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The concept of HCM

This chapter starts with a definition of HCM and its aims. Reference is made to the views of a number of recent commentators on this subject and the chapter continues with a discussion of the relationship between the concept and practice of HCM and that of HRM. The chapter concludes with an examination of the concepts of human capital advantage and resource-based strategy, both of which are closely related to the concept of HCM.

HCM DEFINED

HCM is concerned with obtaining, analysing and reporting on data that informs the direction of value adding strategic, investment and operational people management decisions at corporate level and at the level of frontline management. It is, as emphasized by Kearns (2006), ultimately about value.

HCM is concerned with *purposeful* measurement, not just measurement. The defining characteristic of HCM is the use of metrics to guide an approach to managing people that regards them as assets and emphasizes that competitive advantage is achieved by strategic investments in those assets through employee engagement and retention, talent management and learning and development programmes. HCM provides a bridge between HR and business strategy.

The Accounting for People Task Force Report (2003) stated that HCM involves the systematic analysis, measurement and evaluation of how people policies and practices create value. The report defined HCM as 'an approach to people management that treats it as a high level strategic issue rather than an operational matter "to be left to the HR people"'. The Task Force expressed the view that HCM 'has been under-exploited as a way of gaining competitive edge'. As John Sunderland, Task Force member and Executive Chairman of Cadbury Schweppes plc commented: 'An organization's success is the product of its people's competence. That link between people and performance should be made visible and available to all stakeholders.'

Nalbantian *et al* (2004) emphasize the purposeful measurement aspect of HCM. They define human capital as: 'The stock of accumulated knowledge, skills, experience, creativity and other relevant workforce attributes' and suggest that HCM involves 'putting into place the metrics to measure the value of these attributes and using that knowledge to effectively manage the organization'.

HCM is sometimes defined more broadly without the emphasis on measurement. Chatzkel (2004) states that: 'Human capital management is an integrated effort to manage and develop human capabilities to achieve significantly higher levels of performance.' And Kearns (2005a) describes HCM as: 'The total development of human potential expressed as organizational value'. He believes that 'HCM is about creating value through people' and that it is 'a people development philosophy, but the only development that means anything is that which is translated into value'.

AIMS OF HCM

The four fundamental objectives of HCM are to:

- determine the impact of people on the business and their contribution to shareholder value;
- demonstrate that HR practices produce value for money in terms, for example, of return on investment (ROI);
- provide guidance on future HR and business strategies;

- provide diagnostic and predictive data that will inform strategies and practices designed to improve the effectiveness of people management in the organization.

The more specific aims of HCM are summarized in Figure 2.1.

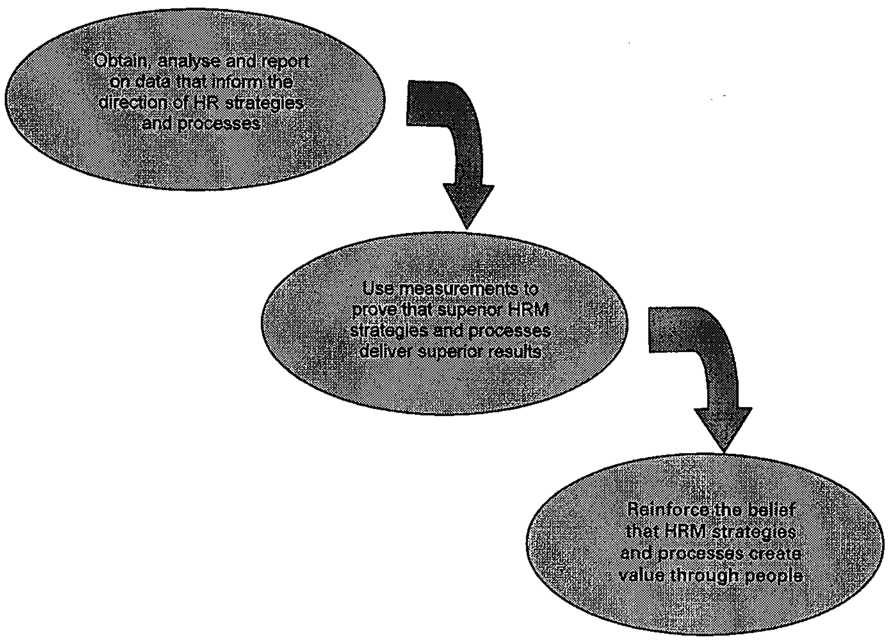

Figure 2.1 Aims of HCM

RATIONALE FOR HCM

HCM provides for evidence-based HRM. As Kearns (2006) stated: 'HCM can and should be in the interests of every stakeholder.' The DTI Accounting for People Task Force (2003) concluded that:

> Greater transparency on how value is created through effective people management policies and practices will benefit organizations and stakeholders. Managers, investors, workers, consumers and clients all have an interest in knowing that an organization is striving to adopt those features of HCM that are associated with high performance.

