PART ONE
Strategic management of people, organization and relationships
Locating the value in people management

Introduction

In Part 1 of this book I will introduce you to the nature and importance of social relationships. Parts 2 and 3 will then describe how organizations can enable and develop these relationships. First, however, I need to clarify how the management of people in an organization, including the development of the relationships between these people, really works – where the value gets created.

Therefore, in this chapter I outline a value chain that can be used to describe all organizational and people management activities within a business, as well as to link these activities to the outcomes they create. This organization value chain helps explain why people and people’s relationships are as important as they are, and why we need to focus on the outcomes we create via this chain. It also helps distinguish the social outcomes that need to be created by a social organization.

Value chains are important and popular tools already used in many businesses and so I first want to set the scene by explaining a couple of other value chains that you or your business colleagues may be familiar with and might be using. I can then explain the organization value chain in the context of these other models. I think it is really important to understand this value chain, so please do read on.

The business strategy map

The easiest way for me to introduce this section is to refer you to the most prevalent planning tool used in business, which is Robert Kaplan and David Norton’s business strategy map, built upon their even more commonly used
measurement tool, the balanced business scorecard (Kaplan and Norton, 2004). This suggests that there are four perspectives that each need to be incorporated into a business strategy. These are usually identified as learning and growth, business operations, customers and financials.

The idea is to identify a roughly equal, or balanced, number of objectives in each of these perspectives, and also to describe the flow through them, i.e. how what a business does in learning and growth informs what it can achieve in operations, which leads on to its success with customers and finally on to its financial results. The learning and growth perspective includes anything that needs to be put in place before a business can perform its operations effectively. This includes all the people and relationships objectives this book is going to focus on. In fact many organizations simply label the learning and growth perspective as people.

The business strategy map also gets referred to as a value chain – the top-level process of any business. It suggests that what a business does is to use people to perform operations so it can satisfy customers, because doing this produces financial results. It is important to note that there are a number of variants around this model, particularly in the public and voluntary sectors. Here, for example, stakeholders can replace customers; mission can replace financials; or the order of customers and financials can be swapped around. This indicates that financial success is important but only to the extent that it enables an organization to service and satisfy customers.

With these few broad variations, this value chain sounds like it could apply to just about any business. It is also very high level, which is why it can be applied so broadly. But there are also a number of more detailed or specific value chain models, which all look a bit like the model in Figure 1.1.

**Figure 1.1** Generic value chain model
**The financial value chain**

The best well known of these more specific models is management guru Michael Porter’s business or financial value chain (Porter, 1985). This suggests that there are a number of primary activities that lead directly to margin, profitability and growth. For a traditional manufacturing company these primary activities might be procurement; manufacturing; distribution; sales; and customer service. Other sectors will have substantially different value chains. Even companies within the same sector will have different value chains that reflect their own particular business strategies.

To help companies align their value chains with their business strategies Porter suggests businesses need to choose between a couple of generic strategies: niche or differentiation, and cost leadership. These are about the products or services offered by a firm. Differentiation is about providing a product or service with a unique feature. Not all potential customers will want this feature, but enough will and those who do will be prepared to pay extra for it. This means that every time the product or service is sold the firm makes more margin, hence is more profitable and can grow more quickly, eventually taking over its rivals and becoming a monopoly. Cost leadership is about providing the same product or service as everyone else but doing so more cheaply, which also leads to higher margin, profitability and growth.

There are also a number of secondary activities in the value chain. These do not contribute directly to margin but support the effectiveness of the primary activities in doing this. One of these secondary – or support – activities is people management, or HR. A company that only uses Porter’s approach, therefore, defines people management as a support activity, and HR as a support function.

Porter suggests that the only way a company can gain competitive advantage (or for organizations in the public/voluntary sectors to transform the type and level of services that are provided) is to use his value chain. However, there are already other value chain models available too.

