Personnel inventory

The Portfolio Approach to
Human Resources Management

Special Management Report

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THE PORTFOLIO APPROACH TO HUMAN RESOURCES MANAGEMENT

by

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For almost a century it was considered bad form to treat an employee as an asset. Such a designation was seen as categorizing a worker as a slave or as some kind of domestic animal; it was viewed as patronizing and perhaps demeaning to workers.

Considering the quality of work life in the last century, maybe it wasn't so unfair to make a comparison between factory workers and domestic beasts of burden. At least Karl Marx made a lot of it in his "commodity theory of labor" in which he said that capitalists treated human beings as commodities rather than as real people who were made for better things.

This coyness about treating employees as assets has diminished in this century, and especially in the past twenty-five years. For one thing, high-talent people like engineers, accountants, scientists and lawyers hold few of the attitudes of the oppressed and aren't likely to be insulted if they are treated as an asset. For another, highly paid people who are treated as an asset are willing to discuss how their value relates to the return that comes to them for their skills. As a result of these attitudes, there has been a rising interest in treating employees as assets, in the same fashion that machines, patents and goodwill are treated as assets of the organization.

Personnel and human resources managers everywhere can take comfort in the selection of Theodore Schultz for the Nobel Prize in Economics in 1979. His concept of investment in human capital is an important contribution to economics. In his 1961 presidential address to the American Economic Association Schultz said:

"Although it is obvious that people acquire useful skills and knowledge, it is not obvious that these skills and knowledge are a form of capital, that this capital is a part of a deliberate investment that has grown in Western societies at a faster rate than conventional (nonhuman) capital, and that its growth may well be the most distinctive feature of the economic system."

Since then there have been numerous studies and opinions emphasizing the concept of investment in human capital as the major conceptual idea behind the personnel and human resources programs of business and nonprofit organizations. In the eighties this investment management may grow into one of the most important breakthroughs in personnel administration since Hugo Munsterberg set forth the rudiments of scientific employment of people in 1904.

ARE EMPLOYEES REALLY TREATED AS ASSETS?

Early efforts to apply human resources accounting seemed to be hung up on some particular kinds of accounting protocol. Mainly such studies tended to work over the profit-and-loss aspects of the accounting field, and some firms even prepared parallel P&L statements showing the effects of expenditures in acquisition, training, and development of human resources as being partly expense items and partly investments that should be carried on the asset side of the balance sheet.

Many professors at the leading business schools have written extensively and imaginatively on the subject of human resources accounting, including Eric Flamholz (who has authored a text on this early state of the art), William Pyle, Lee Brummett, Willard Graham, and Rensis Likert (who has proposed that measurement of human assets calls for measurement of attitudes and opinions of people as being a concrete part of the valuation of human assets of the organization).

The idea of human resources accounting has not been without its critics, however.

Many traditional accountants have noted that since slavery ended one human cannot acquire title to another, thus the ownership of the asset is in doubt. This means that the ordinary conventions of accounting are not always readily accepting of the treatment of human assets as real assets, except perhaps if valued under "goodwill."

Others have noted that the basis for valuation of human assets is rather soft and that the casting of certain personnel management expenses into the balance sheet is arbitrary and capricious, even when done consistently from case to case.

Yet the concept of treating employees as assets has cast a long shadow over the strategies of human resources planning, for the treatment of personnel expenses as capital expenditures places a long-term connotation on such expenditures that does not exist when all personnel budgets must be considered as short-term because the money is paid out in a single year.

APPLYING THE PORTFOLIO APPROACH

Every prudent investor or investment department finds that it treats all of its investments as a sum of its parts, and that sum is often identified as its portfolio. The trustee in the bank, the investment manager for the mutual fund or pension plan, or the investment department of an insurance company all engage in portfolio management. They have a portfolio of stocks, bonds, debentures and the like which are viewed as earning assets, and the value of those assets is related to the level of earnings. The idea is to maximize the earnings from the whole portfolio by analyzing the content of the portfolio and dropping those assets that are earning the least and adding new ones that will actually earn more (or that promise to earn more in the future).

