

Delivering on the promise of HR transformation

Creating an HR operating model that drives the business strategy

Although many companies worldwide have completed, or are in the process of, an HR transformation, there remains a significant gap between what's expected of HR leaders and what they deliver. Drawing on Mercer's global research study, Philip Vernon examines the key challenges to implementing a successful HR transformation.

NEARLY 80 PERCENT of companies globally have completed, or are in the process of, HR transformation. They are being driven by the need to align the HR function more closely with business objectives and by the desire to offer more strategic support to the organization. But many HR departments have yet to deliver improvements from the transformation process, and there remains a significant gap between what is expected of HR leaders and what they deliver.

The definition of HR transformation has evolved out of a number of perceived and real pressures on the HR function. The function is expected to support the business, provide the right direction for the people management strategy, and then execute the strategy. It also has to demonstrate an improvement in value, yet at the same time carry out cost-heavy administration. In response to these challenges, the transformation process that many companies have embarked on involves examining the HR strategy and how it supports the business strategy, and then changing the HR operating model to achieve optimum delivery.

Drivers of HR transformation

An 18-month study by Mercer involving 1,100 organizations worldwide revealed a remarkable consistency in the key drivers to HR transformation across the globe. The main driver was the need to align HR delivery with the organization's business strategy. Second was the desire to transform both the perception and reality of HR as a high-cost, low-value function to a low-cost, high-value business partner. Through the transformation process, HR begins to move away from administration and towards a more value-added strategic role. The objective is to align the function with the organization's goals, making it a strategic contributor that's responsive to today's dynamic business climate.

Despite these good intentions, a recent CFO Research Services/Mercer¹ report suggests that while some progress has been made, nearly 60 percent of finance executives still view HR as more of a cost center than a strategic partner.

Data from Mercer's regional HR transformation studies reveal that HR has a very different view and some executives perceive that they are spending more time on strategic activities. Nonetheless, there is no escaping the fact that the incremental gains and demonstrable impact on business performance do not reflect two decades worth of effort. HR is still primarily an administrative and compliance based function with almost 50 percent of its time being spent in these areas. Less than 15 percent of its time is spent on strategic, value-based interventions.

The missing HR competencies

Why has HR so far failed to achieve a strategic focus?

Although four out of five HR functions globally have embarked on some form of transformation, they are yet to be credited with driving business outcomes. The research shows that although the function has strong competence in professional knowledge, team, interpersonal and leadership skills, it lacks competence in financial management, data management and technology. In short, it lacks the skills that are required to deliver the business credibility that HR transformation is seeking to address.

Indeed, the skills of the HR function are seen as one of the major barriers to effective HR transformation. Together with inappropriate skills, the inability of the function to use technology effectively has often meant that significant business investments have been under-utilized. The function has also observed a general lack of business commitment for HR transformation both in terms of the need for HR to play a more strategic role and the confidence in its capacity to do so. In short, the function has neither the skills nor the infrastructure to deliver effective transformation and the business leadership is not always convinced of the need.

The HR operating model: from strategy to action

To achieve success the HR function must attend to its business model and ensure that it is integrated with the business strategy. Mercer's model for HR business design comprises four broad but interrelated dimensions (see Figure 1, right).

When properly aligned, each dimension flows predictably from one to another. More importantly, each dimension plays a critical role in formulating a comprehensive strategy – and, by extension, in maximizing business performance.

In terms of driving effective transformation, the survey showed that the key to success or failure lies within the HR operating model. This is where HR strategy is put into action and the area which was universally identified by organizations as inhibiting progress. The key areas of the HR operating model are sourcing, infrastructure and governance.

Sourcing strategy

The sourcing strategy provides the greatest opportunity to reposition the function entirely and get the most out of limited resources. The main options are:

- insourcing – when all operational, technological and human capital functions are developed and maintained internally;
- co-sourcing – involves a partnership with vendors to share responsibility for operational, technological and human capital functions and resources; and
- outsourcing – where there is a contract with suppliers to provide all operational, technological and human capital functions and resources.

