

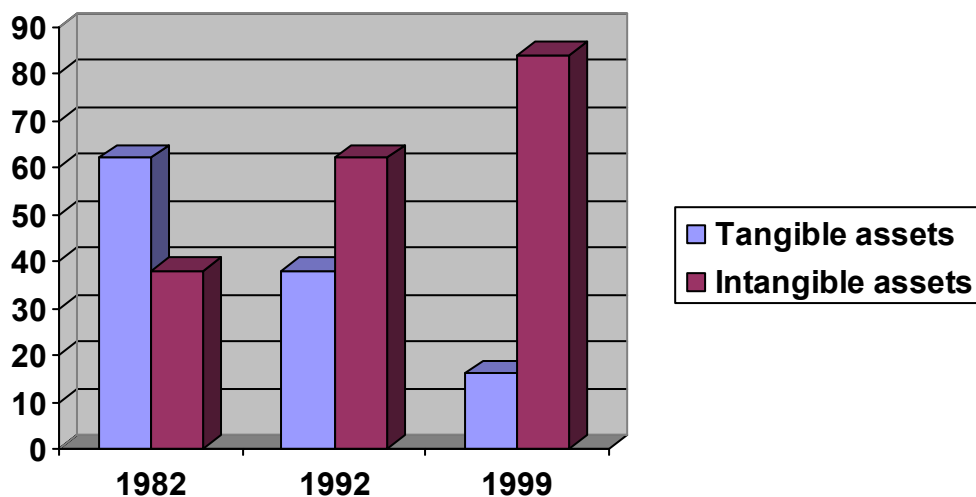
Is HRM a Dinosaur in the New Economy?

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Over the past two decades there has been a dramatic shift in the way the market has valued publicly listed companies. In the early 1980s tangible assets such as plant and equipment, accounts payable and receivable, inventory, formalised processes and so on accounted for over 60% of a firm's market value. Today, tangible assets often represent less than 20% of the market value asset base.

As Figure 1 shows, intangible assets have become the key drivers in the new economy. Things like leadership and governance, know-how, tacit knowledge, credit ratings, plant flexibility, customer and employee loyalty, informal processes, and brand strength are much more important factors when it comes to the future growth expectations of investors³.

Figure1. Changing Asset Base
(% Change of market value of the S&P 500 over the last two decades)



Source: Juergen H. Daum, *Intangible Assets and Value Creation*, John Wiley & Sons, 2002

Other studies reinforce this finding. Research undertaken by the Accenture High Performance Business Institute, in conjunction with the New York based intellectual capital and business value consultancy, AssetEconomics Inc, shows that as of May 2003, some USD\$7.6 trillion, or 58% of the aggregate value of the US stock market, as measured by the Russell 3000 Index, is based on perceptions of future value arising from intangibles.

While the percentage mix is likely to be lower for Australian companies, figures for a selection of well known listed companies shown below indicate a similar phenomenon.

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² Principal, John Barton Associates; Director, AssetEconomics Inc.; Director, Fred Emery Institute; and Visiting Fellow, NGSM, ANU.

³ Baruch Lev, distinguished US professor of accounting and finance and author of 'Intangibles', Brookings Institution Press, 2001, defines intangibles as "the claim to future benefits that do not have a physical or financial (a stock or bond) embodiment".

Figure 2. Intangible % Value for Australian Companies

Company	Net Tangible Assets per Share	Share Price	% Value in Intangibles
Patrick Corporation	4.79	10.68	55
Macquarie Bank	9.39	33.26	72
Toll Holdings	4.64	31.7	85
Telstra	0.82	4.66	82
NAB	13.75	25.66	46
Pacific Hydro	1.38	3.03	54
St George Bank	3.88	15.15	74

Source: Huntley's Share Market Handbook, 2003 Edition

Because of this shift in the way companies are valued, accounting firms across the globe are scrambling to find better ways to recognise, report and manage both tangible and intangible assets. According to Kaplan and Norton, the Balanced Scorecard pioneers, intangible asset management is the new wealth-creation driver in business – and is currently the ‘holy grail of accounting’.

But what is HRM doing to take advantage of this change and to add value to the organisation it supports? Unfortunately the evidence indicates not a lot.

A report last year by Lawler and Mohrman from the University of Southern California titled ‘HR as a strategic partner: What does it take to make it happen?’ highlights that in their study of HR organisations there has been very little change over the last 5 years in actual HR practices and the way HR spends its time.

HR expert, Professor Dave Ulrich, from the School of Business, University of Michigan, has long argued that the role of HRM needs to be much more that of a strategic partner. However, for most of its history HR has mainly focused on the administrative components of HRM.

In Ulrich’s recent book, co authored with Smallwood, “Why the Bottom Line Isn’t- How to Build Value Through people and Organization” (Wiley, 2003) Ulrich presents a hierarchy of market value drivers that starts with leadership credibility, and traces back to clarity of strategic direction, resource capabilities aligned to strategy, and the ability to create capabilities.

The research by Accenture and AssetEconomics mentioned above identifies an extensive list of intangible assets covering human, organisational and relational asset classes⁴. A representative sample follows.

