MARYLHURST UNIVERSITY

Valuing Human Capital

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> *"... the future protection of your intellectual property will depend on your ability to control your relationship to the market–a relationship which will most likely live and grow over a period of time. ... The value of that relationship will reside in the quality of performance, the uniqueness of your point of view, the validity of your expertise, its relevance to your market, and, underlying everything, the ability of that market to access your creative services swiftly, conveniently, and interactively."*
>
> *--John Perry Barlow - Aug 1995**

In any given discipline, the success of a venture or the lack thereof can nearly always be traced directly back to the vision and will of the leadership. In any given boardroom, the question of how best to leverage the human capital at hand rises to the top of a pile of current needs pressing for attention. In any given decade, there is a new corporate theology vested in how to get the most out of your workforce, systems, processes, assets, capital. Today's mantra beats out the refrain of the necessity of understanding how to best gain strategic advantage from the intangibles in business; how to measure the immeasurables. The Golden Rule has regained its veracity as research has linked its tenets to the financial bottom line. Increasingly the value of the human element is gaining traction as a critical factor, defining the bounds for potential value in an organization's portfolio of assets.

The entire concept of human capital as an asset is fairly new, emerging from characteristics intrinsic to an economy based on knowledge and information, one that's currently in the midst of overturning established business models. In the preceding industrial period of US and global economies, the driving forces were primarily of a physical nature: finite, easily measurable, and focused on the tangible, including such things as product, distribution, infrastructure, and access to financial capital. The unfolding knowledge-based economy in grounded in change and driven by technology. This dynamic is compounded by political and social upheaval; forces which are converging to reassemble the very nature of our ideas about ownership, political systems, and the power of information – both of its creation as well as its dispersal. The net effect is that intangibles are increasingly being recognized as a crucial resource, on a par with the tangibles when assessing a company's overall value. Intangibles refer to the market perception of future financial value which stems from knowledge: information, innovation, R&D, patents and trademarks, brand value, technology, intellectual capital, company culture, capabilities, and leadership. The very nature of knowledge has elevated education and formal training of the workforce to priority status, viewed as an investment for maintaining competetive advantage in the face of relentless market demand. The primary business challenges in recent years concern globalization, technology, revenue growth, talent, capabilities, and the ability to adapt on demand. All these hurdles relate directly to the issues of human capital – the aggregate fruit of human intelligence, talent, knowledge, and creativity. In successful companies, these factors are competitively linked to the organizational capabilities of strategic speed, workforce agility, customer responsiveness, and employee committment. Thus begs the question; how to most effectively leverage the workforce? Different parameters are relevant depending on from whence the question arises – whether from the vantage point of executive leadership, supervisor, individual team member, or from the department of human resources.

According to the American Heritage Dictionary of the English Language, "leverage" is defined as follows:

> n. leverage (1). a. The action of a lever. b. The mechanical advantage of a lever. (2). Positional advantage; power to act effectively: started his . . . career with far more social leverage than his father had enjoyed (Doris Kearns Goodwin) (3). The use of credit or borrowed funds to improve one's speculative capacity and increase the rate of return from an investment, as in buying securities on margin.
>
> tr.v. leveraged leveraging leverages (1). a. To provide (a company) with leverage. b. To supplement (money, for example) with leverage. (2). To improve or enhance: It makes more sense to be able to leverage what we [public radio stations] do in a more effective way to our listeners (Delano Lewis) [1]

Around 250 BC, the Greek mathematician, Archimedes, stated that if he had a lever long enough and a place to stand, he could move the whole earth. The ability to communicate powerfully via the use of facts, symbols, and emotions offers that same leverage to leaders, giving them the means to foster "engagement" in their organizations.[2] The need for leadership to be able to fully engage their employee base has become a matter of considerable significance: recent research by a Gallup survey reveals that only 26% of the total sample reported being "engaged", with a telling 19% who reported being "actively disengaged".[3] Obviously, organizations cannot compete in a knowledge economy with an indifferent workforce. To engage employees, to motivate them to commit to action, leaders must communicate clearly and effectively. The theories on good leadership communication are almost as numerous as are leaders. All theories ascribe to certain accepted hallmarks; people will only follow a leader if that leader has a clear and compelling vision, one who has integrity and is perceived to be trustworthy, and who connects with the flock on an elemental level. The measure of leadership calls not only for the possession of these attributes, but also that these characteristics exist in concert with a leader's ability to deliver business results.

