How to Improve Your Organization's Return on People

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Two “Human Capital” roads to economic profitability

1. The “low-road”

   People are “costs” and investments in them are minimal

2. The “high road”

   People are “assets” (as well as costs) and investments in them are a source of strategic competitive advantage

Human capital management on the low road

– Competitive advantage is achieved through being the low-cost, low-margin producer

– This perpetuates low-wages, low-skills, and high-turnover

– For producers who are not located in the lowest-wage countries, this is a sustainable strategy only in markets that are impervious to foreign trade

Human capital management on the high road

- Business model focuses on creating high margins by producing more valuable products and services
- Competitive advantage depends on superior human capital management
- Creates and depends on a “virtuous cycle” of high wages, high skills, and innovation
- Achieved through heavy investments in human capital
- A potentially sustainable strategy in an increasingly knowledge-intensive world

The agenda

What the research tells us about:

1. What constitutes superior “human capital management”
2. The returns to superior “human capital management”
3. What to do first
4. What to do second
5. The role of government

What constitutes superior "human capital management"

- A synthesis of the research points to 5 attributes that distinguish highly effective organizations from their competitors*:
  - Leadership Effectiveness
  - Learning Capacity
  - Workforce Optimization
  - Knowledge Optimization
  - Talent Retention

* Bassi and McMurrer, "What to do When People are Your Most Important Asset," *Handbook of Business Strategy*, forthcoming.

Defining these 5 key attributes, Part 1

1. **Leadership Effectiveness:** The effectiveness of leaders' ability to optimize an organization's human capital through communication, performance feedback, efforts to instill confidence, and demonstration of key organizational values

2. **Learning Capacity:** The organization's overall ability to learn, change, innovate, and continually improve

Defining these 5 key attributes, Part 2

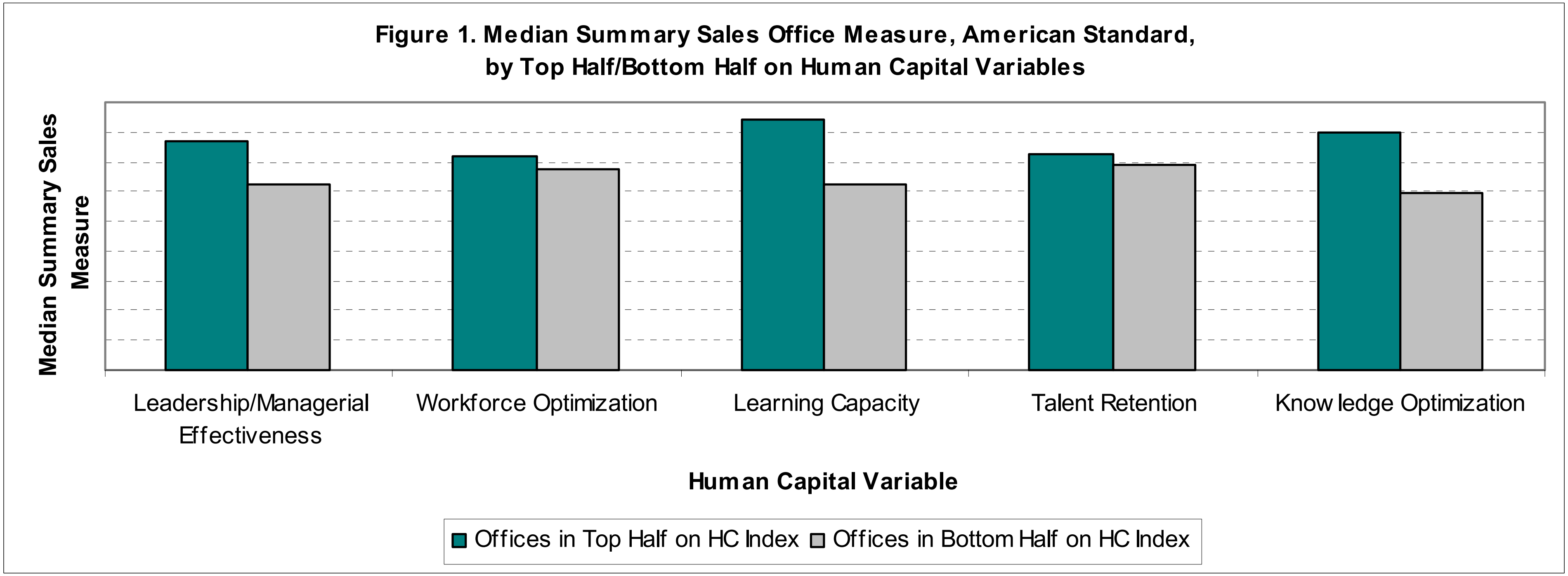
3. **Workforce Optimization:** An organization's success in optimizing the performance of its workforce by means of developing and sustaining talent (skills, competencies, abilities, etc.) and guiding and managing its application on the job

