

People Capital

The aim of the paper is simply to define the complex field of People Capital. It also explains:

- Why People Capital is important to value creation
- How leaders can develop People Capital in themselves and in their organisation.

This paper sets the conceptual framework for the Culture Audit findings.

What is People Capital?

The knowledge economy relies on relational, structural and human capital.

Human Capital refers to the skills, attitudes, abilities, competencies and qualities of an organisation's employees. It comprises, for example, the knowledge and expertise employees apply to produce products and services, and to the operations to the organisation itself.

Structural Capital refers to the structures and processes employees develop and deploy in order to be productive, effective and innovative; it includes the virtual, social, cultural and physical infrastructures that influence and guide the work practices, mindsets and collective philosophies of employees.

Relational Capital refers to the better management of stakeholder relations, be they customers, suppliers, governments, distributors, local communities or others, and is particularly concerned with the creation of reciprocal information flows and learning opportunities between the organisation and its key stakeholders.

For our purposes, the skill to achieve the human and relational capital and the ability of leaders to build the structural capital are described as '**People Capital**'. These are fundamentally different skills and capabilities than those required in previous economic systems.

Why People Capital is important to value creation

Historical social context

Economic transformation over the last 200 years has seen growth in service-based industries which rely on 'intangible resources'.

Table 1 – Economic Transformations¹

Economic Activity		Factors of Economic Production
Agricultural Economy (Pre-1800)	Harvesting	Land Land owners and workers
Industrial Economy (18 ⁰⁰ to late 1900s)	Manufacturing	Labour Machinery Raw material
Knowledge Economy (late 1900s to present)	Mediation of knowledge and services	Relational capital Structural capital Human capital

In 2003, 49% of executives in 27 countries said intangible knowledge and intensive resources are the most dominant factor in shareholder wealth creation.² Organisations need to bring these capabilities to bear in our knowledge organisations in order to create value. Commerciality is to be viewed through lenses where

“We see the traditional value chain, in which tangible resources dominated, being replaced by value shops and value networks, in which problem solving (for example, consulting firms in any speciality) and mediation of exchanges (for example, eBay and third party relationships) comprise the new factors of production.”³

¹ Source: Society for Knowledge Economics, p.19 adapted from Peter Russell.

² Accenture, Intangible Assets and Future Value. Accenture/ Economist Intelligence Unit, 2003.

³ Australian Guiding Principles on Extended Performance Management: A Guide to Better Managing, Measuring and Reporting Knowledge Intensive Organisational Resources, Society for Knowledge Economics, 2005

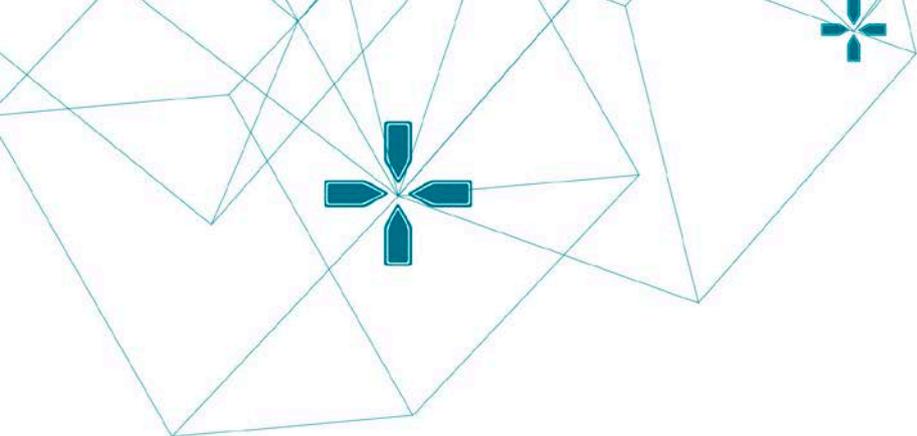


Table 2 below sets out various business models, the different organisational capabilities required and resultant outputs.

