Translating theory into practice – an appraisal of HR practice

CHAPTER 3

LEARNING OBJECTIVES

- To evaluate the take-up of progressive HR practices within organisations
- To assess the reasons why theoretical links between people management and organisational performance fail to make the transition to organisational practice
- To discuss the barriers to high-performance working
- To discuss the nature and scope of the HR role in organisations
- To evaluate the concept of human capital and assess the nature, scope and value of tools, techniques and metrics for evaluating HR effectiveness

INTRODUCTION

The previous chapter reviewed a range of research studies which have established a link between HR practice and organisational performance. While theoretical approaches can be criticised on conceptual and methodological grounds, they nevertheless paint a compelling picture of the economic and business case for good people management. The precise nature of the link remains unclear although Purcell *et al*'s (2003) work has provided insight into the so-called 'Black Box' problem or the what, why and how practices that influence organisational performance and business outcomes.

However, although the conceptual link between people management and organisational performance is well established, the empirical links are less secure. Theoretical developments are not translated into organisational practice and there is a large gap between the rhetoric of HRM and its practical implementation within organisations. The phrase 'people are our greatest asset' may have entered the management lexicon, but there is little evidence to suggest that research findings are having a significant influence within organisations or that business leaders are putting people management issues on a level with other business decisions.

Evidence suggests no increase in the adoption by organisations of progressive HRM practices. In other words, the idea of people as an organisation's greatest asset is not borne out by the reality of organisational practice. As Pfeffer and Sutton (2000: ix) put it,

Why is it that so many managers know so much about organisational performance, say so many smart things about how to achieve performance, and work so hard, yet are trapped in firms that do so many things they know will undermine performance?

Several explanations can be offered for the pervasive and enduring gap between academic research and business practice. However, one explanation for the limited take-up of progressive HR practices by organisations can be attributed to the role and credibility of the HR function. A CIPD (2003) survey of over 1,000 HR practitioners from a variety of sectors reported a growth in the numbers employed in HR, higher levels of influence for the HR function compared with senior colleagues and a key role for HR in achieving business outcomes. However, the survey also reported a gap between HR strategies and their application; between HR strategies on paper and in practice, with HR practitioners more involved in the planning and development of strategy than its implementation. As one survey respondent (CIPD, 2003: 24) put it,

Anyone can read a book or policy document which gives the answers to 'how' to do something or 'how' to resolve an issue. HR needs to think more of the 'why' and then be able to lead on managing change.

One third of HR practitioners reported their primary role as being strategic business partners, while the majority were inclined to see the function as operational rather than strategic. In other words, although the HR role is evolving and changing in line with changes in business priorities, the function still has some considerable way to go in establishing its strategic business credentials and making a real strategic contribution. As the CIPD (2003: 9) survey suggests, HR needs to become significantly more business-focused and strategic in the future.

The challenge for HR professionals appears to lie in the ability to communicate a clear and consistent message about the value of people and to develop effective tools and understanding to demonstrate the contribution of people to organisational effectiveness. Research by Purcell *et al* (2003) and others has demonstrated the ways in which effective HR policies and practices can deliver bottom-line performance and HR practitioners need to do more to drive such a strategic contribution.

This chapter evaluates trends in the take-up of high-performance progressive HR working practices within organisations and examines the reasons why theoretical linkages fail to make the transition to organisational reality. In particular, the analysis focuses on the HR role and the credibility of the HR function and HR practitioners in supporting business goals and making a contribution to organisational performance. There is, of course, much more to the effective management of people than the HR role, and issues relating to the creation of an environment that supports high performance are discussed in Chapters 4 and 5. Here, however, the analysis focuses specifically on the HR role and contribution. The final part of the chapter evaluates the concept of human capital and discusses a range of metrics in measuring the contribution of people to organisational success.

THE TAKE-UP OF PROGRESSIVE HR PRACTICE IN ORGANISATIONS

As Chapter 2 outlined, high-performance working practices (HPW) reflect aspects of work organisation that result in improved organisational performance. Although discrepancies were noted within research studies of the precise aspects of HR practice that result in enhanced organisational performance, a consensus nevertheless appears to be emerging (EEF/CIPD, 2003: 7) of the common characteristics of HPW:

- appropriate selection and recruitment processes
- comprehensive induction programmes
- sophisticated and wide coverage of training
- coherent performance management systems
- flexibility of workforce skills
- job variety and responsibility
- teamworking
- frequent and comprehensive communication to employees
- use of quality improvement teams
- harmonised terms and conditions
- market-competitive pay
- use of rewards related to individual and/or group performance
- policies to achieve an appropriate work–life balance.

As Purcell *et al* (2003) have suggested, HPW practices improve organisational performance through three causal routes – by increasing employee skills and abilities; by promoting positive attitudes, increasing motivation and promoting discretionary behaviour; and by providing employees with opportunities at work to make full use of their skills and abilities

Few organisations, however, are applying high-performance HR practices. The Workplace Employee Relations Survey (WERS) (Cully *et al*, 1998) analysed the take-up of 16 core HR practices clustered around appraisal and reward, involvement and participation, training and development, status and security, and found that only 20 per cent of over 2,000 organisations sampled had half or more of these practices in place, and that only 2 per cent had ten or more in place. Guest *et al*'s (2000a) study, which centred on the nature and distribution of HR practices and covered over 800 different organisations in the UK, found a relatively low take-up of high-commitment HR practices. The research focused on 18 typical HR practices (eg recruitment and selection, training and development, appraisal, flexibility, job design, two-way communications, employment security, harmonisation) and found that only 1 per cent of organisations had more than three quarters of these practices in place and applying to most workers, and that 20 per cent of organisations made extensive use of less than one quarter of typical HR work practices.