**The customer value chain**

A particularly important alternative or addition to Porter’s model is the customer value chain. This focuses on attracting and retaining customers and building more business from their custom. Marketing professor Francis Buttle (2003) proposes that this consists of customer portfolio analysis; customer intimacy; network development; value proposition development; and managing the customer life cycle.
You can see why this chain is important through a profitability analysis, shown in Figure 1.2. A business can increase profits by increasing prices and therefore revenue or by reducing fixed and/or variable costs. Or it can increase turnover to shift the point at which margin is calculated over to the right. It can do this either by increasing the number of its customers, or by increasing loyalty and encouraging each customer to spend more. This is an approach followed by firms such as Apple, Marriott and Southwest Airlines. The strategy makes good sense, given that analysis completed by Bain’s Frederick Reichheld, which led to the development of the Net Promoter Score, suggests that a 10 per cent increase in customer retention can count for a 125 per cent increase in customer value (Reichheld, 2003).

**Figure 1.2  Customer profitability analysis**

This model is a value chain. But unlike Porter’s model it does not deal with building products or services. Instead it deals with maximizing customer spend when they then buy the products. The customer value chain happens before the financial one. In fact it applies to the customer perspective in Kaplan and Norton’s strategy map, whereas Porter’s value chain covers the financial perspective in the strategy map.

**The operations value chain**

There is another value chain in the operations perspective of the strategy map as well. This deals with improving the way the business works, leading to a fit-for-purpose business model, and in particular the quality, alignment and
effectiveness of its business processes. It is not about executing these – that is included in the customer and financial value chains – it is about improving them in advance of their execution.

You can also think about the outputs of the operations value chain as core competencies. These are bundles of business processes plus supporting technologies and intellectual capital (patents and knowledge) that enable a business to do certain things well. Authors Gary Hamel and CK Prahalad (1996) write about US manufacturing company 3M as an example of this type of approach. 3M has well-developed and aligned business processes, technologies and intellectual capital in glues, substrates and adhesives and competes largely on developing these core competencies through the operations value chain rather than the customer or financial ones.

The activities included within this value chain focus on improving process quality and alignment across the organization. A good example is the use of six sigma techniques to reduce process variance. It is these types of activities that are the main focus of quality and business excellence award programmes such as the Malcolm Baldrige National Quality Award (particularly the operations focus) and the EFQM Excellence Model (particularly the processes perspective).

**Linking value chains**

Finally, or firstly if looking at the value chains in a sequential order, there is the organization value chain. This corresponds to Kaplan and Norton’s (2004) learning and growth perspective. I want to spend a little longer describing this particular value chain, given that it will now be the focus for the rest of the book. However, before I do this I would like to tease out eight key points relating to the overall strategy map and the four constituent value chains:

1. Each of the four value chains I have described link to a particular perspective in Kaplan and Norton’s (2004) strategy map.

2. The primary steps in each value chain consist of inputs (bringing new raw materials, potential customers or other resources into a business); a set of activities (transforming these inputs in some way); and some outputs and outcomes (for me, outcomes are simply the most important outputs).

3. Each value chain also has a number of secondary – or support – activities, which will generally include people management (though not in the organization value chain).

4. The outcomes from each value chain are a form of capital, or some store of value. The capitals I have described so far are financial capital (the
pool of funds available to a business); customer, brand or relationship capital (the value of a business’s relationships with its customers); and business excellence, core competencies or business process capital (the value provided by the quality and alignment of a business’s operations). I will go on to introduce organizational capability as the outcome of the organization value chain.

5 All four value chains are about differentiation or cost leadership. I referred to these options in the section on Porter’s financial value chain and they apply just as strongly to the other three chains too. Business success is not just about having the best products or services, customer service, business processes or people management activities – but the right ones!

6 The inputs to each value chain include the outcomes from the previous value chain (the one to the left of it – see Figure 1.3). So brand capital is an input or enabler to the financial value chain; business excellence is an input to the customer value chain and organizational capability is an input to the operations value chain. This is shown in Figure 1.3.

Figure 1.3 Links between value chains

7 This means that the value chains towards the start or the left-hand side of the strategy map have the potential to make the greatest contribution to business success, as they perform an important role in their own right.
and also inform all the other value chains that follow. An action in the organization value chain will have an impact on organizational capability but also benefits from a multiplier effect on the other three value chains too.

