Reversing the arrow: using business model change to tie HR into strategy

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Introduction

By some accounts the HR function’s very existence is under threat. It must, the story goes, increase its strategic capability. But what might this Strategic Capability look like? Our answer to this question, as explained in this report, is, in short, to focus less on the HR for HR side of the equation and much more on the HR for the Business, or Performance-Led HR: an approach we call “Reversing the Arrow.” This means unlocking and understanding what strategy is within businesses, and understanding the business and people models put in place to underpin strategic execution and delivery.

In this report we have lifted the lid on an issue – that of business model change – and in so doing reveal the complex and messy problems involved. We provide some rich research data to demonstrate this and introduce a lexicon of ideas and conceptual material to bear on this problem, in order to help HR make sense of their contribution in the arena.

This contribution represents an ongoing project. However, a core message for HR is that, as business model change, by definition, demands capabilities that HR should possess or develop, they (HR) have a remarkable opportunity to influence strategy. At the highest level, through facilitating Board level discussions on the organizations’ value proposition and key operating principles; and at the second, design level, through an advanced organization design (OD) capability we refer to as “Architectural Design.”

The question, however, turns on how HR helps organizations to understand how to implement strategy from a people perspective, without insisting that HR is the common denominator to all things strategic. This report is intended to clarify:

1. How we should think about people strategy in the context of business model change?
2. How best can we understand where HR is now?
3. How should we look at strategy and understand the kind of people models that are associated with the emerging business models?

These are important questions, not least because the potential problems and risks associated with innovation in business models can be very high – events at Enron and more recently at Citigroup and Northern Rock attest to this. Many organizations within a sector can essentially pursue the same strategy. If organizations get it wrong, do they all go down like a pack of cards? Or are they capable of executing their business models differently?
The key messages that emerge from the study

We aim to show you that:

1) HR work at strategic level entails a deep understanding of the organization’s business model, in particular its value web (an extended idea of the 2 dimensional value chain comprising several points of value delivery to multiple stakeholders) for HR to be able to add value to the change

2) The transformational nature of business model change entails the primacy of an Organization Design agenda in HR at the highest level for it to be effective. However, what is meant by the term organization design is changing as we shall show. We call it “Architectural Design” in order to signal that organization design should not be confused with organization development (though the latter is still an important issue).

3) HR “Strategy” ceases to exist in the ideal situation; there is business strategy, and this will be associated with an HR process. The two become synonymous with HR nested within the business strategy. You only have a separate HR strategy when HR is not playing at the highest level

4) HR added value derives from an intuitive relationship with the line, an understanding of the organization’s strategy and business model, and a creative business - led explanation of how HR process integrates with it (a process we call “reversing the arrow” counterbalancing recent trend in HR to install certain processes and structures with little regard to business model)

5) A more refined analysis of business model change – based on the scale, and the stage, of change – leads to a better understanding of the nature of HR work at each stage

HR and Business Model Change

In the field of strategy, the issue of business model change is dominating the attention of business leaders and the term has entered the mainstream thinking, we would argue for the following reasons:

1. Interview surveys of CEOs find that in order to remain competitive business model innovation is their main strategic priority over the coming years².

2. Strategy academics argue that whilst strategy concerns the long term creation of value and the process of making strategic choices – analysis of the business model facilitates clearer analysis, testing, and validation of these choices² and a finer grain differentiation in strategy² because business models describe both the organization’s value chain, and its unique resources or position within this.

3. Moreover, the economic value of business model innovation is increasing⁴. A range of institutional bodies and consulting firms⁵ believe that the way in which innovation is fostered is
changing under the influence of globalization, information technology and resulting competitive processes, leading to a democratization of business model innovation. More decentralized ideas generation and handling inside organizations can be used to integrate elements of the value chain in more flexible, but also often disruptive, ways.

4. The UK therefore faces intensifying domestic and economic competition. For example, Taiwanese textiles contract producers that feed Western fashion and consumer goods companies are establishing design-networks, managed by supply-chain experts, that bring together groups of just-in-time suppliers from across Asia into alliances that stay together only as long as each continue to learn. Similarly, the Indian software industry, is moving beyond a low-cost offshoring model, and is developing business models that bring together academic laboratories, start-ups, venture capital firms and large independent software firms and some of their most important customers.

5. Central to this competition is the ability to bring together the known constituents or knowledge bases associated with a new business model (this is called “architectural capability” by organizational learning experts). For HR Directors in organizations undergoing business model change, the people implications of the changing capabilities that are required are often fundamental.

6. The HR implications of this shift in attention to business model change are very significant. In order for organizations to make their models work, they have to understand the potentially deep implications they have for people management. People management experts have to make sure that those engineering the new business models are working on assumptions that can reasonably be executed.

7. Even if their own organization’s models are not (yet) changing, HR Directors are having to prepare their workforce to compete with competitors whose models have changed. Facing competitors from different sectors, their own organizations may still face deep changes in systems, work practices, and the mindset of managers and employees alike. The need to respond so vigorously just to maintain an old model is often not accepted, but better analysis may allow for a more realistic understanding of the task.

8. Deep strategic and operational insight is just the starting point. Given the uniqueness of this knowledge and the need often to operate across partners, bespoke HR structures may be the best way of meeting business needs.

**Business Model: Definitions**

Despite increasing attention to the topic, there is still little agreement on what the terms “business model”, “strategy” and “change” should come to mean. Many people bandy the term “business model” around because of its currency. How are we using it? We offer our definition, below, and then review some of the current strategy literature on the term.
**Key definition**

**Business Model:** A dominant performance logic that specifies how business is done, who the customers are, where the costs and profits are. This logic outlines how and why the organization works as it does, how financial and non-financial resources have to flow through the organization and what organizational capabilities are necessary to ensure such joined up implementation of the business model.

The model typically involves the following elements: a value proposition; insight into the nature of business inputs (such as technology); an understanding about how to transform these inputs; the consequent nature of business outputs; the changes these make to the vertical, horizontal, and geographic scope of the organization and the nature of its customers; and how to organise in order to deliver all of these combined elements.

Innovation in the business model requires developments in the structure and/or the financial model of the business and so also includes strategic partnerships, shared services, or alternative financing vehicles.

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**Getting the measure of Business Models from the Strategy Literature**

The appearance of the concept of “business model” in the strategy literature can be dated to the “internet revolution” in the second half of the last decade when it came to represent changes in the value proposition of organizations brought about by new “virtually organized” internet businesses. The academic treatment of business models therefore, is new, compared with the very rich history of exploration of the subject of “strategy”, a field monopolized until recently by the seminal works of Porter and Mintzberg.

There is, however, little agreement on what the term “business model” should really come to mean in relation to strategy - itself still a hotly debated term. Strategists have attempted to distinguish between “dynamic” and “static” elements of strategizing, with the former elements reserved for the term “strategy”, and the latter for “business model”. However, almost all “classic strategy approaches” suffer from being overly static, and are better viewed therefore as “business models”; thus the distinction is made between “routine” strategies, which change market share, cost and quality position, and profitability; and “transformational” strategies, which change business model.

Business models allow for a finer grain differentiation in strategy compared to classical strategy taxonomies (such as innovation, cost leadership and focus) in situations where there might be a dominant approach to strategy; for example, adherence to principles of a service-profit chain across service organizations, or to technological innovation in the biotechnology sector, or in situations where a majority of organizations might be at a similar life cycle stage.
A comprehensive compilation of definitions of the term has been produced but definitions of “business model” are manifold. Key definitions are:

- an “architecture for the product, service and information flows”;
- “The way in which competencies and assets support the underlying strategy”;
- an “integrated and consistent picture of an organization and the way it aims to generate revenues”;
- “the content, structure, and governance of transactions designed so as to create value through the exploitation of business opportunities”; and
- “stories that explain how companies work”.

Another way of getting the measure of business models is to break the business model down into its component parts.

### Key components of a business model

The academic literature draws attention to a number of components of a business model. The potential for confusion abounds given the complexity of language, but in order to explain a business model, the following analytical components all need to be articulated:

- value stream for the business partners and the buyers,
- revenue stream, and
- logistical stream;
- value proposition,
- transformation of inputs into outputs,
- vertical, horizontal and geographical scope, and organization necessary to deliver this;
- value chain constellation,
- source of competitive advantage, and
- revenue model;
- strategic choices,
- value network,
- resources for creating value, and
- financial processes for capturing value.
Looking at these key components, we believe that there are three recurring themes in the various definitions and analyses. These themes articulate:

- the value network (or web),
- the structure or architecture to deliver the value proposition within and across this network, and
- the strategic capabilities that underpin this structure.

We need to explain the term value network or value web in some more detail, because it is such an important issue. The theoretical underpinning of the business model concept lies in the resource-based view of the firm. From this perspective, the value embedded in any strategy increases as the bundle of resources and capabilities the strategy comprises becomes more difficult to imitate, less transferable, and more complementary. In an analytical framework of business models based on a series of strategic questions, the first two questions that get at the value network are “who do we create value?” and “who do we create value for?”:

“The particular business concept (or way of doing business) as reflected by the business’s core value proposition(s) for customers; its configured value network to provide that value, consisting of own strategic capabilities as well as other (e.g. outsourced/allianced) value networks; and its continued sustainability to reinvent itself and satisfy the multiple objectives of its various stakeholders.”

