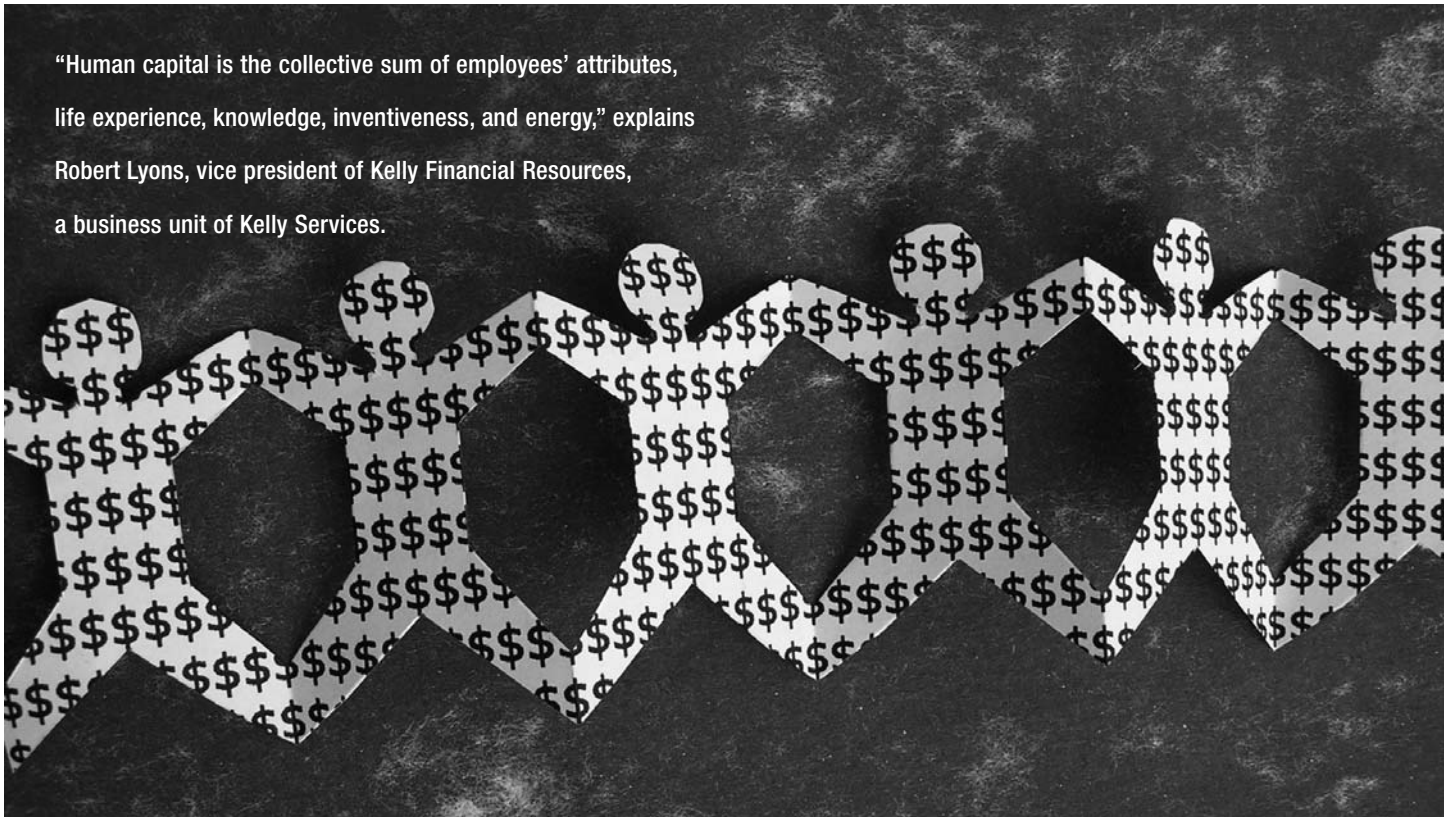


issues & trends

A KELLY FINANCIAL RESOURCES® REPORT

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OPTIMIZING THE WORKFORCE

Measuring and Managing Human Capital

Today, the term “human capital” is generating a lot of buzz in corporate boardrooms and human resources departments both large and small. And it is easy to see why—the intangible capital of a talented workforce increasingly plays a larger role in driving stock prices and market values. Moreover, because an organization’s physical assets no longer dominate its competitive strength, as they did in years past, everyone in the company—from the chief financial officer and the chief information officer to vice presidents and managers—must now master the skills of strategic talent management.

