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**HEADLINE:** Scoring goals for people and company Companies that invest in their employees perform better, says Linda **Bilmes**, who presents a measurement system and the evidence to support the claim.

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**BODY:**

While companies pay lip service to the importance of their people, in reality they invest in almost anything else - sales, marketing, brands, customers, distribution, IT, finance - to enhance performance. Yet the most obvious, and overlooked, source of strategic advantage is to use people better.

Companies have long used human resource policies to gain competitive advantage. In the 1880s, John D. Rockefeller linked managers' pay to company performance. Rockefeller gave shares to senior managers. "I would have every man a capitalist," he said.

In 1914, Henry Ford doubled the average wages of his assembly-line workers. He claimed that better motivated workers made him more money and said the pay rise was "the finest cost-cutting move we ever made". From this view, the present economic downturn is an opportunity to spend time and effort in nurturing workers.

The viewpoint described in this article is based on a study by myself, Peter Strueven and Konrad Wetzker of the Boston Consulting Group, as well as my empirical observations while at the US Department of Commerce. To measure how well companies manage employees, we developed a "people scorecard"; a set of criteria that can be tracked and quantified. In the analysis, companies that scored highest earned higher shareholder returns than their competitors. Further, such companies enjoyed better employee satisfaction, greater employee loyalty and were able to weather downturns more easily. This article lays out the evidence and shows how to use it.

## The scorecard

Why are people neglected in companies? First, human resources is seldom at the centre of corporate power. Everybody knows HR is critical but, perhaps because it is often a female role, it continues to be treated as a support function.

Moreover, HR itself has been too narrowly focused. In the scorecard, we judge companies on both "traditional" HR functions such as recruiting and performance evaluations, and on what we call intrapreneurship - creating an active, entrepreneurial culture in the company (see Box). Successful people-factor companies emphasise both.

Companies also neglect human capital because it is difficult to measure and the benefits of people strategy take time to emerge. However, there is growing evidence to link company performance and people management.

We used the scorecard as a tool to analyse more than 200 companies in the US and Germany. Data was gathered from published material and interviews with staff. The criteria in the scorecard are specific data such as days of training provided, type of training and choice of training subject. Each company was rated and compared with industry peers.

The results are striking. First, companies that scored highest had a higher total shareholder return than lower-scoring companies. In the US, top companies had an average annual return of 27 per cent over the period 1989-98, whereas the bottom ones earned 8 per cent. Companies with middle scores had an average return of 21 per cent, which is close to the 19.2 per cent average annual growth in the Standard & Poor's 500 index.

In Germany, companies with the highest score had a shareholder return nearly three times higher than companies with the lowest score and 35 per cent above the median. This contradicted the prevailing German view that companies pursue high returns at the expense of employees.

The second finding was that scores varied wildly. In each sector, we found a people-factor leader and a laggard. Pfizer, leader in the pharmaceutical sector, has been providing stock option benefits to nearly all employees since 1950. The least successful drug company offers such options to fewer than one in five employees and only started to do so in the early 1990s.

Third, people-factor benefits take time to emerge. Over four years and longer, a pattern becomes clear, with those companies scoring highest on the scorecard enjoying strong performance versus their competitors. But people-factor companies sometimes forego short-term profits in pursuit of longer-term success.

In spite of current troubles, one of the best examples of this approach is US computer maker Hewlett-Packard. Over four decades, the company avoided lay-offs by using across-the-board pay cuts, sabbaticals, shorter hours and cancelled bonuses. It pioneered flexible hours, job shares,

telecommuting, company-wide stock options and linking managers' pay to their rate of new product design. HP encouraged entrepreneurship, even investing in spin-offs launched by former employees and giving them "preferred-source" contracts.

Fourth, companies with high HR scores but low scores for intrapreneurship do not have superior stock performance. How can companies create entrepreneurial energy?

Four Seasons Hotels is a good example. In the company that invented the mini-bar after a suggestion by an employee, ideas are welcomed and well rewarded. Four Seasons was also the first chain to introduce telephones and hairdryers in bathrooms; 24-hour services; and free overnight shoeshine. Most of these innovations were suggested by employees.

So, HR should reinforce and foster entrepreneurial opportunity. Do good people policies create good companies, or vice versa? It is a fair assumption that better-managed companies are better at managing people. But beyond that, there is strong evidence that the best people-factor companies create an advantage in the market.

A company that does well on all parts of the scorecard seems to translate that into better performance through a more contented and loyal workforce. This was the conclusion of a survey of 2,000 US and German workers carried out for our research by polling organisation Penn, Schoen and Berland Associates.

## Findings

The survey produced two main findings. First, investing in people-factor criteria strongly increased job satisfaction and loyalty. Overall, 34 per cent of US workers and 35 per cent of German workers described themselves as satisfied with their jobs. But among workers in companies that offered people-factor benefits, job satisfaction was much higher - 58 per cent of US and 63 per cent of German workers.