As a concept, the business model describes the value chain, the series of activities this entails, and the unique resources or position that this brings to an organization:

“(The business model) creates value, and it captures a portion of that value. The first function requires the defining of a series of activities (from raw materials through to the final customer) that will yield a new product or service, with value being added throughout the various activities. The second function requires the establishing of a unique resource, asset or position within that series of activities in which the firm enjoys a competitive advantage.”

However, for most organizations, the “series of activities” comprising the value chain now extends beyond the internal configuration of core capabilities into external partnerships or other key relationships. This is why the term value network or value web becomes a more appropriate term. Importantly, business model design needs to take into account the “architecture of the transactions that a focal firm engineers with its partners, suppliers, and customers.”

This literature, therefore, broadly points to the business model of an organization as a static map or snapshot of the configuration of its value “web” or proposition, often referred to as an “architecture”. This is underpinned by strategic capabilities and typically now extends across traditional organization boundaries.

The extent of HR challenge just in supporting an existing business model becomes evident from this. But what happens when the business model itself also changes?
Why Business Model Change?

It is generally accepted that the economic value of business model innovation is increasing. A recent special edition of the Economist offered some interesting insights into the subject of radical innovation that carry important messages for "UK plc". A range of institutional bodies, such as the OECD, Booz Allen Hamilton, Boston Consulting Group and the McKinsey Global Institute believe that the way in which innovation is fostered is changing under the influence of globalisation, information technology and resulting competitive processes. Vertically integrated research and development organizations and government-backed policies to enhance corporate research are proving to be too slow and insular and a new model is emerging, which is dependent upon more decentralised, democratic and anarchic process of ideas generation and handling inside organizations and business model innovation that integrates elements of the value chain in more flexible, but also often disruptive, ways.

"...Business model innovation is far more radical... than conventional product or process innovation... Globalisation and the spread of IT allow the creation of unexpected and disruptive business models... as the knowledge component of industries continues to grow, it will low even further the barriers to entry in many businesses. Yet the same democratisation of innovation... can be used to generate much greater innovation from within established companies".

This democratisation of business model innovation means that in the UK we face intensifying domestic and economic competition, increasingly driven by business model change.

For example, in order to move beyond the transitory advantage of low labour costs, the Taiwanese textiles contract producers that feed Western fashion and consumer goods companies have themselves established design-networks, managed by supply-chain experts, that bring together groups of just-in-time suppliers from across Asia into alliances that stay together only as long as each continue to learn. Unlike the Japanese keiretsu arrangement in which suppliers and producers were brought together under interlocking shareholdings, more nimble combinations are created. The Indian software industry, similarly needing to move beyond a low-cost offshoring model, is developing business models that are described as a "global innovation ecosystem". This brings together academic laboratories, start-ups, venture capital firms and large independent software firms and some of their most important customers. The need to involve HR in such changes is clear.

The Business Model Vacuum

Nevertheless, discussion of the HR elements of business model change is almost entirely absent from academic or even practitioner literature (as opposed of course to the all pervasive coverage of Strategic HR). Consequently, our study is seeking to fill this vacuum in the HR executive knowledge base.

A central task facing HR is to identify how its leaders, the function itself, and the people processes it manages, add value during periods of business model change.
Business model thinking represents the core logic that is used to create, capture and leverage value in a way that generates both profitable and sustainable revenue streams. It requires the specification of how an organization brings together both the pattern and importance of existing organizational capabilities and/or future innovations in this pattern.

Considerable work on how these aspects come together into one value chain under the aegis of HR architecture - its infrastructure, its system or organization and employee behaviours has already been undertaken.

Little work, however, has been undertaken on the possible ways in which such an HR architecture interchanges with the existing business strategy and business models to add value. This interchange between strategy, business model and HR architecture we refer to as strategic reciprocity.

**Strategic reciprocity:** is more than the alignment of HR (and its architecture) ‘within the larger system of a firm’s strategy implementation’. Strategic reciprocity captures the current state of HR in relation to the interchange that takes place during emergent strategy and business model change. Crucially, reciprocity does not suggest that HR strategy is determined by an overarching business strategy. Rather, it is complimentary to it. For example, whilst overarching business strategies and models may move through significant change, the underpinning business models and state of HR may be able to meet the people management aspects of such strategic changes whilst simultaneously remaining itself unchanged. It has been designed in such a way that it can adapt its capabilities to meet new ends. Conversely, whilst organizations may find themselves in a period of strategic consolidation with little overarching business model change, HR functions may be experiencing internal transformations involving the radical overhaul of their structures, capabilities, service orientation and, critically from our perspective, their underpinning business models and their correlation to overarching business strategies.

These critical capabilities are often a consequence of bringing together or understanding the interdependencies of systems. They might relate to the supply chain, distribution and logistics, product and service innovations, consumer insight, knowledge or information flows. The model may be delivered through an organization’s own architecture, and/or through a network of partners whose own business model helps create, market and ultimately deliver value. Understanding a business model therefore requires both deep strategic and operational insight.

*For HR, influencing thinking around the business model is more important and impactful than being aware of strategy and having a seat at the top table.*

Strategic capability, then, is about being situated in the operational /hot seat in such a way as to ensure the alignment and execution of HR so that it drives the business models underpinning organizational strategy.

Business model changes alter the strategic value that is attached to particular types of knowledge (see below). It also changes the way that different types of knowledge have to relate to each other.
In the box below we use the word knowledge. Of course, knowledge represents the starting point, but once this knowledge has become internalised into an organization and is supported by all of the supporting systems, structures, and processes, a deeper capability has existed.

Central to this is the ability to bring together the known constituents or knowledge bases associated with a new business model (this is called “architectural capability” by organizational learning experts42).

We develop this idea later in the report, but for now, what does this mean? As one example, a useful avenue towards the breakthroughs necessary for the development of cleaner, software-rich cars of the future requires organizations to combine software and smart electronics knowledge (the “chip guys”) with traditional energy and car manufacturing expertise (the “engine guys”). This capability also requires the ability to understand and manage combinations of knowledge without damaging innovation. To do this, the organizations involved have to deal with the conflicts that inevitably result from these new insights as these new fields converge.

As can be seen, business model innovation though always requiring transformational change, may still be considered as more or less radical. HR Directors (potentially) have to cope with alterations to strategy, business model and the change management approach. How do they fit together? What is their respective contribution?

The type of knowledge shifts involved in business model change

HR Directors can help the organization understand whether Business Model change might involve changes to only one, or to a combination of both, of the following:

Component knowledge (also called Operational knowledge): refers to an understanding of the nuts and bolts of the operations of the business. It is based on knowledge of the parts – or components of the business - rather than the whole. This knowledge of common components can be applied to the sub-routines or operations that overlap in the new business model. HR Directors have to understand whether – and how – their organization can develop deep enough knowledge of all the various partner’s (such as internal functions or external business partners) expertise so that it can assimilate, interpret, apply and recognise the value in this knowledge.

Architectural knowledge: requires the shared understanding of how the new strategy and business models require interconnections between of all the operational (component) knowledge. In short, how things fit together. Knowledge of common architecture relates to the organization-wide routines (or indeed cross-organization and cross-partner routines) that have to be co-ordinated and combined, so that the various components can deliver their value. It is knowledge of the bigger picture. It requires the HR Director to be sure that the organization has thought through the strategy and business model and has understood the (potential) conflicts contained within this picture. This type of capability gives the organization a much better chance of to able to tweak and exploit the business model.
The ideas of Ulrich gave much impetus to the HR function from the late 1990s. They have propelled it forwards and helped it look at its contribution to value and the bottom line. However, by thinking more deeply about the changing value of knowledge inherent in business model change, and about the capabilities that HR Directors need to align the HR contribution to this, we can move beyond this.

Two contributions have been made by Ulrich’s work. It has helped
1. HR Directors think about the structures (generally based around how HR organizes its processes) and role changes associated with a separation out into transactional work, HR business partners and centres of excellence.
2. change HR from a process-specific function into a business with its own P&L and concomitant transparency and ROI visibility.

However, Ulrich does not mention the issue of business models in relation to HRM. Instead he mentions strategic business units (SBUs) as the focus of attention twice – once in the context of a chemical company and once in a pharmaceutical company. In both cases SBUs were used as the level at which HR business partners were to be organized as “…the initial point of contact for each business unit’s line managers” and interfaced with the central centres of excellence43. An SBU is an entity within an organization that is given responsibility to serve a particular part of the business area and is allowed to develop its own mission, objectives and strategy. Using Johnson and Johnson as an example, Ulrich notes that SBUs often “…have independent philosophies and operating histories as well as unique customers, products and cultures”44. The term unit relates to a part of the “business” that has a defined external market that enables a separate strategic plan to be developed and so often relates to large organizational structures such as a whole division.

In our language, although these SBUs may be pursuing slightly different strategies and potentially operate to a different business model, these operations can be seen as “components” of the broader performance logic that exists once all such models are brought together under the “architectural” (organization strategy-level) business model.

Aligning HR to the higher level business model is by default a complex task, as it has to deliver a degree of co-ordination across what might be conflicting “component” interests.

HR’s Contribution to Value

We now move beyond discussion of business models towards an understanding of HR leadership as it relates to enabling business model change. Our analysis shows that jumping to off-the-shelf structures on the assumption that they will fit the challenge of business model change can be dangerous.

Before we move to the methodology section of the report it is worth outlining some of the language we used as the project developed that enable HR Directors to demonstrate HR’s contribution to the business and its functioning, or more specifically how it contributes to value inside the organization.

