

**Calculating the Return on Investment (ROI) for
Organizational Development (OD) and
Human Resource (HR) Initiatives**

By:

Temre Green and Michael Brainard
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Brainard Strategy
2121 Newcastle Ave, Suite A
Cardiff by the Sea, CA 92007
www.BrainardStrategy.com
Phone: 760-436-4800
Fax: 760-436-4808



Executive Summary

People are arguably one of the most valuable resources in an organization; thus it is important to understand the return on investing in human capital. It is critical for companies to know the return on their investment in OD and HR initiatives, but more frequently than not, companies struggle to see the return in true dollar figures. The missing elements in traditional ROI calculations are the organizational influencers/ impact variables. This article investigates those missing elements and offers a new perspective and model for calculating ROI for recruiting, selection, training, performance management, coaching, and succession management.

Overview

It may be common knowledge among human resource professionals that human capital- the traits (intelligence and energy) that people bring to a job, their ability to learn (aptitude, creativity, and so on), and their motivation to share information and knowledge (team spirit and goal orientation) - is any organization's most important asset. The ROI of Human Capital arguably offer the greatest long term value in an organization (Fitz-enz, 2001). Jac Fitz-enz explains that in today's marketplace, every function must add value. In order to show HR's value, three factors are required:

- A new vision of HR's purpose
 - A more effective relationship between HR and its internal customers
 - A quantitative performance-measurement system.
- (Fitz-enz, 1994).

Experts' Opinions and Thoughts

Jim Hatch, principal with PricewaterhouseCoopers/ Saratoga, a leading source for HR metrics and benchmarking, says that Human Capital ROI- the amount of money you get back in profits for every dollar invested in human capital- is a good predictor of mid- and long-term success. Laurie Bassi, chair of Bassi Investments Inc. in Washington DC, also believes that Human Capital keys can predict future corporate profitability. Furthermore, she has years of solid research to back up her claim. According to Bassi, who is a former Economics professor at Georgetown University, the chief indicator for ROI is Training Expenditures per Employee.

Summary of the Problem

Because companies spend so much of their budgeted dollars on OD/HR initiatives, it is crucial that we are able to measure the added value. We need to know that we are getting a return on our investment, but how can we calculate it? One of the reasons that ROI can be particularly difficult to calculate is the different organizational influencers that impact an initiative. These influencers are implicitly and/or explicitly impacting time, quality, and money, but are not hard dollars and therefore are difficult to put into a basic equation of: output / input equals productivity (output/input = value). The problem can be as simple as a math equation.

For example, the cost (input: one side of the equation) is a different unit of measurement than what is often seen as the outcomes (satisfaction, commitment, retention, etc). We expect that if the input is in dollars, that the outcome will also be in dollars; however that is not always the case with OD/ HR initiatives. In this case, we are not comparing like units (e.g. dollars to success metrics, rather than dollars to dollars). So then, it is important to understand and measure the impact/ influencer variable to ultimately see an outcome that can be expressed as a dollar value.

Our Approach

There are two options to attempt to adequately measure ROI:

1. Stop trying to measure ROI traditionally. (E.g. The problem = 10k for a service = an *assumed* 25k in return), the more traditional and less rigorous way.

Or

2. Measure ROI in three steps: First, calculate the cost of initiatives (**input**). Second, determine the variables that will be impacted by the initiative (**influencer/ impact variable**). Third, calculate the return for that impact/ change initiative (**return on investment**). (E.g. 10k for a service = increased retention).

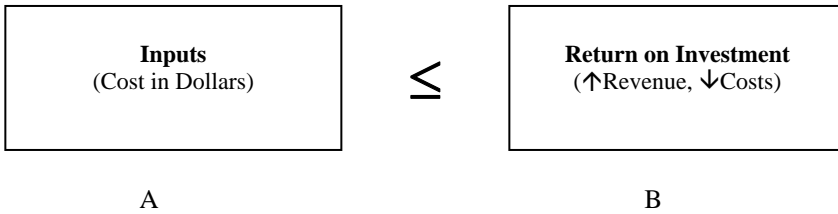
Example: Attrition in 2004 was 15% at the Director Level and above. Post-initiative attrition was 12% at Director Level and above. Attrition at the Director Level and above costs the company \$650,000 at 15%. After the initiative, the attrition rate at the Director Level and above was 3% less or \$450,000 in net cost to the company. Thus, the initiative has an ROI of \$200,000 in net savings on a \$10,000 investment.

The focus of this article is to present and investigate options for measuring ROI that incorporate these influencers in an effort to see value added through various success metrics. Specifically, we will look at OD/HR initiatives such as recruiting, selection, training, performance management, coaching, and succession management.

