

Relationship between Human Capital and Firm Performance

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ABSTRACT

At present the concept of human capital is gaining attention in this competitive and global environment. Human capital is able to enhance the efficiency and gaining sustainable competitive advantage. For accelerating the economic growth both developing and developed countries taking necessary initiatives and efforts for improving and developing human capital. Development of human capital is necessary for attaining the competitive edge and for survival in globalization era. This paper highlights the impact of human capital on firm performance. Human capital refers to the individual skills, knowledge and expertise of the workforce to perform a particular task. The literature based paper shows some evidence that there is positive influence of human capital is on the firm performance as well as human capital is also helpful in attaining the competitive edge via improved workforce. Human capital plays a significant role in improving the productivity and outcomes also generate creativity and innovation among the employees and organization.

Keywords: Human capital, intellectual capital, performance of the firm, competitive advantage

INTRODUCTION

In the present scenario of the market companies are formulated by many competitors reckless of the industry. To enhance and develop the competitive advantage it is necessary for the firm to develop and train its workforce as competitive drivers. It is important to consider improved workforce productivity because it helps in attaining the competitive edge and enhance the value of the firm. Firms attempts to enhance the capability of their workforce through an extensive human capital development programme. It is also very important for the long run sustainability and survival of the firm. For achieving this goal, firms need to consider invest in human capital to clinch that their workforce has adequate skill, knowledge and competencies which is required to work effectively and efficiently in this competitive and rapid changing environment.

Human capital refers to the stock of knowledge, skill, competencies, capabilities and experience of the individual for producing an economic value. Human capital concept is mainly given by Schultz. Schultz (1993), the term “human capital” has been defined as a key factor in enhancing the firm assets and employees in order to raise the productivity and also helps in attaining the competitive advantage. To increase productivity and to sustain the competitiveness in the organization human capital becomes the essential source. Human capital defined as the processes that relates to education, training and some other professional initiatives in order to raise the standard of social assets, skills, knowledge, values and abilities of the workforce which will leads to level of satisfaction among the employees and their performance. Eventually leads to performance of the firm. Rastogi (2000) explains that human capital is

an essential input for every organization especially for workers continuous improvement gradually on skills, knowledge and abilities. So that the definition of human capital refers to as “the knowledge, skills, competencies and attributes embedded in individuals that facilitate the creation of personal, social and economic well-being” (organization for economic co-operation and development OECD 2001: 18).

For acknowledge of variation, most of the firms have adopted the human capital development programme to attain the competitive advantage and helpful in enhancing the higher performance of the firm. Now it becomes a necessary part of primarily exertion to attain the cost effective and improved firm performance. Therefore, firms need to be aware about the human capital programme that will help in attaining the improved performance of the employees as well as they will satisfy. Despite the fact that there is wider assumption that human capital has positive impact on firm performance, the idea of the performance for human capital remains mainly unexpressed. Therefore, this paper will highlight the relation between firm performance and human capital in the developmental economies. Hence the research question is used to show our examination to that at what level human capital creates its effects the performance of the firm.

The continuously changing business environment involves firms to reaches for higher competitive edge with this flexible business policy and plans which includes innovativeness and creativity. Innovation and creative workforce who is very essential for long run survival and sustainability of the firm input of human resource always plays a vital role in improving the firm performance and attaining competitive advantage (Barney, 1995). At a glimpse, the affluent studied were carried out on human capital and its significance on the firm performance were extensively enclosed and it is certainly improved human capital will lead to higher performance and competitive edge (Agarwala, 2003). For the time being, there is positive relation between human capital and performance of the firm, creativity and innovation (Dess 2005). For linking this performance of the firm's definition can be different from each other, on the other hand the clarification of the definition of firm's performance is in circumstances of improved human capital can be moving forward. In some of examples are financial performance of the firm can be measures in percentage of sales it can be resulting from development of new product, capital employed, profitability and (ROI) (selvarajan et al., 2007). Instead of return on investment, net income after tax and earning per share (EPS) they can also be utilised for analysing the financial performance of the organization (Grossman 2000). Incidentally the investigators also direct towards the standards of managerial accounting except financial measures in six attributes which are; quality (number of production error), productivity (payroll expanses divided by output), workers compensation (these expanses divided by sales), operating expenses (total operating expenses divided by sales), shrinkage (e.g. defects, inventory loss, sales return) (wright et. al., 2005). On the other side firm performance can also be assessed by using 'perceived performance approach' also referred to as subjective performance measures. In Likert scale like scaling is used to analysing the firm performance by the perspective of top management (Selvarjan, 2007).