4. **Knowledge Optimization:** The extent of the organization's "collaborativeness" and current efforts and ability to share knowledge and ideas across the organization

5. **Talent Retention:** The organization's ability to retain, engage, and optimize the value of its people

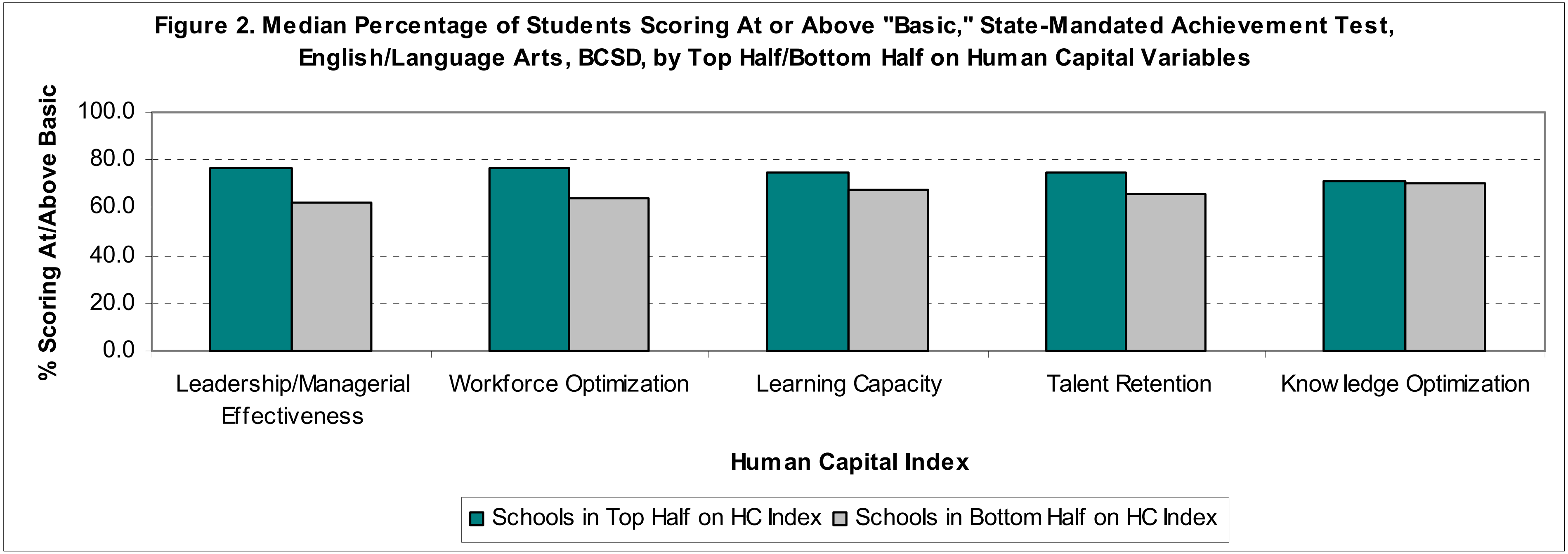
Example #1—A Global Manufacturing Firm

Sales statistics are better in the sales offices that score higher on these 5 key attributes