Mercer's regional studies show that outsourcing HR

KEY POINTS

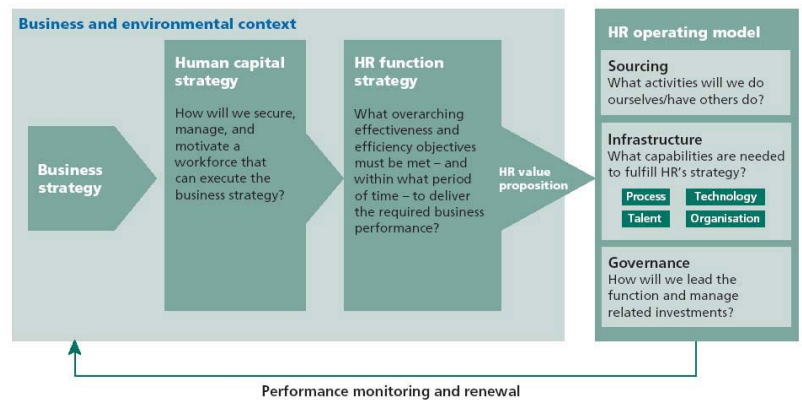
- HR transformation involves examining how the HR strategy supports the business strategy and changing the HR operating model to achieve optimum delivery.
- The key areas of the HR operating model are sourcing, infrastructure and governance.
- Determining the optimal sourcing mix – insourcing, co-sourcing or outsourcing – for the organization requires HR to apply rigorous business analysis and decision protocols.
- Investments in technology and reorganizations of the HR function are often not rooted in strategy. HR process re-engineering receives little focus or direct investment.
- HR governance is usually synonymous with compliance, but a systematic approach can enable the organization to achieve strategic and operational objectives.
- In organizations globally the most respected HR leaders are business executives first and HR specialists second.

activity happens almost everywhere, with US businesses outsourcing more often than those in Europe and Asia. But current outsourcing decisions are rarely taken as a strategic view of sourcing.

In recent years, maturing vendor capabilities and advancing technologies have expanded the breadth and depth of sourcing alternatives available in the

Figure 1. Mercer's model for HR business design

Four dimensions of effective HR business design



marketplace. Determining the optimal sourcing mix for the organization requires HR to apply rigorous business analysis and decision protocols.

An effective sourcing strategy will maximize the return on internal resources by concentrating investments on the areas of core competence and of highest strategic relevance to the organization. It will also enable organizations to take advantage of external suppliers' investments and specialized capabilities that are often prohibitively expensive to



Philip Vernon

is a European Partner at Mercer and works in the area of HR service delivery, organization design and technology enablers. He has a specific knowledge of the HR supplier market, and HR outsourcing and supports clients which are considering outsourcing some of their HR activities.

- ◀ duplicate internally. Thirdly, it will provide a variable cost structure leading to the ability to scale service capacity to meet organizational needs – an essential requirement given the dynamic nature of today's marketplace.

HR and strategic skills

The Mercer survey shows that HR remains strong in traditional skills such as interpersonal and team skills and functional HR expertise, but weaker in strategic areas including business understanding, cross-functional experience and financial skills.

The gap between traditional and strategic skills must be filled, and the primary solution adopted by 95 percent of respondents is to train and develop existing employees. Less than half would rely on new hires or transferring skills, while around 40 percent would depend on outsourcing to close the gap.

Training is of major importance and has a big part to play in transformation, but it's unlikely to be the only action that a function needs to take. The links between traditional skills and the knowledge now required are being stretched. Administrators may not be effective at planning, strategy and design, while HR generalists are not always the best strategic business partners. The increasing complexity and scope of today's functional strategies demand skills and competencies which were not needed 10 or 15 years ago and are not available through traditional training.

In projects where Mercer has been involved, effective transformation has often resulted in a 35-50 percent turnover of existing staff to obtain the requisite skills and competencies to drive business performance.

Technology and transformation

Over the last 15 years the HR function has been pumping a great deal of money into technology without realizing a return on the investment.

Frequently, HR technology projects don't deliver the expected results, and a key factor in this is a failure to define functional requirements clearly. By not rooting these requirements in a solid HR strategy, organizations spend too much money on ad hoc software purchases or, even worse, under-use multi-million dollar HR software suites by not implementing modules that could be of significant value.

Within many organizations a large portion of purchased functionality in Human Resource Information Systems (HRIS) goes unused, ending up as shelfware – in other words, software modules are bought but not implemented. The modules most likely to be left on the shelf are those considered key to operational human capital management, including competency and career development, recruitment, performance management and succession planning.

Along with the right software, clean data and tight integration are critical success factors which are often

overlooked. Key stakeholders must have access to accurate, consistent, integrated data which cannot happen unless HR and IT objectives are fully aligned. This successful alignment requires an understanding that changing technology alone will achieve little. Change starts to deliver its value only when supported by and integrated with other elements of the infrastructure – and when part of an explicit HR strategy.

Getting processes right

Process is the third key element of HR transformation. The HR function is process-intense, but basic inefficiencies in many of those processes, which range from payroll administration to employment law compliance, prevent HR from delivering full value.

Companies who are successful at managing overhead costs have a significant advantage over their competitors. In general, organizations can simplify almost half of their HR activities into common processes.

Redesigning and streamlining processes can be the most difficult job facing the function. One of the most effective approaches to process redesign is through activity-based costing that assesses each activity's time and cost, as well as headcount and full time equivalent involvement. Such an approach pinpoints the likely causes of operational problems, quantifies what they cost and reveals how best to solve them. Understanding the details of process cost, process overlap and process effectiveness is at the heart of identifying the opportunities and areas where significant improvements can be made.

