From Capability to Profitability

Realizing the Value of People Management
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Realizing the Value of People Management

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July 2012
Good people practices confer a performance advantage. This finding is especially important today, as companies cope with a growing talent crisis and chronic economic uncertainty. But just how strong is the correlation to economic performance? And what practices count the most? BCG, in partnership with the World Federation of People Management Associations (WFPMA), recently explored this question as part of its annual *Creating People Advantage* research study.

**People Practices and the Bottom Line**
Companies that are highly capable in 22 key HR topics consistently enjoyed better economic performance than those less capable. In several topics, this correlation was striking—up to 3.5 times the revenue growth and as much as 2.1 times the average profit margin. So what do high-performing companies do differently?

**Where Do High Performers Stand Out? The Big Three**
The high performers differentiated themselves dramatically in three of the most important topics: leadership development, talent management, and performance management and rewards. Within each area, they did more, and they did so more effectively. Among other things, high-performing companies use incentives to engage leaders in people development. They define talent more broadly, strive hard to attract internationals, and nurture “emerging” potentials. And unlike their less-successful peers, they clearly define performance norms and standards and adopt them enterprisewide.
In the wake of the financial crisis, departmental budgets have increasingly been allocated on the basis of return on investment. For HR departments, quantifying the economic value of people management is a tricky proposition. Yet now is not the time for companies to skimp on their people expenditures. With the pressures of globalization, the growing scarcity of talent, and an employer-employee relationship frayed by persistent economic pressures, companies today—more than ever—must regard their human capital as an asset worthy of continual investment.

There’s yet another compelling reason to remain committed to investing in people: companies that do so enjoy better economic performance. Those that excel in leadership development, talent management, and performance management, for example, experience substantially higher revenue growth and profit margins. For the companies that keep dedicating capital to their human capital, what is the nature of this connection? What are they doing right?

The Boston Consulting Group and the World Federation of People Management Associations (WFPMA) recently conducted major research to probe the relationship between people management capabilities and financial performance. We surveyed 4,288 HR and non-HR managers on their current HR capabilities and challenges, the strategies and approaches they use to address these challenges, and the difficulties they foresee in attracting, managing, and developing people.

People Practices and the Bottom Line

Our analysis confirmed what “people” companies have long sensed: good people practices confer a performance advantage. But just how strong is the correlation to economic performance? As a preliminary test, we looked at Fortune magazine’s “100 Best Companies to Work For.” Consider the average growth in share price for these companies between 2001 and 2011. (See Exhibit 1.) The perennial “100 Best” (that is, the companies that have made the list for three or more years) outperformed the S&P 500 in eight out of ten years—and over the course of the decade, they cumulatively beat the S&P 500 by 99 percentage points.

Does this mean that good HR practices drive good performance? Or that good performance enables good HR practices? To claim a direct cause-and-effect link here would be overreaching. But probing the relationship between HR practices and business performance is a worthwhile exercise if it sheds light on those activities that seem to be particularly beneficial.
We then asked our BCG/WFPMA survey participants to rate their current capability in the 22 HR topics that comprise the framework of our annual Creating People Advantage study. Moreover, we asked them to report their company’s revenue growth from 2010 through 2011 and average profit margin in 2011. In 21 out of 22 topics, we identified a positive correlation between capability and performance: companies that rated their current capabilities “very high” experienced significantly greater revenue growth and higher average profit margins than those characterizing their capabilities as “low.” (See Exhibit 2.) Even mastering classic HR processes showed a markedly positive impact on financial performance. These results underscore the fact that people management is a holistic process. Because the impacts of the 22 topics are interrelated, it’s important to excel in all of them.

High-performing companies consistently did more in all major activities within these topics than their low-performing peers, but in certain activities their efforts truly stood out. For six topics in particular, the correlation between capability and economic performance was striking: recruiting, onboarding new hires and employee retention, talent management, employer branding, performance management and rewards, and leadership development. For example, companies adept at recruiting enjoyed 3.5 times the revenue growth and 2.0 times the profit margin of their less capable peers. In talent management, the highly capable enjoyed more than twice the revenue growth and profit margin of those less capable. And companies that are serious about leadership development experienced 2.1 times the revenue growth and 1.8 times the profit margin.

This prompted the question: what concrete actions correlate with business performance? In other words, what do the high-performing companies—the top 10 percent by revenue growth and profit margin—do differently from the bottom 10 percent?
The People Advantage Triad

Taking into account the findings of our interviews with leading business and HR executives across the globe, we focused on three of the outstanding six topics identified above: leadership development, talent management, and performance management and rewards. These three topics encompass more (and more varied) people-management activities, thus offering companies more levers for boosting their performance advantage. Our quantitative survey results confirmed the importance of these topics, revealing significant differences in the concrete actions taken by high- versus low-performing companies. (See Exhibit 3.)

Let’s examine major differences across these three pivotal areas.

