

# The value of Strategic HR processes in Service Management

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Service Management is about continuously creating value in the eyes of the customers. This perception of value and quality of service is formed by the customer in an often brief encounter between a service provider's employees and the customer. This means that the service company must excel at serving the front-line workers, who are the most important link between the company and the customers.

aspector

ISS White Paper  
November 2011



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# Executive Summary

For a service relationship to be successful, the service provider must continuously create value in the eyes of its customers. This value is, to a large extent, delivered by the customer-interfacing employees.

Evidence shows that the service providers with the best HR processes to support these employees are the ones best placed to deliver customer value, and have the best long-term relationships with their customers. HR is often perceived as an administrative support function adding little or no strategic value. This is evidently not true, and HR should be seen as the most important support function in any service organisation.

A well-managed, strategically-focused HR department adds significant value through disciplines such as Talent Management, Succession Management, Employee Engagement, Performance Management and Leadership Development. Prospective customers will benefit from assessing the potential service provider's HR processes – the operational as well as the strategic – as they are critical success factors for the future provider–customer relationship.



# “The moment of truth”



A long-lasting outsourcing relationship can only be a success if the service provider continuously creates value in the eyes of its customers. While this truism may seem fairly obvious, in practice many outsourcing relationships turn sour, with arguments about failed delivery of service. What goes wrong?

Service Management is characterised by an encounter between a service provider and a customer. This encounter defines the quality of the service in the mind of the customer, and is called the “moment of truth” by Richard Normann (2004). This is the often brief moment when the customer is evaluating the service and forming an opinion of its quality. A customer may experience many encounters with employees from the service providers, and each moment of truth is an opportunity for the service provider to influence the customer’s overall perception of the service quality. For example, an employee of a bank may in one day encounter several employees working for the same Integrated Facility Service provider: the receptionist, the cleaning person, the meeting room booking center, the parking lot attendance and the technician..

Jan Carlzon, former CEO of Scandinavian Airlines System (SAS), believed that these ‘moments of truth’ are critical in delivering superior quality. He believed that the organisation exists to serve the front-line workers who have direct customer contact. This meant turning the organisation chart upside down, placing the customer-encounter personnel (formerly at the bot-tom) at the top of the chart. By doing that, it now becomes everyone else’s responsibility to serve those front-line personnel, who in turn serve the customer. Changing the organisation chart signalled a move for SAS to refocus on satisfying the customer and managing “moments of truth” (Fitzsimmons & Fitzsimmons, 2007).

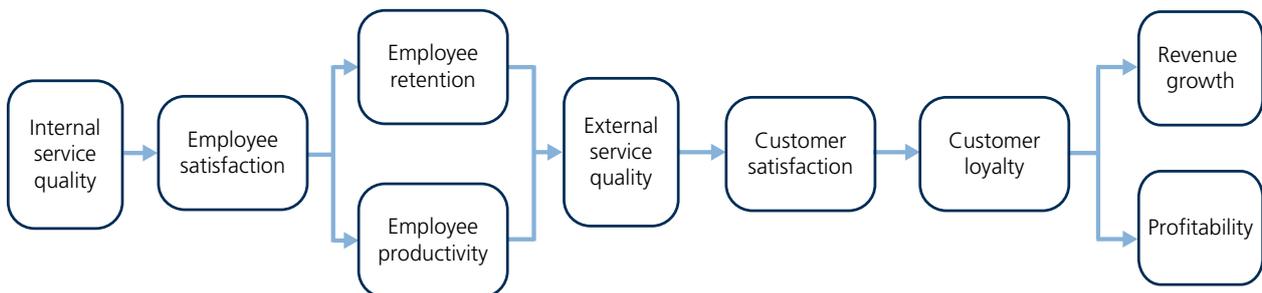
A customer’s impression of service quality is based on the total ser-vice experience, not just on the explicit service that is performed. A concern for employee attitudes and training becomes a necessity to ensure that the implicit service is also appreciated by the customer. When viewed from the customer’s perspective, the entire service process is now much broader.