Our Basic Models

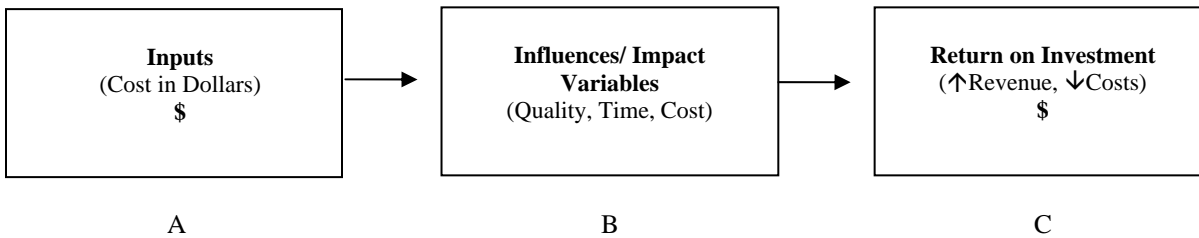
1) The traditional model of looking at ROI is:

Input should be equal to or greater than the Return on Investment:



**When the units in A and B are expressed in dollars*

2) The new model that will be used to research the ROI includes organizational influencers:



**When OD initiatives cannot easily be measured in dollars, we refer to impact variables (B) as success metrics that correlate to dollars (C).*

Value Analysis: Components to Calculate ROI of OD/ HR Initiatives

I. Recruiting

- A. Inputs:
 - i. Recruiting costs
 - ii. Advertising costs
 - iii. Resume management
 - iv. Branding
- B. Organizational Influencers/ Impact Variables:
 - i. Higher retention (lower attrition rates)
 - ii. Reduce turnover, etc.
- C. Return:
 - i. Cost per hire per level
 - ii. Revenue per employee

II. Selection

- A. Inputs:
 - i. Sourcing costs
 - ii. Hiring costs
 - iii. Person-job fit
 - iv. Time and productivity / Time of selectors
- B. Organizational Influencers/ Impact Variables:
 - i. Orientation process
 - ii. Assimilation
 - iii. Management
- C. Return:
 - i. PBT (profit before taxes) per employee
 - ii. Productivity: individual, team, and organizational levels
 - iii. Productivity over time

III. Training

- A. Inputs:
 - i. Needs assessments
 - ii. Cost of training and development per employee
 - iii. Cost of lost opportunities/ work
 - iv. Cost of lost sales (for sales staff training)
 - v. Project management costs
- B. Organizational Influencers/ Impact Variables:
 - i. Retention
 - ii. Technical competence
 - iii. Organizational commitment
- C. Return:
 - i. PBT per employee with training vs. no training
 - ii. Productivity per employee
 - iii. Prevented cost of lost opportunities
 - iv. Prevented cost of future mistakes

Value Analysis: Components to Calculate ROI of OD/ HR Initiatives
(Continued)

IV. Performance Management

A. Inputs:

- i. Hourly cost of implementation (employee hours)
- ii. Cost of design
- iii. Cost of performance management software
- iv. Cost of training
- v. Cost to warehouse data

B. Organizational Influencers/ Impact Variables:

- i. Feedback to employees
- ii. Employee-manager relationship

C. Return:

- i. Productivity: individual, team, and organizational levels
- ii. Revenue per employee

V. Coaching

A. Inputs:

- i. Costs of assessments
- ii. Costs to do coaching
- iii. Time away from daily work

B. Organizational Influencers/ Impact Variables:

- i. Financial impact/ benefit because of behavioral changes in the coachee
- ii. Improved business performance, communication, and leadership skills
- iii. Motivation, employee morale, employee commitment

C. Return:

- i. Cost of turnover
- ii. Employee productivity
- iii. Satisfaction and commitment of direct and non-direct reports

VI. Succession Management

A. Inputs:

- i. Cost to design program and software
- ii. Cost of assessments

B. Organizational Influencers/ Impact Variables:

- i. Successful incumbent
- ii. Meets financial projections
- iii. Satisfies stakeholders

C. Return:

- i. Prevented cost of lost time
- ii. Employee productivity
- iii. Cost to hire from outside vs. promote internally

Factors that Fortune 500 Companies are Measuring

- Turnover costs
- Employee replacement costs
- Economic value of employee behaviors (absenteeism, smoking, etc)
- Economic benefits of developing a superior selection test
- Economic benefits of various training levels
- Economic benefits of additional recruiting
- Economic benefits of increasing job satisfaction, organizational commitment, or similar job attitudes
- Economic benefits of high, medium, and low performance on a particular job

General List of Human Capital Success Metrics

- Average change in performance-appraisal rating overtime
- Climate surveys
- Customer complaints/ praise
- Customer satisfaction/ loyalty
- Employee commitment survey scores
- Employee competency growth
- Employee development/ advancement opportunities
- Employee job involvement survey scores
- Employee satisfaction with advancement
- Employee turnover by performance level and by controllability
- Extent of cross-functional teamwork
- Extent of organizational learning
- Extent of understanding of the firm's competitive strategy and operational goals
- Extent to which employees have ready access to the information and knowledge that they need
- Extent to which employees are clear about the firm's goals and objectives
- Extent to which hiring, evaluation, and compensation practice seek out and reward knowledge creation and sharing
- Percentage of employees making suggestions
- Percentage of female and minority promotions
- Percentage of intern conversion to hires
- Percentage of workforce that is promotable
- Percentage of employees with experience outside their current job responsibility or function
- Percentage of retention of high-performing key employees
- Perception of consistent and equitable treatment of all employees
- Performance of newly hired applicants
- Planned development opportunities accomplished
- The ratio of HR employees to total employment
- Requests for transfer per supervisor
- Retention rates of critical human capital
- Success rates of external hires
- Survey results on becoming the "Employer of Choice" in selected, critical positions