Because Porter’s value chain is the best known of these models, people often assume that the value provided by people management is described adequately by its role as a support activity within this value chain. Nothing could be further from the truth. People management does support the three most right-hand value chains, but it has the greatest impact and performs its most strategic role in the organization value chain.

The organization value chain

The organization value chain describes the inputs, activities and outcomes that relate to the management of people within an organization. I call it the organization value chain because it applies more broadly than people management as it also includes how people are organized and how their relationships are developed and maintained. I also use the word ‘organization’ when focusing on the activities within the organization value chain, whereas I use the word ‘business’ to refer to activities in the operations, customer and financial value chains. This applies to commercial businesses and to non-commercial ‘businesses’ in the public and voluntary sector that might normally consider themselves organizations rather than businesses.

The organization value chain is a little harder to understand than the three I have already described as so much of what we create in and around people is intangible. It is for this reason that the organization value chain is often equated to a black box, and developing an understanding of how it works is likened to opening the box’s lid and peering inside. Nevertheless, our understanding of what is in the black box dates back until at least 1984 when Michael Beer at Harvard developed what is called the Harvard Model (Beer et al, 1984). This suggested that human resource management (HRM) policy choices (activities) had value by aligning to stakeholder interests and situational factors (both inputs) to produce HR outcomes – commitment, competence, congruence and cost effectiveness. It is these outcomes that then enable the rest of the business to produce long-term consequences, including financial results.

More recently David Guest at Birkbeck College, London, as part of his work on the future of work, has proposed that HR practices (activities) need to be aligned with business and HR strategies (inputs) and then cascaded through an effective HR function to produce outcomes – employee competence,
commitment and flexibility. These then lead on to the quality of goods and services, productivity and financial performance (Guest et al, 2001).

More recently still, John Purcell and colleagues at University of Bath concluded that HRM activities produce organizational levels of ability, motivation and, most importantly, opportunity to participate (outcomes). They place an emphasis on the last of these ability, motivation and opportunity (AMO) factors to note that we often employ relatively able and reasonably committed people and then put them in dysfunctional organizations that stop them contributing! The three outcomes are cascaded through an individual line manager’s style to produce employee commitment, motivation and job satisfaction. These lead to the delivery of discretionary occupational citizenship behaviour, ie whether people do the right thing when no one is looking (Purcell et al, 2003).

All three research findings, and other studies, all say much the same thing, which is shown in Figure 1.4. People management in the organization value chain is about using inputs to perform activities leading to outcomes.

**Figure 1.4** The organization value chain

<table>
<thead>
<tr>
<th>Inputs</th>
<th>Activities</th>
<th>Outcomes</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Existing workforce</td>
<td>• Recruitment</td>
<td>• Human capital</td>
</tr>
<tr>
<td>• Time of business leaders and line managers</td>
<td>• Learning and development</td>
<td>• Organization capital</td>
</tr>
<tr>
<td>• Budgets</td>
<td>• Performance management</td>
<td>• Social capital</td>
</tr>
<tr>
<td>• Capability of HR function</td>
<td>• Organization design and development</td>
<td>• Organizational capabilities</td>
</tr>
<tr>
<td>• Technology</td>
<td>• Employee relations</td>
<td>• Other outcomes</td>
</tr>
</tbody>
</table>

**Inputs**

Inputs include the initial states of people and the organization before we take action to change these states. Inputs also include the resources we need to have in place before we take these actions. That is, inputs are anything we need to have or do before we perform our activities, and which inform
these activities. Examples include a budget, management time, sponsorship of business leaders, capable HR professionals, good HR technology and so on. Inputs can also be processes (see below).

An interesting example of an input is an employer brand – which we need to have in place before we implement a recruitment process, or an internal engagement process. This has always been important to our effectiveness in these process areas but changes in the way we manage people are making it even more important too. Examples of this are included throughout the book.