Service quality perceived by the customer is an important way – and perhaps the most important way – to add value for customers (and to make a profit). An important way to achieve this is to raise the service quality as perceived by the service provider’s employees. A study of 23 branch banks revealed a high correlation between customers’ and employees’ perceptions of service quality (Fitzsimmons & Fitzsimmons, 2007).

From this study, it appears that when employees perceive a strong service orientation, customers report superior service. Creating a customer service orientation results in superior service practices and procedures that are observable by customers and, further, seems to fit employee views of the appropriate style for dealing with customers. Thus, even though employees and customers view service from different perspectives, their perceptions of organisational effectiveness are positively related. This means that the way in which management relates to the contact personnel (or internal customers) is reflected in how the external customers are treated.

Graphically, this is probably most eloquently described through the concept of 'the service profit chain'. It proposes a series of relationships linking service quality with profitability. As figure 1 shows, profitability and revenue growth are derived from loyal customers, and loyal customers result from satisfaction, which is influenced by the perceived value of the service. Service value is created by satisfied, committed and productive employees, and employee satisfaction is generated by investing in information technology, training and a policy of employee empowerment.

Figure 1: The service profit chain



Source: Heskett et al., 1997

The service profit chain is linked through a number of connections:

1. Internal quality drives employee satisfaction. Internal quality includes employee selection and development, rewards and recognition, proper workplace technology, and job design. These are all best practice – but nevertheless difficult – operational HR behaviors.
2. Employee satisfaction drives retention and productivity. In most service jobs, the real cost of employee turnover is loss of productivity and decreased customer satisfaction. A high level of satisfaction will minimise both.
3. Employee retention and productivity drives service value. Service quality depends upon the productivity and stability of the front-line workers.
4. Service value drives customer satisfaction. Customer value is measured by comparing the results received with the total costs incurred in obtaining the service. Customer value should always be viewed from the customer's point of view.
5. Customer satisfaction drives customer loyalty. This link has been proved to be very strong.
6. Customer loyalty drives profitability and growth. Because a small increase in customer loyalty can increase profits by a disproportionately large amount, the quality of market share, which is measured in terms of customer loyalty, deserves as much attention as the quantity of market share (Heskett et al., 1997).

Servicing the front-line employees is therefore critical in Service Management and for the success of, say, an outsourcing relationship. Concepts such as service culture, motivation, selection, training and employment empowerment are therefore critical components in any service relationship.

This White Paper will discuss the role of HR in Service Management. While HR covers a broad range of activities, this White Paper will examine in particular the role played by strategic HR processes in delivering superior service and customer value.

# From operational to strategic HR

## The paradox of HR

HR represents something of a paradox. On the one hand, theory such as the service profit chain shows that the behaviour and satisfaction of employees directly determines the quality of service, customer experience and profit of a service company. This tangible value creation has been proven in significant amounts of research and numerous case studies already (Swanson, 2001). Also it is near impossible to open a management book or a magazine today without reading that 'people' is the most important asset for companies today. This all suggests that HR should be the most important department in any service company.

On the other hand, most people – including most top executives – often perceive HR to be an administrative function whose purpose is to make sure that people are paid on time, that employment contracts are signed and that relations with unions are good. HR is not perceived to add much strategic value. This is a paradox.

This gap between the theoretical added value of HR and the perception that HR is not adding much value is in large part down to HR practices. Perhaps the best way to describe the current state of HR is to say that it is an area where practice lags behind knowledge quite a lot. There is a lot of evidence that shows that HR can add customer and shareholder value, but it is also fair to say that that practice is different.

This paper argues that HR has the potential to be the most important area for performance improvement in any company, and that HR itself must deliver on this potential. Recognising this, Jack Welsh – former CEO of GE – suggests that the HR executive should be hierarchically second only to the CEO, and at least on a level with the CFO (Welsh, 2005). Or, to put it in the words of Jim Collins (2001), the best companies understand that they must get the right people on the bus, get the right people in the right seats and then find out where the bus should drive.



