The ROI of hotel human capital investment: What's that about… never heard of it!

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Abstract

This study investigated the relationship between hotel Human Capital Investment (HCI), employee productivity (EP) and the Return on Investment (ROI) of Human Capital (HC). When hotels invest in their HC, they should expect a return on that investment, a concept known as Return on Human Capital Investment – ROHCI.

Semi-structured interviews with general and operational hotel managers and a survey of employees sought to understand HCI, EP, and ROHCI and how these were measured and tracked. Participants were from international and domestic hotel brands in New Zealand.

This research reports hotel managers and senior hotel head office human resource directors do not understand or measure ROHCI at operational or tactical levels. These findings have not previously been considered or reported in the literature. The key message for industry practitioners and hospitality researchers is that they should work together to co-produce research that will help managers better understand ROHCI and its calculation.

Key Words:
Human Capital, Return on Investment, Hotels, New Zealand

Introduction

The value-generating competencies of employees, known as human capital efficiency, are vital for organisational financial success (Barros, Peypoch, & Solonandrasana, 2009). Such competencies are bought into the hotel when the employee is first employed or as a result of training and learning to improve the knowledge, skills, and capabilities, which can lead to positive individual and organisational outcomes (Pelinescu, 2015). Purchasing such competencies and ongoing investment in employee training can be considered Human Capital Investment (HCI); however, there is a lack of research and understanding of how hotels confirm the actual financial return on such investments.

While HCI should be viewed as an investment rather than an expense (Namasivayam & Denizci, 2006; Pelinescu, 2015), measuring the outcomes of such investment has been overlooked (Santos & Stuart, 2003). Surprisingly, the outcome of this research highlights the concept of Human Capital (HC) Return on Investment (ROI), which we term ROHCI, is not understood or used within the New Zealand hotel industry at operational or strategic Head Office levels. This outcome is a significant concern and missed opportunity, given that hotels report their HC as the greatest asset and should know the return this investment makes.

The adage that *if you don't measure it, you can't manage* is valid in many business contexts, and managing ROI is not exempt from this. Evaluating/measuring training as part of HCI was proposed many decades ago by Kirkpatrick (1977), with Phillips (1994) extending the model and adding ROI, which calculated training investment. In acknowledging training is only one aspect of ROHCI, there are several reported reasons for not being able to quantify HC-ROI, including the lack of managers' skills and knowledge to understand and collect the required data for calculation and measurement (Charlwood, Stuart, & Trusson, 2017). Further, Stern (2011) and Kline and Harris (2008) note that managers report not measuring ROHCI due to insufficient time, ineffective tracking systems and metrics, and lack of confidence in reporting incorrect values to higher management, dreading they may lose their jobs. These concerns aside, in today's environment where HC is difficult to find and increasing in cost, organisations should measure HCI to establish ROHCI by collecting appropriate metrics for communicating the impact of human resource work in the organisation (Birasnav, Rangnekar, & Dalpati, 2010).

The focus on ROHCI is one component of the overall productivity discussion that every business has today. Managers generally understand there is a link between HCI and Employee Productivity (EP) (Tangen, 2005); however, it is vital to know how EP finally tracks to ROI.

Past research on ROI considers benefits and costs; for example, Chambel and Sobral (2011) suggested benefits can be material or financial gain and social status, money and lost opportunity. Earlier research by Kirkpatrick (1977) focused primarily on the ROI of training. Still, there has not been any serious discussion on ROHCI in hotels, even though there are models such as those presented by Mankiw *et al.* (1992), Fitz-enz (J Fitz-enz, 2000; 2010), Prosvirkina (2014) and Manuti (2014). Arguably, the lack of interest and action in understanding this is explained by Kline & Harris (2008), who suggest, in a hospitality context, this could only be effectively done by larger organisations due to capturing data as part of the calculation.

The research reported here was undertaken in the New Zealand hotel industry, which set out to fill the notable gap in the literature related to evidence of increased productivity (and ROI) and positive returns from HCI. To achieve this, two research questions guided this research. (1) To what extent does HCI impact EP and, ultimately, hotel performance in terms of their ROI in the New Zealand hotel industry? (2) Investigate if and how hotel managers calculate or track ROHCI.

