



SCENARIO: HUMAN CAPITAL MANAGEMENT

NOTE ON CONFIDENTIALITY

Link's confidentiality policies for current and recent clients prohibit us from releasing client-specific information. The following Human Capital Management Scenario should thus be considered representative of services that could be provided to support a spectrum of client circumstances.

The Applications section at the end of this document addresses how Link's HCM practice can be applied to alternative scenarios.

HUMAN CAPITAL MANAGEMENT – A DEFINITION

Human Capital Management (HCM) has become the preeminent mission-critical strategic process within organizations striving to succeed in an increasingly competitive landscape. HCM starts at the strategy level (business plan level) of an organization, whereas "staffing" operates primarily at the tactical level (e.g. recruiting, interviewing, benefits administration, etc.). In looking at the relationship between HCM and staffing, you can make a comparison with portfolio management; HCM is analogous to addressing the strategic issues of asset allocation and risk profiles in money management, and staffing is more akin to the stock selection process. Appendix A addresses HCM in more detail.

SCENARIO BACKGROUND

Company X was a small industrial services organization that provided maintenance support to a number of industries, including petrochemical and pulp & paper. It had been very successful over the past 15 years in spite of increasingly high employee turnover, which was approaching 35% annually. Senior management had not performed credible exit interviews, and did not have a valid understanding of the reasons employees were leaving. They rationalized that it was a combination of the onerous travel requirements and the cyclic nature of the work which made it challenging to "guarantee" that employees had reasonable long-term job security (leading to frequent company-jumping). The owners and senior management had offset the turnover of experienced staff by spending more time in hands-on project roles, which detracted from marketing, sales, and employee development activities. Profit margins were dropping due to increased overhead energy spent on recruiting and interviewing, as well as more expensive managerial time spent on project performance.

Replacement employees were being hired each month, although well-qualified employees were becoming increasingly difficult to recruit and clients were beginning to signal levels of dissatisfaction.

Link was hired to assess the root-cause problems, develop a plan to improve recruitment and retention, and help implement the plan.

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SCENARIO PRESENTATION

Before proceeding, Link encourages the reader to peruse Appendix A which provides a more detailed overview of Human Capital Management and why an HCM perspective is so important to today's organizations. In essence, HCM has as its objective the optimization of the flow, deployment, and development of human talent within an organization - - a growing portion of which will never "belong" to an organization. Temporary, part-time, contingent, contracted, leased, and outsourced (or whatever the term) workers are no longer merely alternatives to "regular" employees. They have become a necessary part of the resource landscape, and are often the preferred sources of talent to meet specialized skill/knowledge requirements, satisfy peak period demand, increase speed and flexibility, or reduce operating costs and the associated administrative burden. Human capital, in general, is more accurately viewed as a multi-dimensional continuum of employment relationships. Enlightened and visionary employers recognize that their corporate strategies and employment policies must be responsive to, and must take advantage of, this continuum.

The complexity and importance of these strategies demand formulation at the top levels of the organization. Human resource departments play a key role, but must depend on the larger organization for endorsement, support, and insight into the big-picture plan.

Link Observations

Link's initial observation was that Company X senior management had lost sight of the employment "big-picture", and was increasingly pursuing an HR strategy of a traditional "body-shop". Link saw a number of potential improvements that could be made in Company X's strategic plan and approach to the market, but with specific respect to HCM Link felt it was essential that the management of Company X understand that neither the Company's skills, past experience, reputation, current client base were the basis for future success. Rather, the efficient management of the supply and flow of human assets was the primary source of its competitive advantage. Link spent considerable time helping the management team grasp the evolution of the "human resource" model over the past decade, and how the changes applied to Company X. Appendix A summarizes Link's presentation.

