

An ROI analysis of the Management Incubator

By Bill Phillips, Ph.D.

The Management Incubator is an innovative management development program designed to allow key employees to examine management as a potential developmental direction. The Management Incubator's experiential design allows the participant to experience performing leadership skills in both a group workshop and team project setting. The focus is on the individual. The use of competency based assessments and individual instruction allow the participant to objectively examine whether a leadership role is a good fit for them. The series generally has 10 to 14 participants from a variety of industries and includes four full-day workshops, one team project day, three individual coaching sessions, and a competency based 360 degree feedback tool. The series' research-based design ensures maximum ROI for the participants. Components of the series that contribute to the ROI are **competency based development, experiential learning, and individual feedback and coaching.**

ROI Analysis: Competency Based Development

Competency based development is an integral part of the Management Incubator. Each of the participants is given a competency based 360 feedback. The 360 feedback instrument is used to identify competencies present and lacking so that an individual development plan can be created. The development plan is then shared with the participant's manager for input and feedback to ensure that it meets organizational goals. Outlined below is a research-based analysis of ROI for the Management Incubator.

Using basic methodology for making effective calculations for return on investment (ROI) as outlined in an article by Stephen Martin and Lionel

Laroche (2000)¹, we have been able to make the economic case for the Management Incubator's competency based development component.

It is reasonable to assume that the participants in the Management Incubator will most likely have a normal distribution of performance. That is, about 10% of the employees would be performing at superior levels, most would be performing around the middle at an acceptable level of performance, and another 10% would be at or below the margins of acceptability. According to Spencer and Spencer (1993)² "superior" performance is defined statistically by researchers as one standard deviation above average

performance—roughly the level achieved by the top 10% of staff in a given work situation.

The conclusion of extensive research by Hunter, Schmidt and Judiesch (1990)³ is that for most technical and complex jobs, one standard deviation above the mean is worth roughly 40% of output for complex jobs. The jobs of the participants in the Management Incubator are professional, technical and administrative, and fall into the “complex” category.

For the Management Incubator participants, we identified the competencies that differentiate superior performance from average performance for an individual contributor moving to a management role so that training processes could be refocused to develop those competencies. Our goal in the series was to move average-performing employees to superior performers, whether the participants stayed in an

individual contributor role or moved to a management role. To do this, we used the 360 degree assessment to assess the current competency level of the employees, and through individual feedback and coaching, implement a development plan designed to move the employees to superior performance.

A general and reliable rule of thumb according to Smith, Gregg, and Andrews (2000)⁵, values one standard deviation as equivalent to 40% of the compensation paid to that group. The implementation of competency based training would not be perfect. Research by Falcone, Edwards and Day (1986)⁶ indicates that the average effect of competency based technical and sales training is a positive shift of the performance curve by 0.67 of one standard deviation. Using an average wage per employee we were able to calculate the anticipated ROI for the Management Incubator series is calculated to be **376%**:

ROI for the Competency Based Development Program of the Management Incubator*

1 Management Incubator participant with a salary of \$40,000= **\$40,000**

Value of one standard deviation: \$40,000 x 0.4= **\$16,000**

“Imperfection Discount” factor: \$20,000 x 0.67= **\$10,720**

Against the Management Incubator cost of \$2,250, this generates an ROI of:

$(\$10,720 - \$2,250) / \$2,250 = 376\%$

*Based on the average salary of participants of \$40,000.

ROI Analysis: Experiential Learning

An additional feature of the Management Incubator that contributes to the ROI is the extensive use of **experiential learning**. The participants are taught leadership concepts and then practice them through role playing, simulation, and a community based project that they work on in a team setting. The research supporting the effectiveness of experiential learning is significant.

Malcolm Knowles' (1996)¹¹ research about adult learners found that adults need an opportunity to apply and try out learning quickly, and that they learn best by active (as opposed to passive) experiences. Roger Schank's (1999)¹² in his learning theory states that skills are developed and information is obtained in a practical context.