### Three levels of HR

Looking through existing research on HR's role in Service Management, it is clear that primary focus has been on the operational aspects of HR. This is very much in alignment with practice. When interviewed, HR executives and managers say that they spend by far the most of their time on operational activities: often up to 80% of their time. This is changing to some extent, as HR is accelerating the pace at which it is moving toward being more strategically focused. HR is beginning to see itself as a business driver more than just an administrative function, and the people seeking a career in HR are more business orientated, with MBA degrees, than previously (Breitfelder & Dowling, 2008).

In order to understand HR – and therefore how it may be adding value for customers – it is useful to divide its activities into three categories: strategic, tactical and operational (see figure 2).

Figure 2: Three levels of HR activities



Source: Aspector A/S

#### ***Level 1: Operational HR (Personnel Administration)***

Operational HR includes most administrative tasks associated with people in an organisation. Examples include: payroll and benefit processing, recruitment of non-managerial staff, union relations, compensation analysis and negotiation, handling legal issues, team building, health & safety, new hire orientation, design and recording of job descriptions, and much more.

These activities are necessary for the running of any organisation. Problems and issues are often handled in a reactive manner with a short-term time frame. For example, when an employee has just left the company, a new person is hired to fill that position.

Many of these activities can be done at a contract level, and often in co-operation between the administrative staff, the site manager, the line manager and the employee. The tasks often do not require much business understanding, but the people must have good subject matter knowledge.

### ***Level 2: Tactical HR (Human Resource Development)***

Tactical HR includes HR partnering, recruitment of managers, coaching, talent mentoring, on-boarding, training, HR process optimisation and more.

These activities are more proactive and seek to add value by focusing on slightly longer-term issues, and focus the attention on places where the impact is greater. Managers and key people are often in focus, and HR seeks to understand their business and needs in order to serve them better.

Many of these activities are done at local or regional level between an internal HR consultant/HR partner, the regional manager, large account managers and key employees. This often requires some business understanding.

### ***Level 3: Strategic HR (Human Capital)***

Strategic HR includes Talent Management, HR strategy alignment, Succession Planning, Performance Management, ROI measures of HR, Human Capital Due Diligence, People Investment Analysis and more.

These are critical activities to create long-term value and growth for customers and shareholders alike. The proper management of Human Capital and Organisational Capital is done at this level.

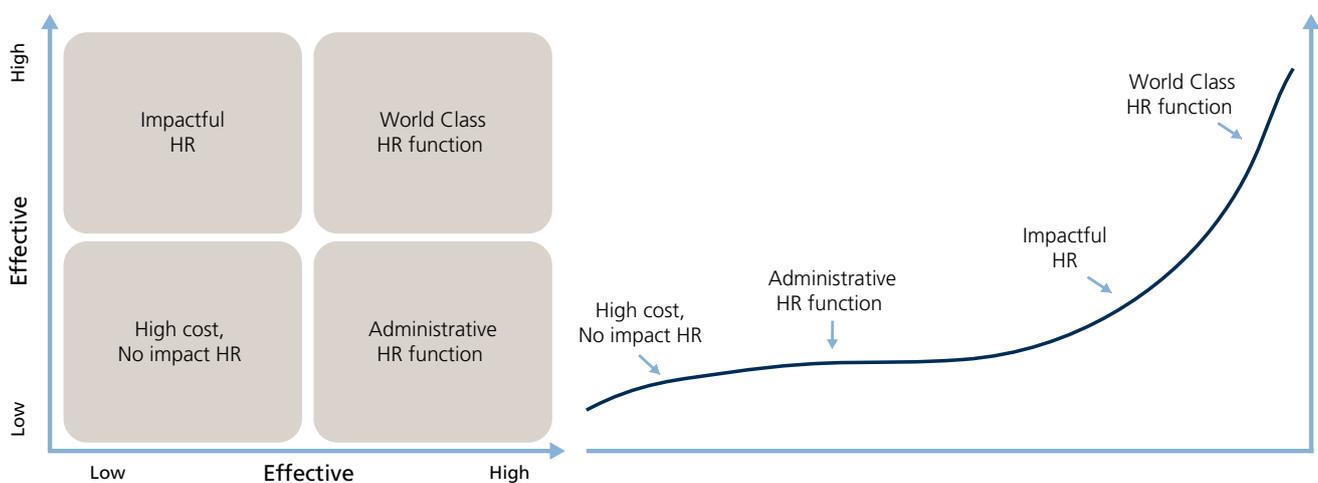
Many of these activities are done at headquarters level or at regional level. The primary people involved are the HR executive, CEO, Board of Directors and regional managers.



