VALUING HUMAN CAPITAL:
THE KEY TO INNOVATION

Legendary adman Fairfax Cone often lamented: “The inventory goes down the elevator every night.” Contemplating the daily ebb and flow of talent, creativity and business savvy at Foote, Cone and Belding during advertising’s heyday last century, he recognized that the competitive advantage of his ad agency hinged on its human capital and the ability of his people to collaborate and innovate. He was ahead of his time.

Fast forward to 2004 and a “Letter from the Founders” written by Larry Paige and Sergey Brin to potential investors in Google’s long-awaited IPO: “Our employees, who have named themselves Googlers, are everything. Google is organized around the ability to attract and leverage the talent of exceptional technologists and business people. We have been lucky to recruit many creative, principled and hard working stars. We hope to recruit many more in the future. We will reward and treat them well.”

Today the recognition of the importance of the human factor in business — its human capital — has become accepted wisdom. A company’s human capital asset is, as defined by the Society for Human Resource Management, “the collective sum of the attributes, life experience, knowledge, inventiveness, energy, and enthusiasm that its people choose to invest in their work.”

As competitive pressures increase in a rapidly globalizing economy and the migration to a knowledge economy continues unabated, human capital — how it is selected, trained, deployed, evaluated, retained and rewarded — is now recognized as a key lever for success.

The evidence is no longer just anecdotal. Research from Watson Wyatt, a global consulting firm focused on human capital and financial management, shows that effective performance management can increase shareholder value by up to 47 percent. Similar research from Deloitte & Touch suggests that effective human capital practices can represent up to 43 percent greater market value between like companies. “The bottom line is,” says Graham Brown, a senior manager in the consultancy’s Human Capital practice, “those companies that tailor their human capital strategy to their unique business strategy and market orientation substantially outperform companies that do not.”

Organizations, he adds, “need to become more strategic when adopting human capital practices and think more in terms of how they link to the critical employee behaviors that drive value and profits in their business.”

Traditional accounting doesn’t factor in the value of human capital, even though intangible assets today make up as much as 80 percent of a corporation’s value. “A balance sheet provides a snapshot of a company’s assets at any one moment in time,” James Ivey writes in Corporate Finance, “but how useful is such a snapshot when a company’s currency is its knowledge and that knowledge can be transported in a split second?”

Traditional accounting statistics indicate how a company has performed in the past; measurement of investment in human capital indicates how the business might perform in the future. “Accounting reports are lagging indicators of a company’s success,” says David Norton, president of the Balanced Scorecard Collaborative consulting firm. “People are looking for leading indicators,” he says, “and human capital is one of the best.”

The investment community recognizes this. Researchers at Cap Gemini Ernst & Young discovered that institutional investors, pension fund and money managers — the people who control most of the stock purchases in the economy — make from 35 to 40 percent of their portfolio allocation decisions based on non-financial information. "This was information not provided by the company, not found in the financial reports," says Jonathan Low, a senior fellow at CGEY who specializes in the valuation of intangibles. "That’s revolutionary."

"Human capital is the ultimate leading investment," says Mark Huselid, a professor of HR strategy at Rutgers University. "There is a big potential payoff for managing people." Jeffery Jeffery
"What gets measured gets managed," says Dave Kieffer, head of Mercer Human Resource Consulting’s human capital strategy practice. This is driving an increasing demand for the tools that will help corporations measure their human capital and its potential. A report issued in February 2004 by The Conference Board on a survey of 110 major companies in the United States and Europe showed that leading corporations will be increasing their investment over the next three years to measure how people practices such as low turnover, diversity and the engagement of their employees contribute to the bottom line.