Opportunities for Action

When People Strategy Drives Business Strategy

Companies have never faced more work-force choices, or more important ones, than they do today. Take just one aspect of globalization: Asian sourcing. Work force costs in China and India are likely to be one-fifth–or even less–of the costs in more developed economies. The off-shoring opportunity, however, raises substantial people-strategy questions and related issues: Can you handle the transfer of operations abroad? Are the necessary skills available in the lowest-cost site or is it worth paying more for better-trained engineers and a developed infrastructure? If you outsource abroad, can you protect process expertise and intellectual property? How do you create a common culture?

Developing a people strategy was once a straightforward matter of figuring out how to create the best possible work force to execute an already defined business strategy. But as the examples above suggest, people strategy today involves much tougher choices and tradeoffs. It may actually drive business strategy as much as business strategy drives it. Are you prepared to recognize and take advantage of this transition?

Radical Change

Besides globalization, other developments are challenging the traditional view of people strategy as a translation or implementation of business strategy:

- Sharp shifts in core business processes
- Diversity
- Increased competition for senior managers
- The aging of the work force[1]
- The advent of "people businesses," which have few assets besides their employees[2]
- New technology that drives human resources processes

Collectively, these trends have fundamentally raised the importance of people strategy, changed its relationship to business strategy, and increased the difficulty of implementation. Consider some of the changes that have accompanied the first three trends.

Sharp Shifts in Core Business Processes. Process changes can be so deep and pervasive that business strategy and people strategy become interwoven to the point that it is hard to tell them apart. In the old days of fashion retailing, for example, buyers selected merchandise from suppliers that controlled design and manufacturing. These days, leading retailers in all fashion categories except luxury goods design their own merchandise and write manufacturing specifications. They purchase fabrics and supply them to low-cost offshore garment manufacturers.

To support this new business model, retailers have needed to hire people with capabilities in apparel design and sourcing. Retailers and department stores that have mastered this transformation in capabilities–such as Zara and The Limited–have experienced greater market success and higher profits over the past ten years than their peers.

1. See "Autumn Leaves," BCG Perspectives, June 2006.
2. See *Rules of the Game for People Businesses: Succeeding in the Economy's Highest-Growth Segment,* BCG report, April 2005.

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Diversity. Diversity represents a huge opportunity to gain competitive advantage, but many companies miss out because they view diversity simply as a way to avoid legal liability. In fact, a diverse work force can have substantial benefits, such as helping the organization reach many different markets. Women now control or influence 75 percent of discretionary spending in developed markets worldwide.[3] By 2050, non-Hispanic whites will make up less than one-half of the U.S. population. In diversifying their work forces, companies can gain an advantage by better serving crucial female and minority markets. PepsiCo, for example, has increased sales of its Frito-Lay brand in urban areas by diversifying its sales force.

But diversity is not just a U.S. issue. In addition to facing gender and ethnic diversity issues, companies in Europe must make full use of Europe's many nationalities. Companies still tend to think in terms of national recruiting pools, but highly skilled employees may be more available and mobile across national boundaries than within them. Airbus, for example, recently announced that it was having difficulty filling engineering jobs in Hamburg. Although there are unemployed engineers elsewhere in Germany, they are unwilling to move to Hamburg, so the aircraft manufacturer is looking outside Germany to fill the positions.

Diversity greatly increases the importance of building a distinctive corporate culture. Here's why: Teamwork, which is critical to performance, requires trust. Trust requires a network of clear mutual commitments about "how we do things around here." If nationality, gender, religion, or old school ties no longer form the basis for such networks, how can organizations build them? This is a topic for board-level discussion and action.

3. See Michael J. Silverstein, *Treasure Hunt: Inside the Mind of the New Consumer* (Portfolio, 2006).

Increased Competition for Senior Managers. Hiring and retaining top-level managers is more difficult than ever. Consider the impact of private equity firms, which take a significantly different approach to motivating the managers of their portfolio companies than do their counterparts at publicly owned companies. Private equity owners expect senior managers to have "skin in the game." In return, they reward those managers handsomely with equity payouts. Lou Gerstner's turnaround of IBM involved transforming a culture of entitlement into one of performance and moving from fixed to variable rewards. Gerstner, who worked for private equity owners before his move to IBM, required senior managers to invest, at a minimum, the equivalent of their salary in IBM stock.

Companies with several business units face a particular challenge motivating managers in this way because the success of an individual unit is not measurable unless the business is sold or otherwise valued. The competition for business unit managers is starting to alter the corporate strategies of some multibusiness companies, providing a reason for greater portfolio focus or partial flotation of stock in subsidiaries.

