HUMAN CAPITAL MANAGEMENT AND ECONOMIC DEVELOPMENT IN REAL WORLD

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ABSTRACT
Recent surveys reveal that although business executives firmly believe that people are the most important asset, most executives are at a loss to prove that investments in people lead to improved business results. Common metrics like economic value added (EVA TM) and return on investment (ROI) shed little light on how an organization's human assets are performing. They say even less about whether an organization's people development processes are attuned to its business challenges. Help is on the way in the form of new practices in the realm of human capital management.

KEYWORDS: *human capital management, human capital development, people development, financial performance, strategic human resource management*

Introduction

Human capital (education, health and motivation) has always been an extremely important determinant of individual and social progress, but is even more important in an increasingly competitive and knowledge-intensive global economy.

We believe any organization hoping to perform at the highest level needs to link investments in people to bottom-line business results. Partial evidence abounds as to the connection between people development and financial performance. We know, for example, that companies that invest in "strategic human resource (HR) management" seem to achieve better financial performance than those that use approaches that are more traditional. Unfortunately, correlation is not the same as causation. That is, it is still not clear whether strategic HR management drives superior financial performance or whether superior financial performance make it possible to take a more strategic approach to HR management The same drawback appears in studies of employee satisfaction. That is, the ability of profitable companies to provide better pay and amenities than their competitors may lead employees to blur "engagement"—which connotes involvement and superior contribution—with satisfaction with pay.

1. Measuring the Human Capital

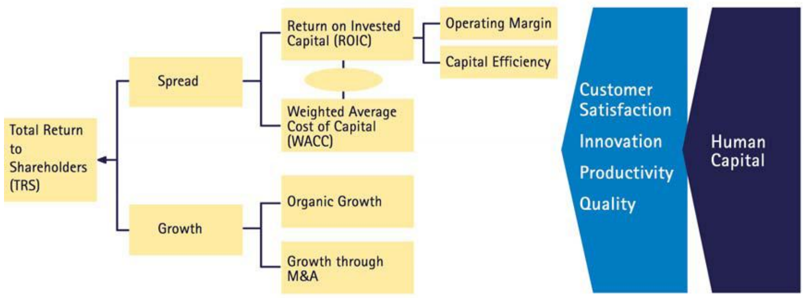
Interviews we have conducted at a company's clients and non-clients with senior HR executives, CFOs and financial analysts yield two recurring themes regarding the measurement of human capital.

First, measures need to be meaningful from an operational perspective. That is, managers want measures that reflect the way value organizations create value. They want a measurement framework sensitive to differences in business models—particularly when an organization houses more than one business model, as is often the case in multi-division enterprises.

Second, measures need to be useful from an investment perspective. Executives want to know where they should be investing for the future—both in terms of the kinds of skills employees will need to achieve the organization’s longer-run strategies and in terms of the kind of human resources capabilities the organization will need to acquire, develop and retain employees with those skills. For example, HR executives and their counterparts in finance and operations want to assess the people-related risks associated with new technologies, new markets and new acquisitions.

We are hearing that superior performance requires managing human capital for today and for tomorrow—and to manage it in a fashion that is aligned with an organization's strategic objectives. To illustrate this point, consider diagram 1, below.

Diagram 1



The left-hand side of the diagram is familiar to CFOs, the center is familiar to line managers and the right-hand side is familiar to HR professionals. An organization’s relative emphasis on spread versus growth is a matter of both competitive environment and strategy, but behind its ability to create value is a finite set of capabilities or performance drivers, e.g., its ability to innovate, to satisfy customers and to produce quality.

The challenge of effectively linking human capital development to financial performance is three-fold:

(1) measures must capture direct and indirect effects;
(2) the measurement process must be simple, repeatable and lead to actionable conclusions;
(3) results need to be compiled so that plans and forecasts can be built from them.

