The HR Image Makeover:
From Cost Center to Profit Maker

Human resources … human assets … human capital. Call it what you will, the collected "people power" or workforce value of an organization is an asset that is difficult to measure. Similar to measuring physical assets like the cost of machinery and equipment, HR measurements have focused on "tangible" items like cost of salaries, cost of benefits, training expenses - items that reflect the dollars an organization has invested in its human assets.

When organizations buy machinery or equipment, the objective is to achieve improvements through increased organizational profitability or productivity. The purchase decision is supported by analyses that indicate a return on investment: increased sales, increased revenue, reductions in cost of goods sold, etc.

But how does HR move its image from cost center to profit maker? The challenge is to calculate the return that the organization receives on its investments in human assets Traditionally, HR has measured the aforementioned tangible items or transactional items, such as headcount, cost per hire, sick days per year, number of employees trained, etc. as costs to the organization. By measuring them, HR reinforces its image as a cost center.

Also because "what gets measured gets managed," senior management is focused on "containing the costs of their investments in human assets, rather than in investing in those assets to strategically direct them toward achieving the company's profitability and productivity goals. Challenged by measurement, HR may propose organizational investments in employee rewards, non-traditional benefits, hourly incentive plans, strategic recruiting processes, training, etc. as opportunities to replicate best practices at other organizations or to "do the right thing for employees." What executives hear is "we must spend more." What they need to hear is, "Organizational results," or how these investments will increase productivity and profitability.

In order to change its image from cost center to profit center, HR needs to shift how it sees itself, measures itself, and helps executives connect HR practices to business results.

HR Practices: High Performance Work Systems

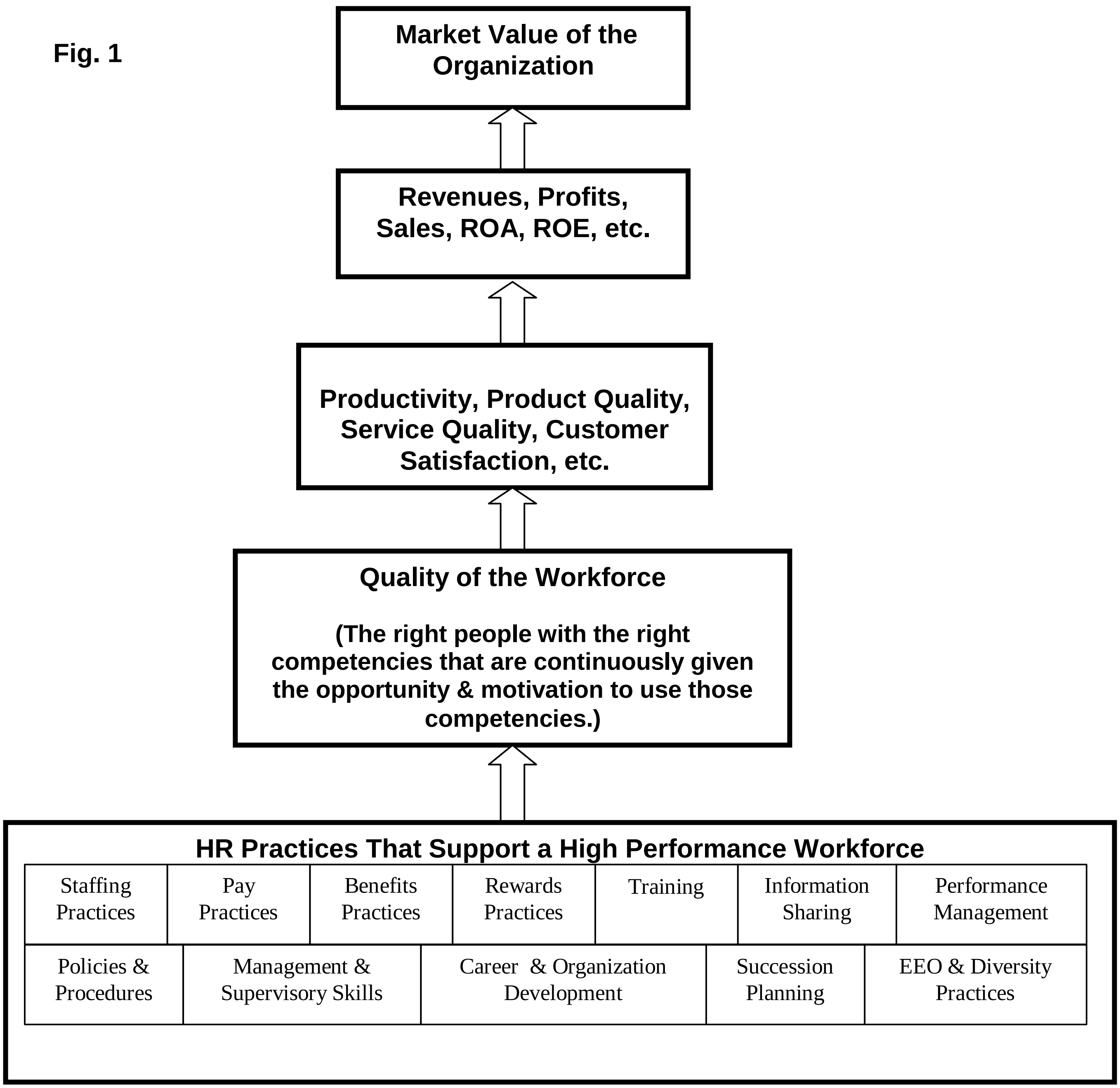
In their book, *The HR Scorecard: Linking People, Strategy and Performance*,[1] authors Brian Becker, Muark Huselid and Dave Ulrich use the term "high performance work system"s (HPWS) to describe bundles of HR practices that are linked and that, together, can affect the overall value of the workforce. For example, recruitment, selection, opportunities for internal movement, and separation can create a HPWS that, if