Edgar Dale, a renowned educational psychologist, referenced in an article by Mingail(2002)¹³ purports that simulated and direct experiences generate as high as 90% information retention rate. In comparison, traditional teaching techniques such as lectures result in a 10% retention score.

In one study reported by SMG (2002)¹⁴ designed to use experiential learning to improve sales initiatives in a Fortune 500 telecommunications company according to an independent ROI study, the company realized an annualized net benefit of over \$60 million on the project. That's an ROI of over 3900%. The study found that the benefit to cost ratio was 40x.

Although a strong case can be made for the value of experiential learning, it is difficult in the Management Incubator setting to define an ROI. Instead, we propose that one of the real values of the Management Incubator is to help organizations ensure that the right choices are made for management. We do know that individual contributors that are not suited for management, when moved into management positions, often end up leaving the company. We also know that the most frequently cited reason for employees leaving a company is a poor immediate manager. A great deal of information exists about the cost of turnover in an organization. It is reasonable to assume that giving Management Incubator participants a chance to learn and practice management roles in an experiential setting might lead to better management fit and reduce turnover. A conservative example of the cost of just one employee leaving an organization is shown below.

Cost of reduced turnover for Management Incubator instruction*:

1 employee at \$40,000 = **\$40,000**

Cost to replace = \$40,000 x .20 = **\$8,000**

If turnover is avoided for one Management Incubator Participant, a savings of **\$8,000** is achieved.

*Based on a \$40,000 per year salary

ROI Analysis: Individual Feedback and Training

Finally, the third feature of the Management Incubator that contributes to the ROI is the use of **individual feedback through coaching** to help employees create an effective development plan and work with their managers on implementation of the plan.

The studies related to ROI for individual feedback and coaching are impressive. According to Spencer (2001)⁷ feedback on mission-critical skill (competencies) can generate a 10% of one standard deviation performance improvement. A study by Turner (2001)⁸ reported that managers that underwent a managerial coaching programs showed an increased productivity of 22.4%. However, a second group was provided coaching

following the training process and their productivity increased by 88%. In a study reported by Manchester (2001)⁹ with over 43 executives receiving coaching, a conservative estimate of ROI of 570% was reported.

In the Management Incubator, a case could be made for some of the same results reported in the studies above. The study by Turner most closely follows the process in the series. Training followed by coaching produced a productivity increase of 88%. It would be reasonable to assume that the Management Incubator could produce a productivity increase of the same magnitude.

Conclusion

Methodology exists to make a case for a substantial ROI for the Management Incubator. The anticipated ROI numbers for a Management Incubator participant are impressive. These ROI numbers are, of course, projections, and we are in the process of conducting additional follow up studies to determine actual ROI.

The ROI for the **competency based** component would be an impressive **376%**. The **experiential learning** component of the program is likely to reduce turnover among employees promoted to management roles, saving companies an estimated \$8,000 per employee who remains satisfied and opts to stay with the company after promotion. Finally, **individual feedback and coaching**, although difficult to measure in ROI terms, will also contribute to the value of the investment. To put this in perspective, according to Phillips (1997)¹⁰ it is generally assumed that a training program must be able to show an ROI of at least 25% during its first year to be effective. Even if post studies show the Management Incubator's actual performance under the anticipated ROI of 376%, it is reasonable to assume the ROI would still be sizeable.

References and Notes

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- ³ "Individual Differences in Output Variability as a Function of Job Complexity", J Hunter, F Schmidt and M Judiesch, *Journal of Applied Psychology* 75, 1990, pp.28-42.
- ⁴ Salary is used rather than "output" because, without extensive research, it is very difficult in most jobs to establish a reliable value for the output directly derived from a particular job - with the notable exception of sales jobs.
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- ¹⁴ Referenced in "A Case for Simulation: A Review of Research on the Impact of Simulation", Strategic Management Group, Inc., 2002.