Method

This study focused on three to five-star rated hotels with 50 or more rooms from three major tourist locations in New Zealand - Christchurch, Auckland, and Queenstown. Using differing star ratings enabled comparison of results while the locations chosen were because this is where most New Zealand hotels are based. The reason for hotels with more than 50 rooms is supported in the literature (Bergin-

Seers, Jago, Breen, and Carlsen (2006). Further, hotels with less than 50 rooms are assumed to be operated by owners and are less likely to involve formal HC and strategy functions (Ladkin & Riley, 1996). Finally, it was considered that larger hotels would understand the concepts of HCI, EP, and ROHCI.

Hotels from each location were listed under their star rating in order of size. Starting with the first hotel in each list, invitations to participate were sent to hotels until at least five hotels agreed to participate, or all hotels in the classification if there were less than five.

Semi-structured interviews with hotel General Managers (GMs) and Operational Managers (OMs) sought to investigate and gain a deeper understanding of how managers (1) define/measure productivity in the hotel context, (2) perceive HCI impacts on EP, and (3) understand and measure the link between HCI and ROHCI. The rationale for interviewing GMs and OMs was to understand if there were differences in their understanding of the HCI, EP and ROHCI concepts.

Transcripts were analysed via NVivo with themes developed using a Grounded Theory approach via standard coding. Employee surveys were captured and analysed via Qualtrics.

Results

This section considers the research results under several headings and begins with the participants' demographics.

Participants

Ninety-two managers were invited to participate in the study, and 25 managers agreed: 12 general managers (GMs) and 13 operational managers (OMs), which consisted of four Human Resource (HR) managers and nine Heads of Departments (HoDs). Over half of all managers held at least a Bachelor's degree, with six managers holding a Master's degree. The majority of managers were over 35 years of age. Finally, male managers outnumber females by fifteen to ten, with males having longer tenure as a GM than females.

Human Capital Investment

Generally, GMs and OMs had different views of HCI, including how HCI impacted EP and ROI. We suggest this reflects their default job descriptions and personal key performance indicators (KPIs). OMs consistently expressed specific, role-focused interpretations of HCI and gave practical ways to do this. This went beyond their professed interpretation of HCI and was closer to the comprehensive understanding of the theory that most GMs professed.

Investment in training was generally via a *buddy* or on-job training with smaller elements of off-job training and in-house e-learning. GMs and OMs acknowledge that each type of investment has advantages and disadvantages, and budgets and staff availability drive the costs associated with each type. However, no matter which investment method was used, no tracking or measurement of its success could be linked to ROI. The value of measurement-to-manage is lost and exampled by one hotel manager who said, "*When it comes to budget, financials, or return on investment, you need to speak to my Chief Finance Officer, who heads the finance department. I definitely know we have a budget, but I can't help with these questions*".

Employee Productivity

GMs generally viewed employees as their greatest asset and HCI as adding value to their employees. Another GM suggested that adding value to employees' professional and personal development improved their productivity: "It is really about developing or adding value to people, and allocating resources for their professional and personal development. HCI is about developing talent for the future and not [just] now. Examples of the investments are training programmes, reward programmes to boost morale and productivity, and flexible working arrangements. Sometimes providing training that is externally focused and not relevant to the work they do. Their own passion makes them committed and loyal, which impacts their work."

GMs have what could be considered a balanced view of how EP is measured. For example, two GMs noted: (1) In the restaurant, when they serve 130 covers at night, is it a good 130 or 130 terrible covers? You don't only look for quantity, but I believe quality has to come in as well. (2) Productivity standards are set to match service quality levels. We don't want to stretch the employees too much because it will have adverse effects on service quality, which is more important to us than just the numbers. While OMs did not discount quality as a measure of productivity, they are more focused on quantitative evaluation exampled by: (1) "Employee productivity is the ability to complete a task within the assigned timeline", (2) Our departments, like housekeeping, have structured productivity, and it is a combination of how many minutes they have to clean the rooms.

Managers identified factors that hindered EP, the most significant being high staff turnover. However, most GMs (22 out of the 25) did not know the cost of employee turnover, and only three managers reported that they had an idea of the cost involved. A GM noted, "We spent about $3,000 to $6,000 for a front-line employee. We invest in recruitment and training. Supervisors and management roles are about $10,000 and about $25,000 for Heads of Departments. Another GM pointed out, "That is a lot of money when you have employees leaving more than expected."