Other Conclusions following a Detailed Assessment

1. The mix of employees was such that 40% of the billable hours in the previous year were performed by "regular" employees, 60% by temporaries hired for just one project. Additionally, too many of the billable hours were being performed by managers that could have been more effectively used in sales, marketing, or project quality oversight.
2. Review of resumes led to the conclusion that temporary staff generally appeared to have resumes that reflected experience levels comparable to that of regular staff, yet performance feedback from projects was that their on-the-job productivity and quality lagged that of regular employees.
3. Comparisons of total costs of each category of employee versus their effective billing rates lead to the conclusion that (ignoring productivity and client satisfaction criteria) the hourly unit profitability of temporary and regular employees was comparable.
4. Regular employees frequently commented that Company X valued temporary more than their loyal employees - - and paid them much better (misconception based on wage versus benefit disparity).



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5. Minimal training had been provided to employees over the past year, beyond that which could be described as informal “on-the-job”.
6. Although organizational charts displayed a rational management hierarchy, presumably with commensurate accountability and authority over subordinates, the reality was that there was inconsistency and confusion regarding authorities and accountabilities. The following were some key indicators:
 - a. A majority of employees stated they had more than one manager
 - b. Managers indeed could not identify the subordinates for whom they were accountable.
 - c. Several ongoing “project teams” floated from project to project without a defined objective, term, or leader - - and did not know how their performance was being assessed.
 - d. No manager believed they were accountable for the long-term careers of subordinates.
7. Compensation and Benefits for regular employees were average compared to Company X’s competitors.
8. Policies and procedures had not been reviewed and updated for several years, and were both inconsistent with each other, inconsistent with the culture and needs of the company, and almost never utilized. Policies for expense reimbursement, paid time off, performance appraisal, justification for raises, and so forth, were subject to individual managerial discretion. This had resulted in a politicized environment with inter-department jealousies, rivalries, and “yes-man” attitudes. Several policies (both written and practiced) did not comply with requirements of the FMLA, ADA, FLSA, etc.
9. The company’s overhead costs were higher than necessary due to the burdensome administrative processes such as excessive paper-flows and unnecessary retention requirements, lack of an automated HR information system, excessive accounting energy spent on correcting sloppy timekeeping and expense reporting that also lead to invoicing errors, and HR default handling of tasks normally the responsibility of managers (such as interviewing/selection, and performance appraisal).

Recommendations:

The following are abbreviated summaries of the just a few of the recommendations made by Link.

1. Overall HCM Strategy
 - a. As part of a revised and broader strategic vision, begin a shift away from the “body-shop” mentality and approach - - toward a higher-skilled, loyal staff mindset.
 - b. Set goals to reduce the need for temporary employees by 50% in the next 12 months, which will likely require pursuit of a different project mix.
 - c. Initiate a procurement program to gradually acquire an inventory of maintenance-related tools that could be effectively utilized on jobsites, justifying



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a higher billing rate, and signaling to employees/clients that Company X is evolving into a broader “service” provider rather than a “staffing” provider.

2. Business Plan Level:

- a. Include within the Business Plan a section on HCM as a strategic program in order to communicate the importance as well as actually lay out a strategy for which the President was accountable.
- b. Include within the Vision Statement a reference to holding a deep respect for employees, their professional growth, and commensurate contribution to the company.
- c. Establish corporate-level HCM goals and objectives, and consider tying a component of management bonus to their achievement (e.g. recruitment, retention, morale, managerial training, etc.)
- d. President must decide on a management philosophy, and implement a manager and subordinate training program to ensure the philosophy will be implemented.
- e. Revise policies and procedures as necessary to ensure consistency, compatibility, and complement with culture.
- f. Attempt to identify the likely complement of employees over the coming year (mix of regular and temporary employees) and set goals relating to supply chain establishment and adequacy.

