Measuring Return on Investment in HR
A Global Initiative for HR Strategy

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Consider these scenarios: Twenty-three Human Resource professionals convened at a downtown hotel near company headquarters for an all day briefing session. They were joined by a variety of executives including the Chief Financial Officer (CFO). On the agenda was a presentation of eight ROI studies conducted by the HR team. These studies showed the impact, including ROI, of a variety of initiatives such as improving work climate, absenteeism reduction, language training, project management solutions, and leadership development. The presentations were professional, on track, and full of information. The presenters were sharp, but a bit nervous. The audience raised many questions, often stirring up debate among participants and the executives. At the end of the day, the studies were a smashing success, and this was the final step for 12 of the presenters becoming certified ROI professionals. After the presentations, the group adjourned to company headquarters for a presentation by the company's CEO, congratulating the HR professionals for their work and their achievement with an eye toward the next 12 participants coming behind them. Certificates designating these HR professionals as Certified ROI Professionals were presented by the Chief Financial Officer. The recipients were relieved and proud they had reached this milestone. The presentation was followed by a wine and cheese reception and congratulations by many other executives in the firm.

In the second scenario, 25 senior HR executives with the title of Senior Vice President, Group HR Head, or Executive Vice President of HR convened in an airport hotel. For an entire week, they were focusing on one critical topic: building key competencies to conduct ROI Studies. These executives were learning how to measure the impact of a variety of programs such as Performance Management System, Leadership Development, Reducing Lost Time Accidents, Executive MBA, Building Manager Effectiveness, and Employee Retention. For five days, they struggled through assignments, discussed applications, and prepared for presentations. Homework was a standard item on the agenda. The groups practiced presenting ROI studies to the top executive team and developed specific plans to conduct an ROI Impact Study, which was required to become a Certified ROI Professional.

In the third scenario, a group of 22 HR managers met at the conference center of a major organization which served as a host for a five day ROI Certification Workshop. These managers were eager to tackle the subject and were enthused about being there. For many of them, this was a long awaited event. Finally, they were learning how to show their contribution—to make a difference in their organization. Their projects and issues explored were as diverse as this country. At the beginning of the session, the participants detailed the concerns they had about ROI, including measuring ROI for soft programs and building management support for ROI. Ultimately, the goal was to develop the capability to conduct ROI studies, routinely, after they achieved ROI Certification.

No, these scenarios are not in New York, Chicago, or San Francisco. No, this is not some type of Human Resources fad or gimmick. These situations represent what is quietly taking place around the globe. The first scenario took place in Santiago, Chile and involves Codelco, the world's largest copper mining company. The President and CEO, José Pablo Arellano, and the Senior Vice President of Finance, Francisco Tomic, showed their support for the use of ROI as it is used to show the impact of human capital in the organization.

The second scenario was in Mumbai (formerly Bombay), India. The executives were attending with an eye to implement the ROI methodology within their organizations to show the senior executives and other stakeholders the value of human capital. These senior executives at the top of the HR function represented some of the most impressive companies in India. They were willing to devote an entire week to make sure they understood the process completely before taking the time and effort to implement it throughout their organizations.

The third scenario was in Johannesburg, South Africa. The participants represented a broad range of organizations including government agencies, to the rail system, postal services, telecommunications, electric utilities, banking, manufacturing, as well as mining companies. They were the elite, well-known, and respected organizations in South Africa and neighboring African countries. For example, one of the executives in the room was head of HR for Safaricom, a telecommunications company in Kenya. Ultimately, he sent additional HR managers to Washington and London for the same training to implement the ROI process in their organization.

These scenarios and others like them are being repeated globally in over 40 countries as the ROI methodology becomes the new tool for the HR executive. HR executives are frustrated with the lack of respect for HR. They are concerned about the image and contribution of HR and are determined to do something about it. These executives are involved because they want to be involved. They have taken a proactive approach to show alignment, contribution, and results from HR using a process that has been evolving since the 1970s.

History

The ROI methodology, which forms the basis for the certification described in these scenarios, had its beginnings in the 1970's at Lockheed-Martin. There, Jack Phillips conducted an ROI study of the company's cooperative education program involving 350 co-op students. Even in those days, there was pressure to show the results. The first study was published in the *Journal of Cooperative of Education* in 1975. Over 4,000 individuals have participated in the certification workshop and process which is now being conducted in over 30 countries. An ROI global network has been formed and now some 50 books and 200 articles support the methodology.