As we are moving to the digital and technological world it is important for every organization to invest in human capital for attaining the competitive advantage and improving the firm performance. For attaining the competitive edge it is important that an organization should have innovative and creative workforce that can adopt changes easily and work according to the rapid changing environment. Human capital is helpful in generating new ideas, innovation and creativity among the workforce of the organization. As per the report generated by McKinsey (2021) the IT sector of India reached \$ 300 -

\$350 billion revenue in next five years. It is growing 10percent per year. It means that \$194 billion Indian Tech industry would be growing very faster than 7.5percent growth rate which is recorded in past 5 years. The growth of Indian IT sector is mainly from the sources of digital services, which is presently accounted for 30percent of the industry revenue. But its share goes upto 50percent over the next five years which is around \$170 - \$200 billion of the revenue for the industry. Financial year 2022 there are top 3 IT companies (TCS, Wipro and Infosys) are expected to offer approximately 1.05 lakhs job opportunities because of growing demand for new talent and skills in the environment. India's IT sector and services market is projected to rise up US\$ 19.93 billion by 2025(INDIA BRIFING).

OBJECTIVE OF THE STUDY

- To study the relationship between human capital and firm performance.
- To study the theory of human capital model.

RESEARCH METHODOLOGY

The study of human capital and its impact on the firm performance able to open up the few windows for the organization to aware about human capital and make it more innovative and creative. Human capital becomes the more valuable asset for every organization and able to achieve the competitive advantage. This paper is based on the secondary data. Data is gathered from articles, newspapers, journals and online websites of human capital and firm performance. This paper is a review paper.

LITERATURE REVIEW

There are two aspects which is focused by human capital is organization and individuals. The concept is further explained by Garavanet.al, (2001) that human capital have 4 main inputs which are as follows; enhancement of individual competencies, individual employability, flexibility and adoptability, development of organizational competencies.

The above inputs shows that it helps in generating the value for the organization and as well as for the individuals also. There are various studies that involve that human capital with greater competitive edge and greater performance and sustainable advantage. (Noudbharg 1998);, increased organizational retention (Robertson et.at.,1991), greater organizational commitment (Noudbhaug1998). Hence all of the above studies mainly focus on the organizational performance and individual of the organization.

From the level of individual, Collis and MontgoMery (1995), explains that the significance of human capital mainly depends on the extent it creates competitive advantage for the firm from economic point of view. Transaction cost implies that an organization can only attain the competitive edge when they have their own firm specific unique products that can't be replicated by other competitors. Therefore, as the innovation and uniqueness of human capital improve and increased. Firms should have motives to make invest in its management resources and through which they can capitalize on productive potential and less risk. For the reason individuals need to increase their knowledge, ability and skills in order to gain the competitive edge and survive in the market.

The theory of human capital gaining attention in every organization, they are aware about the human capital and investing in their human capital by the way of education and training to its workforce. Human Capital has fastest growing development and paying attention in training related aspects. It is mainly related to the individuals view point. Investment in human capital can be in any form that

improves the productivity and quality of the workforce. hence training becomes the important aspect of investment in human capital because it is experienced by the person through which his or her knowledge and skills gets improved and it increases the value of the firm as well. Training increases the capability of the individual and economic value.

There are some recent literatures that explain the significance of training the workforce of the organization. It is pointed that organizations have more trained and knowledgeable workforce have more competitive and more value of the organization. Less trained workforce of the organization has less competitiveness (Green 1993). On the other side higher human capital related with higher productivity and increased salaries of the workers. (Mincer, 1997) Whereas training is related to the long-term survival of the firm in the competitive environment (Bates 1990). Human capital has higher economic value, growth and greater tendency to business (Goetz and Hu, 1996). In addition to all human capital is not only to motivate and improve the morale of the employees of the organization but it also helps to create expenditure for research and development and creates a way to acquire new knowledge for the economy and society. And as well as for micro unit human capital is an important and valuable asset which is positively related with the performance of the organization. At the end we can say that investment in human capital via training is an important aspect for the personal and professional and social point of view.