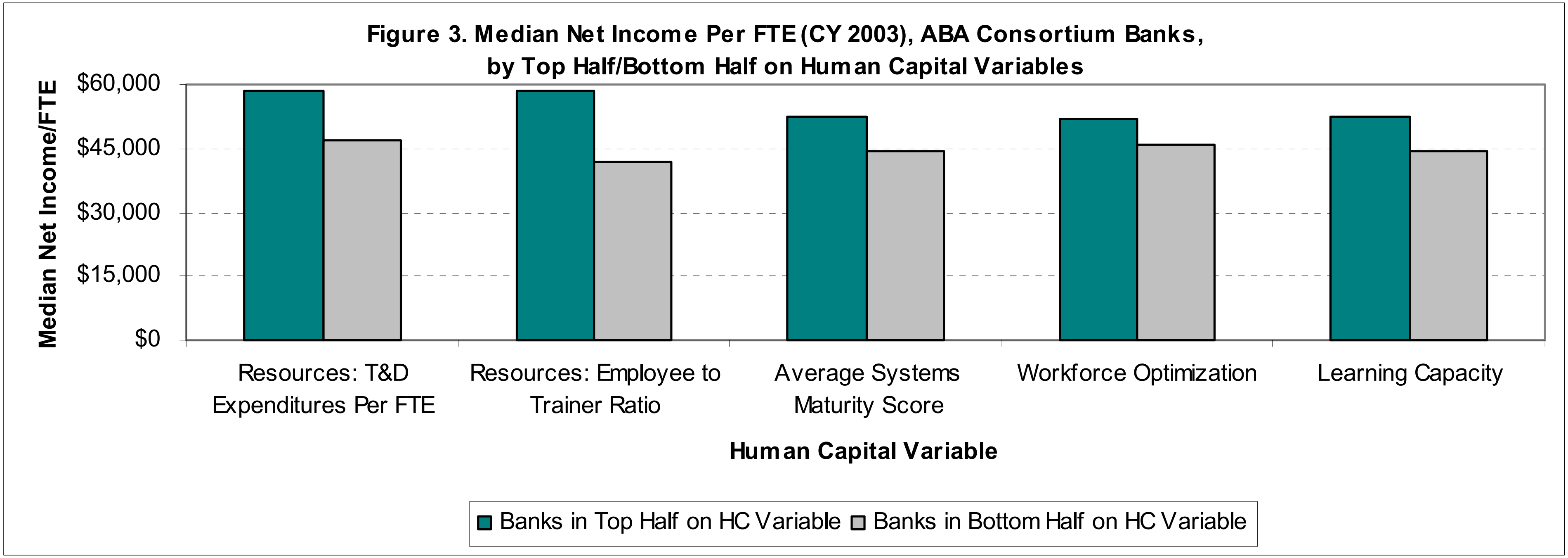
Example #2—A Rapidly Growing School District

Student achievement is higher in schools that score higher on these 5 key attributes



Example #3—A Consortium of 17 Large Banks

Institutions with the greatest commitment to human capital enjoy the greatest financial rewards



Workplace Learning--Effects on Retention*

- One of the most important predictors of whether an employee will stay with his/her current employer is the employee's satisfaction with the opportunities provided for learning and development.

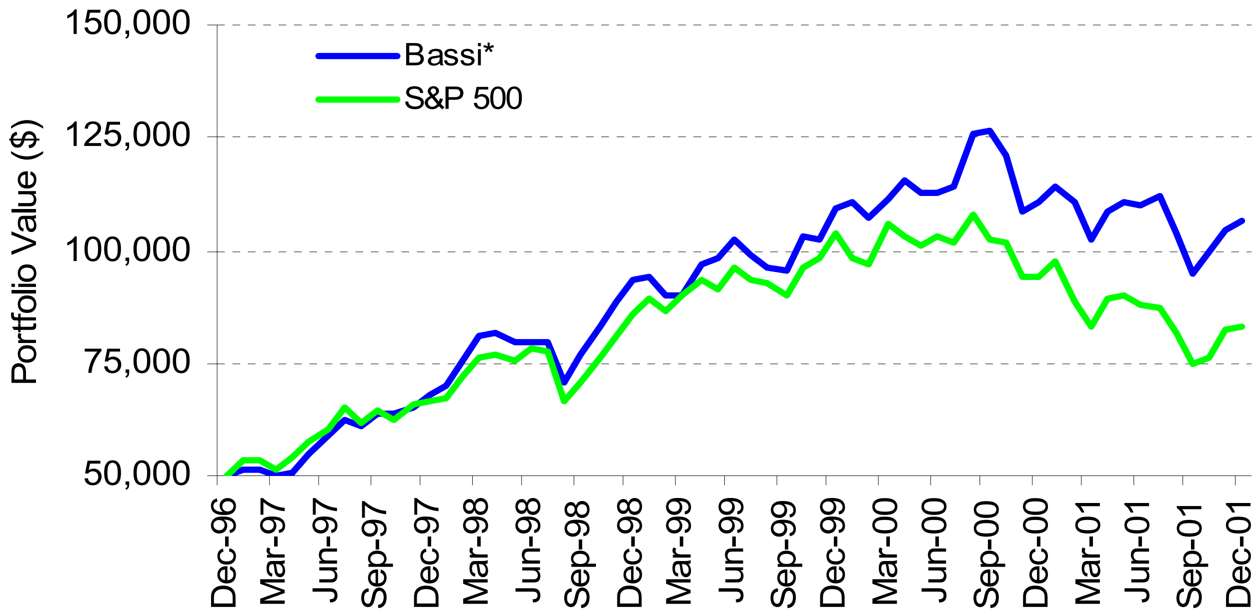
- A firm's ability to retain its key employees is, in turn, a fundamental determinant of a number of important outcomes, such as customer satisfaction, sales per employee, and market capitalization.