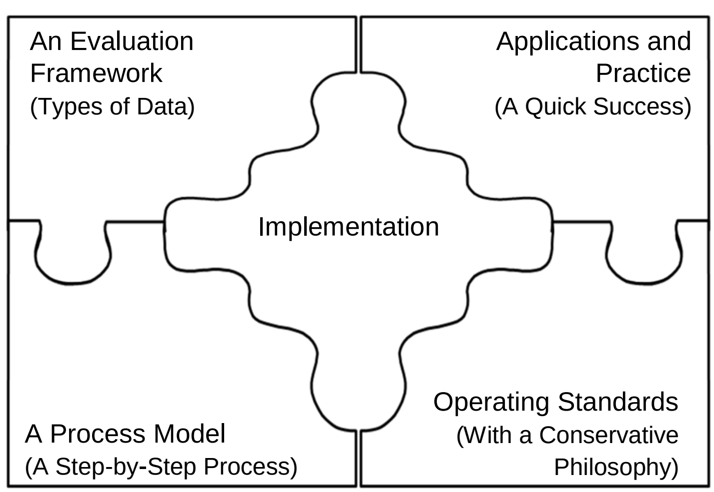
Why ROI?

Calculating ROI has been a valuable measurement tool for a long time – it is not the latest management fad. A century ago, ROI was the emerging tool to place a value on the payoff capital investments. In the 1920's, the Harvard Business Review proclaimed ROI as the tool to measure results. In recent years, the application of the concept has been expanded to all types of investments, including human capital investment. This reflects the growing demand for evidence of positive returns on investing in people and in HR programs. Today, key clients – those funding HR initiatives – require critical evaluation data, and measuring ROI can be a valuable tool for communicating the positive impact of HR's work on the organization. For an ROI process to be feasible, it must balance many issues, including feasibility, simplicity, credibility, and soundness. The ROI methodology described in this article meets these challenges.

Developing the ROI Methodology/Approach

To develop a credible approach for calculating the ROI in HR, several pieces of an evaluation puzzle must be solved and integrated (see figure 1 below). This puzzle comprises five important elements.

Figure 1 – The Key Elements of the ROI Process



The evaluation framework

Figure 2 shows these types of data and our progress with collecting and analyzing them.

