ASIAN JOURNAL OF MANAGEMENT RESEARCH
Online Open Access publishing platform for Management Research

Research Article ISSN 2229 – 3795

Strategic framework for human capital investment to create sustained competitive advantage

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ABSTRACT

A platitude of management is that people are every organization's most important asset. And yet most organizations' processes for building and cultivating these critically important assets are not processes at all. They are programs, which are conceived episodically, opportunistically, or reactively. Then, to compound the problem, most of our organizations have no way to measure the results of our efforts to build the people. We measure the activities and the spending that are inputs towards these purposes. But we don't measure— and in many ways can't measure—their effectiveness. The results researchers have shown that financial compensation is, at best, a hygiene factor. It's important not to mess compensation up, because inequities in compensation create disgruntlement. But financial incentives don't create that deep willingness to sacrifice for the good of the organization. It is as if their hope is to embed within a compensation formula a carrot here, a nudge there, and a kick in the rear end on occasion, so that the people thereby incentivized, don't need to be managed. So many "managers" want to abdicate to a formula that these things that are the essence of management—creating opportunities for the people to succeed at important, challenging responsibilities. One of the greatest ironies of management is that the processes of building and utilizing our organizations' most important resources in the most productive and effective way possible is probably the least understood of all of the dimensions of management. And it is not understood because it has rarely been studied in rigorous ways by those of us who should be studying it. This article intends to provide a framework within which managers can create a sustained competitive advantage through people, removing many of the contradictions that characterize the way we manage our people.

Key Words: competitive advantage, management, framework, compensation, challenge.

1. Introduction

Human capital is the defining component of any successful company. Between every great business plan and every consumer exist the people who will implement the steps necessary to ensure the plan's eventual success or failure. It is at this axle point that hard and soft sciences ram, and for this very reason, human capital remains unfathomable to many in the business world. It is the human element that makes it so explicitly captivating—and volatile. As employee needs and values have transformed and the workforce has diversified, we have started to think about the employee significance strategy as the connection between people and profitability: The critical link between employee and consumer is the key to organizational performance. Although a lot of lip service is paid to the idea that people are an organization's greatest asset, they often are treated as disposable assets.

2. Design & Methodology

This framework has been developed from the conceptual theory of human capital strategy basing on the data in companies which are reputed to be using human capital investment as a method to enhance their organizational excellence and reach a higher state of business productivity which in turn leads to sustaining competitive advantage. The companies which we have studied in depth are Toyota, General Electrics, BMW, and South West Airlines. All these companies are in their own sector the market leaders and also known to be employee friendly.

3. Discussion

3.1 The Objectives of Strategic Human Capital Investment

3.1.1 Organized Human Capital Enhancement

Strategic Human Capital Investment philosophy is to know whether or not the system is geared up for the improved performance plan. This not only answers the question "Did it work?" but also "Where did it work?" Maybe the plan worked in the United States but not in India. Maybe it worked with senior managers but not with supervisors. Capturing data at the lowest level possible, the individual level, helps us answer these questions. It also allows us estimate the value of human capital enhancements to the bottom line. An important role of any executive team is to allocate investment Rupee based on an expected return. Gathering and analyzing human capital data provides executive team members with two important data points: (1) to what extent have human capital investments impacted performance, and (2) what are these performance enhancements worth to customer satisfaction or to the profit line?

3.1.2 Progressively Better Human Capital Assessments

Are bosses across your organization making better human capital assessments this year than they did last year? Is your organization learning through its experience? For example, are competencies or experiences the best predictor for success in the regional manager role? How long does it take, on average, to reach full productivity as a regional manager? What experiences shorten that ramp-up time? All this data probably exists in your organization in separate databases, but someone has to access and analyze it to distill learning. The real value then is in sharing the learning with managers across the business to help them make better informed decisions.

3.2 Strategic Human Capital Investment Framework

To deliver competitive advantage, the human capital organization must align to the Framework of Strategy. It must build and manage a system for delivering each of the strategic components:

(1) effective executive teams, (2) leaders who deliver results, (3) key position excellence, and (4) workforce productivity. Align corporate HR professionals to the strategic components make this dimension primary. The strategic components are plans that describe how to achieve that vision. Achieving the vision requires excellence in four components. If all four are well-executed, it is likely that your organization will have a sustained competitive advantage through people. The first three strategic components are critical roles— roles that are most important for customer and shareholder satisfaction. The fourth component enables the first three.

