

How Smart HCM Drives Financial Performance

By:

Erik Berggren
Director, Global Research

Dr. Jac Fitz-enz
CEO, Workforce Intelligence Institute



SuccessFactors
RESEARCH



PREMISE

The first question of management is what difference does it make if we invest in people, technology or facilities?
The corollary: which investment will give us the greatest return in the shortest time?

SuccessFactors and Workforce Intelligence Institute (WII) believe that there are two fundamentals of management that, over time, will consistently show the greatest returns. They are: **1) performance management through goal alignment** and **2) pay for performance**. Logic has it that if people can see how their work links directly to corporate goals, they will be stimulated to work long and hard in service to that vision. Logic also cautions us that if people do commit themselves to the vision they must believe that their efforts are equitably compensated.

To build on our previous research and test our assumptions, we combined forces to study the performance management system sophistication or maturity of 40 corporations of varying sizes. As one would expect, there was a distribution of financial performance and system maturities across the 40. Our quantitative and qualitative analyses reveal where performance management practices do and do not affect financial performance. Financial performance was tracked in three ways:

- ▶ RETURN ON EQUITY
- ▶ REVENUE GROWTH, LAST 12 MONTHS
- ▶ NET INCOME, LAST 12 MONTHS

The 40 companies were divided into strongest and weakest financial performers with a number in the middle. We compared each company's financial performance with its industry mean. Since different companies operate under different market conditions, comparing across industries does not make sense.

PROCESS

Through survey questionnaires and follow up interviews we gathered data from the companies in these topic areas:

1. CONNECTIONS OF PEOPLE WITH MANAGEMENT PROCESSES.

Our questions touched on the sophistication of their systems, frequency and constancy of application, consistency across the organization and estimates of their effectiveness.

2. EFFECTS OF GOAL ALIGNMENT DISCUSSIONS AND EVALUATIONS.

We looked for evidence of the impact of discussions between supervisors and employees regarding personal performance objectives and their connection to corporate goals.

3. APPLICATION OF PROCESS MANAGEMENT TOOLS.

Our objective was to learn if respondents could identify value-adding effects from investments in performance management technology.

OUTCOMES

From a human capital management viewpoint, the most interesting outcome had to do with the state-of-the-art of performance management systems.

Generally speaking, companies with mature systems that they applied consistently across most of the organization financially outperformed those whose systems were not as robust.

Population size did not allow for statistical correlations, nevertheless the inferences and connections were clear and susceptible to later testing.

Finding 1: **67% of companies with stronger financial performance cover all managers and some levels below with the performance management system. Only 28% of the weaker performers do.**

In addition: 38% of companies with stronger financial performance cover all managers in their succession planning program. None of the weaker performers do.

Performance and planning programs among the weaker performers were typically a set of homegrown, incomplete and disconnected tools that did not warrant the title of a system.

Finding 2: **44% of the stronger performers have almost 100% aligned goals at the managerial level. None of the weaker performers do.**

