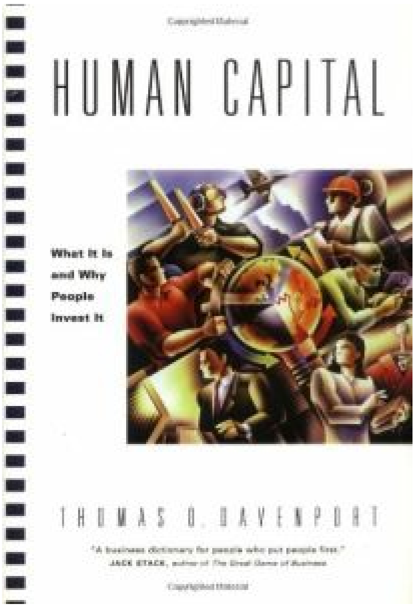

Book Human Capital

What It Is and Why People Invest It

Thomas O. Davenport
Jossey-Bass, 1999

Recommendation

The 1990s may well be remembered as the decade of employee empowerment (at least in management theory circles), but very few companies ever put their money where their mouths were when it came to dismantling the old "command-and-control" structures. Thomas O. Davenport makes a fresh case for empowerment by placing the argument in the context of the current tight labor market, and presenting scarce knowledge workers as investors of human capital. These human capital investors should be valued, nurtured and rewarded by companies in much the same way that financial investors are cared for. Although many of the conclusions that result from this novel theory mirror those of earlier works in employee empowerment, *BooksInShort* strongly recommends this book for its original take on the changing nature of the employer-employee relationship.

Take-Aways

- Most companies say people are their most valuable asset, but few companies practice what they preach.
- Human capital is the ability, effort and time employees bring to the workplace.
- Today, workers own their knowledge and act as free agents.
- Companies that recognize human capital attract and retain valuable employees.
- Valuable employees create a competitive advantage for employers.
- Employers should treat employees as investors rather than as assets.
- With unemployment low, workers have an advantage. They don’t behave like assets.
- Employers and employees should view their relationship as a partnership.
- Hire the right people, recognize their value and work hard to retain them.
- All knowledge is not created equal. Some skills are in more demand than others.

Summary

Workers as Investors

Language matters. Metaphors give leaders the ability to create and describe reality. "People are our most valuable asset" became the buzz phrase of the 1990s, but few companies practiced what they preached.

Even using the term "asset" to describe people can be somewhat demeaning. Assets are objects or legal rights that can produce future service, be owned or controlled, and be valued in monetary terms. Furthermore, assets are bought, sold, or replaced at whim by their owners. Instead, evolve to the next level of the metaphor and think of your workers as human capital investors. The investor metaphor emphasizes ownership and return on investment. Human capital simply means the time, energy, behaviors and abilities people contribute to their work. Workers who act as investors place their capital where it will yield the highest return.

> “It seems clear enough - if training helps the company, pay for it.”

Employment trends illustrate how "knowledge workers" have capitalized on the new economy. As employees realize that what they know is more powerful than what they produce, the market in human capital continues to evolve. More education equals more capital to invest and potentially greater returns on investment. Having a college degree boosts your income potential, especially if your work experience supplements your degree. Likewise, today’s workers have greater flexibility in employment and use their leverage.

> “Human capital is like a joint checking account on which both you and your employer can draw.” [Thomas Stewart]

For your company to take advantage of human capital, you should hire the right people, and then create an environment that encourages contribution and elicits the maximum investment. Continue to build human capital through learning and training, and keep the owners of the human capital engaged and committed.

Hiring Human Capital

You should hire people with appropriate knowledge, skills, talent and behavior. Although your firm can foster and reinforce knowledge and skills, you can’t change a person’s talent or values. Talent is innate and so are some behaviors.

> “Question: Which adds more to productivity: a 10% increase in worker education or a 10% increase in capital stock?
> Answer: Put your money on education.”

A job offer is more than just a formal, written contract. The term psychological contract encompasses the web of written, unwritten, spoken, unspoken and ultimately ineffable aspects of the interaction between worker and company. Traditionally, employees worked for years at the same company and usually had only one or two employers in their careers. Today, employees do not hesitate to move around. They are loyal to themselves, not their employers. Psychological contracts include duration, consideration and provision for change.

Duration

All contracts have a stated or implied duration. Usually in a psychological contract, the duration reflects the period over which worker and company believe their relationship will remain mutually beneficial. Most companies can entice workers by offering strong compensation and benefits packages, but loyalty and commitment take longer to develop. Workers don’t perform to the best of their abilities if they are uncertain about their futures.

> “Promise cautiously, deliver absolutely.”

Take for example Cypress Semiconductor, a Silicon Valley chip manufacturer. Cypress hires many entry-level product-marketing engineers (PMEs) for high-tech sales. In 1996, Cypress noticed a high turnover rate among PMEs. They discovered that PMEs were stressed out and uncertain about their futures. The PMEs wanted more rewards for their work. Cypress divided the PME position into three stages (trainee, contributor and coach) and began formally communicating this structure to current PMEs and new recruits. Once the PMEs had a clearer sense of where they were heading, they were less likely to leave.