## Exponential benefits

Unlike any other asset, people have the potential to add value on an exponential scale. For HR to optimise its value creation, it must master two things: doing the right things (be effective – have a strategic focus) and doing them in the right way (be efficient). Peter Drucker (1966) explained in his famous book, “The Effective Executive”, that, to add maximum value, a function must master both disciplines. By looking at both dimensions, four types of HR function appear (see figure 3):

Figure 3: Four types of HR function



Source: Aspector A/S, Krogager & Schmidt (2002)

The **High cost, No impact HR function** is an expensive department which does not add strategic value to the company. This department may be large and may be responsible for many initiatives and activities. This may in turn erroneously be mistaken for a well-run department, whereas it is in fact the opposite.

The **Administrative HR function** optimises its budget, is very cost-focused and always asks itself, “Can we get more for less?” It is very efficient but lacks strategic focus, and therefore has little impact on the business and on the long-term success of the company.

The **Impactful HR function** has the ability to support the business by aligning all its activities with the strategy of the company. The problem is that it is very expensive, as it is not focused on optimisation. This may, however, be a deliberate decision, and is often the case where the value and earnings of people are very high. In the service industry, this may be in a consultancy company.

The **World Class HR function** has the ability to align its activities in such a way that it supports the business and strategy of the company and is very efficient, getting as high a return on its investment as possible. The value creation is significant in this type of department.

In summary, HR today is viewed as an administrative function, with some justification. This is, however, slowly changing as many case studies, research and anecdotal evidence shows that an efficient and effective HR department adds significant tangible value for customers and shareholders alike.

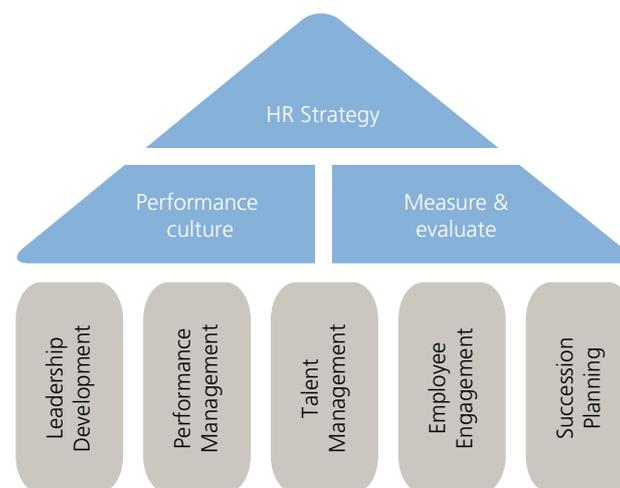
# Key Strategic HR process in Service Management

Service Management is all about creating value in the eyes of its customers. As mentioned above, this value is a perception that the customer forms on the back of the encounters he has with the service provider's service and employees. For these encounters to be successful, the service provider must serve the front-line worker as well as possible.