3.2.1 **Efficient Management Teams**

The key question to ask about the first critical role—efficient executive teams—is: Are our executive teams more effective this year than last year? The executive teams may include the corporate top team, business unit teams, region/country-level teams, and functional leadership teams. Without a high-performing executive team at the top, little will happen below. Executive teams set the end-state vision and business strategies, and invest time and money to ensure that aspirations turn to business results. Just as human capital growth requires a top-down, comprehensive, and integrated enhancement plan, so do executive teams. (However, that's not the way many internal and external consultants approach executive teaming today.) An effective executive team enhancement plan begins when executive team members agree on the team's value-add to the business and define specific activities and measures for realizing that value-add.

3.2.2 Boss Who Bring Results

What is the single most important decision a corporation can make? Arguably, it is choosing the CEO. What about the most important decision for a company's China subsidiary? It's probably choosing the general manager for the subsidiary. At each level, starting from the top and working down, great leaders build the strategy, choose the leadership team, and align the organization. Twenty-five years of Gallup research concludes that how long employees stay and how productive employees are is determined by their relationship with the immediate supervisor. The world's best recruiting, development, and appraisal processes are useless if managers are not top quality.

3.2.3 Key Position Distinction

The most important question to answer here is: Are those in key positions outperforming their peers in competitor organizations? Too often today, people programs and policies are rolled out system-wide, with programs and policies applying to everyone in the organization. Making equal investments in all roles seems fair and equitable, but it's bad for the business. Some roles are more important to customers and shareholders than others. The most important roles should be paid well over industry standards, the moderately important ones at or below standards, and the least important ones below standards or outsourced. Training investments should also vary. When we follow the key position approach, we attempt to increase the performance of the 20 percent of positions that produce 80 percent of customer and shareholder value. Think in terms of your own finances: When you allocate your personal investment dollars, do you invest the same amount in every mutual fund, or do your dollar amounts differ by expected return? The ideal performance measure for excellence in a given position is performance relative to competitors. For sales positions, this may be measured by a customer rating of the sales representative or sales team versus sales reps or teams from competitor organizations. For scientists, it might measure the number of new patents by a scientist or research team that turn into products versus the average of those at competitors. Unfortunately, comparison statistics are not always possible. In these cases, you may choose to use an internal measure of year-over-year performance changes while you continue to search for good comparison measures.

3.2.4 Employee Performance

The key question to answer here is: Has workforce performance improved since last year? No amount of success in critical role development is possible until the organization has a clear strategy and organizational capabilities aligned to that strategy. The strategic component, workforce performance, is actually the first step in any human capital enhancement project. We cannot know which roles are critical until the strategy is set and the organization realigned. We need to have a simple and compelling vision, an aligned organization, a high-performance culture, and an appropriate appraisal and rewards process. These proactive responses demand a well-thought-out, comprehensive view of the market and its forces. Your capability plans must be current and flexible, designed to move with both planned and unexpected change. The model does this, with its emphasis on scanning the external forces and internal factors that may impact the organization, followed by capability planning that considers the marketplace not only next year but five years out.

3.3 Barriers towards implementation of the Framework:

There are several important barriers for the framework

3.3.1 First is the failure to **''walk the talk**.'' In brochures, handbooks, manuals, and training programs, executives proudly proclaim employees as their greatest asset, but they do not necessarily walk the talk. They treat employees as expenditures and investments in employees as expenses in the organization, quickly trimming employee numbers to save costs and to drive revenue.

3.3.2 The second barrier is the ownership issue

It is better to understand in the first place as to who actually owns human capital measurement, monitoring, and management. For many years, it has been the human resources function. Executives have turned to the HR staff to claim ownership for, and make improvements in, this important expenditure. However, for the human capital investment to be successful, it must be owned by the entire organization and managed by the senior executives. HR managers and senior executives must take a role in assuring that proper programs are in place, the appropriate measures are tracked, and improvement is generated. It also means that chief financial officers and operating executives all have important roles in this process to ensure that it functions properly. This is an important focus of this framework.

3.3.3 The third major barrier to change is **the failure to consider the dynamics of the human capital investment**

A variety of programs and projects are often implemented with little or no concern about how they affect various parts of the organization. Sometimes, projects even work in conflict with each other. There has been too much focus on the activities, programs, and projects and not enough on the outcomes, integration, success, and ultimate accountability.

3.3.4 A fourth major barrier is the **lack of appropriate measurements**

Executives who are concerned about the human capital investment do not have a clear understanding of what can be measured, what should be measured, and what is being measured. More important, they fail to recognize the connection between those measures and the success of the organization; or if a particular program or project is implemented to improve a particular measure, how to develop accountability around that project or program.

