INTANGIBLES IRRUPT INTO HR AND LEADERSHIP DEVELOPMENT

Interview with Norm Smallwood, co-founder of RBL and Professor at the University of Michigan

by

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Although close to 50% of a company’s market value is related to intangibles, most companies devote some 80-90% of their energies to managing tangibles (finance, accounting, structure, etc.), and very little to intangibles (alignment, brand, leadership quality, culture, etc.). That is the view expressed by Professor Norman Smallwood of the University of Michigan, co-founder, with David Ulrich, of the company Results-Based Leadership (RBL). A staunch advocate of intangible value creation, Professor Smallwood has developed a number of relevant concepts and tools, such as the Architecture for Intangibles and the Intangibles Audit. In this interview with José Ramón Pin, Professor of Managing People in Organizations at IESE, and José Manuel Alcaraz, collaborator of IESE-IRCO, Smallwood argues that intangible value can be extremely useful for developing new HR methods and practices to improve companies’ operations, performance, and results.

Pin and Alcaraz talk with Smallwood about the relationship between intangibles and the development of organization capabilities; the possibility of using intangibles as a tool for employee training or personal career plans; the framework for measuring intangibles (through the RBL method developed by Smallwood and Ulrich’s company); and the challenges facing HR in the immediate future.

Financial Dynamics and HR

Companies with the same earnings may have very different market value. From a financial perspective, it has been shown that 50% of market valuation is related to intangibles. Why should we ‘be concerned’ about these things in leadership development or HR?

These things should be of interest to us because they focus our attention on developing leaders and HR professionals in areas that increase value for the company. It’s interesting to look at how much time, energy and money is spent managing and measuring tangibles, which account for the other 50% of value. Typically, we spend 80-90% of our effort on managing those tangibles (finance, accounting, structure, etc.), and very little on the intangibles (alignment, brand, quality of leadership, culture, etc.). A recent Accenture study of global executives found that 95% of executives perceive intangibles as an important source of shareholder value, but less than 20% had an explicit process for managing them. HR professionals should be particularly interested in intangibles because it plays to their strengths while putting them at the table with senior executives around value creation.

From the original question ‘How can HR create value for stakeholders (employees, customers, suppliers, investors)?’, you’ve lately focused on investors and how we can create market value through people and organization. What is the essence of your more recent work?
As you said earlier, a rule of thumb right now is that about 50% of valuation is tangible and the other 50% is intangible. Intangible value has grown as a percent of total market valuation. Based on our work with many companies, we have crafted what we call an “Architecture for Intangibles” that guides intangible value creation. There are four levels:

1. **Keep your promises** - Having a reputation for keeping financial, customer, and employee promises is the table stakes for increasing intangible value. If there is a lack of confidence that the organization can meet its earning and service goals, there is no credibility to do more.

2. **Articulate a compelling strategy** - Stakeholders must understand and have confidence in how the firm will grow. Executives must describe this growth in understandable terms. Typical growth strategies include product innovation, geographic expansion and customer share.

3. **Invest in core competencies** - There must not only be a clear strategy for growth, leaders must invest their technical resources in a manner that is consistent with the strategic intent of the firm. For example, if a company promises product innovation, one would expect to see higher levels of investment in R&D and sales and marketing than in a firm with a different growth strategy. Across-the-board investments in everything equally is a sign of poor management.

4. **Increase organization capabilities** - Organization capabilities represent the identity of the firm and are a sustainable source of competitive advantage. Organization capabilities delight customers and make employees proud to be part of a world class organization. We identify 7 typical capabilities: collaboration, leadership brand, talent, accountability, speed, shared mindset, and learning.

HR plays a key role in partnering to create capabilities since the capabilities become the deliverables or outcomes of HR work. We do staffing, training, or compensation, for example, to ensure the capability of speed or collaboration. By integrating HR practices to capabilities, HR professionals can create a clear line of sight from their work to the firm’s intangible value.

We are very excited about a concept we call an Intangibles Audit, which is the starting place for increasing intangible value. Through the Intangibles Audit, leaders can solicit stakeholder feedback (executives, employees, customers, analysts…) in relation to the Architecture for Intangibles. Essentially, it is a tool for organizations to obtain data from both inside and outside the organization on the capabilities required for success. It’s exciting because it gives HR and line leaders direct feedback from stakeholders about how they are doing related to the creation of intangible value and where they can target improvements. We invite your readers to take a look at it on our website (www.rbl.net).