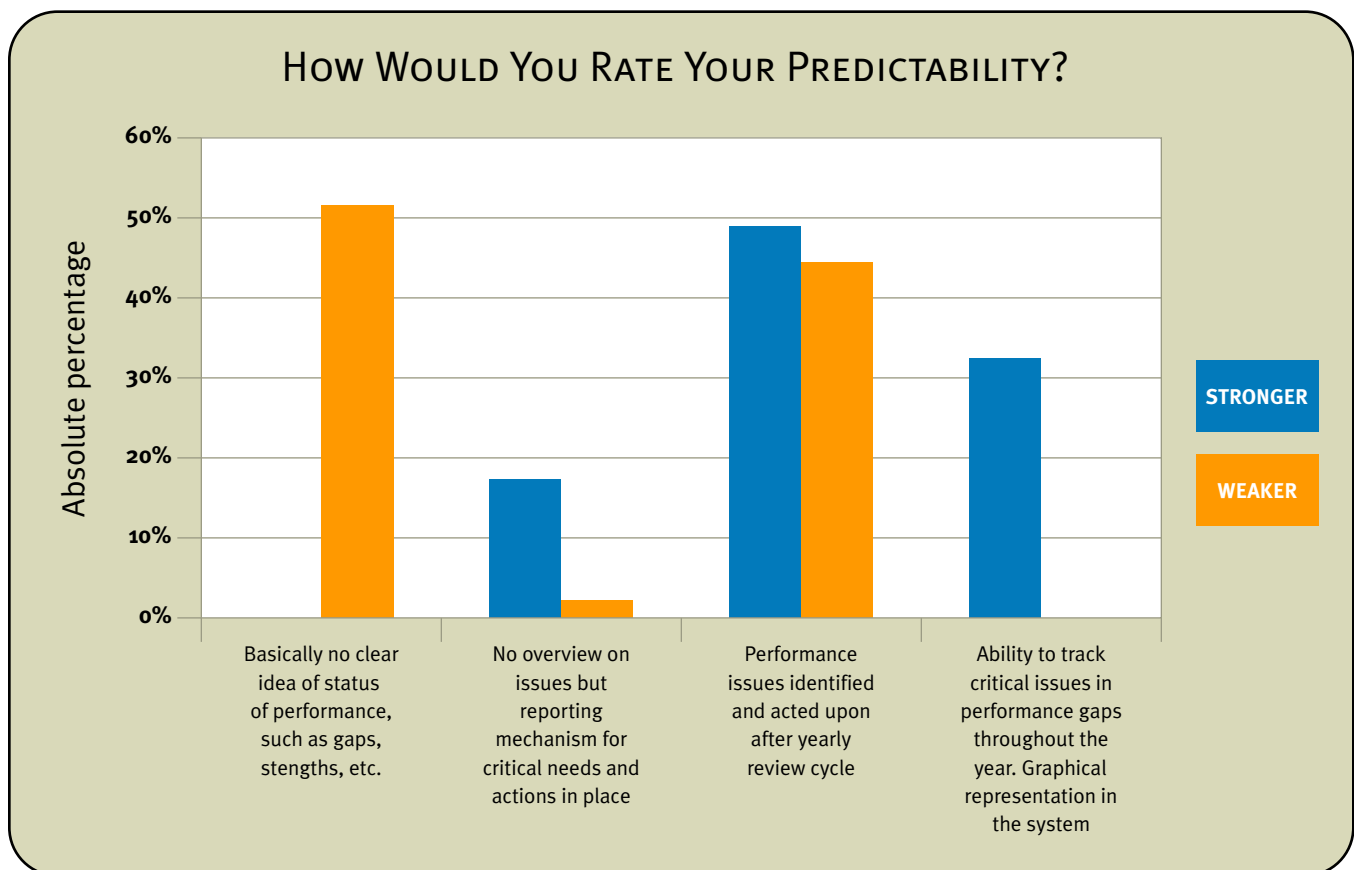
In addition: 46% of the stronger group also has more than half of the employees goals aligned. Only 18% of the weaker performers do.

Few respondents in the weaker group could connect, in a definitive and objective manner, employee effort with corporate performance. Many noted that some employees were confused as to their role and contribution. This confusion often drove misdirected effort. A common complaint was that employees were not being engaged and their energies were often dissipated.

OUTCOMES (CONTINUED)

Finding 3: 63% of the high-growth group review employee performance more than annually. 22% of the low-growth companies do.

Respondents stated that close attention to and frequent assessment of performance stimulates communication on key performance indicators. In addition, it gives managers the ability to act quickly to plug any gaps.

