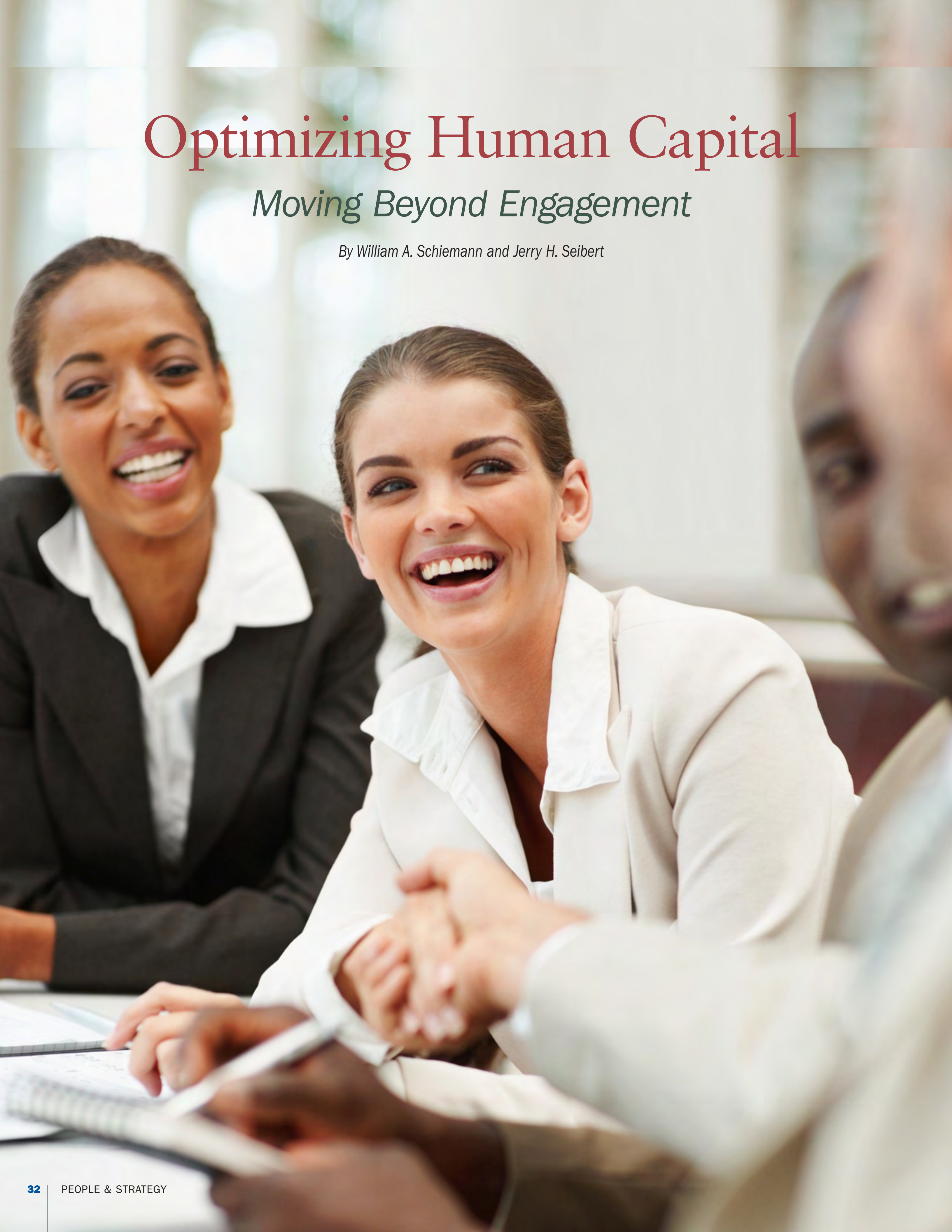
Optimizing Human Capital

Moving Beyond Engagement

By William A. Schiemann and Jerry H. Seibert



Several key questions have plagued human capital research and practice:

- *Why do organizations that get high engagement scores often fail to achieve top quartile financial, operational and customer outcomes, and in many cases, still have significant turnover and performance challenges?*
- *Despite the reductions of headcount during the recent global recession, research by the Metrus Institute has found that only 20 percent of organizations have optimized their huge investment in people (Schiemann 2012). In recent interviews with more than 100 senior leaders, about over four-fifths have expressed indicated frustration with the level of leadership capabilities and bench strength.*

We have found answers to these questions in a human capital framework that was introduced in this publication in 2006. This framework titled "People Equity" includes three factors — Alignment, Capabilities and Engagement (or ACE) — that research has demonstrated is an excellent way to assess how well talent investments are being optimized in organizations. Talent is defined as the collective competencies, values and attitudes, experiences and behavioral dispositions of all labor in which the organization has invested. This article is intended to update the early model introduced in these pages, share further research and, most importantly, to discuss many applications and insights that the model has afforded leaders of business, association and government organizations.

