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Make Human Capital A Source of Competitive Advantage

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Survey after survey has found that executives believe finding and developing the right talent should be one of their top priorities, and that their company's human capital is one of their most important assets. Yet few corporations are designed to operate in ways that recognize the importance of human capital.

Most companies understand how to leverage financial capital, machinery and equipment, but when it comes to human capital, it is a very different story. Jobs are designed to follow a simplified, standardized approach to the execution of work processes, and individuals are controlled through well-defined hierarchical reporting relationships, budgets and close supervision. Rather than encouraging people to be important contributors, most of the systems in organizations are designed to control their behavior. If we really took human capital seriously, we'd run companies in a very different way.

Yes, we would treat people well and say they are important, but we would do much more. We would design organizations so that people are a source of competitive advantage. Hiring some highly talented individuals won't do it! Training programs won't do it, either! Even being a best place to work won't do it.

Making human capital a source of competitive advantage requires much more than making some quick fixes to a control-focused organization. It requires attracting and retaining the right people as well as organizing and managing them effectively. Attracting and retaining the right people is not easy, but most organizations can get it done if they devote enough resources to it. Actually developing and employing organizational structures and operating systems that lead to an organization's human capital being a source or the source of competitive advantage is another story. It requires the right managerial behaviors as well as the right design of most of an organization's major operating systems in order to create a Human Capital centric (HC-centric) organization.

What does a company that's truly built to leverage its human capital look like? First, it has corporate board members armed with sufficient expertise and information to advise on human capital and organizational effectiveness issues. In fact, the board would regularly receive the kind of detailed information about the condition of the organization's human capital as it does about its financial situation. Second, it would develop executives who practice shared leadership and are committed to developing leaders throughout their organization. Third, it would consider the human resources (HR) function its most important staff group. HR's ranks would be filled with individuals who understand the business as well as know the intricacies of human capital management systems. Finally, it would have information systems that report accurately on the strategically important competencies and capabilities of the organization and of each employee.

CORPORATE BOARDS

Corporate boards can and should do a lot when it comes to human capital management in HC-centric organizations. Boards should examine the effectiveness of their organization's human capital management systems as well as the status of its people. Boards need to know at least as much about the condition and utilization of their organization's human capital as they do about the condition and utilization of its financial and physical assets. Boards need metrics that accurately report on the condition of the organization's human capital. They also need analytics that show how the management metrics drive corporate performance. They need to use this information when they make strategy decisions, do evaluations of senior managers, and make decisions about organization design, change, and effectiveness.

Knowledge about human capital management and organizational effectiveness is an obvious foundation that boards need in order to make high-quality human capital management decisions. Essentially, boards have two major sources they can draw upon for knowledge. The first is their own members, and the second is nonmembers who are asked to make presentations or consult to the board and its committees. The key question, therefore, is: Do either board members or the individuals they look to for information and advice have a deep expertise in human capital management? The answer for major corporations in most cases is no. HR executives are not on boards and in fact don't consistently attend board meetings. Unlike experts in finance and experts in accounting, experts in HR typically are not on boards.

Finance and accounting professors sit on numerous corporate boards, but membership on major corporate boards is a rarity among professors of HR management and organizational behavior. One of the few exceptions is David Ulrich, management professor, who sits on the board of Herman Miller Inc., the office and home furniture company. Herman Miller is itself atypically preoccupied with human capital issues; one of its former CEOs, Max De Pree, is well known for his book *Leadership Is an Art.*

When I have asked board members whom they rely on for HR expertise, they cite the chief executive officers (CEOs) on their board. There is no doubt that many CEOs have some understanding of the human capital issues that corporations face, but they rarely have the kind of in-depth expertise that a professional in HR can bring to a board. Effective human capital management requires a great deal of expertise in organizational systems and a great deal of understanding of motivation, competencies, traits, and organizational behavior. Skilled managers often have a good understanding of people and some organizational systems, but they rarely have the kind of expertise that a knowledgeable expert can bring to bear on the major human capital decisions that organizations need to make. Human capital decisions need to be based on research evidence, facts, data, and informed judgment. Because of this, boards need to have at least two members with an in-depth knowledge of human capital management.

Corporate boards need to do more than just focus on how their organizations manage people. They need to be expert people managers themselves. Boards need to evaluate the performance of the CEO and other senior executives, and they need to evaluate their performance as a board and that of their members.

Why evaluate board members? Because members of the board are a critical part of human capital of any organization. Thus they need to be evaluated and rewarded. A valid ongoing evaluation process can form the basis for decisions about continuing board membership. As a result, it can have a motivational impact that stock-based reward programs lack.

In terms of evaluating others in the organization, the board's most important responsibility is to evaluate the CEO. Today, virtually every *Fortune 1000* company has a formal evaluation process for the CEO. Well over 80% of board members say that they do a very effective job of evaluating the CEO. This may be a bit optimistic, since boards have few agreed-upon standards with which to determine what an effective CEO evaluation looks like, but it is encouraging. It would be more encouraging if the board members had expertise in management and boards evaluated the human capital management performance of the CEO as regularly and as rigorously as they evaluate the financial management performance of the CEO.

LEADING

Without question, executive leadership is very important to the effectiveness of all organizations. The quality of an organization's CEO and the quality of those who hold senior executive positions clearly affect the performance of the organization as well as the motivation and satisfaction of employees.

But senior leadership is only one of the major determinants of organizational effectiveness. Many studies, in fact, show that the *key* determinant of most employee behavior is not the leadership of the CEO or the senior executives, but the behavior of an employee's immediate supervisor or supervisors. These are the individuals who can provide the most important day-to-day motivation and sense of direction to the members of an organization. These are the managers who should possess – and pass along – technical and organizational knowledge when it comes to strategy implementation, change management, and work processes. They are also the ones whose behaviors shape the culture in a much more tangible way than the behavior of the senior executives.

Mark Hurd, the CEO of Hewlett-Packard Co., has argued that leadership should be a "team sport," played by everyone. Effective leadership at all levels is particularly critical to the success of HC-centric organizations for two reasons. First, it is what substitutes for the bureaucratic controls and structures that are absent. Second, it is the best source of the kind of motivation and culture that makes human capital a competitive advantage. As Sam Palmisano, the CEO of IBM Corp., has said, "You just can't impose command-and-control on a large, highly professional workforce."

What do effective leaders do? They focus on the following activities.

Look to the Future

Effective leaders learn from the past by debriefing the successes and failures that have occurred, but their major focus is on the future. An important part of this focus on the future is setting expectations, and providing an inspirational view of how the performance of people can provide winning business performance. How does this get done? A piece of the answer lies with understanding the competitive environment and how it is changing. Many competitive advantages can quickly become outdated as other organizations copy them. Thus leaders need to constantly monitor the external environment to see what the next source of competitive advantage is likely to be and prepare their organization for it.

Manage Performance

At the top of the list of key activities for every manager should be managing performance. Perfor-