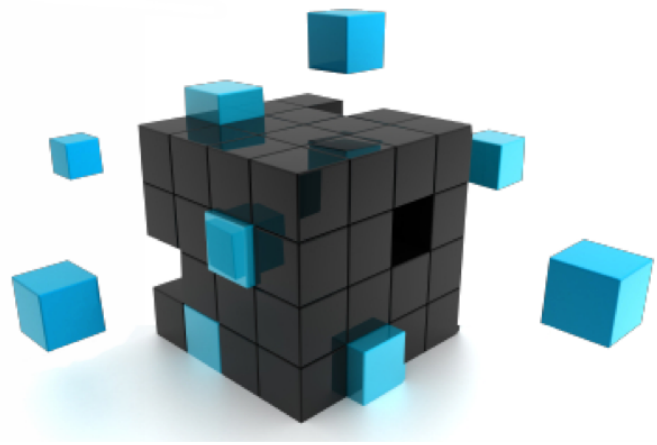
Economic Value Add Of Competency



Citigroup Centre, Level 39, 2 Park Street, Sydney, NSW, 2000 Australia

T +61 (0)2 9004 7810 F +61 (02) 9004 7070 info@onirik.com.au www.onirik.com.au

Abstract

Modern corporations have a reputation for attention to performance management. In particular they have had success with process management and asset management. Top performers (experts) have skills and capabilities (expertise) that often remain an untapped resource in terms of developing commercial effectiveness and productivity. Corporations haven't had the same track record with replicating the talent of top performing managers and front line staff that have direct impact on production throughput and quality.

It is now possible using applied cognitive psychology and Nuero-Linguistic Programming (NLP) modelling techniques to discover how top performers produce their outstanding results. Custom-designed training and coaching programs can teach these effective strategies to average performers, improving their productivity, and enriching their organisations.

Why Model?

The world is filled with human beings manifesting an endless variety of behaviours and abilities. These human abilities are as diverse as being able to effectively negotiate, tell a joke, lead a large group, or operate an excavator or dragline. Many human beings are repositories of abilities in which they are expert, or "exemplars."

Is there a way to quickly transfer the ability of an exemplar to someone who needs and wants that ability? The purpose of modelling is to enable us to answer this question with a "Yes."

Duplicating the talent of top performers (modelling) can produce measurable financial results. Just as successful athletes take on trainers and coaches, and copy the most effective moves or swing to improve their game, so do senior and middle management and key front line staff in successful organisations.

EVA of Superior Performance - Measuring the Financial Value of Competency

It'd make a big difference to your business if everyone on your team were a top performer. The primary objective of modelling is to take a skill inherent in several exemplars' behaviour and transfer that skill to other persons who in similar roles. For the skill transfer to be deemed effective, the learners must be able to replicate the results of the models.

Economic Value Added (EVA), return on investment (ROI), payback period and cost-benefit analysis are being used more and more to evaluate modelling, training, coaching and other capability transfer programs. Significant research has been conducted into the EVA of superior performance.

A competency may be defined as "an underlying characteristic of an individual which has a cause-effect relationship to effective or superior performance in a job". Superior performance is defined as "performance that delivers results one standard deviation, or more, above the mean". This definition may be stated more generally as any individual characteristic (or combination of characteristics) that can be measured reliably and that distinguishes superior from average performance, or effective from ineffective performers, at levels of statistical significance. This superior performance definition of competence (specifically one standard deviation above the mean or the top 15% of performers in a job) is preferred because the EVA of competency improvement programs that deliver superior performance is easily calculated.

The EVA by competency-based interventions is found by:

(1) Determining the EVA by performance one standard deviation above the mean (EVA+1 SD), and
(2) Determining the percentage of this increased productivity attributable to competency vs. independent variables (% EVA attributable).

Therefore the EVA by competency based intervention = (EVA + 1 SD) x (% EVA attributable). As illustrated in Figure 1 (Hunter, Schmidt, and Judiesch 1990), depending on the complexity of the job, researchers have found that performance one standard deviation above the mean is worth between 19% and 48% of EVA in non-sales jobs; and that it results in a 48% to 120% increase in productivity in sales jobs. These percentages are actual productivity or measured EVA "performance distribution" figures - not merely "global estimation" guesstimates by employees, managers, or human resource staff.