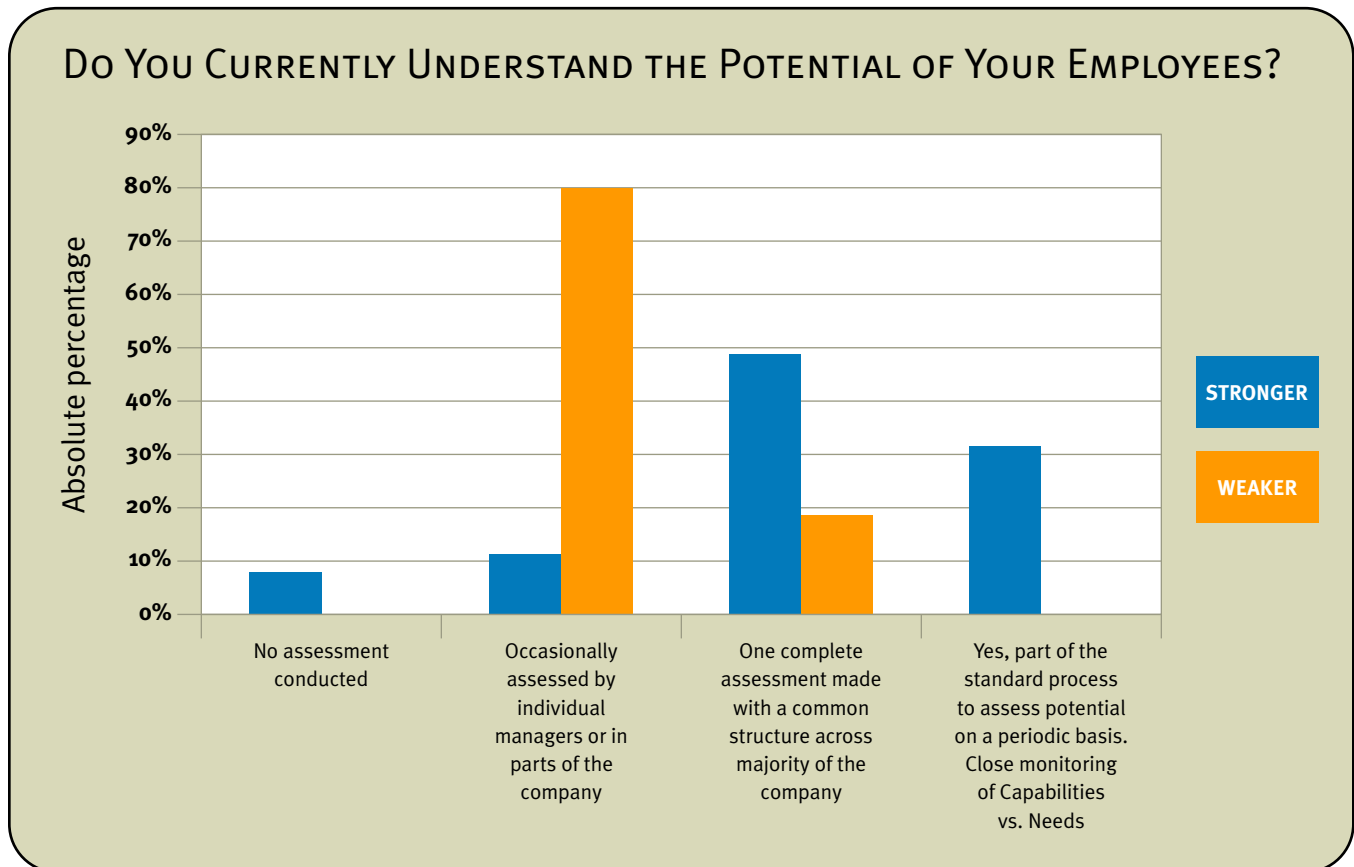


Eighty-three percent of the group with superior financial performance has the ability to act on performance issues after the yearly review cycle and 34% can track and act upon this on an ongoing basis leveraging technology. 45% of the companies in the group of weaker financial performance can do it yearly and 0% on an ongoing basis. This is a significant hindrance in driving financial performance.

OUTCOMES (CONTINUED)

Finding 4: 91% of the strong performers have a system that identifies high-potential people. 67% of the weaker performers do.

The ability to identify high-potential personnel allows the organization to look ahead. This supports succession planning, increases management readiness, and reduces the risk associated with an unexpected loss of key executives. Having this capability is a distinct competitive advantage. To delve deeper into the issue of employee potential we looked specifically at the ability to understand potential and cross referenced it with Net Income Growth.



Eighty-two percent of the stronger net income growth group has at least made one complete assessment and 32% has it as a standard process. Nineteen percent of the weaker income growth group has at least made one complete assessment and 0% has it as a standard process.

SUMMARY

Generally speaking, many HR systems were found to be siloed. A few contacts opted out of the study due to their lack of knowledge of what has happened in other parts of the HR function. This is remarkable given that we conducted interviews principally with directors and vice presidents.

In this and related research by SuccessFactors and the Workforce Intelligence Institute we have found, rather consistently, that the human resources function is fragmented. Planning and communication across planning, staffing, compensation and development is minimal and cooperation is in many cases functionally nonexistent. It was clear from many comments that performance management systems were not well connected to hiring and development and only tangentially to pay programs. Platitudes take the place of data sharing.

In case after case, research has shown that HR systems that logically should support each other are not at all connected.

For example:

- ▶ DATA FROM JOB PROFILING IS SELDOM CONSIDERED IN DEVELOPMENT, PERFORMANCE APPRAISALS OR HIRING STRATEGIES. THE RESULTS ARE POOR HIRES, MISSPENT PAY, SCATTERED DEVELOPMENT PROGRAMS, INEFFECTIVE PLANNING AND CONFUSED, DISENGAGED EMPLOYEES.
- ▶ COMPANIES MAINLY USE EMPLOYEE POTENTIAL AND PERFORMANCE DATA FOR PROMOTION PURPOSES, BUT:
 - 71% *don't use it for retention purposes*
 - 64% *don't use it for development needs*

SUMMARY (CONTINUED)

Overall, the view is that, in order to improve human performance, management systems have to improve. Disconnected technology, piecemeal approaches and inconsistent applications frustrate employees and managers and inhibit performance. Put more positively, process efficiency supports people effectiveness.

