Connect & Transform Human Capital Insight Series - N° 5

HR in Transition

The Building Blocks of a New HR Operating Model

Connect & Transform

More information:
jan@connecttransform.be
+ 32 478 31 24 24

More Connect & Transform Human Capital Insights on
www.connecttransform.be

HR in Transition – The Building Blocks of a New HR Business Model

Jan De Visch

Imagine you are the Chief Human Resources Officer (CHRO) of a large company going through a business model transformation. As CHRO, you have supported this transformational process by adapting your sourcing, performance, talent and remuneration strategies. In your HR report to the CEO, you proudly affirm that employee commitment, absenteeism, and turnover are far better than industry standards, and that the staffing plan has been met despite the shortages in the labor market. Your training manager delivered on the training plan within a challenging budget and the performance cycle was experienced as excellent by more than 90 % of the managers.

Nevertheless the CEO is unsatisfied. The Human Economic Value Added (HEVA), which is a measure of the true economic value of managerial actions (see calculation at the end of this article) and the Human Capital Return on Investment (HCROI), which looks at the ROI in terms of profits for monies spent on employee pay and benefits (see calculation at the end of this article) dropped with more than 3 %.

Worse yet, the scenario replays itself the following year: the HR team delivered on all items in the HR business plan - demonstrating an ability to attract, retain and productively manage a shrinking pool of talented, motivated people - but still the HEVA and HCROI further dropped.

What is going on here?

For the past 10 years, HR focused on:

- Transforming core processes and technology platforms,
- Creating new roles (eg. business partner, employee champion, centers of excellence), and
- Trying to surface and prioritize which services their businesses needed, deciding how those services could optimally be delivered, and launching them into action.

And while significant services have been developed and improvements have been made, the impact often falls short of breakthrough change. The basic premise is that the HR department is responsible for people-related issues so that "business" managers can monomanically focus on business results. The salient question becomes "How effective are our human capital investments?" For more than 80% of companies, the straightforward answer to this question is "We do not know." *Our* hypothesis is that human capital investments are sub-optimized by three factors:

1) ***Today's HR operating model lacks a clear and universally valued aim***. The model fails to define how human capital contributions truly impact business results. There is insufficent theory on how HR adds value, resulting in unclear accountabilities and overlaps between the diverse HR units. This lack of clarity is explicit and obvious in the absence of clear focus between centers of excellence, business partners and shared service centers.
2) ***Each HR unit operates primarily within its own silo and at its own pace***, resulting in nonintegrated and mistimed outcomes. While each unit may build on best practices and world-class programs, the end result is often disconnected. Managers continually receive new programs and instructions, but in service of which end-state? Each unit delivers on the activities they find important, not on a coherent set of aligned performance indicators or outputs. This results in an undisciplined and unmanaged program of projects.
3) ***Today's 'HR operating model' concentrates on the important value of treating all kinds of people issues*** but leaves out the rigorous discovery of whether or not the models used make sense. What would happen if a physician treated incoming patients just by reacting to problems and by addressing symptoms? Treatment based upon *symptoms* alone can never get at the roots of disease. It is essential that the physician examine the patient to ascertain the significant *signs* of illness. This examination calls for the use of technical diagnostic procedures – not just the stethoscope and thermometer, but also more sophisticated investigatory assessments, e.g. X-rays, complex blood tests, and MRI's. Once the *symptoms* are established, the physicians must have recourse to a *theory* in order to evaluate the warning signs to make a diagnosis. Contemporary HR often confuses signs, symptoms and theory and is not able to predict year-over-year capability and performance improvements.

The bottom line is that HR lacks an integrated model from which to design strategies, carry out operating initiatives and drive competitive advantage. To make a real difference, HR should focus on activities that help create value for the company.

The good news: the opportunities for HR to do just that are significant and increasing. We are on the threshold of the most exciting and promising phase of the evolution of human resources and human capital management. Three developments are stand outs:

- The first development answers the question, "***How to dismantle silos in Human Resources and best integrate the various operations?"*** T

  The fundamental idea for this is that each HR role must have a specific value-add focus. The key insight is that each layer in an HR structure should be responsible for a higher level of integration that creates value that is clearly differentiated. This principle supports shifting the design of work in the HR department from activities-based to a unique value-adding structure.

- ***The second development has to do with embracing analytics and realizing the same success and benefits as the other parts of organizations.***

- Until now, a substantial number of *HR analytics* are in the form of:
  - time (to serve), count,
  - proportion,
  - costs,
  - and evaluation/rankings.