“Human capital is the collective sum of employees’ attributes, life experience, knowledge, inventiveness, and energy,” explains Robert Lyons, vice president of Kelly Financial Resources, a business unit of Kelly Services. “Everyone in the company has to understand that *talent* is the only thing that will make the company successful. They also need to understand that the singular way this focus shift will happen is to manage talent effectively. You must motivate your employees, develop them, select them properly, and release them when appropriate.”

According to *CFO* magazine, 79 percent of the chief financial officers in the United States directly or indirectly manage their company's human resources functions.



Managing Human Capital the “Tigers” Way

Lyons points to his hometown baseball team, the Detroit Tigers, as a prime example of effective human capital management strategy at work. In 2003, the Tigers nearly set a sports record for the most losses by a major league baseball team. Then in the off-season, the team acquired several top players, including Ivan Rodriguez, the former catcher for the World Series Championship-winning Florida Marlins. As a result of adding Rodriguez and other vital players to the roster, the Detroit Tigers quickly moved from the bottom rung to a leadership position, where they may be only a few games away from capturing the 2004 Central Division title.

“Applying the Detroit Tigers’ analogy to the business world, consider the impact to a finance department if a company hired superstar managers from the top firms in that company’s industry,” says Lyons. “As a competitive tool, it would help take a company to the next level. For instance, when Jack Welch retired from General Electric and named his internal successor from a group of GE’s executive vice presidents, it was no surprise that companies such as Home Depot and 3M immediately went to work recruiting those who didn’t get the nod.”

As these examples clearly illustrate, the hallmark of today’s leading companies is the ability to attract, develop, and retain outstanding people. However, to do this, companies must leverage best practices in measuring human capital to achieve productivity gains as well as hard-dollar savings.

Why Measuring Human Capital Matters

Since payroll and benefits account for approximately 35 to 40 percent of a company’s operating expenses, it is surprising that organizations have not focused more of their efforts on measuring and developing human capital. According to *CFO* magazine, 79 percent of the chief financial officers in the United States directly or indirectly manage their company’s human resources functions. Whether or not a CFO oversees HR directly, payroll, selling, and general and administrative expenses make up the number-one expense on the corporate balance sheet, and therefore costs related to human capital cannot be overlooked.

Consulting firm PriceWaterhouseCoopers and its affiliate, the Saratoga Institute,¹⁰ have identified five key factors that make the business case for human capital measurement:

- **Improvements in information technology.** IT advancements create a better integration between core systems such as human resource management, payroll, applicant tracking, and general ledger.
- **Increased expectations of human resources.** Along with powerful new IT tools come greater requirements for better human resources performance.
- **Human resources process improvement methodologies.** Human resources departments are expected to show operational progress using quality improvement methodologies.
- **The state of the economy.** Cost controls are tighter, and human resources departments are expected to make financially based decisions now more than at any time over the last decade.
- **The trend toward value reporting.** Analysts and investors look deeper into the intangibles, such as human capital, that contribute to a company’s true value.

Calculating the Value of Human Capital

When a top performer leaves an organization, the change affects everyone from customers to co-workers. The company must spend valuable time and money finding a qualified replacement. But just how much does the departed employee represent to the company in current terms—and in future shareholder returns? “This kind of loss is not as easy to calculate as determining the loss of a building or the costs of product spoilage, because human capital is not like any other capital,” notes Lyons. “It simultaneously represents a company’s single greatest potential asset and its greatest potential liability.”

According to *HR Magazine’s 2003 Research Quarterly*, value in an organization is created by financial assets such as cash and marketable securities; physical assets like property, plant, equipment, furnishings; and intangible assets, which include intellectual capital (patents, product designs, process technology), goodwill, and human capital.

The results from Watson Wyatt's 2001 Human Capital Index survey link superior human capital practices to higher shareholder return. The study identified 49 specific human resources practices that have the greatest impact on shareholder value.



Jac Fitz-enz, author of the groundbreaking book, *The ROI of Human Capital*, suggests that organizations implement a human capital scorecard, based on the balanced scorecard monitoring and reporting method, and use it to organize and monitor their human capital information. The metrics used should thoroughly look at the investment and utilization levels of human capital by including cost, time, quantity, and quality measures. For example, a corporate human capital scorecard might look like this:

FINANCIAL	HUMAN
Human Capital Revenue <i>Revenue divided by full-time employees (FTEs)</i>	Exempt Percentage <i>Number of exempt FTEs as a percentage of total FTEs</i>
Human Capital Cost <i>Cost of pay, benefits, absence, turnover, and contingents</i>	Contingent Percentage <i>Number of contingent FTEs as a percentage of total FTEs</i>
Human Capital ROI <i>Expenses minus total labor cost, divided by total labor cost</i>	Accession Rate <i>Replacement hires and hires for new positions as a percentage of the workforce</i>
Human Capital Value Added <i>Expenses minus total labor cost, divided by FTEs</i>	Separation (Loss) Rate <i>Voluntary and involuntary separations as a percentage of head count</i>
Human Economic Value Added <i>Net operating profit after tax, minus cost of capital, divided by FTEs</i>	Total Labor Cost Revenue Percentage <i>All labor costs as a percentage of total revenue</i>
Human Capital Market Value <i>Market value minus book value, divided by FTEs</i>	Employee Development Investment <i>Cost of all training and development as a percentage of payroll</i>

In developing a human capital scorecard, organizations must remember that selecting metrics is an ongoing process, not a singular event. Additionally, the chosen metrics should not be slanted to show only "good" results while avoiding the "bad" ones. To benefit from the process, a company must be open to showing improvement trends rather than strong initial results.

Impacting Shareholder Value

Organizations that take the time to consistently measure their human capital and implement steps to increase its value find that their efforts usually generate significant benefits. The results from Watson Wyatt's 2001 Human Capital Index® (HCI) survey link superior human capital practices to higher shareholder return. The study identified 49 specific human resources practices that have the greatest impact on

shareholder value. The research quantifies the amount of increase in a company's market value that can be expected from an improvement in each of those practices. Some examples of the key findings were:

PRACTICE	IMPACT ON MARKET VALUE
Total rewards and accountability	16.5%
Collegial, flexible workplace	9.0%
Recruiting and retention excellence	7.9%
Communications integrity	7.1%
Focused HR service technologies	6.5%
Prudent use of resources	-33.9%

[Expected change in market value associated with a significant one standard deviation (SD1) improvement in HCI dimension.]

Source: Watson Wyatt's 2001 Human Capital Index® (HCI) survey

The 2001 HCI data indicates that over time, human capital practices can lead a company's value creation. The survey reinforces Watson Wyatt's theory that by hiring the right people, leveraging technology, and fostering an environment that supports creative thinking and increased productivity, businesses will reap the rewards.

Taking Advantage of Your "Greatest Asset"

The ability to understand and measure human capital opens up a whole new approach for organizations to take in managing their talent. By targeting and exploiting critical human performance capabilities such as organizational adaptiveness and stakeholder engagement, companies can achieve and sustain a high-performance culture.

Consulting firm McKinsey & Company has identified five imperatives that companies need to act on if they are going to win the war for managerial talent and make talent a competitive advantage:

- **Embrace a talent mindset.** Companies such as GE and Amgen believe that to achieve business success, you must first have great talent.
- **Craft a winning employee-value proposition.** Everyone wants to be given challenging development opportunities with a forward-thinking, market-winning company.
- **Rebuild your recruiting strategy.** Hunt for talent all the time, not just when a position is vacant.

“Without a doubt, changing business practices and emerging technologies have transformed businesses, as well as the roles employees now must perform—from top management on down,” says Lyons.



- **Weave development into the organization.** Improve the frequency and encourage the candor of feedback, and institutionalize mentoring.
- **Differentiate and affirm your people.** Cater to your top performers, help middle performers improve their game, and remove weak players.

“Without a doubt, changing business practices and emerging technologies have transformed businesses, as well as the roles employees now must perform—from top management on down,” says Lyons. “If companies believe that their people are their greatest asset, then companies must also recognize that their ability to compete is affected by the people they employ. Recruitment firms can play a large role in helping businesses maintain a competitive advantage by providing highly qualified management professionals and even temporary contractors, without disrupting the bottom line.”

“In fact, some of the best run companies allocate for a significant percentage of their hires to come from outside resources, versus promoting from within. This helps to recalibrate what a new manager’s expectations are versus the established company norms,” continues Lyons. “By measuring and developing its human capital, an organization can ensure that its most valuable asset is utilized to the highest degree.”

Kelly Financial Resources has experienced and knowledgeable recruiters who find talent in a number of disciplines in accounting and finance fields, including public accounting, general accounting, payroll/billing, internal audit, tax, budgeting and cost accounting, financial analysis, treasury, cash management, investor relations, mergers and acquisitions and credit management. For more information about Kelly Financial Resources visit www.kellyfinance.com.

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RESOURCES:

CFO Magazine

“The HR Scorecard: The New Way to Measure Your Human Capital,” James Hatch, PriceWaterhouseCoopers and the Saratoga Institute

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Watson Wyatt’s Human Capital Index®