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Of Human Capital

WE, the people of the modern ICE age, seem to have come full circle, to taking a look at ourselves. Management theories are veering round to a re-evaluation of that invaluable human factor and its critical contribution to the creation of wealth. In fact, they have gone one step further to stress that people are the wealth. Pundits of today assert that while the other forms of capital, including material, equipment, tools and technology, only represent inert potentialities, it is the human capital that converts this potential and energises the creation of wealth.

Let us take a peep into this fascinating attempt at pricing the priceless, or what was hitherto considered priceless simply because not many serious attempts were made at its valuation. What makes the challenge more interesting is that this form of capital is floating rather than fixed. No organisation can own its human capital the way it owns its other assets. And, inevitably, there is a constant 'flight of capital'. Here we have all the trappings of perpetual dynamics when compared to static assets whose tenure can be safely projected.

Today, there is nothing sacrosanct about employer-employee relationships and a professional parting of ways is an accepted way of life. For instance, the only loyalty the silicon generation exhibits is to the Silicon Valley itself, not to any individual organisation within its bounds. The imperatives of attrition have to be accorded due recognition, and this is the other dimension an organisation has to focus on. Employers have to understand the value that is lost when a key employee leaves. So, we will also examine the cause of attrition in the new knowledge-oriented organisation and what can be done to motivate loyalty.

Capital redefined

An organisation is made up of competencies which we can loosely call 'capital'. Its key components are 'customer capital', 'structural capital' and 'human capital'.

Broadly a company's strength arises out of its customer base which purchases its products. This customer capital triggers a number of key decisions such as new product

and service packages, new designs in anticipation of customer preferences and new locations from which a number of customers could be profitably served. We have heard of a company being acquired purely because of the strength of its customer base.

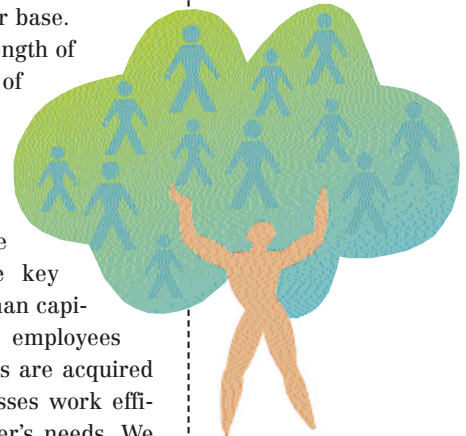
Besides customers, the strength of an organisation arises out of the efficiency of its operations. This is characterised by the manner in which its processes are designed and operated. We can call this the structural capital. But the key strength comes out of its human capital. It is the expertise of its employees which ensures that customers are acquired and retained, and the processes work efficiently to satisfy the customer's needs. We can say that human capital is the basis for the creation of customer and structural capital.

The accounting system does not capture the values of these forms of capital. Indeed, even a management information system hardly captures the accretion or depletion of these critical components in the functioning of an organisation.

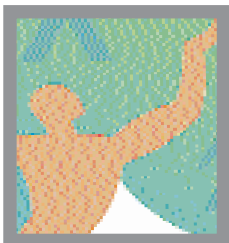
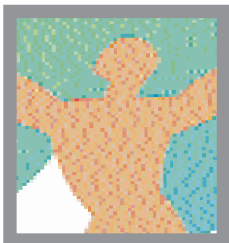
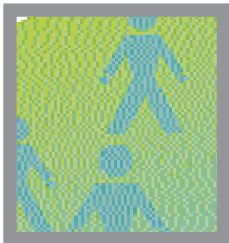
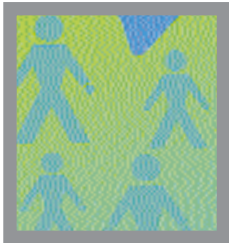
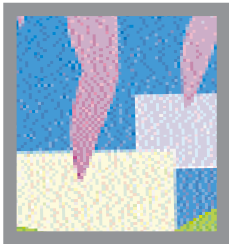
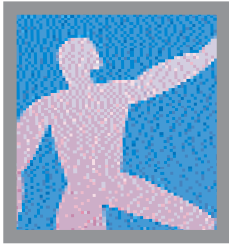
For a knowledge base on the knowledge worker

In the information technology (IT) industry, we started examining the issues relating to the human capital of an organisation. If people hold the key to prosperity anywhere, it is more so in the IT industry which employs knowledge workers. Here, human capital is not merely one component of capital; it is the critical component that forms the basis for other forms of capital: People with their expertise are the sole creators of value to the customer and people through their effort are the key to the optimisation of its process efficiency.

Perhaps the natural corollary to this is the high attrition rate in the IT industry. So IT organisations have a critical need to know the value they would forego when they are about to lose a person. This knowledge is important in taking appropriate action, in making counter-offers, in keeping up a constant preventive effort to fine-tune the



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compensation structure. All these should always be in line with the value being provided by the employees.

