

# Human Resources Finance

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# The language of business

- Why do I have to learn this stuff?
- Who struggles with the numbers?
- Finance and other numbers/metrics are one way business people communicate



# Today's Agenda

- Financial Statements and Forecasting
- Financial Terminology
- Ratio Analysis and HR metrics
- Capital Expenses
- Merit Budgets
- Creating a Variable Pay Plan
- Analyzing Employee Survey Data
- Questions



# Financial Statements

- Income Statement
  - Records revenues and expenses
- Balance Sheet
  - $\text{Assets} = \text{Liabilities} - \text{Owners Equity}$
- Other
  - Cash Flow, Statistics, Ratios, Variance Reports, Ranking Reports, Daily Labor ...



# Income Statement

- Starts with summary pages
- Current period vs. year to date
- Dollars vs. percentages

C	U	R	R	E	N	T		Y	T	D		
LY	%	CY	%	Bud	%	Item	LY	%	CY	%	Bud	%

- Revenues
- Expenses
- Profit: Dept Profit, GOP, Net Income, EBITDA



# Financial Terminology

- Gross Operating Profit – Controllable  $\Pi$
- Net Income –  $\Pi$  after indirect expenses
- EBITDA – another form of controllable  $\Pi$
- Cash Flow – actual cash in and out
- Productivity – amount produced over time
- Mix – the make-up of a given distribution
- COGS – cost of goods sold
- CAGR – Compounded Annual Growth Rate



# Compound Annual Growth Rate

$$\text{CAGR} = \left( \frac{\text{Ending Value}}{\text{Beginning Value}} \right)^{\left( \frac{1}{\# \text{ of years}} \right)} - 1$$

- CAGR isn't the actual rate of return, it's an imaginary number that describes the rate an investment will grow if it grew at a steady rate. You can think of it as a way to smooth out the returns. In reality, the actual growth will not be so artificially even.



# Key Financial Ratios

- Current Ratio
  - cash and inv over liabilities
- Quick Ratio
  - cash over liabilities
- Net Working Capital
  - net wkg cap over assets
- NPV (net present value)
  - current value of future cash
- IRR (internal rate of return)
  - hurdle rates (Op cost capital)
- ROA (return on assets)
  - net income over average total assets
- ROE (return on equity)
  - net income over average stockholder equity
- ROI (return on investment)
  - gains over expenses
- EPS (earnings per share)
  - Measure of owners' gains and a measure of dilution
- PE Ratio (price:earnings ratio)
  - Multiple reflects confidence



# HR Metrics

- FTE Calculation:

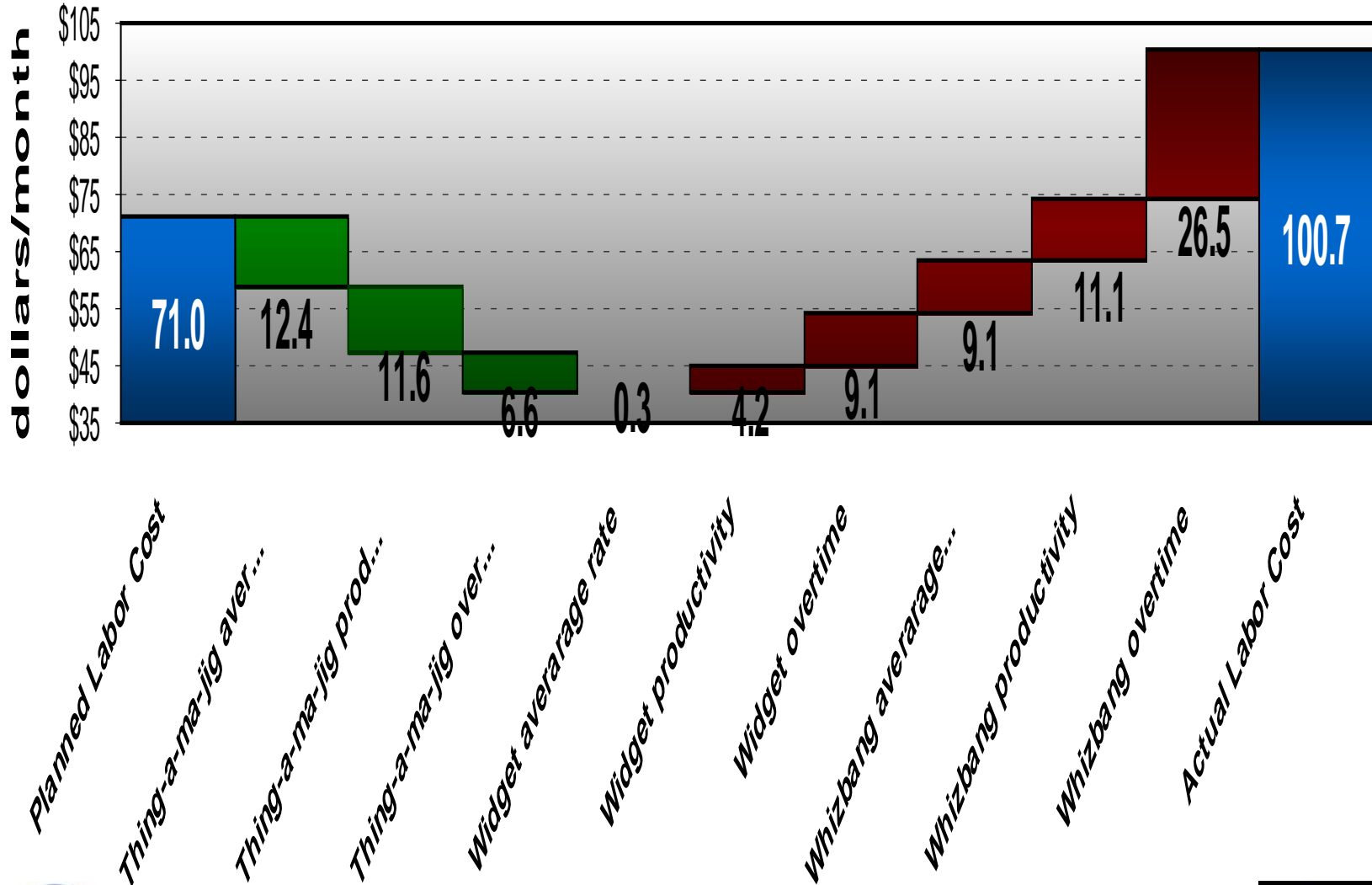
$$\frac{\text{Total labor hours}}{2080 \text{ hours}} = \text{FTE's}$$

- Productivity or percent of labor? Which is the better measure?
- Retention or turnover?