This idea of things being part of a portfolio has in recent years been adapted to other areas of concern besides stocks and capital assets of the firm. The most notable of such approaches—and perhaps the origin of them—has been that of the Boston Consulting Group (BCG) which analyzes the products of the firm in terms of market growth and market share. Based upon these two variables it classifies products as being in one of four major categories:

- *Dogs* are those products which are sold in slow-growth or no-growth markets and which the company has a low and perhaps declining share of the market. BCG proposes that when a firm discovers a "dog" in its product line that it divest itself of that product or market by cashing it out and transferring the resources being used for more fruitful and higher yield applications.
- *Cash cows* are those products for which the firm has the leading share of the market, but the market is neither especially fast-growing nor stable. This would be exemplified by such products as Vaseline petroleum jelly for Chesebrough Ponds, or Ivory soap for Procter & Gamble, which dominate a special market which is rela-

tively stable. BCG suggests not investing large sums aimed at increasing market share, but rather to hold the share and "milk the cow" to keep it constant as a source of cash for building promising new product and market lines.

- *Stars* are products and markets that show promise of being the fastest growing, and into which market development money will help gain an increasing share. These are the breadwinners of tomorrow that should command the best marketing development efforts of the firm.
- *Problem children* are products for which a high market potential exists because the market is growing, but for which the firm does not have an average share. The action proposal here is that the "problem child" be analyzed intensively with a view to turning it into a "star" or, being no feasible way of doing that, turning it into a "dog" and abandoning it.

While this terse and wholly unauthorized explanation of the Boston Consulting Group's system of categorization has attracted the attention of senior management and strategic planners in most major corporations, it also suggests a model for managing a portfolio of other kinds of things, including the investment in human resources.

This proposal of a portfolio approach to human resources management is based upon two successful experimental applications of managerial assessment in Fortune 500-size corporations. In one case the assessments were made by a review board, in the other they were made by staff people on the basis of MBO-based performance appraisals.

The design of the portfolio for human resources employed was adapted from the stock analyst's model and a BCG grid. It classifies managers in the organization at the time of assessment based upon their current year's performance. Note that it is based on performance, not personality, credentials, or other factors.

The four classes of "stock" in the human resources portfolio were as follows:

I. DOGS

While the term is clearly pejorative and is hardly suitable for public labeling, it proposes that people whose performance qualifies them only for this classification are incompetent, unsatisfactory and wholly unsuitable occupants of their present positions. It means that they have low potential for growth and that they are not even living up to that low level of potential in their actual performance. Such people are often over their heads in their job, underqualified, and probably not even trying to perform well for various reasons. Since these reasons may be situational as well as personal, only a very small percentage of people on the managerial payroll will be found in this category. (In the firm using the review board assessment method the number of managers identified as "dogs" was less than two percent. In the firm using staff assessments the number ran somewhat higher.) The indicated action here is removal, either through demotion or separation.

II. WORK HORSES

These are the people who have reached their peak of performance in the light of definitely limited capacity. This is the largest classification for managers; it is akin to the "cash cow" category in financial or product portfolios. People in this classification have reached the likely optimal level of their performance, but a person is placed in this category only for the year in question because of the possibility of human change. The assessment is renewed each year and people who suddenly appear to have made a breakthrough can be moved. The indicated action is to do nothing but to keep them abreast of the cost of living through salary increases while assuring them that they are secure in their jobs (at the same level). Seventy-nine percent of the more than 1,500 managers studied were found to be in this category by their assessors.

III. STARS

These are the people of high potential who are performing at the highest quadrant of their potential. Often they are young people of considerable ability who have exhibited a high level of motivation, but they may also be senior technical people or staff experts who remain creative and productive. The category may also include a general manager of unlimited potential who takes over troubled divisions and turns them around, and whose performance is both high and growing. Fifteen percent of the managers assessed were positioned in this category.

