

# Performance Measurement using THE HR SCORECARD

## Measurable Performance as part of Strategy

### INTRODUCTION

The HR (human resources) scorecard is a tool that matches business strategy against HR deliverables and objectives to provide a statistical basis by which HR efficiency and contribution to strategy implementation can be measured.

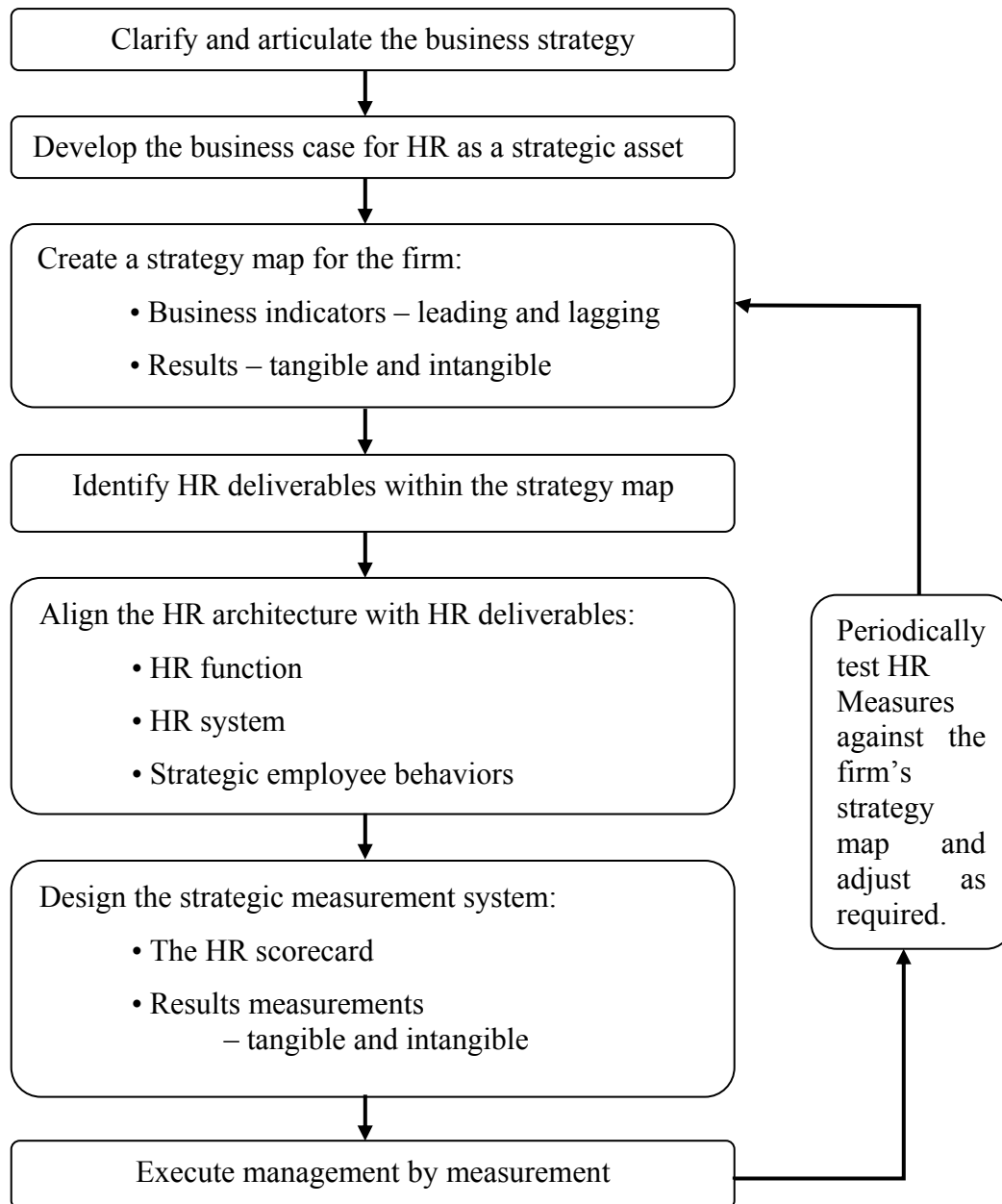
As such, the HR scorecard is a management tool which allows a business to:

1. Manage HR as a strategic asset and a source of competitive advantage.
2. Quantitatively demonstrate HR's contribution to the firm's financial results and bottom-line profitability.
3. Create and measure the degree of alignment between the strategy of the business and its HR architecture.