Moreover, few organisations reported any plans to introduce high-commitment HR practices in the future. Guest *et al*'s (2000b) subsequent study of the 1998 Workplace Employee Relations Survey, covering 2,000 workplaces and over 28,000 workers, confirmed a positive link between greater use of HR practices and a range of outcomes such as productivity, labour costs, quality and financial performance. However, it found that the adoption of core HR practices was generally low, and that only 41 per cent of private sector workplaces and 70 per cent of public sector organisations represented were using more than half of the HR practices analysed.

A survey by the Engineering Employers Federation (EEF) in conjunction with the CIPD in 2003 analysed workplace initiatives which encapsulated some form of HPW, and found that while manufacturers were embracing some aspects of HPW, half of the firms studied had done so moderately, minimally, or not at all. The majority of firms used basic practices such as output monitoring and individual performance appraisals. The take-up of more imaginative initiatives such as employee involvement, individual/team incentives and profit-based pay was significantly lower.

The evidence thus points to a low adoption of progressive high-performance working practices across British industry. Moreover, even if organisations implement a wide range of HR practices it does not necessarily follow that these are embedded or effective. Studies have highlighted inconsistency, fragmentation and a 'pick and mix' approach to the implementation of HR practices (Truss *et al*, 1997).

ACTIVITY . . .

Compare your organisation (or an organisation you are familiar with) against the list of HPW practices shown above.

To what extent has your organisation adopted high-performance working?

What have been the reasons for the adoption/non-adoption of progressive HR practices?

What scope exists within your organisation for the introduction of HPW?

EXPLORING THE GAP BETWEEN RESEARCH EVIDENCE AND ORGANISATIONAL REALITY

Several explanations may be offered as to why theoretical and conceptual linkages between the management of people and organisational performance fail to make the transition to implementation and practice. The EEF/CIPD survey (2003: 20) identified a number of specific reasons for the non-adoption of HPW practices within manufacturing organisations. These were:

- *alternative strategies* – organisations might adopt alternative strategies such as increased outsourcing, new technology, improved recruitment and training which might be viewed as cheaper and better able to deliver results in the short term
- *system inertia* – the introduction of HPW requires change and may be resisted because organisations may get locked into their initial choice of practices and the switch to HPW may require investments in new production and distribution technologies with additional costs. More generally, the organisation may be resistant to change
- *mistrust* between management and employees can inhibit the introduction of HPW especially where poor employee relations exist or where there is a legacy of mistrust following redundancy exercises
- *costs* – there are additional costs involved in the introduction of HPW, particularly as such initiatives take time to design, implement and require time to become effective.

Wider situational factors that might inhibit the adoption or widespread implementation of HPW relate to the level and standing of HRM in the UK context, structural and cultural factors within organisations, and the 'ambiguous' role of the HRM function. Inevitably, these factors overlap, but their specific features are discussed below.

The structure of financial markets

Sisson and Storey (2000: 9) have suggested that key features of the UK business system and the structure of UK financial markets have created an environment which is inhospitable to treating people as the key to success. Their analysis highlights the following features as significant;

- an overwhelming emphasis on shareholder value as the key business driver, as opposed to the interests of other stakeholders
- institutional share ownership by investment trusts and pension funds which encourages a focus on short-term profitability
- the relative ease of take-over which reinforces pressure on short-term profitability but also encourages expansion by acquisition and merger rather than by internal growth
- a premium on 'financial engineering' as a core organisational competence and domination of financial management over other functions.

In the UK national context, management performance is focused to meet annual, even quarterly, reporting targets which emphasise immediate returns and cause managers to resort to opportunistic, fire-fighting, reactive solutions. Such approaches inhibit the development of a long-term vision conducive to the adoption of high-performance HR practice. As Storey and Sisson (1993: 76) put it,

> **short-term reporting periods tend to put pressure on managers to have recourse to opportunistic quick-fix agreements, firefighting solutions and Tayloristic job design methods which are built on command-and-control rather than the more time-consuming and consensus-seeking methods.**

Nationally, the effects can be seen in a traditional lack of investment in training and development in UK society and industry (Keep, 1989; Handy, 1987; Constable and McCormick, 1987). At the organisational level, this approach works against many HRM and HPW initiatives which are geared to a positive return over a longer time horizon. Marchington and Wilkinson (2005: 145–6) suggest that trends towards restructuring, delayering and devolvement within UK organisations have reduced the importance of HR issues at the expense of 'harder', production-oriented priorities.

Occupational management labour markets

Features of the UK business system outlined above are reflected in the number of accountants in senior positions within British industry. The occupational structure of British senior managers has emphasised financial competence and the accountancy profession has been a recognised route into senior management. This has resulted in the dominance of accountancy logic and accountancy-driven management control systems (Storey and Sisson, 1993: 76).

A dominant accounting terminology has served to undermine the contribution of people to organisational success as people management practices are difficult to quantify and measure.

However, organisational socialisation processes and power relations in organisations can serve to constrain and limit management education and professionalism.

The informal organisation

The metaphor of an iceberg (see figure 5) is frequently used to contrast the formal and informal aspects of the functioning of organisations and to emphasise the importance of informal elements on behaviour at work.

