Measuring human capital

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Abstract

Purpose – *The aim of this paper is to identify how human resource (HR) professionals can best approach the measurement of human capital. This is an evolving area and those organizations held up as exemplars are constantly reviewing their approach and measures and striving for better understanding of people contribution.*

Design/methodology/approach – *The paper draws on experience and research from within the Chartered Institute of Personnel and Development in the UK since 2000 and up to 2011, as well as external research sources.*

Findings – *The paper finds that there is no one way to carry out human capital measurement as it is context-specific. However, there are certain people management measures that when applied would provide managers with useful insights in most organizations. More important than specific measures is that the processes around measurement are accurate and trustworthy.*

Practical implications – *All forms of capital must be evaluated and analyzed in context to understand how people drive business performance. Human capital only adds value if it can be successfully converted into goods and services that will make a profit.*

Originality/value – *The paper examines people management measures which provide managers with useful insight in most organizations. However, it concludes that it is more important that the processes around measurement should be accurate and trustworthy.*

Keywords *Measurement, Human capital, Intellectual capital, Human resource management*

Paper type *Conceptual paper*

Measuring human capital has always been viewed as challenging. First there is the problem of defining human capital itself. Even the very term has been the subject of heated debate with one side hailing the benefits of treating people as assets rather than costs and the other side lamenting that people should be considered on the same terms as inanimate forms of capital. However, the term is here to stay and human capital is most commonly defined as an element of intellectual capital along with social capital, consisting of the relationships and networks that enable the creation and transfer of knowledge, and organizational capital, including the firm's policies and procedures together with patents and other forms of knowledge owned by the organization rather than individuals.

Human capital then is the knowledge, skills and experience of individuals and also their willingness to share these attributes with the organization to create value. As a result measuring human capital is not just about measuring skills or even contribution in the form of productivity; it is also about measuring how successfully that knowledge and contribution translates into organizational value. This was recognized as far back as 1999 with Lepak and Snell (1999) commenting that ''the value of human capital is inherently dependent on its potential to contribute to the competitive advantage or core competence of the firm.''

The Chartered Institute of Personnel and Development (CIPD) has been researching the most appropriate measures of human capital since 2000 and we have managed to reach a number of conclusions:

1. That there is no one right way to measure human capital. Measures are context specific and will vary over time and according to the needs of organizational strategy. What is constant is the requirement for contextual explanation of people management data.
2. There are certain areas of people management in which some data will always be useful to inform management action, as follows:
   - how talent is attracted, recruited and retained;
   - how talent is developed and utilized;
   - how talent is rewarded and motivated; and
   - how knowledge and performance are managed.
3. Specific measures are less important than the process of assessment, evaluation and feedback and any information generated needs to be accurate, trustworthy and communicated with adequate explanation and guidance for implementation and action.
4. High value human capital does not always equate with high organizational value. All forms of capital must be evaluated and analyzed in context to understand how people drive business performance and human capital only adds value if it can be successfully converted into goods and services that will make a profit.
5. Human capital measurement is an evolving area and even those organizations held up as exemplars are constantly reviewing their measures and striving for better understanding of the people contribution.

Measurement in context

The bedrock of human capital management is the belief that the contribution of people to organizational performance is crucial and that their contribution can be managed to a more positive or higher value outcome. The most valuable measures are therefore those that help to identify the performance levers and inform the people management actions that will maximize them. The first step to achieving this is about recognizing the role of people in adding value. Research by the Chartered Management Institute in 2006 (Scott-Jackson *et al.*, 2006) found that 86 percent of directors agreed that they value their employees as key assets and 77 percent believe that their workforce development is aligned to business goals. However, only 68 percent actually measured the contribution of employees.

Much has been written about the difficulties of measurement. Work for the CIPD in 2003 (Purcell *et al.*, 2003) concluded that firms would not value and not measure aspects of employee behavior or capability that they cannot use in the pursuit of their business objectives. At the firm level the contribution of human capital is contingent on the supply and relevance of employee competencies to the business needs of the organization as determined by its strategy. This context dependency therefore makes it impossible to identify a single set of measures that will be relevant and applicable in all circumstances and also means that individual organizations have to put a great deal of effort into identifying the measures that are most relevant for them.

As a result many organizations become competent in generating and communicating employee data to inform management action but fail to identify a framework where this can be used for assessment and evaluation. This means that even the impact of individual activities, such as training interventions or performance management processes, is not assessed other than through tracking data such as take up, spend or completion of paperwork. In addition, the absence of generic measures makes is impossible for human capital contribution to be compared across organizations or sectors that makes many organizations question the value of measurement for external use. However there are some notable exceptions. A certain financial institution has a long history of human capital measurement (CIPD, 2006). Its approach is summarized below.