When used effectively, HR scorecards link the things people do with the strategy of the company. The HR scorecard also allows a HR architecture to evolve which is measurement managed and systematic. And the HR scorecard allows the human resource function to fill a strategic role in the business – participating fully in the balanced goals of cutting costs and creating added value.

In total, the HR scorecard makes it possible for HR to enhance its role as a strategic business asset.

# The Seven-Step Model for Using HR as a Strategic Business Asset<sup>1</sup>



<sup>1</sup> Brian E. Becker, Mark A. Huselid, and Dave Ulrich. “*The HR Scorecard: Linking People, Strategy, and Performance*”, 2001, pp 211-212.

# ELABORATION

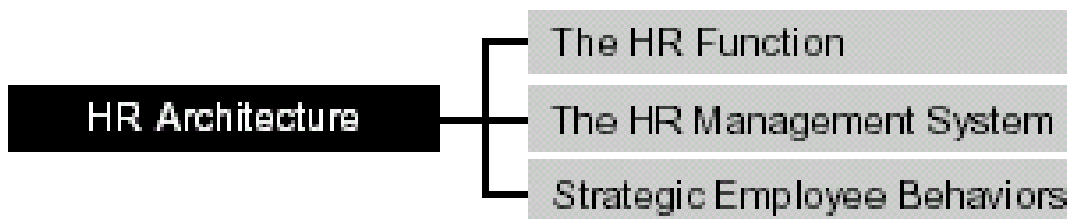
## 1. Clarify and articulate the business strategy

### Main Idea

Until a firm clarifies its business strategy precisely and in a way that employees understand, it will be impossible to measure how successful the organization is. Therefore, before focusing on implementing the strategy of the business, there must be the capacity to definitively state the preferred business strategy clearly, concisely and free of ambiguities.

### Supporting Ideas

In the emerging digital business era, the emergence of a new paradigm wherein wealth is created from intangible assets is beginning. This new paradigm suggests HR has a direct impact on business performance since the HR architecture influences how effectively a business can execute its preferred business strategy.



A firm's HR architecture has three components or dimensions:

- *The HR Function*

Historically, HR managers focused on the delivery of services such as recruiting, compensation and benefits. Today's HR managers tend to be more interested in finding ways to deliver HR services that directly support the designated strategy of the business. HR managers are acquiring the competencies required to provide strategic human resources management services.

- *The HR Management System*

This system attempts to maximize the overall quality of the organization's human capital by putting in place and supporting policies and practices which:

- Create links between promotions and competencies.
- Provide skills training.
- Attract and retain high performers.

- *Strategic Employee Behaviors*

All the employee actions which are productive in implementing the firm's preferred strategy are strategic employee behaviors. Therefore, this area will incorporate behaviors that flow from core competencies as well as situation-specific behaviors required at key points in the value chain. HR focuses on motivating the appropriate behaviors.

To demonstrate and quantify HR's contribution:

- HR needs to show it is helping control costs by driving out inefficiencies in the HR function.
- HR needs to show it is creating value at all points of intersection between parts of the HR architecture and the strategy implementation process.
- HR's conventional metrics (hours of training, time to fill a position, turnover rates) need to be replaced by new metrics which are part of the value creating process itself.