However, it is generally recognized that the value of analytics is having indicators that inform on current performance, but also in comparing differences in the averages of populations or differences from some standard as a way to predict and manage change. The basic question is which predictive analytical model(s) enable(s) HR departments to be ahead of the curve in identifying staffing and performance opportunities and to anticipate problems before they happen.

- ***The third development is to upgrade and reframe HR initiatives and projects into a portfolio management system.***

  In a number of business disciplines, like marketing, finance, operations, IT and others managers group together a number of initiatives into a portfolio that supports, a business segment, product, or product line (or some other segmentation scheme). *These efforts are goal-driven; that is, they support major goals and/or components of the enterprise's business strategy.* The essence of portfolio management is that managers must continually choose among competing initiatives (ie.g., manage the organization's investments), selecting those that best support and enable diverse business goals (e.g, diversify investment risk). Leaders must also manage their investments by providing continuous oversight and decision-making on initiatives to undertake, which to continue, and which to reject or discontinue. The methodologies consist of a workflow mapping which expresses dependencies between steps in the different projects. Essentially, portfolio management is a roadmap for building an integrated improvement process that connects the value-add of different stakeholders in change initiatives and improves year-over-year performance results. Given the limited resources of most HR departments, a portfolio methodology to maximize delivering on their strategy is critical for success.

Let' examine the three axes by which you can build a Human Capital Blueprint. The three building blocks form a strategic, unifying model increasing HR's internal efficiency and greatly facilitating its ability to positively affect the people and organization(s) it services.

Building block number one: Align HR roles.

The challenge in HR departments is to create accountable structures and synergy amongst the different HR professionals. Accountability entails being answerable to another person for a product, service, process, or result that is measurable in terms of quantity, quality, and time. When reviewing an employee's role in an accountable system, three key questions should be asked:

1. First, why does the job exist? Does it ultimately add value for the customers? (By "customers" we mean anyone who benefits from the HR services work or products)
2. Second, for what is this person held to account?
3. Finally, how well does this individual fulfill that accountability?

One of the leading questions to make an inventory of levels of accountability is "What decisions do you make that your subordinates cannot make, and in addition, what decisions are you making that your boss does not need to make?" Clarifying accountability levels can also be done through examining the unique contribution on a comprehensive set of role dimensions (such as scope of problem space, level of customer focus, planning horizon, integration complexity, …). Our research and findings are based on the Work Levels Framework, and instructs us that in Human Resources, there are maximum four accountability layers:

1. **Service and quality delivery.**
   - This is mostly the accountability level at which all kinds of services are provided within the boundaries of the established procedures and tools, ranging from supporting, staffing, compensating and developing activities.
   - *One finds single performance metrics like cost, time to respond and repair, percentage of filings on time, error rates and human reactions (like customer satisfaction)*.

2. **Service optimization and differentiation.**
   - This is the accountability level at which problems are addressed from a logical cause-effect analysis. This is the first level of evidence-based human resources management where one sees a slow assembly of required data, often developing answers to flawed processes and focusing on where to fix problems.
   - This is also the first level at which professionals develop specific initiatives/activities to address specific line expectations which are not fully serviced at the first level, e.g. performance management, employee satisfaction, leadership development, turnover, etc. Traditionally, performance at this level is measured in terms of projects completed or simple metrics like turnover by segment, HR:FTE ratio, HR Cost Per Employee. The measurement systems use a set of internally-focused, activity based measures which are not put in a comprehensive framework. Evidence based HR showed that truly effective practices at this accountability level should be based

on a series of *combined performance indicators*, such as recruiting quality and cost differentials, training effectiveness and performance differentials, engagement and revenue linkage.

3. **Rethinking systems and processes.** This is the accountability level at which the greatest leverage opportunity is found in how HR services are delivered across the organization. As many as 95 percent of HR departments deliver their services and support in a fragmented manner, each function operating in its own silo. This is the level at which HR systems and processes across the organization are aligned and integrated. The main HR process areas are Recruitment and Staffing, Compensation and Benefits, Talent Management, Performance Management and HR Controlling. (Bus. Partner is advisory? – shld we say?)

   The performance indicators used at this level are often based on comparative data within an industry sector, trying to identify 'best practices' and 'trying to translate these practices into 'effective practices' for the company. This strategy is rarely works. The benchmarking focus is still activity based, related to today's sub-profession aligned HR organization and one can seriously question the relevance of this data. In sustainable growth companies (see research Jan De Visch, 2011) performance indicators at this level are linked with financial indicators that relate to current performance, like Net Operating Profit After Taxes/FTE, Earnings Before Interest/FTE, Present Value/FTE. Human Economic Value Added (HEVA) and Human Capital Return on Investment (HCROI) are also examples of indicators used at this level. The common ground in these indicators is that they direct the attention to the *value chain* through which the HR services are delivered, such as the strategic planning, succession planning, operational planning and budgeting, performance management and goal setting. The key question asked at this level is: 'How can we rethink our current human capital processes and how will they affect our organization?'