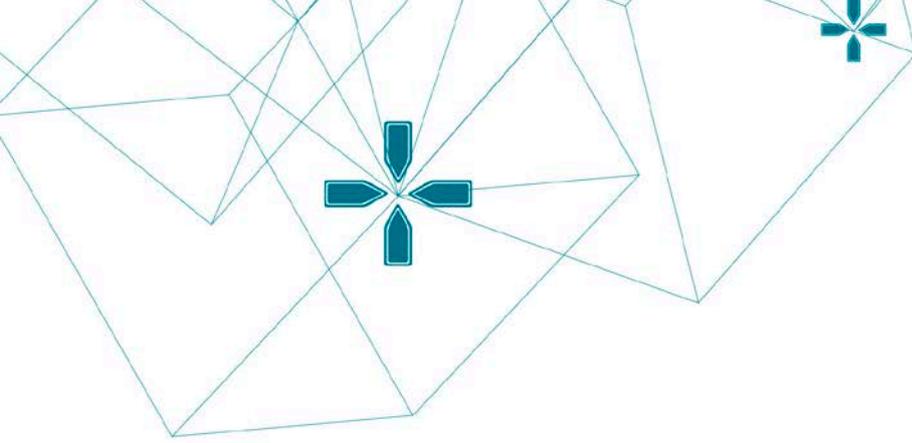
Table 2 – Changing Business Models and Organisational Capabilities¹

Business Model	Organisational Capability and Output
<p>Value Chain</p> <p>Tangible and monetary resources form the basis of competitive advantage</p>	<p>Production</p> <p>Objective is to produce products and, in doing so, reduce costs and increase margins</p>
<p>Value Shop</p> <p>Human capital forms the basis of competitive advantage</p>	<p>Problem Solving</p> <p>Objective is to produce solutions to problems which entail capturing knowledge about problems and applying problem-solving skills and creativity</p>
<p>Value Network</p> <p>Relational and structural capital form the basis of competitive advantage</p>	<p>Mediation</p> <p>Objective is to create value through the establishment of connections and the mediation of exchanges. Focus is on managing the developing relationships with actors⁴ in value networks, and finding new actors.</p>

People Capital and its importance for managing risk

In traditional performance measurement and accounting, intangible assets and resources (especially People Capital) are largely unaccounted for. These intangible assets often drive profitability, competitive advantage, innovation and growth to a greater extent than tangible assets. This means that, from a balance sheet perspective, the true value of the organisation is not wholly represented. More importantly, if *what gets measured gets done*, then intangible assets are not given a proportionate share of management attention, investment or governance.

⁴ The term actor relates to a person or organisation in the value network.



In terms of profit and loss, this situation also means some of the most important drivers of business growth and value are not represented. Shareholders in particular want to know how the assets of their investments are being managed, and this is not possible if they are not accounted for.

Not managing your intangible resources increases your risk profile.

The current scientific approach to risk management is insufficient to mitigate the impact of intangible risk on business success. There is now a shift in thinking and an appreciation that the intangible qualities of 'culture' are critical to the issue of risk management and corporate governance. Compliance and regulation mechanisms used alone, without explicitly including the intangible aspects of mindsets and political systems, serve to increase an organisation's systemic risk.

These subtle aspects of people and systems, their mindsets and their interface with the cultural/ political system, are the greatest determinants of what really happens within organisations – often despite the systems and processes that leaders of an organisation put in place to direct and control the behaviour of their employees. 'That which is in awareness is in control.' If organisational leaders are unaware of the subtle aspects of their People Capital, this aspect of the organisation becomes the most risky of all.

