The Economic Case for People Performance Management and Measurement

Compelling research links financial results and customer satisfaction to engaged employees and channel partners.

Organizations of all kinds understand the importance of promoting their brands, products and services through compelling marketing and selling strategies. More recently, many of these same companies recognize the need to better motivate their employees and channel partners to increase customer satisfaction. Nonetheless, many companies have yet to see the financial benefits associated with connecting the dots between employee engagement, customer satisfaction, and profits. Many continue to address their critical relationships—with customers, channel partners, salespeople and employees—in silos, applying different, often disjointed approaches to engaging each of these separate constituencies.

A growing body of research supports the hypothesis that concrete financial gains can be achieved by linking external to internal marketing communications. The traditional view that engagement cannot be measured no longer applies when it's now possible to much more precisely identify which employee behaviors affect customer satisfaction, and how customer satisfaction can link to profits.

This helps explain the growing interest in the field of People Performance Management and Measurement (PPMM), which seeks to maximize organizational growth through integrated business strategies that align the management of consumer, channel partner, sales and all employee performance improvement efforts. In a PPMM model, engagement is an integrated process that cuts across traditional silos to get employees and all other critical personnel focused on the same customer, company and brand goals.

Intuitively, C-suite executives tend to "get" why a thoroughly integrated strategy better enables them to increase understanding, buy-in and engagement across the organization. More difficult to measure, though, is the return on investment, especially the kind of results that can directly affect quarterly or short-term profits. What do companies stand to gain financially by shifting their marketing to a customer-focused approach that aligns all promises made to customers back through the reseller chain to all employees?

Today, the body of research proving the economic benefits of making this connection has become too compelling for even the most cynical executive to ignore. Many different organizations, coming at the issue in many different ways, have found concrete connections between employee engagement and customer satisfaction, and customer satisfaction and profitability. A sampling of this research includes:

■ **The Russell Investment Group:** A recent, highly relevant study[1] comes from the Russell Investment Group—the investment strategies firm best known for creating the oft-cited Russell Index of stocks. This ambitious study examined the stock performance of publicly traded companies on *Fortune*'s annual list of the "100 Best Companies to Work For".

The findings? Since 1998, stocks on this list returned <u>five times</u> as much to investors as the market in general—a clear correlation between employee satisfaction and economic performance. "There used to be people who didn't believe it," said Amy Lyman, president of the Great Place to Work Institute (which produces the annual *Fortune* list), "but it has proven itself out."[2]

■ **"An Empirical Analysis of the Relationship between Employee Attitudes, Customer Attitudes and Customer Spending."** One of the more compelling studies was led by Dr. Schultz, Professor Emeritus-in-Service at Northwestern University, who has written and researched extensively in the areas of Integrated Marketing Communication, brands and branding, and the development of marketing and communication

About the Forum

The Forum for People Performance Management and Measurement conducts research on the link between employee and channel partner motivation and engagement, customer satisfaction, and financial results. It is affiliated with the department of Integrated Marketing Communicaitons, the Medill School, Northwestern University.

measurement metrics. Dr. Schultz and his team studied the workings of a major hotel chain[3], based on a hypothesis (called the Integrated Internal Marketing model) that, in part, postulates that a key measure of employee value is their impact on the income flows from customers and prospects. In other words, Dr. Schultz's study tested his belief that engaged employees directly, and positively, influence company financial performance.

A key part of the study—which can be found at www.performanceforum.org—evaluated customer visitation and spending behavior as a function of four key "psychological drivers": 1) strives for precision, 2) fast and efficient check-in, 3) options and amenities, and 4) tries to satisfy customers.

The results are illuminating. Of the four drivers, only one—"tries to satisfy customers"—is a significant determinant in terms of how much money hotel guests spend. Schultz's formulation is that a 10 percent increase in the hotel's "Tries to Satisfy" ranking (based on customer surveys) yields a 22.7 percent spending increase over the course of three years.

Further, the same driver—"Tries to Satisfy"—was also the only one to influence customer spending per individual visit to the hotel. A 10 percent increase in these scores can mean (according to Schultz) a 20.3 percent increase in spending-per-visit.

"Employee Engagement, Customer Satisfaction and Profitability."

Working with the Forum for People Performance Management and Measurement, Professor Oakley (of Purdue University) designed a set of organizational surveys to focus on linking internal performance strategies to market and financial outcomes.[4] In particular, the goal was to understand the organizational characteristics that best engender the necessary employee attitudes and behaviors to drive an organization's market and financial success.

The study uncovered a direct link between employee satisfaction and customer satisfaction, and between customer satisfaction and improved financial performance. Organizations with engaged employees have customers who use their products more, and increased customer usage leads to higher levels of customer satisfaction. Further, it is an organization's employees who influence the behavior and attitudes of customers, and it is customers who drive an organization's profitability through the purchase and use of its products. In the end, customers who are more satisfied with an organization's products are less expensive to serve, use the product more, and, hence, are more profitable customers.

> Even Employees Behind the Scenes Affect Customers.