IV. PROBLEM CHILDREN

These are people who have great potential and genuine capacities who are working well below that capacity or only with mixed results. In some instances they divert their energies to making mischief, engaging in harmful actions, or in being too easily diverted into trivial or wasteful uses of their talents. This is obviously the most complicated of the categories of human assets. It includes young people who have great ability but who are hazy on career potentials, and older people who show flashes of brilliance interspersed with stretches of disappointing failures. These people should command the best attention of the management development specialist, the counsellor, and maybe even the company psychologist. Sometimes the placement of people in this category grows out of their unfavorable experiences in the organization in the past, such as bad management by prior (or present) bosses. The managerial action indicated includes sound counselling, job reassignments, and new challenges. Each "problem child" is worth saving because of his or her high potential and occasional excellence, but individual assessment and analysis is neccessary. Failure over many years should be considered a signal that perhaps the person really is lost. If they don't grow into "stars" or settle down to become "work horses," they may become "dogs." The number of people in this group varies from firm to firm and no standard figure is possible here since each case is situational in character.

HOW TO CLASSIFY PEOPLE IN YOUR PORTFOLIO

The decision to classify people into useful categories is one that calls for managerial action in every case. As an officer of one of the firms using the portfolio approach described the system in a delightful oversimplification, "We polish the stars, fix the problems, feed the work horses plenty of hay, and shoot the dogs."

Common sense and caution is needed before leaping forth along the lines of this quick lumping together of people into categories without criteria or without a reason for doing so. If the organization has no intention of taking actions to change behavior or to move people into more suitable work, then it has no reason for assessing managerial performance or for categorizing its managers.

There are, however, some chronic concerns in managing human resources that recur again and again which can be assisted by such an annual classification:

- Selection of people for employment or for existing jobs.
- Promotion of people to higher levels of responsibility.
- Rewarding of performance through merit pay, bonus or incentive systems.
- Recording of performance information in the salaried personnel file to become part of a performance inventory.
- Identification of training needs and development requirements for individuals and organizations.
- Means for appraising managers and for using those appraisals in judging managerial competence and potential.
- Guidelines for the coaching of subordinates by supervisors.
- Identification and segmentation of problem managers so as to avoid classifying them as either "ordinary" or as "candidates for immediate discharge."

All of these managerial decisions must be based upon some criteria. Such decisions are already being made, but making them in this fashion merely substitutes system and rationality for sentiment and intuition, as well as bias and favoritism.

THE REVIEW BOARD ASSESSMENT METHOD

In the review board method of assessing managers, the top management of the organization, usually the chairman and key officers in a business firm, take a couple of days each year to review with division managers all of their officer and key subordinate personnel. As operated in such firms as Sears and Ford, this usually produces a kind of inventory of the quality of management in place at the time of the review. Such reviews often lead to a classification of all of the managers into one of five or more categories, ranging from "superior" to "unsatisfactory." These two extremes usually are defined as follows:

- *Superior* – this category is limited to those few people whose performance during the recent year and in prior years as well has been exceptional, beyond ordinary expectations. It is a category reserved for the few truly high achievers who make great breakthroughs or who accomplish extraordinary results.
- *Unsatisfactory* – this category is reserved for that small segment of the managerial staff whose performance has never been more than adequate, or whose best efforts have long since been finished and who has most recently evidenced serious performance problems and perhaps a few major errors.

Those who cannot readily fit into either of these extreme categories comprise the great majority of people, and it is in this middle range that classification becomes most difficult. It is also this area in which good people can be lost.