* James Heskett, Thomas Jones, Gary Loveman, W. Earl Sasser, and Leonard Schelesinger. 1994. "Putting the Service-Profit Chain to Work." *Harvard Business Review* (March-April).

Workplace Learning--Effects on Shareholder Return*

A series of portfolios of firms that made the largest investments in worker training subsequently returned 16.3% per year, compared with 10.7% for the S&P 500 index

Growth of $50,000 Invested on 1/1/97, through 12/31/01,
Bassi Investments Hypothetical Portfolio vs. S&P 500
(*net performance after dividends and deduction of all fees)



*Bassi and McMurrer. Forthcoming. “Are Skills Costs or Assets”? *Milken Review.*

What to Work on First: Effective leadership and managerial practices

- Surveys show that employees will tolerate "bad" organizations if they have good bosses, and are more likely to leave "good" organizations if they have "bad" bosses

- Hence, professional management of people is essential to being able to retain high performing employees

- Investments in leadership and managerial capability is an important first step for organizations that are seeking to improve their return on people

What to Work on First: Effective leadership and managerial practices

- You can either "buy" or "build" leadership/managerial capability:
  - "Buying" is fast but expensive, and the long-run effects are often mixed
  - "Building" is slow but less expensive, and the long-run effects are often better than "buying"

- The most essential attributes to be developed in leaders are:
  - An ability to communicate effectively (openly and honestly)
  - The skills to identify and eliminate barriers to creating an effective and productive work environment

What to Work on Second: Opportunities for employees to grow and learn

- Employees have come to understand that their careers and earnings potential hinge on their "human capital"

- Hence, investments in employee education and training that increase productivity have the additional advantage of being viewed as a "benefit" by employees

What to Work on Second: Opportunities for employees to grow and learn

- The direct effect of investments in employee training is that employees have the skills and competencies they need to do their jobs

- The indirect—and perhaps more important effects—are that employees:
  - Are less likely to leave (provided that leaders are effective and wages are competitive)
  - Develop valuable relationships with customers

Making Employee Training Cost Effective

The challenges to be overcome in developing cost-effective, training programs:

1. Time and space
2. Cost
3. Effectiveness

Making Employee Training Cost-Effective

- Electronic forms of learning can help ameliorate the constraints of time and space. They have:
  - High fixed (development) costs
  - Low variable (per worker) costs

- An important method for reducing the cost and improving the effectiveness of training is through training collaboratives organized through trade associations or government-subsidized consortium

Policies That Help Improve the Cost-Effectiveness of Training

There is an important role for public policy to play in promoting workforce skill development:

1. Tax subsidies—with a stream-lined process for certifying eligible expenditures

2. Facilitate and subsidize multi-employer consortia that work together to share the fixed costs of developing high-quality general skill development

3. Finance research collaboratives that help employers identify, and improve, the impact of investments in workforce skill development

Summary and Conclusions

A growing body of research shows that effective leaders and managers—along with large investments in employee training—create a virtuous “human capital value chain”:

- Knowledgeable, productive employees
- Greater ability to retain high performing employees
- Higher rates of customer retention
- Greater profits

To create an innovative, high-margin, high-wage economy, large investments are needed from both the private and public sectors

Summary and Conclusions

- When combined with effective leadership and management, employers' return on investment in worker training is very high

- There is a clear, well-defined role for government to play in financing and facilitating employers' investments in training