Distinguishing between management and measurement

The institution makes a clear distinction between the management and measurement of human capital. The approach to managing human capital contains three distinct steps:

1. Understanding the sum total of the talents, knowledge and skills of employees.
2. Developing the ability to grow and apply these productively to achieve the organization's strategic intent.
3. Measuring and reporting on key people metrics, including both lead and lag measures of performance, and changes over time.

The institution's approach to measuring human capital has three dimensions:

1. Measuring the efficiency of the HR function. This is managed by the HR operations team for the purpose of functional performance management, but falls outside the institution's approach to human capital measurement and reporting. Such measures include the ratio of HR employees to total employees.
2. Measuring the effectiveness of people processes, that is, whether processes achieve their intended objectives. For example, measures used identify whether the institution's talent management process results in the growth of its talent pipeline, the accelerated development of its best people and objectivity in selecting high-potential employees.
3. Measuring the impact or return on investment of key people processes. This extends beyond measuring HR process effectiveness to evaluating whether such processes positively impact on business performance, with measures including productivity, revenue growth and customer satisfaction (CIPD, 2006).

Commonly used measures

There are a number of areas where most organizations collect at least some data that has relevance for human capital measurement. These are summarized in Table I.

However, although common data might be collected in each of these areas, which may give some useful insights into the value of human capital, it is the outcome measures or rather the impact that human capital makes on performance that will have the greatest value both to managers inside the organization and to external stakeholders anxious to improve their understanding of how the organization might perform in the future. These measures often require greater analysis of the data to understand what it means. Some examples of the desirable outcome measures in each of these areas are shown in Table II.

The process of assessment and evaluation

Having reliable and robust data is a good foundation for human capital measurement and a good place to start, but it is by no means the end of the story. More important than data is having a robust assessment and evaluation framework within which to analyze and explain the data to achieve measures related to outcomes.

Recent work by the CIPD (2011) stresses the importance of assessment and evaluation in identifying and maximizing the drivers of sustainable performance. This work defines assessment and evaluation as ''[. . .] the processes that occur at different organizational levels to gather qualitative and quantitative information, to assess the impact of actions and inform decision-making.'' It found that external context has a profound impact on the measures that organizations pay attention to. For example, one of the case studies investigated has as a core value in returning value to the customer so their measures are influenced by customer need. For one contract in the public sector the context of cutbacks has shifted the important measures from being demand led to cost driven. Another has

Table I Commonly collected data

Area of measurement	*Examples of data collected*
Acquisition	Time taken to recruit Strength of brand recognition Number of applications in response to advertising Number of unsolicited applications Time taken for new employees to reach optimum competence levels Number of difficult to fill posts Feedback from recruiters on ease of use of selection tools Data from equal opportunities monitoring Time taken to recruit
Development/ talent management	Training spend/days training provided Number of names appearing against roles for succession planning Number of individuals on development programs or acquiring professional qualifications Results of skills audits Identified skills gaps Feedback from training
Reward	Numbers achieving performance-related bonus or increments Comparability or reward package with other employers Satisfaction with reward
Retention	Turnover/attrition rates Number of people with transferable skills Percentage of staff with an active development plan Number of internal promotions
Exiting	Feedback from exit interviews Demographic information on age and gender profile
Motivation	Engagement scores Absence rates Productivity data such as sales per employee or revenue per employee
Performance	Numbers achieving high performance ratings Numbers of instances of poor performance dealt with Accident rates Numbers achieving objectives

Table II Outcome measures

Area	*Example outcome measures*
Acquisition	Resources adequate for optimum customer service Successfully attracting high-caliber applicants Organization not experiencing significant skills shortages
Development	Can demonstrate agility and capability to cope with changing circumstances Can demonstrate that new knowledge is being acquired and embedded
Reward	Compensation tied to business success
Retention	Can demonstrate effective talent planning including succession planning Can demonstrate that the organization is successfully retaining vital skills
Exiting	Demographic issues effectively managed Vital skills and knowledge effectively retained
Motivation	Organization able to track the relationships between engagement, and commitment and effort Organization understands and demonstrates the impact of high engagement on business factors such as customer retention.
Performance	Organizational capability Ability to innovate

shifted from measures of efficiency to measures of effectiveness in response to pressure from external stakeholders – measuring value for money rather than cost.

