

The Return on Human Capital

Historically, one of the key financial measures of corporate success is return on assets (ROA). Corporate strategists and financial investors use ROA to compare management's use of the firm's total assets to industry averages as well as to the firm's direct competitors.

While ROA is still a valuable measure, depending on it becomes problematic in an era when the traditional definition of "assets" is becoming outmoded. The assets ROA takes into account are easy to identify and count—they're physical things such as manufacturing plants, rolling stock, and natural resource reserves or financial assets such as cash and investments.

Today, however, more and more of a firm's assets are less tangible. In fact, for many if not all firms, the principle assets are intangible and hard to identify, compare, count, and value. Those assets are in the form of intellectual capital (e.g. knowledge assets, process know-how, brands, public trust) and human capital.

While much work is being done to value knowledge and other intellectual capital (in the form of brands, for instance) for balance sheet purposes, relatively less information and guidance about human assets is available to strategists.

This state of affairs is particularly troublesome as it's no secret to any CEO or business owner that quality people, especially quality leaders, are the primary key to corporate success. All the grand strategies are useless if capable management is not in place to execute them. The companies that can hire and retain top-tier managers will lead; those that cannot have little hope of catching up.

Managing Five Critical Equities

I like to suggest to strategists that when formulating strategy they recognize that today's senior executive manages five critical corporate equities:

- Customer Equity: the value of customer relationships.
- Brand Equity: the value of the strength of the firm's products and services.
- Public Equity: the firm's ability to operate unfettered by public or government interference.

- Human Equity: the stock of human capital and employee talent.
- Shareholder Equity: the financial sum of the above as measured in capital markets.

Today's capital markets increasingly reward firms for their intellectual property—be it technology, best practice methods of conducting business (such as advanced customer relationship management or electronic supply chain management), or brands. But until recently the markets overlooked the most enduring type of intellectual property: human capital. This is changing. Although no definitive studies are yet available, anecdotal evidence suggests that even after the recent meltdown in the

NASDAQ, firms leading in the development of human capital consistently capture higher multiples than do those whose principal assets are physical.

Growing Market Caps by Growing People

Investing in human capital is a proven way to boost a firm's market cap. However, human capital is not something that is harvested from the earth, discovered on a shelf, or constructed from wood and steel. It is an asset that is derived solely from the individual and collective minds, creativity, and energy of a firm's employees around the globe—particularly high potential managers.

A 2000 study conducted by the American Society for Training and Development (ASTD) examined the average annual training expenditures of more than 500 U.S.-based publicly traded firms. The study concluded that firms in the top half of the group (i.e., firms that spent the most on training) had a total stockholder return 86% higher than firms in the bottom half—and 46% higher than the market average.

As capital markets increasingly reward companies for their management of human equity at a rate far greater than for their stock of plant and equipment, growing a globally competitive workforce has leapt to the top of the CEO agenda.

People are the key to success in the new economy, say respondents to a recent Chief Executive/Accenture Survey reported in Chief Executive magazine. CEOs believe:

- The greatest challenge in the new economy is finding/retaining good people (47%)
- Compared to three years ago, people issues are more important (84%).

- Top people issues are seen as attracting the best talent (39%) and retaining/motivating key staff (26%).
- Compared to three years ago, recruiting and retention strategies have changed significantly (26%) or somewhat (50%).
- Developing current talent has become more important than training (62%; 34% saw those two equally important).

Global Education Challenges

Business owners know they need to offer high-quality management education in order to recruit and keep the best talent. At the same time, those with a widely dispersed workforce often voice the complaints along the following lines:

- “Our managers work on global teams, and customers are demanding global prices, services, and products. Our managers need to understand and use common terminology and approaches to satisfy those customers’ needs.”
- “Our weak point is in global execution. We need our high-potential managers around the world to execute as one team. They need to have similar education and training to do that.”
- “Management education of the type and quality we are used to in the U.S. is just not available in much of the rest of the world.”
- “Our training needs are rapidly outpacing our budgets. Travel costs and time off the job for employees are killing us.”

Despite the layoff headlines currently making the news, there is a worldwide shortage of executive talent. A recent study commissioned by IBM and American Express noted that the shortage of qualified entrants into the workforce in the U.S. will become acute in the next several years. For example, new entrants into the workforce, a critical resource for businesses, will decrease in absolute numbers by some 4.1 million people between 1996 and 2010.

Companies are finding that the skill sets employees need are changing rapidly and are constantly increasing in complexity. Companies are therefore turning to training of current employees to retain and upgrade their workforce in the U.S. and abroad.

Traditional education and training methods, however, do not meet the needs of today’s global, fast-moving corporation. Bringing executives to the U.S. for two or more years of graduate education is

disruptive and expensive, yet foreign institutions cannot offer the quality and consistency that is generally required.

