

Human Capital Risk



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The key to understanding the talent gap and unlocking the human capital potential in your organization.

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This paper focuses on how the practice of Human Capital Risk Management can unleash hidden assets and productivity to help companies succeed. Companies that understand and adopt Human Capital Risk as a key performance indicator to guide their business will be better positioned to leverage their talent. In turn, they will gain a strategic competitive advantage, innovate faster, and survive downstream macroeconomic and geopolitical events as a stronger organization.

Introduction

We have undergone the greatest dislocation of human capital in recent memory. Current events in the global economy are causing severe economic disruptions leading to corporate downsizings, restructurings and bankruptcies. With this prolonged contraction, unemployment continues to be higher than normal in the US and globally.

Without the benefit of foresight, companies have quickly shed jobs and radically shifted their workforces. The consequences of this lack of foresight have caught companies off-guard, justifying restructuring decisions on cost alone and leaving many talented, accomplished, and experienced employees without work. Indeed, the speed of events has exposed the inherent weakness in companies' ability to effectively manage their most significant asset - human capital.

What Makes Companies Successful

There are many commentaries regarding what makes a company successful, which can be summed up by four factors; people, market, products, and financials. All four are critical in ensuring the success of an enterprise over time.

Of these factors, nothing can begin without people. People create and maintain the intellectual capital within organizations that drives innovation and shapes products. People manage the finances, cash flows, and forecasts. The market may be an external factor, but it requires people to generate interest and deliver the messaging to gain

market acceptance. People make companies a reality and people make companies successful.

If people are the genesis and nexus of a business, how can we correlate the success of a company to the actions of people? Research has determined that success, or performance, of a person in an organization is directly influenced by motivation and talent. Talent in this case can be defined as the skills possessed by the person. This begs the question of how to evaluate in a measurable way the level of motivation and talent a person possesses, and in turn, using this insight to drive success at a corporate level.

Problem of Human Capital Proportions

The problem encountered in quantifying human performance is that measuring motivation and talent has been a widely varying exercise without much consensus or clarity. The current methods of measuring human capital are for the most part intuitive and lack the accuracy and reliability needed for any tangible insight.

Many of these challenges stem from the initial focus on motivation. While understanding motivation is inherently useful, there is still little consensus on what and how to measure it, thus the proliferation of behavioral and psychometric tools in the market. By its very nature, motivation is difficult to measure as it requires understanding human nature and its complexity, a field of study that is still evolving.

In a similar fashion, companies looking to measure talent have been equally challenged. The tools of the trade have focused on either inconsistent methods or have relied on unreliable source data. Many common talent assessment tools use competencies to define the framework for measurement. However, with every solution provider and every business using entirely different categorization schemes, the ability to derive insight is diminished due to lack of clarity or a common basis for measurement and comparison. These problems are further amplified when the data used to develop competencies and populate individual evaluations is based on resumes and job descriptions. While these documents are rich in data such as experience and expectations, they are information poor, failing to clearly elucidate the specific skills in the person as required by the specific position.

This lack of a standard measurement for talent and the insufficient level of information collected has a direct impact on the workforce, presenting three key areas of risks:

- Workforce is not equipped with the right skills to achieve corporate goals
- Recruitment, development and retention practices are inconsistent and costly
- Key contributor workforce becomes unstable, losing institutional knowledge

The result is that companies are operating blindly in the face of the challenges and risks across their workforce. Lacking a sound methodology and consistent basis for measuring talent, companies are exposed in a very real and direct way to potential weaknesses that can prevent achieving their goals and upend their business.

What Is Human Capital Risk

Human Capital Risk simply stated is the ability for the workforce to meet the objectives of the business. Put another way, the work required to be performed should balance with the skills of employees who are expected to perform the work. When the work and the necessary skills are out of balance, gaps arise in the organization. More specifically, Human Capital Risk is the measurement of the gap between the goals of the organization and the skills of the workforce. The process of reducing this gap is called Human Capital Optimization, but in order to start, some method is needed to measure the gap.