We increasingly believe that the HR value contribution is evidenced in three ways.
How do HR Directors argue contribution to “Value”?

1. **Value creation**: ensuring the organization has the ability to build and acquire talent and in turn develop the value proposition inherent in the business model. This requires: 
   - understanding the new organizational capabilities central to the business model; 
   - managing immediate and sustained talent challenges; 
   - and developing HR processes that engender the requisite performance outcomes such as innovation, customer service, efficiency or effectiveness.

2. **Value improvement and leverage**: enhancing the business model as it develops and learning how best to execute the business strategy. This requires: 
   - the HR function to be involved in transferring knowledge; 
   - to know how to optimise policies and practices; 
   - to manage the learning that results from any change or execution process associated with new business models; 
   - and to have multiple channels that ensure engagement of the business with such issues,

3. **Value protection and preservation**: making sure that any value that has been created does not then get lost. This requires: 
   - the design and maintenance of effective governance processes; 
   - constructive surfacing of the risks inherent in a business model and appropriate mitigation strategies; 
   - ensuring that the organization has a strong reputation across a range of stakeholders; 
   - and that it is able to retain its best capabilities (both people and systems).

**Articulating how HR contributes to the creation, improvement and leveraging of value through the reconfiguration of business model change in our view now represents the central challenge to today’s HR executives.**

This is far from a straightforward process. Value may well have become, in Ulrich and Brockbank’s words, “the bellwether for HR,” and the function’s value remains very much in the eye of the receivers not givers of HR services.

But there no one-size-fits-all structure or line of best fit we can use to combine business strategy, model and HR, as the daily challenges faced by organizations are highly contingent on the contexts in which they operate.
Methodology

“…Companies use radical (or transformational) strategies to change their business models and routine strategies to change their market positions.”

The project reported upon here focuses upon the original request of the centre membership — which was to discover by systematic research, what are the activities that HR departments should engage in, and be prepared to deploy, when faced by demands to support successfully all business model movement and change.

To understand this, in our research interviews, we questioned both operational and HR executives, within our member companies, about the key characteristics of the business model deployed both at the present time and potentially in the future and having clarified the characteristics and requirements of that model we then moved to discuss the contribution of HR.

This study has purposefully been based on interviews with those senior line and HR players intimately involved in business model change processes. The issues raised present the opportunity both to understand the value that is added by HR to business model change and then deliver that value to the organization.

We feel that only by combining the insights of Capability and Transformation Directors, Chief Executives, Business Directors and HR Directors can the people implications be truly understood. The research is based on 30 primary interviews conducted across eight case organizations. The job titles of interviewees reflect high-level business understanding. The perspectives that we have explored include: two Chief Executive Officers, Managing Director UK Business-to-Business, Managing Director UK Consumer Business, Chief Information Officer, Finance Directors, Marketing Director, Transformation Director, Capability Director, Head of Transition, Superintendent Major Projects, Strategy and Marketing Manager, Group HR Directors and VPs, HR Transformation Director, HR Director Organizational Capability and Development, HR Director Shared Services, HR Capability Manager, HR Employee Engagement Director and a number of HR Business Partners.

To support the interviews we have analysed secondary material on each organization, such as public discussion of generic business models, annual reports, publicly available investor relations reports and presentations, as well as wider business media coverage. Behind this lies detailed literature reviews, under the headings of value creation, business models and strategy.

In selecting our business contexts to analyse, we have attempted to capture the diverse realities faced by HR Directors. Before embarking on the research we were clear that:

1. The thinking inside organizations is at varying degrees of sophistication in terms of the level of insight into a new business model.
2. Regardless of the necessities for HR change dictated by a business model change, the relationship between the HR function and the business will reflect different levels of strategic embeddedness.
3. The degree of control that HR Directors or indeed their CEOs have over the business model might be subject to other external influences.
4. The pace at which new business models have to be operationalized (the need for transformation) has to be balanced against the need to ensure safe steady-state operations.
Different Contexts entail different degrees of Business Model Change

The findings in this report is based on an analysis of eight settings, each reflecting a different context, and different HR challenge. The business context in each setting must now be briefly explained. In reading about the changes faced, consider whether a one-size fits all way of structuring HR will remain viable?

NG Bailey: The perfect storm: changing competitive landscape of the construction industry

At NG Bailey the strategic landscape could be called “the perfect storm”. There is a changing competitive landscape in the construction industry. NG Bailey is among the UK’s leading providers of building services, mechanical, electrical, ICT, off-site manufacture, interiors, systems integration and maintenance solutions. The Group Operating Profit for 2007 was £12.1 million, a rise of 37 % over the previous year. The Group comprises of various subsidiary firms each providing specialist construction engineering solutions to its clients. It is a prominent sub-contractor to primary construction contractors in UK.

Historically, their business model was based on revenue being generated through short-term subcontracts. NG Bailey is proactively pursuing a strategic change in its Business Model. From being a supplier of electrical and mechanical products and expertise to the construction industry on short term contracts, it is now positioning itself to be an organization which, in their terms, “makes buildings come alive”. The value offered by the organization will also become sector specific. The organization has and will continue to develop construction and maintenance expertise in a particular field in order that the requirements of that sector can best be built into the offering. They refer to this transformation internally as “sectorization”.

The ultimate aim is to restructure the business to provide an integrated offering, integrated both in its ability to offer a range of installation services to the same client in the area of its core expertise; and over time, to be able to offer the necessary maintenance of those services.

Co-operative Financial Services: Reinforcing strategic capabilities and developing a performance culture

At Co-operative Financial Services (CFS) the key challenge was reinforcing strategic capabilities and developing a performance culture. The merging of the banking and insurance arms under a common organization in 2002 did not in the first instance create a single business model. According to the CEO the customer base was different, the value proposition was different and the operating model was still organized around silos with a wide variety of capabilities, technology and processes. Furthermore the renowned ethical approach of the Bank was not replicated in the Insurance division.
There is now a new business model. In essence the different parts of CFS were still entirely separate businesses united only by the cooperative brand. CFS’ long-term vision is “to become the UK’s most admired Financial Services Business” \(^4\). The CEO writes that the organization is in ‘year one of a 10 year vision’ to become “the UK’s most admired financial services business.” In the last two years, CFS has developed a single business model operating in different sectors so they are in the words of the CEO “focused back from our target customers in terms of delivery of what they want”. They are also clear on the capability needed to deliver this in terms of product, service, and quality. This has also involved thinking about how they give those people value, defining why the customer would buy from CFS and not someone else, and the consequent service and quality propositions and ethical stance.

Nestlé Rowntree: Looking at a Business Model through new lenses

Nestlé Rowntree is looking at an existing business model through new lenses. Nestlé operates across a range of business models, categorized as globally-driven premium businesses, regionally-managed (zonal), very local, stand-alone or service-driven. It relies on the GLOBE system to allow businesses to operate their own optimal structure whilst benefiting from best practice adoption and continuous improvement in components of the business model such as food quality, pricing, supply chain management and marketing. Nestlé UK is an important component of the Nestlé’s multinational operations. Nestlé Rowntree was formed after the 1988 acquisition in 1988. It is the UK’s third largest confectionery company after Cadbury’s and Mars. The brands include Kit Kat (the UK’s top selling confectionery product and 11th overall consumer brand) Milky Bar, Aero, Smarties, Quality Street, and After Eight.

Senior management was overhauled in late 2003 in order to refocus the business, and then again in 2005 when the sector share was eroded after a series of unsuccessful spin-off products. The performance of the Kit Kat brand had provided one of the incentives for Nestlé to acquire Rowntree. By 2004 the UK confectionery market was worth nearly £4 billion (the biggest in Europe) but growth was hard to come by and competition was fierce but sales of the leading brand Kit Kat had first met saturation point and then fallen by 5% in a year. In December 2003 the incoming Managing Director was reported by analysts such as Datamonitor and Information Resources as announcing that Nestlé Rowntree (or at least the marketing) was a business in crisis. The stated strategic intent was to get ‘more people to buy more products more often at higher prices to make more money for ourselves and our retail customers’. Attention was given to the relevance of the brand. Nestlé Rowntree decided to target workplace snacking, while still retaining its former association with relaxation. The launch of the first brand extension of Kit Kat Chunky in 1999 was followed by limited-edition flavour variants (such as orange or mint) and spin-offs such as Kit Kat Kubes. The strategy also involved reducing expenditure on trade marketing and the levels of supermarket discounting, with a strategy of strengthening partnerships with retailers ‘by introducing strategies to increase sales and efficiencies and make us more joint profit’.
The strategy met with mixed success but, as the MD left less than two years later, also criticism. Despite heavy investment in brand proliferation sales fell. Whilst consumers had bought more, variants cannibalized sales of the core brand. There was a lack of customer focus or attention to retailers and continued issues with product quality. The solution of the current Managing Director was a restoration plan based on a business improvement strategy. Key processes had to be fixed. Poor forecasting had created problems with demand planning, such that stocks had built up to very high levels leading to production slow-downs. Attention and investment was shifted away from sales into brand management, measurement of stock-in-trade, sustainable new product development and product quality. As a result of process reviews, a number of management processes around business modeling capability were altered.

In late 2006 the decision was announced to shut down the antiquated five-storey Victorian building at its plant in York, some production was move elsewhere in Europe and £20m was invested in the York plant to improve production facilities. By August 2007 Nestlé was noting in its financial reporting that there had been a “notable performance improvement” at its UK Nestlé Rowntree confectionery business.