Figure 2 –Measurement in the HR Field

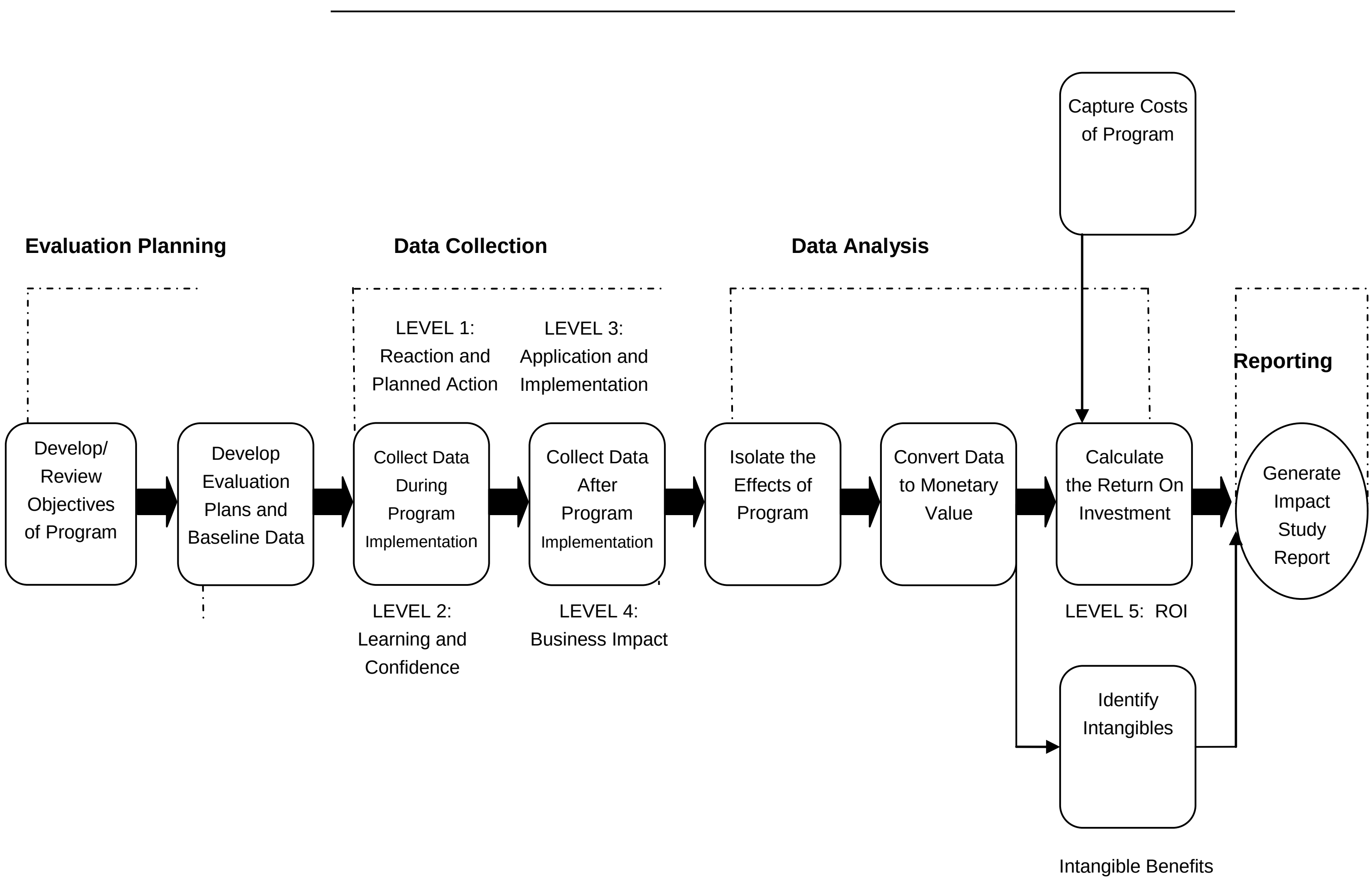
Chain of Impact

Level	Measurement Category	Current Status*	Goal i *	Comments About Status
0	**Inputs/Indicators** Measures inputs including the number of programs, attendees, audience, costs, and efficiencies	100 %	100 %	This is being accomplished now
1	**Reaction** Measures reaction to experience, content, and value of the program	100 %	100 %	Need more focus on content and perceived value
2	**Learning** Measures what participants learned—information, knowledge, skills, and contacts (takeaways from the program)	30–40 %	80–90 %	Must use simple learning measures for most programs
3	**Application and Implementation** Measures progress post-program–the use of knowledge, skills, and contacts	10%	30%	Need more follow-up
4	**Impact and Consequences** Measures changes in business impact variables such as output, quality, time, and cost-linked to the program	5%	10%	This is the connection to business impact. The influence of the program is isolated from other factors
5	**ROI** Compares the monetary benefits of the business impact measures to the costs of the program	1%	5%	The ultimate level of evaluation

*Percent of program evaluated at this level.
Add your percentages

A chain of impact should occur through the levels and types of data as the skills and knowledge learned during the HR program are applied on the job as implementation takes place to produce business impact and drive a positive ROI. It is recommended that data be conducted at all levels when planning an ROI evaluation.

Figure 3 – ROI Process Model



The process model
Represented by the model in Figure 3, the ROI process has been refined and modified over many applications. As the figure illustrates, the process is comprehensive as data are developed at different times and gathered from different sources to develop the seven types of measures. Each part of the process is outlined below.

Evaluation planning. The first two parts of the ROI process focus on critical planning issues. The first step is to develop appropriate objectives for the HR initiatives for each of the levels in Figure 2.

A data collection plan is developed to detail the type of data collected, the method for data collection, data sources, the timing of collection, and the various responsibilities for collection. An ROI analysis plan details how the HR initiative is isolated from other influences, how data are converted to monetary values, the appropriate cost categories, the expected intangible measures, and the anticipated target audience for communication.

Collecting data. Data is collected during and after the launch of the HR program using a variety of methods. Questionnaires, action plans, interviews, focus groups, and performance monitoring are common.

Isolating the effects of the HR program. An often overlooked issue in most evaluations is the process of isolating the effects of an HR program. This step is essential because many factors will influence performance data after an HR program is implemented. Specific strategies in this step will pinpoint the amount of improvement directly related to the HR program. A total of ten strategies have been used to address this important issue. The most common strategies include control groups, trend, line analysis and expert estimated.

Converting data to monetary values. To calculate the return on investment, business impact data need to be converted to monetary values and compared with HR program costs. This requires a value to be placed on each unit of data connected with the HR program. Ten strategies are available to convert data to monetary values.

Tabulating the cost of the HR program. The denominator of the ROI formula is the cost of the HR program. The typical cost components are initial analysis and assessment, development/design cost for the HR program, participant/stakeholder time for the HR program, implementation costs, maintenance costs, administration costs, and evaluating and reporting costs. The conservative approach is to include all these costs.

Calculating ROI

The return on investment is calculated using benefits and costs. See the box for more details on the calculation.

The BCR and the ROI present the same general information but with slightly different perspectives. Here's an example that illustrates the use of these formulas.
An absenteeism reduction program for city bus drivers produced savings of $581,000, with a cost of $229,000. Therefore, the benefit/cost ratio is:

$$\text{BCR} = \frac{\$581{,}000}{\$229{,}000} = 2.54 \text{ (or 2.5:1)}$$

As this calculation shows, for every $1 invested, $2.50 in monetary benefits is returned. In this example, net benefits are $581,000 - $229,000 = $352,000. Thus, the ROI would be:

$$\text{ROI} = \frac{\$352{,}000}{\$229{,}000} \text{ X } 100 = 154\%$$

This means each $1 invested in the program returns $1.50 in net benefits, after costs are covered. The benefits are usually expressed as annual benefits for short-term programs, representing the amount saved or gained for a complete year after the program has been implemented. Although the benefits may continue after the first year, the impact usually diminishes and is omitted from calculations in short-term situations. For long-term projects, the benefits are spread over several years. The timing of the benefits stream is determined before the impact study begins, as part of the planning process.