But before taking that journey, we should delineate each of the elements of People Equity:

- Alignment is the degree to which everyone in the organization is rowing synchronously in the same direction. Strong alignment would be indicated by behaviors that are aligned with goals, customers and the brand. Furthermore, and a point of greater emphasis based on our subsequent research, horizontal alignment — units working synchronously together across structural boundaries — is also quite important.
- Capabilities in the People Equity model is defined with the customer in mind. It is the extent to which competencies, information and resources are sufficient to meet internal or external customer expectations.
- Engagement, in the People Equity model, is comprised of three factors: satisfaction, commitment and advocacy. Research that we have conducted over the past several years has shown that high engagement must include high levels of all three factors. For example, when basic satisfaction drivers — job security, compensation and benefits, fairness — dropped in difficult economic conditions, engagement plummeted. In contrast, when satisfaction and commitments are high, organizations that can also achieve high advocacy — such as endorsing the organization publicly — have the highest engagement.

Ralph Izzo, CEO of Public Service Enterprise Group (PSEG) encapsulates this saying, "To be successful, you need great leaders who know how to optimize their talent by focusing it, developing the right capabilities and creating engagement."

The Evidence

Many of the research efforts on People Equity have been published elsewhere, so we will only summarize some of the new insights since the original article. The original article described how People Equity can impact a variety of important organizational outcomes, including higher financial performance, greater quality and lower employee turnover. Subsequently, we and others (Borg, Croenen, et al., 2010) have not only validated this in a variety of organizations and industries, but also extended our understanding of the power of ACE to explain and predict important outcomes. Let's first take a look at some large scale cross-industry findings:

- In a study of 2,041 companies from 30 industries (Kostman & Schiemann, 2005), we found a high correlation between People Equity business results as indicated by financial performance, quality and employee turnover. For example, top quartile People Equity companies had one-half the turnover that bottom quartile companies reported.
- Seibert and Lingle (2007) investigated the challenges of elevating organizations to higher quality, found that People Equity and a Quality culture (e.g., support and use of six sigma, lean) actually have a multiplier effect. While improving either People Equity or Quality processes alone improves performance, the combined effect is multiplicative, often yielding a fourfold increase in performance. This may explain the criticality of not only designing and applying quality processes and principals, but also improving the alignment, capabilities and engagement of those who will use them.
- Seibert and Schiemann (2010) found that internal value was also related to ACE. That is, if we improve ACE in our internal staff and supply chain functions (e.g., HR, IT, Finance, R&D, Marketing, Manufacturing), it also enhances financial and customer outcomes. In the case of internal staff functions, high People Equity departments are rated as delivering far higher value than low People Equity units.
- In a study of outsourcing and suppliers (Seibert and Schiemann, 2011), in addition to documenting some serious shortfalls in the expected benefits from outsourcing, we also gained insights into the importance of having outsourced labor suppliers who are also aligned, capable and engaged with the organization and its mission. If an organization has outsourced a function that used ➤

