

EXPLORING THE BUILDING BLOCKS OF EMPLOYEE LIFETIME VALUE (ELTV)

A WHITE PAPER DEVELOPED BY THE

FORUM
For People Performance
Management and Measurement



This document examines properties shared by Employee Lifetime Value and Customer Lifetime Value, which are explored in further detail in a 45-page research report entitled Employee Lifetime Value: Measuring the Long-Term Financial Contribution of Employees.

This white paper and the full report were produced by the Forum for People Performance Management and Measurement and the Performance Improvement Council.

Today, more than ever before, companies have at their disposal valuable resources to gauge Employee Lifetime Value (ELTV). Historically, employees have been treated as cost creators, rather than as value creators. While it has been relatively easy to associate value with sales performers who generate revenue, the value non-sales performers contribute to an organization has been much harder to quantify.

New technology enables managers to accumulate extensive information about

organizational performance at an individual employee level. Furthermore, any organization, regardless of industry, size, revenue or number of employees can take the first step to estimating the value contributed by their employees. This white paper, the second in a series developed by the Forum for People Performance Management and Measurement and the Performance Improvement Council of the Incentive Marketing Association, defines ELTV and presents a tactical approach to begin strategically evaluating ELTV.

What is ELTV?

Employee lifetime value is a quantitative measure of the long-term financial contribution an employee makes to an organization. Before exploring how to estimate ELTV, it is helpful to ascertain what precisely qualifies a person as an employee, what determines a “lifetime” and what is meant by value. In addition, it is helpful—and eye-opening—to expand our understanding of an employee’s “financial contribution” to go beyond mere revenue generation activities.

In the past, employees often stayed with the same employer, sometimes performing the same job, over the course of an entire career. Today’s workforce comprises, among other arrangements, independent contractors, leased employees and temporary employees. For the purposes of this white paper, the term “employee” refers to anyone working for an organization, on either a full- or part-time basis, who is enrolled in a formal compensation system.

Because the term “lifetime” connotes a permanent employment relationship that does not correlate exactly to today’s workplace, there are two general ways to define the term for today’s marketplace: 1) delineating a spe-

cific period of time, or 2) the length of time an employee has been employed by an organization. The ELTV model presented below considers “lifetime” to extend to the lifetime of the employment relationship.

The most obvious way to represent the value of an employee is by identifying measurable flows of money to an organization that can be directly attributed to an employee’s performance. The best example is revenue generated by a field salesperson whose incremental financial contributions to an organization can be directly measured. Other employee situations where financial contributions can be directly attributable include certain retail sales clerks, service personnel in health care, financial services and travel services, among others. The Forum research study digs deeper into other areas where employees create value for their

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firm, which while not as easy to measure, can be systematically quantified. These critical areas include:

- **Referral activity:** Non-selling employees convince people to be customers.

- **Cost savings and efficiencies:** Employees identify or implement cost savings in production, purchasing, distribution, pricing or other areas.

The study also suggests ways in which employees create value that are much harder to measure, but which have a clear qualitative impact on the organization:

- Employee enthusiasm helping make a company look attractive to potential customers or employees.

- Creative and innovative employees helping organizations deliver superior and competitive processes, products and services.

- Employees generating good will through interpersonal relationships, inside and outside the workplace.

- Cultural effects such as more efficient processes or positive contribution to a company’s defined values.

The bottom line? It is clear that value is not limited to direct, measurable cash inflows. Some activities that clearly create value are difficult to measure and, because of this, often go unrecognized by manage-

ment. As ELTV measurement matures as a management practice, more complete assessments of employee contributions will be incorporated into ELTV models. For now, the ELTV Performance Metric—developed by Frank Mulhern, Associate Dean for Research, Medill School Northwestern University and Yuri Moiseyev, graduate student in Integrated Marketing Communications at Northwestern—focuses primarily on linking financial in-flows to individual employees.

Variables That Determine ELTV

Models of ELTV may vary from industry to industry, from one organization to another or from one business environment to another. Nevertheless, we can identify ELTV variables across a variety of business situations. Before delving deeply into ELTV measurements, organizations must have a clear understanding of how the computed lifetime value scores will be used and whether the computed values will inform decisions about employee hiring or retention, among other applications. They must also have an intuitive grasp of how their people generate value. Once these types of qualifiers have been determined, the following variables are necessary to estimate ELTV:

- Selecting employees for inclusion in the analysis.
- Obtaining information on financial in-

flows to the organization.