The New Face of Recruitment

Consideration is the value exchanged under a contract. Many managers describe the hiring process as making a match between worker abilities and job requirements. Organizations must compare their return on investment (ROI) capabilities with the marketplace. They should analyze their compensation packages, intrinsic job fulfillment, growth opportunities and recognition. One size does not fit all. Companies should tailor job offers to individuals' needs.

> "Nowadays, a different contract holds sway, one that requires the individual to look to the value of his human capital as the only source of job security."

Contracts must offer flexibility, which usually takes the form of accommodation, evolution, and replacement. Managers can help their employees understand and cope with contract changes by breaking with the past and living the new contract. Candidates should be treated as investors who deserve to get as much out of the process as they put in. Recruitment is more than a process; it is a message that tells candidates "this is how we treat people here."

Building a Foundation

Hiring human capital is only the first step. Maintaining it is the second step. The 1997 Towers Perrin Workplace Index study identified ways to create a corporate environment that encouraged growth. It surveyed 2,500 workers at companies with 500-plus employees at all organizational levels in a variety of industries, except government agencies. Companies that achieved the maximum investment on human capital met these conditions:

- Individual investment and business strategy were aligned.
- Workers clearly understood what was expected of them and what their jobs required.
- Both parties felt they were getting a good deal and honored their contracts.

> "Workers are not jars to be filled; they are active participants in the quest to fill themselves with learning."

Interaction between supervisors and subordinates is typically a three-step process. First, managers give employees a sense of how the organization functions as a whole. Second, managers and employees work together to define how their department affects the organization. Third, employees define their individual contributions to the department.

Information Gathering

For people to work efficiently, they need a clear understanding of their organization. Corporate mission statements may look good, but they hold little value for employees unless the big picture includes their individual goals. Managers should help people understand how they fit in their organizations. For example, "The Eastman Way" at Eastman Chemical calls for avoiding layoffs, retraining workers and sponsoring recreational clubs. The average employee stayed 18 years and gave the firm an 85% favorable job security rating.

Trust

Trust is the key to confidence that the psychological contract will hold. Trust means we have faith in others and ourselves, and believe we will be treated fairly. Trust stems from social norms and social structure. Social norms are based on our values, beliefs and experiences. Social structure is based on rules, regulations and contracts. Companies need social structure because people don't all share the same values.

> "Practice without principle is aimless; theory without principle is useless."

Companies that do not try to foster trust waste time and resources. Monitoring behavior is expensive and time-consuming, and most employees resent not being trusted. Participation helps build trust and gives employees a sense of ownership. "Participation accelerates the creation of behavioral norms that can substitute for more formal, rigid (and expensive) social structures." Human capital investors are like venture capitalists; they want the same kind of control over their plans and investments that regular venture capitalists demand.

> "Rigid boundaries confine the expansion of knowledge and self-governance, and so inhibit the quest for competence."

Once trust is built, nurture it carefully because it is fragile. A single incident or broken promise can destroy it instantly. When it comes to trust, actions speak louder than words. Who gets hired and fired, well paid or slighted speaks to the real contract. People know that what actually happens is more important than policies written in the manual.

Maintaining High Investment

Competency, autonomy and reinforcement pave the way for high investment and returns. Workers with more competence have more to invest. Opportunities to increase competence act as powerful catalysts of effective human capital investment. Many companies use competency models for hiring, measuring performance and setting compensation. However, few organizations consolidate these efforts into a single, cohesive human capital system. To fill in the gaps, corporations should:

- Define human capital in a broadly applicable way.
- Carefully assess the level of involvement each element requires.
- Differentiate hiring from developmental needs.
- Involve everyone in decision making.
- Communicate programs to all employees and train all of them.
- Monitor programs quarterly and check them for consistency.

> "Deficits in justice decrease human capital investment by putting speed bumps on the road to workplace contribution."

Executives must reinforce the idea that competence is valued. Most employees take their cues from the top. If executives continually work to improve their own competence, then their employees will follow suit. Companies must also resist replacing humans with machines. While automation may save workers from more routine tasks, it undermines competence as a value. For instance, many big companies reduced their accounts payable staff by as much as 50%, although competent accounts payable staffers can catch errors a computer may miss.

Autonomy

Autonomy means self-governance and is different from empowerment, which means giving up power or transferring control from managers to employees. Many managers fear that giving workers autonomy requires them to give up their authority, but employees who make their own decisions are more likely to cooperate with management. The Families and Work Institute reported, "Workers with more job autonomy and control of their work schedules are less burned out by their work, are more satisfied with their jobs and take more initiative." Companies that foster autonomy typically:

- Make sure people know what needs to be done.
- Give their people the information they need, i.e. how the business works, how it makes money and how their contributions matter.
- Build the capacity to do work effectively.

Rewards

Companies should also use rewards for support, not control. The tactic of paying people to produce more and withholding pay when they do not undermines autonomy and reduces motivation. Rewards are always extrinsic and usually emerge from a system of control.

> "When markets are tight, the natural response is for organizations to offer enticements to stay put, to say 'not interested' when the headhunters call."

Employers should be careful that rewards do not drain autonomy. Allocate rewards in a way that seems equitable, since perception about the fairness of pay levels influences job satisfaction more strongly than actual pay. Tie pay to performance and communicate the pay structure to everyone.

About the Author

Thomas O. Davenport works in the San Francisco office of Towers Perrin, a worldwide consulting firm. He gives *Fortune* 500 clients advice on human resource strategy, organization effectiveness and business strategy.