HCMI

Ebook

Examining HR Analytics through the Lens of Finance

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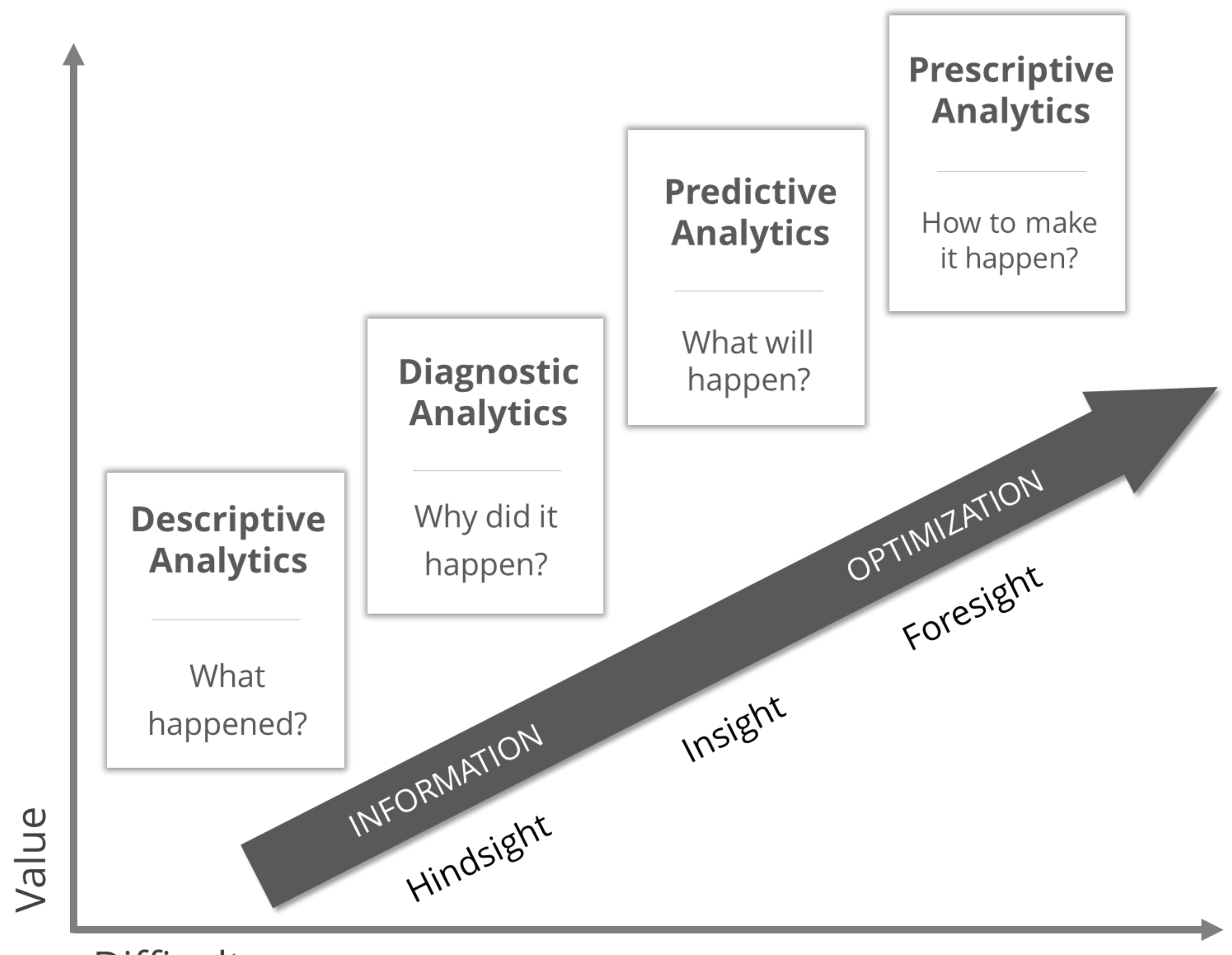
Analytics Adoption Over Time



Source: Gartner 2014

In much the same way carpenters have specialized tools for each step in a woodworking project, HR executives have access to specialized metrics and analytic methodologies to deliver value in areas such as reducing turnover, increasing retention, and improving the ROI of management training. Knowing when and which metrics to apply is challenging, especially when each decision has the potential to impact the lives of many people.

Traditionally, the HR function has not had a set of standardized metrics to rely on. In lieu of official metrics for measuring important KPIs like productivity, many companies turned to metrics like Revenue per FTE and Profit per FTE. These metrics have their place in understanding the productivity of the workforce but are best used in conjunction with other productivity metrics for an accurate understanding of the health of the organization. Per FTE metrics are a good place to start investigating productivity. However, there are challenges to using per FTE metric, the biggest one being the ambiguity around what counts as an FTE.

For example, should employees on leave be included in the count of FTEs? Additionally, contingent labor is often excluded when tallying employee headcount but can be a large portion of total labor costs. With these traditional per FTE metrics, it is possible for organizations to appear as though productivity is improving while cutting staff (and by assumption, costs), by hiding the total effort of the workforce through contingent staff.

