Chapter I

Introduction
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Human resource (HR) is the most valuable asset held by an organisation today. It is a unique and elusive asset to manage for a variety of reasons. Human resources simultaneously represent the single greatest potential asset and the single greatest liability that an organisation acquires as it goes about its business. According to the resource-based view of the firm (Barney, 1996, p. 469), the strategic assets of a firm are mostly confined to the intangibles, mainly the human capital. The human capital cannot be replicated and hence serves as the vital factor for providing sustainable competitive advantage to a firm. While there are other intangible assets in an organisation, HR is the only intangible asset that can be influenced, but never completely controlled, invested in wisely, or wasted thoughtlessly, and still have tremendous value. The computation of the value of human resources is not an easy task as it is not like other resources. These distinguishing features are what make HR unique, and also what makes it an elusive asset (Weatherly, 2003).

The human capital theory proposed by Schultz (1961) regards people as assets and stresses that investment by organisations in people will generate worthwhile returns (Baron & Armstrong, 2007, p.10). It is well accepted by the management that people are the critical differentiators of a business enterprise. People are the profit lever, and this is indisputable. The stock market has recognized the leverage of human capital by awarding a market value for service and technology companies that exceeds their book value by several times. All the assets of an organisation, other than people, are inert. They are passive resources that require human application to generate value. The key to sustaining a profitable company is the productivity of the human capital (Fitz-enz, 2000, p.1)

The current technological advancement and the automation of farms and factories have freed many workforces from the domain of physical labour and gave rise to a new type of work termed as 'knowledge work'. We needed people with different traits who were able to perform the knowledge work, and then emerged a new crew of workers called 'knowledge workers'. The knowledge workers are the 'workers who could produce the information in the first place, extract meaning from it, and take action on it' (Davenport, 2005, p. 4). The existing literature reveals that the companies with a high proportion of knowledge workers,
also referred to as knowledge intensive, are the fastest growing and most successful ones. We can cite the Indian IT and ITeS sector as an example.

Based on research evidence to date, it is becoming increasingly clear that the HR system is one important component that can help an organisation become more effective and achieve a competitive advantage (Becker & Huselid, 1998, p. 53). HRA system can add value to the organizational performance and thus provide sustainable competitive advantage. Scholars in the area of strategic human resource management argue that the human resource satisfies four conditions necessary to achieve sustainable competitive advantage: human resource is rare, valuable, inimitable and nonsubstitutable (Barney, 1991). Competitors can easily duplicate competitive advantage obtained via better technology and products, but it is hard to duplicate competitive advantage gained through better management of people (Khatri, 2000, p. 337).

In the 1990s, a new emphasis on strategy and the importance of HR systems emerged with a new zeal. Researchers and practitioners alike began to recognize the importance and made attempts to measure the impact of HR’s influence on the firm’s performance. Although many kinds of HR models are in use today, we can think of them as representing the following evolution of human resources as a strategic asset: (Becker et al, 2001, p. 3)

- **The personnel perspective:** The firm hires and pays people but does not focus on hiring the very best or developing exceptional employees.

- **The compensation perspective:** The firm uses bonuses, incentive pay, and meaningful distinctions in pay to reward high and low performers. This is the first step toward relying on people as a source of competitive advantage, but it does not fully exploit the benefits of HR as a strategic asset.

- **The alignment perspective:** Senior managers recognize their employees as strategic assets, but they don’t invest in overhauling the capabilities of the human resources. Therefore, the HR system cannot leverage management’s perspective.

- **The high-performance perspective:** HR and other executives view HR as a system embedded within the larger system of the firm’s strategy implementation. The firm manages and measures the relationship between these two systems and firm performance.
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This evolution aspect highlights how the HR has experienced dramatic shifts in its role in the last few decades.

The new economic paradigm which is characterized by speed, innovation, short cycle times, quality, and customer satisfaction, is highlighting the importance of intangible assets such as brand recognition, knowledge, innovation and particularly human capital. There is a gradual shift from material goods to intangible goods (Al-Hawamdeh, 2005, p. 8). This new paradigm can mark the beginning of a golden age for HR. The most persuasive action that the HR managers can take is to develop or adopt a HR measurement system that will help to measure the contribution made by the human resources.