In the opinion of many of the FTSE 250 companies consulted by the Task Force and the CIPD, human capital evaluation and reporting is a 'must have' capability that is crucial to sustaining long-term performance. A number of the FTSE companies are concerned with making better quality information available on their human capital to both internal and external stakeholders and feel particularly under pressure from shareholders and customers to explain and justify the intangible value of their organizations. In knowledge-based industries in particular, obtaining, developing and retaining knowledge that can be embedded into goods and services is the key to success. As knowledge cannot be easily divorced from people, human capital information is particularly important in underpinning the processes that will enable organizations to manage their knowledge successfully.

Walters (2006) suggests that:

> Effective HR processes need to be matched by an understanding of their impact on the cost-drivers of the business. Some of these linkages may be relatively straightforward and familiar (though perhaps still not fully evaluated or addressed) – for example, the business costs of labour turnover or absence. Other linkages may be less tangible or more difficult to quantify – for instance, the impact of employee engagement on factors such as productivity, service and quality. In all these cases, however, the adoption of a human capital approach, with appropriate processes for measurement and evaluation, is likely to help provide valuable insights into the dynamics of employee and business performance.

Matthewman (2006) believes that: 'HCM offers the opportunity for fact-based analysis, policy formulation and execution. In the past, too many HR projects were launched on instinct with little quantified success criteria or any calculation of the real return on investment (ROI).'

Managements are more likely to be persuaded by a business case if it is supported by data. As Mayo (2001) points out: 'managers are conditioned to working with numbers and nothing has a greater impact'.

HCM AND HRM

It is necessary to consider the difference, if any, between HCM and HRM. Is HCM an entirely separate activity? Or is it an aspect of HRM that highlights the significance of human capital measurement? In the opinion of Mayo (2001) the essential difference between HCM and HRM is that the former treats people as assets while the latter treats them as costs. Kearns (2005a) believes that in HCM 'people are value adders, not overheads' while in HRM 'people are [treated as] a significant cost and should be managed accordingly'.

The claim that in HRM employees are treated as costs is not supported by the descriptions of the *concept* of HRM produced by US writers such as Beer *et al* (1984). In one of the seminal texts on HRM they emphasized the need for 'a longer-term perspective in managing people and consideration of people as potential assets rather than merely a variable cost'. Fombrun *et al* (1984), in the other seminal text, quite explicitly presented workers as a key resource that managers use to achieve competitive advantage for their companies.

According to Kearns (2005a), in HRM 'the HR team is seen as a support service to the line' – HR is based around the function and the HR team performs 'a distinct and separate role from other functions.' Conversely, 'HCM is clearly seen and respected as an equal business partner at senior levels' and is 'holistic, organization-wide and systems-based' as well as being strategic and concerned with adding value. This assertion that HRM is simply what HR practitioners do in isolation from management is again not in accord with the generally accepted concept of HRM. In 1998, Legge defined the 'hard' model of HRM as a process emphasizing 'the close integration of human resource policies with business strategy which regards employees as a resource to be managed in the same rational way as any other resource being exploited for maximum return'. Guest (1987) believes that one of the key policy goals of HRM is strategic integration: 'The ability of the organization to integrate HRM issues into its strategic plans, ensure that the various aspects of HRM cohere, and provide for line managers to incorporate an HRM perspective into their decision-making'. He has stated (1991) that 'HRM is too important to be left to personnel managers.'

The concept of strategic HRM matches that of the broader definition of HCM quite well as is shown in the following definition of the main features of strategic HRM by Dyer and Holder (1998):

- *Organizational level* – because strategies involve decisions about key goals, major policies and the allocation of resources they tend to be formulated at the top.

