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## **WHITE PAPER**

# **The impact and value of Human Capital Management [HCM] in today's organisations**

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### **White Paper Objective**

It is the intention of this white paper to examine the impact and value of Human Capital Management [HCM] in today's organisations.

This paper illustrates the importance of Human Capital Management and how this can impact an organisation's bottom line.

A key focus of this paper is to understand the value of measuring

human capital and the role that outcome and performance driven Human Capital Management plays in providing intelligence to make critical business decisions.

### **Introduction**

Organisations today compete in a global marketplace. In order to survive they must adapt quickly to an ever changing environment whilst meeting the demands of their increasingly sophisticated consumers and balancing the demands of their shareholders.

With technology changing rapidly and new technologies being widely available, the only sustainable competitive advantage of organisations in developed nations is their people.

Almost every organisation will state that "people are our most important asset". They often spend significant amounts of money in training, development and recruitment of their people. Despite this spend, research indicates that on average, organisations spend up to 8% of their total wages and salaries bill managing human capital issues, many of which could be avoided or turned to bottom-line contribution.

With the increasing pressure on organisations to justify their spend, most organisations struggle to demonstrate or quantify how their investment in people directly impacts the business bottom line and the achievement of strategic goals. In most cases this spend is accounted for as a cost in the P&L rather than an investment in an asset.



This paper will examine ways of measuring human capital as an integral part of strategic management.

## Human Capital – Means What?

The term human capital has been around for many years.

Human capital is variously defined as:

“A measure of the economic value of an employee's skill set. The concept of human capital recognises that not all labour is equal and that the quality of employees can be improved by investing in them. The education, experience and abilities of an employee have an economic value for employers and for the economy as a whole.”<sup>1</sup>

“The term human capital is recognition that people in organisations and businesses are an important and essential asset who contribute to development and growth, in a similar way as physical assets such as machines and money. The collective attitudes, skills and abilities of people contribute to organisational performance and productivity. Any expenditure in training, development, health and support is an investment, not just an expense.”<sup>2</sup>

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<sup>1</sup> <http://financial-dictionary.thefreedictionary.com/Human+capital>

<sup>2</sup> Derek Stockley  
<http://derekstockley.com.au/newsletters-05/018-human-capital.html>

## Organisational Pressures

Organisations are facing increasing pressure from many areas to quantify and measure their human capital:

### Organisational and Board

**Pressures:** Accountability and transparency demand that all significant capital expenditure must be justified.

Company executives and senior management need to justify the spend by submitting business cases, outlining the benefits, both tangible and intangible, and ultimately quantifying the impact on the bottom line (ROI) of the organisation.

**Governmental Pressures:** Pressures from governments and other influential organisations have arisen with regard to due-diligence, best practice and compliance to regulations, to the point where business in Europe may soon be required to illustrate and quantify the investment made in their people, such as the spend on training and development.

**Pressure to change:** Large and dynamic business environments require the resources and tools to correctly evaluate and measure their human capital. A change in organisational direction, whether driven internally or by external factors, requires human capital with both the motivation and the correct competence to implement and drive the change process.

## Measuring Achievement

A good Human Capital Management system always starts at the strategic level.



Organisations need to articulate what they want to be and where they are going. A clear vision must be understood and shared within the organisation; the objectives must be communicated and well understood. Equally as important are the culture, image and values which must be part of the strategic direction and stated and demonstrated from the most senior management levels down through the organisation.

Understanding the relationship between the organisation's strategic direction (including the culture and values) and the contribution made by the people working in that organisation needs to be clearly defined in objective and quantifiable terms.

The process requires two main steps:

1. Translating the strategic goals into specific outcomes and, setting the performance criteria to measure the organisation's progress to achieve these goals.
2. Determining the specifications for each role required to achieve the strategic goals.

## **Strategic Direction to Outcomes**

The process of disseminating the strategic goals into specific outcomes and cascading these down through the organisation is critical to success.

Including outcomes in role descriptions requires the measurements to be outcome-focused as well. A common issue in organisations is that performance measures have the wrong focus and are often largely subjective.

An illustrative example of such a situation is where sales personnel are

rewarded only by financially quantifiable sales measures. Although these measures directly impact on the bottom line in the short term, they do not take into consideration other longer term factors such as customer satisfaction, response handling, etc which could have a direct impact on the organisation in the future.

With a clear understanding of the strategic goals, the organisation's performance framework can be established. This performance framework includes specific performance criteria, including both financial and non-financial measures, related to each outcome derived from the strategic goals.

These performance measures can then be cascaded down through the organisation, defining what each role produces and how the achievement of these outcomes is to be measured.

A strong framework is a valuable tool providing a roadmap and milestones for making strategic decision. It assists in determining where investments should be made as well as highlighting areas which are weak within the organisation.

## **Defining Role Contribution**

Once the frameworks are established the contribution of each individual to the organisation can be determined and their performance measured.