Huselid, Becker & Ulrich showed that a 5 percent increase in employee commitment leads to a 1.8 percent increase in customer commitment and a 0.5 percent increase in financial results. Becker also mentioned in an interview that “a one third improvement in performance emphasis of the HR system is
associated with a 10-15% increase in shareholder value in the US”. Could you give us some vivid examples or measures of the link between ‘people intangibles’ and the increase of market value?

Two examples come to mind recently about the impact of intangibles. Last year, a dead cow was discovered in northern Alberta, Canada with symptoms of mad cow disease. The next day, McDonald’s value dropped by $2.5 billion. Obviously, what changed is investor perception of McDonald’s future sales.

The airline industry in North America is another case that shows the power of people. Southwest Airlines’ market value is about $10 billion, which is almost five times the value of the next five airlines combined – Delta, United, American, Northwest, and Continental. They come in at $2.1 billion. Even more surprising, Jet Blue and AirTran, at $1.9 billion, have a combined value approaching that of the big five hub carriers. Jet Blue alone, at $1.5 billion, is worth almost three times the value of Northwest. So, what’s going on? Customers and investors perceive that Southwest, Jet Blue and AirTran stand out from the crowd. This differentiation in intangible value translates to market value. Personally, I don’t know what’s different about United and Delta when I travel. However, I know that when I fly Southwest, I will experience low price, on-time arrival and departure, and what can be described as a “fun” crew who will tell dumb jokes. Southwest has developed a cultura that resonates with its target customers; and it gets value for it.

To what extent does this intangibles perspective help us get closer to the ‘business partner’ role we have been so desperately searching for in HR?

One of the dilemmas we have faced in HR is that we have done a lot of talking about how to be business partners, but we have not been taking enough action. Just doing an Intangibles Audit is doing strategic HR. The data from the audit should inform the choices that HR makes about how to invest its time and energy. It is the foundation for the strategic agenda for HR. Every time we discuss this idea with senior executives they tell us that this is what they want from their HR people.

Building Organization Capabilities

In the intangibles architecture, ‘organization capabilities’ – the capabilities that delight customers – play a pivotal role in creating sustainable advantage. They are things for line managers to work with, the new ‘deliverables’ HR must produce. To what extent do they need to be built on a ‘customer value proposition’?

The choice of which capabilities to focus on should come from the strategic intent of the business. Basically, a strategic intent has two parts: customer value proposition and financial objectives. Therefore, the question that guides which capabilities to build rests on the answer to the question: Given our customer and financial objectives, which capabilities will most help us deliver on our goals?

Turning to your favorite capability, talent, you have defined it as competence (do we have employees that know how to do things?) multiplied by commitment (the desire to commit and deliver). Can you tell us a little about this concept?
Most concepts about talent just consider one side of this equation—competence. However, we believe that winning organizations have people who really care about what they do and invest tremendous amounts of discretionary effort because they care about the goals and aspirations of the firm. It is the integration of the two that makes talent so valuable—people who have the skills and really care about using those skills to deliver results.

Then there’s shared mindset, that is, having a culture that resonates with customers, or knowing what experience you want your customers to have, and making your employees know how to deliver it. This intangible helps us to get closer to a vision of “creating unity from the outside-in”.

In a nutshell, most companies have brand promises that ring hollow. Companies spend lots of money telling customers what they want to hear. High performing companies are much better about describing the brand and then ensuring that employees also deliver the brand whenever they interact with a customer.

At RBL we use an exercise that demonstrates this point. Think of a business that you have visited recently (store, hotel, restaurant...). Before you went there, write down two or three of the reasons that caused you to go there. Now, write down the behavior you experienced while you interacted with employees. How consistent was the brand message (price, service, innovation, quality) with the employee attitude and behavior? Ideally, you want a full overlap between brand promise and employee attitude and behavior.

Speed of change (important things happening fast) seems to be a tremendously relevant intangible for competing today.

Speed of change means that an organization is able to do important things fast. There are several things that get in the way of doing important things faster, such as slow decision making; too much bureaucracy; cultural idiosyncrasies; lack of a rigorous change management approach...

We have developed tools to overcome each of these inhibitors to speed. We recognize that certain things must not be done fast. For example, we don’t want to hurry up and make things unsafe. However, there are many ways that organizations just get bogged down unnecessarily.

In order to develop accountability, could you give us some ‘tips’ for instilling personal ownership and responsibility within our organizations?

