

July 2004

Generic measures of human capital

The UK Accounting Standards Board (ASB) has a problem. The trade and industry department has asked it to develop a set of standards governing performance measures that may be used in the forthcoming operating and financial reviews that all UK quoted companies will be required to produce for financial years from January 1, 2005.

Apart from the various environmental, social and community issues that will need to be covered by the reviews, perhaps the most taxing area of performance measurement will be that covering employees, the so-called human capital of the business.

Linking the contribution of a workforce to a company's bottom line has become something of a Holy Grail for the human resources profession. If businesses and their investors could be presented with a rationale explaining the true value and potential of employees, it could help to link management strategies with shareholder support.

Many organisations are already committed to measuring various aspects of their employment polices. The Co-operative Society, for example, measures the ethnic diversity of its employees, Body Shop measures its spending on internal training, and Royal Bank of Scotland has a comprehensive list of measures that includes the average salary of employees.

Much of this measuring is specific to either the sectors or the corporate thinking of individual companies. One of the big issues facing the ASB is determining or recommending a set of measures that could be considered generic to all employers. A desire for such measures was outlined in the Accounting for People report on human capital management, published in late 2003.

The ASB has set up an advisory committee to look at performance measurements and standards. It is not likely to issue any proposals for consultation until later in the year but some idea of its thinking is already beginning to emerge.

One committee member, Andy Neely, of Cranfield School of Management, is sceptical about the wisdom of recommending a set of generic measures: "It's not practical to develop generic measures that apply to all organisations because measures should reflect the strategy of a particular organisation. In some companies, for example, staff turnover and retention may be a central issue. In others, it may be less important."

He stresses that this is a personal opinion not shared by everyone on the committee, but his expertise in human capital measures should count for something in a group which is light on HR knowledge, accepting that it will be consulting widely in the profession. That such a consultation exercise is necessary seems odd, given the time and scope allowed for carrying out the very same exercise for the Accounting for People task force.

That report highlighted a number of areas from which shared standards might emerge: the size and composition of the workforce, the retention and motivation of employees, skills levels and training, pay and fair employment practices, and

leadership and succession planning.

The ASB's advisory committee is sifting through hundreds of different measures in the marketplace. As Prof Neely points out, measuring in isolation is likely to produce information of limited value. "Measures of customer satisfaction, employee satisfaction, sales turnover or customer retention, for example, need to be looked at holistically," he says.

Then there is the argument that a sophisticated analysis of performance measures producing a deeper understanding of the relationship between strategy and performance, could be viewed as a recipe for success that a company would not want to share with the competition.

Is this a reasonable fear? The complex chemistry of human relations, underpinning most successful companies with large numbers of employees, is influenced by many variables. Performance management is not some form of alchemy that can be solved with a secret formula.

There are scores of books featuring case studies of well-managed companies; there are lists of "good companies to work for"; and there are companies that have worked for years, building up a strong and embedded knowledge of how to handle their workforces. But none of these enterprises is immune to fundamental changes in market conditions.

You might have the best employee relations and training systems in your sector but these count for nothing if your biggest competitor suddenly decides to shift its labour-sourcing offshore, undercutting your overheads by 50 per cent. The hard reality of investor behaviour in the face of, say, a compulsory redundancy programme cutting the workforce by 10 per cent, could result in an immediate and sustained rise in share prices.

Human capital reporting is not going to rid the marketplace of such behaviour but it should mean that companies will need to articulate their employment strategies.

If they have an expensive state-of-the-art training scheme, for example, do they know what impact this will have on employee retention, morale and corporate reputation - all factors that can influence buying decisions among customers?

Prof Neely recognises that any deliberation on human capital measuring must deal with diverse sets of opinions. "My sense is that there are some groups who would like defined measures and some that would not. We are walking a tightrope between different pressure groups," he says.

He also acknowledges the probable consequences of quoting examples of measures in any report. Their very presence might popularise their use so that they become standardised. But this could be a good result if the measures are effective.

Most measures of human performance are controversial. The IQ test, for example, measures certain facets of the way our brains work but not, for instance, empathy or morality. Howard Gardner, a Harvard University psychologist, believes there are many different ways in which people can process information and that all of them can be defined as a form of intelligence. Who is to say which is the right one for any particular set of circumstances?

The UK state education system has introduced standard assessment tests (SATs), which concentrate on English and mathematics. Opponents say these tests are stifling the curriculum, removing the joy from teaching and learning. But the tests mean that parents and education authorities can now at least make comparisons, however imperfect, between different schools.

If the education system can have SATs, why can't companies have generic measures of employee value?

In some senses the standards board is facing an impossible task that is bound to attract criticism. But doing nothing is not an option.

Ultimately it may decide to settle for posing a series of questions around human capital that guide companies towards areas of measurement. After all, walking a tightrope is mostly about balance.

©2004 Richard Donkin