4. **Determining the human capital investment model.** Essentially this is the accountability level at which the future is created and the HR organization is aligned around business results. This accountability level is only recently recognized (Hall (2008), Fitz-Enz (2010), Boudreau (2011)) and called the New Science of Human Capital. The focus of the role designed at this level is to improve the human capital performance in the future. This happens through helping the organization develop the organizational capabilities to deliver the strategy. The most important indicator at this level is the company's Future Value (FV)/FTE. Mathematically, the Future Value can be calculated for any company by subtracting Current Value from the business' overall enterprise value. So, start with enterprise value, which again is the market value of a company's equity plus the net value of its interest-bearing debt obligations. Then subtract current value, which is after-tax operating profit divided by the weighted average cost of capital. The result is Future Value. The significance of future value lies largely in how it compares with the future values of the company's industry peers. To understand how the FV/FTE can shape the company's future consider the following questions and how your answers would affect your talent investments:
   - "Where are you making important assumptions about the future in the industry that are different from our competitors?",
   - "Where does our people strategy require sustained differentiation from competitors?", and
   - "How can we make it difficult for our competitors to duplicate the human capital set-up?"
   - The FT/FTE will inform you about the quality of the choices you are making at this accountability level.

The golden rule of Work Levels is that a healthy hierarchy requires no more than one *leadership* role per level. In a specific chain of command, if more than one *leadership* role is found at a given level, it suggest over-tiering, with the roles in that level having overlapping decision rights ("compression"). If a training professional has single performance indicators and the training manager also has single performance indicators, then one can expect dystunctionality in the system because the unique value-adding component of each role is not clear. It is also possible for a hierarchy to be too flat by having a missing *leadership* role. In many cases, the payroll people with single performance indicators needed to report to a HR manager with Value Stream indicators. This also leads to a dysfunctional structure. A qualitative analysis of HR departments indicates that ***less than*** 35 % of the role-role relationships in the HR department are designed in an optimal way. This means that approximately 65 % of the HR-professionals have overlapping and/or non-aligned accountabilities. This partialy explains the continuous struggle between business partners, center of excellence professionals, and shared service professionals.

The way forward to rethink the human resources department is not about trying to agree on activities and project responsibilities. The way forward in each professional discipline is to look first at how the HR roles can be designed in such a way that they become unique in their value-adding contribution. This is the only way to prevent profession-aligned silos produce profession –aligned projects. If the business results are the objective, the HR organization and systems must be aligned to deliver business results, aligning the specific performance indicators with the accountabilities at each level and avoiding overlaps and gaps in the HR structural set-up.

Building block number two: Develop predictive modeling capacity.

Most HR departments today are engaged in some type of measurement. The problem is that most of the measures have not moved past the cost, quantity and basic quality (satisfaction) level. Examples of more sophisticated measures are the *employee-satisfaction index*, the *Career-path ratio* which is the ratio of promotions to total movements (including transfers, sideways moves, and demotions) within the organization or the *training-effectiveness index* which takes into account the retention rate of high performers before and after training. All these can be useful as after-the-fact data for the HR staff. However, they do not excite management because they focus on costly activities and reveal nothing about value-adding results.

To manage for tomorrow, you need new metrics that are inherently predictive. We call these leading indicators. The latest and more exciting value-added measurements are leading indicators and intangible metrics. A short list would include the *cultural entropy indicator* (Barret) which signals the amount of energy in an organization that is consumed in unproductive work, the *optimal organization structure index* (Eliot Jaques) which exposes how well your organization is designed or the key position excellence index which tells you something about how well key positions perform in their roles. These predict what is most likely to happen in important future events.

There are a number of intangibles that can be turned into leading indicators, such as engagement, leadership, knowledge management. In addition, lagging indicators such as turnover can be reverse engineered and turned into leading indicators. Issues such as manager tenure and absenteeism are signposts for the knowledge professional.

The big question is: "How much value could you create with this intelligence?" The value will be many times the expense in terms of cost reduction, customer delight, innovation, speed to market, revenue generation, and risk mitigation. As with most approaches, there is probably not *one* best model that exists. The challenge will be in finding out what is the best model for *your* organization. This is without a doubt possible and requires hypothesis formulation and a set of simple statistics; and, you will formulate assumptions on strategic components that are both necessary and sufficient for delivering the human capital vision.