**United Utilities: Becoming a world class operator of utility infrastructure**

United Utilities (UU) is the UK’s largest listed water and wastewater company, with an annual turnover of £2bn and pre-tax profits of £445million. United Utilities PLC was created from the merger of North West Water and Norweb in November 1995. Its principal activities are managing and operating the regulated electricity distribution, water and wastewater networks in North West England, a region with a population of around 7 million. As well as operating its water, wastewater and electricity networks in the North West, the group also uses its core utility skills to manage other infrastructure assets, through its United Utilities Contract Solutions business.

The arrival of a new CEO, Philip Green, in March 2006 proved to be the catalyst for a rethinking of UU’s strategy and Business Model. Green inherited, in his words, “a sort of mini-conglomerate” with 90% of business in one of the units, and two or three others which were “neither relevant to its core competences nor did they have scale”, which were sold off. The regulated business was seen as steady and secure; the non-regulated as entrepreneurial, risk-taking and innovative. It quickly became clear to the CEO that the performance of the non-regulated businesses (essentially work contracted to other Utilities companies) was significantly higher than in the regulated businesses. He also surmised that there was little or no learning or transfer of capability between the different areas of the business and so chose a business model that drew upon entrepreneurial elements of the contracting business.
British Aerospace Systems: Leading the way towards through life capability management

BAE Systems is the 4th largest defence company in the world (2006 defence revenue data), behind the US firms of Lockheed Martin, Boeing and Northrop Grumman, with annual sales of over £15 billion and 97,500 employees. It is engaged in the development, delivery and support of advanced defence and aerospace systems in the air, on land and at sea and has customers and partners in over 100 countries. In the defence industry many constituents may be suppliers, customers and partners but also competitors, firms can act as both suppliers and contractors, and a significant range of processes may be outsourced. In the old business model, based around large contract procurement, concern grew that there was a risk that the UK could end up having no onshore defence capability and that open competition might actually decrease the ability of UK firms to compete globally. Procurement decisions were sporadic, so if an organization lost capability it might be 5 years before the next contract, by which time the skills could be lost to other sectors. BAE was able to use its work with certain sectors – for example on logistics issues with defence equipment suppliers – to argue that there could be a more intelligent service model.

As an integrated suite of equipment was developed, after which it became possible to make the final switch to an availability contract business model. BAE Systems would take on the management of a customer's assets, and reduce their cost of procurement by the hour. The new business model – for which there were some parallels in lean management within the automotive industry and the aircraft engine design sector – was based around the contracting for availability of military assets, and involved shared ownership and shared risk taking over these assets. Central issues were asset and inventory cost management, which could best be solved through better supply chain management, linked to procurement and the predictability of costs. This thought process enabled a clearer value proposition to be articulated for government. The model required a shift in attention to Through Life Costs - the resources needed to run equipment throughout its life cycle - and this depends on the complexity involved in its design.

Reflecting this thought process, the Defence Industrial Strategy (DIS), published in December 2005, recognised that many of the Armed Services' platforms will likely have long service lives, requiring extensive support and upgrades, and set out those industrial capabilities for which the UK needs to maintain both appropriate sovereignty over this capability. The most expensive aspect of military platforms is rarely the acquisition cost but is the ongoing support and maintenance contracts. Through life begins from concept design, assessment and demonstration, through manufacture and migration to initial service, in-service support and transition out of service.

A number of agreements followed the DIS. The Secretary of State of the time explained that "...In short, we are telling industry what we think we will need, what will be strategic to the UK, where we will be spending tax payers money, and how we will engage with the market". BAE Systems has applied the model principally to military air platforms such as Tornado and Typhoon, land systems and
some naval programs such as Type 45 frigates and Astute class submarines, but as it builds its capability to operate the business model and demonstrate sustainable profitability, it will be applied both more deeply and also to wider parts of the business in Air, Land and Sea. From an HRM perspective the model also requires that a strong service capability be developed on top of the existing production, engineering and project management culture. The model also shifts the relative importance given to different people, knowledge, skills and experience.

Sellafield Ltd.: Decommissioning or development? Managing the political and economic environment and strategic direction

At Sellafield Ltd. the challenge has been dealing with models based on decommissioning or development, and managing the political and economic environment and strategic direction during this period. Sellafield Ltd is a specialist site management and nuclear clean-up business, employing around 14,000 people, and is part of the BNFL Group. The strategy and focus of Sellafield Ltd is to deliver accelerated nuclear clean-up programmes, safely and cost-effectively for customers in the UK and overseas. Sellafield Ltd products and services range from fuel manufacture, electricity generation and reprocessing of spent fuel, through to the decommissioning and clean-up of redundant nuclear facilities and the disposal of solid low-level radioactive waste.

The business model applying at Sellafield has gone through a complex evolution in the last ten years driven largely by external events. The complexity of Sellafield's external environment dates back to the mid 1990's, a time when the government had a negative view of the nuclear industry. It was seen as a financial drain carrying massive liabilities (around $50 billion in decommissioning costs), and as an industry run inefficiently; relationships with senior management at the then BNFL were poor. The received wisdom (with an eye on the US model where the nuclear industry had been subject to "contractorization") was that the private sector needed to be involved, and the attempt was made to privatise BNFL as it stood (an owner operator). However the private sector proved to be unwilling to take on the substantial risk of liabilities and so privatization was shelved in 1999.

The government came up with a different model in 2004, to retain ownership of the assets and therefore the liabilities as a government agency, which became the NDA [Nuclear Decommissioning Authority]. Management and ownership of the assets would be contracted out; a process which led to the creation of the British Nuclear Group (BNG), recently renamed Sellafield Ltd – a renaming that was the result of a further shift in direction by the Government in 2007. The NDA was to concentrate on decommissioning and clean-up and being contract manager through that process. Originally BNG was created out of the old BNFL as a site management company, by creaming off an element of the management group from each of the operating parts of the business. BNG would become a full market player, and be able to compete in the international environment, predominantly in the decommissioning area.

To a great extent the strategic direction and the change in business model at Sellafield Ltd. are one and the same issue, more so than our other cases. The largest strategic decision, of course – over the future of the nuclear industry in the UK – has been at the heart of the problem of running the industry over
the last 10 years or so, and the lack of a clear answer to that question, until very recently, appears to have created uncertainty in all other choices, not least on the business model. It is clear that decisions over the future of the industry are out of the hands of the managers running Sellafield Ltd. as is, largely, the choice of business model. There is accountability for the retention of nuclear capability for the UK within the NDA’s scope. They are setting up national working groups, but this is still very much anchored in the decommissioning agenda. Their remit does not cover new nuclear developments (yet). The broad steps of implementation however are relatively well understood. The “parent body” of the site, today Sellafield Ltd. (wholly owned by BNFL) will be put out for competition and awarded in April 2009, at which time the current management team will hand over to the winning company (or companies).

Royal Mail: Re-positioning against new business model competition

At Royal Mail the challenge is one of re-positioning against new business model competition. Royal Mail Group Ltd is the parent company of Royal Mail, Post Office, and Parcelforce Worldwide. The Group is a good example of the unique pressures that some public sector companies’ face in today’s fast changing business environment. One on side are a series of social responsibilities, business values and ethos embedded in centuries old history that must be adhered to: an argument that “post matters” to the UK economy, the requirement to offer a universal service at common price which means that costs cannot be removed from the business in line with volumes; and a social cohesion role with regard to small businesses, social customers and communities.

On the other hand are business pressures that deregulation of postal services has brought on the Group. In the exchanges during the independent review of the UK postal services sector from December 2007 to May 2008, both the reviewers and Royal Mail agreed that the old business model “was untenable”49. Not long ago Royal Mail was a monopolistic business with assured revenues. But liberalization and deregulation of the postal market in the UK brought new challenges and new competitors. The challenge now is to devise a business model that provides incentives for Royal mail to modernize operations and stabilize finances. Royal Mail argue that it needs more access to equity but also that the regulatory regime was based on erroneous assumptions about the decline in post volumes, level of price controls and returns, controls over its retail and wholesale businesses, product development and withdrawal, and artificial incentives to new entrants and disincentives for Royal Mail to remove costs.

Consequently the pace at which new entrants (such as TNT) have captured share in the upstream delivery business has been faster than anticipated. Changing technology, the decline of postal services as a share of the communications market and e-substitution continue to decrease the size of the market. The Group needs to find a fine balance between its financial success, which makes the group commercially viable in face of new businesses eroding its customer base, and its social responsibilities (which its competitors are not bound to) of having to continue operating many of its loss making rural branches.
Undeterred by the new world order, the vision of Royal Mail remains unchanged: “To be the best and most trusted mail company in the world”. However, in face of the new world reality the Group has changed its strategy to achieve this vision and be in step with changing times. “Modernization” of Royal Mail is the Group’s main agenda today. Modernization means making the culture more customer focused and focusing on complex and sometimes conflicting performance demands for innovation in products and services (for example transforming the value of advertising mail, providing a new range of sender and receiver options, offering sustainability through recycling on top of recent additional sources of revenue through ventures into new financial products markets through Instant saver accounts and credit cards). But it also must be driven by productivity and efficiency.

