



March 2004
Online Version

Harvard Business Review

Click here to visit:
> | <http://www.hbsp.org>

FORETHOUGHT
HUMAN CAPITAL

How's *Your* Return on People?

Companies that invest in employee development can outperform the market.
Just ask their shareholders.

by **Laurie Bassi** and **Daniel McMurrer**

Laurie Bassi (lbassi@knowledgeam.com) is the chairwoman and **Daniel McMurrer** (dmcurrer@knowledgeam.com) is the chief research officer at Knowledge Asset Management, a money management firm in Bethesda, Maryland.

Managers are always claiming, "People are our most important asset." But deep down, they can't shake the feeling that employees are costs. Big costs. And they treat them that way. Quarterly earnings off? Cut the perks, rein in training, and downsize. This strategy may increase earnings in the short term, but it's myopic. Recent studies suggest that layoffs actually destroy shareholder value. And our research shows that treating employees like the assets they are—by investing in their development—boosts returns over the long term.

For years now, our research has measured the effect of spending on employee education and training—a "cost" that is buried in general and administrative expenses—on the stock prices of 575 publicly traded firms. We created four hypothetical portfolios (one each for years 1997 through 2000) consisting of between 20 and 40 companies that invested at roughly twice the industry norm in employee development in each of the previous years (1996 through 1999). We followed the performance of these portfolios through 2001. Their returns were robust and in line with a growing body of empirical research showing that organizations that make extraordinary investments in people often enjoy extraordinary performance on a variety of indicators, including shareholder return.

In December 2001, we decided to put our money where our research was and created a live portfolio of companies that spend aggressively on employee development. In its first 25 months since inception, that portfolio has outperformed the S&P 500 index by 4.6 percentage points (2.2% versus a decline of 2.4% for the index). In January 2003, we expanded our investment strategy by launching two additional live equity portfolios made up of similar development-oriented companies. The results speak for themselves. While past performance is never a guarantee of future results, and while it is always possible to lose money, each of these three portfolios outperformed the S&P 500 by 17% to 35% in 2003. (See the exhibit "The People Payoff.")

The People Payoff

Portfolio ¹	2003 total return	Value one year later of \$50,000 invested on January 1, 2003
Portfolio one, created in January 2003	35.7%	\$67,850
Portfolio two, created in December 2001	31.8%	\$65,900
Portfolio three, created in January 2003	31.1%	\$65,550
S&P 500 market index	26.4%	\$63,200

1. These three portfolios are managed by Knowledge Asset Management (KAM), the investment firm founded by the authors. Returns are net of all fees, expenses, and dividends.

Copyright © 2004 Harvard Business School Publishing Corporation. All rights reserved.

How are *you* investing in your most important asset?

Reprint Number F0403B

Copyright © 2004 Harvard Business School Publishing.

This content may not be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopy, recording, or any information storage or retrieval system, without written permission. Requests for permission should be directed to permissions@hbsp.harvard.edu, 1-888-500-1020, or mailed to Permissions, Harvard Business School Publishing, 60 Harvard Way, Boston, MA 02163.