It is not possible to say that some HR practices are purely strategic and some purely operational. All core HR activities are both. For example, recruitment: the strategic side of recruitment includes identifying competencies which can serve customer's future needs and take the service provider company to where it wants to be in five years' time. The operational side of recruitment is to identify people with these competencies, agree pay and benefits and hire them.

Some HR disciplines are, however, more strategic in nature. Best practice strategic HR suggests a strategic framework and five core strategic HR disciplines, as depicted in figure 4:

Figure 4: Best Practice framework for strategic HR



Source: ISS

## The strategic HR framework

The strategic framework is the set of principles and guidelines to which all strategic HR activities should adhere. They should be documented and implemented in such a manner that they are aligned with the company's own mission, and operational so they can be used in the HR processes. There are three areas that such a framework should cover:

### 1. HR strategy

All HR activities must be strategically aligned with the company's overall strategy. At the end of the day, the overall purpose of an HR department is to create and deliver the right set of competencies and organisation, which in turn can deliver Service Management is all about creating value in the eyes of its customers. As mentioned above, this value is a perception that the customer forms on the back of the encounters he has with the service provider's service and employees. For these encounters to be successful, the service provider must serve the front-line worker as well as possible.

### 2. Performance culture

All companies have a culture, but not all promote high performance and superior customer service. While HR is not the bearer or primary shaper of a company's culture, it is up to HR to design and implement activities so they promote such a culture. Studies show that, where HR is activity integrating the concept of performance culture into all its activities, companies perform better in the long run.

The success of this is measured by how well the (leadership) principles are converted into practice and behaviour.

### 3. Measure & evaluate

HR must measure and evaluate its initiatives constantly in an objective and tangible way – something that is not a core competency of HR in general. By using tools such as HR Analytics, HR can make better strategic and people-investment decisions, thus making HR more efficient (Davenport et al., 2010).





## The five core strategic HR components

### 1. Leadership Development

Leadership Development is a must-win battle for service companies in order to deliver excellence in service offerings. Leaders shape the culture of the organisation and make the processes stick. Leadership Development must involve top management participation to underline its significance. Leaders, at all levels, must be able to guide and motivate based upon human understanding, respect and responsibility – competencies which must be constantly developed. Leadership Development can take many forms: classroom education at universities, tailor-made programmes for the leadership team, individual development plans and coaching etc. Leadership Development is not just about focus on the individual person (leader) but also on developing leadership as a process in the company. This includes team dynamics, organisational climate and relationships.

### 2. Performance Management

Performance Management is one of the most effective Strategic HR activities. Research shows that it is directly linked with: 1) higher profits, as employees clearly understand and meet their individual goals; 2) quicker execution of company strategy; and 3) reduced employee turnover through higher engagement in their work. Goal alignment also makes it possible to establish a true pay-for-performance culture by linking reward systems with both individual and team performance.

To achieve goal alignment through Performance Management, strategic business objectives must first be communicated clearly across the entire company. Goal sharing also helps departmental heads find ways to better support each other, thus breaking down silos.

Through a strong performance management culture, business performance and employee contribution to service excellence can accelerate. In addition, performance management both serves as a clear measure of individual performance and development, and also provides a clear pipeline to talent identification and succession planning.

### 3. Talent Management

The War for Talent – a phrase coined by McKinsey (Chambers et al., 1998) – is continuing with increased speed despite the current global slowdown. A survey among 40 of the world's largest companies revealed that most CEOs did not believe that they had the right talents, or enough of them, to fill their strategic management positions, even though 97% said that they had formal processes in place (Ready & Conger, 2005). Board members in multinational companies across the world single out the ability to attract and retain talent as the single most critical catalyst for growth today (Economist, 2007).

Talent Management is a range of continuous processes and development programmes that aim to identify, attract, retain, engage and intelligently deploy the best employees in order to become the future leaders on all levels – a leadership pipeline.

For the service provider, an effective Talent Management programme will develop the most gifted talent and adapt the organisation to current strategy and focus areas. For the customer, it means that the quality of people responsible for managing their site(s) is high.