To compete with its new competitors the Royal Mail has plans to improve efficiency and transform operations very significantly. In addition to massive recent efficiency gains and cost cuts it needs to take out an additional £1.5 billion of costs. It plans to restructure the Post-Office Network (rationalising the mail centre network and delivery offices) to deal with chronic loses and has a long term strategy for creating sustainable future for rural services and maintaining an integrated business. It is putting in new technology and replacing obsolete equipment, and must standardize and simplify work practices.

Vodafone: Future – proofing talent in a world of continuous Business Model change

Finally, at Vodafone the challenge can be categorised as future – proofing talent in a world of continuous business model change. Vodafone Group Plc is the world’s leading telecommunication company with a significant presence in Europe, the Middle East, Africa, Asia Pacific, and the United States. In its Half-Yearly Financial Report 2007, Vodafone reported revenue of £17 billion, an increase of over 9%. With a customer base of over 241 million, Vodafone is looking to consolidate its presence in mature markets and expand its presence in the emerging market of Asia and Africa.

Vodafone has three segments of customers: Enterprise, wholesale, and individual consumers. It operates in four product areas: mobile voice, mobile data, specialist products (where they sell live to customers), and mobile solutions (bespoke solutions for organizational clients). The previous business model focused on capturing market share in the mobile voice product area but increasingly the industry is moving towards convergence where the phone can do everything. Though, its basic operating business model remains the same - sell mobile products and solutions - Vodafone customizes its strategy to do so according to the market it is operating in. Currently, Vodafone has five key strategic objectives: cost reduction and revenue stimulation in Europe; delivering strong growth in emerging markets; innovating and delivering on their customers’ total communications needs; actively manage its portfolio to maximise return; and align capital structure and shareholder returns policy to strategy.
Although there are no transformational changes in Vodafone's business model, it is (like all other telecommunication firms) highly susceptible to four forces: changes in technology; new entrants in the competition (such as providers of fixed line services, or providers of other services such as VoIP); changes in regulations; and an increasingly aware, discerning, and demanding customer with lots of options.

In response, Vodafone is concentrating on developing expertise in selling complex IT solutions to targeting high revenue generating Enterprise customers. It also identifies the need to stay ahead of its competitors in technological innovations. Convergence of voice and data providing true mobility for its customers is Vodafone's major objective. To innovate and deliver on customer's total communication need is the next big thing. Under this they have focused on four key areas: increasing data revenue by continuing to develop product and services to integrate the mobile and PC environment; increasing presence in fixed broadband business; converting fixed line users to mobile through fixed location pricing plans offering customers fixed prices when they call from within or around their home or office; and increasing revenues generated through mobile advertising and concentrating on technological innovations that help them do so.

Our findings are based on analyses of these business model change processes as they are happening "on the ground" in our sponsor and member organizations.
A Typology of HR-Business Model Responses

When we look across these business contexts, and our analysis of other Centre partners, we can differentiate four different taxonomies that HR Directors face with regard to business model change.

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Criteria</th>
<th>HR Headline</th>
<th>Case Examples</th>
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<tbody>
<tr>
<td>1. Incremental Model Change</td>
<td>Stable or slowly evolving competitive landscape</td>
<td>Value through exploitation of performance logic of current business model Continuous improvement of HR practices or reinforcement of capabilities relevant to model</td>
<td>Shell, McDonalds, Rowtree Nestlé</td>
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<td></td>
<td>Unchanged demand for value from customer</td>
<td></td>
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<td></td>
<td>Business model relatively well know, already implemented</td>
<td></td>
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<td></td>
<td>No change in strategic capabilities</td>
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<tr>
<td>2. CHANGING the Rules of the Game</td>
<td>Organizations’ leaders proactive in driving transformational (business model) change</td>
<td>HR can be at centre of change through Architectural Design capability and innovative HR structures</td>
<td>NG Bailey, United Utilities, BAE Systems</td>
</tr>
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<td></td>
<td>New capabilities needed</td>
<td></td>
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<tr>
<td>3. The Changing RULES OF THE GAME</td>
<td>External change in the competitive landscape means organization value proposition is no longer valuable New capabilities needed Organization may or may not be responding with Business Model Change</td>
<td>HR reacts to short term strategic challenges, uncertainty HR needs to help place business model change on the agenda</td>
<td>Royal Mā, Sellafield, Co-operative Financial Services</td>
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<td>4. Fluidity</td>
<td>Continuous change in competitive landscape, entailing continual business model evolution</td>
<td>HR can be at centre of change HR needs world class Design capability and highly flexible HR team HR a strategic partner sharing and leading strategic evolution within the business</td>
<td>Vodafone</td>
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</table>

Figure 1: A typology of business model change scenarios
This typology is intended to be illustrative and not prescriptive. It represents the current state of strategic reciprocity in the organizations studied. Each of the case examples positioned in the taxonomy have, and may well in future, evolve through the different stages shown. An important task is to understand the HR architecture associated within each, and in transitioning across each.

1. INCREMENTAL:
   Evolutionary Model Change

In the first taxonomy, the strategic landscape is known and comparatively stable or evolving slowly, and the business model is being refined and extended but concepts, and core capabilities, underlying the business model remain the same (franchising, for example, or the content of a financial transaction). In the case of McDonalds, franchising as a business model is well established and is now being extended widely in the UK. Shell's competitive landscape has evolved in the last 10 years, and the company has added renewable energy to its strategic goals, but the underlying business model for the exploitation of hydrocarbons is relatively stable. The company is therefore aiming at exploiting its top quartile performance position in its market. Rowntree Nestlé acts as a disconfirmation of business model change. The business model has remained broadly the same. However, the shift in strategy means that in order to maintain the health of the model, investments were made in different components of it. The way the components fit together is broadly unaltered. It is easy to assume that just because there is a significant business improvement or process redesign programme that this automatically entails model change.

The key challenge for HR is therefore to advance their value proposition through better internal exploitation of the core performance logic of the current business model. This may involve taking the lead in advancing a case for the added value of HR where this is not well understood. At McDonalds, the HR focus is on continuous improvement of the engagement-performance link by (for example) setting up HR metrics to measure the link, clarifying HR's value proposition to employees, capitalising on a good social mobility position, and implementing coaching and development to improve restaurant level HR climate.
2. CHANGING THE RULES OF THE GAME: Internally Driven Business Model Change

In the second taxonomy, the change may be in response to a shift in the competitive landscape; but the organizations’ leaders have reacted quickly to drive business model-led transformational change through the organization, often before competitors have reacted, or before others see the necessity of the change.

At United Utilities, the arrival of a new CEO began the drive to an entrepreneurial mindset from a public sector, bureaucratically – oriented mentality. At NG Bailey, the leadership team grasped the implications of intelligent building solutions as a value proposition despite the enormous shift this entailed from the company’s traditional role as a subcontractor of maintenance services. At CFS, the Insurance and Banking arms existed as separate models until the arrival of the CEO brought them together under a single value proposition, architecture, and set of capabilities. And at BAE Systems, the through-life capability business model is allowing them to take a lead position in a highly competitive landscape. Those organizations that understand both the key capabilities that get thrown up by the model – such as integrated business systems modelling or partnership arrangements – but can also demonstrate secure execution of these capabilities can capture significant value in existing markets and apply this learning to the development of new markets.

In this situation, HR has the opportunity to be on the ‘front foot’. Not only does the HR agenda have the potential to be central to the success of business model change, to an extent the HR agenda may be synonymous with it. Business model change entails redesigning the organization’s value web, and developing new strategic (or “architectural”) capabilities, both firmly in the domain of HR expertise.

In each of these organizations there is still an element of the “Janus” effect, but there is likely to be much more forward – looking transformational activity on the part of the HR function. At United Utilities, the HR Director is both leading a reorganization of the function to ensure that transactional processes are efficiently conducted through a shared services unit; at the same time as advising the Executive Team on what the new business model should look like. At NG Bailey, HR is leading the way on the creation of new organizational functions such as Business Development, and the development of new organizational capabilities for project managing long term building maintenance. BAE Systems’ HR leadership has already reacted to the demands of changing the rules of the game by outsourcing of most of its HR function. At CFS, technology and regulation have placed demands for the increasing speed of financial transactions. Until recently the point of delivery of value to the customer and the nature of the product and service has been well established. This may involve taking the lead in advancing a case for the added value of HR where this is not well understood, so that at CFS, for example, the development of people – related capabilities (such as performance management, consumer intelligence, and leadership) to support organizational change has become central to the way the organization is evolving, whereas previously these were considered peripheral at the Executive level.
3. THE CHANGING RULES OF THE GAME: Externally Driven Business Model Change

In the third taxonomy, a fundamental shift has taken place in the way that customers, or other key stakeholders (government, or regulators), perceive the value of the organization’s product or service. This will, ultimately, result in a threat to the survival of the organization, as its traditional capabilities will rapidly become outdated.

The organization should be reacting to this shift with a transformation of its business model; the nature and speed of this transformation will depend on how quickly the organizations’ leaders perceive the threat and are able, or free, to react to it. In Royal Mail, the threat is from competition from privatised companies and the internet, entailing its traditional offering – and its cost – becoming untenable. At Sellafield Ltd., the uncertainty of the Government’s position on the future of the Nuclear industry – only recently resolved – meant that until recently the organization knew only that the model was changing, without knowing precisely to what.