[1] Brian E. Becker, Mark A. Huselid and David Ulrich, *The HR Scorecard: Linking People, Strategy and Performance* (Boston, MA: Harvard Business School Press, 2001).

used strategically, can help an organization to continuously improve the quality of its workforce.

As shown in Figure 1, each of the links in these HR high performance work systems has both an independent and a collected impact on the quality of the workforce. In turn, the quality of the workforce links to productivity, product quality, customer satisfaction, etc. Taking it to the last step, HR high performance work systems ultimately have an impact on the organization’s performance measured in market value.

Fig. 1



Pay, benefits, rewards, and recognition practices are other HR high performance work systems. The links in this system have both independent and collective effects on who a company attracts and retains, and on overall employee satisfaction and motivation. If pay is used as a strategic tool to attract, retain and reward high performing employees, pay decisions are not isolated decisions, but are *strategic* decisions that can affect company performance, profitability and, ultimately, an organization's value.

Looking at HR practices as bundles of high performance work systems allows HR to see that the true measurements of these practices is the overall effect on the company's performance measured in organizational terms.

HR Metrics: Moving From Transactional to Strategic

Transforming HR's image to that of a profit maker lies in the measurement of HR's impact on the business in terms that the organization *values:* – the company's mission, vision, and strategic goals and objectives. HR practitioners need to identify the work systems that create and support the high performing workforce that enables the organization to excel and effectively compete in the workplace.

The HR transactional efficiency and activity metrics captured in Figure 2 might measure efficiency within the HR department, but are not meaningful to senior management if they are not *connected* to organization performance. This connection helps senior management understand how HR practices "drive" the performance of the organization's strategy. The metrics that connect are strategic measurements such as the quality of the workforce, employee satisfaction, the depth of organizational talent, etc.

Fig. 2

EXAMPLES OF HR MEASUREMENTS

TRANSACTIONAL	STRATEGIC
Headcount	Employee turnover by performance level
Applications processed	Employee turnover by controllability
Total jobs filled	Average change in performance appraisal rating
Total performance appraisals completed per month	Average performance appraisal rating of new hires
Benefits forms processed	Percent of HR budget spent on outsourced activities
Total employees trained	Extent of cross-functional teamwork
Total training hours	Percent of workforce that is promotable
Total incentive bonus paid	Percent of employees receiving incentives based on performance tied to organizational goals & objectives
Lost time days	Percent of employees who understand the goals and objectives of their job
Total awards processed	Employee satisfaction survey scores
Total missed days of work	
Total safety incidents	
Total grievances filed	
Total discrimination charges filed	

Turnover is a measure commonly used by HR to reflect cost to the organization. Analyzing turnover by performance level and controllability, however, indicates the quality of employees who are leaving the company, as well as how effectively the organization recruits high performers. If a company is not effectively attracting or selecting high performers and is losing its best performers, the quality of the workforce will decline, having a negative effect on productivity, profitability, customer satisfaction, quality, etc. Over time this will affect the organization's value.

Incentive pay plans become "disincentives" if they are not tied to performance (i.e., do not reward employees for helping the organization achieve its strategic goals and objectives), or if the managers who administer the plans are not properly trained and held accountable for using them strategically.