Bundle of competencies

An employee has a bundle of competencies, each of which needs to be valued. In the computer software field, with which I am most familiar, we classified competencies under five major heads – domain, technology, project management, initiative and leadership.

A software project attempts to computerise applications such as production scheduling in a manufacturing organisation, trade settlement in a stock exchange or recoveries for an insurance company. An analyst developing the requirements for the system must have expertise in the specific business area such as manufacturing, securities trading or insurance. We call this business knowledge the domain expertise. A software designer must be knowledgeable about the technology that provides the platform for the system and makes it work. Similarly, project management is an essential area of expertise for a person leading a part or whole of a project, to ensure that resources are marshalled to yield effective results in the required time. Besides these, what makes a person valuable to the organisation is the consummate acumen for enterprise and execution – the generation of ideas and the speed of implementation. These come under the umbrella of initiative. Finally comes the quality of being an inspiration to others: Is a person a thought leader? The ability to apply a new technology in ways unanticipated is one example of displaying thought leadership.

The depth dimension

We have defined different categories in which the skill-level of a person can be classified. This will bring out the breadth of expertise. We need to also know the depth of experience. There are four levels of

expertise that are termed exposed, experienced, expert and excellent. A person who has merely gone through a training programme is only exposed to the technology. If he has practised that skill in one or more projects for an acceptable minimum period, he becomes experienced. An expert is one who is recognised by his peers to be knowledgeable, to whom they turn for resolution of complex problems. Excellence is attained and proclaimed when an outside committee of experts in the field recognises a person's expertise. This level is usually reached when a person passes an examination or is invited to become a member of an exclusive club of experts.

Now for the verdict...

Therefore, a person's competency can be judged by looking at both the breadth and depth of his skills. The all-important question now is whether these skills are of value. For example, expertise in an old computer language, which has become obsolete, has little market value. However, before January 1, 2000, this rare skill was of great importance to people who still had running systems that used these obsolete languages. The value therefore is contingent upon the use to which the expertise is put. In the software field, as in most others, there is value to a skill so long as it is usable and there is effective demand for people possessing that skill.

Is there a magic formula?

Once we have determined that there is value, we need to establish its quantification. A skill has a value so long as it can fetch a return. One method is to look at possible returns over the next five years and thereafter discount the amount by an accepted percentage to arrive at the current value. This will require us to forecast the revenue that can be generated each year over the next five years for a person (for

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instance, a Java programmer). The attempt is to calculate the value of a competency at a point in time. Therefore, we do not bother about the additional value that may accrue to a person as he moves up the competency ladder

A person has a set of competencies and a value is assigned to each of these competencies. The sum total of it is the value of an employee and the sum total of the value of all employees is the human capital of the organisation. This human capital, together with the customer and structural capital produces the revenue.

To retain Ms High Value

When an employee leaves, an organisation loses that much of capital as determined by the valuation given above. The organisation's response to this situation should be guided by the value being lost. Unfortunately, there may be no escalation when a valuable employee leaves. The senior management gets into the act only when a very experienced employee leaves, irrespective of whether he has a higher or lower value than a less experienced person. An organisation needs to look for a system for the scientific computation of employee values, stored in a constantly updated database, with triggers for intimation to top management based on employee valuation. Management can then be made to sit up and take notice whenever high-value employees leave, irrespective of the years of service. In fact, compensation across the board can be structured to be in line with this valuation system.

Why do employees leave an organisation? Compensation is only one of the factors and, unfortunately, that is the only factor looked into. In my organisation, we did a detailed survey on what would result in increased commitment to the organisation, which intrinsically meant reduction in attrition. We realised that increase in job satisfaction as

well as increase in opportunities at higher levels of value had a positive influence. These resulted in a person moving up the expertise ladder. There are supplementary factors too, such as improvement in the work environment and elimination of irritants largely brought about as a result of bureaucracy. What kind of effort is needed to enhance satisfaction levels as well as eliminate irritants? It again depends on the potential value created or lost. A major factor for a person's loyalty to an organisation is the compensation structure. The value of a person can certainly be a guiding factor in arriving at the appropriate compensation level.

Miles to go...

Organisations are getting differentiated on the basis of the knowledge each possesses. In a world of constant technological changes, an organisation prospers from the quality of its people. People who are relevant for today's work may not be able to meet the challenges of tomorrow. We need to get them to forget some aspects of today's competency and build the requirements of the future into them. Increasingly, the investment decisions of top management will not be restricted to the acquisition of brick-and-mortar assets, but of building additional competencies in people.

Human resources valuation has remained an academic exercise and largely ignored even in industries where the expertise of employees is the key differentiating factor. The process of valuation is complex and challenging. But unless we adequately assess the value of human resources, we will not be able to respond to future needs. ■

*(The author is Executive Vice-President,
Tata Consultancy Services)*