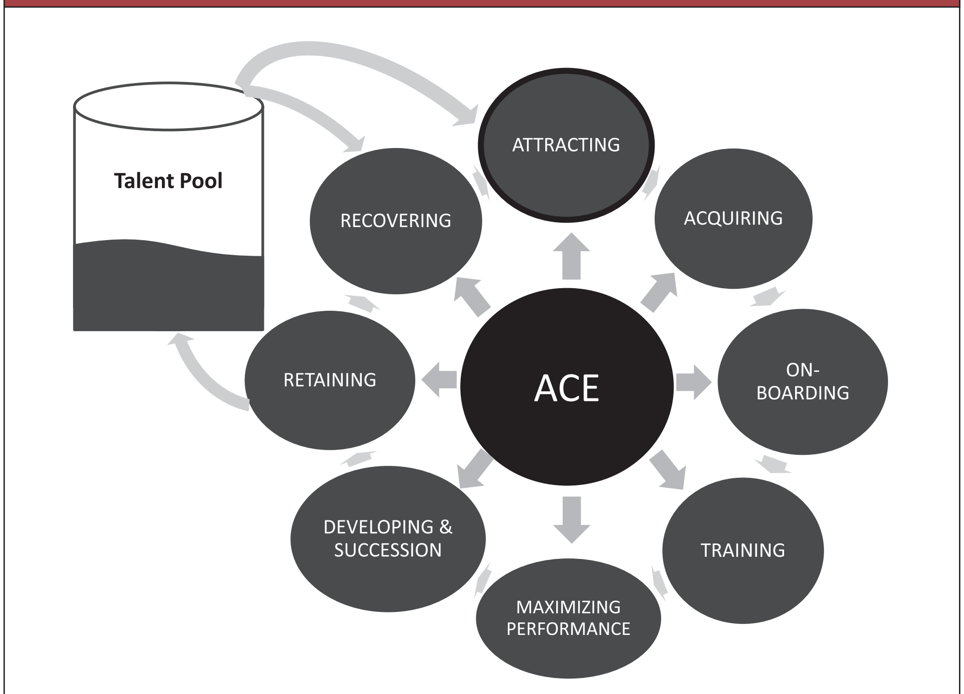
to reside within the organization — or perhaps has those former employees still working on-site but paid by an outsourced supplier — we still want the benefits of high ACE: higher employee retention, discretionary effort, work focused on high priorities and attention riveted on meeting customer expectations.

New Insights

In the past decade since this model was introduced, the Metrus Institute and others have provided a wealth of new insights (Schiemann, 2009; Schiemann, 2012), a few of which are highlights here:

- First, while A, C and E are often correlated, they provide distinct predictive power with each of contributing in different ways to performance:
  - For example, while Engagement is often a strong predictor of turnover, in a variety of studies we have found it not to be the dominant predictor.
  - The Capabilities dimension is often the most important predictor of customer outcomes such as customer satisfaction, retention, complaints, mystery shopping scores and spend.
  - Operating and financial performance may be best predicted by the Alignment dimension, but often are predicted by a combination of all three factors.
- Second, beyond the statistical results, using the ACE framework has been helpful in understanding and overcoming gaps in talent management processes. Thinking through an ACE lens at the talent lifecycle (see Exhibit 1), we have discovered a number of important insights:
  - Performance management, a frequently scorned process, often fails because of a basic conflict among the elements of People Equity. For example, in our attempt to create Alignment by setting clear goals and measures and providing feedback on the gaps, people leaders often compromise Engagement. Providing feedback is a much researched area, requiring developed skills. A review of employee survey databases from Metrus Group over the last 20 years reveals that when managers don't do it well, over 36 percent of employees walk away disengaged. The link to Capabilities is also often sacrificed in the zeal to create Alignment. Managers are often so focused on goals and gaps, that they do not provide sufficient time to coach their people. They come down quickly on Alignment gaps, but not on development ones.
  - Hiring is fraught with challenges that relate to ACE. I/O psychologists tell us that we are lucky to hit 60 percent success rates in hiring (Levin and Rosse 2001). Using the ACE lens, the picture becomes clearer. Senior leaders at executive talent forums that we host repeatedly report that many hires fail due to fit. Competencies are rarely the issue because organizations have honed those selection skills. However, many organizations are ill-equipped to select for ability to become aligned and engaged with their mission and culture.
  - Acculturation is frequently an afterthought during onboarding. Says Susan Bershad, former HR leader at Johnson and Johnson, "Onboarding is often procedural and with little focus on what the managing supervisor is doing." And yet, years of research such as LMX theory (Dansereau, Cashman and Graen, 1973)[1] tells us that bonds are crafted early in a new relationship. Again, gazing through an ACE lens, many organizations focus on Alignment issues (e.g., polices, procedures, goals) or Capabilities (e.g., training) but often miss the early Engagement aspects that are so important to connecting with leaders, peers or subordinates.
  - The top 5 to 10 percent of talent is highly sought after, yet retention of top performers in pivotal jobs[2] (Boudreau and Ramstad, 2007; Cascio and Boudreau, 2011) is a significant challenge. It is often assumed that most departing employees are leaving their supervisor. While this is certainly the case in many situations, we find numerous cases in which training (leading to feelings of incompetence) is deficient or alignment factors are culpable, such as rewards not connected to performance or mismatched values. While some are under the control of immediate manager or coach, others are tied to policies, values, resources or senior leader behaviors.
  - In examining talent processes, we have discovered that ACE is a helpful framework for coordinating the entire talent lifecycle (Schiemann 2009; Schiemann 2012). For many organizations, coordination and communication of consistent messages is a serious challenge. One telecommunications firm excelled in many stages of the talent lifecycle: Great re-