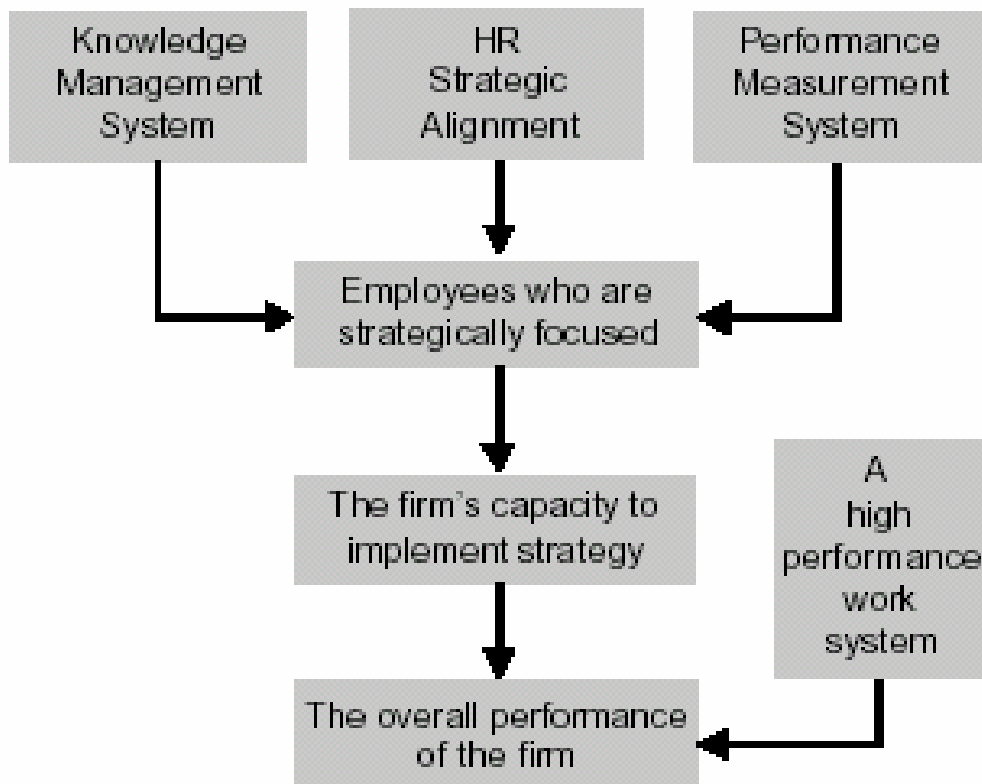
- HR practitioners must restructure their role using new tools so the way they add value is derived from a few key measures that can be tracked rather than a broad basket of intangible measures which are impossible to understand.

## 2. Develop the business case for HR as a strategic asset

### Main Idea

Once a firm has clarified its strategy, HR professionals need to be able to build a compelling business case for why and how HR can support that strategy. The overriding theme of this business case should be implementation of the firm's strategy, and HR's contribution to implementation through:

- Creating value with good HR alignment.
- Controlling costs, thereby enhancing operational efficiency.



## Supporting Ideas

Some characteristics of good HR measures:

- Good measures capture both the amount of something and the cause.
- Good measures have context – they provide benchmarks for comparison.
- Good measures are unambiguous – they don't use language which can be interpreted several different ways.
- Good measures are simple – they avoid blurring the picture with unrelated information.
- Good measures contribute in meaningful ways to overall performance evaluation. They are the metrics that matter and can be acted upon.

Developing measures which accurately capture the results of HR functions is especially difficult since the results of many HR initiatives are often not realized for several years and even then they may result only in improvements in other drivers of performance rather than direct bottom-line numbers. Despite those challenges, however, the opportunity to develop a sound business case will rely on an ability to quantify causation and flow-on effects of HR actions.

A good HR business case will typically include:

- Measures which quantify HR's contribution to as many of the firm's strategic performance drivers as possible.
- Causal inferences and linkages – for example, the fact that a 20-percent increase in competency A generated an extra \$300 per employee per week in increased cross-selling business.
- Multi-level business analyses – which evaluate HR's contribution from the enterprise, divisional, team and employee perspectives.

- A distinction between lagging variables (like customer satisfaction) and leading variables (such as HR).
- New measures which are developed from the top-down rather than bottom-up.