Identifying intangible benefits. During data analysis, every attempt is made to convert all data to monetary values. However, if the conversion process is too subjective or inaccurate and the resulting values lose credibility in the process, the data are listed as intangible benefits with the appropriate explanation.

Reporting results. A final operational step of the ROI process is to generate an impact study to document the results achieved by the HR program and communicate them to various target audiences. A variety of different reports and formats are used to disseminate the information, ranging from the complete impact study described above to a one-page summary for clients who understand the process.

Standards-Guiding Principles
To ensure that each study is developed in the same way, consistent processes and operating standards for the measurement and evaluation process should be implemented. The following guiding principles should be used as operating standards when implementing the ROI process:

1. When conducting a higher-level evaluation, collect data at lower levels.
2. When planning a higher level evaluation, the previous level of evaluation is not required to be comprehensive.
3. When collecting and analyzing data, use only the most credible sources.
4. When analyzing data, select the most conservative alternatives for calculations.
5. Use at least one method to isolate the effects of the program or project.
6. If no improvement data are available for a population or from a specific source, assume that little or no improvement has occurred.
7. Adjust estimates of improvements for the potential error of the estimates.
8. Avoid use of extreme data items and unsupported claims when calculating ROI calculations.
9. Use only the first year of annual benefits in the ROI analysis of short-term solutions.
10. Fully load all costs of the solution, project, or program when analyzing ROI.
11. Intangible measures are defined as measures that are purposely not converted to monetary values.
12. Communicate the results of the ROI Methodology to all key stakeholders.

These guiding principles will ensure that the proper conservative approach is taken and the impact study can be replicated and compared with others. More importantly, the principles build credibility with, and support from, clients and senior managers who review and scrutinize results.

Application
Another major element of the ROI methodology is application. As with any new change or process, there must be a speedy application to ensure that what was learned is used properly. Participants involved in ROI Certification are required to conduct an ROI study before they achieve certified ROI status. The types of projects undertaken vary and represent any type of project, program, event, or initiative imaginable.

Implementation
The best tool, technique, or model will not be successful unless it is properly utilized and becomes a routine part of the HR function. As with any change, it will be resisted by the HR staff and other stakeholders. Table 3 shows typical barriers to ROI use. Some of the resistance will be based on realistic barriers, while much of it will be based on misunderstandings and perceived problems that may be mythical. In both cases, specific steps must be taken to overcome the resistance by carefully and methodically implementing the ROI process. Implementation involves several issues, including assigning responsibilities, building the necessary skills, and developing the plans and goals around the process. It also involves preparing the environment, team members, and support staff for this type of comprehensive analysis.

The greatest challenge is fear. Some HR staff members do not pursue ROI because they perceive the ROI as an individual performance evaluation process instead of a process improvement tool. A planned implementation will help to overcome these barriers and meet the challenges.

Benefits of ROI Use

With the ROI process, the HR staff and the client will know the specific contribution of an HR program, with data not previously developed nor in a language understood by the client. Measuring ROI is one of the most convincing ways to earn the respect and support of the senior management team— not only for a particular HR program, but also for other HR projects as well. The client, who requests and authorizes an HR program, will have a complete set of data to show the overall success of the process. Throughout the cycle of HR program design, development, and implementation, the entire team of stakeholders focuses on results. Because a variety of feedback data are collected during the HR program, the comprehensive analysis provides data to drive changes in HR processes and make adjustments during program implementation. If a program is not effective, and the results are not materializing, the ROI process will prompt changes or modifications.

Outlook

While the ROI methodology has enjoyed success, it has just reached the tipping point in the HR world. Although the benchmarking results vary by country, it is estimated that in most countries only 10 to 15 percent of HR functions are using this methodology. Yet, the same benchmarking shows that as many as 75 to 80 percent of them plan to use ROI. They wish they were using it now. This huge gap between “actual use” and “wish we were using” creates a great opportunity, but also some great challenges. The payoff, in terms of building support for programs, improving programs and increasing funding for programs, is huge. As more organizations understand the success that can be achieved with this methodology, more will embrace it.

References

Jack J. Phillips and Patricia Pulliam Phillips *Show Me the Money: How to Determine ROI in People Projects, and Programs*, San Francisco, Berrett-Koehler Publishers, Inc., 2007