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Measuring HR?

*Benchmarking is **Not** the Answer!*

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While common functional benchmarks are safe and easy, adopting customized strategic performance measures is where HR can truly demonstrate its value.

Measuring HR's performance is an increasingly important concern for HR professionals, senior line managers and CEOs. The challenge of HR measurement becomes particularly salient when the CEO and senior management team ask HR to justify its contribution to the organization.

To respond to this challenge, HR professionals have routinely relied on benchmarked comparisons of cost and other efficiency-based performance outcomes associated with activities of the HR *function*. But a reliance on these types of benchmarking measures not only fails to measure HR's important contributions to firm success, it also can encourage an approach to human capital management that is counterproductive.

Instead, HR professionals should judge their performance relative to their firm's own *strategy* rather than the HR efficiency of other organizations.

Measures Must Reflect HR's Value Proposition

How does HR create value in your organization? If you say that the primary means is by reducing costs and becoming more efficient, you have missed an important opportunity to define the role of the workforce in the strategic success of your business. >

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Benchmarking vs. Strategic Performance Metrics

Benchmarking	↔	Strategic Metrics
Emphasizes administrative efficiency as performance standard.	↔	Emphasizes strategic impact as performance standard.
HR function is primarily a cost-center.	↔	HR professional is primarily a strategic partner.
Measures based on dollar equivalents.	↔	Measures based on strategic relationships.
Low risk, low return.	↔	Higher risk, higher return.
Can rely on current HR competencies.	↔	Requires new HR competencies.
Focus on HR activities.	↔	Focus on business outcomes relevant to line managers.
Typically can collect data using off-the-shelf software.	↔	Often requires customized information technology.
Reconfigures existing data.	↔	Requires new measures.
HR owns only HR.	↔	HR shares responsibility for human capital performance with line managers.
Requires no understanding of strategy.	↔	Irrelevant if not driven by strategy.
Results in HR being managed like a commodity.	↔	Results in HR being managed like a unique strategic asset.
HR increasingly marginalized and outsourced to low-cost vendor.	↔	HR not easily outsourced because contribution is firm-specific and based on more than cost control.

Managing the HR function efficiently is important. But focusing on cost reduction as the primary measure of HR's performance will ultimately result in HR being managed like a commodity, rather than a strategic asset. In contrast, our research of more than 2,000 firms over more than a decade has shown consistently that managing a firm's workforce effectively can increase shareholder value by 10 percent to 20 percent. How are gains of this magnitude possible? They certainly don't come from improving your cost per hire by 10 percent or from beating the industry standard on training costs by 6 percent.

Instead, just as most companies avoid strategies that reduce their products or services to commodities, so too is HR more likely to create real value when it helps an organization to differentiate itself from its primary competitors. The basis of that differentiation is the underlying source of value creation in the firm—its strategy.

Strategies are successful when they create a unique value proposition for the consumer, and strategy execution is the most important determinant of strategic success. For example, our research indicates that executing a firm's strategy successfully had a six times greater impact on shareholder value than

did the choice of that strategy. Does that mean the strategy you choose is irrelevant? Of course not. It means that the real challenge is not choosing the right strategy, but executing it!

As author Michael Porter observes, "strategic positioning means performing *different* activities from rivals or performing similar activities in *different ways*." To the extent that HR can drive human capital performance in these activities, it contributes to firm performance. But that means the measure of HR's *strategic* performance must be focused internally on those unique, strategically relevant contributions—not externally on non-strategic measures such as cost per hire or benefits as a percent of revenue.

An Illustration

The difference between managing HR by relying on efficiency-based benchmarks and managing HR based on strategic performance measures is illustrated by the recent experience of a large multinational firm. In this business, HR professionals were under increasing pressure from line managers to justify HR's performance against external benchmarks.

This is a common source of HR's measurement problem. Line managers often hold the view that HR largely represents



a cost to be minimized and pressure HR to adopt performance measures that are limited to efficiency goals.

In the absence of a business case for HR's strategic impact, HR managers are trapped. In this case, HR responded by significantly improving its performance on efficiency measures, such as time to fill jobs and cost per hire, compared to industry benchmarks.

Unfortunately, the consequences for the firm's business performance were unanticipated and unacceptable. HR reduced cycle time by shifting from recruiting channels that emphasized college graduates and experienced professionals to temporary agencies and job bank applicants. The unanticipated conse-

quences were higher training costs, higher turnover and—of more concern to line managers—lower customer service levels among front-line employees. In this company, this type of benchmarking actually reduced HR's strategic performance because the measures did not capture HR's strategic value proposition.

the "commoditization" of HR, this tradeoff between accessibility and appropriateness is ultimately a losing proposition. Second, benchmarking performance has a superficial credibility. The measures are objective, are often expressed in dollars and give HR professionals performance "cover" because they are linked to external standards.