Human capital is an important aspect at organizational level; it plays a significant role in strategic planning in the organization. It helps planning and how to create competitive advantage in the business environment. Snell work followed et. al., (1999). It explained that human capital of the firm has two dimensions which are unique and valuable. Firms point out that their resources become valuable when they allow capitalizing and effectiveness on opportunities and also aware about the threats of the organization. Human capital creates value for the organization in relation of effective management, focus on improving the value of the organization and profit comparison with the costs. Therefore, human capital of the firm can increase the value of the organization if it consumes lower cost and also helps in improved performance.

A further study done by Seleim, Ashour and Bontis (2007) evaluated on the relationship between organizational performance and human capital of the software companies. Authors find out that the human capital indicated a positive relation with the higher organizational performance. These pointers of human capital for example team work practice, training attended and it tends to result in superior performance of the organization whereas productivity can be increased for both organization and employees. It was also assisted by Dooley (2000) the author noticed a substantial positive correlation between the value of the market shares and quality of the developers. On the basis of the studies we can summarize that human capital pointers improved the firm performance in both the ways directly and indirectly.

A study done by Bontis and Fitzenz (2002) point out that the importance of human capital management and the authors entrenched the relationship between the economic growth, business performance and human capital management. In this research, the author collected data from 25 companies of financial services were selected. This study evaluated human capital effectiveness with its 4 metrics which are expenses factor, human capital rate of return, revenue factor and income factor. The main perspective of every organization are to create higher income for employees and for organization also. Human capital

provides a direct effect on the intellectual capital of the organization that is helpful in generating higher return for the organization which improves the financial position of the organization in the market. The development and growth of the human capital in the organization is affected by the training and educational levels of the workforce also improve their satisfaction. Hence, development of human capital has direct effect on rate of return of the firms.

There is another model of cross - sectional data developed by Selvarajane et al. (2007) explained that enhancement of human capital creates a route for creativity and innovativeness and it will result into a positive and higher performance of the organization. Meanwhile, performance of the firm and human capital can also be seen in the way of higher performance work systems (Hsu et al., 2007). It was indicated that implementation of human capital enhancement will surely lead to high performance rather than high performance work system.

There is no doubt that human capital development and its enhancement definitely creates an important contribution on the competition in the environment and also helps in attaining the competitive edge. It becomes a great step for creativity and innovation for the organization. Current review of literature explains that implementation of human capital in the organization helps in attaining the higher performance of the organization (Noe et al., 2003, Youndt et al., 2004). There are some other studies show that human capital development is reward to a greater and improved financial performance of the organization (Delaney & Huselid, 1996) and by adding the significance of organizational human capital with the performance of the organization was continued as assisted by Hsu et al., (2007). According to (Shrader & Siegel, 2007) there are some evidences that are collected by the authors that human capital to firm performance is becoming primary in this technology based new venture markets. It can be enhanced by human capital tools that are able to improve the quality of the employees. These small technologies based new ventures create its great effect on the firm performance.

Meanwhile, enhancement of human capital in terms of top management team also play a vital role for firm performance. Heterogeneity sometimes it is also called diversity it mainly results into a higher firm performance because the indication of heterogeneity promotes different types of characteristics that is to be noticed among the employees of the organization. It can be of any type for example; different age group of people, educational background, their functional background, gender and tenure. All of the mentioned factors can impact the firm performance positively which already studied by (Hambrick & Mason 1984), in his theory of upper echelon. The further research finds out that heterogeneity helps in generation of creativity, knowledge and innovation among the entire workforce of the organization (Watson et al., 1993; Maimunah, 2008). Heterogeneity provides better and creative solution of the problems (Micheal, Hambrick 1992). Therefore, diversity or heterogeneity can create better firm performance and according to total quality management firms can be evaluated by using its financial and non – financial performance. Financial performance involves market share, workforce productivity and defect rates whereas non – financial performance involves customer satisfaction, skill development, workflow improvement and innovation. (Kaplan & Norton, 1994),