EXHIBIT 1: TALENT LIFECYCLE



1 LMX stands for Leader-Member Exchange

2 Pivotal jobs are those jobs where improving the quantity or quality of the talent has the greatest impact on organizational success.

EXHIBIT 2: ACE PROFILES

Alignment	Capabilities	Engagement	Profile	
↑	↑	↑	Optimized Talent	
↓	↓	↑	Misguided Enthusiasm	Sub-Optimization
↓	↑	↑	Strategic Disconnect	
↑	↓	↑	Under Equipped	
↑	↑	↓	Disengaged	
↑	↓	↓	Unable/Unwilling	
↓	↑	↓	Wasted Talent	
↓	↓	↓	High Risk	

↑ High ↓ Low

cruiting strategies, superior selection and validation tools, great training, sophisticated performance management and innovative retention strategies. Except for one problem: they were not coordinated around a clear Talent Value Proposition (TVP) (Schiemann, 2012) and values that integrated messaging, policies and behaviors across the talent lifecycle. New hires would say “This is not the organization I thought it would be.” Existing employees didn’t believe in the culture that was being espoused to recruits. People who left often reported that such disconnects created trust issues. This major Alignment gap spilled over to Engagement eventually.

- Third, people leaders — immediate managers or coaches — are in the pivotal position to optimize people investments. And yet, less than 20 percent of employees report high Alignment, Capabilities and Engagement within the units in which they work. Many people leaders in our tracking studies continue to have scores well below 40 percent favorable — typically resulting in lackluster performance at best, or customer animosity at worst. Before an organization measures A, C and E, it is easier to cover up real causes and blame other factors for a lack of true leadership skills. After all, isn’t leadership about followership? If a leader doesn’t have people who are aligned with the goals and vision, have optimal competencies and high engagement in the tasks at hand, isn’t something wrong? Are they the right person for a job that requires talent optimization?

  - Of the eight most prominent ACE profiles — combinations of high and low A, C and E (see Exhibit 2) —only one is optimal. The others call for a variety of actions to address the gaps. In some case, such as “strategic disconnect,” something has gone awry in the connection to goals — perhaps the company direction is cloudy or that goals have not been set clearly; or it could be that every unit is competing rather than cooperating to achieve overall goals. In other profiles, such as “under-equipped,” skills, teamwork, information or resources need attention.

- Fourth, can I control ACE? The good news is that we have had time to test the five drivers and four enablers of ACE that we introduced in the original article in this publication (See Exhibit 3) with some new insights:

  - The “talent systems” (originally labeled HR systems) contain a good deal of both predictive and solution power. Performance management is a significant example as we described earlier. It is important to have ways to capture the different elements of these systems so that when there is a gap in A, C or E, one can quickly find out where it is coming from. For example, in one U.S. firm, we found that Alignment was generally the lowest scoring area across the board. When we drilled down to look at the drivers, we found three culprits in the nine drivers and enablers relevant to that organization: the Performance Management in the Talent Systems driver, Direction/Strategy and Structure. Within the performance management systems, we found specific items on the survey that were used to assess Alignment pointed to confusion about top company priorities, misalignments of departments, confusing goals and weak linkage to rewards. This helped the organization reexamine these four areas, recognizing that by improving them, all groups would benefit.