3. Management Training: Conduct managerial and subordinate training to communicate:

- a. Specific accountabilities of a manager:
 - i. Veto appointments of subordinates.
 - ii. Assign work and set the contexts and objectives
 - iii. Coach
 - iv. Give verbal and written appraisal
 - v. Promote, demote, adjust pay, with concurrence of the “manager-once-removed” (the manager’s manager)
 - vi. Provide assessment and feedback to manager-once-removed of subordinate potential and career counsel
 - vii. Note: this shifted many responsibilities away from the HR department and into the managers’ domains.
- b. Accountabilities of the manager-once-removed for mentoring the subordinate and looking after his/her long-term career.
- c. To minimize office politics and employee concerns that many employee departures were over “personality conflicts”, specifying that managers can not terminate subordinates for reasons other than “for cause”. If an employee and subordinate have irreconcilable differences, the manager-once-removed



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assumes direct accountability for the subordinate and attempts to find a productive role in the organization with a different manager.

- d. The differences between a manager and a supervisor.
4. Employee Training
 - a. Identify cost-effective internet-based technical training programs that employees can pursue when between project assignments.
 5. Mentoring Program:
 - a. Explain to employees that their manager-once-removed is their mentor and is responsible for their long-term career. Periodic communication with their mentor is encouraged, and if the employee has problems with their manager or with any other aspect of the company they the mentor relationship provides them with an additional communications outlet.
 6. Compensation and Benefits:
 - a. Conduct orientations for all regular employees to educate them on the strategic shift being pursued by the Company, and on the legitimacy of differences between compensation/benefits of regular versus temporary employees.
 - b. Since Company X's financial condition was not able to support immediate increases in compensation to improve morale and attract new talent, the recommendation was to enhance selected aspects of the benefit package that had minimal short-term economic impact but which would help distinguish Company X in the marketplace. These included, for example:
 - i. Allowing participation in the company's 401K Plan after 3 months, eliminating the 1 year waiting period.
 - ii. Establishing a training program for staff that provided increasingly (tied to years of service) attractive opportunities to paid time off to pursue approved training courses.
 7. Policies and Procedures: Complete a comprehensive review and revise as necessary to make them consistent, compliant, user-friendly, and complementary to the new corporate culture.
 8. Employee Attitude Surveys:
 - a. Each quarter conduct a brief employee attitude survey to gauge the perspectives of the employees and to communicate to them that their perspectives are important to management.
 9. All-hands Meetings
 - a. Schedule a quarterly meeting between all employees and the President where the President communicates the "state-of-the-company" and solicits comments and recommendations from employees.



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Results:

Company X implemented all recommendations. Company benefits were improved, signaling to employees that the Company was trying to improve their total compensation package and providing managers a tool (albeit small) to attract new recruits. Overhead costs decreased as managers assumed accountability for accurate time/expense reporting and more comprehensive management of their subordinates (e.g. interview/selection processes, performance appraisal).

The ultimate net results were very positive, with a decrease in turnover of personnel to less than 15% over the next twelve months. Customer satisfaction began to improve as current employees garnered more skills and experience in their roles. Managers were able to spend more time in sales, marketing, quality oversight, and employee development roles.

Although revenue initially dropped due to tighter project selection criteria, profitability began to improve due to higher hourly profit margins and less overhead. Revenue subsequently began to improve due to increasing managerial time spent on marketing and sales.

APPLICATIONS

The Human Capital Management concepts discussed above apply to virtually any organization, whether for-profit or non-profit and in any industry or government applications. There are, however, as many HCM approaches as there are organizations, since each senior executive has distinctive strategies and cultures that are infused into the organization. The senior executive's approach to delegation of authority, centralization of administration, pursuit of innovation, etc. influences the design of the HCM structure. The wrong HCM approach can hinder achievement of goals.

Link's broad, hands-on industry experience allows us to understand and empathize with the senior executive's style and vision. We then assess the organization's current culture, structure, processes, problems, and so forth, and develop a customized HCM approach that optimizes the achievement of your strategic objectives.

As HCM advocates, we are eager to discuss possible applications to your situation. Please contact us.

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Appendix A: UNDERSTANDING HCM

Background

The efficient management of the supply and flow of human assets is rapidly becoming the primary source of its competitive advantage. The traditional importance of managing of capital assets continues to be important but ever less so. This shift has been precipitated by fundamental changes in the economy, such as:

- 1) increasing importance of company's "services" as either a revenue base or a prerequisite to maintaining their revenue base;
- 2) increasing product complexity, accelerating innovation, and shortened product life-cycles - - and the attendant demand for higher skilled workers;
- 3) new definitions of work and organizational structure; and
- 4) increasing number and complexity of employment-related laws and regulations.