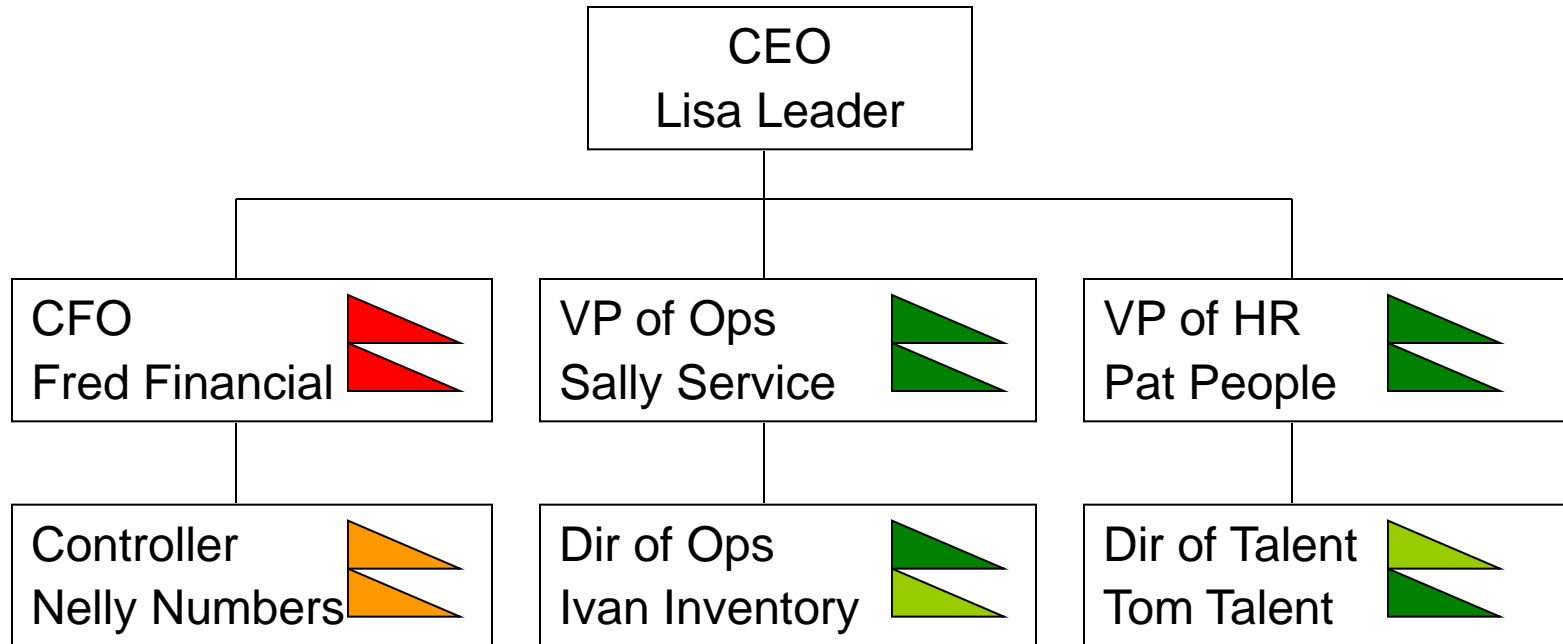
- Extras:
- Waterfall slide
  - A visual way to inform
- Succession Planning
  - Talent review



# July 2010 Actual vs. Planned Labor Cost



# Talent Review



# Capital Expenses

- Also known as CapEx ...
  - when a newly purchased fixed asset with a life-span of more than one year
  - or an investment that improves the useful life of an existing capital asset
  - this allows the company to spread the cost of the expenditure over the useful life of the asset (depreciation effect)
  - however, if the expense is one that maintains the asset at its current condition, the cost is deducted fully in the year of the expense



# Merit Budgeting

Merit Matrix	Bottom Quartile	Second Quartile	Third Quartile	Top Quartile
Tops	8%	7%	6%	5%
Wow	6%	5%	4%	3%
Solid	5%	4%	3%	2%
Almost	3%	2%	0%	0%
No Way	0%	0%	0%	0%



$$(4\% + 3\%) / 2 = 3.5\%$$

# Merit Budgeting

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# Merit Budgeting

	Merit Matrix	Bottom Quartile	Second Quartile	Third Quartile	Top Quartile
10%	Tops	8% 3%	7% 3%	6% 2%	5% 2%
25%	Wow	6% 6%	5% 7%	4% 6%	3% 6%
50%	Solid	5% 13%	4% 11%	3% 14%	2% 12%
8%	Almost	3% 2%	2% 2%	0% 2%	0% 2%
7%	No Way	0% 5%	0% 1%	0% 1%	0% 0%



# Budgeting the merit increase

- 8% x 3% = .24%
- 7% x 3% = .21%
- 6% x 2% = .12%
- 5% x 2% = .10%
- 6% x 6% = .36%
- 5% x 7% = .35%
- 4% x 6% = .24%
- 3% x 6% = .18%
- 5% x 13% = .65%
- 4% x 11% = .44%
- 3% x 14% = .42%
- 2% x 12% = .24%
- 3% x 2% = .06%
- 2% x 2% = .04%
- 0% x 2% = .00%
- 0% x 2% = .00%
- 0% x 5% = .00%
- 0% x 1% = .00%
- 0% x 1% = .00%
- 0% x 0% = .00%

3.65% wage increase



# Other merit pay factors

- Timing of the increase
  - Focal point? When?
  - Randomly throughout the year?
  - Rule of 54
    - $1/12 + 2/12 + 3/12 \dots 12/12 = 78/144 = 54.2\%$
- Frequency of the increase
  - Orientation period, first year increases?
  - Promotions?