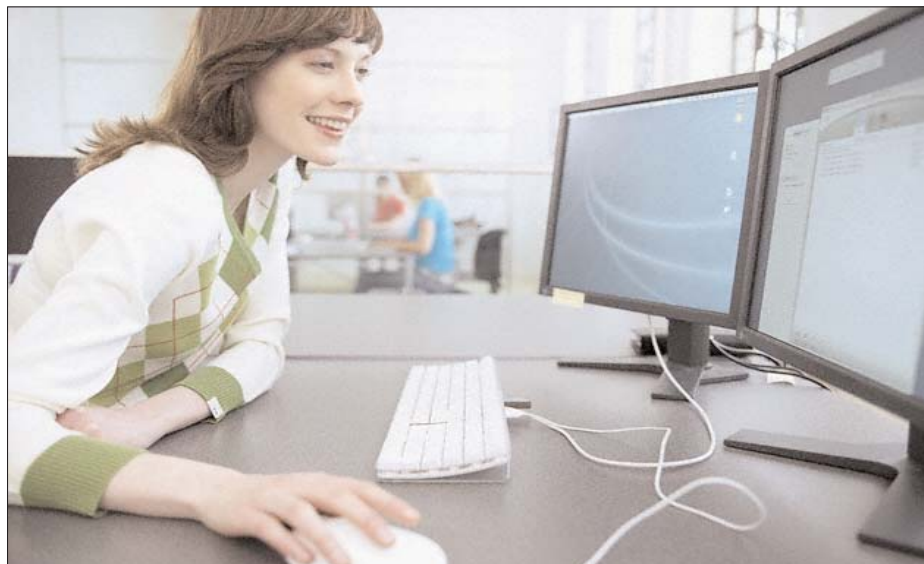
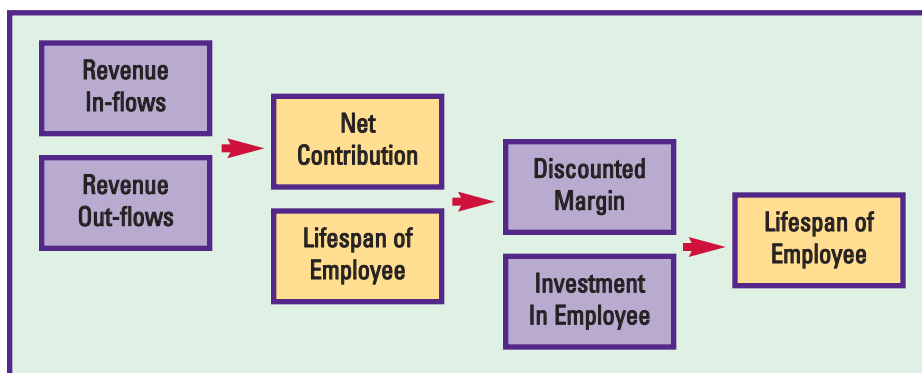
- Allocating financial in-flows to individual employees or groups of employees.
- Compiling and/or predicting financial in-flows for each time unit.
- Creating models to measure and allocate value generated by specific non-sales activities.
- Obtaining information on costs of maintaining an employee.
- Assigning costs to individual employees for each time unit.
- Constructing a financial model which includes discounting monies over time if needed.

Some research has been done on the value of individual competence to a firm. The work of Karl-Erik Sveiby on the Intangible Assets Monitor Framework suggests that Individual Competence is one of three intangible assets that do not appear on the balance sheet. While not a specific for-

mula, the Intangible Assets Monitor is based on the notion that people are an organization's only profit generators. (*Karl-Erik Sveiby, The New Organizational Wealth: Managing and Measuring Knowledge-Based Assets, 1997*)

In the absence of other metrics, another approach is allocating profit to all a firm's employees. In an article in the *McKinsey Quarterly*, Lowell L. Bryan suggests that profit per employee is a new approach to measuring financial performance that is based on maximizing returns on people. (*"The New Metrics of Corporate Performance: Profit per employee," Lowell L. Bryan, 2007 #1*)

Salaries and wages are best construed as part of the ongoing cost of maintaining an employee and should be subtracted from the financial in-flows attributed to an employee to yield a net contribution as depicted in the chart below:



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A primary benefit of estimating ELTV is that it helps focus managers on individual employees and their long-term performance. Development of tools to acknowledge and measure the intangible values contributed by non-sales employees is a critical next step in expanding definitions of value creation by employees. ELTV measurement is also a measure of organizational success as our production-based economy transforms into an information and service economy, and as managers find new ways to maximize the value created by their people. In this new economy people and their performance are the driving force in organizational success, and workforces are the real value creators. Upcoming white papers will address additional elements pertaining to ELTV, including a discrete ELTV metric, based on the results of the full study, which is available on the Forum's Web site: www.performanceforum.org

The Forum for People Performance Management and Measurement, which designed the study, is a research center within the Medill Integrated Marketing Communications (IMC) graduate program at Northwestern University. A central objective of the Forum is to develop and disseminate knowledge about communications, motivation and management so that businesses can better design, implement and manage people-based initiatives both inside and outside an organization.

The Performance Improvement Council (PIC), a strategic industry group within the Incentive Marketing Association, is a professional organization of performance marketing executives, collectively focused on helping companies optimize their investment in human capital through proven and innovative reward and recognition solutions. www.peopleperformance.org