### 3. Create a Strategy map for the firm

#### Main Idea

A strategy map (or a value chain) shows how the firm creates value in terms managers and employees can relate to. In other words, the strategy map details which organizational processes and capabilities drive firm performance. To state that clearly:

- Indicators are specified which either drive performance (leading) or measure results (lagging).
- The complete spectrum of results are incorporated, both those that are readily visible and quantifiable (tangible) and those that aren't (intangibles).

#### Supporting Ideas

Every firm has a value chain – even those companies which have never taken the time or effort to articulate the process by which they embed added value within their products and services. A strategy map details each link in that chain.

The strategy map should outline how the six core HR competencies are integrated and measured. These HR competencies are:

##### 1. *Knowledge of the business*

HR managers and professionals need to understand the financial indicators of business success, the measures customers use to determine success, competitor strengths and weakness and have a working knowledge of the firm's processes. With that background knowledge base, good HR decisions cannot be made which will drive business success.

## *2. Delivery of human resource services*

HR managers need viable measurement metrics so they can make informed decisions about which HR systems to adopt, what the trade-offs are between various HR options and to identify which HR practices are generating the greatest return and should therefore receive the greatest amount of attention. Measurement systems will also be used to determine when the marginal benefits from specific HR programs are falling.

## *3. Management of culture*

Whatever gets measured gets valued and ultimately is integrated into the culture of the firm. HR professionals and managers take the lead in this area because of their competency in management and their ability to articulate the benefits of the firm's culture from the customer's perspective.

## *4. Management of change*

HR managers are well versed in the demands and rigors of rapid organizational change. Therefore, they are advantageously positioned to understand the most likely internal impacts of the change process and develop ways to facilitate those changes effectively. By acting as change agents, HR managers generate an internal capacity to move quickly in response to evolving market conditions – which can be a sustainable competitive advantage for any firm.

## *5. Personal credibility*

Good HR managers “walk the walk and talk the talk”. They exemplify and live the firm's values and effectively act as good role models. That gives them credibility and acceptance from other line managers.

## *6. Strategic HR performance management*

This is the ability to orchestrate the firm's implementation of strategy by using balanced performance measurement systems. HR managers not only need to know what to measure but also how to measure it.

## 4. Identify HR deliverables within the Strategy Map

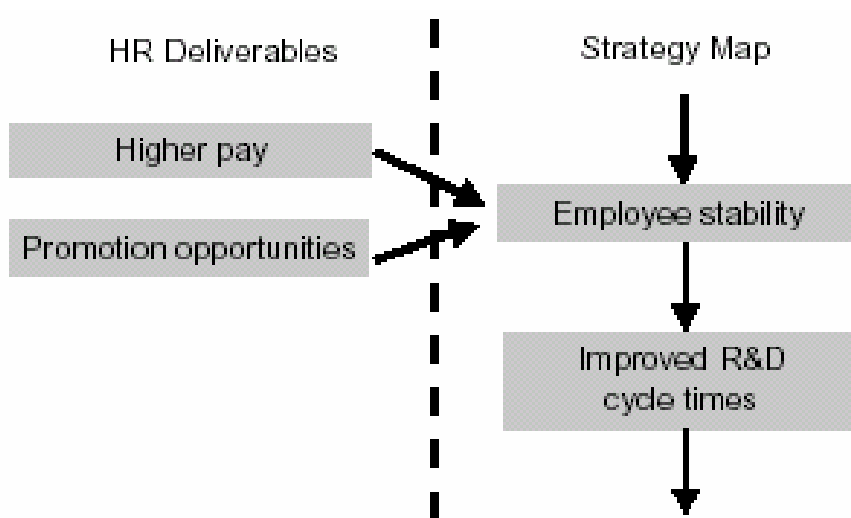
### Main Idea

Most HR outputs are created wherever the HR system intersects the strategy implementation system. Thus, HR managers should identify all HR performance drivers and HR enablers or deliverables which exist within the strategy map. By identifying those drivers and enablers, HR policies which enhance those factors can then be developed.

### Supporting Ideas

To be able to correctly identify where HR creates most of its value, HR managers must understand the business intimately and in detail. That will then give them the insight to see precisely where HR deliverables are supporting the firm level performance drivers in the strategy map.