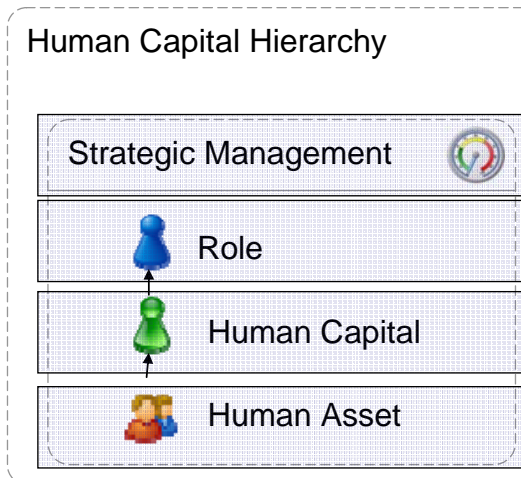
Having a methodology and the tools to accurately measure achievement, provide decision makers with critical business intelligence to confidently "invest" in their Human Capital and

measure and report on the impact of this investment.

The two stage process outlined above also impacts on the individual employee's motivation and satisfaction. A well-defined role description, incorporating outcomes and the objective performance measures which specify the standard required in producing these outcomes, provide the individual with a clear understanding of how they personally contribute to the strategic goals of the organisation.

Individual development programs, in line with the strategic direction, can be developed from both historical performance measures and a clear understanding of the future human capital requirements of the organisation.

## Human Capital Management Hierarchy



Human Capital Management can be considered as a hierarchy. The advantage of this approach is the separation of the management of the Human Assets (i.e. the individual) and the management of the Human Capital

(i.e. managing people from a business perspective) as independent layers.

**Strategic Management Layer:** The strategic management layer is the aggregation of the other layers in the hierarchy. Its purpose is for strategic management, assessment and evaluation of the organisation's Human Capital. The strategic layer is focused on developing the strategic goals into outcomes that can be quantified by tangible measures. Understanding the goals and performance measures, as well as historical achievement, empowers strategic decision makers to make informed and defensible decisions.

**Role Management Layer:** The role management layer is the dissemination of the organisational structure into unique roles. This is not to be confused with an actual employee. A 'role' sets the specification for an employee; in a similar manner that one would specify the requirements for a physical asset before purchasing a particular brand. Focusing on roles allows an organisation to define their requirements and needs now and into the future. Roles become the driver for current and future planning. Understanding the roles and future role requirements provide a road map which can be executed and managed as part of the human capital process.

**Human Capital:** The Human Capital layer is interface between the role and the employee. It is business focused and includes the process of setting specific performance targets for each individual.

It provides for objective assessment of an individual against the roles performance criteria and the critical



competencies required to produce the outcomes at the required standard.

Business decisions relating to investment in human capital are managed here. They are focused on achieving the organisation's strategic goals, preparing the organisation for the future and risk minimisation e.g. succession planning and competency gap development.

**Human Asset:** This is the individual level of the hierarchy. It includes reviews, assessments, and development plans for the individual.

Critical factors that determine individual performance are competency which is defined as knowledge, application and attitude.

Individual issues with performance can be addressed at this level; lack of knowledge through training, issues of application through mentoring and demonstration, and attitude with counselling.

## HRmonise HCM Framework

HRmonise is a HCM application which provides quantifiable and defensible business intelligence to strategic decision makers.

HRmonise is designed to assist organisations to reach the ultimate goal of quantifying their human capital. HRmonise is a tried and tested framework driven from the strategic direction of the organisation and cascaded down through the organisation to the individual level.

HRmonise has been deployed in many different ways to get the best out of the application.

1. **Future Planning and Development:** HR and senior managers model and develop future structures in the organisation. Managers can understand the contribution of the new roles to the organisation and plan strategies to ensure that these roles can be filled by competent individuals; ensuring that the change process will be supported by competent people.
2. **Strategic Alignment:** Implementing HRmonise ensures the HR function is in sync with the organisation's strategic direction and enables progress to be monitored and measured. This empowers strategic decision makers to make quantifiable and demonstrable decisions relating to investments not only in the Human Capital Structure but also in core investment areas such as Marketing, IT, operations.
3. **Restructure and Development:** The HRmonise recruitment framework can be used to review the organisation's current human assets to determine development needs or their ongoing potential to the organisation.

## Conclusion

It is no longer acceptable to just say "people are our most important asset". It is imperative to act on this statement, managing and measuring the people so each one understands their role and importance within the organisation. Measurements must be objective, defensible and quantifiable to have meaning and to provide intelligence on which to base critical and strategic business decisions. Plant and equipment depreciate but people, provided with clear direction and



training and development, are an appreciating asset.

As Burud Tumolo states "Adaptive organisations choose to invest in people, to consider people as human capital and worth investments of various kinds, rather than as costs to be minimised. This choice... recognises the reality that the demand for qualified knowledge and service workers exceeds the supply in many labour markets and will continue to do so for some time to come."<sup>3</sup>

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<sup>3</sup> Burud, S. & Tumolo, M. (2004). *Leveraging the new human capital: Adaptive strategies, results achieved, and stories of transformation*. Palo Alto, CA: Davies-Black Publishing.