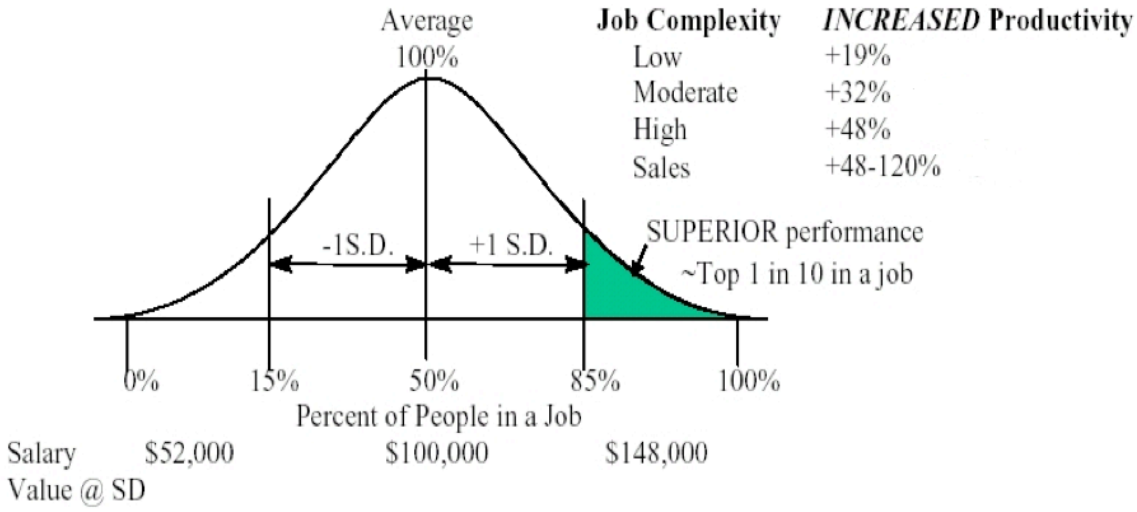


Figure 1 – Distribution of EVA Added by Individual Superior Performance

Based on this chart a simple means of valuing superior performance (i.e. that which is one standard deviation above the mean) for any job is to multiply the average salary for the job (for example, $100,000) by 100% plus the additional percentage of productivity contributed by superior workers. If a superior worker in a complex job is 148% more productive than an average worker, he or she has a productivity salary value of $148,000, even if he or she is paid less than $100,000. Conversely a poor performer one standard deviation below the mean may be paid $100,000 but has a salary value of only $52,000.

Most studies of economic value added by superior performers suggest that such global estimation by salary value is very conservative. First, using the full cost of employment (salary plus benefits plus overhead, usually totalling 1.5 - 2.5 times base salary as the economic value an employee must attain for the organisation simply to break even) is a better method of estimating.

Second, most employees in key roles with direct impact on business results (i.e. valuable jobs) can leverage economic benefits that are vastly greater than their salary or employment costs alone. For example, average salespeople earning about $70,000 in direct salary sell $3 million worth of goods or services. Superior salespeople, who are one standard deviation above the mean, sell 123% more (Sloan & Spencer, 1991). They sell goods and services worth $6.7 million. This 123% difference between superior and average salespeople is at the top end of the 48% to 120% range found by Hunter, Schmidt, and Judiesch (1990) and yet consistent with the independent research. Note also that the $3.7 million in economic value

added is not 123%, but 5,280%, or fifty three times, salary. Even if we only use margin to calculate the value add – let's assume 25% margin – the value add is an amazing 1,320%.

Similar considerations apply for other job roles that have a direct impact on production - front lime managers, equipment operators, field service staff, customer service representatives etc. or teams as shown in Figure 2 below (Hunter, Schmidt, and Judiesch 1990).