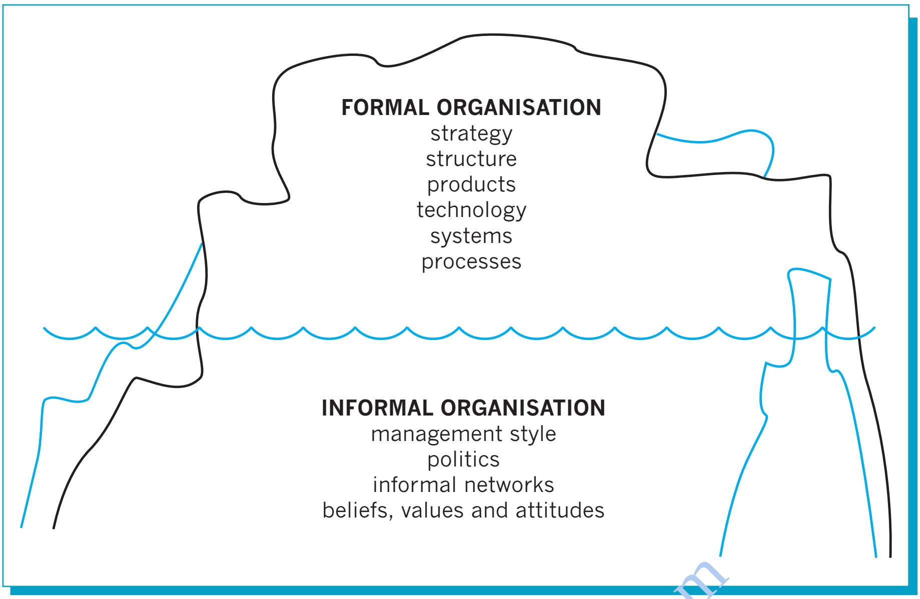

Figure 5 *The organisational iceberg*

The formal structure of any organisation incorporates explicit elements which arise from the interactions and relationships of individuals and groups within the organisation such as hierarchy, strategy, structure, rules and regulations and lines of authority. However, the organisation is likewise based on more covert, 'hidden' systems of social relations, power and influence which can constrain and undermine formal, overt policies and systems.

People are unpredictable and have diverse needs, attitudes and motivations, and the informal organisation can serve to satisfy the social and psychological needs of employees outside the formal, official structure. The informal organisation can likewise influence attitudes towards change and may fuel employee scepticism stemming from past change initiatives. The informal organisation thus exerts an important influence on employee behaviour, and a lack of congruence between employee and organisational values, goals, relationships and norms of behaviour can serve to undermine or even de-rail wider organisational initiatives. The workings of the informal organisation can be an important factor in the ownership of initiatives such as HPW and the degree to which these become accepted and embedded.

Power and politics in organisation

Organisational politics and issues of power, influence, co-operation and conflict form a part of the fabric of the informal organisation and represent an essential aspect of the functioning of the organisation. Pfeffer (1993: 204–5) defines power as

> **[the] potential ability to influence behaviour, to change the course of events, to overcome resistance, and to get people to do things that they would not otherwise do. Politics and influence are the processes, the actions, the behaviours through which this potential power is utilized and realized.**

Organisations are replete with political rivalries, departmental splits and functional conflicts that may make it difficult to translate corporate goals into specific workplace practices. Internal political issues can thus be critical in explaining why decision-makers choose to or choose not to implement HPW practices. They can also help to explain why organisations choose to implement particular sets of HR practices which are subsequently changed with the appointment of a new Chief Executive. However, even if senior decision-makers elect to adopt specific HR practices, it does not follow that these will be enacted or implemented by lower levels of management.

Purcell *et al*'s (2003) study highlighted the key role of front-line managers in influencing the relationship between the management of people and business performance. Front-line managers were identified as having a crucial role in implementing HR policies, practices and values. As Purcell *et al* (2003: x) put it,

> **It is not enough to have performance-enhancing HR policies and practices – what also matters is the way they are implemented. Managers have discretion in the way they practice good people management in the sense of, for example, communicating, solving problems, listening to employee suggestions, providing coaching and guidance, treating employees fairly, and showing respect.**

Front-line managers are defined as managers in the first line responsible for work groups comprising 10 to 25 people. Such managers are normally placed at the first level in the organisational hierarchy and are accountable to higher levels of management (Hutchinson and Purcell, 2003: 4). Front-line managers were identified as having a major role in the extent to which HR policies were implemented and embedded. As the Tesco example below illustrates, the way that store managers interpreted and applied standardised policies had a key impact on store performance.

ILLUSTRATION

Tesco

At Tesco, Purcell *et al* researched section managers in four stores in similar demographic areas and found that differences in store performance could be explained by differences in management behaviour. Tesco is a highly centralised organisation with standardised policies and procedures and processes, and each store is governed by the company routine handbook which provides detailed information on how every task is to be performed. This, in turn, provides a guide to management behaviour. Yet there were considerable variations. Store C in the study had a very controlling style of management and significantly also was the worst performing store. Although there was a heavy standardisation of routines and processes, local store managers were clearly able to exercise discretion in how they put policies into practice, which in turn had a marked impact on store performance.

Adapted from S. Hutchinson and J. Purcell (2003) Bringing policies to life: the vital role of front line managers, pp18–19

Notwithstanding the key impact of front-line managers on managing people, the devolution of HR responsibilities to front-line managers has left many unprepared, under-supported, poorly trained and having to choose between conflicting goals (Hutchinson and Purcell, 2003: 41). Devolvement has served to accelerate a focus on the short term by increasing the workloads of middle managers with a resulting emphasis on meeting targets that will affect their own performance. Such targets are invariably production-oriented rather than people-centred. As Marchington and Wilkinson (2005: 146) put it,

Without explicit proactive support from senior managers, and recognition and rewards for their work in the HR area, it is easy to understand why line managers do not take this part of their job seriously.

Pressures on front-line managers

'You never get anything completed. There's so much to do, covering areas . . . doing the work of my team.'

Responses of front-line managers

> **'It feels like a treadmill at times. I have a lot of staffing issues, trainees and absentees . . . It's about keeping your head above water.'**

S. Hutchinson and J. Purcell (2003) Bringing policies to life: the vital role of front line managers, pp18–19

In addition to a lack of skills and competences, Marchington and Wilkinson (2005: 144–5) suggest that the respective power bases of line managers and HR specialists can also be influential in the degree and extent of adoption of HR practices. Where HR work is held in disdain or where the status of the HR function is perceived to be peripheral to the functioning of the organisation, HR issues can become marginalised.

ACTIVITY . . .

To what extent has your organisation devolved responsibility for HR issues to front-line managers?

What activities have been devolved?

How effectively do front-line managers perform their HR responsibilities?

How might you persuade a sceptical front-line manager to take his or her HR role more seriously?

