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Investing on Human Capital: Safe bet or a gamble?

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ABSTRACT

The development of human capital has been recognized by economists to be a key prerequisite for a country's socio-economic and political transformation. Capital and natural resources are passive factors of production; human beings are the active agents who accumulate capital, exploit natural resources, build social, economic, and political organizations, and carry forward national development. People are often spoken of as assets but are generally treated as costs, because there is no credible system of valuing them. In today's knowledge-based organizations value is driven more by people than by any other factor. As widely recognized, investment in human capital is subject to a considerable risk. Organizations do employ some who indeed should be seen as investments rather than costs but the vast majorities are value adding. Intellectual capital includes a broad range of people, knowledge and relationship assets. These intangible assets are the key to the company's growth, innovation, and competitive advantage. Though global competition, market volatility and declining labour pools make investing in people a high risk gamble, still future success is dependent primarily on the ability to attract, retain and productively manage this shrinking pool of talented and motivated people. This in return helps to gain a strategic competitive advantage, innovate faster and evolve as a stronger organization. The purpose of this paper is to provide a simple theoretical perspective in which the various uncertainties associated with human capital are discussed. The paper also intends to study and find an explanation for business corporations to consider investing on human capital as a profitable option and suggest ways to practice the same.

Key Words: risk, human capital, profit, investment, strategy, intangibles.

1. Introduction

Competition and change exists side by side in this fast paced world. Any competitive edge gained by the introduction of new processes or technology is short-lived if competitors also adopt the same technology. But to implement change, their people must have the same or better skills and abilities. Hence corporations, especially the service organizations, are recognizing the importance of investing in their employees now more than ever before. Companies are beginning to understand that to stay on top they need to place more and more emphasis on developing and retaining their people.

Nobel Prize-winning economist Gary S. Becker, who coined the term "human capital," says that "the basic resource in any company is the people. The most successful companies and the most successful countries will be those that manage human capital in the most effective and efficient manner." Human capital is a valuable concept because it recognizes that people should be treated as assets, rather than as an expense.In business terms we might describe human capital as a combination of factors such as the following:

1. The traits, one brings to the job: intelligence, energy, a generally positive attitude, reliability, commitment
2. One's ability to learn: aptitude, imagination, creativity, and what is often called ''street smarts,'' savvy (or how to get things done)
3. One's motivation to share information and knowledge: team spirit and goal orientation

The four factors; people, market, products, and financials are critical in ensuring the success of an enterprise over time. The human component is clearly the most vexatious of assets to manage. The almost infinite variability and unpredictability of human beings make them enormously more complex to evaluate than one of the electromechanical components that comes with predetermined operating specifications. Nevertheless, people are the only element with the inherent power to generate value. All other variables—cash and its cousin credit, materials, plant and equipment, and energy—offer nothing but inert potentials. By their nature, they add nothing, and they cannot add anything until some human being, be it the lowest-level laborer, the most ingenious professional, or the loftiest executive, leverages that potential by putting it into play.Thus understanding the value potential of human capital is of immense importance to understand the risks involved in investing and the returns they generate (tangible or intangible). This paper is an effort in that direction. The paper intends to

1. discuss the various uncertainties associated with human capital
2. study and find an explanation for business corporations to consider investing on human capital as a profitable option and
3. suggest ways to invest in the intellectual capital

2. Design & Method of Study

The paper is conceptual and review paper in nature. Data collected for this paper is basically from secondary sources. This paper critically examines the various uncertainties the employees pose for an organization and the way an organization needs to tackle them. A range of recently published (1990-2010) works, which aim to provide practical advice are examined to aid the research. After reviewing around fifteen numbers of research articles it has been thought that investment in human capital is the call of the hour and these intangible assets carry a lot of worth in transforming the future of an organization. Specific cases of organizations in different countries are studied through the published research papers retrieved from secondary sources like books, e-journals, business magazines, etc. for analyzing the importance of investing in human capital and its various contributions for organizational growth and success.

3. Discussion

Human assets are valuable to the firm, but their returns may not remain stable over time due to changes in business conditions, changes within the firm or changes in individuals who own the knowledge, skill and abilities that comprise human capital. These uncertainties associated with human assets and the role that certain human resource practices play in managing these uncertainties is important to be discussed.

3.1 Risks of Human capital

Economist intelligence Unit Survey 2007 identifies Human capital risk as the most significant threat facing the global business operations. In this context it becomes essential for any research work to concentrate on various areas of where an organization is faced with risk to their human capital. We discuss few of them in this section.