For example:



To be able to link HR deliverables and the strategy map, analytical methods are required to assess the short- and long-term payoffs. In practice, this is usually achieved using a cost-benefit analysis – the costs of the HR deliverables are weighed against the benefits generated for the firm. And that, in turn, should allow the return on investment (ROI) in HR to be calculated.

In theory, this should be a simple three-step process but most often collecting empirical data is difficult and extensive reliance on estimates will be needed. The steps are:

Step 1 – Identify all potential costs.

Costs comes in various flavors and types:

- Fixed – those that don't vary with production levels.
- Variable – those that change directly with the level of output.
- Sunk – the total resources invested in a project.

Probably, the most practical approach will be to develop plausible cost estimates which align with the general estimates used by line managers or other experts. HR managers could also develop a cost range, with true costs assumed to be lying somewhere between best-case and worst-case scenarios. Or, costs can be broken down into specific categories and estimated separately.

Step 2 – Identify the likely benefits.

Since HR is centered on human assets, benefits projections will usually involve some type of estimate of the relative impact of high-performing employees as opposed to the output of low-performing employees. This will be difficult if for no other reason than the fact employee performance levels differ significantly even in the absence of any type of HR initiative or other factor.

One approach to estimating the benefits of HR would be to look at two factors:

1. Understand the economic contribution generated by an average employee – to show whether employees in specific jobs make a large or small contribution to the firm's financial performance.
2. Gauge the variability of financial results on employee performance. Specifically how much more bottom line profits are generated by the high performers – or do they make only a marginal difference?

As for costs, estimating the benefits will be part intuition, part insight and part calculation. Fortunately, as HR managers work through the process, many develop inside tips which enable these benefit estimates to be made more confidently and with greater credibility.

Step 3 – Calculate the ROI of the program.

Armed with plausible cost and benefit estimates, the ROI on HR projects can then be calculated. The ROI:

- Can be expressed as a percentage.
- Can be given in dollar terms.
- Can be calculated as a payback period – the amount of time required before the program covers its costs.
- Can be stated as a breakeven volume – the number of participants required for the program to pay for itself.
- Can incorporate multi-year periods – to reflect benefits that will accrue in future years as a result of this years actions.
- Can include more sophisticated net present value calculations to reflect factors like the opportunity cost of capital, uncertainty and risks.
- May incorporate benchmarks from peer group companies as a way to provide context.

## 5. Align the HR Architecture with HR Deliverables

### Main Idea

To align the HR system with the firm's strategy implementation system, a competency model and development program will be needed to generate the requisite HR deliverables. This will require internal alignment (between all three components of the HR architecture) and external alignment with all other elements in the value chain. In essence, unless there is alignment (with the periodic reshaping that will be required as firms change their business strategies), the HR strategy will not only fail to create value but may even destroy value.

### Supporting Ideas

Alignment between the HR architecture and the strategic requirements of the firm is obviously of vital importance in producing a strategically focused workforce. There are two types of alignment:

1. *Internal – the ability and potential for the firm to use HR as a strategic asset.*

Internal alignment is measured by evaluating the feedback from those who interact with the HR system on a daily basis – line managers and front-line employees. If those people feel there is a high degree of fit and consistency, then there is most likely a strong correlation between the HR architecture and its deliverables. Conversely, internal misalignment means the HR system is consistently sending conflicting signals about what the organization values. By diagnosing and analyzing internal alignment, HR managers can spot problems within the HR architecture and undertake quick remedial actions.

2. *External – the extent to which the HR system is designed to implement the firm's strategy.*

External alignment measures the match between the firm's strategic value drivers and the HR deliverables which contribute to each driver. To make this measurement, both scale

(the measurement tool used) and perspective (individual viewpoints) are required. External alignment is usually measured by making tests. The HR deliverables are evaluated on how closely they match the strategy map. Then the HR system is tested to determine specifically what HR deliverables are being generated. That will show whether or not the HR deliverables are, in fact, the key performance drivers for the firm's strategy.