THE HR ROLE AND FUNCTION

A final factor in the application of HR theory into organisational practice can be attributed to the ambiguous role of the HR function within organisations. The HR function has been described as a 'Cinderella' function which has traditionally found it difficult to demonstrate a unique contribution to organisational success. This has contributed to a vicious circle, illustrated in Figure 6, from which it has proved difficult for the HR function to break out (Legge, 2005: 68).

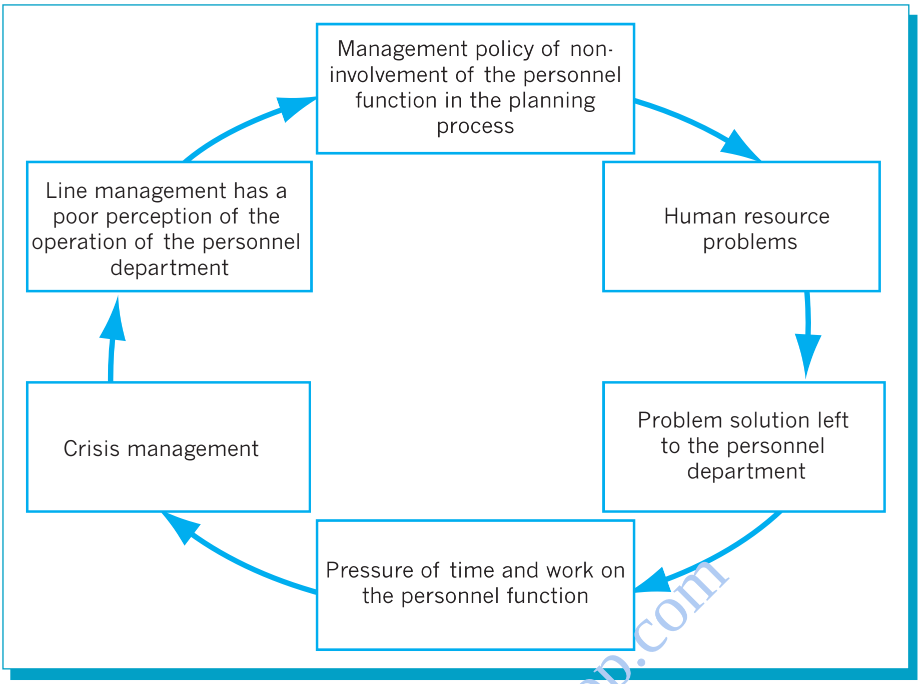

Figure 6 *A vicious circle in personnel management*
Source: K. Legge (2005) *Human Resource Management: Rhetoric and realities*, p69

PAUSE FOR THOUGHT . . .

Three professionals – an architect, an accountant and an HR manager – were discussing which (apart from the obvious one) was the oldest profession. The architect said: 'Well, of course it's architects because, if you remember your Bible, God created Heaven and Earth, and of course that's essentially an architectural job.' 'Ah,' said the accountant, 'but before he created the world, God created order out of chaos, and surely that's the essence of accountancy – so accountants must be the oldest profession.' 'Wrong!' said the HR manager. 'Where do you think the chaos came from?' (Legge 2005: 48)

What is your view? Does the HR function suffer from a lack of authority and status within organisations? If it does, why does it?

ILLUSTRATION

HR role and influence

'Anyone can read a book or policy document which gives the answer to "how" to do something or "how" to resolve an issue. HR needs to think more about the "why" and then be able to lead in managing change.'

'Give me one month and I'll make a good business person into a good HR person; too often you'd need an eternity to reverse the trick.'

'HR professionals need to understand business realities and create practical and pragmatic solutions to advise on best practice, meet legal requirements and be seen as an integral part of the business.'

– Respondents to CIPD (2003) HR survey *Where We Are, Where We're Heading*

'We hear ad nauseam about why aren't HR directors on the main board, and my answer to that would be, because not enough of them have the ability to prove the case that HR can contribute.'

'I think HR are probably the worst practitioners … They are the worst at developing their people, they are the worst at managing their people, their people are usually the most dissatisfied in the organisation, and they are the worst at doing the administration. So they are usually pretty poor. But they have grand ideas.'

– Respondents to Guest *et al* (2001) *Voices from the Boardroom* research report, CIPD

ILLUSTRATION

Thornton's scraps HR director post

Thornton's has scrapped its HR director post because the chief executive believes it is a 'luxury' the company cannot afford. Peter Burdon, chief executive of Thornton's, said the company dropped the post to save costs and that he would now take on much of the role, supported by a senior HR manager. 'We have been undergoing a cost review and concluded that the HR director was a luxury we could not afford. I have always taken a deep interest in HR,' said Burdon. Although he has no HR qualifications, Burdon said he had been managing people for 22 of his 24 years in business, which gave him the experience required for the job. 'The university of life is the best way of learning to manage people,' he said.

People Management, 15 July 2004, p9

The role played by HR professionals has evolved over time and continues to evolve and respond to changing business pressures and concerns. The roots of the HR function can be traced back to a welfare function concerned with improving the working conditions and well-being of employees. At the beginning of the twentieth century, many large organisations (eg Cadbury, Lever Brothers), often driven by strong moral and religious convictions, employed female welfare workers to look after the physical and social needs of women working on production lines. The Welfare Workers Association was established in 1913 and from this stemmed the professional body representing personnel practitioners. The welfare role subsequently broadened to incorporate responsibility for a range of employment issues including health and safety, wages and training, and in 1934 the Welfare Workers Association became the Institute of Labour Management, reflecting the broader and more formalised role of the personnel function. In 1946 the Institute of Personnel Management was formed reflecting the increased professionalism of the function. In 1994 this became the Institute of Personnel and Development and in 2000 the Chartered Institute of Personnel and Development.

