



National Association of State Personnel Executives

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“A 21st Century Concept of Human Capital”

This presentation draws directly on my experience as the Cabinet Minister in the New Zealand Government responsible for labor market policy. It also reflects a continuing interest in these matters in association with American academics and policy makers.

The Next Revolution:

Throughout history our societies have evolved, from the hunter-gatherers, to the agricultural revolution, to the industrial revolution, to what we are experiencing now -- the beginnings of the information revolution. Each of these revolutions has brought exponential change to society. The comparison I want to draw is between what we know of the industrial revolution and what we expect of the information revolution. From that comparison I then want to extrapolate what might happen to the labor market of the 21st century.

The Industrial Revolution:

The major feature of the industrial revolution was massive standardization. Standardization had a profound affect on mankind as human lives were shaped to the needs of the production line. For the first time, everyone worked the same number of hours, during the same hours of the day, on the same days of the week, for the same number of days per year. We ate our meals at the same time, normally eating the same food, dressing in much the same way, driving the same cars, developing the same skills, retiring at the same time.

However, this standardizing dynamic had a far more profound effect, workers were identified as a unit cost of production, infinitely replaceable, and likely to spend most of

their working life at the same job with the same employer. Management's major focus was on minimizing the cost of labor as an input to production. Remuneration reinforced these principles by basing financial reward upon the amount of time spent working with little reflection on the value of what was produced. This practice became the basis for the evolution to remuneration being directly related to the hours spent working, or what can be described as time based payment.

Workers focus during this period was very much on job security. Job security in the main was interpreted as finding a stable employer who had the potential to offer secure employment for the working life of the employee. Being seen by the employer as loyal, dependable, hardworking and a team player was the formula for keeping the job.

The Information Revolution:

That was then, this is now.

The Information Revolution may become a period in time where labor markets are governed very much by spontaneous order, the potential complexity of the rate of discovery, the demands for flexibility from workers, and the competitive impact of globalization will make "command and control" or "central control" approaches disastrous.

The information revolution is already challenging every one of the tenets of the industrial revolution. Already it is clear that rather than standardization, the information revolution will feature massive customization. From our shopping trends, to our food choices, to the time and place for our eating our meals, to our education -- everything is being individualized. Nowhere is this change going to be more dramatic than in the working lives of the population.

The 21st century labor market is going to be dominated by the concept of "Human Capital". This concept is being driven by the realization that in the economy of the 21st century wealth creation is going to be directly related to the creativity of the enterprise. How to discover the new, better, cheaper, more exciting product will drive decision making in corporate boardrooms. Having a workforce that can think creatively and discover new and better processes and procedures will be the ambition of every high performance organization. Compare this new focus on the entrepreneurial skill of the worker to the 20th century where the skill of the workers hands drove wealth creation.

The exciting challenge here for academics, policy makers and employers is the fundamental shift in the perception of the workforce. The old perception was of a worker as a "unit cost of production", an input that was controlled for cost. The new concept is of an employee as a capital asset, something of considerable value to the enterprise, something to be fostered, developed and improved. The talent and skill of the enterprises workforce will substantially determine the value and performance of the organization. To maintain and improve the value of this asset will require investment. Inherently this requires that the employee be considered as an individual and not just part of a collective

of workers. As a result, terms and conditions of employment will need to be more individualized, not collectivized.

Human Capital:

The term “Human Capital” is now commonplace but in my experience it is used with no clear consensus of exactly what it means or even a consensus about what it should mean. In my view it will be a disaster if the result is just a new improved “Human Resources” policy. In my work I have invented my definition of this term, and I must admit in part I have done so in an attempt to push the debate towards my own conclusions.

That definition is as follows:

- Human Capital is the cumulative total of the talents and skills, appropriate to the interests of the enterprise, of its employees.
- Human Capital determines the ability of the organization to accomplish its mission.
- This definition forces recognition that appropriately skilled employees are an asset of the organization and must be managed accordingly.

In this enterprise of the future where success is going to be determined as much by the quality of the human capital as by the quality of the physical assets, it follows that human capital management assumes equal importance with physical asset management. It is my firm belief that in the enterprise of the future the performance of the enterprise will be determined **NOT** by its physical assets but by the quality of its’ Human Capital. The ability of organizations to achieve their full potential will be a reflection of the capability of the management team to identify the skill needs of the enterprise and then create that skill capital.

If I am right in my presumption then there exists a huge learning curve for enterprise owners if they are to advance their competitive advantage. Prudent management in the future will have a human capital strategy that will identify exactly what human capital capability the enterprise has now, what it will need at given stages in the future and how those gaps are going to be bridged. To the best of my knowledge no one has perfected this process yet. In fact it would be fair to say that most enterprises have not even started down this road.

Current analysis of skills obsolescence says that skills have a shelf life of about four years. After that they begin to deteriorate rapidly. That means that for an enterprise to keep its human capital current it would need to be providing either repairs and maintenance or capital skill training to 25% of its workforce each year. That is just not happening at the moment.

So what are the potential consequences of failure to build an appropriate Human Capital management plan?

- The most powerful example I can find comes from the report of the 9/11 Commission. The report identified that one of the intelligence failures in

numerous agencies was that while they had a relatively full complement of translators only about 2% were proficient in Arabic languages. As a result intelligence gathered was sitting for up to 9 months awaiting translation. Some of that backlogged intelligence may have prevented 9/11.