Building the optimal Human Capital Strategy for your organization requires systematically tracking performance over time and isolating relationships between lagging indicators (e.g. revenue growth, profit, customer satisfaction) and leading indicators (i.e. effectiveness of teams, leaders who deliver on results, employee engagement and workforce performance). This requires a basic regression equation between each of the leading indicators and one or more lagging indicators. The result will tell you the relative impact on profit per employee for each indicator you considered as *leading* gauge. Discovering that one or more *leading* indicators does not contribute value (e.g., 'leaders delivering on results') informs leadership development initiatives and help you wonder, "What if there are other important strategic components we should have measured but didn't?"

Roles operating at an accountability level of *service optimization and differentiation* and above (see previous subheading) should build their interventions on capturing data and analyzing data over time. Each accountability level in a Human Resources department should make their intervention model explicit. This can range from the components determining the *Individual Employee Life Time Cycles* in the training and development area to the *Performance and Motivation Improvement Model* in the remuneration and benefits unit. This is already happening in well-known organizations such as Google, Samsung and Tesco.

The models at higher levels of accountability should be more integrative than the ones at lower accountability levels. Employee Champions (working at the *level of service differentiation*) could work on dimensions like absenteeism and turnover, choosing the angle of individual knowledge management and continuity, while business partners working at the level of systems redesign could focus on revenue increase/FTE. While both foci are sides of the same coin, the latter demands undoubtedly a more integrated approach than the first.

Building block number three: Integrate projects in a portfolio management set-up.

The secret to integrated delivery is not in the adoption of a particular method (e.g., a performance management tool or a competency framework), nor in the successful completion of activities. The key to sustainable change is in the way the different initiatives are managed in a portfolio. This means acknowledging the interdependencies of the specific projects and the multiple learning cycles through which the human capital strategy unfolds. The change initiatives that are seen to emanate too frequently from the HR division are unfortunately often resisted and not respected. To galvanize support and commitment to this change, there *does* need to be a specific and concentrated effort on aligning the different HR initiatives. This is challenging because many HR professionals operate fairly independently within the HR function. They primarily define their value through their individual relationship with their line leaders or sub-discipline industry colleagues; and they hesitate to give up that independence, and instead prefer to align around a common professional operating model, based on clear accountabilities, performance foci and predictive modeling.

Portfolio management is the third building block of an effective Human Capital Strategy. It is a process designed to ensure that the HR group spends its scarce resources on the work that is of the highest value. This process serves as a filter so that only the most valuable work is approved and managed across the entire enterprise.

Implementation of a portfolio management model usually starts with trying to identify and prioritize the work of the portfolio, most likely because that is obviously where one will find the greatest value. However, if you start there directly, you will soon find your group is in disagreement over what work provides the most value.

The value that work brings to your organization is typically, though not necessarily, based on the cost/benefit implications and how well it aligns with your organization's strategy, goals and objectives. This is a discussion rarely held in Human Resources. Human Capital projects and objectives are usually expressed as high-level statements that describe what one is trying to achieve (through goals and objectives) and how the organization plans to achieve it (strategies and tactics), not in terms of cost/benefits, nor in terms of interdependencies, nor in terms of alignment of learning processes. If you do not have this latter base of reference, you cannot evaluate your work for alignment.

Conclusion: The Future is Now

We started this article with the story of the CHRO who delivered on activities, but not on results. We discovered that the answer was not in the quality of the HR strategy document. The roadmap to a differentiating Human Capital Strategy begins by building clarifying roles and responsibilities, professionals that insist on an analytical approach to support interventions and a management of interdependencies.

There is a lot to think about when making this fundamental change in the management of human capital. Given the current economic uncertainty, organizations can not afford to stick to old paradigms and approaches. All disciplines are continuously challenged in how to create sustainable advantage. In most industries business success requires a disciplined approach to improving the performance of people. How this transition is emerging in Human Resources is already going on. The future of human resources is now!

Author

Jan De Visch is Managing Director of Connect & Transform (www.connecttransform.be) and Executive Professor HRM at the Flanders Business School MBA program (Belgium). He has more than 25 years of experience in Business model shift facilitation, innovation in human capital processes, and supporting sustainable business development. He works on the alignment of accountability design, performance management and talent development. He is author of *The Vertical Dimension. Blueprint to align business and talent development* (2010) and *Leadership. Mind(s) Creating Value(s)* (2014)