# Variable Pay

1. Must relate to company philosophy
2. Understand what the market does
3. What are the goals of this incentive
  - Goal setting (attainable vs. stretch, forecast)
4. What data is available to measure results
5. Keep it simple, especially for lower levels
6. Funding – will this be self-funding?
7. Communication plan – clear and often



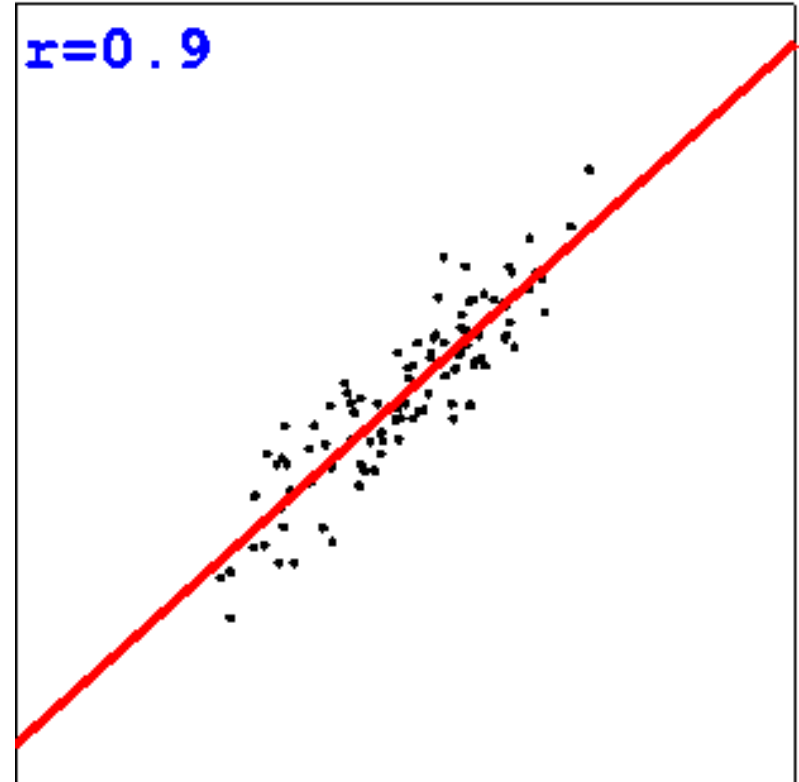
# Correlation Coefficient

$$r = \frac{\sum X_i Y_i - \frac{\sum X_i \sum Y_i}{n}}{\left[ \left( \sum X_i^2 - \frac{(\sum X_i)^2}{n} \right) \left( \sum Y_i^2 - \frac{(\sum Y_i)^2}{n} \right) \right]^{1/2}}$$