In a subsequent, follow-up study[5], Professor Oakley identified the eight key drivers of employee satisfaction and engagement:

Driver 1: The employee's intention to remain in the organization
Driver 2: Skill variety employees are able to exhibit in their job
Driver 3: Level of customer-service orientation achieved
Driver 4: Degree of coordination between units of the organization
Driver 5: Reduced role conflict
Driver 6: Proper training
Driver 7: Personal autonomy
Driver 8: Effective utilization of expert, referent, and exchange power by managers

Understanding these drivers in order to better satisfy employees is central to a PPM strategy, which in turn is central to enhancing customer satisfaction and profitability.

Towers Perrin/ISR Employee Engagement Report

Towers Perrin/ISR, one of the world's premier employee research and consulting firms, recently conducted what it refers to as one of the most extensive Employee Engagement studies ever, culling from survey data spanning more than 664,000 employees at numerous company types across 50 countries worldwide.

To quote from the prestigious researcher's own briefing, found at www.isrinsight.com: "Previous ISR research found that companies with highly engaged employees have lower staff turnover rates, lower absenteeism, higher customer satisfaction and loyalty…ISR's latest research reveals the difference an engaged workforce can make to the financial performance of an organization."

Specifically, ISR compared the financial performance of organizations with highly engaged workforces to their peers with a less-engaged workforce, over a one-year period.

In ISR's own words, the findings were "striking." Among the findings were that among the companies with high levels of employee engagement, operating income improved by 19.2 percent in the 12 months, while companies with low levels of engagement saw their operating income decline by 32.7 percent.

Further, over the same period, the more highly engaged group of companies saw its net income rise by 13.7 percent, versus a 3.8 percent decline for peer companies. In yet another measure, earnings-per-share (EPS) rose by 27.8 percent among the companies with highly engaged employees; this compares to an EPS decline of 11.2 percent for the other analyzed companies.

Workforce Management

According to David Creelman and Dave Ulrich, the authors of an article titled, "The New ROI of HR: Return on Intangibles,"[6] until the 1980s the typical company was worth about the same as it book value. But, by 2000, the average S&P 500 company had a market value six times higher than book value (a ratio that has since fallen, but the fact remains that company values exceed their balance sheet numbers.)

Why? The authors believe that

people began to better understand the "intangibles" that influence value—intangibles which are influenced by sound people strategies. They cite research conducted by Jeff Pfeffer, who found that "good HR practices account for (business) gains of 40 percent or more." They reference findings from Ernst & Young, Gallup, Deloitte & Touche and Watson Wyatt that all yield similar data—"good people management pays off in both financial and nonfinancial results."

■ **The McKinsey Quarterly**

A recent edition of *The McKinsey Quarterly* posts a new metric of corporate performance: Profit per employee.[7] Author Lowell L. Bryan, a McKinsey director, argues that companies focus too much on measuring returns on invested capital, and not enough on measuring the contributions of their people. He believes that the "intangible" contributions of people are indeed measurable, and that "the most valuable capital that companies possess today is precisely intangible rather than financial."

Like the *Workforce Management* authors, Bryan points to the typically large differentials today between companies' market value and their invested financial capital (book value). He acknowledges that measuring intangibles is difficult, but believes strongly that "strategically minded executives must embrace a radical idea: changing financial-performance metrics to focus on returns on talent rather than returns on capital alone."

Clear Performance Indices

Over the last two decades, organizations have debated the measurability of advertising and traditional marketing, specifically in an increasingly fragmented media world. Whatever its flaws, as is evident from the above-cited studies, PPMM can be measured by:

Return on Investment (such as dividing incremental profits by program investments)

Outcome-based Measurement (areas such as accounts receivable and inventory levels that can be affected by sales improvements), and

Post-Hoc Measurement (making use of historical data, after program implementation.)

The key is for organizations to determine which form (or forms) of measurement makes most sense for their needs.

The Bottom Line

The body of evidence regarding the economic merits of PPMM is clear and growing rapidly. Organizations that quite appropriately obsess over matters such as spending, investment and the costs of manufacturing are well advised to make room for integrated internal and external marketing on their "short list" of factors that most greatly impact their profitability and overall economic performance.

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Footnotes

[1]Evaluation of *Fortune* "100 Best Companies to Work For" List, Russell Investment Group, 2007.

[2]*Motivation Strategies*, www.motivationstrategies.com.

[3]"Testing the Internal Marketing Model: An Empirical Analysis of the Relationship between Employee Attitudes, Customer Attitudes and Customer Spending," Don Schultz, Heidi Schultz, Frank Mulhern and Robert Passikoff; www.performanceforum.org.

[4]"Employee Engagement, Customer Satisfaction and Profitability," James Oakley (Purdue University), www.incentivecentral.org.

[5]"The Path to Employee Engagement," James Oakley (Purdue University), www.performanceforum.org.

[6]*Workforce Management*, "The New ROI of HR: Return on Intangibles," David Creelman and Dave Ulrich, 2006.

[7]*The McKinsey Quarterly*, "The New Metrics of Corporate Performance: Profit Per Employee," Lowell L. Bryan, 2007.