In 1950, 20% of the work force was considered skilled labor; today about 60% of the work force would classify as skilled labor. Higher skill levels translate to broadened employment alternatives and increased worker mobility in a "free agent" economy. Successful businesses are rapidly evolving away from a traditional hierarchical organization, and embracing a broader and fluid mix of long-term, temporary, contracted, and outsourced employees, augmented with an extra-organizational network of suppliers and partners.

HCM as a Strategy

A growing portion of the talent will never "belong" to an organization but will be imported and exported as necessary, somewhat akin to the traditional flow of capital in and out of a corporation (except of course that Human Capital also have a voice in the process). This increasing shift toward a market-based relationship between employer and employee requires organizations to accommodate an inherently higher flow of talent in and out of organizations. Human Capital Management (HCM) therefore has as its objective the optimization of the flow, deployment, and development of human talent within an organization.

HCM starts at the strategy level of an organization, as an integrated part of the overall business plan and not just an afterthought that takes shape within the Human Resource
HCM begins with fundamental strategic issues, such as

- 1) What are the one-year and five-year projections regarding the need for human capital?
- 2) What is the mix of quality and skills over time?
- 3) What human capital supply profile (core, temporary, outsourced, etc.) is optimum, considering issues such as employee commitment, productivity, wage cost, benefit cost, recruitment costs, and turnover costs - - as well as probably longer-term needs?
- 4) Can re-training of existing workforce cost-effectively satisfy the need to new skills?
- 5) Do available sources of human capital fit the projected needs?
- 6) Does the company's supply-chain-management process measure up to the task?
- 7) Do internal company policies and procedures ensure effective and fair management of all human capital?
- 8) Does the company have a process to gather and evaluate reliable data (metrics, benchmarks, and feedback) on which to base operating and investment decisions, as well as ultimate return-on-investment (ROI).



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Whereas HCM is strategic, “staffing” operates primarily at the tactical level. Staffing involves a series of tactical steps, including identifying the candidate, matching the right person to the right job, negotiating the acceptance of the pay rate, delivering the person to the job, then actually becoming the employer and issuing a W2 (with all the back office work that implies), benefits administration, regulatory compliance, security and substance abuse issues, labor contract management, etc.

When considering the relationship between HCM and staffing, you can make a comparison with portfolio management; HCM is analogous to addressing the strategic issues of asset allocation and risk profiles in money management, and staffing is more akin to the stock selection process.

The Employment Continuum

Temporary, part-time, contingent, contracted, leased, and outsourced (or whatever the term) workers are no longer merely alternatives to “regular”¹ employees. They have become a necessary part of the resource landscape, and are often the preferred sources of talent to meet specialized skill/knowledge requirements, satisfy peak period demand, increase speed and flexibility, or reduce operating costs and the associated administrative burden. Increased flexibility and alternatives regarding access to human resources are enhanced by the emergence of the Internet as an entrepreneurial and transactional platform for independent professionals as well as third-party representatives such as staffing companies, professional service firms and recruiters.

The distinction between regular-full-time and temporary employees is also becoming blurred. On the one hand, companies are increasingly rejecting the paradigm that the “traditional” employment relationship demands a life-long commitment; and on the other hand regulators and legislators are gradually closing “loopholes” in employment rules that allow companies to deny various benefits to employees by placing them in a particular category.

From one perspective, the reality is that knowledge workers today are essentially “rented” for as long as the employer can provide an environment - - decades or weeks - - that is challenging, stimulating, educating and rewarding, or so long as the employee offers a skill set compatible with the organization’s immediate requirements. Human capital, in general, is more accurately viewed as a multi-dimensional continuum of employment relationships. Enlightened and visionary employers recognize that their employment policies must be responsive to this continuum. In particular, these employers attempt to fairly apply compensation, benefits, and treatment across the spectrum so that each human asset, regardless of the employment relationship, receives “felt-fair-compensation” - - and even felt-fair-recognition (or at least each individual recognizes the employer is striving to do so).

