



## The Blake Group Not Just Consulting. Solutions.™

March-April 2011 Newsletter

### Investing in People is Serious Business

**Question: Does investing in people really make a difference?**

**Answer: Only if you want to make more money!**

There is absolutely a strong correlation between investing in employees and better bottom line performance. Several studies prove the connection. The concept of looking at people as an asset is called human capital management (HCM); and it is not the latest fad. It is a sound business practice. Think of it this way: If you don't take care of your assets, they won't take of you.

Don't take my word for it. I will provide empirical evidence in this newsletter to prove it. However, giving more than lip service is critical if you and your organization want to increase bottom line performance.

First, a Watson-Wyatt study shows that effective human-capital management practices by line managers, and senior management, yielded superior and increased shareholder value. Three key findings from the Watson-Wyatt HCI study can be used to make this case:

- **Superior management practices are leading--not lagging--indicators of financial performance.** This means that effective management practices drive positive business outcomes more than positive business outcomes lead to good management practices. Changes made now will help companies recover more quickly and emerge stronger when the economy rebounds.
- **Shareholder returns are three times higher at companies with superior management practices than at companies with weak practices.** During the boom years of the late 1990s, that difference was significant, but not nearly as large. It's even more important to focus on human-capital superiority in tough times.
- **Not all practices are created equal.** Some create a lot of value. Others actually diminish it. Companies must examine programs and practices to ensure they are adding to shareholder value.

Research clearly shows that 22 percent of employees have left their jobs because of "poor relationships with their managers," according to a survey of 1,308 people. In addition, 25 percent blame their departure on "ineffective leadership," while 30 percent quit to pursue other opportunities because their jobs weren't challenging their skills. Twenty-one percent said they jumped ship because their contributions weren't appreciated. A glaring weakness: Nearly 60 percent of employees say they are not "fully engaged" in their work, causing a sharp decline in morale and productivity, and a corresponding rise in turnover.

### A Champion for Employee Investment

For more than a decade, Laurie Bassi, Ph.D. has been the prophet of investing in companies that invest in their people. Bassi, co-authored a groundbreaking study showing a link between investments in training and company success. Later research demonstrated that companies that spend more on training on a per capita basis do better in the stock market in the year following the investment than do those companies that spend less. Bassi also created an investment fund designed to prove in hard dollars that employee development pays off.

Particularly in today's knowledge-based economy, vigorous training investments make sense. Based on her research, training budgets could signal whether a firm is focused on a long view of success. Bassi and

her business partner Dan McMurrer were able to show that the degree to which an organization is willing and able to take the long view rather than to focus excessively and sometimes destructively on quarterly earnings, training and development investment drops creates better overall performance.

In 2001 Bassi and McMurrer started an investment fund using their research to build a portfolio. The result: Her investment portfolio has outpaced the market as a whole. In their study of 40 publicly traded firms, Bassi and McMurrer found preliminary evidence that companies that invest more heavily in training and development were more successful and profitable. Bassi and McMurrer say their main fund - launched in 2003 - has outperformed the broader S&P 500 index by about one-third on a cumulative basis over the past six years, prior to management fees. Even taking those fees into account, the portfolio has outperformed the S&P 500. Clearly this shows that firms that spent heavily on training showed more net sales and gross profits per employee.

But the most striking difference between big and small spenders on training had to do with stock performance. Bassi and McMurrer looked at a metric known as market-to-book ratio. That ratio considers the market value of all outstanding shares of company stock against the firm's "book" value, defined as its net assets minus liabilities. Over the course of 1996 and most of 1997, companies in the top half of spenders on training per employee in 1996 increased their market-to-book ratio, on average, by more than double the increase found for the bottom half of spenders.

Bassi and McMurrer—and two other researchers—undertook a larger investigation of about 390 publicly traded companies. That 2004 study also found a strong link between training expenditures and subsequent stock market performance. The research also indicated training ought to be seen as an investment, like research and development, that had a future payoff—rather than as a standard administrative cost.

Further, her recent finding is that spending on training is a very strong predictor of bank stock prices. Their primary results – training spending – were recently vindicated in a 2009 study on the banking industry. The report is based on 30 observations about banks, one of the industries for which Bassi and McMurrer have gathered the most data. The researchers conclude that changes in annual training budgets accounted for nearly half the change in banks' stock performance relative to peers a year later.

### **Training Is Serious Business**

There are signs that companies are taking training more seriously. According to the American Society for Training and Development (ASTD), direct training expenditures made up 1.98 percent of payroll in 2001, not counting benefits or taxes. In 2007, the figure was 2.15 percent.

During the recession, companies have not axed training as they might have five or 10 years ago according to ASTD. In contrast to the outdated notion that training is among the first things to go in a downturn, not all organizations trimmed their employee development budgets, and some increased spending.

If organizations are clearer about the connection between training and business results, Bassi's work has served as a foundation. In Bassi's view, the stock market has penalized—in the short run—firms that invest in people. Those people investments are treated as a cost and drag on earnings. Even if Bassi's work up to now hasn't changed that situation much, bigger trends such as globalization may do the job.

In other words, the prophet has a new, larger message. "Increasingly, it will just be good business to be 'worthy,'" Bassi says. "It would be a good thing for the world."

### **Suggested Resources:**

**"Maximizing Your Return on People"** by Laurie Bassi & Daniel McMurrer, *Harvard Business Review*, March 2007.

**Human Capital Management Predicts Stock Prices**, by Laurie Bassi and Dan McMurrer, McBassi & Company, June 2010. Superior human capital management is an extremely powerful predictor of an organization's ability to outperform its competition. This white paper describes some key evidence that supports this claim, and briefly explores its implications.

**“The ROI of Employee Training and Development: Why a hearty investment in employee training and development is so important”**, by Rachele Williams and Lawson Arnett, APQC. A joint APQC, IBM and Workplace Management data collection initiative with more than 200 participants show how investing in your employees through training and development can really pay off.

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