This system of executive leadership relationship is created within a deceptively simple framework, constructed on such high-level traits as vision, integrity, consistency, and connection.[4] Employees look to their leaders for direction; a clearly articulated strategic vision from executive level leaders allows people to have a shared mindset, and thus to apply their individual efforts toward achieving the company's goals. To leverage an employee's committment requires stimulating both their cognitive identity and their discretionary energy.[5] Cognitive identity is the net effect of what happens when employees feel connected to the company and identify personally with the organization's values and goals. Discretionary energy refers to the personal effort exerted by an individual, over and above what is expected of them to reach those goals. To build commitment and activate employees, there are seven key leadership practices which help leaders leverage their workforce: vision, opportunity, incentives, communication, impact, community, and entrepreneurship.[6] Vison, as previously indicated, refers to leadership direction; employees are more committed when they feel their work has meaning. Opportunity builds committment by allowing employees to develop their skills and abilities. Incentives simply permit employees a share in the fruits of their labor. Impact refers both to the impact on the firm from each individual, as well as the impact of the firm's work taken as a whole. Community is what engages employees, through sharing a common mindset. Good communication ensures that employees are aware of the goals, strategies, and circumstances affecting their organization and the reasons behind the actions taken. Entrepreneurship empowers employees to have a sense of personal ownership about their work. Leaders who can put these principles into action will start to assume a leadership brand, thus creating value for not only for employees, but for investors and customers as well.[7]

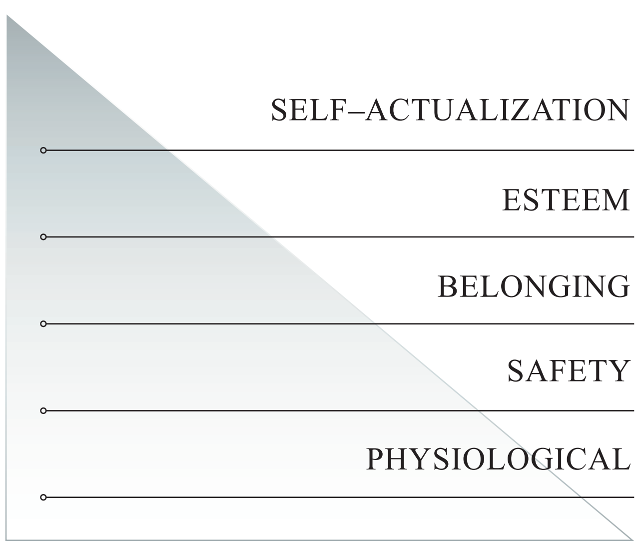
The role of the supervisor or manager in an organization is perhaps the most crucial of all efforts in successfully leveraging the workforce. Supervisors are those closest to the actual work being performed, and hold a unique position and influence in either rousing an employees best efforts, or provoking low morale – which soon translates to a loss of personal initiative. Typically, both positive and negative results stem from the supervisors communication skill set. Research from the Gallup Organization indicates that employees usually don't quit a company; employees quit their own manager. Recent data from Gallup demonstrates that 71% of workers polled cited difficulties with supervisors as the primary reason for leaving their recent position.[8] Several other employee surveys report similar results, with an addendum that the inability of supervisors to communicate was the chief complaint cited by employees.[9]

The research from the Gallup Organization analysis displays a statistical pattern across twenty-four companies and twelve different industries, drawing on data polled from over 100,000 individuals; the consensus is that managers are the master key to creating a strong workplace. The researchers looked at four core business outcomes; productivity, profit, retention, and customer service. These were linked to twelve questions that were developed to best measure vital elements in attracting and retaining top intellectual capital. From the overall group of twelve questions, six were considered to be "***most powerful***", due to the fact that these six were most strongly correlated with the four key business outcomes. The six "***most powerful***" questions are:

1. Do I know what is expected of me at work?*
2. Do I have the materials and equipment I need to do my work right?*
3. At work, do I have the opportunity to do what I do best every day?*
4. In the last 7 days, have I received regognition or praise for doing good work?
5. Does my supervisor or someone at work seem to care about me as a person?*
6. Is there someone at work who encourages my development?