**Activities**

Activities are the actual things we do, building on these inputs and leading to the creation of outcomes. They include the HR processes and practices spanning across the employee life cycle. They are also the organization design changes and the organization development interventions we undertake.

One way to categorize these activities is by using the McKinsey 7S organization model. This is the most popular holistic model of an organization used within organization design. The model is popular partly because it originated with the management consulting firm McKinsey and also because Tom Peters and his consultancy colleagues were quite clever in picking seven levers available within an organization that all begin with the letter ‘S’. These levers include the ‘hard triangle’ of strategy, structure and systems (meaning processes, including IT systems), and the ‘soft square’ of staff, skills, style and – in the centre of the model – shared values (or superordinate goals). The 7S model is used primarily for change management not organization effectiveness, so each ‘S’ refers to change activities not just to the results of the changes within that area. For example, the staff element can focus on activities such as implementing new management development programmes as well as describing the actual quality of the people working in the organization (Waterman, 1980).

**Outcomes**

Outcomes are what we create using the above activities. They are the qualities we develop in our people and organizations such as competence, commitment and opportunity to participate. They are also what the rest of a business uses to create business success in the other value chains, culminating in the financial results.

There are three types of outcome or aspects of organizational capability that are produced in the organization value chain. These are human capital,
organization capital and social capital. The inclusion of human capital is why I sometimes refer to the organization value chain as the human capital management (HCM) value chain. However, it is important to remember each of the three types of capital produced in this value chain as they are each quite different from the other.

First, human capital is the value organization’s gain from their people’s own resources or capabilities (their own individual human capital), including their abilities, level of engagement, wellness etc. It is also based on the level of diversity across the workforce.

Whilst human capital is formed out of the qualities people own inside them it is not just another name for people – it is the value these people provide. For example, you could imagine there might be a group of people who could offer substantial amounts of human capital to one organization that needs the skills these people could provide. But the same group of people might provide no human capital at all to an organization down the road if this second firm does not need the skills these people can provide.

Second, organization capital is the value of the way people are organized to get work done, including their alignment and enablement. It is based mainly on the harder, more tangible aspects of an organization, particularly its structure and systems/processes.

It is useful to understand that processes can form part of organization capital or other outcomes, but they can also be inputs or activities leading to these outcomes. Which exactly depends on their relationship to organizational and business outcomes. If a process leads directly to the production of business results in the operations, customer or financial value chains then it is an outcome in the organization value chain. An organizational budgeting process would be an example of this. If, however, a process leads to an organizational outcome then it is an activity. A recruitment process that provides people and human capital is an example of this. If it does not even lead directly to an outcome – if it only supports another process – then it is an input. An example of an input process might be leadership development which in one context might not create outcomes by itself. Instead, it might be used so that leaders and managers become more competent in their roles, helping them to maximize other processes such as performance management. It is the performance management process that is an activity. This is because this is the process that creates a useful outcome in terms of better skilled and managed people working in the business.

Designing the right organization may not always be as important as getting the right people (hence the old adage, ‘the right people in the wrong organization will still get the job done but the wrong people in the right
organization won’t’). However, even then the organization can still have a large impact on business performance.

Finally, social capital is the value provided by the connections, relationships and conversations taking place within the organization. This is based on the way people work with each other and the effectiveness of teams, networks and communities. It is often the most important basis for the way people work in an organization, the beliefs they live by and the values they demonstrate. Social capital is also what people often mean when they talk about culture.

It is important to note that the words ‘value’ and ‘capital’ do imply a direct financial worth. They simply mean that we are interested in the aspects of people and organization that are important to a particular firm. However, all three capitals do lead on to financial value through their impact on and through the other three value chains. Therefore, they have an indirect impact on financial value rather than a direct financial value of their own.

It can also be useful to think about organizational capabilities. These are the few, differentiated outcomes at the top level of the organization that will be strategically useful in creating competitive advantage. Capabilities are similar but also different to the core competencies produced in the operations value chain. Using the analogy of an individual working in an organization, the person’s leadership abilities will be broadly similar to organizational capabilities, while their functional or technical competences will be more like the organization’s core competencies.

