

Case Study: Investing in People who Invest in People

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By David Creelman

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Laurie Bassi is a researcher who has long felt that investing in people, specifically via training and education, pays off. This is not a hunch. Working with the American Society of Training and Development (ASTD), her team built a database with information on the training and education expenditures of over 3,000 organizations. As anyone involved in working with HR metrics knows, an easily stated term like “training expenditures” is, in the real world, massively ambiguous. The critical work of Bassi involved collaborating with companies to create a consistent, reasonable and practical definition of “training expenditures” and getting companies to report their expenditures to ASTD. This tedious work paid off because amongst those 3,000 organizations were found 575 publicly traded firms for whom extensive financial data was available.

An analysis of this data showed firms that invested heavily in training subsequently outperformed the stock market. The cumulative difference in performance became very noticeable after four or five years. Between the years 1997 and 2001 an investment in the S&P 500 would have yielded a return of 66 percent; an investment in the firms that spent heavily on training yielded a return of 111 percent. Training did pay off—so what?

BUT WHAT DO YOU DO?

Bassi and her colleagues would sit around over coffee in lively discussion about the implications of their findings. “Somebody could make a lot of money if only they invested in these high-training firms!” “Somebody should set up an investment fund built around the research!” “Somebody should....” The conversations petered out as it became clear to Bassi that the “somebody” was her. There was nobody else who cared enough about the data or understood the research well enough to do something with it. Laurie Bassi was going to have to start an investment fund.

This was a big leap. Dr. Bassi is a researcher and former professor with a background in economics and public policy. Like many deep thinkers she is an introvert, almost a recluse. If you sat beside her in an airport you would never mistake her for a Wall Street player. Yet,

Bassi had one big advantage—she had no idea how difficult it was to set up a fund; and so, she went ahead.

Her first breakthrough was hooking up with Stan Sorrell, the retired CEO of the Calvert Group, a socially responsible investment fund. He helped her understand the broad parameters of the field. Bassi learned there are different ways to run an investment fund. In a mutual fund the money of many investors is pooled, and investors own shares of the mutual fund itself. An alternative is a limited partnership, which is allowed when there are fewer than 100 investors, the majority of whom are deemed “sophisticated.” Many hedge funds fall into this category. Finally, there are individual accounts whereby each investor directly owns the stocks and the firm manages each individual’s investments.

Sorrell’s expertise in mutual funds quickly revealed that his expertise was not going to be helpful since there was no way on earth that Bassi’s small team could ever launch a mutual fund. A mutual fund is a big deal, subject to extremely rigorous reporting requirements—it’s a good vehicle for Fidelity Investments, not for Bassi et al. The limited partnership was also a non-starter, which left them with individual accounts.

Setting up the administrative and legal apparatus took six months of serious effort—all the while paying the bills by doing her day job at McBassi & Company where she helped firms develop better human capital metrics. However, against all odds the work got done and in late 2001 Bassi Investments was launched.

GETTING INVESTORS

The first investor in Bassi Investments was, appropriately enough, Ms. Bassi herself. It is one thing to do outstanding statistical research

showing firms that invest in training outperform the market average, and quite another to put one's hard earned money on the line. On the day the system was to go live, Bassi turned to her researcher and muttered, "Um, let's go over this one more time." But her researcher was confident and the Bassi money was invested according to the Bassi theory.

How would it fare? That answer would take some time to determine.

In the meantime, the fund needed investors and the obvious place to go was the huge number of dedicated training professionals who believed passionately that their work was of great value in driving organizational success. She was helped by Dr. Curtis Plott, CEO emeritus of ASTD, who helped her to reach out to the training community and gave them a chance to invest in their beliefs. This initiative yielded, in mathematical language, zero. It turns out that whatever faith training pros have in their craft is swamped by risk aversion.

A second pitch went out to the big union funds that would no doubt be looking for a research-based approach capable of generating superior returns while at the same time promoting a social good. These financial professionals investigated Bassi Investments using what is known as the "sheep method." They asked, "What is everyone else doing?" Had other people invested, say, half-a-billion dollars in her fund then they'd have been happy to put in their own cash. Otherwise, no thanks. This ungulate behavior reflects a real world where the reward for innovative investing, even by financial professionals, is dwarfed by the risk of doing something outside the norm.

Bassi Investments sat with its relatively small stake of invested capital, just a few million dollars. Now the question became, how would that invested capital perform?

GETTING RICH?

The first year was the roughest. They had to translate the theory into an operational practice for day-to-day investing. At times they would get cold feet and second guess the theory—Should we really invest in this firm? On top of start-up anxieties, 2002 was a disastrous year for the markets; nobody was making money. And yet, despite their fears the predictions of the theory seemed to be playing out. The firms they picked did well. After that first year it was easier. They stuck to their model and invested their cash. Today, after 39 months in operation, their fund continues to outperform the market.

Will the fund make Bassi et al rich? It's nice to think about, but

that's not why Bassi Investments was launched. According to Bassi, the fund was set up because the market was—in the short run--penalizing firms that invested in education and training by undervaluing them as they made that investment. This not only hurt individual firms, it also hurt society since training is recognized as a social good. It was a matter of social policy. Since there seemed to be little hope of influencing federal policy, the most promising lever left open to Dr. Bassi was to try to use the market itself. If her fund was successful, ultimately other investors would copy it, and firms that invested heavily in training would be appropriately rewarded by the market in both the short and long run.

However, undercutting her own advantage has proven difficult to do. Economists like to think that markets are efficient, but that assumes money will respond to new insights into how firms create value. And, as Dr. Bassi has discovered, that process takes longer than anyone might expect. In the meantime, she continues on her work, having very clearly put her money with her mouth is.

FURTHER READINGS

Articles documenting and supporting Bassi's research can be found at:"

www.mcbassi.com/freeresources_whitepapers.html"

And

<http://www.workindex.com/hrexecutive/cover.asp>



ABOUT THE AUTHOR

David Creelman is CEO of Creelman Research, providing research, writing, analysis and commentary of issues of human capital management. He has a variety of clients in the US, Canada, Japan and China.

David has served as a management consultant in Canada and Malaysia, most notably with the Hay Group; and has taught at the University of Malaya. Before venturing into human resources consulting, David worked in finance for Gulf Canada and IT for Wood Gundy in the UK. He has a MBA from Western and an Hons. B.Sc. in Chemistry and Biochemistry from McMaster.

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