Four* of the six "***most powerful***" questions are also included in a group of five questions that most directly link to an employee's relationship with their immediate manager.[10] All six "***most powerful***" questions revolve around effective communication, consistent expectations, and respect for the individual. An effective supervisor acts as a "catalyst", accelerating positive reactions between the employee and both the company goals as well as the customer needs. The role of "catalyst" requires four core activities to get the most from employees; ***select the person*** (for talent, not experience), ***set the expectations*** (by defining outcomes, not procedure), ***motivate the person*** (by focusing on strengths, not weaknesses), and ***develop the person*** (for the right fit, not simply for career advancement). If supervisors are performing these four activities well, they get strong positive links to the six questions, and they're able to leverage the full potential of their team. These four key activities allow for the development of a culture based on open and upward communication, establish personal relationships between supervisor and employee, allow employees to participate in key change initiatives that affect them personally, solicit feedback and ideas from employees, and hold all parties accountable for successes and failures.[11] The best managers focus inward; looking to the heart of the company and each individual to find the best means to free up particular talents, and transform employee skills into measurable business performance.[12]

At the level of leveraging individuals, you have to start with Maslow. Maslow diagrammed his famous 'Hierarchy of Needs' in the late 1960's, originally shaped as a pyramid. Maslow believed that as man ascends to higher degrees of development, his primary needs change from food, shelter, and safety at lower levels, to social interaction and self-actualization at the higher levels.



At the bottom of the hierarchy, people work for money. Once that need is satisfied, employee commitment tends to be galvanized primarily by a strong leader who communicates a clear direction, and by working towards a higher purpose.[13] On the low end of the scale, people need to feel safe; they function best in conditions of economic and emotional security. They need to know what's expected of them, and how their performance level will be judged. They need to be aware of the goals of the organization and how their work ties in with the overall plan. These needs correlate with questions one and two from the list of the six "***most powerful***" questions.[14] As basic needs are met, individuals move up the scale.

In order to be fully vested in their work, people basically need to feel that what they do matters; they need to know they ***are valued*** and that they ***add value***. They need the challenge of risking failure in order to achieve success. To prepare a workforce that can respond quickly to competetive challenges, people must be allowed to make autonomous decisions. Governance should proceed from the "Law of the Situation", defined well ahead of it's time in 1925 by Mary Parker Follett, an early visionary in the discipline of management science. The "Law of the Situation" states that the response to the situation should be based on the facts, not on the personalities of the participants involved; it grounds process in the outcome rather than seeking to assess blame for errors. This allows for a shift in perspective to occur that honors teamwork over heirarchy when finding solutions to problems.[15] These values correspond to questions three through six of the six "***most powerful***" questions, and enter the realm of questions seven through twelve, dealing with culture, shared mindset, innovation, and personal passion.[16] When employees reach the top of Maslow's heirarchy, when their effort is perceived by their superiors to have meaning and purpose, work becomes self-actualizing. Employees will work harder and longer, make more sacrifices, expend more personal energy, and be more committed; in short, they'll be fully engaged.

At the heart of all human capital issues lies the department of human resources. As the delegated keepers of employee-related processes and protocols, HR has inherited the challenge of defining management practices that will apply competitive organizational capabilities to the task of leveraging the inherent potential of human capital. This increased responsibility demands the HR discipline to take on multiple and overlapping roles in generating value for their organizations. The roles are defined around the HR department's focus and activities. The focus ranges from strategic outlook to operational administration, and activities extend from managing processes to people. Thus, the four principal HR roles and their corresponding deliverables[17] are as follows:

1.1 HR Role – Management of strategic human resources
1.2 HR Deliverable – Alignment & execution of HR with business strategy
2.1 HR Role – Management of company infrastructure
2.2 HR Deliverable – Building administrative and organizational efficiency
3.1 HR Role – Management of employee contribution
3.2 HR Deliverable – Provide employee resources & increase committment
4.1 HR Role – Management of transformation and change
4.2 HR Deliverable – Ensure capacity for change and renewal

In the role of strategic partner, HR executives need to focus their efforts on aligning HR practices to best execute the business strategy. This requires HR to define the most effective organizational methodology able to accomplish targeted business objectives. The process begins with an organizational diagnosis, a step by step means to analyse and align organizational practice with key business goals. The starting point for the diagnosis is to define an organizational architecture or model for how the company conducts business. This incorporates the six factors defining how organizations operate; shared mindset, competence, consequence, governance, leadership, and capacity for change. This template can be used as a tool to design a framework for auditing the systems that need modification to execute the strategy. The assessment process designates every business plan with a corresponding organizational plan intended to map the strategy into action.

