CLARKSTON CONSULTING

Human Capital Management: ROI

Return is one of the most basic financial measures companies consider when evaluating investments, but it has been difficult to quantify in HCM investments. Will an HCM investment in your organization generate new revenue or optimize costs that otherwise would not have been possible? How long before that ROI payoff appears – will it be two years, five years, or never? The Clarkston Consulting HCM ROI Model seeks to answer these questions.

This has always been the Holy Grail of Human Capital Management: ***How do you calculate the ROI of HCM initiatives?***

The Concept of Fully-Loaded Human Capital Costs

The Clarkston HCM ROI model begins with 30+ key metrics for an organization, and extends on those metrics with projections about how a given project will reduce the total, fully-loaded Human Capital cost for an organization. Fully-loaded costs start with the total payroll costs for the organization, including the cost of insurance and retirement benefits, as well as the cost of recruitment and other staff retention and augmentation costs. The developed model reflects the entire cost of the human work force.

The Value in Aggregating Costs

Apart from a few industries like aviation, where fuel is likely the largest single cost, almost every other industry will find that the fully-loaded cost of human capital is the single largest cost they have. For example, consider a 10,000 person organization with a fully-loaded HCM cost of about $300 million annually. If by implementing a new Employee Self Service Talent Management solution, an organization can trim 1% annually from that HCM cost, they have realized significant cost savings and the ROI determination is well under way.

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How the Clarkston HCM ROI Model Works

The key metric of fully-loaded HCM cost is paired with other measures, including but not limited to current and historical turnover rates, and internal and external training percentages and costs. In building into the model these additional metrics, a more holistic view develops that includes the costs of finding, growing, and keeping our human capital. Conservative projections can then be made about how the HCM initiative will help trim those costs.

Projections and Assumptions

Projections and assumptions are a secondary aspect of the Clarkston HCM ROI model.

Suppose an HCM initiative being considered is a Recruiting solution that will allow more accurate hiring of highly skilled resources. As a result, a moderate projection is made about the ability to scale down annual training costs. The Recruiting solution also allows us to reduce dependency on outside search firms. By examining the data, we conclude that search firm costs can be trimmed 5% annually.

Additionally, because the new recruiting solution should allow organizations to recruit more efficiently, it will also enable them to move faster. If the average days to fill open positions can fall from 45 days to 39 days – a significant reduction - this in turn may reduce the cost of supplemental labor. It may also reduce overtime costs among the hourly workforce, and thus add another conservative assumption into the model.

The net result of all of this is that for the HCM project under consideration, the Clarkston HCM Model methodology will inventory and develop more than 30 careful projections of how a project will help trim costs across a holistic view of any organization. Those projections make ROI increasingly apparent for the project.

Incorporating New and Increased Costs into the Clarkston HCM ROI Model

Any project will introduce new costs, and a large portion of those new costs is the initial investment in the project. The Clarkston HCM ROI model looks at the cost profile for a project over a three to five year life, with regards to various categories of cost including consulting expertise, internal labor, licensing, etc.

Transparency and flexibility are the very purpose of the Clarkston HCM ROI model. Without a transparent model, HCM ROI is really just a guess.

For example, during Year 1 of a project, when it is still being implemented, all of the cost is being borne, but none of the benefits have begun to accrue. But in Year 2, benefits emerge. While the major project implementation costs may have subsided, there may be new related costs to consider. There may be additional implementation costs required for upgrades or other enhancements. These kinds of costs may continue to impact project profitability over the course of years 3, 4 and 5.

This same approach is used with the cost savings. It may be that due to pent up demand, or a backlog of bad practices, an organization can accurately predict a 2% reduction in the cost of recruiting in the first year after implementation (Year 2 of our HCM ROI model). Expecting that sort of reduction in costs for years 3, 4 and 5 is not realistic, and as such, the model permits the incorporation of declining returns.

The Clarkston model spreads both new costs and cost reductions across a multi-year horizon, and gives a very accurate projection of real-world HCM ROI. And in most cases, we have the ability to supplement estimates with industry benchmarks and analyst research. The Clarkston HCM ROI model can incorporate any degree of blended projections for maximum accuracy.

The Clarkston HCM ROI Model is Transparent and Up For Debate

Transparency and flexibility are the very purpose of the Clarkston HCM ROI model. Without a transparent model, HCM ROI is just a guess. Our process is designed to build a model that can be exposed, challenged, and most importantly, improved. Questions can be asked. Why did we assume that a better Learning Management System can reduce training-related travel costs by 3% in Year 1? Wouldn't a 2% reduction be more likely?

The goal of the Clarkston HCM ROI model is only that we build a model that represents the truth and let the numbers speak for themselves. The truth may be that the HCM initiative makes great financial sense, or it may indicate that such a project will be a colossal waste of money.

Learn More

To speak to us about the Clarkston HCM ROI model directly, contact **David Watts**, our subject matter expert, at **903-704-0756** or **dwatts@clarkstonconsulting.com**. We are happy to share more details, and work with your organization to better define your Human Capital Management ROI.

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