**LEADERSHIP: MAKING PEOPLE DEVELOPMENT PART OF THE JOB DESCRIPTION**

High-performing companies recognize that leadership is about more than just steering the business. It’s about nurturing, energizing, and challenging the people who help make it run—and who keep it competitive. To sustain success, a company...
needs leaders who care about and develop their people—leaders who understand that building a talent pipeline should extend beyond successors to top management to include everyone whose contributions are essential to the company’s future.

Specifically, what do high-performing companies do differently?

- **They are 1.5 times more likely to have in place a leadership model that describes expected contributions and behavior**. Such models go beyond clichés, offering actionable guidelines that inspire leaders—and that leaders aspire to—daily.

- **Their leadership model guides talent selection and promotion decisions—1.7 times as often as low-performing companies**. In high-performing companies, the performance management system is tied to the company’s business strategy and includes leadership objectives and talent development activities. Managers are thus promoted on the basis of their individual performance as well as their people-development activities—both of which are linked to company strategy and objectives.

- **They make leadership planning an integral part of their people-planning efforts 2.2 times as often as low-performing companies**. Ensuring a leadership pipeline is seen as
an ongoing practice and not an ad hoc effort. High-performing companies embed their leadership planning in their comprehensive strategic workforce planning. They divide their entire workforce, from leaders to entry-level personnel, into job families and conduct long-term supply-and-demand analysis, which they use to plan concrete actions for their recruitment and training and development efforts.

• They make leaders’ compensation and career advancement dependent in part on leaders’ people-development efforts—3.4 times as often as low-performing companies do. High-performing companies do not relegate people development to the HR function. Instead, they view their leaders as the frontline developers of talent. Leaders are best positioned to see people in action and to recognize, shape, and inspire potential talent. They are also best positioned to cultivate in their direct reports the kind of leadership traits valued by the company (and those necessary for success in the twenty-first century, such as the adaptive leadership qualities we’ve observed in today’s best-run companies). As Jordi Gaju, chief development officer at the Chilean retailer Falabella, says, “Every boss must become a human resources manager.” To make sure their leaders embrace this responsibility, high-performing companies link career advancement, performance bonuses, and other rewards to leaders’ people-development activities.

**Talent Management: Proactive, with a Broad Development Repertoire**

Excellence in one critical HR area won’t compensate for shortcomings in another. Having an attractive employer brand might help you nab the talent, but it’s not enough to help you hold on to it. High-performing companies understand this well; they distinguish themselves from the rest in the sheer extent of their talent-development efforts. (For an example of the multifaceted approach to talent management, see the sidebar “How L’Oréal Is Building a Talent Advantage.”)

They know, for example, that global talent risk is soaring, and they therefore realize the importance of building—rather than just “buying”—talent. As we discussed in the December 2011 BCG article “Make Talent, Not War,” relying too heavily on external talent often leads to bidding contests that can diminish the quality of new hires, yield bad matches, increase turnover, and raise expenses. Mindful of the urgency of the talent shortage, high-performing companies also accelerate critical activities wherever possible.

According to our survey, high-performing companies capitalize on a broad array of strategies, initiatives, methodologies, and programs to ensure they have the talent they need, now and in the future. These efforts include the following:

• They are 1.8 times as likely as low-performing companies to try to attract international employees. High-performing companies recognize the strategic and practical importance of diversifying the talent base. As companies’ operations and customer bases each become more globalized, local talent that understands local markets will give companies greater long-term competitive advantage. Furthermore, high-performing companies’ interest in international talent applies across the experience spectrum. These companies are 40 percent more active in managing an international talent pool for senior leaders.

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“Our employer brand is attractive, so I’m sure we have a lot of talent. The problem is, we lose many good people because they are not identified as talent, and we don’t create sufficient career-development opportunities for them.”

Deputy Group Senior Vice President, Human Resources, leading European telco
High-performing companies are 1.4 to 2.7 times more likely to provide development programs for “emerging” as well as “high” potentials. They actively work to leverage and retain existing talent at both ends of the talent development chain. They systematically define development requirements for high-potential employees; for example, they maintain a list of critical assignments appropriate for the development of high potentials much more often than low-performing companies do. High-performing companies also define talent more broadly—not just in identifying emerging potentials but also in seeking and nurturing diverse, complementary thinkers and those with deep functional expertise, rather than just management track candidates.

High-performing companies are 1.7 to 2.1 times more likely to offer career advancement opportunities with clearly defined career tracks. High-performing companies provide a broad menu of horizontal as well as vertical opportunities. Doing so keeps employees satisfied and professionally fulfilled while also helping companies retain the full range of talent necessary for enterprise success.
High-performing companies are 2.9 times as often better than their competition in offering a change of work location. Moreover, the number-one reason for workforce relocation for high-performing companies is personal development—unlike low-performing companies, which use relocation primarily to fill local knowledge gaps. High-performing companies actively foster employees’ individual development, and relocation and job rotation are among the development opportunities they provide. They recognize that beyond job stability and a good salary, today’s employee seeks a fulfilling work experience as well as the opportunity for personal growth. In particular, those employees from the so-called Millennial generation have greater expectations and are more willing to leave employers that can’t meet them. As the vice president of HR at a major media company says, “We believe that creating a fast-paced, stimulating environment that fosters individuals’ growth is a much more engaging environment to work in than one that is purely profit-oriented.”

