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From Capability to Profitability

Realizing the Value of People Management



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AT A GLANCE

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?

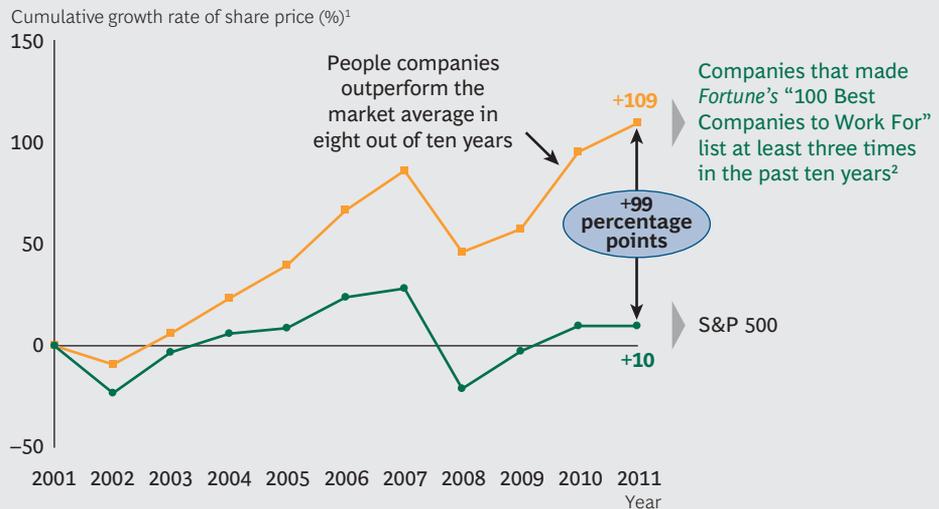
The Boston Consulting Group and the World Federation of People Management Associations (WFPMA) recently conducted major research to probe the relationship between people management capabilities and financial performance. We surveyed 4,288 HR and non-HR managers on their current HR capabilities and challenges, 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.

EXHIBIT 1 | “People” Companies Outperform the Market Average



Sources: 2012 BCG/WFPMA proprietary web survey and analysis.

¹Based on end-of-year closing prices.

²Average growth rate of companies' share prices in percent (weighted by 2001 share prices), dependent on sample composition for each particular year.

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?

EXHIBIT 2 | Economic Influence Is Discernible in All HR Topics but Is Most Pronounced in Six

Topic in which most capable and least capable companies were compared	The impact that the most capable companies achieve over the least capable companies in...	
	... revenue growth	... profit margin
1 Delivering on recruiting	3.5x	2.0x
2 Onboarding of new hires and retention	2.5x	1.9x
3 Managing talent	2.2x	2.1x
4 Improving employer branding	2.4x	1.8x
5 Performance management and rewards	2.1x	2.0x
6 Developing leadership	2.1x	1.8x
7 Mastering HR processes	1.8x	1.8x
8 Global people management and international expansion	1.8x	1.7x
9 Enhancing employee engagement	1.8x	1.6x
10 Providing shared services and outsourcing HR	1.6x	1.7x
11 Managing diversity and inclusion	1.6x	1.5x
12 Managing change and cultural transformation	1.5x	1.4x
13 Actively using web 2.0 for HR and managing associated risks	1.5x	1.4x
14 Strategic workforce planning	1.4x	1.5x
15 Delivering critical learning programs	1.5x	1.4x
16 Managing corporate social responsibility	1.5x	1.3x
17 Transforming HR into a strategic partner	1.4x	1.4x
18 Health and security management	1.2x	1.5x
19 Managing flexibility and labor costs	1.2x	1.4x
20 Restructuring the organization	1.2x	1.3x
21 Managing work-life balance	1.1x	1.2x
22 Managing an aging workforce	0.8x	1.1x

Source: 2012 BCG/WFPMA proprietary web survey and analysis.

Note: Revenue growth and profit margin are defined as categories in the survey. For analysis, categories are transformed into category means; extreme categories are transformed into -20% or +20%. For each topic, we compared average revenue growth and average profit margin of respondents who chose "5" (high capability) against those who chose "1" (low capability).

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

“The whole idea of leader as coach and facilitator will take hold.”

*Cynthia Trudell,
Chief Human Resources
Officer, PepsiCo*

EXHIBIT 3 | In Three Key Areas, High-Performing Companies Differ Substantially from Low-Performing Companies

Compared with low-performing companies, high-performing companies ...