The review board idea is that each person in the managerial ranks is given some personal review and discussion by the top management team. In some organizations this review starts with a complete personal history of an individual's work experience in that organization, including prior appraisals, salary progress, special notes and assignments, and the personal observations of the person's general manager. This process is valuable for the general manager because the prospect of facing the review board to describe and discuss the performance of one's subordinates has the effect of forcing the payment of more attention to the subordinates and their progress than might happen with a conventional performance review plan.

The weakest part of this method of assessment lies in evaluating what the capabilities and potentials of an individual might be. The most valuable and firmest part of the process is the information of actual results achieved against objectives.

The portfolio classification of people using review boards sharpens considerably the importance of the review, the quality of the choices and judgments that are made, and the likelihood that some kind of specific developmental action will occur.

The nature of the linear scale (from "superior" to "unsatisfactory") treats all of the assessed people equally, only some are more equal than others. This scale does not permit enough consideration on individual differences, as would be required to determine whether the person is a "dog" or a "problem child."

THE STAFF REVIEW OF APPRAISALS METHOD

In the second firm applying the portfolio approach, no company-wide or division-wide review board system was employed. Rather the director of management development sat at a desk with some subordinates and did a paper-and-pencil assessment of people based upon the performance appraisals received from line managers. The firm had a fairly well developed MBO system which it worked hard at and which was deeply embedded in the managerial climate of the organization.

The MBO system required people to define objectives in the following three major categories:

(1) *Regular objectives* cover the ongoing, repetitive, measurable aspects of the job.

(2) *Problem-solving objectives* are aimed at restoring things that have gone wrong to satisfactory levels. They involve such things as controlling costs, cutting accident rates, and reducing customer complaints.

(3) *Innovative objectives* change the character and direction of an organization, exploit resources more fully, and produce new situations so as to do things better, cheaper, faster, easier, safer, or with greater dignity to people.

By building their appraisal system around MBO, and by having these three categories of objectives for every management position, it was quite feasible to classify people according to the portfolio management system:

- People who aren't even doing their regular responsibilities are either "learners" or "dogs." This method of classification sets up a new category in the portfolio system which one analyst proposed should be labelled "pups" rather than "dogs." Presumably these people are still on their way, but falling into this category indicates that change is needed to bring their performance up to the minimum level on some time schedule.
- People who do the regular things and nothing more are the "work horses." They carry the great bulk of the managerial work load and should be carefully tended, fed and maintained to keep them productive.
- Problem-solving includes both the ordinary and recurring kinds of things (which are the province of the "work horse" manager) and those which call for brilliance,

daring and star quality. One of the attributes of the "star" is an ability to solve insoluble problems and to develop startling and creative solutions. Thus, accomplishment of problem-solving objectives can indicate that one is either a "work horse" or a "star" manager.

■ "Stars" are people whose contribution in problem-solving and innovative objectives is creative. They make the great mergers, or design the new strategy or product. They take impossible situations and turn them around, and change confusion into order and happiness. They set high goals and attain all of them.

■ You are more apt to recognize the "stars" than the "dogs" because the latter group's one capacity is self-protection; they survive by concealment and thus remain hidden.

■ "Problem children" are the hardest to categorize. Indeed, a person is classed as a "problem child" only after having received a great deal of individual attention from his or her bosses. Such people are apt to be contentious in ways that surround them with controversy. Often they have excellent achievements or brilliant minds. Some examples are the great producer who gets in the way of others; the person who does a fine job while infuriating some colleagues; the person who has many strengths along with a few stark weaknesses; the person who has some bad personal habits, such as drinking or drugs; the person whose racist, sexist or other social attitudes and behavior are outdated and not acceptable under current laws; the strong technical person who is a weak manager; and the person who cannot delegate, who either abdicates or refuses to let his or her subordinates do anything. The dominant characteristic of "problem children" is that they have both performance strengths and performance weaknesses.

MANAGING THE PROBLEM MANAGER

One of the more important effects of changing your assessment system from a linear one (rating people from high to low on a straight scale) to a portfolio approach (choosing a quadrant where they fit in) is the heightened importance which must be placed upon the problem employee. Such people are usually recognized, but are often wrongly classified.