There are a number of categorisations of the personnel/HR role reflecting different environmental and situational conditions (see Legge, 1978; Tyson and Fell, 1986; Storey, 1992). Ulrich (1998: 38) identified four distinct roles for HR professionals:

1. *Partner in strategy execution* – according to Ulrich, HR should be held responsible for defining the organisation's 'architecture' and ensuring fit between architecture and culture, competencies, rewards, governance, work processes and leadership.
2. *The administrative expert* role was concerned with improving efficiency by doing things quickly and more cost-effectively.
3. *The employee champion* role involved ensuring that employees felt committed to the organisation and its goals and involved training and developing line managers to get the best out of people, monitoring levels of employee morale, consulting on work processes.
4. *The change agent* role involved HR professionals in creating an appropriate culture and specifically mapping how to move from the present culture to the desired culture.

Ulrich developed his categorisation as a response to developments in the HR function, but his categorisation – in particular, his 'business partner' role – has been very influential in shaping the HR role. His original argument was that all four roles were to some extent business partners but within organisations there has been a selective adoption of his categorisation with 'business partner' emerging as the dominant model. The trend has been to equate the term 'business partner' with Ulrich's 'strategic partner' role to the exclusion of other roles. The *People Management* Guide to Recruitment Consultancies (2005: 16) reported that the number of advertisements seeking HR business partners had increased by 30 per cent in 2004, with an increasing number of organisations advertising for 'strategic' business partners.

However, the precise meaning of term 'strategic business partner' remains unclear and can vary from organisation to organisation. Moreover, the shift in organisations to the business partner model has not been accompanied by any significant new training and development activity for the function (Pickard, 2004: 30) and HR professionals and the strategic partners themselves are often unclear about the new role and what it involves.

The CIPD (2003) HR survey of over 1,000 HR practitioners from a range of industries and sectors found that only one in three HR practitioners saw his or her current role as that of strategic business partner, although many had aspirations to become more strategic. As the survey report (2003: 11) put it,

> **One third of practitioners currently see their primary role as being strategic business partners, one in four see themselves as change agents and fewer than 24 per cent as administrative experts. In terms of preferred roles, nearly three in five aspire to be business partners, while 23 per cent see their current role as business player – ie acting as coach, architect and facilitator; only 15 per cent see this as their preferred role … possibly because they feel it would take them too far away from their HR moorings.**

A large number of HR professionals felt poorly equipped for a more strategic role, and the survey found a sizable gap between organisations' expectations of HR partners and partners' skills and knowledge. Key development needs were identified as business knowledge and strategy tools and skills of influencing and political astuteness.

ILLUSTRATION

Business partners at Royal Mail

People management

Royal Mail has introduced the business partner role since the arrival of Tony McCarthy, group director of people, 18 months ago. Under his stewardship the organisation has adopted the Ulrich shared service model. Each of Royal Mail's regions will be represented by a business partner.

There are six capabilities of a business partner:

- *People and organisational development* – advising on HR interventions that would improve business performance

- *Leadership* – delivering results and building strong relationships
- *Personal credibility* – behaviours necessary for delivering projects in complex environments
- *Consulting* – in a shared service environment, the organisation is reliant on business partners delivering
- *Organisational design and development* – dealing with cultural change
- *Business knowledge* – understanding the commercial environment

Perfect partners, *People Management* Guide, April 2005, p19; **www.peoplemanagement.co.uk/recguide**

Ulrich (2005) recently adapted his HR role categorisation to five roles. The revised categories included employee advocate and human capital developer which replaced employee champion; functional expert which replaced administrative expert; strategic partner which incorporated the partner in strategy and change agent role; and leader. The revised categorisation is illustrated in Table 3 on page 74.

In the modified categorisation Ulrich stresses the employee advocate and human capital developer rules as forming the centre-piece of HR. However, the CIPD (2003) HR survey found that few senior HR practitioners saw themselves in such roles or aspired to such roles in the future. Over-emphasis on the strategic partner role appears to have had serious consequences for employee relations.

Research by Francis and Keegan (2005) highlighted the adoption by organisations of a range of HR initiatives to shift responsibility for HR issues in areas such as absence management, grievance-handling, coaching and counselling to line managers in order to free up HR practitioners to become more 'strategic'. Such initiatives included shared service centres, IT-driven changes to integrate HR activities, centralisation of HR administration, administrative templates and support packs for line managers to handle recruitment and discipline. The consequences of this shift have been problems related to loss of employee trust, costs to employee well-being and disenchanted practitioners and truncated careers. As Francis and Keegan (2005: 27) put it,

The profession needs to reflect seriously on the consequences of devolving transactional tasks to line managers while locating HR advisers in distant service centres. As HR practitioners vanish from the shop floor, employees may lose trust and confidence in the HR function to advocate their needs.

Table 3 *Evolution of HR roles*

Mid-1990s	Mid-2000s	Evolution of thinking
Employee champion	Employee advocate (EA) Human capital developer (HC)	EA focuses on the needs of today's employee; HC developer focuses on preparing employees to be successful in the future
Administrative expert	Functional expert	HR practices are central to HR value. Some HR practices are delivered through administrative efficiency (eg technology, process redesign), and others through policies, menus and interventions
Change agent	Strategic partner	Being a strategic partner has multiple dimensions: business expert, change agent, strategic HR planner, knowledge manager, and consultant
Strategic partner	Strategic partner	As above
	Leader	Being an HR leader requires functioning in each of these four roles; however, being an HR leader also has implications for leading the HR function, collaborating with other functions, setting and enhancing the standards for strategic thinking, and ensuring corporate governance

Source: Ulrich and Brockbank (2005) Role call, *People Management*, 16 June, p26

ACTIVITY . . .

How would you categorise the HR role within your organisation? Which of Ulrich's role categorisations apply, and why? Do you see the need for the HR function to be performing roles outside those they are currently performing?

THE CONCEPT OF HUMAN CAPITAL

The growing body of theoretical evidence demonstrating links between HR policy and practice and improved organisational performance have been accompanied by an emphasis on HR metrics or tools whereby the value and return on investment of an organisation's human assets can be measured and evaluated.