Capabilities will generally include a combination of human, organization and social capital, though they will also sometimes focus predominantly on just one or two of these sources of value. The social organization focuses on the creation of social capital as the most important aspect of organizational capability.

The differences between outcomes, capital and capabilities are summarized below:

- Outcomes are important outputs in any of the four value chains. People and organizational improvements are outcomes. Other benefits obtained within the organization value chain (for example, revenues from having other organizations attend an internal training course) may be outputs but are not outcomes.

- Capital relates to outcomes that investors or other stakeholders care about, generally because they are either large scale or are particularly important.

- Capabilities consist of instances or combinations of the three capitals that contribute to the strategic success of a business.
We will probe further into the outcomes of the organization value chain in Chapters 3–4 and the rest of the book will then focus on the development of social capital.

**The need to shift focus from activities to outcomes**

Hopefully this value chain, building on inputs and activities to create outcomes, will resonate for you, as it is what all organizations do. However, it is not how we usually think. I see this whenever I work with business executives on their business strategy maps. When I look into the learning and growth perspective I will always find plenty of objectives for activities but very rarely anything for inputs or outcomes. Similarly, when working with HR or others on people management strategies I will find the same focus on activities and a similar absence of objectives for inputs and outcomes.

There is a reason for this, which is that in our psychology we pay more attention to things that we can see, touch and describe – things that are tangible – than things we cannot as they are intangible. This is part of the halo/horns effect, which explains the way that our perceptions about people and things are framed by the most readily available information on them (Rosenzweig, 2007). Many of the outcomes of people and organizational activities are intangible so we tend to pay more attention to the tangibles (ie the activities) than the intangibles (ie the outcomes). But doing that is a mistake.

We need to have a more balanced approach to setting objectives, including targets for inputs and outcomes as well as activities. Shifting focus from activities to outcomes is particularly important as it provides three important benefits – becoming more strategic, being seen as more credible and creating value – as set out below.

**Becoming more strategic**

First, focusing on outcomes tends to make HR and people management more strategic. The outcomes in the organization value chain are our deliverables. It makes no sense to ignore them. Doing so is a bit like a car manufacturer paying all their attention to their engineering and manufacturing operations but not bothering to check on the finished vehicles.

In addition, if we focus on activities we tend just to do more of these activities. (If you have a hammer every problem seems to become a nail.) My best example of this comes from my time working as HR Director at Ernst & Young (now EY) in the UK when the international firm announced that 90 per cent of its development activities would in future be provided
by e-learning. In my view, doing this was a mistake, contributing to lots of fairly boring e-learning (a common experience back then and which still puts many people off e-learning even today, despite how far this technology and the solutions that are available have improved). The problem occurred simply because we were developing strategy by looking at the activity of learning, not the outcomes we needed to achieve.

The common alternative to just focusing on activities is to try to connect activities and business results, ie to miss the outcome step in the organization value chain. Unfortunately this tends not to work that well either. It is actually quite hard to look at the business objectives of a firm and then identify what HR activities will support these objectives. It is a lot easier, and results in better alignment, to ask what organizational outcomes will support and enable these business objectives, and then what activities will create those outcomes.

I like to explain this by looking at performance management. I do not particularly like competency frameworks but I think one benefit they provide is helping to connect performance objectives and training needs. So, if a manager and employee sit down at the start of the year and the performance management system asks a manager to identify six specific and measurable objectives, most managers can give this a decent go. However, if the next page of the form or system asks them to identify the training that will help that person to achieve their objectives, many managers will struggle – and the person does not get any training.

It is easier if the second page of the system asks what competencies will help the person to achieve their objectives. Most managers can do this. And then if the third page asks what training does the person need to develop these competencies they can do that too. Result – the person gets more training to support their competencies to achieve their objectives. These two systems are asking the same thing, but without the use of competencies there is just too big a conceptual jump between what the person needs to do and the training they need in order to do it. Competencies help cut down the time and distance between the work and training objectives and make each question smaller, making them easier to answer and providing greater alignment too. It is the same with the organization value chain. It is actually quite hard to look at the business objectives and then say what HR activities will support these objectives. It is a lot easier, and results in better alignment, to ask what outcomes will support and enable these business objectives, and then what activities will create those outcomes.