Linking HR Practices to Profitability: Short- vs. Long Range Decision-Making

HR practices that are presented as bundles of high performance work systems that strategically use metrics can help management see HR decisions in terms of their long- range, strategic impact on the organization. But when the immediate need is the focal point, a short-term "solution" often results in a long-term problem for the company.

Assessment Testing Put to the Test

One company eliminated pre-employment assessment testing to speed up the hiring process, put more candidates in the pipeline, and save costs. But one unanticipated result was a 65 percent increase in turnover among new hires during the first three to six months of employment. Turnover caused a fall in service quality and increased customer complaints, which ultimately affected sales and customer satisfaction.

One way to evaluate the effectiveness of the recruiting and hiring process is to measure the quality of new hires by tracking their average performance appraisal rating throughout their first year of employment. Before eliminating the assessment testing, HR could have proposed a trial hiring process without the pre-employment assessment test. Average ratings for new employees hired without taking the assessment test would be collected and compared against the ratings for those hired who took the assessment. This would have helped determine the value of the assessment testing to the quality of new hires.

To increase the efficiency of the hiring process, HR needed to analyze all the variables using a "fishbone diagram" in order to pinpoint the steps in the process that have the most impact on its timeliness. Also, HR needed analyses of turnover by performance level and by controllability, and data indicating the cost of turnover or the cost of unfilled positions to the organization in terms of poor service quality and customer service. This would have helped convince management that eliminating the assessment testing was not the best solution.

Opportunities Not Taken

Another company implemented an incentive program that paid incentives to all hourly production employees each month based on the organization achieving certain production objectives. Per employee award amounts were calculated using the total number of hours, including overtime, an employee worked that month. The program was designed to enable the organization to meet a substantial increase in product demand and short turnaround times without adding more full-time employees, and to reward employees for working extra hours.

The company did not offer a paid sick or personal time benefit because the CEO did not believe in paid time off. Within six months after launching the incentive plan, absenteeism rates increased fourfold. Employees calculated that they could miss up to eight days of work per month and still maintain their monthly base pay by working overtime and collecting incentive pay. They had created their own paid time off benefit.

To meet production demand, hiring remained the same; turnaround time improved only slightly. Overtime costs increased, although they were offset somewhat by the increase in unpaid time off.

In this case HR missed a number of opportunities to strategically evaluate the current situation:

- There was no data to indicate reimbursement rates, employees' willingness to work extra hours.
- Historic absenteeism rates would help HR to determine the importance of unpaid time off to the workforce.
- An analysis of overtime hours per employee would have helped HR determine what percent of the workforce was willing to work extra hours.
- An employee satisfaction survey could have been used to determine which rewards employees valued most.

This type of data would have indicated the value the workforce placed on pay, time off, and monetary rewards. HR could have presented this to management to help evaluate whether the incentive program, as designed, truly would achieve the intended results.

Three Major Challenges to Human Resources

Information systems that efficiently and effectively collect and analyze data are necessary to allow HR to measure what is important to the organization. Although payroll systems have been around for years, the value of high quality HR information systems is just being recognized in many companies.

There should be an alignment between high performance HR practices and organizational culture and characteristics. HR is not solely accountable for the effectiveness of high performance HR practices; everyone is accountable. For example, the effectiveness of employee rewards not only depends on how well they are designed, but also how well they are used by line managers outside of the formal pay and performance appraisal processes.

HR cannot simply handoff HR activities but must work as a business partner with line managers. To do this, HR must understand the business and how senior management measures its success. The value of data is dependent upon HR's ability to use it to drive organizational performance.

If HR is to attain total involvement in the strategic issues facing an organization, HR management must demonstrate competency in areas such as strategic thinking, diagnostic ability, critical evaluation, financial analysis, business analysis, marketing, and communicating with influence. These are among the competencies that will enable HR to measure, evaluate and present HR practices in terms of their impact on profitability.

HR Must Take Ownership

An organization's human resources represent its greatest opportunity for increased profitability and productivity. Despite this, HR management practices have yet to achieve the strategic level of importance they deserve. On one hand, organizations have not been very strategic in how they staff or use the HR function. On the other hand, HR must "step up to the plate" armed with the knowledge, skills, tools, and resources it needs to demonstrate its effectiveness.

Data speaks loudly, but it must be strategically collected and "crunched" with the goal of demonstrating the bottom-line impact of HR processes on the organization. To ultimately change HR's image, HR executives must take ownership of the business and gain acceptance as internal consultants who help executives connect HR practices to business results.

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