My tip for ensuring accountability is to follow the four steps that ensure it:

1) Clear goals. Know what you want people to be accountable to do;
2) Clear measures. Find ways to measure outcomes from these goals and, if you can, behaviors that support them;
3) Ensure consequences. Make sure that it matters whether people achieve their measures on their goals. These consequences can be financial (i.e. bonus) or non-financial (i.e. time off);
4) Foster a feedback culture. Make sure that people know where they stand.

**You defined the essence of collaboration as “the whole being greater than the part”. What’s important when building a true collaborative organization?**

Organization collaboration is the principle that a firm must be more than the sum of its parts. If the break-up value of an organization is greater than its current value, then the organization is in jeopardy. A typical conglomerate or holding company buys and sells businesses assuming that each part (each business) will achieve profitability so that the whole is equal to or greater than the sum of the parts. A business with high collaboration intangible value makes the sum among the businesses a multiplier. It succeeds at sharing and leveraging customers, technology, people, or ideas so that the businesses are much better off together than separate.

**Can the intangibles approach be applied at an individual level and be considered also a framework or ‘road map’ to personal success?**

At the individual level, the Architecture for Intangibles is quite intriguing. Keeping Promises is how an individual builds trust. Articulating a compelling strategy means that each person should have a personal life mission that includes work, family, physical and spiritual fitness, and so on. Aligning core competencies asks the personal question: have I invested my time and energy consistent with my life mission or am I out of balance in some areas (e.g. too much work and not enough family)? Building organization capabilities is the process of increasing my intra-personal and interpersonal skills to ensure that I am investing in myself and how I interact with others through learning, holding myself accountable, increasing my talents, etc.

**HR ROLE**

In this shift from activities to outcomes, from doables to deliverables, what role is there for the traditional HR activities (staffing, training, compensation...), now that we are moving to the intangibles arena?

The traditional HR activities become the means to obtain the new deliverables. For example, let’s say that a firm needs world class collaboration. How does it go about increasing sharing best practices across boundaries? First, HR could identify the competencies of collaboration and begin to select new hires based on those competencies. HR could identify or create training that provides frameworks and tools for doing a better job at collaboration. HR could make collaborative behavior something that is rewarded. HR could take the lead in providing information to the rest of the organization about people and organizations that are acting collaboratively. HR could do an Intangible Audit to identify how internal and external stakeholders perceive improvements in collaboration. In other words, the doables of HR become the means to build the new business deliverables.
Seeing this, HR professionals may need to get familiarized with some financial background and indexes like the Price to Earnings Multiple...

I don’t think HR people necessarily need to learn how to do the financials, but they do have to conceptually understand what they represent. Your example of the Price to Earnings Multiple is a good indicator of intangible value because it is an industry index that provides a level of investor confidence about the future. HR needs a conceptual understanding of these financial indicators.

Employee Training

How might employee training be developed or shaped so as to be aligned with market value creation and the ‘logic’ of intangibles?

There are two kinds of employee training: technical skills training and soft skills training. The opportunity to align with market value creation and intangibles is in the soft skills training. The trick is to shift from generic soft skills training around interpersonal skills, leadership, communications or whatever to a focus around how to use those soft skills to provide value in the eyes of various stakeholders. For example, there is solid evidence that having a culture that resonates with target customers is a key differentiator to customers. So, train employees who interact with customers so that they know how to behave at every interaction.

A question that must be asked as training is designed is how can we make this relevant to customers or other stakeholders? One way to do this is to invite customers to attend training –leadership training is a good example– that you provide to your employees. There is a very small incremental cost, customers will appreciate it, and it should keep things focused on what is most relevant.

Finally, you can provide training to teach people intangibles tools and the application of them. We partner with companies to do this all the time.

Are there any significant concerns we should take into consideration when generating relevant ideas and generalizing them through the organization?

Our definition of learning is that organizations must be able to generate new ideas with impact and then generalize them across a boundary. We believe that learning does not occur until it crosses a boundary of time, structure, or geography. Without transferring ideas with impact across boundaries we are getting information but we are not learning. The real trick in learning is to ensure that there are clear processes for gathering best practice information from all parts of the organization and then disseminating them to the places where they are most relevant. The biggest obstacle to this is that certain groups, e.g. corporate, often think that their ideas are the best and don’t ever look for or find good ideas from the rest of the organization. Higher performing organizations look for and find great ideas throughout regions, functions and business units.
**Measuring intangibles**

You’ve worked on the ‘organizational audit’ concept and tool, which is about getting something like ‘720 degree feedback’ on an organization from all its stakeholders (customers, investors, employees, suppliers...), asking them to help the organization identify the capabilities it needs in order to succeed. Can you explain to us a bit more about this approach and similar tools?