Together, these quantified findings highlight what employee surveys tell us: a variety of enriching talent-management programs and practices are the main reason people stay with their employers—compensation alone won’t do.

- Incentivizing leaders to identify and develop talent on their team. This measure helps embed the talent culture while promoting mentoring.
- Motivating talent to migrate to strategic, high-growth zones by linking career development opportunities to these areas, through proactive rotation and international mobility.
- Appointing talent managers in critical markets to reinforce local recruiting, promote the employer brand locally, and optimize onboarding. This initiative is also designed to minimize the high turnover common in emerging markets.
- Establishing talent incubators to help feed the pipeline. Through special yearlong assignments, talent development is accelerated, and people are placed in management roles quickly.
- Enhancing career visibility and leadership expectations by establishing clear, uniform definitions of talent and performance standards.

Among its many benefits, L’Oréal’s talent-planning program reinforces the business-HR partnership by creating a common understanding of the company’s major business priorities and their HR implications. As Jérôme Tixier, group HR director, observes, “The focus and involvement of our managers and HR is what makes our company a true talent builder.”
**Performance Management and Rewards: Clear Norms, More Precise Incentives**

Many high-performing companies link managers’ bonuses or other incentives with business KPIs to ensure managers are aligned with company strategy and goals. But these companies also know that performance management goes beyond ensuring employee alignment. High-performing companies understand the importance of a well-constructed, balanced performance-management system in motivating and developing employees.

To foster—and sustain—excellent employee performance, companies need to create the right incentives. Developing a culture of meritocracy is key. High-performing companies recognize the value of fair, transparent measurement and rewards systems in promoting such a culture.

- *They have clear norms that drive performance—2.6 times as often as low-performing companies.* Employees understand clearly what constitutes superior performance and, just as clearly, what is unacceptable. A performance management system that is overly complicated or obscure, however, can hamper employee engagement. Organizations that don’t clarify unacceptable performance—and then surprise employees with repercussions—may engender ill will and risk tarnishing the company’s reputation. And those that don’t clearly explain their rewards system undermine workforce cohesiveness and even risk losing valuable talent.

- *High-performing companies have global performance-management standards in place 2.2 times as often as low-performing ones.* Although many corporate HR departments provide guidance on performance standards throughout their organizations, units continue to follow localized standards at most companies. High-performing companies use state-of-the-art performance-management methods and systems and ensure that these are adopted on a global basis.

In all the activities we studied, high-performing companies reward behavior, not just results, to a greater degree than low-performing companies. And while they put greater stock in performance management systems, they do not get mired in process. They avoid bureaucratic or protracted review processes that can actually allow problems to worsen. High-performing companies emphasize feedback and open discussion, as well as more frequent, often informal, reviews. These have the added benefit of motivating employees.

**Critical Mass Counts**

It’s no news that being well-rounded in people management represents an investment in the company’s long-term success. But at many companies today, that investment is at risk—even as talent risk has escalated. Before leaders yield to the temptation to cut back on people spending, they must keep in mind that people management has become an imperative.

The good news is that it’s not just an imperative; it’s an investment with a tangible, near-term return. As we’ve shown, the correlation between people capabilities...
and economic success is undeniable. People management mastery translates into economic success—and competitive advantage.

But excelling in leadership development, talent management, and performance management is not enough. Being a people company means doing more across the entire spectrum of people management activities, from employer branding to employee retention.

And critical mass matters: companies must be good at many activities, and they must integrate those activities. Moreover, it’s not enough to carry out important people-management activities in a step-by-step, linear fashion. Each critical topic, and the critical activities it entails, needs to be carried out in parallel. There is an integrated logic in how a company builds, for example, its talent management, leadership development, and performance management efforts. So apply as many levers as possible simultaneously. That’s the key to keeping the supply of talent and leadership—along with economic performance—steady and sustainable.

NOTES
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Acknowledgments

The authors would like to offer their sincere thanks to Christian Adler, Vinciane Beauchene, David Bendig, Jacqueline Betz, Florian Grassl, Alexander Kluger, Stefanie Michor, Cleo Race, Martin Scheunemann, Ulrich Schlattmann, and other BCG colleagues for contributing their insights and for helping to draft this report. They would also like to acknowledge Jan Koch for her writing and editing assistance, as well as Katherine Andrews, Gary Callahan, Sarah Davis, Oliver Dost, Kim Friedman, Abigail Garland, Bernd Linde, and Sara Strassenreiter for their contributions to the report’s editing, design, and production.

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