Aligning activities with outcomes also helps ensure that these activities are best fit, rather than simply best practice. This means that they are designed
to be appropriate for a particular organization, its strategy and context etc, rather than just copied from what other organizations are doing. This is particularly important as many of our current best practices are not even that good, never mind best! But there is also a growing amount of evidence that what is important to organizational success is best fit, not just best practice.

My favourite example of this comes from John Boudreau and Ed Lawler at the University of South California (Lawler and Boudreau, 2015). Their research into global trends in HR suggests that the effectiveness of HR activities depends upon the business strategies that are being followed. A very relevant example for the social organization is that a business following a strategy focused on innovation would seem to benefit strongly from investments in social networking activities and systems (correlation coefficient $r = 0.33$). However, investments in employee relations correlates in reduced performance for these same innovation-focused businesses ($r = -0.16$). That is not an issue with employee relations – other businesses, for example those using a sustainability-based strategy, would seem to benefit from investments in this practice area ($r = 0.16$). The research indicates that what matters is not best practice, it is best fit.

**Being seen as more credible**

As well as making us more strategic, focusing on outcomes makes those of us who focus on people management, eg in the HR department, seem more credible. People who create something are always seen as more valuable than people who just do something. For example, HR practitioners will be seen as more impactful if they talk about raising commitment or the skills of the sales forces rather than if they talk about running communications briefings or delivering training courses.

In addition, one of the major challenges faced by many HR practitioners in raising their credibility is showing that they are accountable for something important in the organization. In fact many business leaders question whether HR is accountable for anything at all, and if they are not accountable, whether the function can be abolished.

It is easy to see how we have got to this situation – HR is obviously accountable for the design of the quality and effectiveness of HR processes but no one cares very much about that. More important is the use of these processes, but it needs to be line managers who are accountable for the bulk of this as they are the people who implement the processes. It is important to remember this point. When HR tries to be accountable for delivery of activities we end up taking a policing role, which can substantially interfere with our desire to be strategic. There is also a need in most businesses
to strengthen line managers’ accountability for the operation of these processes, which often makes HR wary of taking accountability in case this further reduces the accountability that line managers are taking.

HR is also clearly not accountable for business results (though we do play a role as a support function in helping to produce them). So if we only focus on organizational activities and the broader business objectives we very naturally end up not taking accountability for anything important. Outcomes give us a way to square the circle – to take accountability for something that is absolutely critical to business performance – the outcomes in the organization value chain. This is not about accountability at the individual team or department level. It still needs to be team leaders, line managers and business leaders who take accountability for the people in their teams and units. But we can take accountability for the outcomes we develop across the whole organization. For things like the overall levels of skills, engagement and people’s propensity to collaborate. And if we do not do this, who will?

Note that I am not suggesting HR should take more responsibility for delivering people management activities. But HR can, and I strongly believe should, take accountability for providing the capabilities our organizations need to be strategically successful. Therefore, the HR practitioners in my earlier example will be seen as even more credible if, as well as talking about the increase in sales skills, they put their jobs on the line and accept there will be consequences if they do not succeed in ensuring that this change is delivered. We need to focus on outcomes because that makes it more likely that we will talk about, and take accountability for, these outcomes too.

Creating value

Finally, outcomes provide the most important basis to create value through people, which will be the focus of Chapter 2.

The changing nature of competitive success

The fact that each of the four value chains I have described correspond to a step or perspective in Kaplan and Norton’s (2004) strategy map can be considered to mean that these are simply more detailed processes operating at the next level down below the top-level process provided by the strategy map. However, the four value chains can also be seen as alternative top-level options that each stress different sources of competitive value.

