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A KELLY FINANCIAL RESOURCES® REPORT

HUMAN CAPITAL AND THE ROAD AHEAD

What is its value to your future success?

When budget reductions stretch corporate resources, cost is often placed before value in many operational areas, even when it comes to a critical item such as a company’s employees. As a short-term gain, HR and hiring managers may look to trim the salaries of the talent they hire, a tactic that often results in attracting only candidates of average to below-average caliber. In the end, the costs of turnover far outweigh the longer-term investment in attracting the best talent—a far higher price than many companies had originally bargained for.

Compounding the problem, an old-style management philosophy still exists in corporate America, where more importance is placed on tangible items such as the value of plants, equipment, and material possessions.

“Too often, the value of human capital is overlooked because there is no universally recognized standard on how to value human capital like there is for a company’s material possessions,” says Robert Lyons, vice president of Kelly Financial Resources, a business unit of global staffing provider, Kelly Services, Inc. “As a result, few companies understand which employees are essential or how best to structure their workforce.”

The good news is that savvy, forward-thinking finance executives have begun to view HR as their strategic partner in helping them to understand the value of human capital and create a talent strategy to recruit, develop, and retain vital, top-performing talent.

Despite growing recognition of the importance of human capital, only 38 percent of companies recently surveyed by Mercer and CFO Research Services made a concentrated effort to weigh the value of skills, knowledge, and experience against payroll savings when downsizing.

Why Companies Should Place a Value on Human Capital

Human capital is the collective sum of the attributes, life experience, knowledge, inventiveness, energy, and enthusiasm of employees. Employee talent is a critical driver of corporate performance; a company's ability to attract, develop, and retain talent will be a major competitive advantage into the future. According to McKinsey & Company's Talent Management Index, companies that scored in the top quintile delivered (on average) a 22 percent higher return to shareholders than their industry peers.

Moreover, key findings from interviews conducted during a survey by Mercer and CFO Research Services, "Human Capital Management: The CFO's Perspective," echo this expanded CFO focus on human capital as a primary value driver:

- **Despite high spending, few companies know the return on human capital investments.** On average, companies spend 36 percent of revenues on human capital expenses, yet only 16 percent of those that participated in the Mercer survey reported that they know the return to a "considerable" extent.
- **Companies now manage human capital at both an investor and board level.** Forty-nine percent of companies surveyed reported that investors are beginning to ask about human capital issues; 23 percent say their boards are highly involved in human capital issues.
- **Building leadership and raising workforce productivity are top workforce priorities.** Forty percent of companies with over $1 billion in annual revenues want to measure the influence of human capital on attaining business objectives.
- **Few companies consider human capital value when making layoff decisions.** Despite growing recognition of the importance of human capital, only 38 percent of companies in the Mercer survey made a concentrated effort to weigh the value of skills, knowledge, and experience against payroll savings when downsizing.

Clearly, companies that recognize the correlation between human capital and its long-term return will maintain a significant advantage over those stuck in the old ways of reducing workforce numbers to cut costs. But simply understanding that human capital has value is not enough. To make the most cost-efficient hiring, promotion, and layoff decisions, businesses need to dig deeper by first identifying their top talent—the "A" employees—and then determining their above-average workers, or "B" employees; and their average, "C" employees.

Classifying the Three Types of Employees

Following are many of the characteristics of "A," "B," and "C" employees:

Candidate Type	Characteristics
"A" Employees	• Learn quickly; figure out a solution before being taught • Become independent quickly • Require less management and support • Consistently achieve objectives • Always performs on time and on budget • Work well with a team • Demonstrate leadership qualities
"B" Employees	• Require a basic learning curve • Demonstrate a higher comfort level as a team member • Seek management direction before action • Regularly meet objectives • May not lead, but won't hold a team back • Require time to ascend to leadership
"C" Employees	• Are competent but require too much pushing • Have weak people skills • Are inflexible • Listen too little • Learn too slowly • Get by on personality vs. hard work • Tend to drain the energy out of a team
The bottom 10%	• Lack ability • Lack motivation • Have a bad attitude

The Challenge of Quantifying Work Value

Once organizations have identified the categories of employees they have, the challenge HR professionals and CFOs often have is trying to quantify the value of work output that can be achieved with an "A" employee versus a "B" or "C" employee.

One simple formula many businesses use is Revenue per Employee (RPE). This formula takes a company's total revenue and divides it by its permanent employee headcount. A company's RPE can be used for comparison against companies of similar revenue size or employee count, and it can also be used for comparison against similar companies in the same industry.

"Companies should review their past existing workforce analysis and planning efforts to determine how the company may be affected by increased retirement rates, a rapidly maturing workforce, or a change in age or ethnic demographics," notes Lyons.

To look at quantifying value another way, consider the hypothetical Acme Industries. The company has a savings goal of $3 million this year. How many of each type of employee would Acme need to employ to achieve this goal?

