good deal better at identifying the best measures, and acting on what they tell us, but evidence suggests that, after a long build-up, this is now well and truly on the agenda. 