A prospective customer should evaluate whether a service provider's Talent Management programme is 'just another HR programme' or is deeply rooted in the provider's culture and behaviour of managers across the company. The customer is only likely to receive notable benefits from a provider if the programme is culturally rooted.

#### **4. Employee Engagement**

It is widely recognised that Employee Engagement is a major driving force behind many business outcomes. Research clearly shows that engaged employees are more productive, more profitable, more customer-focused and more loyal. For example, Gallup concludes that companies with world-class company-wide engagement have 3.9 times the EPS growth rate compared with organisations with lower engagement in the same industry (Gallup, 2010).

Improving engagement requires a constant focus on changing behaviours, processes and systems to anticipate and respond to the organisation's needs. From the leadership team to the front-line employees, all levels within an organisation must commit to making these changes.

Improving engagement means measuring and analysing the level of engagement. It is not possible to improve what you cannot measure. A company-wide engagement survey should link directly with the user (customer) experience survey. In this way, the engagement survey will give a clear picture of exactly by which parameters the engagement level is affecting the customer experience and which exact actions should be taken to restore potential issues.

## **5. Succession Planning**

Succession Planning has two main purposes: one is to mitigate risk by having emergency successors identified, to step in when needed; the other is to have a longer-term development view of how positions are filled. The advantages of doing this well are anchored in business continuity. An effective, proactive succession plan leaves the organisation prepared for the loss of key employees, and prepared for growth, filling new jobs and employee promotions.

Succession Planning involves several steps: 1) identify key roles and positions which, for risk mitigation purposes, require someone to step in if needed; 2) identify and/or recruit a successor for each identified key position; 3) assess gaps for each position between desired level of competence of each successor and current level; 4) make individual development plans for each successor; and 5) develop each successor to the required level of competence.

Succession Planning processes, in particular, should be reviewed carefully by prospective customers, and may even form part of the RFP process and be a key KPI. Many service relationships fail due to turnover of key employees at the service provider.

If the service provider excels in all five core strategic HR disciplines within the core strategic HR framework, it will be what Peter Drucker described as “very effective”. The next chapter will describe in more detail how this effectiveness adds value for the customer.

# Value and benefits of process

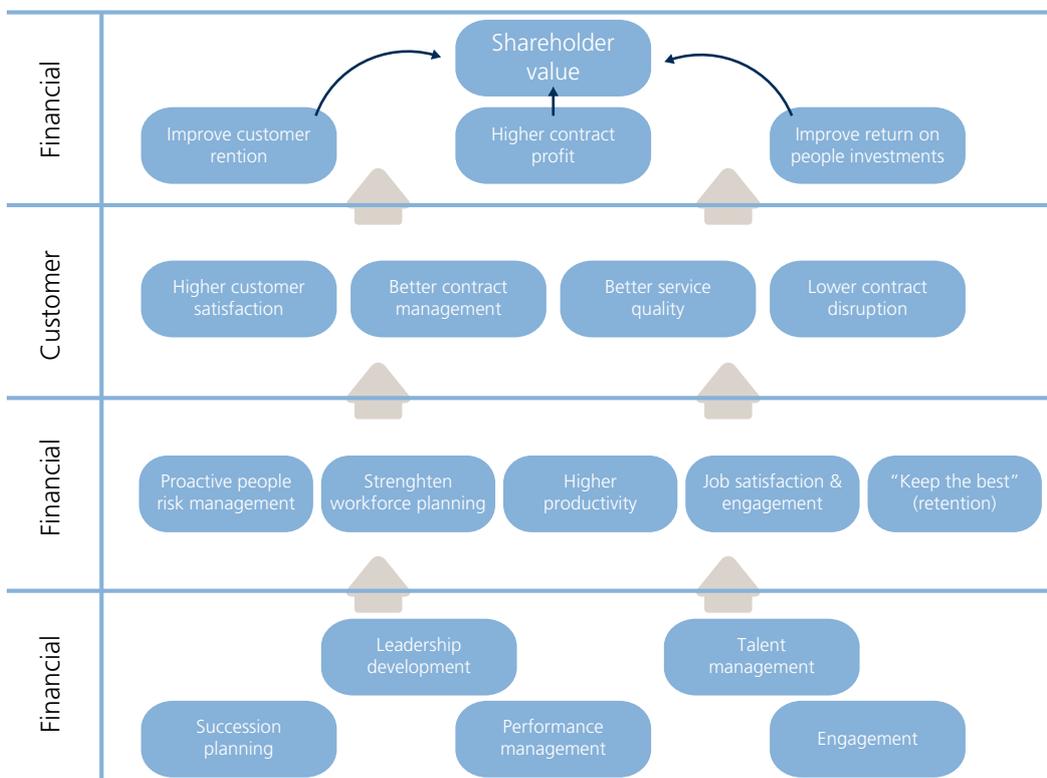
Studies show that strategic HR adds value for customers through five core practices. One of the best ways to illustrate how strategic HR activities link directly with customer value is through the strategy map.