- *Focus* – strategies are business-driven and focus on organizational effectiveness; thus in this perspective people are viewed primarily as resources to be managed toward the achievement of strategic business goals.
- *Framework* – strategies by their very nature provide unifying frameworks which are at once broad, contingency-based and integrative. They incorporate a full complement of HR goals and activities designed specifically to fit extant environments and to be mutually reinforcing or synergistic.

Both HRM in its proper sense and HCM as defined above treat people as assets. Although, as William Scott-Jackson, Director of the Centre for Applied HR Research at Oxford Brookes University argues (Oracle, 2005), 'You can't simply treat people as assets, because that depersonalises them and leads to the danger that that they are viewed in purely financial terms, which does little for all-important engagement.'

However, there is more to both HRM and HCM than simply regarding people as assets. Each of them also focuses on the importance of adopting an integrated and strategic approach to managing people, which is the concern of all the stakeholders in an organization not just the people management function.

So how does the concept of HCM reinforce or add to the concept of HRM? The answers to that question are that HCM:

- draws attention to the significance of what Kearns (2005a) calls 'management through measurement', the aim being to establish a clear line of sight between HR interventions and organizational success;
- provides guidance on what to measure, how to measure and how to report on the outcomes of measurement;
- underlines the importance of using the measurements to prove that superior people management is delivering superior results and to indicate the direction in which HR strategy needs to go;
- reinforces attention on the need to base HRM strategies and processes on the requirement to create value through people and thus further the achievement of organizational goals;
- defines the link between HRM and business strategy;

- strengthens the HRM belief that people are assets rather than costs;
- emphasizes the role of HR specialists as making a strategic contribution to business success.

The concept of HCM complements and strengthens the concept of HRM. It does not replace it. Both HCM and HRM can be regarded as vital components in the process of people management and both form the basis for achieving human capital advantage through a resource-based strategy.

THE CONCEPT OF HUMAN CAPITAL ADVANTAGE AND RESOURCE-BASED STRATEGY

The concept of human capital advantage as formulated by Boxall (1996) is based on the belief that sustainable competitive advantage is achieved when the firm has a HR pool that cannot be imitated or substituted by its rivals (Barney, 1991).

Unique talents among employees, including superior performance, productivity, flexibility, innovation and the ability to deliver high levels of personal customer service are ways in which people provide a critical ingredient in developing an organization's competitive position. People also provide the key to managing the pivotal interdependencies across functional activities and the important external relationships.

It can be argued that one of the clear benefits arising from competitive advantage based on the effective management of human capital is that such an advantage is hard to imitate. An organization's HR strategies, policies and practices are a unique blend of processes, procedures, personalities, styles, capabilities and organizational culture. One of the keys to competitive advantage is the ability to differentiate what the business supplies to its customers from what is supplied by its competitors. Such differentiation can be achieved by having HR strategies that ensure that the firm has higher quality people than its competitors, by developing and nurturing the unique intellectual capital possessed by the business and by focusing on organizational learning and knowledge management. This is the resource-based view of the firm and the rationale for a strategy based on it was produced by Grant (1991):

> When the external environment is in a state of flux, the firm's own resources and capabilities may be a much more stable basis on which to define its identity. Hence, a definition of a business in terms of what it is capable of doing may offer a more durable basis for strategy than a definition based upon the needs (eg markets) that the business seeks to satisfy.

HCM and resource-based strategy have much in common. They both emphasize that a business strategy based on the acquisition, retention, motivation and development of high-quality people provides human capital and therefore competitive advantage.

CONCLUSIONS

The whole area of HCM presents both an opportunity and a challenge for the HR profession. It presents an opportunity to recognize people as an asset that contributes directly to organizational performance, and a challenge to develop the skills necessary to identify, analyse and communicate that contribution and ensure that it is recognized in business decision making. By developing better and more accurate information on human capital and communicating this both internally and externally, organizations will not only improve their business decision making but also enable various stakeholders to make more accurate assessments about the long-term future performance of the organization. There is evidence of a growing demand, from the investment community in particular, for better information to explain intangible value. Many organizations are beginning to understand that, in an increasingly knowledge-intensive environment, the key to good management lies in understanding the levers that can be manipulated to change employee behaviour and develop commitment and engagement. This, in turn, encourages individuals to deliver discretionary behaviour or willingly share their knowledge and skills to achieve organizational goals.

Systematically collected and analysed human capital data can really help managers to begin to understand factors that will have a direct impact on the people they manage. It can also help executives to understand and identify areas where there may have be issues regarding the effective management of staff and to design management development programmes to address these.