Any valid unit of measure must provide information that is quantitative, consistent, and reliable. Such a unit of measure must be granular enough without being too cost prohibitive to collect and analyze. It also must address the problem of superficial analyses without the corresponding problems of data overload. Skills provide such a measure.

A skill is defined as a specific body of knowledge, and the ability to apply that knowledge. Knowledge is expressed through a mastery of methods, processes, procedures, techniques, and tools while abilities enable this knowledge. When we build these skills into specialties and functions, we have a taxonomy that covers the compendium of skills that define an organization and its workers.

Measuring Human Capital Risk

With any novel approach, the natural question becomes how to implement the change in a way that minimizes impact to the organization. The key step is to define the skills taxonomy at the very beginning of the process.

The original skills-based methodologies were cumbersome to use due to the level of specificity created. Research from the late 1980's¹ provides the framework for building a proper skills taxonomy along three distinct categories of skills: technical, leadership and management. Coupled with the function – specialties – skills approach suggested above, modern skills taxonomies limit unnecessary levels of specificity. Based on customer studies over the past 30 years, a collection of over 1000 skills across all corporate functions and industries have been identified, of which between 600 and 800 define most businesses.

Once the skills taxonomy has been created, these skills can be directly mapped to positions in the company. The mapping process begins with an understanding of corporate goals and the definition of discrete tasks required to accomplish these goals. These tasks are further defined by the skills required to complete the tasks based on the skills taxonomy. The result is a set of position profiles which vary by role, responsibility and experience. Most mid-level management or individual contributor positions will have anywhere from 80 to 120 skills while corporate officers could have upwards of 150 to 200 skills.

Once position profiles have been created, each employee would complete an assessment of his / her skillset against the profile created for their current role. With the advances in Web 2.0 and SaaS-based delivery, this becomes a more distributed, iterative and real-time process for organizations. As with any significant change initiative, it will be necessary to incent employees for participation in the assessment process and to deliver a clear vision where employees understand the value for them.

The analysis from these assessments will generally require both some amount of validation and refinement as well as an engine to sift through the data to model the types of information that will be useful. For validation purposes, using input from

¹ Katz, R. L. "Skills of an effective administrator," Harvard Business Review: Cambridge, MA, People: Managing Your Most Important Asset (1989) pp. 45-57.

employees themselves as well as implementing a management review process ensures that the assessment data is statistically credible. Direct input from the highest performing employees within their position can further refine position profiles. Being rigorous in validating data will ensure that the information from the analytics leads management to a correct understanding.

From understanding derives insight into the existing state of the workforce and the gaps between the skills of employees and the goals of the company. From this insight, strategic plans and tactical actions can be developed to address these gaps using information that is based on an accurate, reliable, consistent, and quantifiable measure of talent.

Addressing Human Capital Risk

By having a sound methodology to evaluate workforce challenges in a measurable and consistent way, companies can begin to address human capital risk in an informed and direct manner. These risks can be addressed at the workforce, employee, and position levels using traditional human resource processes such as recruiting and performance management as well as using strategic corporate actions such as acquisitions and joint ventures.

The most important inducement for companies to use a measurable understanding of human capital risk is to create a greater likelihood of meeting corporate goals and financial projections. The adage that you cannot fix what you cannot measure is apt in this context. Understanding what gaps exist, as well as the severity of those gaps, enables companies to prioritize and justify decisions on an economic basis, as much as a cash flow analysis or sales projections would influence and guide the decision making process. Likewise, decisions can be evaluated not only by traditional means such as cost, time and people required, but also by the overall impact on human capital as it relates to potential risks now and in the future.

Utilizing human capital risk as a decision tool for leadership opens possibilities beyond its use in generic business operations to support new business models and foster innovation. With a detailed understanding of the overall skillfulness and types of skills inherent in the company, leaders can dynamically create innovation clusters of knowledge specialists outside of the existing corporate hierarchies. These pockets of

highly concentrated skill sets can lead to faster development of new products and services because companies are using the right people with the right skills. These innovation clusters can also spawn new businesses that assist organizations to overcome the challenges posed by disruptive technologies and more nimble competitors.

