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The Era of Human Capital Has Arrived

Warren I have news, the era of human capital has finally arrived. I'm not sure when this important era began, but I can say with some confidence that it was only recently. I can also say that its arrival was predicted by you decades ago. Indeed, one of your mentors, Douglas McGregor, put in place many of the intellectual foundations of it in the late 1950's and early 1960's, and of course, your work has helped make it happen.

Why did the era of human capital take so long to arrive and why is it happening now? There is no single reason why it has finally happened, but it is possible to identify some key technological, political, and economic changes that have combined to make human capital a critical and nearly universally acknowledged element in the effectiveness of organizations. The growth rate in scientific and technological knowledge is one key driver that has contributed to the growing importance of human capital. The growth of knowledge continues to accelerate; it has changed the very nature of what organizations need to do, the type of products they produce, and how they produce them. A striking example of the rapid evolution of technology is the Internet. In just a few years, it has created a host of new businesses that serve customers in new and different ways and it has created organizations that are very different in their structure, operations, and performance.

Because of the growth in knowledge and the ways it is used by organizations, the very nature of individual work has changed. Increasingly, work in developed countries is knowledge work in which people manage information, deal in abstract concepts, and are valued for their ability to think, analyze and problem solve. Fewer and fewer people are doing the mind numbing, repetitive manual tasks that used to dominate the work scene. These are being done by machines, or in some cases, sent to low wage economies.

With the recent fall of communist and totalitarian regimes around the world, more and more of the world's economies are open to competition and free trade. This has had two profound effects: first, it has raised the level of competition in a number of industries because new competitors have entered the market. Many of these new competitors have advantages that range from geography to high-skill, relatively low-wage work forces. Secondly, it has opened new markets to existing organizations and challenged firms to deal with global markets and consumers. Overall, change has created a world in which what used to be good enough often is no longer good enough when it comes to organizational performance.

The combined effects of the growth in scientific knowledge, the changes in the nature of work, and the creation of a highly-competitive global economy present organizations with a fundamental challenge: finding competitive advantage in a world in which many of the old sources of competitive advantage are no longer winners. Historically, organizations could often gain competitive advantage by obtaining and allocating low-cost financial capital and physical assets or by capturing critical supplies of raw materials. They could also gain competitive advantage by dominating a national market where they were protected from competition by the government or geography. The problem with these traditional sources of competitive advantage is that they no longer are effective because, in many cases, they are easily duplicated or overcome. Thus, organizations must look for new sources of competitive advantage.

Competitive Advantage

What are the sources of competitive advantage that can produce winning organizations in the future? I see three major sources that when combined can produce organizations that are likely to be winners (Lawler, 1996; Lawler, 1998). The three are all concerned with the human side of business: human capital, organizational capabilities, and core competencies. These three go together in the sense that organizational capabilities and core competencies require the right kind of human capital in order to be created and sustained by corporations. Organizational capabilities and core competencies, however require more then simply talented labor. They require the right organizational systems and management styles, but they clearly rest on the talent of the individuals in an organization. Given this, it is hardly surprising that there is an increasing emphasis on human capital and a dramatic increase in organizations competing for talented human capital.

Before I discuss the implications of the “big three” being the primary sources of competitive advantage, I need to briefly distinguish between organizational capabilities and core competencies. Core competencies have been written about extensively in the strategy literature originally by Prahalad and Hamel (1990). They are the technical capabilities that allow an organization to design and produce products and services that allow them to win in the marketplace. Typical core competencies include: Honda’s ability to design and manufacture gasoline engines, Dupont’s understanding of chemical processes, and Intel’s understanding of microelectronics. Organizational capabilities refer to the ability of an organization to perform in ways that delivers products and services that provide distinctive and superior value to the customer. Organizational capabilities include: Cisco’s ability to manage acquisitions, Motorola’s quality processes, and Southwest Airlines’ ability to operate a low-cost, customer-focused service.

Implications for Organizations

The new business environment and the importance of core competencies, organizational capabilities, and human capital have a number of implications for how organizations need to be designed in order to be effective and of course, how people interface with organizations. The most obvious is that we finally need to put to rest the traditional, hierarchical, job-based, bureaucratic model of organization that has dominated business thinking for so long.
Yes Warren, democracy is inevitable, even in the workplace and the evidence suggests that this is more and more becoming a reality (Lawler, 1998). Hierarchical organizations are simply too inflexible and rigid to compete effectively in today's business environment. They fail to attract the right human capital and to produce the right core competencies and organizational capabilities. As a result, they need to be replaced by lateral forms of organization that rely heavily on teams, information technology, networks, shared leadership, and involved employees.

