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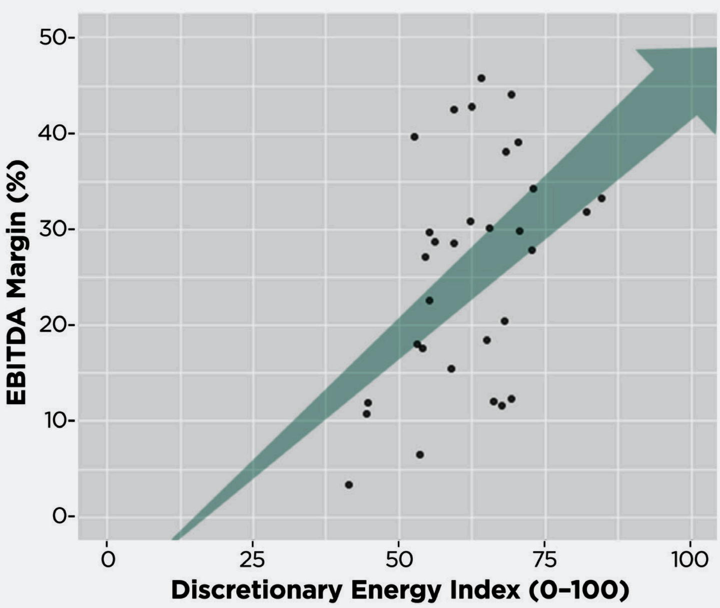
Getting more mileage from your people: improving discretionary energy boosts EBITDA and ROA

Discretionary energy refers to employees' willingness and ability to go above and beyond what is expected in their current roles. Unleashing employees' discretionary energy has measurable impact for organizations, resulting in an 8.1 percent difference in three-year average return on assets (ROA) and a 16.3 percent difference in three-year average earnings before interest, tax, depreciation, and amortization (EBITDA; Figure 1).

Employers always look for creative ways to get more from their staff. Typically, this involves greater efficiency and doing more for less, such as double- or triple-hatting couched under the umbrella of job expansion and talent development. Because the nature of jobs has evolved tremendously in the past decades beyond clearly defined sets of tasks and responsibilities into more ambiguous roles, discretionary energy has emerged as a construct that explains how and why employers get more mileage out of their employees.

Figure 1

Organizations that score high on the Discretionary Energy Index scored 16.3 percent higher on three-year average EBITDA margin.



> **Unleashing the discretionary energy of the workforce can be achieved in part by giving people the right tools, conditions, and structure they need to do great work.**
>
> (Lewis and Hezlett 2016)

Human capital outvalues physical capital, yet organizations struggle with measuring it.

The combined potential value of human capital in eight economies is $1.215 trillion, 2.33 times greater than the value of physical capital (Korn Ferry, 2016). Every dollar invested in human capital resulted in $11.39 added to organizations' gross domestic product.

There are two key reasons why people represent not only significant financial value but also value-generation capability for organizations: potential and appreciation. First, people's performance can be influenced; hence it has immense potential to develop and lead to future utility. By creating the right environment, organizations can enhance performance by generating and releasing the power of discretion, what we have labelled discretionary energy—the hustle that we will never see from a machine. Second, humans do something that traditional machines cannot: They gain experience and knowledge over time. The more experienced people become, the more they grow their ability to generate greater value, oftentimes exponentially. It is not surprising that the value of human capital appreciates over time, whereas the value of physical capital depreciates.

While human capital is more valuable than physical capital, only 4 percent of leaders state that measuring revenue per employee is a critical performance indicator for their organization. Further, 46 percent say their organizations do not understand how to measure workforce performance. Clearly, there is a stark void in the current methodologies organizations employ to measure the value of their intangible human capital.

Nailing down the elusive discretionary energy.

Facing uncertainties in an adverse VUCA (volatile, uncertain, complex, ambiguous) environment, executives often suffer from what experts call a "tangibility bias": They put a priority in their thinking, planning, and execution on what they can see, touch, and measure. Increasing their dependence on technology and physical assets seems to provide the competitive advantage required to operate and sustain growth in the future. However, not all technological change guarantees long-term sustainable competitive advantage (Porter, 1985). Early adopters who jump onto the bandwagon of untested technological change shoulder greater risk in the hopes of winning big.