As suggested earlier, HR is unique among business functions in that it is hard to quantify the contribution made to the bottom line and this poses a distinct set of problems for financial reporting. The development of effective metrics that provide a robust measure of how HR adds value and the ability to measure the contribution of HR practice to organisational success represents a central concern for HR practitioners. This final section evaluates the concept of human capital, appraises a range of measurement tools and techniques and evaluates the extent to which organisations are undertaking external and internal reporting of HR issues.

The term 'human capital' is used to describe the organisation's human resources and the contribution they make to the organisation. Scarborough and Elias (2002: 9) define human capital as 'the competencies which employees apply to the production of goods and services for an employer'.

The distinction was made in Chapter 2 between human capital advantage and human process advantage, to the effect that human capital advantage clarifies what it is that is uniquely and exceptionally valuable about human resources, and human process advantage is focused on how managers might obtain, develop and retain valuable resources (Boxall and Purcell, 2003: 85). Human capital falls under the human capital advantage umbrella and refers to the stock of skills, experiences, competencies and knowledge assets in an organisation. Fundamentally, human capital is about measurement.

The concept of people as an organisational resource has its roots in the economic theory of human capital. The logic of human capital theory suggests that increasing the stock of human capital requires investment now for future returns. Thus investment in training and development can enhance the stock of an organisation's human capital just as an investment in technology can enhance physical capital. Equally, both can depreciate and become obsolete through neglect and lack of investment. The concept of human capital is relevant at both a macro, national level as well as a micro, organisational level and has implications for external and internal measurement and reporting.

External reporting of human capital

As suggested earlier, the accountancy profession and accounting controls have been a prominent feature of British industry, and financial measures are pre-eminent indicators of organisational performance. Companies are by law required to produce an annual report and accounts in which they provide information about their financial and business performance. The financial statements that need to be included in published accounts include the profit and loss account (a summary of income and expenditure), balance sheet (a summary of the company's financial position at the end of the accounting year showing assets and liabilities) and a cash flow statement (showing how money has been raised to finance the business and how it has been spent).

There is, however, rarely any systematic accounting for 'hidden' intangible assets such as the knowledge of employees, the replacement costs of IT systems or the return on investment in training and development. As Scarborough and Elias (2002) suggest, management and accounting practices are insufficiently developed to enable human capital to be properly reflected in management decision-making and external reporting.

There is thus often a gap between the value of an organisation's tangible assets as shown on the balance sheet and its stock market value. Libert *et al* (2000) suggest that in 1978 the average book value represented 95 per cent of market value; ten years later the figure was 28 per cent. Today it is estimated that 80 per cent of stock market value is driven by assets that don't appear on the balance sheet – ie people, brand, knowledge and relationships. Companies such as Glaxo Wellcome and Microsoft are worth many times their balance sheet value. In a rapidly changing business environment, it is increasingly intangible factors – people, ideas, reputation – which underpin the best-performing businesses. Successful companies recognise that investing in these intangible aspects of their business is essential to their ability to create world-class, high-value-added products and services.

Human capital reporting was a key recommendation of the DTI sponsored 'Accounting for People' Task Force which highlighted the critical nature of the people element in the so-called intangible assets of growing organisational value. As Denise Kingsmill (2003), the Chair of the task force put it,

We need to develop a business culture that recognises that a company's investment in human capital is at least as important as its investment in plant and machinery. This means finding ways in which it can be measured and reported for the benefit of all the company's stakeholders.

However, although the task force identified generic measures (eg absence levels, turnover figures) it stopped short of recommending any specific sets of measures for how organisations should gather and report information on human capital, with the result that there remains considerable uncertainty about the meaning of human capital management and how human capital-related information can be turned into practical measures for demonstrating how people management and development impacts on business performance.

In May 2004 the DTI launched plans to make an operational and financial review (OFR) a statutory requirement for company reporting from April 2006. However, the OFR remit was subsequently scaled down and quoted companies will now be required to produce a simpler, scaled-down 'business review'. Companies will still be required to provide information on employees and social and environmental matters where this is material to the business, but business reviews are likely to be less descriptive and more flexible. It is left to companies to decide what information to provide about employment and employees.

Intellectual capital can be crucial for an organisation yet it is generally excluded from external reporting because it is difficult to measure and there is no framework for assigning a value to human capital that would enable organisations to measure and account for changes and movements in human capital. Scarborough and Elias' (2002) study highlights the paradox of human capital; that the very features that make human capital so crucial to organisations are the same features that inhibit evaluation.

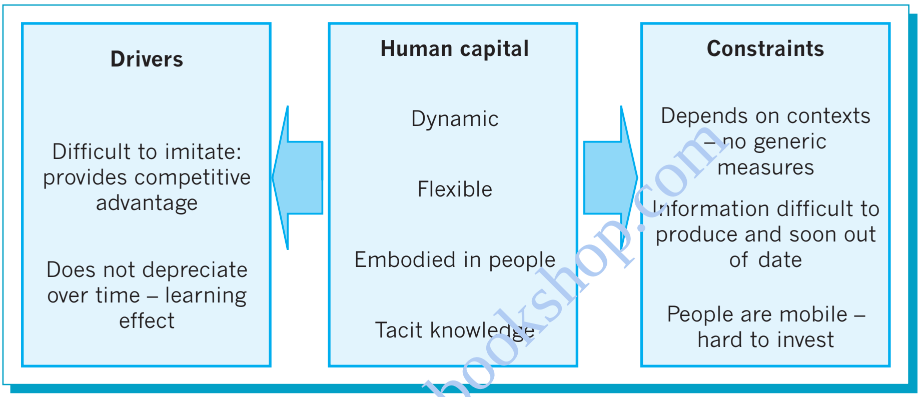

Figure 7 *The paradox of human capital management*
Source: H. Scarborough and J. Elias (2002) *Evaluating Human Capital*, p5

ILLUSTRATION

Managing intellectual capital at Skandia

Skandia is a multinational insurance and financial services company based in Sweden with total assets of $35 billion and employing around 11,000 people worldwide. Since 1991 Skandia has developed a range of measures to assess its human capital. These measures include how customers are handled, how operational processes, business development and logistics are handled and measures of employee professional insights, applied experience and organisational learning.