In the role of administrative expert, HR staff need to improve process efficiencies both in their own sector, as well as for the organization as a whole. With an escalating emphasis on downsizing, re-engineering, and consolidation as methods for containing costs, this more traditional HR role sustains potential for adding value by focusing on increased efficiency and developing solid infrastructure. Expertise in this role ultimately undergirds the credibility of HR in becoming full strategic partners.

In the employee champion role, HR professionals act from the heart of their knowledge base to mold an engaged, fully competent, and committed workforce. This is a daunting challenge in light of our current transformation from industrial-age economic base to one driven by information and technology. In addition to the mandate of understanding and appropriately addressing employee needs with adequate resources and information, HR is ultimately responsible for identifying, obtaining, and developing top intellectual capital, providing a crucial source for a firm's intangible value.

In their role as change agents, HR must develop and strengthen the organization's capitilization upon and capacity for fast adaption to change. In current global markets, the whirlwind of technology, innovation and information form a whorl of competetive challenges that call for fast and accurate interpretation and action on the issues-du-jour. Responding to a particular business challenge, HR often creates a change model identifying the key success factors for a particular change initiative, then use the model as a tool to assess points for possible improvement. The seven key success factors for a given change iniative are: leading change, creating a shared need, shaping vision, mobilizing committment, redefining systems and structures, monitoring progress, and designing change initiatives with the power to prevail. The biggest challenge for HR as change agent is achieving transformational change in the culture, values, and identity of a company. The ultimate goal for sweeping change in corporate culture is to improve the company's competetive market position by changing protocols to better correlate with customer's needs.[18]

With a global transition to an information-based economy based on information and knowledge capital as the leading currency, the unique capacity for human reason, innovation, creativity, and learning will ultimately set the critical determinants for best practices in managing workforce and organizational capabilities. Since people are persons and not things, human capital can not be manipulated as are processes and infrastructure. People respond to facts, symbols, and emotions; this response fosters or cripples connections. The same complexity in relationships generating innovation and passion can also breed conflict and apathy. To manage an organization effectively at a juncture where human knowledge and skills account for those quintessential intangible assets that drive effective competition calls for writing a new playbook. One of the cardinal rules of strategic leadership is having full grasp of the business in which you're engaged. If people are the currency traded in a knowledge-based economy, then the nuances of human interaction must be fully comprehended, including motivation, relationships, psychology, and communication. The task is further complicated by the emergence of the global playing field represented in capital markets today, and the additional ramifications from diverse cultures and customs.

This shift to a service and knowledge economy has propelled interest in the market valuation of "intangibles", stemming from academic research which demonstrates that an increasing proportion of a firm's market value can be traced to the value of its intangible assets, primarily its human capital assets. This will require organizations to find ways to properly value and reward workers and their contributions to the success of the company. Since HR is perceived as exerting considerable influence on the mindsets of workers, competencies, and behavior, the HR role takes on new meaning.[19] When human capital is motivated, enabled, and developed, the results show up in a most tangible way; posted as profit and shareholder value on the financial bottom line.

There is broad acceptance for the idea that the linchpin for success in competitive organizations lies in how people are treated, how processes are governed, and how work is coordinated. The tools for actualizing these concepts lie in a renewal of the HR role. As in developing any other asset, investments in human capital and their HR counterparts cost money. To justify the considerable investment of capital will require an ability to measure what HR contributes, how its systems achieve that contribution, and an accurate valuation of the resulting deliverables.[20] Current research has defined six key principles for measuring human capital performance in order to manage it as a strategic asset.[21]

1. The focus should be on the strategic impact of "productive results" from human capital. Relevant human capital measures are the performance behaviors of employees impacting the key strategy drivers in any given firm.
2. You need to begin with the correct perspective of the HR function; HR as strategic partner, invested in aligning HR systems with the firm's strategic goals. The measures should be designed to reflect how well the system delivers performance behaviors that drive business outcomes.
3. The influence of human capital per the financial bottom line is indirect, since it's actually the human capital influences on strategic drivers that bear the greatest impact on financial results. This creates a challenge when measuring actual human capital performance; it's necessary to focus on the relationship between the humans and the specific drivers of financial performance, rather than simply using monetary levels for rewarding performance.