Measuring Return on Investment

This research reveals that the concept of ROHCI is not understood by participating hotel GMs or OMs as exampled in the following vignettes.

Even though I know the importance of calculating and knowing your investments, we never track our ROI. It is interesting. I report to the CEO of the company and the CFO, and I get questioned on payroll costs, food costs, using too much soap in the guest rooms, etc. For over 40 years in this industry, no senior management has ever questioned me about ROI. This is something that never comes up for discussion." A further representative quote, *"Yes, we do use our profit and loss statement and balance sheets to see how well we are doing."* Finally, *"I have no idea how to calculate ROI. Our ROI financials are done at the head office. Every month, they send us reports showing our profits."*

These statements are of concern, with the first statement from a very senior and experienced GM. The second statement is irrelevant to ROHCI as increased profit may result from increased prices, not EP. The final statement is a mix of the former and an admission they do not understand how to calculate any form of ROI. However, managers did view indicators, such as guest satisfaction score, employee retention, turnover levels, career progression, profitability, profit and loss (P&L) statement, KPIs, and productivity levels as measures of ROHCI.

Given that hotel GMs and OMs did not understand the concept of or ways ROHCI can be calculated, the researchers approached a major hotel chain head office, where a senior HR Director said: *"ROI was not calculated or tracked because it was time-consuming, owners are not prepared to invest in software that can be used to track these investments. The industry is more focused on operational aspects, and nobody has the time to sit behind a desk to calculate ROI."*

Discussion

This research sought to understand the linkages between HCI and EP to ROI. Developing this understanding is vital given the extensive discussion in the literature and general hotel industry about employees being a hotel's greatest asset and increasing productivity. Yet, there is almost no discussion or research related to checking the ROI hotels make in their HCI aimed at lifting EP.

As a prelude to this discussion and subsequent results, it is important to remember that hotels, at the macro level, are not homogenous; therefore, no two hotels will have the same KPIs, EP from HCI or subsequent ROI. That said, in the main, hotels have similar operational variables; for example, they invest in employees, have rooms to clean, and have restaurants and bars where guests are served.

With the above in mind, this research proposed the movement from HCI to ROI would be sequential (see Figure 1), and there would be a positive transitional outcome from HCI to EP to ROHCI. However, this research shows that hotels do not engage the last component (ROHCI). As such, hotels have no idea

whether HCI and EP are better or worse in different departments or if there are operational improvements from year to year from HCI. There is a disconnect between HCI and ROHCI.

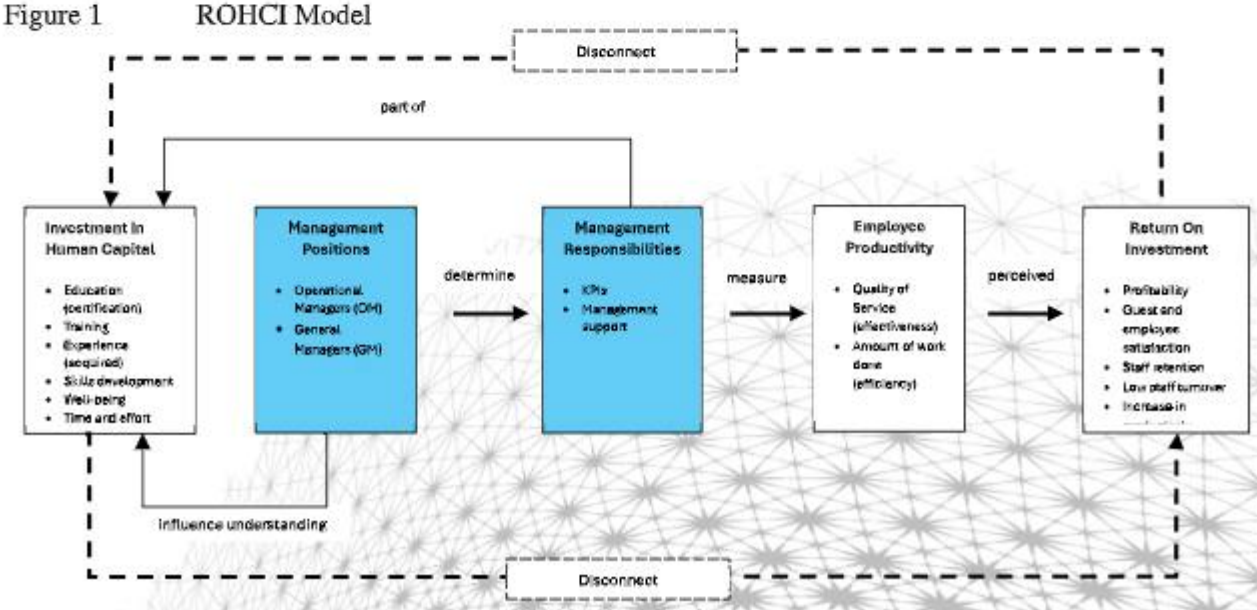
GM's default analysis of ROHCI is from the Profit and Loss Account, and they showed no understanding of the ROHCI concept as a measure of effectively managing the HCI. The assumption is that if the P and L report is better than the previous one, then the HCI has been worth it, which they further assume has increased EP, but this may not have been the case. Increased room prices may drive up revenue, but it does not necessarily mean that EP has been better. Another example is that costs in some products may have been reduced, but there is no change in HCI. GMs and OMs, including Human Resource Managers, did not discuss the concept in general operational meetings and have never been asked about it by Head Office. When the researchers queried the concept, all managers felt it might be something that the Head Office might do. This outcome is surprising and, as mentioned above, worrying, given that HC can be the most significant cost to a hotel. The researchers were even more surprised when the Corporate Head Office Human Resource Managers were not interested in gathering or analysing such information. From an overall chain perspective, such analysis would be valuable to learn where HCI and EP are better than others and take those learnings across the chain.