Finally, reliance on benchmarking is relatively quick and painless because it allows HR professionals to report measures of HR performance without fundamentally changing their perspective on HR or developing any new competencies around HR measurement or strategy execution.

But effective strategy execution is about sharing responsibility for business problems with line managers. It is more than finding ways to do traditional HR activities more efficiently. It requires a new perspective—a broader perspective—on what is meant by HR performance. Measuring HR's

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The Misguided Appeal of Benchmarking

We believe that relying on external benchmarks as a measure of HR's performance is fundamentally wrong. In contrast to the strategic HR framework we propose, no published research supports a relationship between typical HR performance benchmarks and ultimate firm performance. Nor is there a plausible business case in favor of this approach.

So why is performance benchmarking so common? The table "Benchmarking vs. Strategic Performance Metrics," left, highlights a number of reasons for benchmarking's appeal. First, it's doable. When HR is under increasing pressure to provide performance measures, benchmarking measures are

accessible. However, unless your goal is to limit HR's role in the firm to that of a cost center and you are willing to accept

strategic performance is not about doing the same things HR professionals have always done and then reconfiguring data to demonstrate HR's heretofore unrecognized contribution. It's about *developing* new measures based on the unique demands of the firm's strategy, not looking them up on a list of "10 best measures of HR performance."

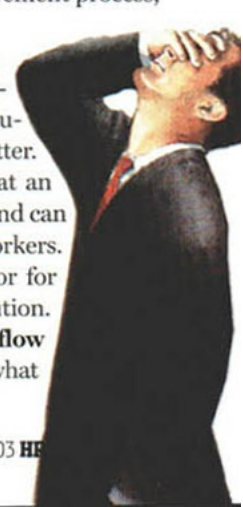
Moving to Strategic Metrics

Strategic performance measurement for HR requires a new perspective as well as new measures. This strategic approach to HR performance measurement is not as simple as benchmarking, because it requires a different measurement process, summarized in the following steps:

Step 1: Clearly define business strategy.

We believe that it is important to distinguish between strategy formulation and strategy execution, and we highlight the importance of the latter. Our focus on execution, however, assumes that an organization has consensus about its strategy and can describe and communicate it clearly to its workers. Having a strategy in this form is the precursor for defining the drivers of successful strategy execution.

Step 2: Draw a map describing the causal flow of strategy execution. A strategy map takes what



Online Resources

For links to more information about strategic HR metrics, see the online version of this article at www.shrm.org/hrmagazine.

Figure 1:

How HR Architecture Drives Strategy Execution in a Retailer



tends to be an externally focused vision in Step 1 and links it to an internal roadmap that "show(s) how an organization plans to convert various assets into desired outcomes," as authors Robert S. Kaplan and David P. Norton wrote in their article, "Having Trouble with Your Strategy? Then Map It" (*Harvard Business Review*, September-October 2000).

Mapping is an essential part of managing HR as a strategic asset because it provides the basis of aligning the "HR architecture," or overall approach to HR management throughout the business, with the firm's strategic drivers. It provides the organizational logic that transforms HR from a transaction-oriented function to an organizational asset with strategic impact. In short, it shows "what causes what" in the business and how the firm will win in the marketplace.

Why do we use the term HR architecture? When senior line

managers describe "people" as a strategic asset, they are describing employee performance and behaviors that help execute the firm's strategy. But just as organizational performance is a function of both people and systems, the appropriate HR system is required to select, develop and reward employees in ways that produce those strategic behaviors. HR professionals must still have the perspective and competencies to drive this process.

Step 3: Link HR architecture to the strategy map. This is the most important step in transforming HR to a strategic asset and is what distinguishes strategic performance measurement from benchmarking. The term "HR deliverable" is just shorthand for the outcomes of the HR architecture that directly drive successful strategy execution. How the organization chooses to define HR deliverables will reflect what role line managers and HR professionals will play in managing



people as a strategic asset. Figure 1, "How HR Architecture Drives Strategy Execution in a Retailer," left, illustrates this step in the retail industry.