4. Although benchmarks may provide appropriate measures for the HR administrative role, they are not appropriate as a method for measuring human capital's strategic performance. The implication of managing capital as a strategic asset is to measure performance based on its impact on strategic implementation. This approach has no corollary to traditional practices of benchmarking in the industry at large, because firms all implement their strategies differently.
5. You have to start with the question you need to answer. You don't measure what is easy to measure; you measure what makes sense in context. So it is critical to first ask the appropriate questions that correlate to the business strategic objectives, in order to choose the corresponding performance behaviors for measuring. If you begin with strategy and work backward, you can identify the determinative human capital measures. If a strategy map is used to pinpoint principal revenue drivers, it may be easier to establish correct relationships between a pertinent performance behavior and how it ties to revenue growth.
6. A human capital architecture should be established as a tool to manage human capital creation, and to measure human capital performance. These processes are interrelated, and both line managers and HR executives must participate in developing the architecture for use as a strategic asset.

The elements of a human capital architecture are made up of the ***HR function*** (the administrative management of human capital), the ***HR system*** (the set of organizational practices that acquire, develop, motivate, and appraise the human capital), and the ***human capital deliverables*** (the strategic employee behaviors that impact business outcomes). Some of the benefits of using this architecture as a strategic tool for analysis are as follow:

1. It allows the firm to clearly identify appropriate measures of the HR function's strategic performance
2. It provides guidance to key executive leaders for managing HR systems as a strategy driver
3. It emphasizes the role of human capital deliverables as measures of human capital performance by establishing their link to strategy drivers
4. It focuses on human capital as as organizational asset, impeling shared responsibility for human capital management by HR and line managers.[22]

Effective measurement aligns with strategy in ways that can be tracked to reinforce accountability. Performance measurement for deliverables is a critical step in appraising strategic progress. The criteria for determining which measures to focus on should verify that the measures taken are important, complete, timely, visible, controllable, cost effective and intrepretable.[23] This should spur increased accountability through each progressive stage: by clarifying strategic goals for specific outcomes, by clearly defined expectations, by designing relevant positive and negative consequences for performance, and by providing feedback for improvement.[24] A properly designed human capital architecture allows managers throughout the organization to understand exactly how people create value, and how to measure the value-creation process.[25]

We live in a time when a thought assumes the power of a thing. A time when information is an action occupying time, rather than a state of being occupying physical space.[26] A time when MIT offers OpenCourseWare free via the internet to any user, in any location. A time when business models in the music and media industries have been overturned by peer-to-peer transfer and user content. A time when the open source movement threatens industry giants such as Microsoft. A time of nanotechnology and macroeconomics, as the borders of nations are redefined by precepts of globalization. We live in a time when information is the business resource, and innovation is the work.[27] The foregone industrial era relied upon hierarchy and the matrix as organizational structures best suited for the task, both using power as the fundamental organizing principal. In both structures, communication moved along preordained lines, established by protocol and procedure. The network is the organizational structure most appropriate for the emerging information economy, which by design requires the free and transparent flow of information and resources, and so is organized around the work itself.[28] Communication thus becomes the new medium of exchange which connects relationships within information networks, thereby defying time, space, and all previous canons of power once seated in the ownership, control, and distribution of ideas.

"... If nature has made any one thing less susceptible than all others of exclusive property, it is the action of the thinking power called an idea, which an individual may exclusively possess as long as he keeps it to himself; but the moment it is divulged, it forces itself into the possession of everyone, and the receiver cannot dispossess himself of it. Its peculiar character, too, is that no one possesses the less, because every other possesses the whole of it. He who receives an idea from me, receives instruction himself without lessening mine; as he who lights his taper at mine, receives light without darkening me. That ideas should freely spread from one to another over the globe, for the moral and mutual instruction of man, and improvement of his condition, seems to have been peculiarly and benevolently designed by nature, when she made them, like fire, expansible over all space, without lessening their density at any point, and like the air in which we breathe, move, and have our physical being, incapable of confinement or exclusive appropriation. Inventions then cannot, in nature, be a subject of property."

--Thomas Jefferson - Aug. 1813**

ENDNOTES:

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