Traditionally, companies have competed through Porter’s generic strategies in the financial value chain. However, if you review the literature on strategic
management my suggestion would be that we have developed three other main schools of thought about strategic success since Porter’s model was developed. This does not mean that Porter has become any less popular. One of the best-selling business books since the start of the new millennium has been W Chan Kim and Renée Mauborgne’s *Blue Ocean Strategy*, which largely restates the case for Porter’s competitive positioning (Kim and Mauborgne, 2005). However, this is no longer the single model for competitive strategy.

The first alternative basis for strategy to become popular was customer first. As shown by the customer value chain this approach is much more significant than simply pushing customers to buy more product in the financial value chain. It is about investing in customers, growing their number and their loyalty in terms of the percentage of the lifetime spend provided to the company. Some companies prefer to put their focus here rather than focusing too much on the products they are selling. Of course the financial value chain is still important, but for many companies following this strategy there is a belief that if they get close enough to their customers then these businesses or individuals will help them develop the products that they need.

The second alternative approach to competitive success is internal resource-based strategy, and in particular development of the resources called core competencies promoted by business thinkers Gary Hamel and CK Prahalad, as well as others. As described earlier, core competencies are bundles or clusters of business processes, technologies and intellectual capital that are created in the operations value chain. A little like my description of the customer-first approach, the idea is that if you create the right core competencies the more the financial value chain starts to take care of itself.

So, for example, 3M marketers and researchers do not worry too much about studying the types of glues made by their competitors, or trying to find a new niche. They just focus on innovating and experimenting with different types of glue and glue-making processes, believing that if they do this they will develop the products that their customers need. This of course actually happened with Post-it notes, which were developed when 3M found a clever and profitable use for a glue that did not stick.

Hamel suggests that given the rate of change in business, competitive positioning is no longer a sustainable basis for competitive advantage. Competitors can copy your differentiated or cost-leading products or services, but they will find it much harder to copy your business processes and technology or core competencies.

The last alternative approach is the development of organizational capabilities, which I have also referred to previously and will return to again in Chapter 2. Capabilities are based on the value provided by people and their
organization. Although there may be some overlap between organizational capabilities and core competencies, capabilities have a clear bias towards the organization value chain whereas core competencies focus much more on the operations value chain.

The concept was first introduced by Igor Ansoff (1965). Whilst best known for his product-market grid, his contingency model also refers to firm-level capabilities, which includes organizational values, managerial competencies, organizational structure, processes and technology. More recently, most of the thinking around capabilities has taken place in HR. HR’s chief guru, Dave Ulrich, suggests that capabilities are things an organization knows how to do well. For any organization to compete successfully in today’s market, it must focus on building not only from the outside but from the inside too (Ulrich and Lake, 1990).

These days, however, the idea is also gaining a lot of traction in businesses and strategy consultancies too. The consultancy BCG suggest that lasting transformation hinges on capabilities. These capabilities sound quite a lot like core competencies but they also suggest that at the core of the capabilities are behaviours: ‘the activities, interactions, and decisions made by a set of individuals in a company who exemplify that capability’ (Hemerling et al, 2016). PwC’s strategy and consulting arm have a similar perspective, focusing on superior, distinctive and reinforcing capabilities that overlap with core competencies but that also extend to take in culture (Leinwand and Mainardi, 2016).

But the best example of a business strategy consultancy’s focus on organizational capabilities comes from McKinsey. This firm calls their version of capabilities ‘organizational health’. McKinsey consultants Scott Keller and Colin Price, writing in their book Beyond Performance (2011), note the increasing pace of change within business making it easier to copy a competitor’s competitive advantage. However, ‘what can’t be so easily replicated is the ability to grow from within through better ideas and better execution, ie better health’.

Keller and Price explain the difference between the traditional basis for business performance and organizational health: ‘Performance is very much about our strategy, the big goal we’re going for that we can measure in financial terms, the set of initiatives we’re going to go after, the sales force stimulation programme, the lean production programme, whatever bundle of things they’re going to do in order to get to those numbers. The health side is very much about me – how well do we align people on where we want to go, how efficiently do we execute against that, and how effectively, and how do we renew ourselves along the way, keep our energy up and be able to continue once we even get to that target’ (Mlabvideo, 2011).
That sounds to me a lot like activities in the organization value chain! By the way, it is also interesting to note that McKinsey has also switched its focus from activities (the 7S model) to outcomes (organizational capabilities/health), reinforcing the need for us to put more focus on outcomes within our organizations too.