As these examples demonstrate, business strategy and people strategy feed off each other. Unfortunately, at many companies, senior managers do not live, eat, and breathe people strategy. As we outline below, companies that figure out how to integrate employee development, skill building, and recruitment into business activities–and people strategy into corporate and business strategy–will create a winning advantage.

Building People Strategy

In the new environment, people strategy must be embedded in the organization, at the center as well as within the business units and the HR function. Different companies will choose to place responsibility for various aspects of people

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strategy in different areas, depending on their specific challenges and organizational structure. But whatever the balance, we have identified four basic approaches to help a people-oriented system flourish.

Give line managers specific HR responsibilities. Because people strategy critically influences business strategy, line managers need to do more than just manage employees. They need to be deeply involved in people strategy, and the HR department needs to be deeply involved in business strategy. In recognition of this interdependent relationship, best-practice companies are increasingly rotating executives between HR and business units. That is just a small step. Companies should also give line managers specific HR responsibilities and coach them to carry out various HR tasks.

Best-practice companies also deploy scorecards that translate people goals into individual management objectives. For example, Repsol YPF, an integrated oil and gas company, has set up an HR committee that includes key members of the executive committee and is led by the chairman and chief executive. The chairman and his top management team use individual scorecards to plan and track each manager's initiatives relating to such targeted areas as employee development, accountability, entrepreneurship, collaboration, and recognition.

Treat HR like finance. Finance has historically been the most critical and nurtured staff function. The chief financial officer often sits on the board. He or she oversees both strategic planning and financial planning, which form the backbone of corporate anatomy. The HR function should be treated more like the finance function. Companies should consider the following steps:

- Give HR a seat, if not on the board, then at least on the executive committee.
- Explicitly define people strategy and reflect it in the overall business strategy. Organizations need the flexibility to change the business strategy if it is fundamentally incompatible with the HR environment. The process of defining people strategy requires honesty concerning such issues as moving manufacturing offshore or recognizing deficits in leadership, succession planning, employee skills, and diversity of gender, age, ethnicity, and culture.
- Integrate people strategy and goals into the business-planning process. People strategy is not just about strategy but also about implementation. People plans should be developed and monitored with the same care as financial plans, consuming at least one-fifth of a company's overall planning time. Because the people plan and the business plan should dovetail, the former should remain a work in progress until executives know that the latter is achievable.

Develop and deploy standard HR metrics worldwide. Many executives today have "dashboards" on their desktops that give them a quick picture of traditional financial and business performance metrics. These dashboards should also have quantitative and qualitative HR metrics. Quantitative metrics could include employee productivity, attrition, or–to address the performance of the HR function–recruiting success. Qualitative measures should include scores on employee surveys assessing leadership and employee engagement. Now more than ever, companies need to make sure employees are content and motivated. Until senior executives have a fuller and more accurate view of HR activities, the HR function will never achieve its proper role within the company.

Boost the HR organization's performance. If HR does not have its house in order, it will not have the time or credibility to play a strategic role. A few helpful steps can apply to almost all HR organizations.

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As mentioned earlier, rotating high-caliber line managers into the HR organization can increase its visibility and sharpen its business focus. But that is not enough. Through standardization and automation, HR processes can function much more efficiently. Some leading companies are moving certain HR administration tasks into a separate shared-services unit with transparent price setting, clear governance structures, and stringent performance control.

Moreover, new HR technologies allow line managers and employees to take responsibility for HR activities without involving the function in daily administration. There are risks, however, in depending on technology to provide "solutions," especially if that means deploying a global enterprise-resource-planning (ERP) system for HR. In the end, these systems may make sense, but in the short run they can be difficult to implement and quite costly. There are easier ways to create efficient processes and to measure and manage talent and motivation. Groupwide succession-planning systems for senior managers, for example, are inexpensive for even the largest companies.

Companies can achieve savings of 30 percent or more in the HR function by standardizing and automating operations. However, cost cutting in the HR function should not be the aim of a people strategy. The cost of HR operations is too small to be a crucial factor in an organization's overall people strategy.

Transforming the Organization

All the initiatives described here start at the top with a commitment from senior executives, especially the chief executive. Companies with a strong and effective people strategy have a CEO who cares about people strategy and an HR executive who is a close confidant of the CEO. The people strategy team needs a deep understanding of overall business economics and a broad perspective on how people strategies can drive business strategy and boost performance.

Creating and implementing a people strategy is demanding work, especially when the success of your business depends on the availability of hard-to-find and hard-to-keep skills and talents. If you are not paying as much attention to your people strategy as you are to your financial strategy, it is time to reevaluate your priorities.

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