# White Paper

2021

# Strategic Human Resources

## The Business Context

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# Executive Summary

We've been advocating for the growth and development of a strategic human resource function for decades. While some progress has been made, there are still large gaps in that journey. One of the gaps is how the executive leaders of businesses view human resources. This whitepaper outlines the fundamental three types of capital that all business have and need to pay attention to, and it places human resources in that context. There are three fundamental categories/types of capital: Financial, Physical, and Human.

# Financial Capital

Financeers, accountants, and economists debate semantics and definitions of financial capital, and it's not our aim to try to resolve their debate. Our aim is only to render a nominal definition for the purposes of contrasting financial capital from physical and human. Financial capital comprises economic resources that a company controls and can put to use. Depending on the sources you consult, you'll find that there are 3 types of financial capital, or 5 types, or 8 types. In all types, financial capital is usually considered "capital" when it's being put to work for production purposes. As an example, cash would not be considered capital unless it's being put to use.

# Physical Capital

Physical capital consists of real/tangible things that tend to have longer-term value. Think of assets that have a multi-year value that might be depreciated over time. Examples include real estate, land improvements and buildings, equipment and machinery, computer and networking systems, and vehicles. Physcial capital are things that have a lifespan that is greater than the production cycle; in other words, they are not used up when producing products and services.

# Human Capital

Human capital is interesting because there are a large number of sources that state that a business' people are an *intangible* asset. I beg to differ on calling people "intangible!" People can be counted; the costs of human resources can be counted. We know that cost of labor runs on average 20-50% of a company's revenue. We also know that without the people, there most-often is no business. You might be able to run a business with little-to-no physical or financial capital; however, you will struggle to find a business that can run without people. (Maybe A.I. will change that though.) Not only can we count the costs of human capital, we can also project workforce needs, volume or work, throughput of tasks, and work activities. There is a base capability, capactiy, and output-expectation. Human Capital is **Very Tangible**. And, yes, it may not be a line item on a balance sheet *today*, maybe it should be *tomorrow*!

Where human capital becomes "intangible" is in the area of potential. It seems that financial "experts" like to zero-in on this aspect of people. Human skills, intelligence, training, development, growth, health, and culture set up an *unknown potential*. Frankly, that makes human capital far more exciting *and important* than either financial or physical capital! And, that makes the function of Human Resources far more valuable to a business than either finance or operations.

# The Story of 3 Capitals

We've defined the three capitals. Let's look at their stories and how businesses treat them. Financial capital consists of debt, equity, and working. Physical capital consists of facilities, assets, and equipment. Human capital consists of people, talent, capabilities, culture, and human contributions to production.

- **Financial capital** has a direct impact on the business operation. A business must have financial capital to invest and operate. But, financial capital is by-and-large a depreciating asset.
- **Physical capital** has a direct impact on business operations. A business must have equipment, systems, and tools to produce products and services. But, physical capital is by-and-large a depreciating asset.
- **Human capital** has a direct impact on the business operations. A business must have people to design, develop, market, sell, produce, service, and manage the business. AND, people are by-and-large an ***appreciating*** asset!

  There's a caveat here though: to be an appreciating asset, a business must lead, develop, and deploy its people with skill and expertise. Poor leadership, a lack of development, and unskilled deployment will make human capital a depreciating asset. There's nothing you can do to turn financial or physical capital into an appreciating asset, but how you lead and manage *people* can make a huge difference in the return on investment for human capital!

The story gets more interesting when we examine how these three capitals are positioned within businesses. Entrepreneurs, owners, CEO's, and Presidents treat financial and physical capital management as both being more important than human capital.

- **Financial capital leadership:** 64% of small businesses and 85% of medium businesses have a leader of finance and/or accounting. Of these, 93% report directly to the CEO (or equivalent role.) One of the biggest issues cited (about 50% of the time) by businesses, regarding their accounting leadership, is that they are more reactive than proactive.

- **Physical capital leadership:** This one is a little harder to pin down to a percentage because leadership of physical capital comes in many different forms. The simplest is if a company employs a head of operations, as operations leadership roles often manage the majority of physical assets. Depending on the type of business, industry, and segment, these titles vary dramatically. Common categories of titles include: operations, manufacturing, production, and service. In the case of small businesses, often the founder will fulfill the operations leadership role and manage physical capital directly. When you bundle these together, our estimate is that 98% of small-medium sized businesses have some form of an operations leader who oversees the physical capital of the organization. And, a similar percentage, 97%, report to the CEO or an equivalent role.
- **Human capital leadership:** Only 30% of small businesses (under 50 employees) have a human resources leader. In the cases where there is a HR leader, 65% of them report to the CFO or equivalent. Then, 70% of these small businesses add HR onto the job duties of employees who are not trained or skilled in human resources. As frightening as these statistics are, they do get better as the size of the organization increases. Medium and large businesses will target a ratio of employees to HR. Ratios will range from 150:1 to 500:1, depending on the industry and type of roles in the company. Across all sizes of companies, the reporting relationship of the HR leader is riddled with variability. The role will often report to a position other than the CEO or President, sending a clear message that the company does not believe that people are as important as money or equipment.

The story of the 3 capitals should lead you to scratch your head in puzzlement. Human capital is by far the most valuable of the three capital categories. It is the only one that has the potential to be an appreciating asset. It is the only one can be led and managed to deliver incremental and multiplied levels of output. It is the only one that can generate innovation. Yet, we relegate, delegate, and subjugate human resources…in businesses where this is done, a very clear message is sent that leaders do not value people. Still, business leaders often and frequently report that human resources professionals lack the skills to contribute at the highest level in business. Half of business leaders report that HR is not ready, and just over 40% say that they do not provide needed training and experiences for their HR staff. It could be just me, but maybe – just maybe – business leaders shouldn't be assigning HR duties to people who lack formal skill training or professional qualifications (70% of HR professionals enter the field without specific HR training.) It's clear to see we have a conundrum.

This is why we partnered with one of the country's leading business schools, The University of Texas at Dallas to develop a Strategic Human Resources program. This program directly addresses these skill gaps and prepares HR professionals to "KEEP their SEAT at the Table." It is our aim to make the Chief HR Officer and the Chief People Officer the default successor to the CEO role. In the famous words of Patrick Lencioni, "*Not Finance*. *Not Strategy*. *Not Technology*. It is **teamwork** that remains the **ultimate competitive advantage**, both because it is so powerful and so rare" [emphasis mine].

# Contact Us

Our offices are based in Dallas, Texas. We operate a network of qualified consultants globally to meet your needs wherever you do business.


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## About the Author

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Dr. Albrecht has fulfilled executive leadership roles in Human Resources, Consulting, and Organizational Development. He also has significant career experience in project management, engineering, technical operations, and workforce education. He has worked in several industries including retail, manufacturing, telecommunications, medical devices, construction, and Department of Defense. He has considerable experience consulting with most corporate functional areas including supply chain, engineering, software development, sales, marketing, human resources, information technology, and service/support.