REVIEW OF DIFFERENT METHODS OF VALUING HUMAN CAPITAL

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ABSTRACT

Human capital is an important asset for all types of organizations. Interestingly its valuation is not reflected in the Balance Sheet unlike other assets like land, building, machinery, stock and others. However, regular attempts are seen on the part of economists to value human capital. This article carries a review of the different methods that have been put forward for valuing human capital. The methods can be broadly divided under two headings – monetary and non-monetary. Monetary methods are based on the economic value of the human assets. Non-monetary methods consider other factors like productivity of the human resources in arriving at their valuation. It is felt that organizations should value their human assets notwithstanding the fact that they are not considered in the Balance Sheet. The valuation will lead to measurement and what gets measured gets managed better.

Keywords: *Human capital, Valuation, Monetary methods, Non-monetary methods*

Introduction

What gets measured gets managed better. On the other hand what doesn't get measured, its management may not be effective. Human capital is an important input for all types of organizations. The human resources carry an economic value and they lead to value addition for an organization. Despite this, the valuation of human capital has remained a debatable issue with not much of an agreement amongst economists and accountants as to which method should be applied for the valuation. This article carries a review of the different methods that have been put forward for valuing human capital. The methods can be broadly divided under two headings – monetary and non-monetary. Monetary methods are based on the economic value of the human assets. Non-monetary methods consider other factors like productivity of the human resources in arriving at their valuation.

Literature Review

Ghasemi et al. (2018) in their paper propose an improved economic value model for human resource valuation. For this purpose, the probability of promoting people to a higher position and the satisfaction coefficient of employees and customers have been computed by competency and Kano models. The human resource value of the company under study has been estimated over 29bn rials (Iranian currency). The obtained results indicate that the proposed approach as an integrative monetary and nonmonetary measure can remove the limitations of the economic value model.

Fulmer and Ployhart (2013) propose a multilevel organizing framework to facilitate the linkage between the financial valuation issues highlighted in our review and the recent literature on strategic human capital/strategic human resource management. Based on the insights drawn from this review, we then propose a series of next steps or "action items" to stimulate future research that holds promise for yielding both new theoretical insights and important practical implications for organizations.

Bessong et al. (2012) conclude that human resources cost approach to corporate performance measurement which have gained substantial attention and use in recent years provides further opportunities for utilization of human resource accounting measures. The study therefore, recommended that banks should use career management programs to assist their employees in career planning.

Flamholtz t al. (2002) provide an overview and history of human resource accounting (HRA) with the objective of promoting both continued academic research and organizational applications. The history of HRA illustrates how academic research can generate improvement in management systems. The paper defines HRA and suggests implications of measuring human capital for financial reporting and managerial uses. Recent Swedish-based HRA applications with respect to measuring human assets and intellectual capital, including the Skandia Navigator, illustrate how intellectual history and developments in business schools can influence business history.

Ojokuku and Oladejo (2015) establish that HRA information as a key driver of strategic human resource planning and budgeting by being a key source of input in making meaningful choices between various types of human resource investments, and investment in other assets. The use of HRA is however limited by lack of universal approach to its reporting and low level of awareness and acceptance of the technique.

Arkan (2016) write that historically, accounting has not recognized human resources as an asset in the statement of financial position, because of a dearth of acceptable metrics applicable to people under employment, and also due to a lack of suitable models for use in attributing a value to a human resource. Clearly, a knowledge gap of this nature raises questions for accounting practices where human capital is the focus. Human resource accounting has the potential to provide an alternative solution helpful to management decision-making especially regarding the adequacy of human resources when viewed within a financial health framework.

Akpan (2014) in a study examined the impact of human resource valuation on corporate performance. The major objective of this work was to explore the extent to which human effort could be recognized as asset and also seek for the need to disclose them in the financial statement.