If a "B" employee can save the company $500,000, then:

- An "A" employee can probably save the company $750,000 ("B" x 1.5).
- The "C" employee may save the company only $250,000 ("B" x .5).

Using this formula, Acme Industries would need only four "A" employees to achieve its goal, while it would need to keep six "B" or twelve "C" employees on the payroll to realize a $3 million cost savings. Taking into consideration salaries, benefits such as healthcare and 401(k) matching contributions, and administrative costs, it would be far more efficient to employ four top performers than twelve below-average ones.

The Importance of Ongoing Employee Development

Given the sheer number of applicants and the often-immediate need to fill positions, companies tend to err by treating people with diverse skills as an undifferentiated resource rather than quantifying them as "A," "B," or "C" employees. As a result, companies lose the opportunity to make gains in productivity, profitability, and personnel development.

A study by Lominger Limited Inc., a leadership development consultancy in Minneapolis, studied managers at many levels and across multiple industries to evaluate how well they performed in 67 defined competencies. At the bottom of the list was "developing direct reports." Another workforce development firm, Pittsburgh-based Development Dimensions International Inc., reports that "developing others" is rated the lowest of 22 leadership competencies.

In the article, "How Executives Grow," from *The McKinsey Quarterly*, 2000, author Helen Handfield-Jones notes, "Recruiting all of a company's senior executives externally sacrifices cultural cohesion and institutional memory…companies that can't develop their own talent find it hard to attract good people from the outside."

However, one company that is universally considered "best in class"—particularly in employee development—is General Electric (GE). Each year, GE recruits approximately 350 finance employees and typically sends 700 candidates through its financial management programming course. The company values and promotes finance staff who can think clearly, communicate well, and have the courage to stand up for what they believe is best—in other words, "A" employees. Peter Mondani, GE's manager of financial leadership development and human resources says, "Developing leadership skills is key. I never know when a finance job will open up or an acquisition will go through, requiring another seasoned individual to fill it."

In addition to development, retention and career laddering are priorities. For example, the company moves promising employees into "stretch assignments" or challenging positions that require them to use or develop strong leadership and intellectual skills—the kind that ultimately deliver a higher return on human capital investment.

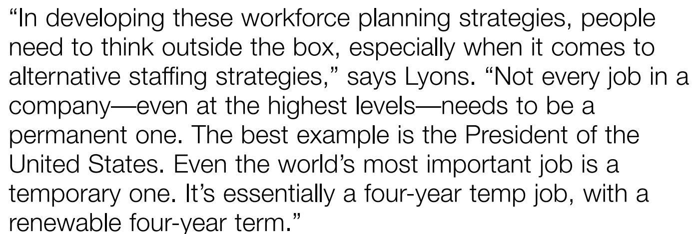
Incorporating Workforce Analysis and Planning

An effective workforce plan is an essential tool to identify appropriate workload staffing levels of "A", "B", and "C" employees and justify budget allocations for development. By systematically identifying the human capital required to meet company goals, organizations can then develop strategies to meet those requirements.

"Companies should review their past existing workforce analysis and planning efforts to determine how the company may be affected by increased retirement rates, a rapidly maturing workforce, or a change in age or ethnic demographics," notes Lyons.

Specific suggestions to help guide workforce planning include:

- Determine potential reductions, growth, or reorganizations that may affect staffing in the next few years.
- Compute average turnover rates and retirement rates for each business unit/department.
- Identify staff members who will be eligible to retire in the next five years (or longer).
- Determine how key positions or programs may be affected by retirements.
- Identify organizational changes or position level changes that could occur due to vacancies.
- Identify internal and external sources for candidates to replace retirees.
- Identify potential problem areas for replacement staffing (training of internal staff, unemployment rates, graduation rates, or market availability).
- Develop strategies for overcoming potential difficulties such as succession planning, potential reassignments, internal training/development/mentoring, use of part-time employees, retraining, or an alternate organizational structure.



"In developing these workforce planning strategies, people need to think outside the box, especially when it comes to alternative staffing strategies," says Lyons. "Not every job in a company—even at the highest levels—needs to be a permanent one. The best example is the President of the United States. Even the world's most important job is a temporary one. It's essentially a four-year temp job, with a renewable four-year term."

Creating Excellence

Companies are only as good as the people they employ. As shareholders and boards of directors continue to look at human capital as both a competitive advantage and an earnings driver, organizations need to find new ways to identify and develop their top-performing "A" talent.

Kelly Financial Resources can serve as a consultant to help companies evaluate their current workforce and create strategies for attracting and retaining the talent required to best meet their long-term financial objectives. With nearly 60 years of recruitment and development expertise, Kelly has long been considered a valued resource for finding "A" talent in any industry.

"By adding contract professionals to your workforce, an organization can immediately infuse the company with experienced talent and specialized knowledge at a fraction of the costs of hiring equivalent permanent talent," says Lyons. "It's the difference between being able to intelligently and effectively drive company value and falling just short of objectives."

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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