... build stronger people leaders

- 1.5× more likely to have a leadership model that describes expected contributions and behavior
- 1.7× more often have a leadership model that drives promotion decisions
- 2.2× as often make future leadership planning an integral part of people planning
- 3.4× as often make their leaders' compensation and careers dependent on their people development efforts

... do more to attract, develop, and retain talented people

- 1.8× as often try to attract internationals to diversify talent
- 1.4–2.7× more likely to have programs for high- and emerging potentials to improve development and retention
- 1.7–2.1× more likely to offer career advancement opportunities and have clearly defined tracks to improve development and retention
- 2.9× as often better than competitors in offering change of work locations
- #1 reason for workforce relocation is personal development (vs. technical knowledge transfer, the #1 reason for low-performing companies)

... treat and track performance with transparency

- 2.6× as often have clear norms that drive performance
- 2.2× as often use global standards in performance management

Source: 2012 BCG/WFPMA proprietary web survey and analysis.

Note: High performer = top 10% of companies by profit margin and revenue growth; low performer = bottom 10% of companies by profit margin and revenue growth.

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 and that is grounded in company values. 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).¹ 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.² 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.³ 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.

"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

HOW L'ORÉAL IS BUILDING A TALENT ADVANTAGE

With 27 global brands and €20.3 billion in 2011 sales, L'Oréal Group dominates the global beauty-products market. And it has every intention of remaining number one, with a growth target for the next decade of more than 1 billion new customers.

The linchpin of its growth strategy is building what the company calls its “talent advantage.” L'Oréal has adopted a strategic approach to developing its talent portfolio and allocating resources. Its purpose: to support growth by ensuring a steady supply of leaders and key competencies in critical geographies.

Using quantitative models, HR and business leaders analyze anticipated business needs—such as sources of growth or expanded production—to identify the company's future talent needs. They also examine HR's needs; for example, how much onboarding will be required as a result of recruitment efforts?

Projecting out five years, leaders then calculate the number of people needed by geography, function, and managerial level. The modeling pinpoints oversupplies and gaps, enabling L'Oréal to take preventive action. For example, it allows the company to modulate the career pace of certain employee groups early enough to avoid frustrating talent in the event of a slowdown—or to accelerate it to fill any talent or experience gaps that might arise. HR also projects the costs and potential return on investment of various scenarios. “Talent planning helps us to strategize growth and to support our ongoing transformation,” says Jean-Claude Le Grand, global senior vice president of executive talent.

This supply-and-demand methodology helps L'Oréal to efficiently leverage its multifaceted talent system, which is designed to boost executive talent development. The system involves the following:

- *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.*

- *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."

- *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.

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.

“We have a firmly established performance-management process in place with clear and transparent performance criteria. We apply it consistently across the entire organization. This enables us to continuously promote our top performers and, at the same time, motivate and manage all other performance groups.”

*HR Executive,
global telco*

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

STUDY METHODOLOGY

This study is a preview of the findings of our forthcoming 2012 global survey on people management, which is part of the *Creating People Advantage* series BCG has published annually since 2007.¹ It is also the third global study produced in partnership with the World Federation of People Management Associations (WFPMA). For the 2012 study, we surveyed 4,288 respondents in 102 countries across a broad range of industries, from consumer goods and transportation to banking and health care. From our list of 22 HR topics, we asked companies to rate their current capabilities on a scale of 1 to 5 (where 1 = least capable and 5 = most capable); we then identified the capability gaps between high- and low-performing companies. To

determine the correlation between people capabilities and economic success, we also asked the survey respondents to indicate their revenue growth and average profit-margin change from 2010 through 2011.²

The complete study results, along with comprehensive analysis, will appear in the full *Creating People Advantage* report, to be published in October 2012. Visit bcgperspectives.com for further details.

NOTES

1. The most recent *Creating People Advantage* report, *Time to Act: HR Certainties in Uncertain Times*, was published in September 2011.
2. Due to a technical adjustment, there were two different response-category ranges used for these questions (“10% to 20%” versus “10.1% to 20%”), which showed no impact on the results.

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

1. See *Winning Practices of Adaptive Leadership Teams*, BCG Focus, April 2012.
2. See *Global Talent Risk – Seven Responses*, a report published by the World Economic Forum in collaboration with BCG in 2011.
3. “Make Talent, Not War,” BCG article, December 2011; derived from *Creating People Advantage 2011: Time to Act—Certainties in Uncertain Times*, BCG report, September 2011.

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