Intangible Assets

- Knowledge-creating capability
- Innovativeness
- Quality and experience of senior management
- Strategy execution
- Quality of corporate governance
- Appropriateness of organisational design
- Organisational and personnel reputation

⁴ Future value: The \$7 trillion challenge, J. Ballow, R. Thomas, G. Roos, Accenture Outlook 2004, Number 1

- Brand strength
- R&D productivity
- Informal networks
- Employee loyalty
- Customer loyalty
- Informal processes
- Problem-solving ability
- Capabilities
- Know-how
- Tacit knowledge

This list of intangible assets clearly is human and knowledge centred and brings to the fore the profound strategic challenge for HRM; that is, ***how to create shareholder value from intangible assets and human capital?***

With the proliferation of companies that rely on knowledge-based competitive strategies, leveraging intangible assets has never been more critical to business performance. This situation offers an opportunity for HR departments to fundamentally alter their role and become credible value-adding strategic partners. But can HRM step up to this challenge?

In a paper on the role of HRM in entrepreneurial start-up companies to be presented at the forthcoming 2004 Babson Kauffman Entrepreneurship Research Conference in Scotland, Dr Leah Kaye from Monash University's Department of Management, concludes that "HRM as articulated in much of the literature is counter to the opportunity seeking start-up organization, which is characterised as a collaborative organization based on loosely coupled networks and alliances. HRM fits into a frame of hierarchy (guidelines, policies); whereas, the entrepreneur wants to fit the 'network' frame.... This means a re-conceptualization of HRM is necessary if it is to be compatible with the entrepreneurial start-up".

Despite the limitations of this research - only two cases were considered- Kaye's observations resonate with what one observes with new economy companies like eBay, Intel, and Nokia- all companies whose market value is largely determined by intangibles.

The significance to human resource managers of the above findings is that traditional HRM practice is essentially aligned to the management of the tangible business and less aligned to the intangible drivers of value.

The same point is made in Dr Kaye's observation that in entrepreneurial start-ups, the "human" aspect has much more to do with abilities to align with the thinking of the entrepreneur, be opportunistic, and to help establish an architecture of support relationships for the start-up, most of which is based on the belief that significant rewards will only come when the entrepreneur achieves success.

What then, can the traditional HR manager do to address this shift in ground? In the first instance, it may be necessary to drop the HRM title! But of greater substance, is the necessity for the HR manager to start to really understand the significance of knowledge and intangibles as key value drivers.

This involves not only understanding an organisation's business model and how it will meet the future growth expectations of investors, but also requires a high level of understanding of the enabling conditions that need to be in place to generate revenue growth and productivity efficiencies from intangible assets.

In short HR managers must be more commercially savvy about the new economy. They will need to have the following capabilities in order to have a 'seat at the strategic table' and be considered a true strategic partner.

- Understand the extent to which increasing returns drive your business/industry
- Understand the importance of tangible & intangible drivers of value in an increasing returns business, and the role of knowledge in particular
- Manage the *organisation* of your business around value creation and delivery systems- not silos; adopt an "open systems" view
- Manage the continuous development of strategic assets and capabilities - our rate of learning needs to be greater than the rate of change in our environment
- Develop an integrated strategic approach to knowledge management
- Have an ability to apply (open) systems concepts including the associated systems tools and action learning

A good place to start the process of redefining the role of HRM for the new economy is to adopt a holistic view of knowledge management⁵.

Knowledge management presents four fundamental challenges:

1. How to create new (tacit) knowledge.
2. How to make selected tacit knowledge explicit.
3. How to manage explicit knowledge and make it available for decision- making.
4. How to achieve strategic integration of the first three challenges with the organisation's strategic directions.

Fortunately, we now have a rich bag of tools that address each of these components. Respectively these include:

1. Nonaka's theory of knowledge creation and Senge's five disciplines for building the capabilities of a learning organisation.
2. The numerous approaches to mapping processes and both qualitative and quantitative model building.
3. Information systems, including systems that track capabilities.
4. Gary Hamel's concept of strategic intent.

And in addition to these KM tools we have a strong theoretical base from which HR managers can create value from intangible assets and human capital.

For instance, much of the recent research and literature has emphasised the importance of enabling conditions for successful knowledge management - the Japanese concept of "ba" (place) being the most prevalent.

And many years ago, the late Professor Fred Emery, arguably Australia's most important social scientist ever, formulated the concept of what he called "Design Principle 2" (DP2), based on the idea of designing organisations with "redundancy of functions". Case examples demonstrate the power of DP2 in the promotion of knowledge creation and sharing while improving bottom line performance and job satisfaction.

⁵ A 2003 PhD Thesis by Tare, M. from Swinburne University of Technology on 'A Future for Human Resources – A specialised role in Knowledge Management' found that: 'Although there is good growth in KM awareness and its importance, proper KM practice is occurring only in 11% of companies'.

Just as Read and Scheuermann, “The CFO as Business Integrator” (Wiley, 2003), present the case for the CFO to be the “Business Integrator”, given the extent to which market value is being determined by intangibles, surely the opportunity exists for forward looking HR managers to broaden their credentials and also put their hands up for a “leadership/knowledge integrator” role at the strategy table.

For further information about the contents of this paper or a related Executive Development program titled ‘Creating shareholder value from intangible assets’ please contact:

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