It is beyond the scope of this chapter to discuss in detail what these new organizational forms look like. There is room, however, to note that they will have flat, agile structures, open information, power that moves to expertise, and systems that create knowledgeable employees throughout the organization. Because they will have these characteristics, their human capital will be much more valuable and require different treatment than has been true of the human capital in traditional organizations. This different treatment needs to start with solutions to the significant challenge of attracting high-talent individuals to join the organization, or perhaps more appropriately, to be affiliated with it. Organizations need to think of themselves as having a brand as an employer. This brand can be a single dominant brand in which all employees are treated the same and offered rewards that are attractive to the type of employees the organization wants to attract and retain. Alternatively, organizations can develop individualized work relationships and multiple brands in order to attract the diversity of employees they need.

The key strategic issue concerns what type of human capital organizations need to attract and retain. A second issue concerns how long they want to retain their human capital. A final issue concerns what types of rewards will attract and retain the right kind of human capital. Once these three issues have been dealt with, organizations need to identify what type of employment deal (or deals) is best for attracting and retaining the employees they need. It may be a single set of practices that treats most employees the same or it may be an approach such as the one which is often used with retail products where a wide-range of variations of the same product are offered. My guess is that most organizations will go to a multiple-employment-relationship brand simply because it has the greatest chance of attracting individuals from diverse backgrounds, but it is not always the right choice. For example, in certain-customer service organizations where the organization wants to have a single face to the customer, it may make sense to strongly emphasize a particular kind of employment relationship. Southwest Airlines has done this well by only hiring employees that have a particular style and offering only a single employment brand to most of its employees.

Whatever approach organizations take, it is clear that they need to move away from job-based approaches to managing people and utilize knowledge- and skill-based approaches (Lawler, 1996). The bureaucratic model is built on the idea of jobs. Jobs are the basic molecule of the organization upon which the other elements are built. Individuals are assigned certain tasks and responsibilities, and are held accountable for performing them. They are also selected based on the nature of a job that needs to be filled, and of course, compensated based on how important or large the job is and on how adequately they perform it.

There are a number of problems with the job-based approach, all of which stem from the fact that it fails to give sufficient importance to human capital. In many respects, the job-based approach is a leftover from the scientific management period in which jobs were designed to be simple and therefore doable by most individuals. A far superior approach, given the needs of today's organizations, is to focus on the knowledge and skill needs of an organization and to make this the basic molecule of the organization. Instead of having job descriptions, organizations need person descriptions that outline what individuals need to do in order to perform the tasks that need to be performed. These person descriptions need to be used as the basis for selecting employees as well as for training and developing them. Finally, they should be used to reward individuals according to what they can do and how well individuals with the similar skills are paid in the external labor market (Lawler, 2000).

The switch to person descriptions from job descriptions represents the fundamental acknowledgment that human capital is critical to the effectiveness of an organization and should be the major focus of the management systems of an organization. Without this, the bureaucratic structure remains the major focus of an organization and creates a world in which people are seen as simply filling jobs rather than providing competitive advantage.

Because of the increasing importance of human capital, the relationship between employees, customers, and bosses is undergoing a fundamental change. Historically, the typical employee has held third place with respect to importance, often ending up far behind customers and managers. Employees have been evaluated on how they performed their job, but managers have rarely been evaluated with respect to how they treated their employees. Similarly, customers have been asked about their satisfaction with how employees served them, but employees have not been asked about their satisfaction in dealing with particular customers.

In the era of human capital, employees should be elevated in importance so that they are at least equal to their mangers. They should be asked to evaluate their bosses, and organizations should fire bosses who do not attract or retain the best employees. To a lesser degree, the same phenomenon needs to occur with respect to customers. Organizations need to fire customers who make life intolerable for employees, and customers need to be sought based on their ability to provide challenging and satisfying work. Customers need to be looked at from a cost-benefit perspective just like products. If they cost more than they deliver, then they may not be worth having. In doing the cost-benefit analysis, of course, it is critical to look beyond just the direct costs of serving customers and to look at indirect costs such as causing employees to leave.

Impact on Individuals

Increasingly, individuals own the method of production that their organizations depend on. They deliver services, solve problems, write software, and develop products. Once they leave, it is not simply a matter of bringing another operator in to run a piece of equipment but a matter of finding an individual who can play a key role in producing a product or service. As a result of employees owning the method of production, they are much more important and valuable than they were in the era of technology-based production methods in which the physical assets of organizations were the highest value-added parts of the production process. This change from the employee facilitating production to owning the method of production is a fundamental one in terms of its implications for how individuals will be treated as the era of human capital continues. It is likely to lead to individuals getting a much higher rate of return on their capital. Since their human capital is mobile and can easily move to other organizations and situations that offer higher returns, the bargaining power of individuals is significantly higher.