Low and Siesfield (1998) carried out a study on the use of information relating to intangibles by the financial analysts and portfolio managers which reveal that, for the average analyst, 35 percent of their investment decisions are determined by non-financial information. The top ten non-financial variables considered by the financial analysts are execution of corporate strategy, management credibility, quality of corporate strategy, innovation, ability to attract and retain talented people, market share, management expertise, alignment of compensation with shareholders’ interests, research leadership, and quality of major business processes. If we consider the first variable – execution of corporate strategy, we know about the contribution of HR in this regard as revealed by the existing literature in the field of strategic human resource management. In this way we can find that seven of these variables are associated with the effective functioning of the HR system. From this we can have an idea about the kind of responsibility that has been entailed on the HR function.

The information on the non-financial variables valued by the financial analysts are not easily available to them. So the organisations need a mechanism through which they can generate accurate and reliable information on these variables. For sharing the information on the non-financial variables proper disclosure practices is also required.

The importance of intangibles is being recognized by many business houses. The management of these intangibles is really a challenging one. The accounting system used today emphasizes tangible capital both financial and physical. In today’s knowledge-based economy where we are giving emphasis on knowledge and intangible assets, conventional accounting system actually creates dangerous informational distortions (Becker et al, 2001, p.11). We believe that the numbers on the financial statements prepared on the basis of
double-entry bookkeeping, which has been practiced over half a century, are truths. But these numbers can be termed as facts, but seldom truths. There is only one number in the balance sheet—cash which is verifiable as truth. All the other numbers depicted in the balance sheet are a combination of hopes, agreements, and expectations. The current accounting system tells us what has happened in the last accounting period, on the basis of the practices agreed upon. The financial statements prepared on the basis of the current accounting practices are not depicting the ‘true and fair view’ of the organisations and every businessperson knows that they are manipulated. The current accounting system looks inside the organisation and it is focused on the past. If we want an internal and backward look, accounting does the job. Conversely, today we need to focus on the issues that will create wealth, those actions that will extract value from the marketplace, and we need to focus on the future. We cannot be successful by backing into the future with our eyes locked on the past (Fitz-enz, 2000, p. 5). The initiation of new forms of accounting – namely, human resource accounting, economic value added and the balanced scorecard approach – is a promising step in this direction. “So let us accept accounting for what it is, but not worship it to the exclusion of other useful data.” (Fitz-enz, 2000, p. 5)

As per the traditional accounting system the HR system is considered as cost centre rather than a profit centre. Under financial pressure the companies generally invest in physical resources at the cost of the human resources. Layoffs at the time of depression may serve as typical example in this regard. The current accounting methods should provide measurement tools that can provide vital information relating to HR to its stakeholders and exhibit HR’s contribution to firm performance.

It’s high time that HR professionals focus more on the HR deliverables than on doing their work better (Ulrich, 1997, p. 17). They must adopt such practices that create value and ensures achievement of the organisational goals. It has been observed that the HR professionals and their stakeholders operate in separate worlds. However, to create value, we must learn what value is, and remember that value is defined more by the receiver than the giver. That means HR professional must learn to help their stakeholders address the issues most valuable to them (Ulrich & Brockbank, 2005, p. 21). It has also been observed by Ulrich and Brockbank that the changes in HR practices help to create employee commitment,
which in turn creates customer commitment, which in turn boosts financial results (Ulrich & Brockbank, 2005, p.46)

In the corporate arena, it is realized that without hard data on human resources activity and productivity it’s very difficult to compete. The vast majority of data stored in organisational databases is not retrieved or organized in a manner that helps executives manage their human resources problems or utilize them effective. Since employee costs constitute a major chunk of corporate expenses, measuring ROI in human resources is very essential. Management needs a system that describes and predicts the cost and productivity measures of its human resources. Both quantitative and qualitative measures are required to have better insights into results and drivers, or causes (Fitz-enz, 2000, p.3).