A further issue for assessment and evaluation is around getting the right mix of qualitative and quantitative data. Managers, particularly finance managers, are keen on quantitative data, which demonstrates impact, but it is not always clear what this means without the qualitative narrative. For example, service delivery figures need to be balanced with qualitative information about the quality of service. An interviewee in the CIPD (2011) *Shaping the Future* report commented: ''Just because a service is delivered it does not mean the customer has a good experience.''

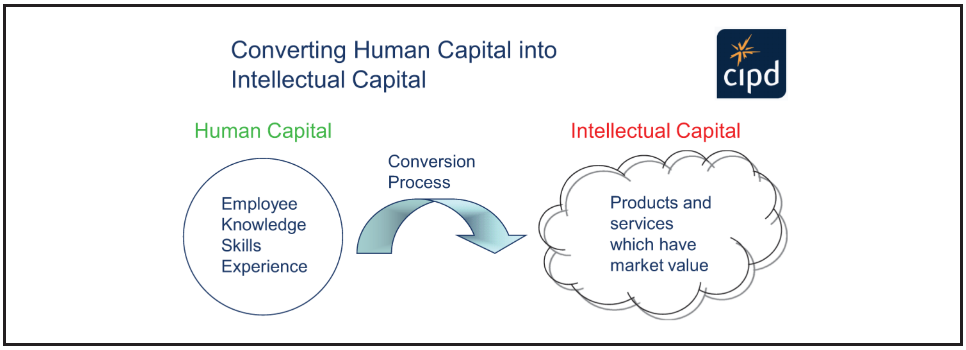
Perhaps the biggest challenge for assessment and evaluation is how to present data as measures of impact. This means correlating data from different sources to provide some insights about the impact of different variables on measures of performance. A good example of this comes from the Nationwide Building Society's Genome model which allows them to demonstrate a link between employee commitment, customer satisfaction and business performance by correlating data collected from employee surveys, customer feedback and sales figures and examining the figures in relation to different parts of the business. The Nationwide experience is reported more fully in Baron and Armstrong (2007).

Translating human capital into organizational value

As discussed above perhaps the most useful – and the most difficult to achieve – measures are those that evaluate the contribution of human capital to organizational value. However, another important area for measurement is the process of converting human capital into intellectual capital (see Figure 1), which also involves the use of social capital. As a result, measurement also has to consider the effectiveness of the management process and the depth of understanding about what will motivate individuals to share their knowledge and skills to the optimum benefit of the organization. It means understanding the real impact of engagement, talent development and organizational design that will enable people to come together in a positive way to share, acquire and develop their knowledge to enable it to become embedded into organizational learning.

So, for example, an organization contributing to a CIPD research project on knowledge sharing (Kinnie *et al.*, 2006) captured and fed back the outcomes and learning from the bidding process to inform its development and skills requirements and also to enable it to become more responsive to customer needs. To support this, it also developed a series of HR practices to stimulate the key forms of human capital that it has identified as crucial to its own and its client's needs. For example, it has developed a training strategy that drives its values and creates opportunities to participate across teams, to share learning and procedures and to manage workflow without constraining autonomy and creativity.

Figure 1 Making the most of human capital



Looking forward

Measuring human capital is an evolving area but one where understanding is increasing all the time. Recent CIPD research (King, 2010) demonstrates there is an increasing appetite from external stakeholders, including the investment community, for more information about human capital as long as this can be rooted in context and capable of evaluating the impact of people on business objectives.

The CIPD's *Shaping the Future* work argues that organizations should be able to use data to inform future operations and to scenario plan, enabling them to be more agile. The organizations contributing to this work talked about the importance of capturing and analyzing information on a regular basis. This ranged from enabling people to reflect on their learning at the end of a development program to establishing sophisticated management information systems that allow lessons to be learned from current work and fed into the planning for future work.

Human capital measurement is about taking incremental steps from a bedrock of solid data to analyze and interpret the true meaning of that data to a range of stakeholders both internal and external. This means collecting data from a variety of sources and reflecting not just human capital but the other forms of capital – social, organization and intellectual – to inform action and report on impact and outcome. More of an art than a science, it involves good communication and interpretation skills as well as the ability to link the data to business issues to create real understanding of how people add value.

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Angela Baron has been a CIPD adviser since 1990. In that time she has been responsible for a number of major projects on various topics including total quality, organizational culture, job evaluation, performance management, lean organizations, HR strategy, the relationship between HR and business performance and, most recently, human capital management. She is currently looking after the subject areas of engagement and OD and contributing to the CIPD's major work looking at sustainable high performance. She holds a Master's degree in occupational and organizational psychology and is a chartered member of the CIPD. Angela Baron can be contacted at: a.baron@cipd.co.uk