Instead of this diversity is helpful in retain and attract the best talent available in the market and organization for attaining competitive advantage unique talent is necessary for the organization. Diversity also helps in cost reduction due to lower turnover, improving the market understanding and market ability, provide better solution for the problems at strategic level (Bantel, 1993). There are some more

studies that also provide some thoughtful information about the heterogeneity that effect the firm performance in positive way (Maron 2008). No doubt heterogeneity is in the form of human capital can make sure provide significant effect on the firm performance and also it is great input for human capital development its implementation in the organization make organization more creative and innovative for long run and attaining the sustainable growth at global level of the organization(Grossman 2000). According to (Huang et. al., 2002; Wu et. Al., 2002) explained that input of international human capital, output based human capital and transformational human capital provide assistant to the competency of the top management team. However, there are some studies that show that relation between organizational performance and innovative HR practices that are indirectly involved can be mentioned as a ‘non - linear’ (Barry, Becker 1996; Chadwick, 2007). Author empirically explores the impact of intellectual capital of Indian firms on firm performance. Here author explains the elements of intellectual capital involves human capital, structural capital, and customer capital all efficiently effect the performance of the firm it also able to provide firm competitive advantage(SheshadriChatterjee 2021). In addition of this there are few studies which that there is positive relationship between human capital and performance of the firm.it also explains the role of innovation speed and quality playing mediating role in firm performance. Data is collected from 328 high technology companies of China there are 3 elements of intellectual capital which are structural, operational and human capital all are positively related to firm performance in both ways operational and financial (Zhining Wang 2018). Author explains the concept of new data source which helps in access employee performance in real time it can also support in finding and development of knowledge stars that able to enhance the financial performance it also reinforces the firm capability. On the other side for big data analytics to be successful in HR field, ethical and regulatory challenges and threats also addressed for enhancing firm performance and workforce performance (R.H Hamilton 2020). Another research conducted on Indian listed firms are able to be performing well and efficiently using their intellectual capital, hence human capital has a major role in performance of the firm. It also explains the relationship of capital employed efficiency and structural capital efficiency both equally important for the growth of sales and market value of the firm. There is growing importance of intellectual capital is helpful in creating the values for the firm (NehaSmriti 2018). The research in conducted on employee of US public companies along with their skills, demographics and education. Author show that there is social skill set and technical both are negatively related to the operational and financial level of the firm (AnastassiaFedyk 2020).

World development report (2019) released that nature of work is changing rapidly and vast that able to get opportunities as well as risks for the organizations. There are various proofs that contained that human capital is the most powerful assets of every country. For attaining inclusive and sustained economic growth country needs to be highly skilled and innovative human capital. Inaction and awareness of human capital development is going up because a country can’t grow effectively without an innovative and creative human capital in this global economy. Human capital is very helpful in attaining the sustainable development in the organization. The author explains the continuity of operation, integrity, adaptability and ability to self - study and self - organization. Human capital has positive impact on firm performance and attaining the sustainable development of the organization (O Arefieva, O Polous 2021). A company can create uniqueness and innovation by launching new products to its customers and satisfy its customers by offering new quality products. It also results in higher incentives for workers these incentives and perks are able to improve the performance of the employees as well enhancing the productivity of the organization (David Krescynski 2020).

Theory of human capital

The main root of human capital theory is from the field of macroeconomics development theory (Schultz 1993). Becker’s (1993) classic book, human capital: A theoretical and empirical analysis with special reference to education illustrates this domain. Becker’s also argues that there are various types of capitals that involve schooling, a computer training course, medical course care expenditure. And in fact, lectures on the virtues of punctuality and honesty are also included in capital.

In the general sense, they also add to a person’s appreciation of literature, rise their earning and improve their health for life time. Therefore, it is fully in conformity with the concepts of capital as predominantly outlined to say that expenditures on training, education and medical care etc are capital investment. These are not directly costs but it can be calculated with valuable returns for the investment.