1. **Turnover/ loss of key staff**

   Human capital is mobile, but once we have acquired it and maybe invested in it, we want to hang on to it. As the value of human capital has come to be more appreciated, strategies for retention are now high on most organizations' agendas. With the employee acquisition age becoming lower by the day, it is giving rise to more intuitive decision making from employees ultimately resulting in high employee turnover. Industry specific problems also add to the woes of human resource administrators. Companies coming out with offers like joining bonuses, onsite placements, hefty pay packets, yearly holiday plans, assets loans etc., have made the water even murkier for employers.

2. **Employee engagement**

   It's been noted that the primary reason of employee turnover or discontentment has been either employee superior relationship or the employee feeling "not wanted". Employees of companies, with the passage of time in the organization, develop some sort of expectations from the employers in terms of their involvement in various projects or assignments. When that doesn't happen or things are not consulted due to the fact that a more skilled person for that job has been included, employees tend to retract. This brings about a fall in their performance levels and finally the employee exits. The employers have to be cautious of taking employees "for granted" and have clear engagement plans in discussion with the employees.

3. **Ineffective hiring practices**

   Campus recruitments, poaching, referral recruitments have yielded much less than desired in terms of hiring. Labour intensive industries are constantly facing the challenge of keeping up pace in terms of staffing with the growth in capacity building. Thereby rendering a vacuum between number hired and numbers required.

4. **Talent management**

Acquiring good talent is not just sufficient for Organizations. Making them keep us their good work towards organizational success is a big challenge. Talent management processes give organizations valuable measurements, performance motivators and insights into workforce skills, competencies and emerging leaders. This vision empowers organizations to become more strategic in how they select, train, develop, retain, reward and help employees. Talent management includes recruitment, induction, goal-setting, performance management, assessment, compensation management, learning, career planning and succession planning processes.

These processes aim to retain employees and foster their continuing development of skills and competencies to achieve the organization's immediate performance goals and long-term strategic objectives.

5. **Poaching**

In markets that are competitive for scarce skills, people and teams will be courted and tempted. In a commercial firm, losing a key asset to a competitor is a double loss—not only do we not have the benefit, but it might actively work against us. Some say that the more competitors are tempted to hire your people, the higher the external view of your human capital worth. This may be true, but it can also be a signal of other negative factors like your inability to provide attractive opportunities.

6. **Performance stagnancy**

First of all, it needs to be found out as to why the employees have become stagnant. One could reasonably assume that the person's performance was below par and has been for some time. Why not then focus on improving their performance? If the person's performance improves, it is highly likely that they will be much happier and will be more likely to stay put. Improving performance is not particularly difficult, albeit that it will take time and effort; and it may be some time before sustained improvement is seen. Why is it not difficult? It is widely recognized that optimum performance is achieved when we learn through our job, combined with a strong sense of fulfillment. In other words, performance can be improved if an organization is focused on learning and fulfillment.

Unlike structural capital, human capital is owned by the individual, an individual who can walk out of the door unless it is recorded in a tangible form or is incorporated in the organization's procedure and structure.

3.2 Human Capital - A Key Driver for Business Profitability

Human capital is the collective value of an organization's competencies, knowledge and skills. It is renewal source of creativity and innovation and imparts to an organization the ability to change. Organizational capital includes intellectual property and process data. Executives often look at organizational capital from an internal ownership perspective. This is a protectionist view, which is not totally bad but is certainly limiting in terms of exploiting its potential. They want to know how to secure the intelligence contained within their documents and processes, as well as within the minds of their employees.Intellectual capacity is the ability of a company to extract value from the organization's intellectual capital. Intellectual capital is composed of two types of organizational capital: intellectual property and a complex intertwining of process and culture, plus relational capital and human capital. People are the catalyst that activates the intangible, inert forms of intellectual capital and the equally passive forms of tangible capital—material and equipment—to improve operational effectiveness. Human capital is the most vital asset in an organization, and managing it is the greatest challenge. For a company to succeed it is necessary to map the people-centric strategies with business strategies. Research has proved that organizations with advanced human capital management processes have much higher levels of productivity than companies with a non-focused people approach. The truth however remains that human capital is often underrated, not because the value is not realized, but the fact that organizations do not know the best ways and means of managing their people resource.