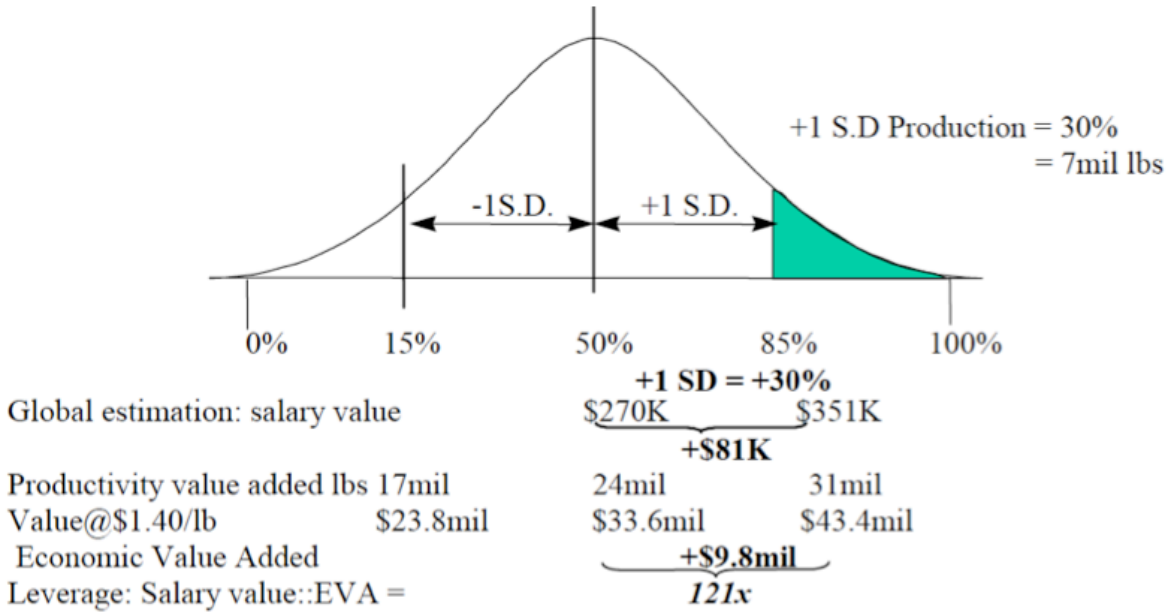


Figure 2 – Distribution of Weight of Production by Factory Workgroups (Teams)

EVA of Shortening the Learning Curve

Modelling activities, training, coaching and performance management also add economic value by:

(1) Shortening the time it takes employees to reach 100% productivity (defined as the average productivity of average experience workers in the job) and,

(2) Increasing productivity by shifting average employees' performance toward that of superior performers.

Using a method involving modelling, training and coaching, and performance management appears a better option (i.e. lower cost and faster realisation of benefits) than replacement for under performers.

The minimum cost of replacing a technical or professional person is generally accepted as equal to his or her direct salary for a year (Spencer 1986); the actual cost is between two to three times direct salary if the full cost of employment, including benefits and overhead, is added to the salary and if lost productivity (from for example, the loss of a production, or a delay in time to market of a new product during those 55 to 57 days it takes to replace an employee) is taken into account (McClelland, 1998; Spencer & Spencer, 1993).

The cost of modelling is significantly less than replacement cost and the accelerated learning curve significantly shorter than replacement time, see the Figure 3 below for the EVA of shortening the learning curve (Hunter, Schmidt, and Judiesch 1990).