2. The Company’s Human Capital Development Framework (HCDF)

The Company’s HCDF uses four distinct measurement tiers in arriving at an assessment of an organization’s human capital practices. These tiers (diagram 2) reflect the key variables that influence the relationship between a company’s human capital assets and its financial performance:

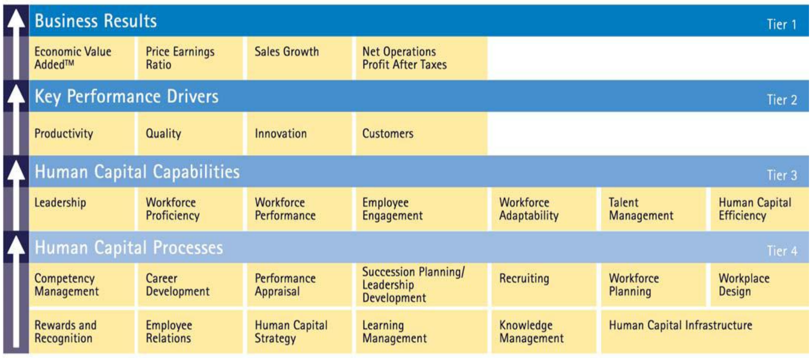
Tier 1, **business results**, consists of measures of organizational performance (e.g. traditional financial analyses featuring EVA TM, revenue growth, market share and stock performance).

Tier 2, **key performance drivers**, consists of measures of intermediate organizational outcomes (e.g. productivity, quality, innovation and customer satisfaction) often captured on a balanced scorecard.

Tier 3, **human capital capabilities**, consists of the most immediate and visible people-related qualities (including employee attitudes and abilities) that are necessary for achieving critical business outcomes. Their influence is felt through key performance drivers.

Tier 4, **human capital processes**, consists of practices that lead to robust and effective human capital capabilities. Included in this tier are core HR processes (e.g., competency management and performance appraisal) and broader human capital processes such as learning and knowledge management.

Diagram 2



Of the four measurement tiers, Tier 4 is the most distinctive. Unlike other approaches to evaluating HR organizations (e.g. the HR Scorecard), we focus explicitly on the maturity of an organization's human capital development processes. That is, rather than look only at levels of spending to get a sense of an organization's approach to human capital development, we seek to understand how complete the underlying practices are and how aligned they are with the organization's competitive strategy and mission. Embedded in each of the Tier 4 variables is a multi-dimensional maturity scale grounded in industry best practices and modified as a result of employee evaluations.

Once data are collected, an assessment is generated that represents—in numbers, graphs and against benchmarks—an organization's ability to use human capital to generate business results (see diagram 3).

Diagram 3

Each attribute in the model is scored to reflect the maturity of the factor to which it corresponds. Low scores indicate an absence of capability or maturity, and high scores indicate an extensive level of capability or maturity. These assessments can be compared across business units in the same enterprise.

Conclusion

The main source of improvements in productivity through time has been the substitution of ideas, skills and knowledge for physical resources and manual labor. But the acquisition of human capital requires resources that poor people everywhere have difficulty acquiring. Because there are limited resources for human capital formation, especially in poor countries, ways must be found to enable people to acquire these resources and to use them efficiently in the production of knowledge and skills. It would be hard to imagine a more important challenge for international policy.

Fortunately, we have considerable knowledge about how to create efficient learning systems, though this too is a controversial subject as learning systems everywhere seek to adjust to the more demanding education requirements of the globalizing information economy. There is, however, considerable knowledge and experience about effective learning that is creating a science and engineering of education that enables professional educators to take responsibility for improving learning. Standards that define what students should know and be able to do at different stages of learning are very important for creating assessment and supportive learning systems to maximize learning efficiency.

Human capital formation is necessary for improving labor standards, but not enough. Learning does not take place in isolation from societies, polities and economies, all of which either improve or diminish incentives and opportunities for learning. Indeed, families, workplaces, and civic organizations are all important learning systems and all of these other systems influence the learning that takes place in school. From an economic perspective, overall economic policies and strategies condition the nature of the demand for human capital. In societies where the demand for skills and knowledge is weak, the returns to education are likely to be lower than where demand is strong. This is one reason there are no consistent relationships between national education expenditures and economic achievement. Clearly, schooling is more focused and efficient if there is strong demand for knowledge and skills and the standards required for work and life are clear.

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