The general understanding is that if a hotel completes HCI, it will naturally lift EP, and there will be a ROHCI; however, there is no evidence to check this is the case. Indeed, some HCI may have a very low or even no ROHCI, while others may generate a significant ROHCI. Just because it may be challenging to measure is not an excuse not to do so. Given the present financial challenges hotels have experienced as part of COVID, arguably at any time, it is essential to know exactly where money is generating a suitable ROI.

There are various ways to calculate ROHCI; however, all require the total *costs of employees* – wages, training, etc. An issue for hotels not being able to calculate ROHCI is that none of the hotels participating in this research calculated employee turnover costs, a key factor in establishing the overall costs of employees. There is very little research on the topic of hotel employee turnover costs, but research by Davidson *et al.* (2010) in Australia noted it could be as much as $9,591.00 per full-time operational employee – being made up of recruitment, selection, orientation and training, lost productivity and pre-departure. The costs for management personnel are much higher.

Returning to the proposed research assumption of a sequential approach from HCI to ROHCI, Figure 1 notes the disconnect but adds the loop-back needed to ensure HCI is considered once ROHCI has been established. We argue that unless a hotel understands and undertakes ROHCI analysis, they have no idea if and where HCI has a positive or negative effect.

Figure 1 ROHCI Model



Returning to the details of this research, the definition of hotel EP differs depending on who you talk to. This research notes that employees and General Managers (GMs) had similar views, whereas Operational Managers' (OMs) views differed from employees and GMs. Employees and the GMs considered qualitative and quantitative forms of EP, whereas OMs were more focused on quantitative, such as the number of rooms cleaned or guests served. To be clear, OMs did not ignore the qualitative aspects, such as customer satisfaction. However, they received less attention, and this outcome is interesting if we consider the career path from employee to OM to GM. We propose that it results from the KPIs in the differing roles.

Exploring this outcome further, we note that employees are primarily focused on daily customer interaction. They are often evaluated via guest feedback and maintaining services numeric standards, so they see their role as having qualitative and quantitative EP aspects. OMs, however, generally have different drivers/KPIs, primarily ensuring guests are served within the department staffing budget and within set limits, for example, the guests served per wait staff. Here, we note guest input as part of evaluation may be less prominent as an OM seeks to meet budget KPIs if, for example, they wish to be promoted, and this will sharpen the mind and potentially drive actions.

Achieving GM status presents a different set of KPIs, which can include budget and guest feedback, and this is where we see employees and GMs having similar views on EP.