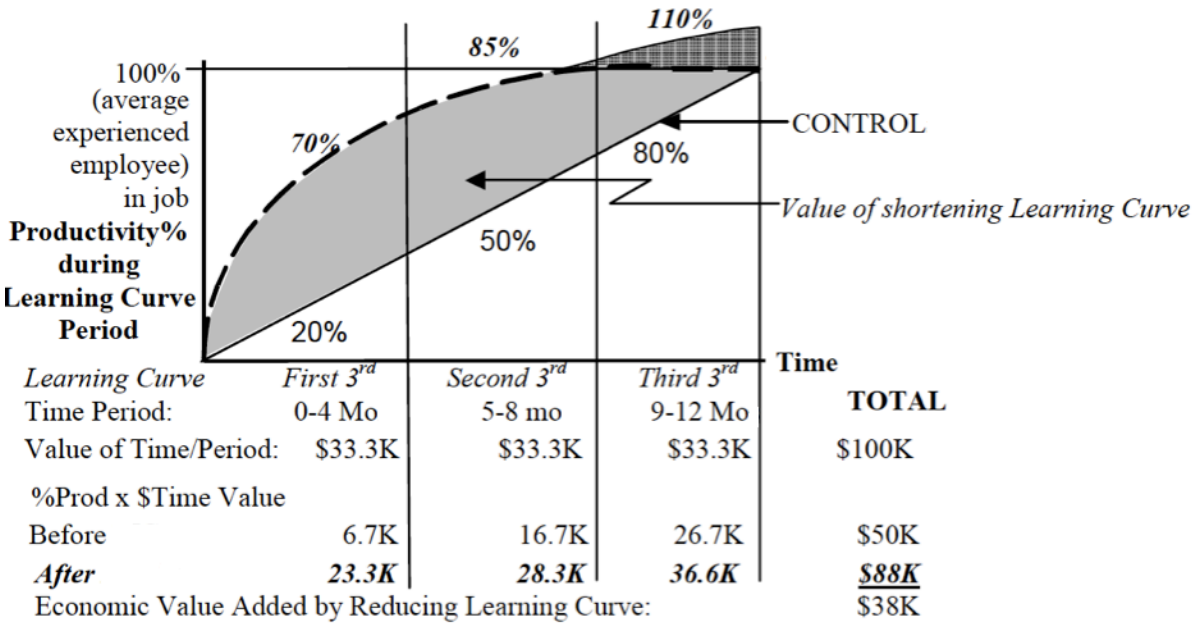


Figure 3 – EVA of Shortening the Learning Curve

Productivity Improvement Case Studies

Onirik has conducted a number of modelling projects with clients. For one client Onirik observed and modelled a number of the organisation's top performing front-line sales staff, including the best performing salesperson with an average close ratio around 90%. Our consultants delivered the model to sales managers and front-line staff.

Prior to our intervention the average close ratio was less than 15%. Four weeks after adopting the high performance models the average conversion ratio increased to over 70%. The project ROI exceeded 400%.

Another client operating an open cut coalmine had high productivity operation with some excavators operating in excess of benchmark. Still the mine had 10% productivity improvement targets in the pipeline and didn't know how they would meet them. There was a 14% gap in productivity (measured in BCM per hour) between the top excavator operators and the least productive operators. Top operators were also more consistent; their production figures varied little between simple digging situations and technically complex or otherwise more difficult digs. There was also a range in performance among the supervisors and thus their teams. Previous traditional training approaches and attempts to copy the easily observed "external" behaviours of the top performers had yielded little lasting improvement.

Onirik engaged in a project provide the capabilities to address these issues by Modelling of top Operators and Supervisors. The results were quick and satisfactory. Within weeks the productivity (measured in BCM per hour) of the excavator operators and truck drivers increased by 19%. The increases endured along with continuing high utilisation and availability measures. The project ROI was over 900% and the payback period less than two months. The project had paid for itself before it was complete – essentially becoming a self-funding exercise.

Conclusion

Whichever way you evaluate skills, you are likely to find an approximately normal distribution of capabilities (that familiar bell curve). Most people fall into the middle range, a few are top performers and

a few are at the other end of the scale. The top performers have skills and capabilities that are a potential gold mine in terms of developing organizational effectiveness and productivity.

The problem has been how to get at these riches. Now it is possible to discover, from top performers, exactly how they produce their outstanding results using modelling techniques. Then, custom designed training can be built to specifically teach these effective strategies to average performers to improve their results. Learning a model makes it possible to compress into a short period the many years of trial and error experience that usually accompany excellence. Completing the process with real time on-the-job observation and coaching shortens the learning curve and ensures that the improvements last the test of time.

As the old saying goes, "If you think staff development is expensive - try ignorance."

References:

Hunter, Schmidt and Judiesch (1990)). Individual differences in output variability as a function of job complexity. Journal of Applied Psychology, 75(1), 28-42.Jones, C. (1986). Programming Productivity. New York, NY: McGraw Hill.
Sloan, S. and L.M. Spencer, Participant Survey Results, Hay Sales Force Effectiveness Seminar, Atlanta: Hay Management Consultants, 1991.
Spencer, L.M. (1986). Calculating human resource costs and benefits. New York, NY: John Wiley & Sons.
McClelland DC (1998). Identifying competencies with the behavioural event interviews. Psychological Science. Vol. 9, No. 5, Sept.
Spencer, L.M. & S. Spencer (1993) Competence at Work. New York, NY: John Wiley & Sons.

About the Author:

Geoff Wade is the Founder of Onirik. Onirik is a team of professionals who focus on business value and measurable outcomes, as the reason for our clients to listen to Onirik. Onirik helps their clients get fast and lasting quantum leap improvements in revenue and margins. Onirik helps clients implement the practical applications of research in the field of modelling experts and expertise.