## 6. Design the HR Strategic Management System

### Main Idea

A viable HR strategic measurement system:

- Measures the correct HR performance drivers and enablers.
- Chooses the correct measures for each deliverable.

Ideally, the HR scorecard will accurately measure the impact of all HR policies on firm performance and capture the full impact of HR. The more sophisticated and detailed this measurement is, the greater the potential benefits are.

### Supporting Ideas

A well thought-out HR scorecard has four basic dimensions:

#### 1. *HR Deliverables*

These help you identify the causal relationships through which HR generates value in the firm, with an emphasis on HR performance drivers and HR enablers. Ideally, HR deliverables whose actual impact on the firm's performance can be measured should be used. The acid test for whether the HR deliverables are clearly stated is line managers will understand them and be willing to pay for them.

#### 2. *The High-Performance Work System*

Once the HR deliverables have been clearly defined, the High-Performance Work System

(consisting of HR policies, processes and practices) implements the business strategy and generates the deliverables specified.

### 3. *External HR System Alignment Measures*

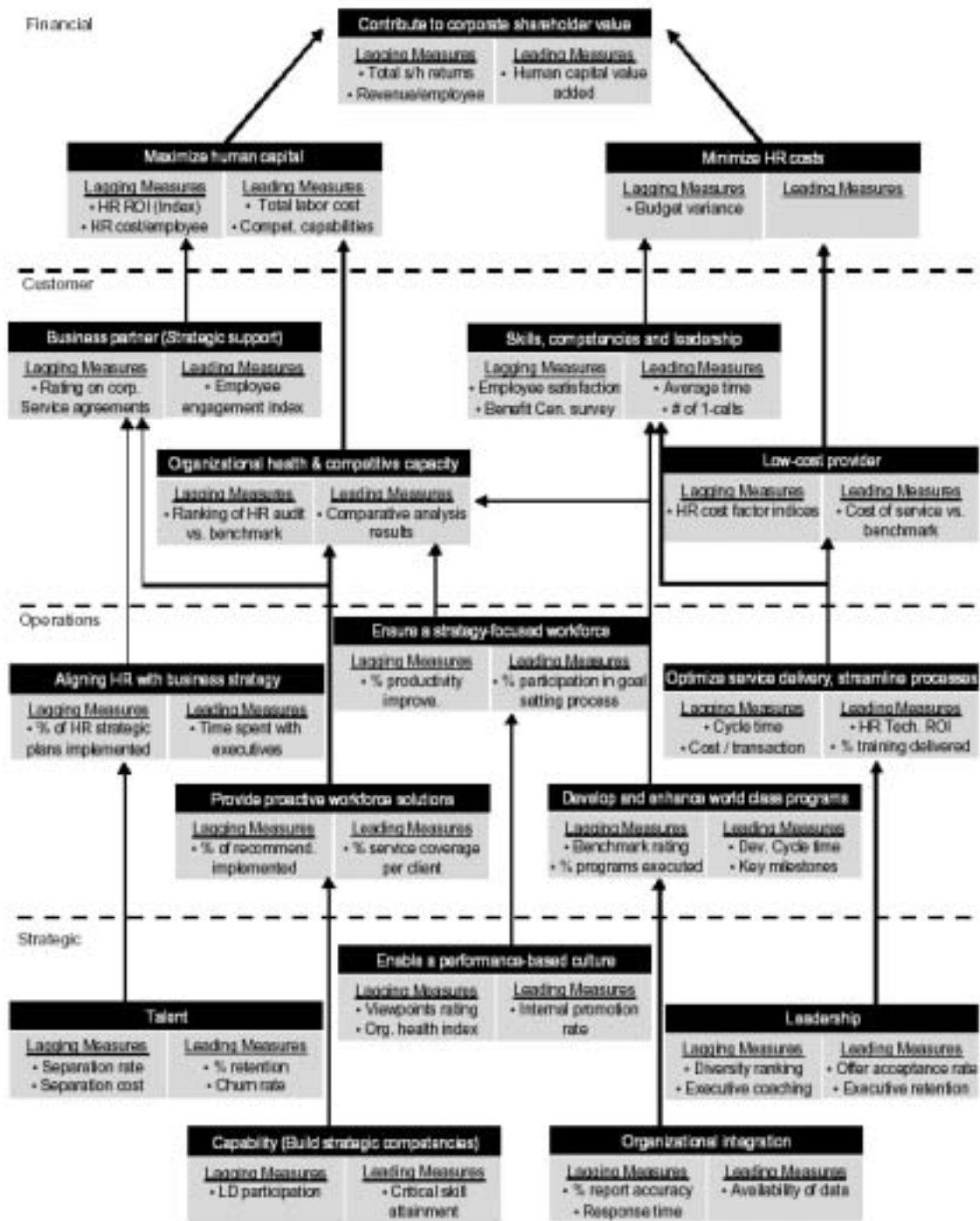
This dimension measures how well the HR system is aligned with the firm's key performance drivers. When properly aligned, the HR system should be making a definable and significant contribution to the value creation process. Regular measures should be incorporated, so if alignment slips, the appropriate action can be taken quickly and appropriately.