The impact of this is already apparent in organizations that are based on the Web. Individuals throughout these organizations are earning returns on their skills that are unprecedented. They are able to earn these because they are in high demand and have a tremendous ability to influence the financial success of the business.

One of the major reasons why employees in Web-based businesses are earning a higher rate on their return in human capital than employees traditionally have is because they have an ownership stake in their organizations. In most cases, this has come in the form of stock options, which have in several respects become the basic currency of the technology world. There is every reason to believe that the growth in employee ownership that this is causing is likely to continue. Increasingly, organizations are distributing stock options to all employees and also encouraging them to buy stock. This has a number of potential advantages for organizations and individuals. If the organization is successful, it can increase the return that individuals get on their human capital. From an organizational point of view, it can provide an important substitute for the traditional loyalty relationship that existed between organizations and individuals. That it can act as a retention device which helps to lock in employees and their valuable human capital for the long-term, something that is badly needed in an era in which there is a tremendous amount of competition for human capital and few employees are committed to a career with a single employer.

There are some very interesting, long-term implications of employees increasingly owning stock in the corporations they work for. For example, it could lead to a much greater role for employees in corporate governance. Historically, employees have not had seats on corporate boards simply because, in most countries, it is not required and they have not been major stockholders. With the increased use of stock options and other stock plans to retain and motivate employees, it is possible that employees will increasingly own a significant amount of stock in the corporations they work for, and as such, they could demand and win seats on the board. This could lead to a significant new voice in the boardroom, one that argues for greater consideration of the impact of board decisions on the workforce.

Perhaps, the most fundamental change that the era of human capital is likely to create for individuals is the generation of more and more options concerning work. Options that will include who they work for, where they work, how long they work for a particular organization, and of course, what work they do. Indeed, the employment options that individuals will have are likely to be limited only by their imagination and skills. If an employee wants to constantly move from organization to organization around the world, this will be possible. Similarly, the individual who wants to work from home over the Web will have this option. And of course, the individual who wants a traditional job that involves going to a work location will also have this option.

In order for individuals to successfully navigate the many options they will have, they will need to become sophisticated managers of their own careers. In the era of human capital, organizations are less likely to worry about helping individuals develop their human capital and more likely to worry about the organizational capabilities they have. They, for example, are increasingly likely to hire critical human capital from the outside rather than develop it, and much less likely to be loyal to people when their skills are no longer needed.

Individuals need to respond to this new world by becoming sophisticated managers of their own careers and human capital. This means they need to know the market value of their skills, the demand for different skills, and of course, they need to constantly invest in developing skills that keep them at the state of the art. For many individuals, the best approach will be to develop a personal brand, which rests on their skills, knowledge, and work history. In order to do this, they will need to focus on developing credentials and visible work products and accomplishments. In the absence of good career management and developing a personal brand, individuals will increasingly be at the mercy of organizations that are not committed to them and technologies that are rapidly changing.

Societal Implications

The increasing importance and mobility of human capital has a number of significant implications for countries. Perhaps the most fundamental one is that in order to have competitive businesses, countries need to facilitate individuals being mobile with respect to both their skills and where they work. When technology and the business landscape are changing rapidly, people need to change in order for old organizations to effectively change and for successful new organizations to develop. In many cases, change means individuals learning new skills and physically relocating to different parts of the country or different parts of the world.

In the United States, physical mobility has been somewhat of a tradition and is often not a major problem for individuals. On the other hand, careers that involve multi-companies sometimes are a problem. Individuals who move from company to company often lose retirement benefits, medical coverage, and other financial support benefits that are critical to their economic wellbeing. It is critical that countries create economic structures that allow individuals to work for multiple companies during their career. It is also critical that societies provide the kind of training that allows individuals to remain current in their skills and to shift their skill sets when it is needed.

It is increasingly likely that individuals will have multiple careers in the sense that they will switch their areas of technical expertise several times during their work lives. This is a virtual necessity given the rapid change in technology and the importance of individuals staying in tune with current organizational capabilities and core competencies. Clearly, organizations should and will provide some of the training support that is needed to develop competencies and capabilities that will give them a competitive advantage, but they cannot be counted upon to do all the necessary training and development. Schools and other institutions also need to offer development opportunities for individuals who wish to switch careers or update their knowledge and skills. Clearly in the era of human capital, lifelong learning needs to be a reality and needs to be supported by companies, governments, and individuals.