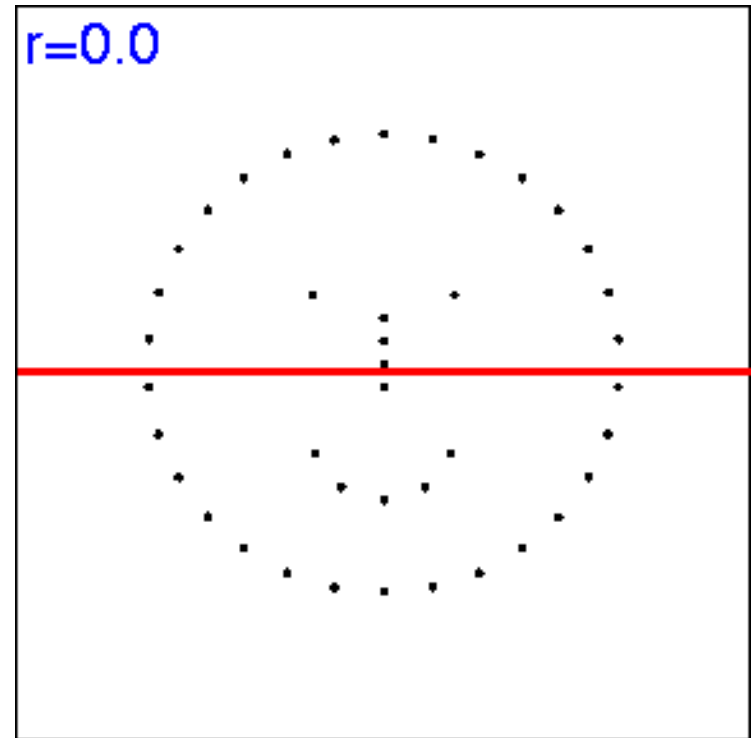
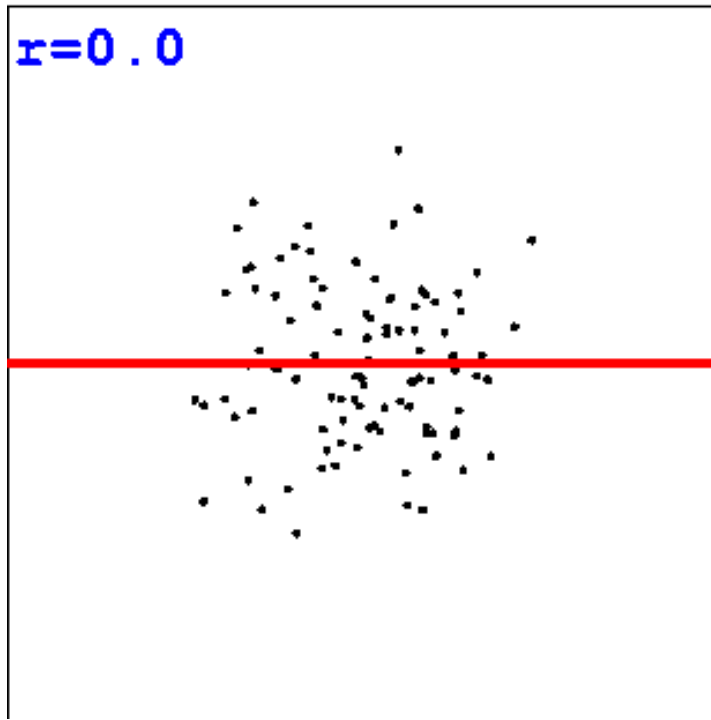
How is the data related?