In this situation, HR may find itself “on the back foot”. It may not yet be clear what the future business model is; HR will therefore be reacting to operational challenges imposed by a shifting and uncertain landscape and – in the worst case – implementing HR strategy which is rapidly becoming outdated or irrelevant, and therefore losing its value to the business. HR may therefore have to look, Janus-like, in two directions: first, establishing stable, “best practice” HR processes to help the organization through a transition period; at the same time, keeping an eye on the strategic goal, where more fundamental changes to the HR architecture will be needed once the new business model is clear. Thus at Royal Mail, the HR strategy has to date been to get to a “steady-state” position – stabilising the industrial relations climate following investment in new technology, implementing major cost reductions, and moving the HR department to a modern operating model. At Sellafield Ltd., the HR team has been focusing on maintaining the capability needed to ensure continuous safe operations, assisting the organization to develop cross – functional structures, and developing new ways of working as the organization shifts from cost – plus to fixed – price contracts. In both organizations, however, the transformation of the business model has yet to take place.
4. FLUIDITY: Continuous Business Model Change

In the fourth and final taxonomy, the competitive environment is in a state of continuous and rapid evolution. The organization cannot afford the luxury of crystallizing one business model for any length of time, due to the volatility of particular the market place, and at the risk of being left behind by competitors. Continuous evolution of the business model is central to competitive advantage and ultimate success within the market place.

At Vodafone, the most recent challenges are the technological shift in its customer value proposition from voice to data, and the political / economic conditions of a maturing Western European market and a rapidly emerging Eastern Europe. This type of continuous innovation demands that the HR department is world-class in what we refer to architectural design capability – a combination of old – fashioned macro OD with strategic consultancy and a well-developed competence in commercial and economic realities. Engagement – the reinforcement and measurement of employee discretionary effort – also moves close to the top of the HR agenda.
Key HR Activities and Capabilities

In this section of the report it is our intention to outline those key elements of HR strategy and practice identified by our respondents that need to be “mastered” by HR Directors and their teams in order to contribute effectively to business model ongoing management and to any proposed change to the model: fluid or incremental. We focus upon the responses to questions given by both operational and HR executives regarding both the leadership and support to the business model that HR provided. We identify those elements of that leadership and support which were considered to be positive and viewed as successful, which were less so and what were regarded as key HR strengths. In addition in a number of interviews we probed for what were the key learning points for operations, support services and HR.

Outlined below are the key activities/functional competences that were nominated in the research as being crucial in terms of allowing HR functions to be both proactive and effective in this lead and support role in sustaining successful business model operation.

Before we describe those key activities/competences it is worth outlining some qualifying points to note:

• First and foremost the following five activities may be viewed as a totality that, if all are present, should provide for a high level of proactivity within that HR function. There is a logic that links each capability to the next, and this logic has dictated the order in which each must be presented.

• However we suspect that few HR functions, at the present time, would have “mastery” of all the competences outlined.

• Our view would be that the balance of HR competence that a particular function needs to possess is dependent upon the business model cluster that they inhabit. So, for instance, an organization operating within the fluid cluster may require a more comprehensive OD resource than one operating within an Incremental change cluster.

From our data there are a number of areas that an HR Director needs to have mastered, if he or she is to engage effectively with the line in order to add value during periods of business model change.

We see these themes as areas of HR capability which an HR Director, and the HR function, should possess as proprietary knowledge; what is at stake is no less than the survival of the function. Get them right, however, and we believe they point to a transformation of the way HR work is thought about, and done, in the 21st century.
PRESENTING THE THEMES

We present these themes in two ways:

1. We believe that they tell a consistent narrative, and have written them up as such. The story is not a simple one, but we can see a consistent thread through it. This thread has to be followed to the end, and is an important one to grasp for those interested in the future of Human Resources.

2. In order to break this narrative down into more easily digestible “headlines”, we have represented each of the themes in three ways i.e. as a series of headline issues; set of strategic imperatives, and number of “must win” battles for HR.

The “headline issue” invites the reader to reflect on his or her own situation and attitude to that particular area of HR work.

The “strategic imperative” represents the theme in one or two sentences – why we believe the theme to be important, and what issue it raises about the HR agenda.

The “must win battle” is our own conclusion about the theme based on the evidence of our data and literature review.

It is evident that HR Directors are not looking for “quick and dirty” solutions to what are after all highly complex problems. However, we have distilled the messages from the research into a series of simple ideas – which for the HR Director have to answer the question “what is in it for me?”

1. A Symbiotic CEO/HR Director Working Relationship

Headline issue:

Does the CEO “get” the people proposition? When they do, do they really think that the HR agenda is as important as any other part of their responsibility?

Strategic imperative:

HR’s role in organization strategy, especially at a time of Business Model change, is largely dependent on the attitude of the CEO. If the answer to the headline issue is “yes”, fine; HR strategy will eventually be indistinguishable from business strategy. If the answer is “no”, then do not even try and talk about HR’s strategic role. Put in place good efficient processes, and look elsewhere if you really want to do strategy. Otherwise you can talk about it, but it won’t happen.

Must-win battle:

Make sure that as HR Director you quickly develop an intuitive relationship with your CEO, as close as any other in the senior team.
It has become a cliché of modern HR work that a “seat at the table” is a prerequisite for success, but with very little precise information about what this might mean exactly. We have concluded that the relationship between the CEO and the HR Director is the start point for the way HR work gets done in the organization, a situation which becomes particularly acute during a period of transformation.

However, there appear to be two facets of the relationship which explain the success, or otherwise, both of this critical relationship, and of the characteristics of the HR strategy that follow. The first is the attitude of the CEO to HR; the second, and related, is how well the two people get on with each other.

We deal therefore with this theme first, as it is a necessary criterion for the second, and main, research question of how HR contributes value to business model change. This CEO clearly believes in the centrality of HR:

“There’s nobody that I’m more intimate with than my HR Director. Typically the person the GM is closest to is the FD. Part of my philosophy is that the two people I’m closest to are my finance man and my HR man.”

There are of course likely to be many ways a CEO will approach the HR agenda. We have simplified this into two alternative stances:

- does the CEO believe that HR is part of and integral to the strategic agenda,
- or do they believe HR is separate from it?

What follows will be fundamentally affected by these two alternatives. A significant proportion of our HR Directors comment that they would never have joined the organization had they not heard the CEO’s clear commitment to HR’s integral strategic role in the business.

To return to the CEO quoted above, their description of the levels of HR work is informative, given their stated attitude. For this CEO “HR Strategy” has no separate identity.

Q: What is on the HR agenda?

A: I usually describe HR at what I call three levels. There’s the foundation level, what we used to call personnel, it’s just pay and rations, recruitment, all that sort of stuff that makes the world go round, transactional work. Level 2 to me is tools, it could be engagement, reward, development, those sorts of things. Level 3 is the strategic engagement. When you say what’s the HR agenda there’ll be items on all three levels.

Q: What’s going on at level 3 in terms of HR strategy?

A: Not HR strategy, business strategy. We have a small business in [country], we should either close it or expand it dramatically. It’s a current business issue for us, and I want HR engaged in that debate.

Processes which for HR people are on the curriculum as “strategic” or as “transformational” are, for this CEO, tools (the CEO later clarifies explicitly that level two HR work is not “strategic”). “HR strategy” ceases to have any meaning for this CEO – there is business strategy, and a suite of HR tools at level one and level two which support it. We finish the sequence of quotations from this CEO with one that illustrates the expectations from HR at level three:
“Two things. I’d expect them to come from the people perspective. Purely from the HR perspective, but also from the business perspective: what do the Board think? What do our shareholders think? Can we make money? Those sorts of questions.”

This is not, however, a situation that occurs regularly. This CEO believes it is rare to find such an attitude to HR at CEO level and finding an HR Director with the competence to engage at this level is even rarer, though one has been found in the current HR Director. Another organization, engaged in a strategic change programme, offers the counter example where the HR agenda for change was a late addition to the suite of change projects made only after canvassing by the HR Director. As the Transformation Director explains:

“Of the 6 priorities not one is about people. I think that’s because the Executive came up with those last year [they] are now starting to see, especially in the last 2 months, how… before we do any of this work it’s something about making sure we’ve got the right people in place.”

The evidence suggests that in this instance the Company Executives instinctively showed the second of the two attitudes mentioned above - that HR is considered separate from business strategy, even in a process of business model change. We will observe potential consequences of this attitude in our discussion below on HR strategy implementation.

The second aspect of this theme is the crucial part played by the relationship between the HR Director and the CEO. One CEO uses the word “intimate”: another HR Director calls it “intuitive” and ensures that the function’s Business Partners have a similar relationship with their senior line people:

“It became very clear that [the CEO] and I connected, I used that as leverage, and then it became a matter of building relationships… if I take the top segment first of all, they get a lot of personal time with the HR Director - almost a coach to the senior person, they get a very personalised internal coaching service. The relationship can become intuitive. What you get with a high level HR business partner [is that] they get access to the discussion and debate on the market and the businesses right at the front end. So like the relationship I built with the CEO - high trust, pick up the phone - that’s what I wanted the BPs to have with their managers.”

Along similar lines another HR Director refers to their “daily” contact with her CEO. Throughout the project the theme of a healthy and mutually supportive relationship has been highlighted as a key component of effective HR activity. HR Directors frequently cite the crucial importance of “connecting” and the simple but crucial element of frequent meetings between the CEO and HR Director.

An effective relationship with the CEO is a precondition of all the subsequent capabilities outlined in this section. The extent to which the HR Director has become socialized into operating through such a relationship helps them of course into a deeper understanding of the business model change, but can also enable HR Directors to lead the top team towards a progressive and people-based insight of the organizational issues involved.