Skandia has a Director of Intellectual Capital whose role is to develop and apply a systematic approach to valuing intangible assets. Leif Edrinsson reports to the Chief

Executive and is a member of the executive board. Skandia uses a balanced scorecard for measuring performance on financial and intellectual capital and have developed a model of intellectual capital (Figure 8).

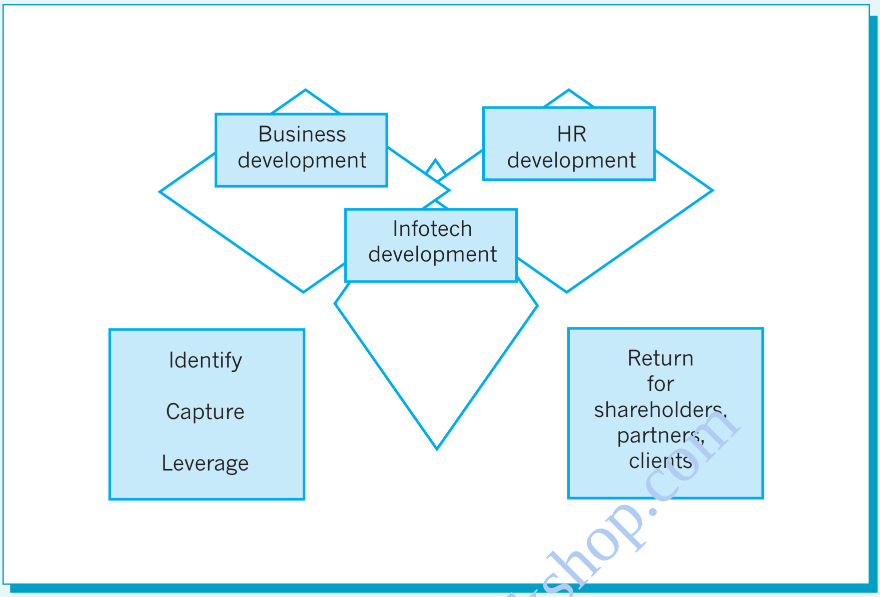

Figure 8 *Skandia model of intellectual capital*

Skandia also includes a statement on human capital in its report and accounts. Visit the Skandia website to learn more about this organisation's approach to valuing and measuring its human capital assets:
www.Skandia .com
www.fpm.com/script/UK/Jun98/930602.htm

Internal measures of human capital

Meaningful information also depends on the development of effective internal mechanisms to collect, analyse and evaluate human capital data.

The Balanced Scorecard

The balanced scorecard (Kaplan and Norton, 2001) is one of the best-known techniques for aligning human capital to organisational performance. The underpinning rationale is that every organisation has multiple stakeholders or groups of individuals whose interests and requirements need to be satisfied for the organisation to be successful.

Table 4 *The balanced scorecard*

Element	Measures
Financial	Cash flow, return on capital, profitability
Customer	Market share, customer retention
Internal business processes	Quality, productivity, product cycle time
Learning and innovation	Percentage revenue from new products, research and development success rate

Source: R. Kaplan and D. Norton (2001) Marked impact, *People Management*, 25 October, p54

Thus the requirements of investors are satisfied through financial performance and measured through profitability, return on capital, cash flow and market value. The requirements of customers are satisfied through the provision of a quality product or service and can be measured through market share, customer retention and customer attitudes. The requirements of employees are met through making the organisation a great place to work and can be measured through employee turnover, absence, retention and productivity.

The balanced scorecard is not specifically focused on human capital measurement but on the development of different measures in each area that meet the needs of the business over a period of time. It can thus be tailored to meet the specific needs of the organisation and represents a useful device for monitoring performance against a range of defined standards in a way that combines an evaluation of intangible assets and human capital with more conventional financial measures.

HR scorecard

As highlighted in Chapter 2, best practice and configurational approaches have been concerned with establishing a quantifiable link between specific HR practices and organisational performance. Such approaches have advocated the use of HR-based measurement systems linked to the organisation's strategic aims and values. Becker *et al* (2001) draw on the experiences of a number of leading US companies to identify a range of processes which can be used to manage human resources as a strategic asset and measure the people contribution to business success. The consultancy firm Watson Wyatt have developed a Human Capital Index to evaluate the relationship between a range of HR practices such as recruitment and selection, reward, flexibility and communications and shareholder value (**www.watsonwyatt.com**).

HR audits and benchmarking

HR audits are concerned with assessing the services provided by HR. Ulrich (1997) suggests that HR services can be clustered into six areas – namely: staffing, training and development, appraisal, rewards, organisational governance and communication – and

Table 5 *HR practice measures*

Domain of HR activity	Possible measures
Staffing	Number of recruitment programmes, acceptance per offer ratio, time to fill vacancies, percentage of internally filled vacancies, cost of filling vacancies
Training and development	Number of training days and training programmes held per year, cost per trainee hour, percentage of employees involved in training, percentage of employees with development plans, percentage of payroll spent on training, payroll expense per employee, efficiency of training administration

Adapted from D. Ulrich (1999) Measuring human resources: an overview of practice and a prescription for results, in R. Schuler and S. Jackson (eds) *Strategic Human Resource Management*, pp462–82

that measures can be identified for each area. Table 5 illustrates the types of measures that can be used in the areas of staffing and training and development.

Benchmarking is based on comparing specific HR policies and practices with those of other organisations either in the same sector or outside. Benchmarking might include retention and turnover rates, recruitment costs per new recruit, average days lost through absence, costs of the HR function as a percentage of total costs, ratio of HR staff to full-time employees.

ACTIVITY . . .