The features that most increased job satisfaction were: allowing people to influence decisions that affect their work life; training; and performance-linked pay. Similar factors increased employee loyalty. In the US, 46 per cent of workers said they were "very loyal" to their companies. But in companies that provided training, linked pay to performance and gave employees some autonomy, 58 per cent said they were "very loyal". In Germany, 86 per cent of workers in such companies were "very loyal", compared with 66 per cent in other companies.

The happiest and most loyal respondents were those who enjoyed both traditional HR benefits (especially training) and intrapreneurship. Employees who agreed with the statement "My company makes it easy for me to put my ideas into practice and to get credit for it" were twice as satisfied, and twice as loyal to their companies, as those who disagreed.

The second finding was that a huge gap existed between what companies thought they provided and

what workers believed they received. Most companies claimed to offer training, performance evaluation and employee involvement in decision-making. Yet only a third of employees said they received such benefits. Moreover, the greatest gap was on attributes that people considered most important. For example, 71 per cent of respondents listed "I am able to influence decisions that affect me" as "very important" - but only 34 per cent of employees agreed that they could do it.

The survey found little evidence of intrapreneurship. Top managers said pay was extremely important to them but only 41 per cent of such managers in the US (fewer in Germany) participated in a profit sharing or stock option plan, and only 30 per cent said their pay was linked to their performance. Even in small companies, 60 per cent of employees said it was not easy to put their ideas into practice.

## Eight steps

Superior stock market performance and the powerful effect on employee morale together create a powerful case for the scorecard. Moreover, the fact that so many workers feel they do not receive people-factor benefits reveals the size of the opportunity. Companies can begin to create an emphasis on people by following eight basic steps.

**Top-level commitment.** If a company is to transform itself into a people-focused organisation, its leader must be dedicated to this aim. General Electric is a well-known example of a US company that has reaped the rewards of patient investment in its people. At GE it took a determined and focused leader (willing to write thousands of hand-written notes to employees) and several years. Jack Welch's vision, and his detailed attention to his workforce, allowed GE to focus on making every employee effective.

**Workforce development planning.** A company must spend the time and effort to assess its workforce needs regularly. It should ask: "How will the market evolve?"; "How must the workforce change?"; "How much outsourcing is desirable?"; and benchmark workforce skills against current and projected needs. Such planning is necessary if the company is to provide meaningful and useful training, career development and performance evaluations for employees.

**Develop versatility.** Skills development needs to be thought out and matched to the needs of the company and its employees. But companies should also use development to become more versatile. For example, the German construction company Bilfinger and Berger used the last recession to upgrade the skills of its workers and managers, so they learned new skills, such as languages and environmental engineering. While competitors shed workers, Bilfinger was able to take on more international jobs and different types of jobs. It gained market share and moved from seventh to third place in industry size rankings.

**Training.** Employees value training and see it as a test of how much the company values them. Training boosted job satisfaction and loyalty for workers at all levels and companies of all sizes, in both the US and Germany. There is extensive literature on running effective training. The essential element of training for people-factor companies is that it must be linked to the personal and career development of the individual.

**Retain good workers.** Staff turnover is inevitable and sometimes desirable. However, an essential ingredient of successful people-factor companies is that they are able to keep their top performers. The survey showed that the most direct influence on an employee's loyalty was linking compensation to performance; such a link requires a fair and transparent way to measure performance. Leading people-factor companies such as HP and GE develop an annual individual performance plan for each employee, with feedback sessions every quarter.

**Structure work.** Work needs to be structured so that people enjoy it. In addition, it should foster intrapreneurship. People-factor companies typically have flat hierarchies and decentralised decision-making. In addition, some have come up with novel structures. US biomedical company Chiron allows its scientific staff to make "creative partnerships", which can be started up or ended easily, instead of going through a protracted legal process. Chiron's approach has yielded numerous innovations, including the discovery of the Hepatitis C virus.

**Reward success.** People-factor companies reward success and mimic the reward structure of an entrepreneurial venture. To link performance and compensation, a company should design work plans for each employee that define goals, tasks and responsibilities, and specify how success will be measured. Further, attributes that support the people factor (such as creativity, teamwork and skills development) should be rewarded.

**Communicate the people factor.** Chief executives who believe in the people factor concept sound almost evangelical. Says William Steere, chairman and chief executive of Pfizer: "We get characterised for our balance sheet or our profit and loss but in the end (people) truly characterise a corporation."

## Conclusion

The people factor is a simple concept: investing in human creativity delivers high returns in terms of job satisfaction and shareholder returns. Implementing it takes sustained attention to a set of basic rules. In the current economic climate, managers preoccupied with short-term returns from cost-cutting often run against the grain of the people factor. Our evidence suggests that companies with the foresight to see beyond immediate difficulties will emerge from the downturn with renewed strength.

This article is drawn from the author's book *The People Factor*, which will be published by FT Prentice Hall in 2002.

## Further reading

Wetzker, K., Strueven, P. and Bilmes, L. (1998) *Geht uns das Risiko zuruck*, Munchen: Carl Hanser Verlag.

Linda Bilmes is a former assistant secretary of the US Department of Commerce. She takes up a teaching post at Harvard University's John F. Kennedy School of Government in January.

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