HR's New Role: Creating Value

This article is based on an interview with Jim Pepitone and was published in *HRfocus*, a newsletter from the American Management Association – January 2000

In today's competitive business climate, HR must shed its gatekeeper image and evolve into an innovator that can continually create value for the organization it serves.

"Because HR influences or controls most of the managerial systems that impact workforce performance, productivity, and employee satisfaction, it is well positioned to create substantial value-added," says Jim Pepitone, managing director and chief scientist of Dallas, Texas-based Pepitone Worldwide, a management consulting firm specializing in the design of high-productivity work systems. In an interview with *HRfocus*, Pepitone explains how HR can readily demonstrate the value it now creates and how it can create substantially greater value.

According to Pepitone, HR creates value in two ways: (1) by having a substantial positive impact on performance and (2) by reducing the resources consumed in meeting enterprise workforce needs. This value-creation formula reads this way:

$ Impact on performance – $ Consumption of resources = $ Value-added

The dollar impact on performance is the market value of the results created by an initiative. The dollar consumption of resources amounts to the resources consumed by the initiative. For HR, such an initiative could be any effort to improve workforce performance, productivity, or employee satisfaction; the key figures are the financial improvement to operations and the cost to create this improvement, he explains.

Defining and Measuring Value
Value is a finance term—a projection of the worth of something—and should not be confused with accounting terms such as profit, margin, or ROI. Value is an estimate of future benefits, whereas accounting is concerned with what happened in the past. Furthermore, value is determined by potential buyers, i.e., the market, and often includes subjective factors that cannot be accounted for based simply on costs.

One example of value creation we can all relate to is real estate development. For example, a developer buys land, adds infrastructure like roads and landscaping, and then sells you an individual lot at a higher price than the cost of the bare land and proportionate development expenses. The buyer sees value-added in the lot when he thinks of how well a house on it suits his lifestyle. Likewise, HR can create value for an organization by finding ways to improve workforce performance, productivity, and satisfaction by creating a positive financial impact on operations.

Says Pepitone, “For HR, management is the customer, so the value of any initiative equals its worth to management. To estimate the value of any service or initiative, HR needs to ask management, ‘What is it worth?’ then proceed accordingly. If management doesn’t see much value, then HR needs to refocus on initiatives in which management will.”

Trying to estimate management’s perception of value is a good place to begin. HR should calculate the value-added of every existing HR program or service by taking the following steps:

1. Calculating an estimate of the financial impact on operations.
2. Considering the casual relationship and roughly guessing what percent of the impact management would say is attributable to HR.
3. Calculating the “present value” of HR’s percent of the impact using a time period management is likely to use (e.g., six months, two years, five years, etc.).
4. Getting management’s buy-in by sharing your figures with them, yet accepting any changes they propose.

Pepitone illustrates his point with this example. “I recently joined an SVP of HR in a customer meeting, during which time the general manager expressed concern that her operation was not getting enough qualified applicants applying for jobs. When I asked about the impact this was having, she replied that it was substantial and had increased training costs and turnover, reduced product and service quality, reduced repeat business, and probably damaged the company’s market image. I then asked about the financial consequences of leaving this situation as it was, and she replied that she felt it was costing the company $150-250K per month in training and recruiting costs, $1-2M a month in lost business, and possibly irreparable damage to the company’s image. We then went to a white board and outlined these estimates in some further detail, adding additional areas of adverse financial impact before arriving at a total of $45-$50M (net present value). Now with the customer’s perception of value clearly in mind, HR could design an initiative to solve this problem and realize the potential value-added.”

Once management sees the value, attention shifts to concerns as: How quickly can we get started? What will you do? What evidence do we have that it will work? Is it something our competitors are doing or know about? “That’s the beginning of a true partnership,” explains Pepitone. Additionally, HR will want to keep management in the loop during the design and delivery process.

HR Takes the Lead

In today’s new business order, management is looking to HR to lead initiatives that improve workforce performance, productivity, and satisfaction, says Pepitone. HR can intervene and add value throughout the enterprise it serves by helping it achieve these goals:

1. Development: aggressive goals, improving innovation productivity, creating more new products and services, more new applications, better ideas.

2. Production: higher standards, increased productivity, better product quality, more throughput, fewer disputes.

3. Marketing: outrageous objectives, higher productivity, more customers, more profitable sales, fewer customer complaints.

4. Distribution: step-increased objectives, increased productivity, reduced service cycle-time, reliable on-time delivery, better image.

These efforts create financial value through improved customer satisfaction, competitive advantage, higher unit sales, greater profit, bigger market share, and faster company growth.

The Value-Based Initiative Proposal and Monthly Reports
An important part of this process involves HR creating a "value-based" initiative proposal—a written one-page report for each initiative. The proposal should summarize the following:

1. The client (business unit, department, section, etc., and manager in charge).
2. An explanation of the project, including the following:
   - The project name or reference, description of the current situation, the initiative objective, and the current gap.
   - A description of the entire initiative to produce the outcome desired by management (activity, timing, cycle time, facilities, etc.).
   - Projected value-added (impact on performance, full investment, value-added, and payback period; i.e., the months it will take to recover the investment).

Since HR's worth to management is the sum of the value of its services, value-added should be a key measure in HR's monthly report. "If all that HR reports is activity and expense, it's easy to understand why HR often isn't given the respect it deserves.

As a value-creation center, HR should report on all of its work in terms of the value being created. Creating this report begins with the systematic calculation of the value of its existing services, then listing them in declining value-added order (highest value-adding services at the top). The total value of all of these services equals HR's value contribution to the enterprise.

Pepitone warns that when HR prepares its first monthly value-based report, it may find that some of its services aren't creating value. "If that's the case," he adds, "HR should talk to management about dropping these services and replacing them with initiatives that do. The opportunity for HR to add value in this way is tremendous."

Pepitone predicts that the next several years will present great opportunities for HR managers and practitioners. "There has been a shift in the makeup of the workforce from the machine worker of 100 years ago to knowledge and service workers of today. It will be up to HR to tap that human capital and unleash its inherent greater value."

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