Looking at these four different approaches to business strategy and their evolution over time there has been a clear shift from an external to an internal perspective on strategy development – from the right-hand to the left-hand side of the business strategy map; from the financial to the organization value chain.

Today, the organization value chain is not only important because of its multiplicative effect on the other value chains but because it is now the most sustainable basis for competitive success. Because, do you know what? Given the rate of change in the business environment your competitors can copy your core competencies just like they can copy your competitive positioning too. The only thing they cannot easily copy is your people and organization and the alignment between these (which is commonly referred to as an organization’s culture).

You can also see this change in the increasing proportion of market value that is based on intangibles. Sometimes people try to show this by looking at the growth in firms’ market values compared to the growth in their fixed assets. For example, one analysis of Standard & Poor’s 500 index (Ocean Tomo, 2015) suggests that the proportion of market value that cannot be accounted for by tangible assets has grown from 17 per cent in 1975 to 84 per cent in 2015 (with a big dip around the global financial crisis in 2007). Other analyses subtract Interbrand or EquiTrend estimates of brand values from the remaining intangibles to try to get a better estimate of human, organization and social capital. Unfortunately this is not really the way which a firm’s market value is set. Investors do not make a direct valuation of a company’s human, organization and social capital. They pay a particular amount for a company because they expect a certain level of future profitability. The growing market value of companies is simply an indication that investors expect these to make greater profits in future. But they do clearly understand that most of this growth is due to the importance of intangibles, ie they have at least some understanding of the flow of value through the four value chains.

This is also the reason why analysts and others are trying to get a better understanding of the value of these forms of capital. For example, the International Integrated Reporting Council (IIRC) has proposed that firms report on six forms of capital – human, social and relationship, intellectual
(organization/core competency) as well as natural, manufactured and financial (from the financial value chain). This is not about putting these capitals on the balance sheet but about understanding the flows between them. In fact the IIRC’s model also uses a value chain based on inputs, activities, outputs and outcomes (The IIRC, 2013).

None of this discounts from other changes in strategy development, including this being increasingly unplanned and emergent, but where formal or informal strategy formulation does take place it should increasingly focus on the organization.

Summary and additional comments

1 Inputs, activities and outcomes – the key elements of the four value chains I have reviewed – are often referred to in descriptions of processes and business transformations. For example, one common approach to defining processes uses the acronym SIPOC – suppliers, inputs, process, outputs, customers. It makes a lot of sense to describe our top-level people and organization management process in the same way.

2 Understanding that the source of value in people management lies in the organization value chain is important. It means that people and relationships are not just a means of supporting the creation of margin in the financial value chain. They are now the basis for important outcomes in their own right.

3 In addition, given the changes in the world of business it is these outcomes from the organization value chain that offer a business its most important and most sustainable basis for competitive success.

4 This also means that people management is a primary business activity, and that HR needs to be seen as a business function with a direct role in creating competitive success.

5 HR functions wanting to contribute strategically should focus on the organization value chain. This is where the opportunity lies to be a strategic driver of success rather than just a support function. I will describe this opportunity further in Chapter 2.

6 Even if your business thinks its business strategy is based on competitive positioning, you can still focus on capabilities as well. First, your business colleagues are probably wrong, and you can offer them the required capabilities even if they do not realize how important these are.
Even if the business really does need a differentiated competitive positioning, it will still benefit from supporting this with useful capabilities too. The link works both ways. If you compete on capabilities, this will help you to develop existing and new core competencies and competitive positions. If you compete on positioning, this will be enabled by aligned core competencies and capabilities as well.

References

Ansoff, HI (1965) Strategic Management, Palgrave Macmillan, Basingstoke