The ability to be nimble and adjust to competitive market pressures through understanding human capital risk allows companies to mitigate the risk of corporate development. The challenges with assessing potential acquisition targets, pursuing joint ventures, and forming strategic partnerships can be understood and addressed more thoroughly through the lens of risk. Particularly for acquisitions where the motivation is to acquire intellectual property and the intellectual capital of the workforce, it is better to understand what human capital gaps are addressed in acquiring the company and what challenges may exist in integrating the two firms. In a similar fashion, partnerships and new ventures can be evaluated in regards to the addition of human capital vis-à-vis the gaps in the organization. This allows a clearer picture in deciding whether to move forward, go it alone, or consider other partners.

For companies that are in a downsizing and restructuring phase, human capital risk can be an invaluable tool. Given the speed, criticality and size of such efforts, many workforce alignment decisions proceed haphazardly at best. The impact is not simply the loss of human capital, but the loss of critical knowledge that could be critical to surviving and emerging from the downturn poised for growth.

Of even more concern are the effects of catastrophic events or macroeconomic calamities that can shake companies to the core. Disaster recovery plans are developed to handle infrastructure, technology, business operations, and people accounting, but rarely is an organizational blueprint available to quickly and effectively address workforce realignment to cover sudden staffing and leadership shortfalls. Understanding human capital risk provides leadership with the blueprint to get back on track quickly and continue business as usual when business downturns or other threats occur.

Future of Human Capital Risk

Human capital risk has the potential to radically change the way businesses view and

utilize their workforces. The benefits of measurably evaluating various strategies based on human capital changes the nature of discussions in the board room. The most obvious benefactor is human resources, which now possesses the information behind human capital risk and the tools to readily assess risk across various dimensions and scenarios. For the first time, human resources can become an integral business partner rather than simply a cost center.

With the adoption of human capital risk as a definable and measurable metric in companies, leaders also have a key indicator of business health as readily available as balance sheets and marketing budgets. The Holy Grail has always been to quantitatively measure human capital, and using skills as the basis of measurement gives management that capability. In a similar manner that CFO's can use numbers to clearly explain the state of the business and future potential to shareholders, human capital risk could hold the same level of impact and interest for shareholders given the tight correlation between goals and skills. It is only a matter of time before human capital risk is used alongside earnings and P/E ratios in conversations on Wall Street and in the pages of annual reports.

Closing Thoughts

How will the best companies define themselves in the 21st century? Where are they going to find the next areas of efficiency and innovation? Having pursued re-engineering, cost cutting, automation, and technology, the last operational area for companies to unleash efficiencies is in their people. Lasting change will not be achieved with the latest and greatest management fads, but through substantive innovation into more rational and informed uses of human capital. Human capital risk is the foundation for this groundswell of change and the best opportunity for companies to compete and thrive in the new global economy.

About the author

Mark Birch is the Chief Marketing Officer of WingSpread. Mark saw firsthand the challenges faced by Human Resources departments in acquiring and managing talent during his time at Oracle working with global clients. In WingSpread, Mark brings his experience in Human Capital Management, his thought leadership, and his vision to make WingSpread the standard in the industry for measuring talent. Prior to WingSpread, Mark also held executive roles at Siebel, Headstrong and Logica.

About WingSpread

WingSpread™ addresses the fundamental equation governing Human Capital Optimization: “The work to be done must equal what workers can do.” Skills are the critical element in solving this equation as skills are measurable and quantitative. Developed from over 30 years of experience in the fields of executive recruiting and corporate strategy, WingSpread™ applies an innovative methodology and web-enabled “SaaS” analytics technology to help organizations to evaluate talent and take decisive action. Our solutions enable companies to overcome challenges of talent recruitment and development, corporate restructuring and mergers and acquisitions to achieve better returns on their investment in human capital.

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