Inhibitors to Growing Talent Globally

The major inhibitors in the development of a global workforce that is able to effectively execute global strategies are:

- Large globally or regionally distributed workforces with disparate competencies.
- Rapid internal or acquisition growth resulting in diverse corporate cultures.
- Declining pool of U.S. employees interested in international assignments.
- Rapid obsolescence of management “best practices.”
- Less effective local education suppliers—non-standard and variable content.
- Slow, expensive, and often inflexible “on campus” options.

A Global Classroom

Many of today’s most successful companies are finding a solution through e-learning initiatives. With Web-based training, students around the world participate in a consistent program, using the same tools, language, and terminology. Time zones and geography become irrelevant, and students can study when it’s convenient for them, rather than when it is convenient for an institution. In addition, these courses offer the opportunity for global collaboration, allowing cross-continent discussions and perspectives that would not exist in a local classroom.

The best e-learning programs provide the following advantages:

- Globally consistent “best practices.”
- Fast, mediated delivery.
- Peer “community” learning for enhanced global cooperation and corporate culture.
- Company customized programs and courses.
- Participant personalized courses and modules.

In addition, e-learning programs allow companies to monitor their students’ progress and aptitude. In traditional classrooms, the instructor’s perception is the extent of the assessment of whether the students are “getting it” or not. In an e-learning

course, students are continually evaluated and challenged, with the results logged and tabulated. This leads to a better understanding of the company's "return on knowledge programs."

Financial Payback

Motorola is widely cited for its belief that the company receives \$33 for every \$1 invested in employee education and training. It's easy to understand why. Standard & Poors lists 124 companies with revenues per employee greater than \$300,000.

Most successful technology and biotech companies are only as good as the executives and engineers they employ. Their differentiation and continual innovation come not from existing products and patents, but from those that are continually coming down the pipeline. Keeping employees educated and developing them for future challenges has become the only sustainable competitive advantage.

Choosing e-learning over classroom training also directly affects the bottom line. According to Brandon-Hall.com, a training-research organization that is benchmarking the successes of e-learning users, e-learning has produced training budget savings of 40 to 60% for large organizations such as Ernst & Young, IBM, the U.S. Internal Revenue Service, and Rockwell Collins. Individual companies agree with these findings: Oracle estimates that it saves \$100 million per year by utilizing e-learning; Cisco estimates it saves \$240 million per year.

Internal Challenges

As knowledge management and development programs move to the forefront of the human resources departments' initiatives, many companies will face challenges in allocating IT resources. In today's companies, the information technology department is already stretched between desktop support, network maintenance, the intranet, the extranet, communications technology, and any e-commerce initiatives underway. Knowledge management and e-learning programs add another area that requires continual attention and maintenance. If these programs are to succeed, upper management must fully commit to them and allocate the necessary resources to make them successful.

As a recent article in CIO magazine pointed out, an e-learning program also requires more bandwidth and server space—for something that isn't tangibly

tied to this quarter's revenue targets. CIO found that: "Many training and HR departments, which traditionally have been the overseers of employee learning, resolve e-learning's resource demands by outsourcing the entire proposition, including the hosting, delivery, scheduling, and tracking of training modules, leaving the IS department completely out of the loop—often with the CIO's explicit or tacit approval." As programs become more deeply imbedded in an overall knowledge management system, however, more of the work will need to move in house.

Companies must also ensure that the programs do not merely replace the classroom experience with something cheaper and faster. Poorly developed e-learning courses will remove the classroom interaction that students enjoy and replace it with a flat, uninspiring course that offers little interactivity. To succeed, companies must be willing to invest the money in courses that replace the classroom with a richer, more effective learning experience that will produce true knowledge and skills development. The best courses will engage the learner with continual evaluation, interactive experiences, and simulations that prepare them for real-world environments.

Who's on First?

E-learning and other human capital improvement programs are creating a heretofore unseen conflict in terms of corporate structures and the use of major management technologies (such as ERP systems). Specifically, which area of the firm takes responsibility for the management of human capital: human resources, IT, or a new corporate entity such as the "corporate university" and the so-called Chief Learning Officer?

It is clear that advanced management education programs, delivered digitally to high-potential managers around the world, are a vital ingredient in the broader knowledge management systems that are the latest (and perhaps final) layer of the corporate-wide IT infrastructure that is essential to the functioning of the modern firm. From a historical perspective, IT systems evolved from factory automation systems, to ERP systems, to data warehouse systems, and finally to global groupware and communications systems. The knowledge management systems now taking hold in corporations (including on-line management education systems) will be the global integrating IT structure of the future.

Undertaking on-line education programs will put IT or human resources (formerly personnel departments) in the forefront of the development of

these comprehensive knowledge management systems.

Whichever unit of the firm assumes control, e learning and other management education programs will play a key strategic role in developing the human equity so vital to a firm's growth. As capital markets increasingly reward firms for their stock of human equity, and as firms attract higher valuations and market caps with human equity than with physical assets, the managers of knowledge systems and corporate learning programs will be the new "line" managers the critical value-creating function of the firm.

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