Since 1984 the Saratoga Institute has been gathering information on different HR benchmarks against which subscribers can compare themselves. Visit the Saratoga Institute website for a demonstration of the Workforce Diagnostic System:

www.pwcservices.com/saratoga-institute/workforce_diagnosis.html

ILLUSTRATION

People management

People strategy toolkit for RBS

The Royal bank of Scotland Group (RBS) has launched an online toolkit for its HR staff, designed to measure the effectiveness of the organisation's people strategy and its impact on business performance. The RBS Human Capital Toolkit was rolled out earlier this month to more than 1,000 HR staff. It offers an extensive range of resources including surveys, measurements, research, benchmarking and reporting on all people management issues.

'This is a real tool to support the business,' said Greg Aitken, head of research and measurement at RBS. 'The point of human capital strategy is to understand the way we manage our people and the ultimate impact that has on the business.' HR staff can get information not only by business division, but also by sex, age and ethnicity. The toolkit also offers benchmarking in dozens of different areas and against a variety of competitor organisations. Along with the rollout of the toolkit, RBS has set up a Human Capital Board, which will prioritise initiatives to ensure the organisation gets the most out of its investment in people.

People Management, News, 27 January 2005, p9

THE EXTENT AND USE OF HR MEASUREMENT

The implications of a human capital perspective for organisations is that employees are seen as an asset to be maximised rather than as a cost to be controlled and minimised. However, research evidence would suggest that few organisations understand the true worth of human capital, that the measures used are ill defined and that their application varies considerably between organisations.

Purcell *et al*'s (2003) study found that organisations undertook very little external reporting on human capital issues and focused instead on internal issues, with the balanced scorecard as the most commonly used measure. Scarborough and Elias' (2002) study of 10 UK-based firms from a variety of sectors found a similar picture and concluded that systems for evaluating and reporting human capital were 'rudimentary or non-existent' (Scarborough and Elias, 2002: 4). A summary of the approaches to human capital by the organisations studied is shown in Table 6 on pages 82–4.

As Table 6 illustrates, there are a number of diverse measures and approaches to human capital management. Scarborough and Elias (2002) suggest that high-performing successful organisations are not obsessed with measurement and that successful organisations create self-reinforcing loops that they act upon.

Table 6 *Summary of approaches to human capital management*

Company	Systems and practice	Impacts	External drivers	Internal drivers
Marks & Spencer	Mapping capabilities through skills survey	Skills mapping shows how employee skills support business plans	Downturn in late 1990s, drop in share price	Renewed emphasis on strategic planning
AutoCo	Records of capabilities profile of engineering population Performance review system Employee satisfaction index	Used to measure 'balanced scorecard' objectives Not used to evaluate the success of HR practices		Changes within the HR function itself – 'getting smarter' HR as strategic partner to top management
Tesco	'Balanced scorecard' (KPIs) on people People Insight Unit	Impact on the strategic planning process Annual people plan Skill profiles a basis for talent spotting	Highly competitive Focus on building customer loyalty	
Xerox	Total quality management approach Competence systems vary for different workforce populations Analysis of exit costs	HR function focused on creating value for the customer Performance profiles linked to career progression	Firm's loss of patent	
Norwich Union Insurance	Balanced Scorecard Transparent systems for career development and reward Training frameworks Brand values	Support reward and development Link into wider strategic goals: profit, morale and service	Merger between CGU and Norwich Union	

Table 6 *continued*

Company	Systems and practice	Impacts	External drivers	Internal drivers
Motorola	Targeted on their leadership population – Learning Leadership and performance team 'Talent web' and use of IT Leadership assessment model	Leadership supply Supports system of reward and development	'War for talent'	
Shell	Define basic, higher-level and leadership competencies Linked to formal assessment and used to identify skill gaps Emphasis on corporate values Balanced scorecard Focus on building talent	Improve leadership capacity Deliver the firm's talent promises Implements people strategy	Long-term development Growth and performance the major drivers More rigorous measurement systems a response to competitive pressures	Complements corporate social responsibility goals
BT	Overcoming reliance on headcount numbers In key areas review skill capability Brightstar programme Balanced scorecard linked to performance-related pay			Decade of downsizing Shift to learning v training linked to career ownership development Greater internal mobility

Table 6 *continued*

Company	Systems and practice	Impacts	External drivers	Internal drivers
BAE Systems	Performance-centred Leadership competence-based system provides effective leadership supply for top 650 management population Improves identification and retention of talent Links to training and development outcomes	Provided coherence to leadership planning	Merger with Marconi	Strategic shift from engineering to systems Development of corporate HR strategy has given HR strategic role
CityCo	Less systematic approach to evaluating human capital Performance of certain individuals measured through revenue benchmarks	Bonuses for retaining staff	Some consultants pay attention to HRM	

Source: H. Scarborough and J. Elias (2002) *Evaluating Human Capital*, pp51–2

As they put it (Scarborough and Elias, 2002: x),

> **Measures are less important than the activity of measuring – of continuously developing and refining our understanding of the productive role of human capital within particular settings. By embedding such activities in management practices, and linking them to the business strategy of the firm, firms may yet be capable of developing a more coherent and ultimately strategic approach to one of the most powerful, if elusive, drivers of competitiveness.**

KEY LEARNING POINTS

- Despite research evidence suggesting a positive link between the management of people and organisational performance, there is limited evidence of the adoption of HPW or progressive HR practices within British organisations.
- There are several underlying reasons why theoretical links between HR practice and organisational performance fail to make the transition to organisational reality, and one reason relates to the ambiguity of the HR role.
- Different categorisations of the HR role have been proposed which reflect different situational and environmental conditions. Particularly influential has been Ulrich's (1998) concept of 'business partner', which has become the dominant organisational model. However the term 'business partner' remains contested and there is evidence that the widespread focus on business partnership has adversely affected employee relations
- The development of measures to establish the contribution of people to organisational success is crucial in demonstrating the value-added of people as an organisational resource but the methodology of human capital is problematic and under-developed.

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