Federal and state regulations, however, have not evolved to meet the needs of this new marketplace, and continue to be rooted in the belief that worker security is enhanced by strict definition of worker categories and attendant benefit entitlements. [For instance, a) even though full-time employees at Company X get benefits, part-timers can be denied benefits; b) non-exempt employees must be paid overtime in pre-defined circumstances; c) independent contractors are not protected under the Americans with Disabilities Act; d) the Family Medical Leave Act applies only to employers with 50 or more “full-time” employees; and so forth.] Note that Link is not taking a position that these regulations are necessarily inappropriate or that worker rights don’t need to be protected - - simply that these rules do not always protect your “workers”, and it is up to each employer to design its human capital strategy to fit its unique needs, taking into consideration a number of complex factors and regulations.

¹ References to “permanent” employees are still common, but really shouldn’t belong in the lexicon describing the current labor market.)



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HCM Investment and Development

Management of human capital is, of course, at least as complex as management of financial capital. First of all, rapidly changing markets and short product life-cycles challenge the forecasting, planning, hedging abilities of the management team. Companies with inadequate planning and short horizons typically respond to swings in the need for quantity and quality of workers by firing and hiring - - just as some companies respond to short-term cash-flow needs by taking out short-term loans at high interest rates. Such tactical approaches are functional, but better planning allows for more effective and less costly solutions. This premise is illustrated with the Saratoga Institute's findings that the 75+ days it currently takes to hire workers can represent half a product life cycle.

Previous paragraphs addressed the use of different mixes of employment relationships to accommodate swings in needs for human capital. Deployment and development of existing capital is another very important aspect of HCM. Just as intelligent deployment/investment of financial capital results in the maximum ROI, effective deployment and development of human assets can yield significant returns - - reducing the costs of terminating staff with outmoded skills, reducing resignations of staff who don't view themselves as "growing", minimizing the costs of hiring replacement staff, improving productivity, and creating an "internal brand" that will attract new employees.

Deployment is most often associated with transferring staff to a different company unit where they will ostensibly gain additional skills, perspective, or experience. Truly effective deployment in the context of HCM requires a high-level strategic process whereby such a transfer yields maximum benefits for the company and benefits for the employee that are synergistic. Development, on the other hand, involves training in the broadest sense. Indeed, courses, seminars, OJT, and education are components, and the diversity of training resources (interactive, internet-based, etc.) provides companies with many alternatives in type, scope, and cost. Yet a more strategic approach to development involves an effective management-subordinate (or mentor- apprentice) relationship where each role has inherent accountabilities with respect to long-term career development as well as short-term performance and productivity. Creation of such a management infrastructure with clear philosophies, semantics, authorities, accountabilities, and evaluation & reward mechanisms is a challenging undertaking and can only be successful with the long term commitment and personal involvement of the senior executive.

Talented people remain with an organization only as long as they are challenged, growing, and rewarded with interesting work and progressive training. The advantages of employee retention are the by-products of successful deployment and development efforts.

Such solutions began with tangible asset-focused MRP (management resource planning) efforts and progressed to the more process- and information-centered SCM (supply chain management) and CRM (customer relationship management) systems. In fact, HCM could, in one sense, be referred to as "human supply chain management."

Summary

Virtually every manager in every company will endorse the statement "People are our most important asset". Some would truly believe it and some would simply know it's the politically correct thing to say. You could ask any CEO right now what his most important strategic focus is, and a majority will say recruitment and retention of good people. Yet if you ask the employees of those same companies whether they are treated as if they are the most important asset, the overwhelming majority will say "no".

Something has to change!



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HCM is an approach that can achieve returns-on-investment on human capital demonstrably higher than other assets, helping the expectations of managers meet the realities of their employees.