Human capital needs to be managed like any other resource, for instance money, material, etc, to get the best return on investment. Human capital management is not a luxury, it is an imperative for success. In a successful firm, it is the motivation and creativity of the junior-most resource that is the key to organization renewal and sustained success. The basis behind any asset is to ensure the desired production out of it. If people assets do not act and react appropriately, then much of the capital (financial, technology or knowledge) is wasted. As a result strategy is not successfully executed, objectives are not met, the mission is not fulfilled and stakeholders are not satisfied. Human Capital Management includes recruitment, training, development, deployment and performance management, working on processes related to all these can lead to better human capital management. Human capital management is directly linked with productivity as the pace of an organization's growth is inseparable from the rate its people grow. Human capital management focuses on building motivated, skilled, productive and innovative people. It also helps make people a source of competitive advantage in delivering superior customer value. Research studies indicated that companies with positive employee attitudes are 50 percent more likely to achieve customer loyalty, and 44 percent more likely to achieve above-average profits. Additionally, the study finds firms that measure in the top quartile with regard to employee engagement averaged 24 percent higher profitability, 29 percent greater revenue and 10 percent less employee turnover than businesses in the bottom quartile. The evidence is clear. Better people management practices produce better business results.

3.3 Human Capital Investment Paradigm

The concept of investment on human capital refers to the education, on-the job training, and work experience of the labour force. It is analogous to other forms of capital in that investments in human capital yield income and other benefits over a long time. An investment in human capital means investing in education or some form of on-the job training to improve workforce quality. Such investments provide returns to the individual as well as to the economy as a whole. Individuals benefit from higher earnings, and the economy as a whole benefits from higher productivity. Investing in the best human assets is an absolute priority in the value creating organization. When human capital is managed effectively, the organization is never taken by surprise. There are some fundamental means of ensuring that this is done well. It would be completely wrong to presume that a human capital investment is direct and tangible only. There seems to be investments which need to be made towards nurturing human capital which may be completely indirect or intangible. Few of the tangible and intangible investments are as below:

1. **Recruitment**

The costs associated with manual recruitment can become quite excessive, partly because of the candidates that are produced. One bad candidate can cost a company more than ten times that individual's salary. There are six basic elements of recruitment cost: advertising, agency and search firm fees, referral bonuses paid to employees, travel costs incurred by both recruiters and applicants, relocation costs and company recruiter costs (including salary and benefits prorated if the recruiter performs duties other than staffing).

2. **Compensation**

The most basic employee need to be satisfied is an individual's compensation and benefits. A competitive compensation offering by organization is important. The obvious tool for organizations to meet those needs is periodic compensation increases. Pay programs can be set up in response to the market, or they can be configured as a strategic tool. In general, the distribution of pay between top and bottom performers is barely differentiated. Everyone knows it, and the salary increase scales prove it. Rather than viewing pay as an ongoing process, we recommend that the pay of all employees above entry level be more flexible both upward and downward.

3. **Benefits**

Employee benefits are background. No one thinks of them except when they need them. Benefits such as child care, recognition events, and those programs having more immediate daily effects should be kept inside and managed closely. These can make a big difference in productivity and retention.

4. **Training**

Employee development is one of the most important issues for the foreseeable future. The right employee training, development and education, at the right time, provides big payoffs for the employer in increased productivity, knowledge, loyalty, and contribution. Learn the approaches that will guarantee your training brings a return on your investment. Licensing, certification, continuing education, and training to retain and grow skills are becoming increasingly important.It is however not enough to just have a satisfied workforce. Having a satisfied workforce does not make a good company. It is a charged up, an excited workforce that delivers customer satisfaction. This in itself is not an easy task, for irrespective of changing market conditions, effective people management for achieving business goals remains the biggest challenge.

5. **Create a learning environment**

Employees must understand why they need to learn else they will be resistant to or defensive against the possibility that a better way to do their jobs exists. Managers, therefore, need to help them discover what is in it for them to change their mindset about learning.

6. **Understanding what drives and motivates them**

There are various instruments available to assess this. However, the most important practice is regular and continuing dialog with people about how they feel about their work and the organization. Every decision to leave is a combination of "push" and "pull" factors. Pull factors come from opportunities for new pastures that are brought to someone's attention. With the continual extension of the headhunter's reach, one does not have to be an executive to "get the call." If the would-be seducer strikes fertile ground where there are already push factors—various elements of dissatisfaction—it is a slippery slope to the employee leaving. We are well aware that monetary benefits are one of the key factors which drive productivity and employee satisfaction. It needs to be understood that a continuous enhancement of pay benefits sometimes loses its shine as a motivator for an employee to withstand the push or pull effect.