  - Second, the immediate supervisor is a strong contributor to ACE but not the only one. It appears that the immediate manager’s ability to flexibly customize the organization’s systems and policies to the needs of a department, job group

EXHIBIT 3: DRIVERS AND ENABLERS OF ACE

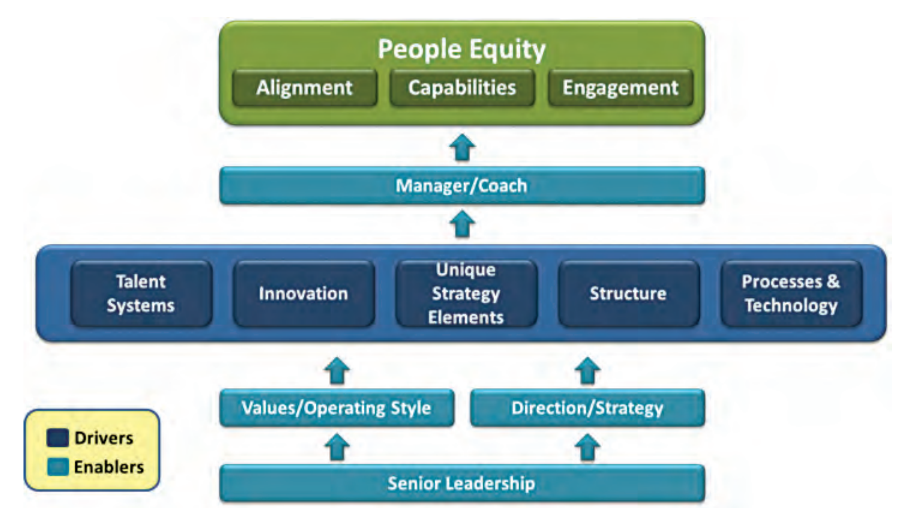
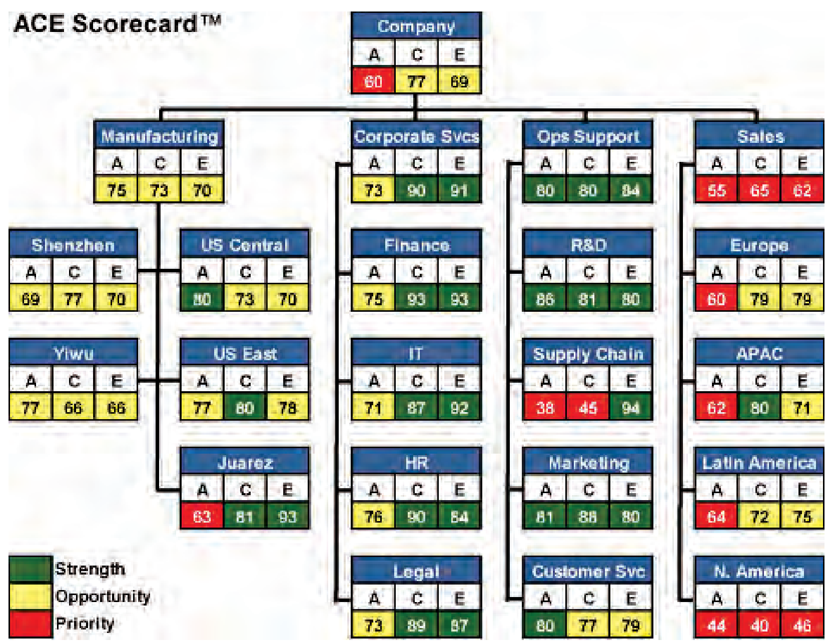


EXHIBIT 4: ACE SCORECARD



or individual people makes a huge difference in ACE. However, supervisors can only do so much, because they are operating within an organization with rules and constraints that can either help or hinder ACE levels. Organizations that are rigid in their talent processes and organizational rules handcuff supervisors and coaches from optimizing their unique talent.

- Third, senior management plays a big role as well. While the manager or coach is the daily quarterback, senior leaders say a lot by their policies, decisions and behaviors. It is not at all uncommon to find employees who are loyal to their managers but score low in Alignment with the organization, or those who will provide discretionary effort for their boss but will not volunteer for organizational activities or advocate on behalf of the organization. Some of the senior leadership issues that we find debilitating to ACE include trust killers such as inconsistent behaviors or communications, failure to behave as they "talk," lack of transparency and outmoded policies such as rigid work hours that are not consistent with emerging cultural practices such as flextime.