Clearly this was a Human Capital failure at a relatively low level of the organizations concerned but that task was “Mission Critical” and it was not recognized as being so important. Good Human Capital management should have detected that strategic risk and solved it before a major mission failure occurred.

Employee Expectations:

Having examined this phenomenon from the perspective of the enterprise it is also necessary to examine it from the perspective of the individual. The cohorts of new employees currently entering the workforce do not share their predecessors’ concepts about job security. Their concept can better be described as employment security where the focus is on maintaining a set of skills that are currently in demand in the labor market. They do not have the same long term commitment and loyalty to the enterprise that their predecessors did for they see their security embedded in possessing skills for which there is a current market demand.

This group of people will be far more mobile in the labor market and will change employers more frequently, probably on average about every five years. At least in part this mobility will be driven by the desire for new work experience in an attempt to keep up with changing skills in a rapidly evolving market. This mobility will also have the beneficial effect of spreading best practice throughout the economy much more rapidly.

In employment contract negotiation employers of the future will need to recognize that the skill development programs offered may have as much or more interest to the employee than the remuneration package. Once again this emphasizes the individual nature of employment contracts of the future.

Social and Economic Objectives:

However this new generation of workers will also be seeking other flexibilities. They will wish to more closely integrate their private life with their working life. They will be heavy users of telecommuting capabilities, they will want flexible hours, and some will want to work longer days but fewer days per week. Most will want their remuneration to recognize their contribution to the enterprise through performance payments, more and more will want the job customized to their needs.

It is my view that given these demands for flexibilities and the complexity of managing those flexibilities there will be a growing trend towards payment for product produced. In other words, remuneration will move away from payment for time spent on the job. Over time we will see a steady diminution of time based payment in labor markets as the normal basis of remuneration and a move towards setting a price for the completion of a body of work.

Finally, there are significant indications that an older generation does not want to retire at age 60 or 65. This changing value seems to be the product of two considerations: one, that work is less physically demanding than it was in the 20th century so people are generally fitter and healthier at 60 than in the past and two, more and more people want to remain attached to what is happening in the economy for social reasons. Possibly for the first time in the history of labor markets there will be a significant cohort of people who will continue to participate in the workforce for what are predominantly non-economic reasons.

In addition, changing social norms will continue to affect the labor market. For example, the female population now sees child care as a finite obligation and desire a meaningful career beyond the raising of their children. They wish to keep their skills current through part time work or by telecommuting, so we must expect a continuation of the trend for women to increase their participation in the labor market. Cumulatively these factors are going to significantly expand the demand for even greater flexibility.

External Factors:

Competition in the labor market is not a phenomenon that is about to occur, it is a reality that has existed for many years and its impact on internal policy continues to expand exponentially. Every thinking person today realizes that jobs are almost as fungible as investment capital and for this reason non-economic factors play an ever increasing role in employment decisions. For example, the new labor force will move almost immediately to more desirable climates despite the economic benefit they were receiving at their previous job. This means Human Capital managers must first be aware of what is happening in the labor market place and have the flexibility to see that their human Capital is not stripped away by competitors.

What is not as well recognized is that the porosity of national borders has reached such a level that nation states can do little to eliminate the competition that globalization has created. Policy makers need quickly to come to grips with the reality that the only lasting defense against globalization is to continuously improve the nation's international competitiveness. Because of the rapid pace of change in today's labor markets, attempts at command and control through the imposition of artificial barriers will all ultimately fail and in the process cause significant harm.

Debatable Factors Influencing Labor Market Policy

The following points are in my view essential components of any debate that focus on labor market policy for the 21st century.

1. Recognition that the 21st century is the information revolution and that applying the principles of the industrial revolution to the 21st century are not appropriate. (Smokestack policies in a high tech world.)
2. Recognition that workers are an asset not a cost of doing business
3. Recognition that there will be a co-mingling of social and economic expectations in the 21st century workforce
4. Recognition that flexibility means treating workers as individuals therefore collective agreements will become more open or an obsolete practice

5. Recognition that skill development will assume equal importance with remuneration packages in contract negotiation
6. Recognition that maintaining the currency of skills is such a huge undertaking that it can only be achieved through worksite programs
7. Recognition that remuneration based on time spent at work is gradually going to be replaced by payment for product produced
8. Recognition that the world is a global market place
9. Recognition that the best defense against this trend is improvement to a nations competitiveness
10. Recognition that the law of contract is the most readily accepted basis for recording and enforcing agreements between parties

Challenges for Public Sector Human Capital Managers:

1. Convincing leadership that Human Capital issues are the responsibility of the entire Senior Management Team
2. Building a Human Capital Strategic Plan
3. That this is not just a HR issue about being a “good employer”
4. That Human Capital failure can lead to total mission failure.
5. That Human Capital Managers of the future have the task of guaranteeing to the Governor, the Legislature or the President the capability necessary to carry out the government’s agenda organization by organization.
6. That Human Capital Managers should be constantly monitoring the organizations future Human Capital needs and building strategies to deliver these capabilities when they are required.
7. That Human Capital Managers should continuously be informing the senior management team of the organizations Human Capital weaknesses and the consequences of leaving them unaddressed.