Figure 1 is the result of Steps 1-3 and demonstrates how HR drives strategy execution and points us to measures of HR's strategic performance. For example, Step 2 determined that one of the drivers of future sales growth is improved customer satisfaction, which is partly driven by the quality of the buying experience. Step 3 identifies the HR deliverables required to improve the quality of the buying experience. In retailing, the buying experience is partly driven by front-line staff that are knowledgeable, timely, helpful and courteous. The HR deliverable, and the focus of HR's strategic performance in this example, is the extent to which HR delivers a sales staff that is knowledgeable, timely, helpful and courteous.

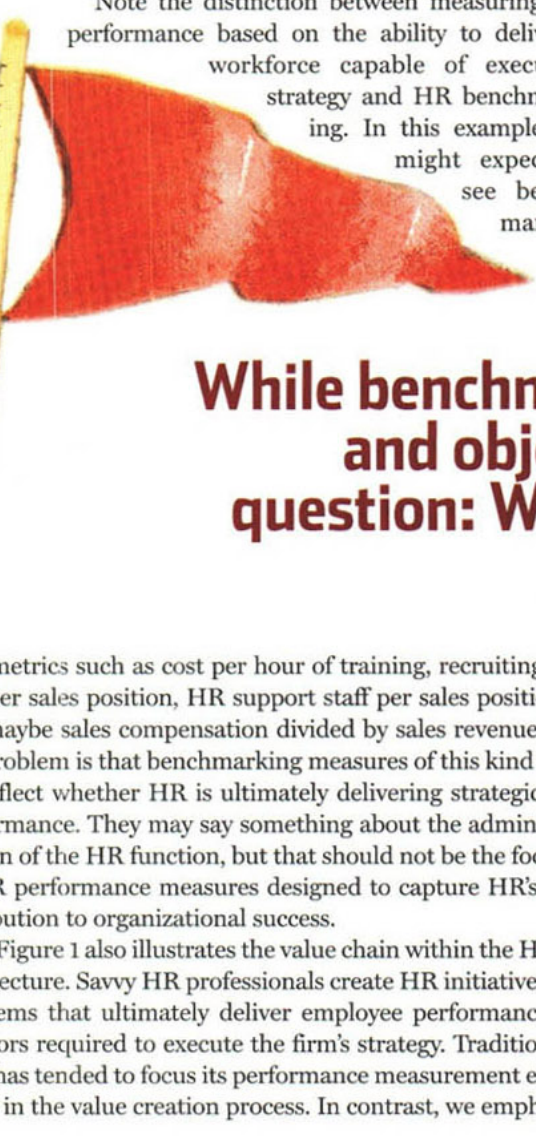
Note the distinction between measuring HR performance based on the ability to deliver a workforce capable of executing strategy and HR benchmarking. In this example, we might expect to see benchmarking

pushing that measurement focus as far up the value chain as possible. In this example, that may even include HR taking shared responsibility (and credit) for achieving targets for customers' ratings of "quality buying experience."

This approach poses both risks and challenges. For example, it may not be as easy to measure deliverables that reflect strategic behaviors. While measures of training activities are readily available, the illustration in Figure 1 might require "mystery shoppers."

Moreover, HR professionals might argue that employee performance and higher-level outcomes in the strategy map are not entirely in their control and therefore they should not be held accountable for those results. But this is a risk-return tradeoff for HR professionals. Being held accountable for the quality of the workforce and the extent to which business goals are attained is riskier, but it comes with the higher return of HR having the potential of playing a strategic rather than just an operational role.

Developing HR performance measures that reflect HR's true value proposition requires a new perspective and new measures. Relying on benchmarking measures that reflect efficiency and costs associated with the HR function reflect HR's old perspective and old measures. It's true that benchmarking is easy, convenient and can provide objective, and often dollar-denominated metrics. But it does not answer the



While benchmarking is easy, convenient and objective, it does not answer the question: What is HR's contribution to the success of the firm?

metrics such as cost per hour of training, recruiting cost per sales position, HR support staff per sales position or maybe sales compensation divided by sales revenue. The problem is that benchmarking measures of this kind don't reflect whether HR is ultimately delivering strategic performance. They may say something about the administration of the HR function, but that should not be the focus of HR performance measures designed to capture HR's contribution to organizational success.

Figure 1 also illustrates the value chain within the HR architecture. Savvy HR professionals create HR initiatives and systems that ultimately deliver employee performance behaviors required to execute the firm's strategy. Traditionally, HR has tended to focus its performance measurement efforts early in the value creation process. In contrast, we emphasize

question being posed to senior HR professionals: What is HR's contribution to the success of the firm?

Developing strategic performance measures can be difficult, slow and might not provide the same sense of clarity as cost per hire. But in the case of HR performance measurement, it is better to be approximately right than precisely wrong. ■

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