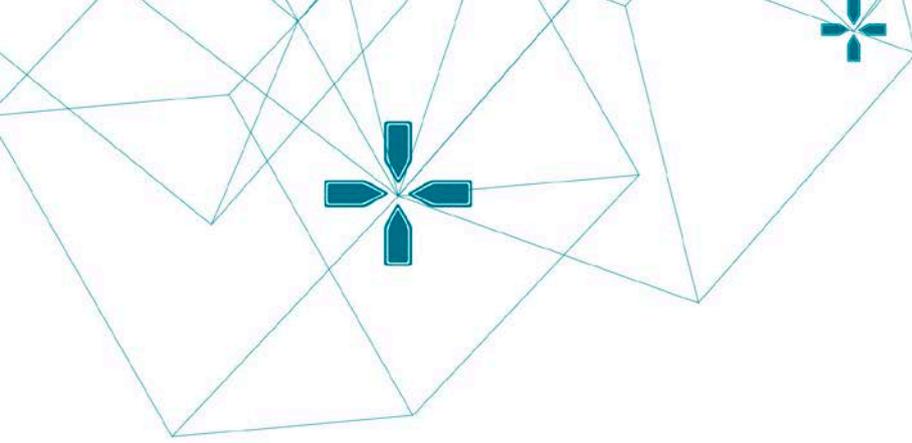
The way forward is for leaders to navigate the complex social systems in which they operate, to maximise the value of the human, structural and relational capital that sits within their organisations.

Minimising your intangible risks builds value in the organisation by giving greater transparency to the downside while, at the same time, evolving the organisation to capitalise on the upside. Minimising your intangible risks creates competitive advantage by ensuring protecting reputation, and brand and market value. It delivers increased organisational agility and speed to move and meet challenges through access to more valuable and relevant business intelligence.

Attending to the intangible resources and risks will materially increase business sustainability.

How leaders can develop People Capital in their organisation

To develop an organisation capable of taking advantage of new opportunities in the Knowledge Economy, senior leaders need to invest in People Capital.



Senior leaders themselves must develop the adaptive capacity to support the organisation to evolve. They need to be able to lead the organisation into its emerging future, with the creative and adaptive capability⁵ to respond to increasing complexity and create a sustainable business.

A methodology for developing an adaptive formulation, which can be likened to a new ‘operating system’⁶, has been developed by Kegan (2009). We cover this topic in detail in our other paper entitled “From Patriarchy to Partnership”.

Applying People Capital in the organisation

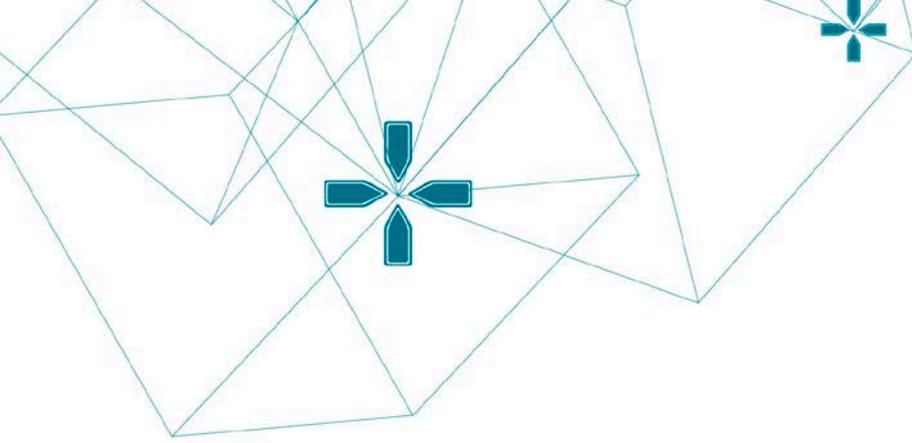
Because most people (in organisations, as in society) have not developed adaptive capability, it is important for leaders to create ‘rules of the game’, ensuring clarity on strategic goals, how success is scored and how people should collaborate to achieve it. This creates context in which people have the confidence to act, feel they can be themselves, and fulfil their values and purpose while achieving goals.

People Capital relies on the organisation creating:

- Context: The parameters for action *‘I know what’s expected and how to go about it’*
- Purpose: *‘Our effort will make a difference and outputs are enduring’* – an enduring noble purpose
- Meaning: *‘I positively impact society, others, my family or myself’* – individuals can create personal meaning and engagement with the activities they perform
- Autonomy: Individuals experience choice and can personally make a difference and act independently to deliver results – *‘I have individual discretion over areas that impact my successes.’*

⁵ Meeting adaptive challenges requires firstly an adaptive reformulation of the problem – understanding how the challenge comes up against the current limits of your mental complexity; and secondly, an adaptive solution – how you need to adapt your mindset. In essence adapting to the challenges of increased complexity is about the fit between the demands of the world and the mental and emotional capacity of the person.