From the view point of classical economic theory, human capital views labour as a commodity that can be exchanged in terms of purchase and sale. The classical theory mainly focuses on the labour by the capital. However, in contrary the meaning of human capital related with the labour. Human capital considers the skill, knowledge and expertise one which compiles via training and education indicates the economic and social importance of human capital theory, (Becker 1993). It is eminent that investment in human being is the most valuable one in all types of investment because it helps in enhancing the standard of living and also enhancing the growth of the firm. Becker also differentiates the general - purpose human capital and firm - specific human capital. Whereas general- purpose human capital is knowledge obtained by education and training in the field of value to a variety of firms. These are the human resource development. the example of firm specific human capital are as follows; accounting procedures, expertise gained by education and training in the management information system and other expertise specific to ordinary firms. Despite of the application author considers the most important human capital investment is the education and training.

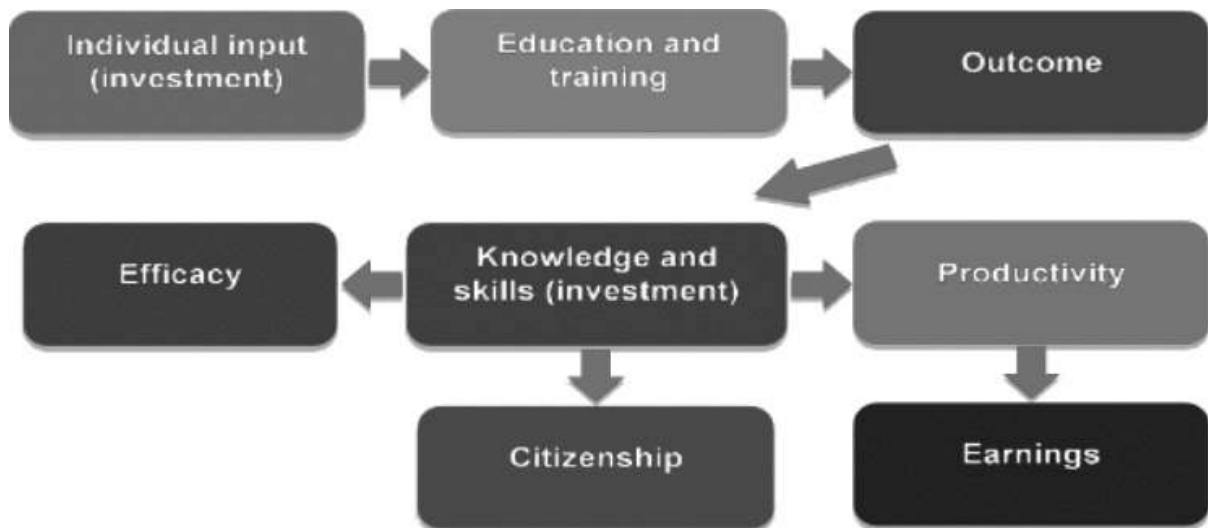


Figure 1 (Model of human capital theory)

(Source:- R. A. Swanson and E. F. Halton. 2001)

CONCLUSION

This paper explains the present scenario and literature of human capital and its effect on organizational performance. The concept of human capital is closely related to the basics of economics and performance of the firm. The review of literature explains that there are some strong and positive proof to show that the involvement of human capital in organization promotes creativity and innovativeness. And also provide higher performance of the organization. A study also shows the result of positive financial performance improved by the human capital consideration in the organization. Human capital is very crucial for the organization and its performance it is able to create innovation and creativity among the workforce of the organization through which the employee retention ratio is reduced and employees are more satisfied with the organization. For investing in human capital, it results into the growth of the organization as well as helpful in the growth of the country. The concept of human capital gaining attention now a day because it leads to improve the standard of living of the employees and their skills and knowledge. After discussing all the reviews of human capital firm performance we can say that human capital is major factor for improving firm performance hence, it has positive relationship.

In light of this to understanding the concept of human capital in relation to firm performance should not be regarded as phenomenon that only adds 'more zeros' in the firm's profits but it also transforms the organizational workforce in the most valuable assets. Through which an organization can create its uniqueness in the market and achieve competitive advantage via creativity and innovativeness. Therefore, companies should plan some effective strategic way to investing in human capital which is not only helpful in achieving the greater firm performance but also investing in human capital ensure firms survival in long run in this competitive environment.

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