

As global business moves deeper into the knowledge economy, there is increasing recognition that talent management is important. However, traditional approaches are seldom regarded as being sufficiently aligned to core business. The Human Capital Strategy approach adds a critical strategic dimension to talent management, ensuring that investments in people are approached as rigorously as other capital investments. Linking people initiatives with business drivers, and ultimately bottom line outcomes, is at the core of the Human Capital Strategy approach. This article includes a detailed case study of how members of the UGM Consulting team applied the approach in a large Australian company.

Overview of the UGM approach to human capital strategy

The knowledge economy v the industrial age: two very different models affecting how talent is positioned

Unpalatable as it may appear, almost a decade into the new millennium and well into the knowledge age, there is ample evidence that industrial age thinking still predominates in many organisations. For example, annual accounts of company performance do not include explicit provisions for the valuation of human capital, although intangibles such as goodwill are calculated and reflected. Some facts which highlight the increasing importance of intangibles are listed below:

- The increasing proportion of human capital in operating costs. In developed nations, up to 75% of GDP is derived from the service economy and labour costs in the US are the single largest expense item at 44% of budget.
- The intangible value of the top 150 companies in the world grew almost 900% from \$800b in 1985 to \$7.5 trillion in 2005. Profit per employee (PPE) is seen as a much more powerful predictor of growth in market capitalisation than the traditional Return On Invested Capital financial indicator.
- In knowledge-intensive businesses, small improvements in productivity can leverage large increases in bottom-line financial performance. BCG estimates that a 1% increase in human capital productivity delivers a 10% increase in profits.

Perceptions of HR as a business partner

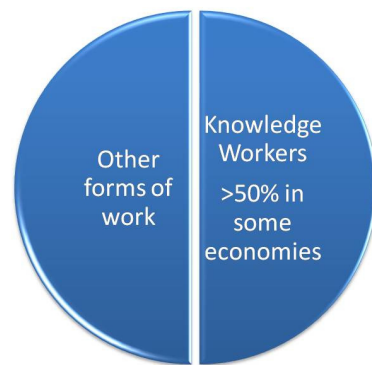
With compelling reasons for maximising the value of human capital, it would be reasonable to assume that the HR function is seen as playing a critical role, particularly in people-intensive businesses, if not in all companies. Yet multiple studies and recent commentaries confirm the disturbingly poor standing of the HR function generally, indicating also that the position is deteriorating. A 2006 Economist survey of 555 senior executives rated the HR function (along with Procurement and Supply Chain Management) as the least critical of thirteen corporate functions. Perhaps unsurprisingly, the respondents also rated the HR function as the worst performing of all the functions and second last, when asked to rank the functions relative to their importance in realising corporate strategy in the following three years. Our clients have had mixed experiences - the HR function is very well regarded in some businesses and very marginalised in others.

The status of the HR function in a company is closely linked to perceptions that leaders hold about its ability to add value.

UGM Consulting has found that the status of the HR function in a company is closely linked to the perceptions that leaders hold about its ability to add value. Almost from its inception, the human resources function (formerly the 'personnel function', and before that 'labour relations' and initially 'purchasing') has been viewed differently from most functions. For example, R&D, operations, marketing, and finance staked a claim in the value chain as producers of value and, more often than not, secured a place at the top table. HR, on the other hand, is more frequently viewed as a cost, and a drain on value and does not necessarily have a seat at the table. It is possible to see how this view arises, particularly when key capital investments are in plant and people are seen as an expendable resource which is easily replaced.

Organisations have achieved significant value gains from the reduction in the cost of handling natural resources. In contrast, the 'handling costs' associated with human resources have exploded. If this is viewed solely from an industrial perspective, it can be judged as leeching value from the value chain. In this type of climate, line managers see themselves as agents of corporate profits and may even distance themselves from HR advocates, who may be positioned as agents of welfare and destroyers of profitability. A key reason that is repeatedly cited in research studies for this dim view of HR is that *today's HR model is not necessarily seen as delivering the expected business results*. HR is not seen as sufficiently strategic!

Regardless of how HR is perceived, few would now disagree that the focus of competition globally is in a knowledge-based, rather than industrial-based economy. Value was once measured in tons (sheer quantity of a natural resource) and subsequently in grams (a highly valued product, developed from raw materials using know-how). However, much of the value that the steadily growing number of knowledge workers (comprising up to 50% percent of the workforce in some developed nations and up to 80% of the workforce in knowledge-intensive industries) create is intangible. Therefore it must be treated and measured quite differently from the old industrial outputs.