- Fourth, structure and processes/technology have both obvious and subtle impacts on ACE. Antiquated IT systems can have an obvious impact on Capabilities. But those same antiquated systems can drag down Engagement over time. Imagine a call center customer service representative who cannot access needed information for a customer because it is "owned" by another part of the business. They can't meet customer expectations (low Capabilities) but they also become frustrated — their enthusiasm and energy will be depleted by regularly trying to manage unhappy callers. A weak IT infrastructure (Processes/Technology driver) combined with organizational silos (Structure driver) makes for a perfect storm.

- Finally, if we want to optimize talent, then we must manage ACE, which means also being able to measure it. While we started out measuring Alignment using a comprehensive audit process (Schiemann and Lingle, 1999), we have achieved better results more cost effectively using a survey of employees (often segmented by business segments or managerial levels) to obtain scores for all three components of People Equity. Additionally, it has allowed us to compare scores on common scales, so that we can assess A relative to C relative to E. This has been useful in helping organizations determine where to focus their first efforts. Exhibit 4 is an example of an ACE Scorecard™ that summarizes the levels of Alignment, Capabilities and Engagement across major units. By using red/yellow/green color coding, patterns within the organizational structure become clear immediately. Both high-performing units and groups that are struggling are quickly identifiable. Consistent themes such as misalignment in the sales division and strong Capabilities in corporate services are also easily observed.

The other insight discovered through measurement is that we can obtain a tremendous amount of information about strategy execution, coordination of priority initiatives, structural barriers, acculturation of new hires, the employer brand and risks by asking managers and employees the right questions in buckets of ACE. We have found that the eyes of the employee (or other labor sources and suppliers) are a great window on the workings of the organization and its relationship to other key stakeholders (e.g., customers, suppliers, environmental or regulatory groups). For example, employees give us an interesting look at customers; when combined with customer value or satisfaction ratings, we can calibrate employees as a reasonable surrogate for customer or consumer issues. By tapping into the thinking of new hires as they move through onboarding and acculturation, and comparing their views with established employees, we gain key insights into the employer brand and how well the organization acculturates new members. Or employees can provide insights into innovation if that is a strategic priority — how ideas are (or are not) generated, developed and implemented.

Putting ACE to Work

The Jack in the Box restaurant group has contributed significantly to our understanding of ACE. Numbering more than 2,200 restaurants throughout the United States and a wide variety of economic environments,

EXHIBIT 5. PERCENTAGE OF PREDICTIVE POWER OF EACH ELEMENT OF ACE FOR KEY ORGANIZATIONAL OUTCOMES

	Alignment	Capabilities	Engagement
Turnover	24%	46%	30%
Productivity	15%	39%	47%
Customer Complaints	35%	38%	27%
Sales	21%	30%	49%
Profitability	21%	37%	42%
Quality	33%	46%	21%

EXHIBIT 6: DRIVERS AND ENABLERS OF ACE: RELATIVE IMPORTANCE

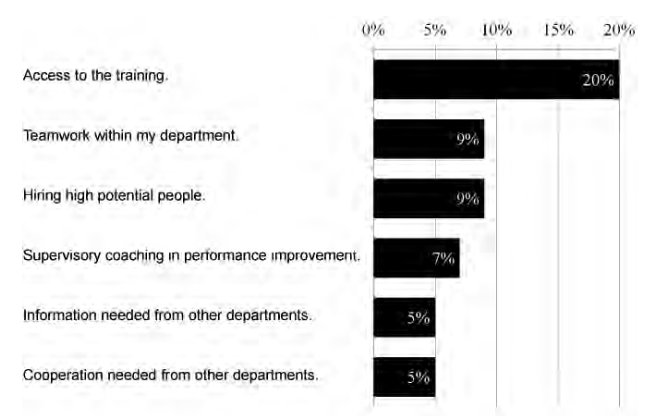
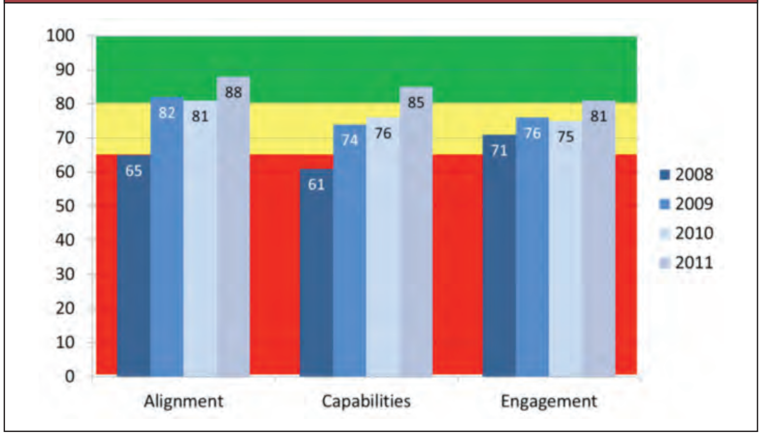