The strategy map was developed by Kaplan and Norton (2004) and is a visual representation of the cause-and-effect relationships between the various components of an organisation's strategy. It is intended to visually describe a strategy for a company so that its objectives can be measured and managed. What it also does, however, is to show how activities on intangible assets – such as HR activities – add tangible value for customers and shareholder alike. Finally, it identifies how investing in intangible assets leads to sustainable growth for the company. It converts intangible assets into tangible outcomes.

Like the service profit chain (see above), it also graphically illustrates how value is created through internal business processes. It is through the internal processes that investments into intangible assets become tangible outcomes for customers.

Figure 5 illustrates how a strategy map focusing on the five core strategic HR processes may look for a service company. There is no correct strategy map – instead, it represents the company's strategy and how it wants the cause-effect relationships to be. The example in figure 5 is therefore made for illustrative purposes only.

Figure 5: Strategic HR strategy map



Source: Aspector, 2011

### ***People***

The people processes (also called 'learning and growth' by Kaplan & Norton) highlight the contribution of intangible assets – in this case, the five core strategic HR practices – to the sustainable value creation in the company, showing how important this is in terms of aligning the company's intangible assets with the company's strategy. The objectives of the HR disciplines must be aligned with the objectives of the internal processes and integrated with each other. These two principles (alignment and integration) are easy in theory but difficult and neglected in practice. In Service Management, the inability to meet these two principles is one of the most common reasons for failure to meet the long-term needs of the customer.

A prospective customer should not assess a potential provider in terms of how much effort it is putting into each of the five people-processes, but instead focus on how well the processes are aligned with the providers' internal processes. This is the greatest predictor of value creation for the customer.

### ***Internal processes***

It is the internal processes that produce service to customers. Ultimately, it is in the processes that the strategy is executed. Operational excellence is then one of the most important elements in executing strategy and delivering service.

Internal processes complete two important components of a strategy: 1) they produce and deliver the value proposition to the customers, and 2) they improve processes and reduce costs, and hence improve productivity (Kaplan & Norton, 2004).

In this illustrative case, the five strategic HR processes directly affect five internal processes: people risk management, workforce planning, productivity, job satisfaction and engagement, keeping the best. These five internal processes will deliver customer value. Many other internal processes could have been chosen; innovation, sales, customer management and many more.

### *Customer perspective*

The internal processes will create differentiated, sustainable value in targeted customer segments. This will only happen if the customer value proposition – the service company's strategy for its customers – is exciting, innovation and value-added.

In the case illustrated above, the customer will experience better quality, higher satisfaction, better contract management and fewer disruptions as a result of the strategic HR initiatives.

### *Financial perspective*

The financial perspective is the ultimate objective for any profit-maximizing company, although it must also be recognised that this objective will only be met through meeting the customer objectives too. There is no value to shareholders unless true value has been created for the customers.

