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CHAPTER 32

IMPROVING HUMAN RESOURCES' ANALYTICAL LITERACY: LESSONS FROM *MONEYBALL*

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Moneyball, the bestseller by Michael Lewis (2003), recounts how one organization achieved a sustained performance advantage over its competitors. The Oakland Athletics were able to become one of the most successful franchises in major league baseball, despite having one of the smallest payrolls in the league. What is surprising about the Oakland As, however, is not *what* they did, but *how* they did it. In a break with baseball tradition, senior executives brought a new analytical literacy to their strategic decision making and redefined *what matters* and *how to measure* it. It is a lesson that has direct application to other organizations and in particular to senior executives (both HR professionals and line managers) attempting to build the workforce and the HR function into a strategic asset.

HR professionals are in the midst of revolutionary change with the increasing importance of intangibles as drivers of firm performance. Our research over the past decade, involving nearly 3,000 firms, has consistently shown that a *high performance* HR system can increase shareholder value. Taking advantage of these strategic opportunities in their own firms presents an important challenge for HR professionals. In *The HR Scorecard* and in our forthcoming book *The Workforce Scorecard,* we argue that HR professionals require a much different perspective on their strategic role (Becker, Huselid, and Ulrich, 2001; Huselid, Becker, and Beatty, 2005). A firm's capability to execute its strategy is perhaps its foremost source of competitive advantage. In this world, it is not enough for HR professionals to be good HR managers—they need to be good strategy managers. Like the Oakland As, they need to redefine *what matters*.

Once HR professionals have redefined what matters and are focused on how HR drives successful strategy execution, there are direct implications for *what to measure* and *how to measure* it. HR's strategic goals should map directly onto the imperatives of successful strategy execution. There should be a clear line of sight between achieving HR's strategic goals and successful execution of the organization's strategy, and this line of sight should be reflected in HR's measures of strategic performance. This means new measures and new ways to measure. New measures mean that conventional metrics such as cost per hire, recruiting cycle time, cost per trainee, or overall levels of turnover rarely qualify. New ways to measure mean that benchmarking is not the answer. The human capital demands of an organization are as unique as the system of strategy drivers underlying successful strategy execution. Measures that capture the strategic value and contribution of either the workforce or HR will be as unique as the system of strategy drivers in the organization. As a result, those measures will not be found by comparing efficiency and activity measures with a benchmarking survey.

DEVELOPING ANALYTICAL LITERACY

The development of HR's strategic role has been an evolution. The first stage required a better understanding of business problems, as opposed to HR problems. This required new competencies on the part of HR professionals, and HR professionals are much more business savvy than they were a decade ago. The next step in that evolution is for HR professionals, and particularly senior HR professionals, to develop what we call *analytical literacy*. The need for greater analytical literacy reflects several trends. First, because technology allows organizations to more easily and cheaply collect data, key organizational decisions are much more data driven than in the past. Second, intangible assets and in particular human capital influence firm performance through a complex system of relationships. Quarterly employee surveys, activity reports, and turnover data rarely measure the strategic relationships that must be managed. Finally, other functional areas (finance, marketing, etc.) increasingly rely on more sophisticated analyses, and line managers expect HR professionals to be comfortable with these terms.

Does analytical literacy mean you have to have a graduate degree in statistics? No. Being a strategy manager means HR professionals should be asking a whole new set of questions about HR and human capital. Measures and their analysis provide answers to questions, and analytical literacy gives HR professionals the competency to recognize the appropriate measures, and the appropriate analyses, for the strategic questions confronting them. *Moneyball* is not about senior executives personally conducting sophisticated data analysis. But it is about senior executives understanding the analytics "well enough to use their conclusions" (Lewis, 2003, p. 57).

Moneyball offers three important lessons about analytical literacy that are applicable to HR professionals in their role as strategy manager.

Business logic drives measurement. Moneyball is not about new measures that just appeared by luck. They are in large part the result of a new perspective on what constitutes success in baseball and what is important about player (workforce) performance. *Moneyball* describes a new theory of the business, of how value is created; and the measures that are used to manage that business follow directly from the new business logic. While the strategic goals may include scoring runs and winning games, the strategic focus in an individual game that will most likely lead to strategic success over a season is minimizing the chances of making an out in each inning. Therefore, "on base percentage" (the probability of not making an out) is a more important measure of player performance than batting average.

The lesson for HR professionals is that an analysis of what is important and what should be measured is a top-down process, not a bottom-up process. The Oakland As figured out what it took for the team to be successful and then defined player performance, and the measures of that performance, in terms of their logical contribution to that success. HR professionals often do just the opposite in their efforts to demonstrate their strategic contribution. They start with the measure, often focusing on operational and administrative efficiency, and attempt to make a bottom-up argument. The business logic is superficial and neither the execution of the firm's strategy nor the credibility of the HR function is well served.

HR professionals, however, face a more difficult challenge than major league baseball executives. In baseball, the game had not changed—the challenge was to find a more successful strategy for the same game. For most HR professionals, the increasing importance of intangibles as sources of competitive advantage, and in particular the role of human capital, is an entirely new game!

Thinking in terms of causal relationships. Human capital rarely has a direct effect on firm performance. This is particularly true when the business logic of HR's effect requires that human capital drive firm performance through its contribution to effective strategy execution. Instead of looking for the strategic holy grail of HR's impact on shareholder value, HR professionals (and line managers) need to recognize that effective strategy execution is the basis of shareholder value and that effective strategy execution is a system of *intermediate* outcomes. Thinking like a strategy manager means recognizing the importance of the causal relationships between HR decisions and these intermediate outcomes that ultimately drive strategic success in your organization.