EXHIBIT 7: THE JOURNEY FROM LOW TO HIGH ACE AND BUSINESS PERFORMANCE OF A MAJOR ENERGY COMPANY



they have examined ACE in sound profound ways. We value this study, in particular, because we have been able to control many of the exogenous variables that often thwart clean conclusions about the impact of various actions on organizational outcomes such as profit, customer loyalty or turnover. In the case of Jack in the Box, HR processes and policies are not a factor, because every location has the same hiring, onboarding, training, compensation and performance-management processes. This means that any variance due to HR systems is held constant. This does not mean that HR processes are not important, but that they tend to affect all restaurants in the same manner. Other variables that might create variation could include economic conditions, competitors and so forth. Because of the large number of restaurants across a wide swath of economies, and work we did to track the relationship of People Equity and its components (ACE) across global economic changes, we were able to account for much of this. Another reason we have highlighted Jack in the Box is that it has afforded answers to important questions about how ACE operates and how you can use it to manage more effectively.

So What Did We Learn That Can Be Applied to Other Organizations?

- *Economic Impact on Alignment, Capabilities and Engagement:* Does ACE make a difference in good and poor economic conditions? Yes, we were able to assess the linkage of ACE to important people, customer and financial outcomes before, during and after the Great Recession. ACE is a strong predictor of important business outcomes, although it has an attenuated relationship to turnover during the worst economic times. After all, when few people are leaving, there isn't much variance to predict! This finding is important with implications for how organizations manage during difficult times. While people may not leave (or have intentions of leaving) during tough times, low Engagement produces suboptimal outcomes: withdrawal, lackluster performance where it can be controlled by employee, bad-mouthing of employer, and so forth. Low Alignment means wasted opportunities for accomplishments when staffing may be at its lowest.

- *Why not just use Engagement? Do each of the ACE elements help in making decisions?* An example of the variability of each ACE element in predicting different business outcomes is displayed in Exhibit 5 with some interesting findings. While it is often thought that Engagement is the biggest driver of turnover, for this organization Capabilities is the largest driver of turnover while Engagement is the biggest predictor of Productivity. Capabilities is also the largest predictor of customer complaints. Each organization is different based on its unique culture, strategy, workforce expectations and a variety of other factors. But it all comes together at ACE. If we know ACE, we generally can understand issues related to turnover, productivity, customer loyalty, quality and financial performance.

- Do the drivers provide enough information to focus action? Armed with the information in Exhibit 5, we can then look at the contributors to Capabilities. Based on advanced statistical techniques that tell us the relative contribution of different driver elements, Exhibit 6 displays a variety of different potential contributors to Capabilities. For example, the first item — access to training — is a big driver of Capabilities — about twice as much contribution as improving teamwork and about fourfold more than access to information. This helps HR and line leaders focus limited resources in areas that are most likely to improve Capabilities, which we know is a driver of turnover and customer complaints in this organization. When investigated in more depth, it became clear that some managers were short-circuiting training or "never finding it convenient to free up their team members" for needed training. This left many employees ill-equipped to face customer questions or to do various aspects of their jobs well. Both customers and employee turnover suffered as a result.

An Entrenched Culture—A Tough Case for Change!

Another example of how ACE can help transform a business comes from the energy industry, a sector that has had its difficulties adapting to change, saddled as it is with long-term and, at times, adversarial union relationships, high-tenured employees who prefer the way it was, and leaders who have often been in place for decades. And, yet, the market is demanding newer sleeker energy producers, competing with many similar organizations on price per kilowatt and a whole host of industry standards. Landing in the bottom or even the third quartile of performance today often leads to a new CEO coming in as boards of directors are under increasing pressure to see that their firm is "hitting the numbers." In such an environment, ACE can play a key role in helping to transform the organization.