7. **Creating a forum to communicate freely**

Performance has been described as potential plus energy minus interference. Potential is improved through learning. Energy is improved by a combination of learning and the sense of fulfillment that we get from our job. Interference is often the most difficult issue to address and reduce. Interference, in the context of performance, can include many things, both at work and also away from work. Possibly the easiest and most effective way to reduce interference is to create a safe, non-judgmental environment. An environment where people feel safe is one where ultimately they can express their thoughts and ideas without fear of criticism and ridicule. The focus is on what people get right and not what they get wrong. Communication needs to be open and honest if a safe environment is to be established and maintained.

8. **Promoting an energetic organizational culture**

Providing new training opportunities may be difficult in some cases, particularly where a job is based around repetitive and mundane tasks. But it's not impossible. Introducing variety by regularly changing roles, whereby people need to learn new skills, can alleviate this particular problem. Investing in enhancing people's general skills is yet another way of doing this.

9. **Having a flexible approach to employment conditions**

The value-creating organization will make available to all employees the same processes of performance review, career planning, application for promotion, and so on. This does not mean that it will treat everyone in the same way as a result. What motivates individuals is so variable that we need a great deal of flexibility to meet people's needs. There are many options for working time and place, flexible benefit policies, and a variety of reward strategies, for example. In large companies, this kind of flexibility can sometimes be achieved by spinning off various units into separate entities, each with its own rules.

10. **Providing an environment that minimizes dissatisfaction factors and maximizes satisfiers**

    This is such a significant influence that the next chapter is devoted to it in detail. Surveys show that the most common source of stress is the relationship with the boss, although many other factors can cause people to look elsewhere. This is one argument for reducing the sanctity of the boss–subordinate relationship, and involving third parties such as coaches and mentors.

11. **Creating an attractive future**

    One increasingly common strategy for retention is providing employees with equity, or another form of long-term reward, to tie them into the longer term or some more specific point in the future. This future can be rolled forward through new awards each year. It is not always easy to radically change the salary base of those whom we particularly want to keep. Nevertheless, rewarding contribution to added value through long-term incentives can be both discriminating, based on the different levels of contribution, and attractive to the individual. There are other kinds of future that provide incentives to stay. These include the anticipation of promotion or greater responsibility; planned expansion and diversification that will bring new opportunities; involvement in some special aspect of the organization outside the current job that might hold particular appeal; the opportunity for an international assignment; or the promise of early retirement.