RBL has developed The Intangibles Audit™, which allows you to make intangibles more tangible. The audit enables your leaders to identify precisely where to invest their time, energy and money to optimize value. Just as financial audits allow your leaders to monitor cash flow, and leadership 360s assess your leaders’ behaviors, The Intangibles Audit™ allows your leaders to monitor and improve on your organization’s intangibles. Your audit assesses which capabilities are most important given your history and strategy, measures how well your organization delivers on those capabilities, and leads to an action plan for improving them. Your entire company, a business unit, or a region can do this exercise – indeed, any part of your company that has a strategy to produce financial and customer results can do an audit, as long as it has the sponsorship of its leadership team. The analysis of the results of these Audits enables your leaders to focus their decision making on those areas with highest impact on performance and value creation.

**What are the steps of an audit of this kind?**

In summary, the steps for doing the audit are:
1. Tailor the focus of your audit – corporate, business unit, geography, or function;
2. Determine the scope of your audit – quick and dirty (90 degree data from a management team); comprehensive (360 data from employees at multiple levels throughout the audited unit); or thorough (720 data including external suppliers, customers, and investors);
3. Identify the stakeholders who will participate in the audit;
4. Tailor surveys to your stakeholders (e.g. for language, industry/company terminology, additional questions) and determine the best method of reaching each one – online survey, personal interview, etc. For example, we recommend that someone personally contact your targeted customers before they receive a survey, whereas for your executives or employees a letter may be sufficient;
5. Administer audit;
6. RBL analyzes your feedback and creates feedback reports by desired demographics (e.g. overall, each stakeholder, business unit, geography, product, and so on);
7. Conduct executive workshop to review the data from your audit and identify key actions and decisions;
8. Monitor effectiveness of key actions taken to reassess specific changes in perception of your target stakeholders through the use of targeted Intangible Audit™ Pulse Checks.
Time to work

In Spain, the majority of businesses are small or midsize companies, many of them with no HR department. How can the intangibles logic be adapted to these companies?

Regardless of the size of the company, building intangibles should be highly desired, since they so clearly link to value. Any leader who is interested in standing apart from competitors should pay attention to the intangible factors. The key to success, whether or not there is an HR department, is not to try to do too much. It is much more effective to determine where to focus and then improve that area. In terms of the organization capabilities, there are many to choose from: speed of change, leadership, talent, shared mindset, accountability, collaboration, learning, and so on. Just pick one and focus on how to improve it. The intangible value comes as employees and customers experience the value of doing something better than competitors.

To what extent and how can Management by Objectives (MBO) help to develop the intangibles architecture?

MBO is a very useful tool because it determines what is important to people and should reward them for accomplishment. These rewards can be financial, non-financial, or both. It is a tool that measures progress against goals. In true MBO fashion, objectives can be set at the top of the company at each level of the Architecture for Intangibles, and then cascaded throughout the organization.

Challenges Ahead

There may be significant differences between US and European culture: differences in our social ‘model’ and ‘values’, in work ‘flexibility’… more restricted compensation opportunities (e.g., stock options and suchlike may be less common), less aggressive retribution differences (e.g. between top executives and employees), etc. To what extent may this be significant for carrying out intangibles development initiatives?

My personal experience in working with Europeans is that there may be more rather than less resonance to these ideas. We have done significant work in Europe with companies like Intercontinental Hotels Group (IHG), Zurich Financial, Unilever, Shell, BAE Systems, Royal Mail, and others. Recently, the CEO of Nestlé said that his primary focus was now on building intangibles.

The real issue is not in the reward system but an interest in building a strong organization that is a great place to work and that builds value.

In your opinion, what are some of the main challenges that the HR profession will be facing in the near future?

Ed Lawler and Sue Mohrman at University of Southern California have described the challenge for HR better than anyone. Their research says that HR has been doing too
much talking and not taking enough action. I agree with this. We are past the time for talking about the need for becoming more strategic. It’s time to do what we know. We have proposed very concrete tools for taking action. My firm, RBL, sponsors a training program that teaches strategic HR skills and uses the logic we have described. As part of this program, the HR participants must do strategic action learning projects and measure their impact. There are no more excuses for not getting started. You have access to the frameworks, the tools and the education. You just have to get started.