Organizations need to realize that there is an alternative to the approach lead by the tangibility bias. Those that can master the art of tapping into the latent discretionary energy of their human capital can create a true, sustainable, competitive advantage without exposing themselves to the considerable risk of untested technology.

Before organizations can tap into their employees' discretionary energy and invest in creating the right conditions for their human capital, they need to be able to measure it, and to show the clear impact that discretionary energy has on financial performance. The Superior Performance Model (SPM)[1] was designed to do just that (Figure 2).

Figure 2

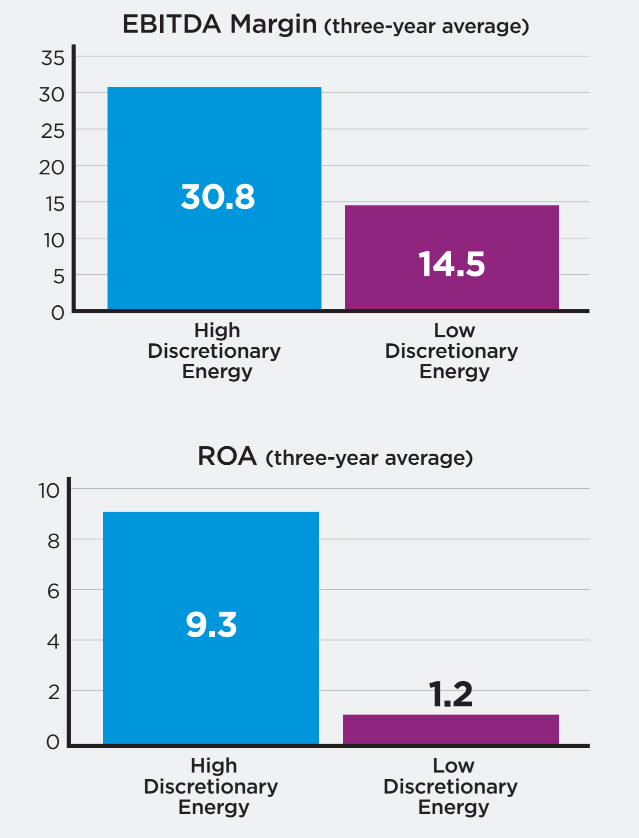
The SPM demonstrates the seven critical organizational dimensions which form the foundation for unleashing discretionary energy in the workforce.

Discretionary energy: a critical component of human capital.

We created a Discretionary Energy Index[2] to explore whether higher levels of discretionary energy lead to better business performance. We found that companies with higher scores on the Discretionary Energy Index tend to experience better business performances (Figure 3). High discretionary-energy companies, compared to low discretionary-energy companies, saw a 16.3 percent higher three-year average EBITDA from 2013 to 2015. High discretionary-energy companies also saw an 8.1 percent higher three-year average ROA, an indicator that is widely used for measuring management's efficiency of resources.

Figure 3

High discretionary-energy companies outperform low discretionary-energy companies on EBITDA and ROA.



Conclusion

How do you unleash discretionary energy in your workforce? The amount of energy released and employed at work depends on three key areas:

1. The extent to which there is a **clear direction and strategy** articulated by the leadership of the organization: Are people aligned in terms of what the organization stands for, what it intends to achieve, and how management plans to achieve it?

2. The extent to which the organization has the **right people, in terms of skills, talent and commitment**, to execute on the strategy of the organization. This includes their attitude, how much they enjoy being at work, and how they feel about the company.

3. Are people **absolutely clear about what is expected of them**, and more importantly, are they on board with it? Do they find their work meaningful, and are they are aware how it contributes to the larger mission of the company? Does the organization reward the desired behaviors?

Discretionary energy is generated only when there is the right balance of leadership, people drivers, and organizational enablers. Unleashing discretionary energy is the fuel of competitive advantage, and competitive advantage creates profit. This is exactly what the power of discretionary energy can do.

References

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[1] The notion of "superior performance" is defined by the organization's unique mission and goals and is measured accordingly.

[2] To construct the Discretionary Energy index, we used a statistical approach based on factor analysis, for which each SPM dimension was weighted with respect to its proportion of variance in the data (OECD, 2005). N > 1,000.

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