### 4. *HR Efficiency Measures*

These are the metrics, benchmarks and standards by which the HR system's performance will be gauged and evaluated. Most HR managers divide their key efficiency metrics into two categories:

- *Core efficiency measures* – significant expenditure items which make no direct contribution to the firm's strategy implementation. These are most likely to be considered expenses rather than human-capital investments. Some examples: benefit costs, workers compensation costs and percentage of correct entries on data input systems.
- *Strategic efficiency measures* – HR activities and processes designed to produce HR deliverables for direct application in strategy implementation. These are accounted as investments in human capital, e.g., cost per new hire, costs per trainee hour, HR expenses per employee.

As far as possible, the HR scorecard should show what the actual impact of HR deliverables is on the firm's performance. That way, the HR manager should be able to confidently make statements like: "HR deliverable \_\_\_ increased \_\_\_ by 20-percent, which in turn reduced \_\_\_ by 10-percent, resulting in a 3% increase in shareholder value for the firm in the financial year ended \_\_\_\_\_."



An Example of an HR Score Card<sup>2</sup>

<sup>2</sup> Source: <http://www.GTE.com>, taken on 2.12.2002

# CONCLUSION

The benefits of constructing and maintaining a good HR scorecard:

- *It distinguishes clearly HR doables from HR deliverables.*  
HR deliverables influence the firm's ability to implement strategy while HR doables do not. By making this distinction more clear-cut, HR managers are encouraged to think strategically instead of simply thinking operationally.
- *It empowers HR managers to control costs and create value.*  
HR will always be encouraged to control costs as effectively as possible, but the HR scorecard also details HR's complementary strategic role as a value creator. In fact, the HR scorecard approach makes it possible for HR professionals to balance the two objectives realistically.
- *It measures the firm's leading indicators.*  
The HR scorecard links HR deliverables with implementation of the firm's strategy. The HR management system will have performance drivers, measures (leading and lagging) and preferred outcomes. The HR scorecard measures how well all of those factors are aligned and provides ongoing feedback.
- *It clarifies HR's contribution to profitability.*  
The HR scorecard enables a HR manager to answer the question, "What is HR's contribution to firm performance?" with measures that are credible, relevant and measurable. In fact, for every measure used, the HR manager will also be able to provide a rationale as well. This will be the framework for a superior system of metrics for quantifying results.
- *It allows HR professionals to manage better.*  
Using the HR scorecard, HR managers can assess precisely how HR decisions will impact on the implementation of the firm's strategy. In other words, the scorecard

heightens the HR manager's strategic awareness and forces them to think systematically.

- *It encourages flexibility and ongoing change.*

When a performance measurement system becomes institutionalized, it is more likely to inhibit rather than encourage adaptability and change. As a firm's strategy evolves in response to changing market conditions, the measurement system needs to move with those changes if it is to remain completely relevant. The HR scorecard actually encourages flexibility and constant evolution because it encourages people to focus on the underlying strategy and not the arbitrary measures being used. By encouraging people to see the bigger picture, the organization is then much better positioned to change direction as required.