Figure 5 illustrates how the five strategic HR processes ultimately lead to increased shareholder value through improved customer retention, higher contract profit and more efficient use of Human Capital investments.



### **Assessment questions**

Customers have a strong interest in selecting a service provider with excellent strategic HR processes, as they in turn will lead to better service quality, lower contract disruption and better contract management. It is therefore recommended that the customer ask – as a minimum – the following questions (for example, as part of the RFP process):

1. Has the service provider identified all key personnel for this contract and developed a specific and detailed succession plan for each position with name, contact details and a gap-closing action plan for each person?
2. Has each manager a personal development plan, which is aligned with both the contract's demands and the company's overall strategy?
3. Does each employee have individual goals which are reviewed twice a year and which are aligned with team, contract and company goals? Are all goals 'SMART' and mutually agreed?
4. Does the service provider measure the level of engagement of its employees and take proactive action to constantly increase this level?
5. Has the service provider a strategically anchored Talent Management programme that ensures that each key position is filled with the right talent?
6. Does the service provider have an explicit, formulated HR strategy with details of each activity, which is aligned with the overall strategy of the company?
7. Does the service provider measure the impact and value of its strategic HR activities and use this to constantly improve the choice and implementation of its strategic HR activities?
8. Does the service provider report on all relevant HR activities that affect the customer, share the findings and engage the customer in a dialogue about how to improve?

Most service providers will not be able to meet all of the above criteria, as they each represent best practice in each area. The customer should therefore set a minimum standard for each area/question and select the provider with the best overall processes.

# Conclusion

Service Management is about continuously creating value in the eyes of the customers. This perception of value and quality of service is formed by the customer in an often brief encounter between a service provider's employees and the customer. This means that the service company must excel at serving the front-line workers, who are the most important link between the company and the customers.

The service profit chain and the strategy maps both illustrate how people-processes add tangible value to customers. Evidence shows these links to be real and strong. Both graphically illustrate how people-processes link with internal business processes, which link with customer value, which in turn creates shareholder value. It is through the internal processes that investments into intangible assets become tangible outcomes for customers.

Evidence shows clearly that HR should be the most important department in any service company. However, most people – including many top executives – continue to perceive HR to be just an administrative function, adding little or no strategic value. HR must change this perception by optimising its value creation by mastering two things: doing the right things (be effective – have a strategic focus) and doing them in the right way (be efficient). This will create exponential tangible benefits.

It is useful to divide HR activities into three categories: 1) operational, which includes most administrative tasks associated with people in an organisation. Problems and issues are often handled in a reactive manner with a short-term time frame. 2) Tactical, which includes activities supporting the line managers in achieving their business goals. The activities are more proactive and seek to add value by focusing on slightly longer-term issues. Finally, 3) strategic HR concerns critical activities that create long-term value and growth for customers and shareholders alike. These are proactive and have long-term timeframes.

Best practice strategic HR suggests a strategic framework and five core strategic HR disciplines.

The strategic framework is the set of principles and guidelines that all strategic HR activities should adhere to. They should be documented and implemented in such a manner that they are aligned with the company's own mission, and operational so they can be used in the HR processes. The strategic framework includes: HR strategy (aligning the HR activities with the company's strategy), performance culture (one which promotes high performance and superior customer service) and measure & evaluate (constantly measuring and evaluating its initiatives).



The five core strategic HR components include:

1. Leadership Development constantly develops core leadership competencies, such as being able to guide and motivate based upon human understanding, respect and responsibility.
2. Performance Management is one of the most effective strategic HR activities as it creates goal alignment, high performance and reduced employee turnover.
3. Talent Management is a range of continuous processes and development programmes that aim to identify, attract, retain, engage and intelligently deploy the best employees.
4. Employee Engagement affects productivity, profitability, customer focus and loyalty.
5. Succession Planning mitigates risk by identifying emergency successors to step in when needed.

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## Company profiles

### Aspector A/S

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