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VALUING YOUR **TALENT**

Life begins at 80: The human capital management challenges of SMEs

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Championing better work and working lives

The CIPD's purpose is to **champion better work and working lives** by improving practices in people and organisation development, for the benefit of individuals, businesses, economies and society. Our research work plays a critical role – providing the content and credibility for us to drive practice, raise standards and offer advice, guidance and practical support to the profession. Our research also informs our advocacy and engagement with policy-makers and other opinion-formers on behalf of the profession we represent.

To increase our impact, in service of our purpose, we're focusing our research agenda on three core themes: the future of **work**, the diverse and changing nature of the **workforce**, and the culture and organisation of the **workplace**.

WORK

Our focus on work includes what work is and where, when and how work takes place, as well as trends and changes in skills and job needs, changing career patterns, global mobility, technological developments and new ways of working.

WORKFORCE

Our focus on the workforce includes demographics, generational shifts, attitudes and expectations, the changing skills base and trends in learning and education.

WORKPLACE

Our focus on the workplace includes how organisations are evolving and adapting, understanding of culture, trust and engagement, and how people are best organised, developed, managed, motivated and rewarded to perform at their best.

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Overview

'What stage does the management of talent transform from one of the many things you have to do as a functional jack-of-all-trades, to something requiring more expert attention?'

This is the second thought piece in the Valuing your Talent series, which accompanies research being conducted by Lancaster University due for release in summer 2014. This report explores human capital from the perspective of a case study in the SME community, and brings in to focus the challenges and opportunities experienced by SMEs today.

An SME economy

When considering how valuable talent is to the UK economy we have to recognise the contribution made by small and medium-sized enterprises. This is not just because UK businesses with fewer than 50 employees comprise 99.2% of all private sector enterprises. Or that one in every two employees in the UK economy can be found in such an enterprise. No, it has more to do with the fact that for every £3 of sales generated by the private sector of the UK economy, £1 is an SME-generated £1.[1]

Size matters

Conversations with SMEs during the Valuing your Talent (VyT) research project have revealed that in the best of Dickensian traditions, it is simultaneously the best of opportunities and worst of challenges when managing talent in the small and perfectly formed part of the UK economy. Working in a small and tightly knit team not only makes clearer the contribution an individual makes to the organisation but also it makes for smoother communication with colleagues, operations and, ultimately, enhanced performance – at least in theory. Life in SMEs, particularly fledgling ones, is precarious. Even when out of the nest, further problems emerge when companies grow at pace, reach a certain size, or both.

Big organisations, on the other hand, feel impersonal – a point underlined by their even struggling to establish a precise value for headcount. Measuring productivity and calculating the value of your human capital is something of a challenge when nobody is quite sure of what the denominator is. In the words of one FTSE 250 finance director I recently spoke to, *'Have you got any idea just how difficult it is to arrive at an accurate FTE [full-time equivalent] figure?'*

This is less of a problem for one owner-manager, who pointed out to us that managing his talent was relatively easy when he can tick off in his own mind the appraisals completed with Jack, Jill, John, Erica, Ernie and Mary, who comprise his entire workforce. But at what stage does the management of talent transform from one of the many things you have to do as a functional jack-of-all-trades, to something requiring more expert attention?

Opinions vary markedly. Some researchers peg the point at which more advanced HR practices will make a difference at more than ten FTEs.[2] Others suggest 20 or more employees might be the tipping point.[3] But then others think the age of the business,[4] the sector in which it operates[5] or access to HR expertise[6] are the differentiators that matter.

The CIPD's own research with SMEs has highlighted that organisations encounter these

'...what point does a lifestyle become a mature business?'

'tipping points' through either growth or maturity. The tipping points represent times when the current people practices and approaches are no longer suitable for the business's future direction or when there are opportunities to take different approaches.[7]

While academics contest when precisely these tipping points may occur, owner-managers have a clearer sense of when the time for enhanced human capital management has come. In the words of Sean Taggart, chief executive of the SME Albatross Group – which he and his business partner Steve Hornby have been running since completing a management buyout in 2008 – it comes down to the distinction between running either a 'lifestyle business' or a company that is continuously changing and progressing through iterative steps along the way. This begs another question: at what point does a lifestyle become a mature business?