Take an organization we will call "GridCo," that literally keeps the lights on during sweltering heat, deep freezes, and in the aftermath of hurricanes. When their new CEO arrived, the ACE scores placed them in the third quartile of performance. And organizational performance had much room for improvement. The CEO and his HR leader took quick action to assess the "is now" and set a target to get the organization into top quartile performance, using ACE as a framework for driving this transformation. Exhibit 7 highlights their journey to an optimized talent profile over a three-year period of time. This is an important lesson regarding ACE: Transformation can be accomplished in a relatively short time, but it does require focus, accountability and vigilance.

GridCo accomplished this with the following key steps:

1. It took stock of People Equity, conducting a survey of all employees to obtain ACE profiles such as the examples displayed in Exhibit 4 earlier. Many of the scores were in the 'red,' meaning that the unit was in the bottom half of organizational performance against high-performance organizations. These profiles enabled executives to do several things:
   a. Pinpoint pockets of the organization, and those leaders, that needed support to increase their optimization of talent. This type of variance is almost a given in every organization we have assessed, and a huge opportunity. If you increase the optimization of units that are in the bottom quartile of ACE performance, it raises the performance of the organization overall, not only because the average scores go up, but also because of their performance in interconnected roles with others as business partners or their role in the supply chain.
   b. Look for overall ACE themes: what areas, if fixed, will likely raise all organizational units. Aided by interviews and focus groups, in this case the data pointed toward Alignment.
2. GridCo selected Alignment as a focus point for overall organizational improvement and investigated the key drivers of low Alignment, which included goal clarity, the performance management system and accountability. Executives created challenge and design teams to address the three driver areas. They soon realized that there were management skills, accountability and recognition gaps. The teams created solutions to these areas and implemented them during the following year.
3. At the local level, GridCo focused on the managers who had lower scoring units and provided coaching and support and oversight by the VP of that business segment to increase their talent optimization skills.
4. In round 2, the company conducted a pulse survey to test how well improvements were going, discovering that they had moved into the yellow at second quartile performance. Alignment moved up 17 percentage points — a huge gain for any index in a survey of this type. Also, there were collateral benefits to Capabilities and Engagement, as focus and energy surged and some people were learning new skills. Some of these improvements in A and C were created from improvements among leaders at the local level.
5. Not satisfied to be second quartile, GridCo redoubled efforts during the next year, conducting focus groups in areas such as diversity, knowledge transfer and other challenges identified in the interim survey, with the goal of now increasing Capabilities and Engagement scores. Once again, dedicated groups with executive oversight and strong CEO support identified issues and solutions. Also, they continued the effort to either improve leaders' talent optimization performance or move them to another role if behaviors could not be improved through coaching or other interventions.
6. At the fourth round of assessment, ACE scores hit top quartile performance. The organization was now reaping the accolades of their customers, with higher satisfaction and increased performance on key industry indicators. The CEO was not satisfied to rest on accomplishments, but reinforced to his leadership team that there were still opportunities to improve further.

Challenges in the Use of ACE

While the benefits of using ACE thinking have certainly been rewarding, there are challenges.

- *The relationship of drivers to each ACE element is not constant,* but often vary by organization, culture or strategy. In some ways, this should not be surprising, as we would not expect the same role played by employees of Wal-Mart as we would of Zappos or Apple. Innovation, for example, might be a more important driver for Apple because its business strategy depends on it and it attracts large numbers of people with high expectations in this area. The good news is that this can be quickly assessed. Conversely, service excellence, a hallmark of Zappos or Singapore Airlines, will also attract employees with different service values and skills and expectations. It will be important to align recognition behaviors and processes with these unique aspects of the business.
- The unique aspect of each organization's strategy and culture led to the creation of a "unique business strategy" driver box in the People Equity model (see Exhibit 2) to accommodate these variations; however, we have found that such distinctions occur in a variety of driver and enablers, leading us to conclude that *organizations get more benefits of understanding decision effectiveness and impact by customizing their surveys* to capture unique values, strategies or aspects of the culture. For example, one retailer included questions that actually test understanding of the strategy rather than merely asking if they understand the strategy or direction of the firm, which most respondents will not deny, whether they truly understand it or not.

Understanding and using ACE as a powerful lens helps leaders zero-in to the heart of an organization, challenge leaders and assign accountability for leveraging talent. After all, talent is one of the most precious resources that most organizations have. ACE should help both the organization and its people be all they can be. P&S

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