We conclude this discussion with a brief reference to the research participants. This study confirms previous literature findings regarding the demographic makeup of hotel management positions, with most GMs being male. At the same time, OMs were split evenly between genders, and Human Resource Managers were mainly female. It is, however, a continual concern that there is a lack of female GMs in today's hotel industry, something noted in the literature for some time but has not translated to change.

Conclusions and Implications

This research highlights differences in understanding of HCI, EP and ROI between General and Operational Managers and, further, of particular concern, the hotel sector's lack of knowledge and even willingness to engage in the discussion about ROHCI. This research identifies three key conclusions: A shared understanding of HCI, defining and measuring EP, and understanding and calculating ROI.

A shared understanding of HCI:

While HCI has been comprehensively investigated in the general literature, the literature is silent on management's understanding or interpretation of the concept, specifically in the hotel sector. This research highlights differences in the interpretation of HCI due to a person's job role, which is inconsistent with HCI literature. GMs and OMs have different opinions, while GMs and employees share similar opinions. This interpretation-disconnect also exists between researchers and practitioners where terms defining and measuring EP in the hospitality industry must include the key elements of quality of service, client satisfaction, and employee happiness.

While this finding may not be unique to the hotel industry, authoritative international organisations, such as the OECD, which try to standardise most things, need to acknowledge this and consider how different sectors measure productivity.

Defining and measuring employee productivity:

The second conclusion is that although hotels are considered a low-productivity sector, EP is not actively discussed within the New Zealand hotel industry as part of employee output. While there is an international definition of productivity, hotels internally define productivity differently, which differs between hotels with different star ratings.

Regarding measuring EP, the findings match previous literature, which says measuring productivity in hospitality is challenging due to the unique characteristics of services (and their inputs), including intangibility, simultaneous production and consumption, perishability, and heterogeneity. Further, this study revealed that measuring EP appears inconsistent within the industry, resulting in an understanding disconnect. This disconnect adds other dimensions to the existing complexities when assessing work outputs by managers within the industry.

It may be impossible to develop such common measures across the whole industry. Nevertheless, a hotel should define EP, which can happen between hotels of the same chains. Finally, because EP is not understood in terms of definition and practice, there will continue to be a disconnect between practitioners and academics on how the sector is perceived in terms of productivity.

Understanding and calculating ROI:

The final and most striking conclusion is that hotels do not track or calculate ROHCI at operational and head office levels. This finding is significant given labour is reported as the highest cost in a hotel's operation, and hotels often refer to staff as their greatest asset. The reasons for not doing so have been reported above, including hotels not having the necessary data or time. This may be correct, but such data can be gathered, for example, staff turnover costs. Further, without time to understand a hotel's ROHCI, even down to the department level, it may be a waste of money that could be best used elsewhere. Knowing why some departments have better ROHCI than others enables overall EP improvement.

A hotel ROHCI calculator

We conclude this paper with a suggested hotel ROHCI model, which we believe is a starting point for hotels to understand better if there is an acceptable ROI on the HCI. In doing so, we acknowledge this requires investment in gathering data and the time to complete the calculation; however, we also believe that this investment will pay dividends as a hotel is better informed as to where and why differing ROHCI appears in the hotel.

ROHCI = (Revenue minus Non-Human Capital Expenses divided by Human Capital Expenses)

Revenue: This can be a hotel's total or department's revenue over any period. A more refined calculation can include removing the cost of capital, depreciation, interest and taxes.
Non-Human Capital Expenses: Operating expenses (including human capital expenses) minus Human Capital Expenses.
Human Capital Expenses: Fixed and variable remuneration, plus benefits (meals, uniforms, health plans, etc.), plus indirect costs, including employee turnover costs, training, education, recruitment and leaving costs, etc.

Example:

ROHCI: $\frac{(\$840{,}000 \text{ (revenue)} - \{\$300{,}000 \text{ (all operational costs)} - \$184{,}000 \text{ (HC expenses)}\})}{\$184{,}000}$

$\frac{\$840{,}000 - \$116{,}000}{184{,}000}$

$\frac{\$724{,}000}{\$184{,}000}$

= $3.93

The $3.93 means that for every dollar the hotel spent related to HCI, it received $3.93. It is important to note that every hotel or department ROHCI will differ. Still, tracking changes enables more effective strategic future HCI decisions and learnings that can be transferred to other hotels or departments.

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