This causal thinking about relationships is illustrated in *Moneyball* with the following simple example. Starting pitchers are generally more effective than relief pitchers, so a team will be more successful if it can get the opposing team to remove its starting pitcher and bring in a relief pitcher. The chances of a starting pitcher being removed increase with the number of pitches he has to throw. So batters contribute to team success, not only when they get on base, but also when they make the opposing pitcher throw a lot of pitches before they eventually get on base. There is a business logic that describes success and a system of relationships linking individual performance to team success.

The notion of the intermediate outcome, the strategic performance driver that is the precursor of successful financial performance, is HR's neglected strategic "return." *Moneyball* is described as a story about efficiency, of achieving more success from a limited budget. Efficiency measures, however, are typically a measure of gain divided by cost. HR professionals too often focus only on the cost dimension of efficiency—the denominator. The story of *Moneyball* is not about how an organization achieved success by driving down costs; it is about how it dramatically increased gains with a relatively modest and stable cost base. The executives in *Moneyball* excelled at numerator management more than at denominator management. HR professionals need to radically redefine their concept of the numerator when they think of the return on HR or human capital. The impact of human capital and HR decisions on your organization's system of strategy drivers should be your numerator focus.

We like to use a simple example from the retail industry to illustrate this focus on numerator management. Assume that a retail firm's strategy to increase revenue growth depends on expanding market share, which in turn requires increased customer satisfaction. A marketing study concludes that customer satisfaction is largely driven by the customer buying experience, which is a function of front line staff who are knowledgeable, courteous, and timely. Developing those performance behaviors is a strategic responsibility for HR, but the return to those HR initiatives should be measured in terms of improved customer buying experience and customer satisfaction. Moreover, the analysis that is the basis for those HR initiatives requires HR professionals to think in terms of causal relationships from revenue growth back down through intermediate outcomes to the necessary strategic performance behaviors.

New modes of analysis are required. Finally, analytical literacy includes an appreciation and understanding of the notion that many of the HR solutions that might be proposed to drive a firm's strategy are merely hypotheses. They are the best estimate of what will work at the time, but they are not guaranteed to work. As hypotheses, however, the results of these decisions need to be examined in light of the results. Again from *Moneyball,* the general manager of the Oakland Athletics "concluded that everything from on-field strategies to player evaluation was better conducted by scientific investigation—hypotheses tested by analysis of historical statistical baseball data—than by reference to the collective wisdom of old baseball men" (Lewis, 2003, pp. 56–57).

The results of interest should be the *relationship* between human capital or HR decisions and key business outcomes. For example, a leading insurance company has implemented a leadership competency model. Does it make a difference? The measure of success is not how cheaply it was implemented, or how quickly or even how widely it was rolled out. The measure of success is whether managers with more of these leadership competencies had more business success than those managers with less of these competencies. The evidence showed a strong positive relationship between leadership competencies and key intermediate strategic outcomes: client satisfaction and policy renewals.

Just as the Oakland As had to move away from modes of analysis emphasizing "gut feelings," HR professionals need to develop more sophisticated modes of analysis. According to Sandy Alderson, former general manager of the Oakland As, "I couldn't do a regression analysis, but I knew what one was. And the results of them made sense to me" (Lewis, 2003, p. 57). Developing this capability may mean bringing it in-house, as at Allstate or with the Sun HR Labs. Or, like Cardinal Health, the organization may rely largely on outside expertise for more sophisticated analysis. But in each case, as with the Oakland As, the senior executives were literate with this kind of analysis and knew how to take advantage of the results.

We need to emphasize that these more sophisticated methods of analysis follow directly from the first two dimensions of analytical literacy, using business logic as the foundation of measurement and thinking in terms of causal relations. Strategic performance measurement is based on the relationship between human capital and the unique strategic performance drivers in your organization. Therefore, benchmarking HR performance using traditional efficiency measures such as cost per hire or recruiting cycle time, is not the solution (Becker and Huselid, 2003). Neither is constructing measures like "human capital value added" that are nothing more than combinations of old measures with new names. HR and human capital strategic performance require new numerators and they will largely be unique to the system of strategy drivers required to execute your firm's strategy.

AN IMPORTANT CAVEAT

There is good news and bad news in drawing lessons from *Moneyball*. The bad news is that the strategic implications of analytical literacy in major league baseball are very different from those in most industries. In baseball, every team is playing the same game. *Moneyball* is largely a story of market inefficiency. One team discovers a better strategy and achieves a competitive advantage. But since all the teams are playing the same game, another team can simply copy what the Oakland team has done and expect to improve their performance. As more teams adopt this new strategy, and several have already begun to do so, they will erode Oakland's competitive advantage.

Most HR professionals do not work in this type of industry setting. The system of strategy drivers, the employee mind-set, culture, and workforce performance required to execute one firm's strategy is often quite different from that of other firms in your industry. That the games you are playing differ from those of your competitors is a mixed blessing. On the one hand, it is bad news because HR professionals need to develop a differentiated workforce strategy that is unique to their own organization. Despite the allure of benchmarking, they cannot simply copy the same performance measures and initiatives used in an industry success story and hope for the same results. The good news is that this differentiation means that if they are successful in their own organization, it should provide a relatively sustainable source of competitive advantage. The foundation of this approach will be a new emphasis on analytical literacy.

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