The brilliant scientist who is a disruptive figure will be defended by the research director as a "star," whereas the general manager will categorize the person as a "dog." If each could agree that the star qualities exist in scientific skills but that the disruptions are costly, some kind of ameliorative action might ensue.

The review board method of assessment does a better job than the staff review of appraisals method in identifying clearly which of the performance categories of the portfolio an individual manager should be placed in.

According to John Miner in his book *The Management of Ineffective Performance,* the ineffectiveness of people who fit into the "problem children" category may grow out of a lack of intelligence or job knowledge, emotional problems, individual motivation to work, physical characteristics and disorders, family ties, groups at work, the organization itself, society and its values, situational factors in the job environment, and a few other highly special kinds of problem areas.

In the review board method a discussion of any or all of these influences as causes of the ineffective behaviors of the problem manager can lead to constructive organizational changes to alleviate the forces that create "problem children" or problem-creating managerial behavior.

Staff assessment of people by simply analyzing appraisal forms cannot deal with situational and organizational factors which explain why the results sought were not achieved. It merely defines that desired results were—or were not—attained.

In addition, staff assessment cannot compare actual performance against potential performance. This lapse occurs because the performance appraisal form doesn't tell us enough about the abilities of the individual in such areas as intelligence, mental ability, knowledge, aptitude, talent, literacy, powers of logic, learning ability, or social skills. It must rely upon results against goals. All it presents is the facts that Manager X set these goals but achieved only those. The appraisal form also doesn't tell how the manager achieved the results, especially how many problems were caused for peers, subordinates and the organization in attaining them. Such considerations are ordinarily left to the immediate superior to deal with.

It is valuable to construct a pattern of organization inventory. In the two large companies that comprise the initial study of the portfolio approach, the percentage of managers placed in each of the four categories was as follows:

	Review Board	Staff Review
Dogs	2.5%	12.0%
Stars	9.1%	10.5%
Work Horses	81.4%	77.2%
Problem Children	7.0%	0.3%

The managerial talent of the individual firms is, of course, the most plausible explanation for the differences, but an explanation that bears close investigation is that staff reviews without close personal inspection of individual cases produces less information about the existence of "problem children" than does the review board method of assessment.

When people achieve their objectives adequately they can keep their problem behavior off the record. Thus its existence may be glossed over. The tendency to call problem managers "work horses" is natural in the absence of information. As a result, no change in work assignment will be made, and no individual coaching, counselling or training will be undertaken to change ineffective behavior.

At this stage, no one would claim that this initial two-firm study is any proof of the validity and usefulness of the idea of the portfolio approach to human resources management. It needs testing with other populations. Yet the indications from this study show it to have some interesting possibilities. It does, however, require the following:

- A commitment of the organization to managing its human resources as an asset.
- Intensive top management attention directed to the quality of the organization's human resources portfolio.
- A systematic attempt to conduct an annual performance appraisal on each manager by his or her boss.
- A willingness to take remedial and improvement actions aimed at developing all managers in the organization.
- A complete and regularly updated inventory on paper of human resources to include goals, actual performance, and evi-

dence of potential. (Potential is described in specific terms, such as intelligence, past experience, educational specialty, willingness to relocate, and health limitations.)

■ The system must be managed by the management development staff, but must involve line management heavily in making judgments.

■ As with most assessments of potential, there is little need to tell an individual how he or she has been classified, and there is considerable reason for confidentiality of such ratings. Whether such secrecy will be possible in the future under privacy laws is questionable. Thus it is important that the criteria for each category be clearly spelled out.

More than another casually selected set of categories for classifying employees, the portfolio approach to human resources management uses the same kinds of categories as are used by the financial analyst to judge an investment portfolio and by the market planner to evaluate a product line. In this sense, the portfolio approach does indeed treat human resources as an investment.

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