Rummler and Brache believe that “measurement is the pivotal performance management and improvement tool and as such deserves special treatment.” They pointed out that without measurement:

- Specific performance expectations cannot be communicated.
- We will not be able to know what is going on inside the organisation.
- Performance gaps that should be analyzed and eliminated cannot be identified.
- Feedback comparing performance to a standard or benchmark cannot be provided.
- Rewarding performances cannot be recognized.
- We cannot support decisions regarding resource allocation, projections and schedules.

In short, we can say that if we do not know how to measure our primary value producing asset, we will not be able to manage it (Rummler and Brache, 1990, p.141).

We need to design and implement a high performance work system which has an economical as well as statistically significant effect on firm performance. The high performance work system calls for strategically aligned HR management policies and practices designed by the strategic HR managers and not the technical HR managers (Huselid, Becker & Beatty, 2005, p. 111).

Considering the above discussion, where we have tried to highlight the importance of human resources in today’s economy and expressed the need for an apt HR measurement system so that proper information may be generated for effective decisions to be made by the internal as well as the external stakeholders, we can propose the Human Resource Accounting practice as a panacea. To recapitulate, the origin of human resource management as a
separate school of thought is usually traced back to the seventies with the development of human resource accounting (Budhwar, 2000, p. 229). HRA emphasized that human resources are an asset for any organisation.

In the words of Flamholtz (1999), accounting today is still based on an industrial paradigm in which physical and tangible property is considered as an asset. One accounting tool that is relevant to the measurement and, in turn, the management of intellectual capital, specifically human capital, is Human Resource Accounting (Flamholtz, 1999, p. 4).

HRA has been defined by the American Accounting Association's Committee on Human Resource Accounting as “a process of identifying and measuring data about human resources and communicating this information to interested parties” (AAA, 1973, p. 169).

To provide a general idea about the HRA system to the executives, a working definition has been designed for this study which is as follows- 'Human Resource Accounting is the process of measuring the cost and value of human resources to an organisation and presenting the information in a significant manner in the financial statements to communicate their value with changes over the period and results obtained from their utilization to the different stakeholders. It mainly caters to the information need of the HR professionals, senior managers and investors for making effective decisions.’

The Human Resource Accounting practice which started in the 1960’s has lost its relevance with the accounting professionals. They have been too busy in 'putting the HR in the balance sheet' and have ignored the larger picture. HRA is not only for assigning monetary HR value on the right side of the balance sheet, it is an effective tool which generates monetary as well as non-monetary information which can be used by both the internal and external stakeholders for effective decision-making. The advocates of accounting have deemphasized the utility of HRA system as they were not being able to reach a consensus with respect to the model to be used for HR valuation. The HRA practice is being used by the HR professionals these days as an effective HR measurement system. The HR practitioners have developed other systems also like, the Human Resource Scorecard, Human Capital Monitor, Human Capital Index (Baron and Armstrong, 2007, pp.72), and so on for effective human capital management. The current literature on human capital management considers human resource accounting as an effective strategic HRM tool. So it’s high time that we start rethinking about the system and make optimum utilization of this system in the field of
accounting also. The current stage of the development of HRA, which can be dated from 1980 to the present, involves the beginnings of a resurgence of interest in the theory and practice of HRA. This study is an endeavour in this perspective. We have made an attempt to identify the problems associated with the HRA system on the basis of the executives' opinion so that we can heal it and revive the concept. The decision areas where HRA information can be used are major concern areas for this study. With the help of case study we have tried to show that the IT companies with HRA system are better performers than the companies not having the system. We have attempted to evaluate the performance of human resources through HRA information, so as to highlight the utility of HRA information. While carrying out this study, we have been able to create awareness about the human resource accounting system among some of the executives of the companies operating in West Bengal. Further we would like to mention that the HRA practice was well appreciated by some of the executives and they tried to explore the feasibility of incorporating this practice in their esteemed organisation. We strongly hope that this study will add value to the existing literature in the field of human resource accounting and help in the resurgence of the practice.
References:

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