Different methods of valuation

Methods of valuation of human capital can be broadly grouped under two categories – monetary methods and non-monetary methods. Monetary methods are those which take into account the cost or economic value of the human resources. Some of the popular monetary methods are described below:

1. Historical cost method: This method is created by RensisLikert. Under this method, all real costs brought about on enlistment, preparing, acclimation, and so forth, are capitalized. Then, at that point, the capitalized cost is amortized, or say, discounted over the period a worker serves in the organization. On the off chance that the employee leaves the organization before his normal help period, the leftover sum is discounted totally in that specific year of his/her leaving the organization. The benefit of this method is that the worth of human resource can be displayed on customary Balance Sheet and Profit and Loss Account. Notwithstanding, its disadvantage, if by any means, is that human resource is compared bringing about under-valuation.
2. *Replacement cost method:*As the actual title demonstrates, under this method, replacement cost alludes to the cost of supplanting a current worker. At the end of the day, supplanting cost is the cost that would cost to replace the current human resources with human resources fit for delivering identical administration. Here, the fundamental costs remembered for replacement cost are the cost of recruit-ment, preparing and improvement, opportunity cost for the mediating time frame till the newcomer accomplishes the productivity level equivalent to that of the old (to be replaced) employee. Thusly, this method helps the administration during the time spent human resource anticipating the organization by making the data accessible on costs to be engaged with the procurement of individuals in future. It could be said, this method is conflicting with the 'historical cost method'. That there may not be comparative replacement cost for a specific asset and the executives may not replace the current human asset on account of its more noteworthy worth than that of scrap esteem are a portion of the downsides of this method.
3. Opportunity cost method*:*This method is utilized to value employees having specific skills and, accordingly, is uncommon in accessibility. Managers ready to get such scant employees offer bid prices. One who at long last gets the scant employees places the bid price as his interest in such employ-ees. The bid price is shown up at ascertaining real or expected rate for capitalisation of the alleged income to be acquired by such employees. Clearly, in the event that an employee can be recruited effectively, there will be no open door cost for him/her. The principle disadvantage of this method is the shortfall of a very much

advocated standard to choose how much the bid, or say, offer.

4. Asset multiplier method:This method depends with the understanding that there is no immediate connection between cost caused on a worker and his value for the organization. This is on the grounds that the value of aemployee relies upon factors like inspiration, working conditions and their disposition toward work and organization. In this method, all employees working in an organization are comprehensively grouped into four classifications; viz., top management, middle management, supervisory management and operative and clerical staff. The salary bill of every classification is duplicated with fitting multiplier to discover the complete value of every class for the organization at a given place of time. Here, multiplier is an instrument that relates the individual worth of workers with the absolute asset values of the organization. According to guideline, the value of human asset should coordinate with the value of generosity. Irregularity in the value of human assets in contrast with generosity is characteristic of incorrectness in multiplier that ought to be changed likewise.

5. Economic value method: Under this method, human asset is valued based on the commitment they are probably going to make to the organization till their retirement from the positions. The pay-ments made to them as pay, recompenses, benefits, and so on, are assessed and then, at that point, limited properly to show up at the present financial value of the people.

Non-monetary methods consider other factors like productivity of the human resources in arriving at their valuation. Two methods under this category are explained below:

6. Expected realizable value method: Under this method, the components of expected feasible value of employee are estimated through social measures. For instance, the efficiency of a worker can be estimated by utilizing objective files and administrative evaluation. Psychometric tests and abstract evaluations can be utilized to quantify the promotability and adaptability of employees. Likewise, mentality overviews can be utilized to gauge worker fulfillment, inspiration, and so on.

7. Discounted net present value of future earnings: This method is propounded by Rensis Likert. The method depends on three factors easygoing, transitional and yield. As per Likert, the adequacy of human capital/resources can be estimated by utilizing these three factors. Relaxed vari-ables, for example, administration style and conduct influence middle of the road factors, for example, morale, motivation, obligation to work, and so on, which, thusly, influence yield factors like production, sales, profit, and so forth

Conclusion

The reason for human resource (HR) accounting is to relegate a monetary value to either individual employees at an organization or the organization's labor force overall. Since prepared and useful employees are important to an organization, they are now and then alluded to as human capital. There is no authoritative method for computing the value of anemployee, and HR accounting utilizes a few unique methods. Every one of the methods has its own benefits and impediments. It is felt that organizations should value their human assets notwithstanding the fact that they are not considered in the Balance Sheet. The valuation will lead to measurement and what gets measured gets managed better. As multiple methods are available, organizations can employ more than one method and take an average value of the different methods as the human capital valuation.

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