Future Challenges

The era of human capital brings with it a number of major challenges. Rather than review all of them, I would like to focus on three: human capital information systems, leadership talent, and the left behind.

The information systems in most organizations are clearly focused on the reporting and allocation of financial and physical assets. They provide almost no information about the human capital in an organization. This is particularly true with respect to the public reporting that corporations are required to do.

Simply reporting on the physical and financial assets of a corporation is no longer acceptable. Managers, society, and investors need to get regular information on the condition of the organization as a performing entity and its human capital. There are a number of major obstacles to doing this but that is not an adequate excuse for failing to push ahead in this area.

With respect to public reporting, at the very least corporations can begin to report on some of their personnel data such as their investments in training, their turnover rate, and the employee satisfaction data that they collect. Without information on the human capital of an organization, it is virtually impossible for investors to make wise investments, and of course, for organizations to effectively regulate the way corporations are managed and run. Thus, moving human capital onto the balance sheet of corporations should be a high priority in all developed countries that are in or are the era of human capital.

Perhaps even more important than the public reporting of human capital information is improving the internal information systems that organizations have with respect to human capital. In order to effectively develop a business strategy and operate an organization, it is increasingly important that organizations have a good inventory of their human capital. In essence, they need to have individual profiles of all their employees that describe their skills, knowledge, and experience. In essence, they need to know how well individuals fit the person descriptions that are created to replace the job descriptions of the past. With the new information technology, these can be stored and individuals at any level of the organization can find what talents currently exist in the workforce and decide who might be the best individuals to do particular kinds of work. The potential exists to move from a world in which there is a lot of knowledge about the jobs in an organization, but little knowledge about the skills and knowledge of individuals, to a world in which there is plentiful knowledge about the skills and knowledge of all employees, knowledge that is available for planning, strategy development, and work assignment purposes.

The era of human capital requires new thinking with respect to the entire area of leadership and leadership talent. As Jim O'Toole has so eloquently argued elsewhere in this volume and much of Warren's research argues as well, we need to move to an era in which leadership is an organizational capability and not an individual characteristic that a few individuals at the top of an organization have. Leadership only at the top is acceptable in the old economy and in the traditional bureaucratic organization. Indeed, it is the hallmark of many effective traditional bureaucracies, but it is not the right approach for the human capital era.

In the era of human capital, individuals throughout the organization need to self-manage because they are the ones who best understand the projects they are working on, and thus are in the best position to lead others who are contributing to these projects. Indeed, individuals often need to move from being leaders to being followers and back to being leaders as the project they are working on change and different individuals have the knowledge and skills that are needed to provide leadership.

For their part, organizations need to focus on broadening their leadership talent by not just targeting leadership development activities to a few individuals who have the potential to be senior executives in the corporation. If leadership is to become a true organizational capability, it needs to be diffused throughout the organization, and that means training and developing human capital in this important area of human capital as well as in areas of technical expertise and knowledge. The failure to develop leadership talent throughout in an organization is a sure prescription for creating an organization that is heavy on technical talent but weak on direction and focus.

I would be remiss if I didn't point out that in the era of human capital there is likely to be a significant group of individuals who are left behind. For a variety of reasons, these individuals will not have the technical knowledge and leadership skills to be valued and to be treated as important human capital. In essence, these people will still be treated and valued in the same way individuals have been for decades, and thus will constitute a left behind but significant minority in developed countries that have moved into the era of human capital. The existence of this group should be a concern to everyone. They represent a potentially disenfranchised group of individuals, and there is likely to be an increasing gap between them and individuals who have high human capital.

The problem of the left behind can be partially mitigated by creating educational opportunities for them to increase their human capital. However, this is unlikely to solve the problem and as a result other kinds of government action is likely to be needed. Specifically, governments may need to provide meaningful safety nets concerning health care, retirement, and stronger requirements that companies pay a living wage. In the absence of these structures, the era of human capital runs the risk of being a polarized era in which some, probably the majority, flourish at the expense of others. This clearly is not a situation that is likely to lead to a stable or desirable society.

Conclusion

The era of human capital that we just entered has great promise. It is very likely to lead to the widespread acceptance of many things that Warren has advocated for decades. It will be clearly marked by leadership, teams, and learning being more important. This means, of course, that Warren's many books will continue to be relevant, and something everyone should have. It also means that Warren will need to continue to provide us with his wisdom and guidance. Organizations are taking new forms, individuals are entering into new types of employment relationships and new leaders are emerging. They all need the thoughtful analysis that Warren can give them and the guiding hand that he has provided for so many years.

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