These CEOs and senior HR managers have developed a close working relationship extending beyond the norm; the language of intimacy and intuition is quite striking. What effects do these criteria (the attitude of the CEO and the relationship between CEO and HR Director) have on the development of HR strategy? This is our next theme.
2. HR for the Business

**Headline issue:**
If one considers HR activity as a value chain, at what point on the value chain does one commence the HR contribution?

Does the HR function start from HR best practices and HR performance management, or from the opposite perspective, a clear and thoughtful evaluation of internal client needs?

**Strategic imperative:**
People are of intangible value. One manifestation of the CEO “getting” the people proposition is that HR have to “get” the business proposition in return. Only then can they release the people value inherent in the business. HR act as value brokers in this regard. Business model change provides a perfect opportunity for HR to provide this value brokerage.

**Must-win battle:**
The HR Director needs to be driven by the analysis and nature of BM change and then the shaping of organization structure and HR processes, not the other way round. Measurement of performance becomes the end of the process, not the beginning; “reversing the arrow” means developing a clear, business – oriented explanatory framework for the centrality of HR.

A view emerged from the research of the criticality of HR bringing value to the business model. To do that, pre-conceived notions regarding HR policies, priorities and practices could be damaging to meaningful value contribution.

HR must be fully responsive to the strategy and business model of the business. HR is not a rule for itself. It is not “HR for HR”, but HR (as broadly defined across the competing stakeholders whom HR has to satisfy) for the business.

When the attitude of the CEO to HR work is as a secondary or lower level agenda, and the relationship between the CEO and the HR Director is not close, then the HR agenda risks being dictated by reliance on “Best Practice” learned from B schools, books, and previous experience; or by the need to prove HR’s worth, by making performance measurement the prime mover of HR work.

We argue that the HR agenda will develop in two possible directions as a result of the attitude taken by the CEO.

1. Either it will remain in lockstep with business strategy and move ultimately (not immediately) to integration through a clear explanatory framework of how HR processes integrate with business strategy.
2. Or, it will remain conceptually separate, with HR strategy separately defined and implemented (in the classic sense of HR “fit” or “alignment” with strategy).
In the latter case HR becomes more theory driven, and defined by a set of externally defined and popularised HR concepts (the Ulrich 3-Box model being one obvious example, but the mantra of “line responsibility for HR” may be another). Measurement of this HR agenda, in order to prove its impact on strategy, assumes much greater importance. We refer to this trend as “reversing the arrow”.

Structuring HR for the business was discussed by a number of respondent organizations as reflecting a key perspective on the part of the HR Director and the HR function if HR was to provide relevant contributions to the business and in terms of the business model.

This HR Director gives perhaps the clearest statement of what we mean by this expression.

Talking generally about recent trends in HR:

“I think we’ve done it back to front, I think we’ve defined the model before we know what the organization is. To what degree is responsibility transferred to the line? And where is the best commercial value for that? Because I think in HR we have a view that says it’s the HR model that dictates it and not coming at it not just from our internal customer, but our external customer. If our values are about value to the customer, sustainability, keeping people safe, what therefore is the HR model that supports that?... I keep saying Ulrich’s never been an HR Director, so what would he know!!”

If we consider the question in terms of an HR “value chain” then the opportunity described by this HR Director is to deliver an HR agenda in which the direction of the arrow is from a clear definition of the clients’ needs, with a deep understanding of the HR elements of business strategy, and with an “intuitive” relationship as a prerequisite, through to the organization’s HR processes, the structure of the HR department, and finally, methods of measurement as the final (and possibly least important) conceptual element.

There may also be an element (preserving the idea of the “value chain”) of understanding the way value is created, captured, and preserved. We will consider this issue in a later section.

However we suspect that many organizations reverse the direction of the “HR value chain” arrow for some of the reasons we have given. HR strategy in this case will be partially or wholly driven by theoretical models from the literature, or more likely from previous HR experience, with a substantial emphasis on the need to “prove” the value of these processes.

We should emphasise that this does not minimise the work of the HR professionals in these cases; it is simply a brutal fact that their senior line people do not consider HR to be integral to organization strategy. It may also be true that part of the difference is down to the stage of transformation of the organization.

Situations where the transformation is in its early stages may offer an explanation of the potential separation of HR and business strategy due to the need to change management attitudes to HR, whereas when the transformation is further through, and difficult decisions on redundancies (for example) have been made, closer integration may be possible.
Notwithstanding these explanations, we offer one example of the difference in language – subtle, but perceptible – that illustrates our point about the two fundamental approaches to HR. The context is line management responsibility for HR, theoretically an essential element for modern HR, but in practice a little more tricky to establish.

The first quotation is from an HR Director where there is still a clear separation (and order of importance) between business strategy and “HR strategy”, and a key challenge is overcoming very traditional “paternalistic” management attitudes. The HR Director is talking about the degree to which line managers are accepting responsibility for people plans under their change programme:

“Of course it’s only the senior people that sign off on this stuff. The amount of times we’ve had to go back over “do we really need to do this”? On one level it’s incredible how [managers] who don’t want to look in the mirror have tried to cancel it. Key question: do the action plans get to the root causes? Do they get to the heart of it or are they not dealing with the root causes? My sense is that there’s an awful lot of content in the action planning that takes the responsibility away from leadership. “If someone else would do something then everything would be right”.

This second quotation is from the HRD of an organization with a related challenge over the acceptance of line manager responsibility:

“Something [that] every HR person in the world believes right now, is that we’ve got to enable the managers to do the jobs themselves, they’ve got to be responsible for their people, haven’t they, we have to provide them with the tools and processes and they have to step up to the plate. Instinctively I buy that, but when I see the level of responsibility, and what these guys have to do on a day to day basis, and I think about John at the [factory] and I’m saying you have to fill in these forms, and do that versus spending time with the customer… I’m scaling back now to what is right for this organization”. We talk about enabling our managers, but actually we think enablement is about giving them a load of tools and techniques and paperwork that they don’t have time to do and that keeps them away from the customer.”

We believe the attitude illustrated in the two quotations toward the people management responsibility – the first, confrontational, that managers will get away with not doing it if they can, the second, supportive, and realistic about the challenges line managers are facing - result in a substantive difference in the way HR will be delivered.

We can now address our central research question in the light of this contrast:

- How does HR add value to Business Model change?*
- How might the answer to this question vary according to the “reversing the arrow” versus the “HR as theory driven” approaches?
3. Organization Design as a Prime Capability

**Headline issue:**
What are the key steps you take, and in what order, to support Business Model Change?
To what extent does your HR function march in lockstep with the change?
Where are you? Have you arrived yet?

**Strategic imperative:**
We observe that some of the five key capabilities/competences outlined in this report are essential whatever the business model situation that the organization finds itself to be in, whereas some are more appropriate to specific business model situations.
The OD team must possess high levels of credibility.

**Must-win battle:**
The HR Director must recognise the primacy of OD expertise in Business Model change.
They must agree what is implied by this capability. We use the term Architectural Design to signal that the understanding of this capability is still vague, but its contours are being shaped by the need to develop the architectural knowledge that is required to deliver changing business models.
This capability might not be seen as being anything to do with HR. HR Directors need to lay claim by having a good OD resource or recruit one fast. The OD discussion is at the heart of the strategic discussion.

On the first day of his new job as HR Director this respondent was immediately involved in an intense discussion with their CEO about the future of the business. Calling it a “meeting of minds”, they realised that they thought very much alike about the fundamental changes needed to transform the organization. Without any delay, the HR Director was engaged in a strategic redesign process which placed the organization design agenda at the centre of business model change process. Business model change in the UK was inspired by HR thinking:

“The OD people … must be in the space, not only advising on different organizational models, but in the strategic direction of the business, and advising that that thinking should be going on around that organizational change: … if you’re at the heart of the OD thinking the rest follows, the resourcing, the engagement piece. It’s all about the relationship with the key guy; the rest follows.”

There is, of course, a long and - mainly - distinguished history of organization development in the HR field. But there is a crucial difference between whether the D in OD refers to design or development.
The Development ‘D’ refers more to understanding the processes necessary to progress a specific strategic path, the centrality of people issues within this as an important leverage factor, and the consequent development implications for these people.

The Design ‘D’ is a much harder-edged capability. It is based on principles of organization analysis, linking strategic outcomes to the structures and system architectures that create them – a more prescriptive and highly-business aware science.

From an academic perspective, organization design refers to the combination of strategy, structure and internal control and co-ordination systems that provide an organization with its operating logic, its rules of resource allocation and its mechanism of corporate governance.

It is the Design D that has been elevated to the centre of the HR agenda, when the strategy involves a change in business model. In the organization quoted above, this was a shift from a functional structure to one oriented towards P+L accountability; but the precise nature of the change is less crucial than the nature of HR involvement in the change.

We have tentatively called it Architectural Design capability, primarily to signal that:

1. the precise nature of this capability seems to be evolving, and
2. this evolution seems to be driven by the drumbeat of building the architectural knowledge required by the business model change.

We acknowledge here that understanding this new capability is now a pressing challenge for practitioners and researchers alike. Indeed, it forms one of the bases of our next stream of work. There does appear to be an emerging pattern to HR’s contribution, however.