Mature systems support consistent application across units driving down G&A expense. More importantly they promote communication with employees, giving them clarity in terms of their effect on the business, thereby driving motivation. This leads to productivity and financial gain.

At the end of the day, performance is a function of employee behavior. The best strategy and business plan can fail on two counts: First, employees must know how they connect with and serve the goals of the business. Second, they must believe that they are fairly compensated for their commitment and effort.

GOOD NEWS

Knowing and accepting the problem are the first steps in recovery. The road to corporate health starts with communication around goal alignment.

Here, and outside this study, we find a growing number of companies recognizing that clarity is essential. Engaging employees is only possible if they understand and buy into the corporate vision and goals. Simply telling managers to talk with employees is not enough. Supervisors and middle managers are especially overwhelmed today. They are charged with carrying out dictates from above while coping with the stress and frustrations of employees from below. They need support in terms of tools that make the communication task simpler, planning more effective and performance connections obvious. In effect, effectiveness starts with efficiency.

- ▶ **COMMUNICATION AND PERFORMANCE.** Goal alignment clarifies for employees both their role and value. Although some believe that a direct link cannot be made from the bottom to the top of the organization, other companies have proven it is not only possible but essential. The key to making the link is to have a totally integrated approach. Just like a chain, one weak or missing link (process or system) destroys total system integrity. Clarity supports employee goodwill and leads to engagement. Engagement is the essential element for top performance.
- ▶ **LEVERAGING TALENT.** While many companies struggle to make their quota in the talent race, some undercut that effort by not leveraging the very talent that is entering the organization. The effective firms have built planning and performance management systems that define and connect competencies with business objectives. Goal alignment discussions are the conduits of an information flow system that feeds employee motivation. The proof of the value of complete and integrated performance management systems was displayed in the Workforce Intelligence Report of July 2006. It showed that companies whose performance management facilitated communication of quantitative objectives and linked them with pay for performance enjoyed the lowest turnover of all companies studied.

The key to talent management starts with a clear articulation of the corporate strategy and major business goals. From this, managers apply performance management technology to align themselves and their employees with that strategy. In effect the PM system is the vehicle on which the managers take employee performance along the road toward that strategic mandate.

GOOD NEWS (CONTINUED)

- ▶ **SUPPORT.** HR needs to obtain the backing of the C-level. This can best be accomplished by applying analytic tools and metrics to connect human capital investments with financial outcomes. Since it is not a simple task, HR must increase its adoption of decision science and technology. The market is complex and fast-moving. It obsoletes past experience very quickly. To track the result of decisions both HR and middle management need these tools. The days of management by intuition are gone forever.

To overcome resistance to technology investments HR must focus on the value of having the data at hand for making decisions as well as showing the value of the expected outputs.

NOTES

The sources for all financial data are Hoovers, individual company corporate websites and annual reports. In total, we have cross-analyzed data from 30 companies. The total study includes 40 companies but we have not had consistent data on financial performance on all participants.

For companies (very few) with superior results in one metric and significantly weak measures in another, a deeper analysis of causes to exclude potential one-time effects on the financial measures that could have occurred has been made to be able to position the company in the right group. If not possible, the company was excluded from the analysis.

Technically speaking, a strong performer company was determined as outperforming its industry mean with at least 20% in two of these metrics and is at least within 10% of their respective industry mean in terms of:

- ▶ RETURN ON EQUITY
- ▶ REVENUE GROWTH, LAST 12 MONTHS
- ▶ NET INCOME, LAST 12 MONTHS

The weaker is underperforming its industry mean by at least 20% in one of the above metrics and not exceeding the mean by 10% limit on the other two.

ABOUT SUCCESSFACTORS RESEARCH

SuccessFactors Research is focused on advancing the art and science of Human Capital Management by analyzing three sources of information. The team analyzes the actual usage traits and patterns of SuccessFactors' customers only available via the pure on-demand model, correlates those findings with financial performance, and adds insights from detailed research studies with individual customers. The insights uncovered through these thought leadership and research initiatives illuminate the unique trends in Performance & Talent Management, and uncover the optimal environment for achieving business results.

Find out how we turn insight into results at www.successfactors.com/research or contact us at research@successfactors.com

ABOUT WII:

Workforce Intelligence Institute is a research firm founded by Dr. Jac Fitz-enz. Fitz-enz is recognized as the pioneer who introduced metrics and benchmarking to the HR profession in 1978. The WII focuses on finding connections between human capital investments and business results. It publishes the semi-annual WI Report, which reports cases of human-business connections collected from companies and thirty research centers and HR vendors.



SuccessFactors
RESEARCH