Life begins at 80

Life in SME HR for Albatross appears to have begun at 80 employees. *'That was the point,'* explains Taggart, that *'HR formally went off my desk elsewhere.'* Up until this point, Taggart, a self-confessed people enthusiast, had been running just to keep up with the HR-Joneses. In the words of the CIPD's research, Albatross was well into *'the entrepreneurial stage, [where] the organisation is characterised by informality and contingency, with an emergent strategy, fluid structures, flexible job roles and tacit knowledge exchange [and] learning is mainly experiential and on the job.'*[8] The time had arrived to hand the reins to a colleague with more than just a passing responsibility for people in the business.

For Albatross and, it seems, many other businesses like it, there are two primary drivers requiring a shift to more formal HR processes. First, there comes a point in many owner-managers' lives that they have to cede control of managing their people. The relationship with a handful of employees is wonderful, or at least it is when it is just with them. But with growth in revenues comes a higher headcount, and with them more processes and management distraction. *'It was a bit of me recognising that I wasn't doing a very good job at it: I didn't have the technical expertise,'* reflects Taggart. Such distraction need not be painted in negative tones. But time spent managing people processes back at base is time lost in front of customers or potential ones. This relates to a second driver instantly recognisable to any manager of a fast-growing business of any size: *'I just didn't have the time,'* remembers Taggart.

Balancing cost and benefit

If tipping point number one was the number of employees, tipping point number two was the trade-off between the perceived costs of investing in HR staff versus the potential benefits of having better individuals and processes managing the growing workforce. In the words of the CIPD's research on SMEs, this second 'emerging enterprise' stage is typified by *'stewardship, future-fit [and] is typically characterised by formalisation of the organisation's structure (including team structures and more formalised job roles) and introduction of processes.'*

However, as the organisation is still emerging, flexibility remains important.

And here we move into more complicated waters and the central question driving VyT.

Establishing the returns on your investment in the management of your people is perhaps more pressing for SMEs than it is for large corporates with correspondingly large budgets and architectures supporting a plethora of different managerial and administrative processes. It is perhaps here where the so-called line of sight between people and the performance of the business is at its clearest. The relatively smaller numbers in SMEs makes for a level of increased transparency of the contribution made to performance by individual employees that FTSE 100 HR directors can only dream of.

Our research has unearthed four major benefits to SMEs of engaging more formally with HR management systems to build 'human capital', which we define as the knowledge, skills and value people both bring and add to a business. There will, no doubt, be more, but these four certainly cut across the different types of businesses we have talked to thus far:

1 *The people agenda is always on the agenda:* Taggart says, *'you get HR more consistently in your face. I get someone whose job it is to make it work. It's an agenda on the board meeting instead of me getting to the last five minutes and saying, "what am I going to do about all of these appraisals?"'* It is all very well to talk about being a people-centric company. Investing in human capital requires a level of engagement with the technicalities of people as a capital asset. The primary benefit here, it seems, is the recognition by SMEs that taking their business to the next level also means taking their human capital management to the next level.

2 *It's cost-neutral:* No, really. For Taggart and others, the shift is gradual until a point when the investment more than pays for itself: *'It wasn't a shift from no cost to a big cost. We did things incrementally. And it paid for itself in the first year because we stopped paying for external advice. As a small business you're paranoid about breaking the law. You're forever talking to lawyers, almost every time a pin drops, but over time we became increasingly confident in making our people decisions and leaving the lawyers behind. I honestly can't remember the last time I had a discussion with an employment lawyer. It must be at least five years. So*

there was no cost to us. We just took it out of one place and put it into another place.'

3 *Moving from doing to facilitating:* It is almost as if each SME has to move, admittedly at an accelerated pace, through the same learning curve the HR function in larger businesses has previously passed through. In the words of Dave Ulrich, HR needs to talk less about what it does and much, much more about the value it delivers.[9] Again, Taggart has a story that resonates with many in a similar situation: *'When we first started our HR department we thought it would be the answer to all of our woes. HR was very much doing things all of the time. Then our head of HR went off on maternity leave and we brought in a new person to cover her with two decades' worth of experience. She transformed our HR. We moved during that year from an HR department which does things to an HR department that facilitates things.'* The primary benefit here, then, is getting ahead of the human capital management curve: rather than responding to issues as they arise, human capital management and HR specialists help businesses to align their people's development with the strategic intent of its management.