4. Literature Review

We can't tell you which country will have the biggest GDP in the year 2050. But we can tell you that Americans who build their human capital—who seek out a good education in the hard subjects, who acquire valuable skills in the workplace, who work hard, and who are taught to save and invest prudently—will prosper. They will adapt to whatever happens and take their place in the coming world order. (Stein B et al, 2006).One way to think of returns on human capital is to consider what their absence means. Everywhere we look, in our central cities in particular, we are presented with the spectacle of inadequate human capital formation, young people who have dropped out of school or never connected with learning in the first place. This is not the place to reckon the cost of a failure to educate, except to note that the common sense observation is true. If you think education is expensive, try ignorance. (Doyle D. P, 1994).If we believe that "people are our greatest asset," then we must also believe that organizations compete for business through the people they employ. If this is the case, then it is to the organization's advantage to ensure that its greatest asset, albeit it's most elusive one, human capital, is utilized to its best and highest use. HR practice leaders, who are truly serious about making a difference, need to "measure" the business impact HR-driven programs have on their organizations as a means of demonstrating the merit and credibility of any program that they endorse. (Weatherly L. A, 2003).In order to achieve professional growth and success in the next period of increased talent acquisition, technology professionals are going to have to step out of their comfort zone and develop the holistic, relationship-focused business skills that companies are requiring. And by the same token, companies are going to have to take a more strategic and supportive approach to recruiting and retention if they want to find and keep the new breed of evolving talent. (Brocaglia J).Companies are already making these investments, says Echols, but they don't subject their performance to the same rigor as tangible asset investments. Nor do they invest with the same confidence, because performance measurement is tricky. (Flynn P, 2009).Volatility and virtuality erode relationship which is why managers must learn to invest in social capital. Trust responds to rewards. In particular, promotions act as powerful signals – when trustworthy individuals are promoted, the organization proves that trust succeeds. (Prusak L. et al, 2001).Senior managers must include in their strategic plan, investing in work force education through expanded company training and development programs in order to improve performance and productivity. This will raise the overall level of employee strategic competencies that make the high performance work place click. (Gordon E. E, 1999).Our Organisations are addicted to the speed of technology. We are applying technology but the effectiveness of that technology application will only be as effective as our human capital can deploy and assimilate the technology. We have a major financial and social factor impacting on our work forces, our partner relationships and our clients, which we are not discussing and treating. We are focusing on the symptom rather than the cause. If we are going to impact our productivity, we need to ensure our people are looked after and maintained and, if depression is impacting between 10% & 25% of the workforce, then we clearly need to find more effective ways to destigmatize the issue and run our businesses more efficiently. (Robinson G. C, 2002).Those organisations that invest in employee training and development will be much better positioned to meet the challenges of the changing healthcare environment. (Clark R. L, 2000).The focus in vocational training has firmly shifted to output – to the results and performance that need to be achieved. The accent is now on achievement, on qualification, on competence. (Holland G, 1990).Internal marketing affects both how the individual perceives their role within the organisation and how these roles relate to the wider operation of the organisation with its environment. This is important given the paucity of empirical work in this area and the emphasis in the marketing orientation literature of organisations adopting a customer focus. (Hogg G. et al, 1998).Strategic human resource management acknowledges that investments in human capital are similar to investments in other types of real assets and thus carry uncertainties. (Bhattacharya M et al, 2005).Although it is intangible, the risks to IC are all too real and tangible. Protect your company from these risks by understanding IC and the unique risks that can threaten it. Identify measure and put in place risk management plans for the specific risks faced by your company. (Adams M., 2006).The term human capital can be used to describe the asset value of your people. Maximizing human capital through acquisition, retention, growth (and sometimes retention) should be a major priority of all executives, not an area left to the HR department alone. It is the area in which measurement is least well understood. People are the one factor of value growth that drives all others. The value that a company creates results from the way that people apply their skills, energies, and expertise to the capital and raw materials that customers want. Of all the business levers available to leaders, the greatest potential to build value is offered by people. It is time indeed to recognize this through demanding a rigorous and credible approach to both valuing this most significant asset, and linking that value meaningfully to the benefits for stakeholders. What gets measured gets managed—and we need reality behind the rhetoric about our people. (Mayo A.).Those organizations that do launch sophisticated learning management infrastructures can begin to use the data capture capabilities they contain. These organizations then can analyze the determinants of human capital advantage and their link to performance in a much more rigorous manner than has been possible before now. (Bhugtoria N)

5. Conclusion

Today's competitive global market environment are focused on management of capital assets – maximizing utilization and minimizing downtime with a minimum of upkeep and maintenance. In order to value people, companies must move beyond the concept of human resources and toward the notion of human capital. The term "resource" implies an available supply that can be drawn upon when needed. The term "capital," however, refers to something that gains or loses value depending on how much is invested in it, and how that investment is made. If intellectual capital was nurtured and maintained in the same way that mechanical equipment was maintained and upgraded, then companies would not consider cutting the training budget, or withholding merit increases when there is a profit shortfall. The asset that thrives is the one that is fed. Investment in people will pay off like investments in other assets. It's a long-term strategy. The last thing a company should do for short-term gain is asset-dumping. Indeed, that's the time to get the assets working extra hard. Everyone knows that without good people, good products cannot be developed, or good services delivered, or good customer relationships maintained. But when times get tough, people are often viewed as expendable. And sadly, the lower down the chain a person is the more expendable they become. Treating people as if they are costs demoralizes and disenfranchises them. A company's competitive advantage erodes whenever investment in people is cut back – when layoffs occur. This takes a predictable toll on the company's health and inevitably the bottom line. Hence it is suggested that employers take a rational view of managing their human capital more effectively by Competitive compensation offering with flexible compensation fixation for higher than entry level employees

1. The right employee training, development and education, at the right time, provides big payoffs for the employer in increased productivity, knowledge, loyalty, and contribution.
2. Create a learning environment
3. Create motivational drivers for employees
4. A forum open enough for clear and honest communication to be established
5. Introduction of variety of regularly changing roles for higher degree of involvement from employees
6. Investment in people's general skill development is necessary.
7. Providing an environment that minimizes dissatisfaction factors and maximizes satisfiers
8. Creating an attractive future

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