What these metrics miss is that there is much more being contributed to the overall effort of workforce productivity than what is being recognized. The result is an over-inflated metric that has very little relation to the actual productivity of the group.

Using the Right Metrics: The Foundation of HR Analytics

IS YOUR WORKFORCE PRODUCTIVITY INCREASING, DECREASING OR STATIC AND WHAT ACTION NEEDS TO BE TAKEN?

By using more ubiquitous values to measure the workforce, a more transparent view of workforce productivity begins to emerge. In a recent publication by the ISO board, a set of 23 metrics aimed at standardizing human capital reporting were released. Among those metrics are a few tailored specifically towards measuring productivity which can help explain productivity on a broader scale. This can help answer important questions such as “Is our workforce productivity increasing, decreasing or static and what action needs to be taken?” and “How does it link back to revenue and profit?”

Human Capital Return on Investment Ratio (HCROI Ratio) is a recommended metric that measures the net operating profit impact of each dollar invested in human capital or the total cost of workforce or TCOW. TCOW encompasses all the expenses necessary for employing a workforce, including total compensation, training, benefits, contingent labor, and all other workforce costs. These measures of productivity have been studied extensively and have been shown to be a stronger predictor of market performance than any other financial metric currently being publicly reported. By comparing the performance of two banks using traditional financial metrics, and then ISO Human Capital Reporting approved metrics, a story emerges.

Diving in deeper into the financial sector we can look at and compare two businesses to understand how advanced HR analytics relates to a company's productivity and value. For example, two multinational banking firms suffered dramatically during the 2008 recession. Looking at Revenue per FTE and Profit per FTE in 2009 the first bank appeared to be performing worse than the second. A different story is told when considering the HCROI

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What to Include in a Business Case

1. **Compelling Questions**
   - *Ask the right questions*
2. **Objective Measures and Facts**
   - *Historical data, key metric indicators, segmented data*
3. **Powerful Visuals Charts** (examples if possible)
   - *Charts with insights, that tell a story & drive action*
4. **Use Qualitative Story Telling**
   - *"Two of our top 3 salespeople came from other industries"*
5. **Link to Business Impact (ROI/Cost/Profit)**
   - *The cost savings is a range of $1.0 to $3.0 Million*
6. **Risk Analysis "What if we do nothing"**
   - *Engagement drops, turnover rate climbs, growth slows*

Ratio, between 2009-2011. The first bank had the highest gain on its HCROI Ratio, corresponding to a higher gain in productivity, while the second bank performed worse. This goes to show that while per FTE measurements help gain some insight into the performance of an organization advanced metrics such as HCROI Ratio give a little more insight into how that company is actually performing. When looking only at the FTEs, it appeared that the second bank was performing better during the recession. Those metrics, while still valuable, weren't able to show the true ROI of the company. When considering HCROI along with those FTEs, more of a story is told. While the FTE metrics showed the first bank was lagging, the productivity of the company and especially of the employees was greater than that of the second bank. (HCMI)

To get a better sense of what HCROI Ratio is and what it measures, here's the formula:

$$\textit{HC ROI Ratio} = \frac{\textit{Total Revenue} - (\textit{Total Operating Expenses} - \textit{Total Cost of Workforce})}{\textit{Total Cost of Workforce}}$$

This metric answers questions that have long been asked, but thought impossible to answer such as: What is the impact of each dollar that is being spent on the workforce? If an amount had to be assigned to a ratio that describes the amount each dollar invested in the workforce returned, what would that ratio be? How has that changed over time? Has the ratio of returns gone up or down after certain changes or initiatives? How are we performing versus peers?

By answering these questions, organizations can effectively begin putting together the puzzle of where money is being best spent and they can see the results in not only their productivity, but also their revenue and profit.

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Let's say that an organization generates revenues equal to $100,000, its total operating expenses are $50,000 and its total cost of workforce is $25,000. By plugging those values into this equation above, the outcome is an HCROI Ratio of 3. For every dollar that this organization invests in their staff, $3 in returns can be expected. If an entity has a HCROI ratio equal to 1 then that entity is breaking even. An HCROI Ratio of less than one is a sign that the organization is not profitable and is losing money on every dollar being invested in the workforce.

Having the right tools to understand a workforce and knowing how to use them is an essential part of workforce analytics. Once those tools have been acquired, understanding the story behind an organization becomes easier. Once the story is understood, big picture questions can be answered, and the organization can function more effectively.

The next step is to then use those metrics/tools to investigate which programs or initiatives are lacking, and where improvements can be made.

Other examples of metrics used to understand workforce analytics can be found here:

(https://www.hcmi.co/Docs/White-Papers/Top-5-Metrics-for-Workforce-Analytics)

(https://www.hcmi.co/Docs/White-Papers/Linking-Human-Capital-to-Business-Performance-White-Paper)

Founded in 2008 in L.A.'s Silicon Beach, HCMI's mission is to fundamentally change how workforce decisions are made by linking people investments to business outcomes through advanced analytics and dynamic visualization.

SOLVE™
WORKFORCE INTELLIGENCE SOFTWARE

SOLVE™ is HCMI's advanced business analytics platform for human resource management that drives competitive advantage through higher workforce productivity, smarter workforce spending and better talent management.

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