4 *Capturing the impact:* For all of the talk about the transparency of performance in SMEs, Taggart points to the difficulties in measuring the direct line of causality between people and the performance of the business. He prefers to provide an account of his performance – and it's a convincing one: *'The extent to which I rely on my gut feeling for knowing whether it's worth it or not is disproportionate. I know our retention levels are increasing year-on-year. It's about retaining and building our expertise. This retention matters when you are moving through continuous change. We were, five years ago, a business that was 90% B2B, whereas now it's an equal balance between B2B and B2C. With all of this change going on, investing in HR has allowed us to put people in the right place. So, in terms of performance, we only ever talk about the business moving in one direction. We're lucky. We have carried our [120] people along with us. We have an engagement survey and we've gone from 68% engaged and 2% disengaged, with the balance indifferent several years ago, to now with 79% engaged and 2% disengaged and with the best order book we've ever had.'* Luck certainly plays a part, but in what remains one of the toughest markets in living memory, exponential growth takes more than good fortune.

The five stages of SME HR life

The human capital management trajectory along which Albatross and Shaun Taggart have followed seems to comprise five stages. He is not alone on this track. Large-scale, multinational publicly listed companies are on similar trajectories with some arguably not as advanced as more sophisticated SMEs like Albatross.

It is perhaps greater agility, transparency and locus of control that give smaller companies this advantage. In the words of one SME owner when asked about whether he was concerned about the business changing as it grew, *'you don't worry about the business because it's your business; you have instilled your own values upon it.'*

On this, Taggart again has words of wisdom: *'People worked for us because they wanted to work for the business. We've always said to everyone we come into contact with, "if we ever start to get corporate, please kill us!" We have a business that combines professionalism with personality and we have done our best to retain that.'*

Returning to that journey, trajectory, lifecycle, experience – call it what you will – of human capital management, what can SMEs learn from others' experience?

Stage 1: Regulation
The early years, then, are largely about making do. Doing business is simply more important than 'doing people'. There is a sense, in the words of one owner-manager, that *'you are either contributing or you're not.'* This is Stage 1: the point at which the business honours certain people-related regulations simply because it has to. Training and development is done on an ad hoc, needs-based basis, and in real time and on 'real budgets'. It is also the stage at which one of the paradoxes of human capital management emerges: people at this stage represent a disproportionate amount of the value of the business, and yet the business is very much at a stage where learning and development are far from under control, taking place at levels never to be repeated again but without any real sense of direction. The smart SME players still find time in the middle of this frenetic stage to reflect, decide on a direction and develop themselves accordingly, which usually coincides with the needs of customers and suppliers. Others get lucky. Others fail, and with them, their businesses.

Stage 2: Operational
As the business evolves, demand for more people-related processes grows. Although more sophisticated, and perhaps with 60–70 employees as opposed to fewer than 10 or 20, experiential learning, or more accurately, making things up as you go along and responding to issues if and when they arise, remains the order of the day. For Taggart, at the time, the human capital management processes put in place feel sophisticated: *'We were very experimental. I've always been really passionate about people: seeing them develop and grow. The thing about SMEs is that they do things that they're passionate about because they have that freedom.'*

But what felt like cutting-edge back then is almost cause for embarrassment now. Here again, Taggart underlines the obligation for constant re-iteration of people management: *'We did have reviews. We did have appraisals. Looking back at them now, they weren't very good. But for us that was ground-breaking. The thing in SMEs is that you keep re-inventing the wheel in our little silos and that's what I was doing. I look back at things now and think, "that was so basic, so wrong!"'*

At this stage, with 120 employees now on the books, Taggart felt the time had come to put the basic transactional elements of human capital management architecture in place. *'When you get to 120 people, you have to put systems and processes in place. When you start, everyone does everything. When you get larger, people become narrower and deeper. There was a lot of continual change. One person would be doing one job and we'd say that's too big and then split it. There is an increasing maturity where people begin to become focused and deeper.'* And here most businesses, big or small, remain despite their best intentions.

Stage 3: Analytical

Breaking through into the third stage requires volume, a need as well as an appetite for evidence-based decision-making, and above all, clarity of strategic direction. For the CIPD, crossing this Rubicon to consolidating the organisation is *'characterised by reflection and improvement, where organisations may choose to take a step back, reflecting on what is in place already and assessing whether it is right for their future direction.'*[10] As one famous observer of people's decision-making put it: *'if you don't know where you're going, any road will take you there.'*[11] Only some roads are more expensive and consequently more profit-prohibiting than others.