⁶ Operating system enhancement for example from DOS to Windows: a more complex operating platform to perform more complex work



This means leaders need to understand the complex interplay between the various components of their organisation – the systems, symbols, behaviours and mindsets – that they influence and create every day. Addressing the interconnectedness between all elements in the organisational architecture is what will create organisational coherence.

This coherence is required for the various elements of People Capital (structural, relational and human) to operate consistently and effectively together.

Practically maximising People Capital ⁷

Getting the most out of People Capital in your organisation requires leadership priorities that include the following:

- clarity on goals
- clarity on team member principles
- the demonstration of lifelong learning and autonomy
- consequence management of inappropriate behaviours

⁷ More details on the components of these priorities can be found in the Appendix.

References

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5. Kegan, R. and Lahey, L. 2009. Immunity to Change: How to overcome it and unlock the potential in yourself and your organization, *Harvard Business Press*
6. Zenger, J., Folkman, J., and Edinger S.K. 2009. How Extraordinary Leaders Double Profits, *Chief Learning Officer*

APPENDIX

Maximising People Capital: Priorities

1. Clear Goals

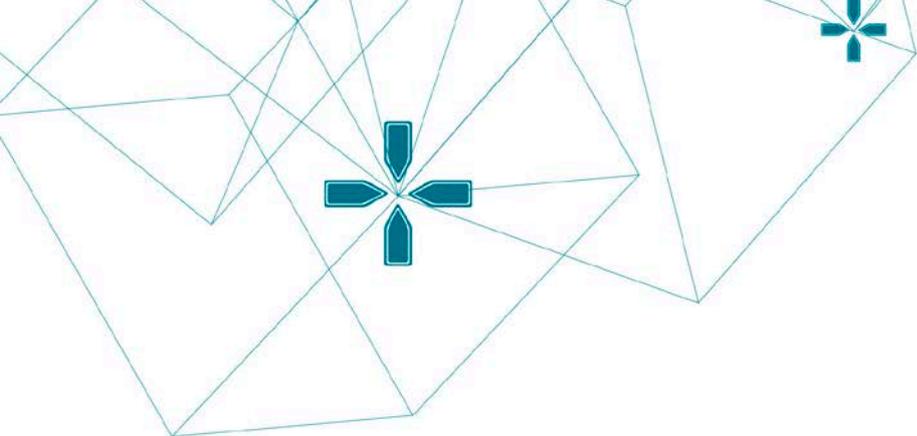
- Why what we do here is important and meaningful
- How we know we are successful
- Simplicity in expressing goals
- Goals that last a few years and can be tracked
- Shared simple measures, including 'lead' indicators like market, network and employee health checks
- Internal communication as a foundational platform that will be used strategically and collectively to inform, educate or reinforce what is important and how we do things around here.

2. Clarity on team membership principles

- What behaviours are expected around here so we can achieve together and thrive
- How we learn and adapt to improve together
- What happens if we don't?

3. Demonstrating lifelong learning and autonomy

- How people, individually, continue to develop and improve
- The shared language and constructs we use to build our "people capital"
- Demonstrate that autonomy can be used to create personal mastery and leadership
- Demonstrate a clear link between purpose and meaning – my role and contribution to deliver objectives.
- Be consistent with words and actions – leaders need to role model and demonstrate personal learning
- Leadership coalitions of enterprise – set up to develop and embed behaviours
- Senior Executive body operate to dive deep into how People Capital is evolving, and specific interventions that can assist development.



4. Consequence manage behaviours

- Senior leaders who achieve results and don't support the behaviours must be acted on
- Consequences for unaligned behaviour must be seen to be consistent across the organisation
- Consequences must be seen to be commensurate with the scale of the mis-step, not necessarily the outcome
- Consequences should leave both the individual and the organisation feeling respected and whole
- Adequate support and skill must be in place as any behavioural management occurs.