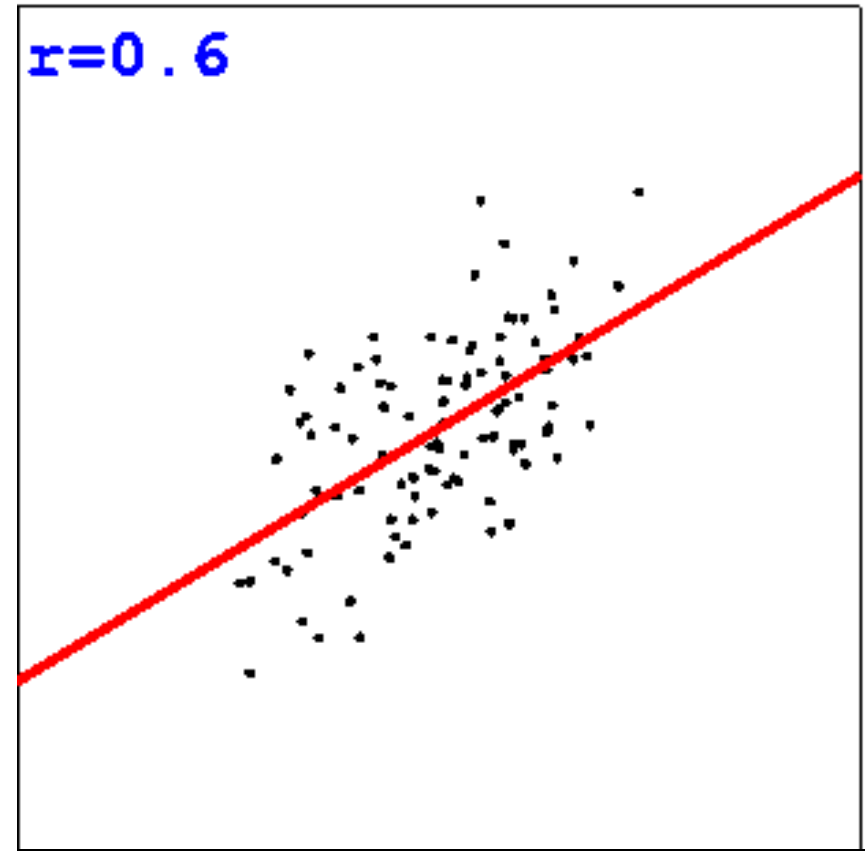
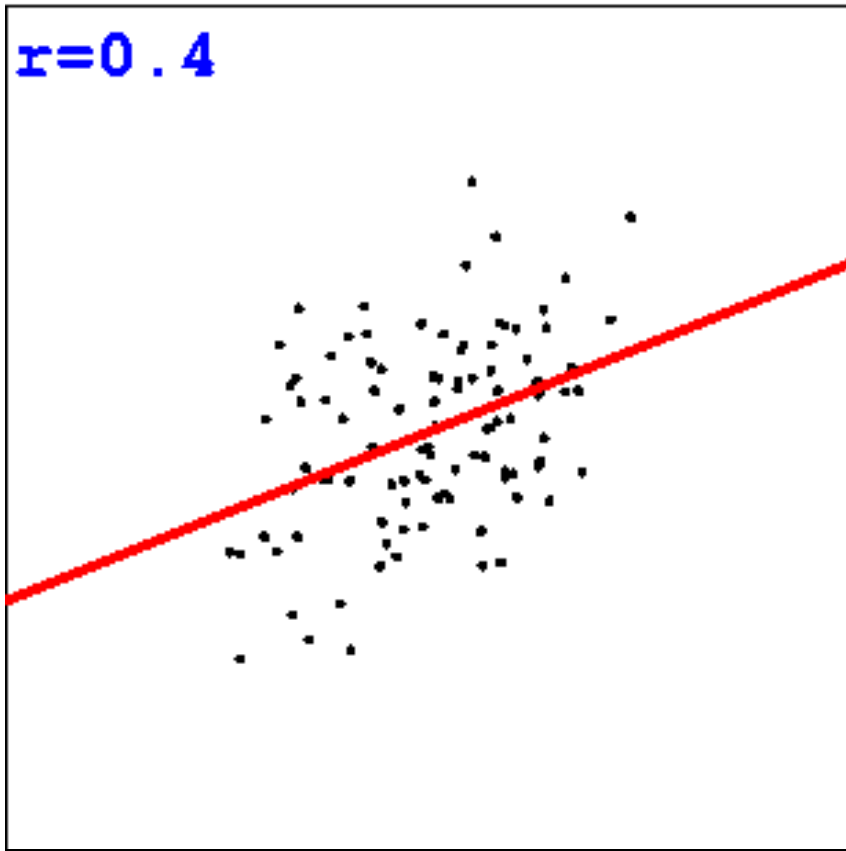
# Perfect Correlation



# No Correlation



# High correlation?



# Employee Survey Data

	SA	A	N	D	SD	r
I would recommend this company as a great place to work	45	34	6	7	8	
I rarely think about looking for a new job	43	21	4	4	28	.76
Prompt decisions are made at top level of the organization	16	23	34	25	2	-.12



# Employee Survey Data

	SA	A	N	D	SD	r
I expect to be working at this company a year from now	38	38	15	6	3	
This company appreciates its employees	41	37	17	4	1	.99
Sr. mgt does very good job of communicating strategy	23	11	24	29	13	-.29



# Employee Survey Data

	SA	A	N	D	SD	r
I am satisfied with work/life balance my job affords me	39	29	16	7	9	
I have the resources necessary to do my job well	22	20	25	21	2	.41
Collaboration between departments is effective	10	16	50	19	5	-.19





Any Questions?