4. Literature Review

It is now largely recognized that balance sheets provide less and less a fair picture of a company's value. This is particularly true of high-tech established companies . . . but more importantly, especially in a very service- oriented economy the physical paradigm is no longer adopted to the measurement of corporate assets. (Bounfour (2003))Executives' concerns about executing and aligning strategy are likely exacerbated by a perceived lack of integration between the company's strategic-planning group and its human resources group. When asked to consider strategic planning's integration with several major corporate functions, respondents rank HR as second-to-last in terms of degree of integration. (2006 McKinsey survey)If there is anything we have learned over the past few years of traveling and talking to business groups, it is that HR rarely functions as it should. That's an outrage; made only more frustrating by the fact that leaders aren't scrambling to fix it. . . . HR should be every company's killer app. (J. Welch and S. Welch, "So Many CEOs Get This Wrong," Business Week (June 2006).)Consider HR mission statements. Here's a typical one: "To provide quality services and support in hiring, training, staff relations, benefits, compensation, and safety beyond the expectations of all employees, enabling them to better serve our external customers." Shame on the managers who approved this slop! Statements like this are painfully short on real deliverables and accountability. Why? I suspect that senior managers don't understand what HR can deliver. (G. Kaufman, "How to Fix HR," Harvard Business Review, September2006).They have made it to the top by building relationships and playing politics, instead of producing measurable business results (You can spot these [people] easily because they are always "in a meeting." They love meetings and think that going to a meeting is more beneficial than reviewing metrics, doing a post-mortem or forecasting people problems.(J. Sullivan, "Vipers in your Midst," Workforce Management, Vol. 85, No. 16 (2006).A 2002 Corporate Leadership Council study of 19,000 employees in twenty-nine countries found that "people management training" improved productivity by only 2 percent.(Corporate Leadership Council, Building the High Performance Workforce: A Quantitative Analysis of the Effectiveness of Performance Management Strategies (Washington D.C.: Corporate Executive Board, 2002).Accenture's 2004 High Performance Workforce Study found that while 65 percent of surveyed executives felt that developing effective leadership capabilities was very important, only percent feel their company does a very good job at this. Accenture, Accenture High Performance Workforce Study (2004), p. 6Despite exponential growth in more sophisticated training programs and technologies, satisfaction with training is also getting worse. Accenture's 2006 High Performance Workforce Study found that the percent of executives who are very satisfied with their training function has fallen from a low 16 percent in 2004 to an even lower 10 percent in 2006. (Accenture, Accenture High Performance Workforce Study (2006), p. 21.)

How one performs is unique. It is a matter of personality. Whether personality be a matter of nature or nurture, it is surely formed long before a person goes to work. . . . A person's way of performing can be slightly modified, but is unlikely to be completely changed—and certainly not easily. P. Drucker, "Managing Oneself," Harvard Business Review (March-April 1999).

5. Conclusion

Systematically improving human capital has been an unfulfilled dream for the past thirty years. The primary reason is that few line managers or HR professionals have defined an end-state vision of success. There is no lack of activity, but without a clearly defined end-state, line managers, heads of Centers of Excellence, and HR business partners are all rowing in different directions. We have discussed four generic strategic components: efficient executive teams, bosses who deliver results, key position distinction, and Employee performance. If a company exceeds the performance of competitors on all four, it will have a sustained competitive advantage. The final task is to determine whether the four strategic components are the best fit for your organization. This requires putting a stake in the ground on the most important components and measuring them over time to determine whether they are truly the most important things for driving your business results in 2004 to an even lower 10 percent in 2006.How one performs is unique. It is a matter of personality. Whether personality be a matter of nature or nurture, it is surely formed long before a person goes to work. . . . A person's way of performing can be slightly modified, but is unlikely to be completely changed—and certainly not easily. P. Drucker, "Managing Oneself," Harvard Business Review (March-April 1999).This will always be a complex balancing act because there is no such thing as a perfect strategy and all strategies, by virtue of the dynamic environment in which they exist, have to be dynamic. Conventional, textbook, economic theory produces a construct of perfect competition where customers have perfect knowledge of products and prices and can express their buying decisions through the existence of perfect markets bringing purchasers and suppliers together, in perfect equilibrium. Yet, in reality, we all know how imperfect markets are and many organizations make good profits from those imperfections. The Internet has certainly provided much better market and price information for purchasers, but the range of features and options on many products and services are just too complex for ready comparisons to be made, whether they are insurance policies or digital cameras. Some companies could even be accused of having a deliberate policy of confusing customers so that they cannot always find the lowest price comparisons so easily. This criticism could justifiably be laid at the door of most mobile/cell phone company's tariffs. So when it comes to getting the best out of people, this is the starting point for our journey along the road towards HR-business strategy. People cannot give of their best in a chaotic organization; it has to be a conscious effort. It might prove to be a Herculean effort, but it should be worth it as long as we ensure we are as well prepared for the battle as possible. What better place to learn some important lessons then than from some of the best strategic thinkers that ever existed, those engaged in the art of war? Let us also stress the word 'art' here because however scientific we try to make the subject of strategic people management, it is always likely to be as much art as science.

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