There is a sense of people analytics being on the agenda for many simply because, enabled by social media and so-called big data, they can. There is a sense of an analytical trap where paralysis by analysis may send a number of well-intentioned SME managers down rabbit holes they would do well to avoid. There is no shortage of external advice, initiatives and other well-meaning interventions on offer.

The utilisation of analytics in HR is more operational and technical than reflective: more information than insight. Taggart certainly made this observation, but he also points out how metrics enable HR to *'bring in bigger issues such as measures of employee engagement, measures of absence and similar related matters. It holds heads of department to account a little bit.'* This challenging role is virtually impossible without data.

Taggart is also keen to point out that HR is the enabler and facilitator of what others in the business are trying to achieve, and with whom ultimate responsibility for people lies: *'HR's a supporting and enabling function. Ownership of engaging and developing our people sits with our owners and heads of department; it does not sit with HR. So responsibility for engagement and ensuring we have the right people in the right place sits primarily with heads of department.'*

Stage 4: Integrated

The key it seems is clarity about what analytics are for. There is a sense that nobody needs to count everything that can be counted. Knowing what needs counting and why is very much the differentiator between those businesses that succeed and those that fail. One owner-manager recently described to me how basic maths was one of the key skills he really needed: *'I needed to do sums quickly in my head during a conversation with my investors. Different scenarios, strategies and financial options were being put in* *front of me and if I didn't get these broadly right, I could find myself a long way from the shore with very little chance of getting back.'*

This stage, then, is when analysis of your human capital plays a major role in shaping the future of your business. Again, for one owner-manager, this was the point at which human-capital-related issues need a champion on the board: *'This is very much something on our agenda at present. Our HR lead is a very good transactional HR person. She gets things done. But we need greater clarity at a strategic level and this requires a different level of experience with integrating people and strategy. It doesn't just happen. Things need putting in place.'*

Taggart, too, highlights the benefits of such an approach: *'HR has allowed us to be a little more aspirational. For example, if I have an idea I can ask my HR director how I'm going to deliver it from a people resourcing perspective.'*

Stage 5: Capitalisation

This brings us back to more human capital paradoxes. As businesses grow and become established SMEs, leaders begin to take stock and reflect on the improvements they can make to their people; the line of sight between their human capital and the overarching performance of their people has become too complex to measure.

This complexity is keenly felt when pivotal employees leave. When a key employee moves on from a small business, perhaps with several other employees, the loss is both immediate and highly transparent – but is it material? Put another way, the cost of replacing talent is surprisingly expensive, even more so when factoring in the lost revenues incurred when key positions are left vacant. And herein lies the issue.

Minimising the time elapsed before a new member of staff can be recruited not only reduces the losses incurred but also reveals the extent to which the company has built an architecture, a complex set of interweaving processes of relationships, resources, skills and talent, like ivy growing round an old stone building. The loss of one employee simply opens up the opportunity to another talented colleague. Not because the employee was replaceable, but because the human capital architectures put in place are robust enough to withstand changes in personnel. In analysts' terms, the whole is greater than the sum of the parts. This is the point at which organisational processes, including HR, have become established.

Some companies' wholes are greater than others, representing a key element of competitive advantage for businesses big and small. It appears that accessing and leveraging this talent, and building the architecture to support it, is perhaps the most important way by which organisations can maximise the outcomes they achieve from their workforce's talent.

Endnotes

[1] See DBIS (2011) *Business populations estimates for the UK and regions 2011* (Statistical Release URN 11/92A), cited in WU, N., BACON, N. and HOQUE, K. (2014) The adoption of high performance work practices in small businesses: the influence of markets, business characteristics and HR expertise. *International Journal of Human Resource Management.* Vol 25, No 8. pp1149–69.

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[8] CHARTERED INSTITUTE OF PERSONNEL AND DEVELOPMENT. (2012) *Achieving sustainable organisation performance through HR in SMEs*. London: CIPD. p8.

[9] Ulrich (1997)

[10] CHARTERED INSTITUTE OF PERSONNEL AND DEVELOPMENT. (2012) A*chieving sustainable organisation performance through HR in SMEs.* London: CIPD. p10.

[11] Dodgson/Carroll (1865)

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