HR processes are generally where the function connects with its internal customer, yet process re-engineering often gets little focus or direct investment. Only a third of respondents from Mercer's regional studies indicated HR process change as a current tool for HR transformation.

Structure without strategy

Changes in organization design are commonplace whether at the level of a function or a global workforce. Unsurprisingly, the Mercer regional transformation surveys identified reorganization and redesign of the HR function as the number one transformation activity, with 44 percent of the respondents worldwide indicating that they have redesigned the function in the past year and another third planning to reorganise within the coming year.

However, for every redesign effort that works, three more fail. Failed efforts typically fall into three categories; design without strategic context, design without consideration of other infrastructure elements, and poor execution.

Making governance explicit

Most HR leaders have not been challenged to think formally about governance issues, so they operate with

an implicit (and, usually, imperfect) model. In those rare cases where HR governance is explicit, it's usually synonymous with compliance. Unfortunately, this view of governance is limited and does not reflect the fact that managing human capital makes the HR function responsible for investments that, on average, account for 36 percent of operating revenues.

HR governance is not a strategic objective, but a systematic approach to management that enables the function to achieve strategic and operational objectives. It, therefore, plays a very important role in the successful transformation of the HR function.

Delivering successful HR transformation

The initial task is to define the current state of HR delivery within the organization, and determine the existing business strategy and priorities. It's then important to gain an insight into what the customers of the HR function, the line managers and employees, think of the services they receive and examine the state of HR processes, assessing whether they are efficient and standard across the organization or if they vary by business unit or country.

By applying various tools it's possible to look at the existing technology, the current organizational structure and the company culture, and identify areas of improvement for HR. The next step is to design a new operating model – which may include outsourcing, service centers and new technology – which is configured to provide the best delivery model for the organization.

Getting it right is worth the effort. Dennis Donovan, Home Depot's HR chief, describes effective HR execution as "the difference between plans that become reality and those that go nowhere." He and other HR leaders have successfully connected strategy and execution and he maintains that the "value added of any HR initiative is the result of the quality of the effort, the acceptance of stakeholders and its execution."

Business executives first, HR specialists second

In organizations globally the most respected HR leaders are business executives first and HR specialists second. They partner with and are confidants of their CEOs and leadership teams and often find themselves at the epicentre of corporate change, being given credit for bringing about the toughest of business transformations.

These HR leaders are also being recruited by progressive domestic and global boards. Responding to the intense focus on complying with new corporate governance legislation and increasing investor scrutiny, boards are retooling to ensure they have the right mix of highly qualified specialists, including HR experts.

The price of failing to make the connection between overall business strategy and HR strategy is high. There will be a temptation for the organization to hand over



CASE STUDY: DUPONT EUROPE

The European arm of DuPont, the science solutions organization, considered that it had lost its edge in supporting a rapidly changing business, and made a clear decision to transform its HR function. The function's structure and focus had remained unchanged despite a staff increase of more than 50 percent. Heavy investment in HR technology had failed to improve management information and process functionality.

It became critical for the function to provide focused strategic support for each global business. Business partners were created to act as the connection point between the business units' needs and functional policies and process, and were the pivotal point for organizational change.

The HR function moved its focus to transactional simplicity and consistency, ease of contact and maximizing the technology that had been seen as a serious weakness. It underpinned these changes with a comprehensive and far-reaching skill change in the way HR is delivered and the people who deliver it.

The new leadership team concentrated on ensuring that the disciplines of excellent change management were paramount throughout the initiative. "The business was involved from the outset in the overall direction, implementation and ownership of the change," says Tim Farrell, Dupont Europe's VP of HR. "Without this business focus the transformation would not have achieved all its goals."

The impact within the HR function was significant. More than half the staff and two-thirds of the leadership were changed and a leader with a non-HR background appointed. "Other companies ask me how we managed to push through significant change," says Farrell. "For an insider with lots of friends in HR this would have been much more difficult."

the HR services to an outsourcing organization who will claim to transform the function and make it work at considerably less cost.

But HR functions which grab the nettle – those that convince the business of the value of transformation, can recognize that skills and capabilities in HR can change if needed and can harness technology – will become effective strategic partners and make a positive contribution to the continuing success of the organization.

CONTACT

Philip Vernon

E-mail: philip.vernon@mercer.com

References

1. *Human Capital Management: The CFO's Perspective*, CFO Research Services and Mercer Human Resource Consulting, February 2003

Mercer has recently released its suite of regional research on the state of HR transformation around the world. For more information and a copy of Mercer's "Unfinished Business" Point of View please contact Philip Vernon at philip.vernon@mercer.com or visit www.mercerhr.com/globalhrtransformation