Proportion of Knowledge Workers

80%

**Knowledge Workers
in some knowledge
intensive industries**

Talent management in the knowledge age

Knowledge and the ability to apply it are key elements in the value chain. The machines of the past were owned, good for years and even decades of production, and largely immobile. In contrast, deriving value from knowledge, which is mostly people-based, is very different. Companies are increasingly just renting, rather than owning, know-how, as essential knowledge and capabilities are retained by individuals. As could be expected, attracting, retaining and aligning the right talent then becomes an extremely important strategic issue. Intensified competition for talent is seen as the most significant by far of the challenges facing businesses globally. Yet not all talent adds equal value and neither do all positions. Some people and some positions are of greater strategic value than others.

Companies are faced with multiple strategic options and also a constrained set of resources. Even with good strategies (not just relating to human capital) in place, companies inevitably leave substantial value on the table. On average around forty percent of strategic value is unrealised due to the knowing-doing gap, or the inability (mostly of human capital) to translate great strategic plans into effective implementation. Effective organisations focus on the drivers that significantly move their performance needle. In particular, successful companies focus on developing the specific human capital traits that will have the greatest impact on implementing the strategic initiatives they've chosen.

Most significant is the fact that, when four key human capital elements (structure, motivators, communication and decision-making) are compared, some elements move the needle much more vigorously than others. For example, initiatives that ensure everyone in the business has clarity around accountability for decision-making were found to have *three times* the impact on delivery of outcomes, compared with initiatives around performance appraisal. Related findings showed that only 32% of individuals in companies weak on execution felt they had clarity around accountability for decisions, in contrast with 71% of individuals in more successful companies

Linking 'human capital management' to business results

This example demonstrates how strategic issues are experienced. Implementation is literally where the strategic rubber hits the road and human capital is inexorably part of this. One might expect that HR would be adding substantial value at this interface. However, we have heard from some of our clients the view that line managers 'don't do HR' and 'HR doesn't do business'. Recent research by McKinsey with CEOs, line managers and HR professionals found empirical support that these perspectives are not just views of reality but are actually being practised. Fifty four percent of respondents suggested that senior managers don't devote sufficient time to talent management and fifty two percent felt that line managers are not sufficiently committed to people development.

Adopting a strategic view of human capital is likely to result in more successful performance due to better alignment of efforts. UGM clients have reported that where HR plays a strategic and valued role it also adds significant value to the business. Research conducted in over two hundred companies in the financial services sector found that when HR practices were internally aligned with one another (and also with overall organisational performance) business performance was significantly enhanced. In the competitive (indeed hyper-competitive) world of business, success is most likely when a company has core competencies that create and sustain competitive advantage. Resources are deployed to increase efficiency and effectiveness, exploit opportunities, and minimise (or neutralise) threats.

The value added by human capital is maximised when it is engaged and managed strategically, with at least the same degree of diligence that is afforded financial capital. A human capital strategy should be an integral part of how the company will achieve its strategic objectives and, ultimately, live its vision. Therefore, a key element of a strategic approach to human capital is not only recognising that some positions move the performance needle more than others, but acting to add value by shoring up areas of core competence that deliver this unique competitive advantage.

Conclusion

We once simply used the term 'post industrial society' to describe the present historical period. But, more and more, the term 'knowledge age' is being used, as a sharper, more precise way of capturing the essence of this current period. In the previous industrial age, it was capital-based access to natural resources and plant that together delivered much of the value. Machines transformed raw materials into commodities in higher volume and more cheaply than individuals ever could. To make this happen, largely unskilled (and expendable) human resources were used to extract value. Factories dominated the landscape.

But, over time, complexity became the vital source of competitive advantage – and humans were the source of this complexity. Alongside this economic development, the human resource perspective evolved to acknowledge the importance and challenge of managing this new type of resource well. This shift was, in turn, accompanied by a social change which brought new legislation and new social attitudes to bear on the management of 'people at work'. In some organisations, a seamless alignment was achieved between the strategy and human resources functions. But all too often they drifted apart, with human resources not seen as aligned to core business. This is where a human capital strategy approach can make a vital difference, bringing together people initiatives and business drivers to deliver results. Our approach puts HR where it belongs, at the strategic heart of the business.