The emerging structure or pattern of HR’s contribution to Business Model change

1. Ensure the function possesses what we call Architectural Design capability (bearing in mind that the term Organization Design may not sufficiently cover the nature of this capability). Naturally there will be an HR orientation to this expertise; however, business model change also incorporates changes to commercial and customer oriented structures as well as organizational ones. The broader the business knowledge the better.

2. The intuitive relationship we described above with the CEO or senior Line person is a necessary condition for the next step – to develop a high level set of organizational principles with the Board. The HR Director acts as a facilitator to this discussion and will use it as a way of further developing relationships with senior players. The process is likely to be iterative, consultative, and will probably involve expert members of the HR team in a consultative role.
3. A new business model is drafted out which is consistent with the principles agreed at step two. In one organization, the HR Director “bunkered down”, to use their term, with their HR team for a month or so as they developed several design options to be re-presented to the Board.

4. Analyse whether the business possesses the required capabilities and knowledge to deliver the new Business Model. Frequently, our research showed that the capability gap represented by business model change entailed not only talent gaps, but a shift in the nature of knowledge from localised, specialist “component” capability to more “architectural” capability, a move explained in part we think by our analysis of the degrees of business model change in Figure 1.

5. Having handled the Organization D for Design questions, manage the change as a “classic” Organization D for Development intervention.

One organization was being transformed through the use of a series of Organization Development oriented steps. The HR Director says:

“We're taking an Organization Development oriented approach [to the implementation of the change]. We define the Organization Development principles and we've created a state of readiness and in order to prove that you're ready for change we've created a checklist, you have to tick 6 boxes. When you have the six you're ready to go, so it's incremental, go when you're ready, everything has to be defined before you change. And basically we're going to redefine the structure of the UK business like that over time.”

We would be naïve to argue that these five patterns of activity are followed consistently and accurately in every case of business model change. But they serve to illustrate our main argument that HR added value comprises a clearly thought out, broadly business based explanation of how strategy translates into a new business model using business architecture design, and thence into HR structures and processes. HR strategy, in this model, is coexistent with and subsumed by organizational strategy and business model design.

It is also clear that the nature of architectural design input will vary according to the stage of business model change in the organization, something underlying, but not made explicit, in the description above. Our description of the design process will be refined later as we acquire more data about HR's role in business model change.

The second pattern of activity – facilitating input on architectural design - seems to be crucial for HR Directors. Being realistic, in several cases the HR Directors in our research encountered ambivalent, lukewarm, or inconsistent responses at this stage of the process. Board members do not necessarily buy in either to the role of HR or the nature of business model change, particularly if the CEO is not attentive to driving the change through consistently.
So at one organization an HR Director laments:

“If only … the Board knew what role HR plays. This is what we’re wrestling with now, the work we’re doing is owned by, let’s be honest, the CEO, the HR Director, the CIO and [the management consultants]. End. That’s what we’re dealing with. I don’t think the organization has talked about what the business model is.”

The Chief Information Officer acknowledges the realisation of the need for HR input:

“We’ve set ourselves some ambitious goals. When I first mentioned those to the Executive Management Team I was met with a few gasps and shakes of the head. Take customer satisfaction for example. 70% of our customers say they’re satisfied with their experience of [the organization]. Which means 30% are not. So we’ve set ourselves a target of 90% which is the highest in the industry. And our customer services people are saying “how the bloody hell are we going to do that?” And it suddenly dawned on them that … they have to start thinking in ways they haven’t thought before. So they’re no longer thinking of the management of the customer relationship, they’re thinking about the whole redesign of the customer relationship, because we’ve set them this target.”

At another organization experiencing business model change, the Transformation Director felt that this was a key failing in the change process – once step one (ensuring organization design capability) had been completed:

“So if you look at the reports coming through [from the Executive], they don’t talk about [the organization design], they don’t try and measure it… a number of attempts to start to tweak it are not being driven through with nearly enough fire and passion. Certain individuals are doing their own thing and driving things through, others aren’t. As a result the people below that level aren’t seeing the changes. They’ve seen a couple of people they liked leave the business and wonder what it was all for, and they haven’t really seen any pressure or benefit to changing.”

Consequently, a key issue for the HR Director with regard to this second pattern of activity becomes the management of performance of the Board, perhaps through helping them to develop new knowledge of Architectural Design.

This HR Director said:

“So the next session was a teaching on how the HR strategy connects with delivering the business strategy. And then updating them on the work [the consultant organization] has been doing to connect the dots for people. I still think I need to do that at Executive Leadership Team level and Board level. Because at the moment we’re in a vacuum really.”

A final key point to make is that HR is being re-positioned not just because of internal organization design pressures, but also as a consequence of changes in the importance of external inter-dependence and partnership. From our analysis of business model change we observed that the organizational “value web” is, in almost every case, extended across traditional organizational boundaries.
It appears to be a defining characteristic of business model change. Relationships with external bodies which were previously characterised as adversarial at best are suddenly having to be redesigned under a partnership model, as long term contracts are developed with other organizations in the same value web. At one large manufacturing organization the concept of through – life contract management is driving a “partnering” culture; for many employees this partnering culture may well involve a physical change in location from a factory site to a partner site.

To illustrate how widespread is this element of business model change, we note that another participating organization, in an entirely different sector, is experiencing precisely the same shift from “adversarial” to “partnering” relationships with outside bodies. At the same time, new relationships are being forged with organizations which would previously have been kept at a distance:

“We want to align our capabilities and offerings to meet an end customers’ needs... so we’re moving up the value chain. Whether we do it on our own or in partnership with other contractors is an interesting debate. The fifth one is about managing relationships beyond [our company] better, key suppliers of existing products, and also forge relationships with people we don’t typically have a relationship with such as architects, professional consultants and even business consultants. We can envisage a situation where in the retail trade where a [company] solution could get very close to the kind of solution [strategic consultancy] does for example. Then you start to get into relationships way beyond where we are traditionally - a real mind stretch for the organization. (Transformation Director)”

What are the implications of this explanatory framework, then, for HR structure?
4. The Business Utility of the 3-Box Model

Headline issue:
How do you organize your HR function and delivery service to employees? What does the nature of this delivery look like? Does the context of business model change alter the business utility of Ulrich’s 3-Box model?

Strategic imperative:
The current dominating influence of the Ulrich 3-Box Model upon HR structures was amply demonstrated by the frequency with which the topic occurred during the research project. In our interviews both HR and operational managers demonstrated familiarity with the characteristics of the model and what it could imply for the HR contribution.

Overall we seemed to be witnessing some advocacy for thinking through carefully whether an introduction of the 3-Box Model structure would enable HR to lead and support the business model. Does it fit what HR aspires to achieve?

Must-win battle:
HR Directors need to ensure that the Ulrich model – even if it is the right high level structure for HR – follows the analytical process we described above, and does not precede it.

It is clear from our data that HR functions have become extremely focused on the Ulrich 3-Box model of structuring the HR department, even though this model is not the only way to address the headline issue noted above. The majority of HR interviewees in the research mentioned the model, and had already implemented it or were thinking about it. We do not believe there is anything wrong with the model per se, and indeed if well thought through, it can of course add value; but the precise nature of the structure implemented should be as a result of a careful analysis of business requirements rather than pure implementation of Best Practice HR. One HR Director describes the concern:

“What the previous HR Director had told people before I arrived is that as an HR model we would go with the Ulrich model which I’m incredulous at because I’ve never described the model we use from an HR point of view from a business text book because it immediately makes people feel very uncomfortable. It is impractical and the devil is in the detail.”

At another organization, the Transformation Director is very clear that the HR Department restructure, very clearly identified by the HR team as the Ulrich model, was about HR best practice and not driven by business need:
“HR has been relatively reactive and not responding to the express wishes of the organization. There’s no broad consensus about how HR should be delivered. The whole transactional and compliance stuff is not being driven by the business, I don’t believe. This idea of centres of excellence and restructuring is not a business need, it’s best HR practice in the HR world.”

At a third organization, the HR structure is also a familiar one:

“Within each of the operating companies we’re moving toward a three box model, I have an HR Director in each of the operating companies, and each operating area will have a centre of expertise, with an organization development person, a reward person etc then generalist HR practitioners, called business partners now, to deliver the end to end HR service, to whatever the customer base looks like.”

As a side note, a recent PWC report notes that there is no clear evidence that the Shared Services model in HR actually improves client service or has a positive impact on the bottom line. What is important is that the HR Director “reverses into” the model. When you reverse you attend more carefully to the collateral damage that poor positioning creates and sometimes you realise it is not the space you should be going into.

To use an HR Director’s phrase:

“(The Head of Shared Services) is working on what the shared services should look like for us, not what Ulrich said it should look like. We’ve kind of reversed into this model…if you take the three bubbles of the Ulrich model - the business partner, the specialist and the admin expert, we’ve come up with our model, its not different, we’ve called it different things, business partner, specialists and shared services, and we’re trying to define what sits in each bubble.”

The famous 3-Box model therefore may see considerable adjustment according to the organizational design work that precedes it.

A number of obvious tensions in the model were evident:

- Managing the “role drift” associated with each of the three boxes as they get dragged into the operational. In a number of organizations the devil was in the detail, and there was considerable post 3-Box implementation adjustment needed to truly align HR to business demands. It could be argued that this is however just a case of doing your homework and ensuring some bespoke determination of the core Ulrich roles.

- Re-instating a strong HR operations orientation within the core function in order to help determine the business-relevant projects that needed central oversight and co-ordination, or creating specialised support for the management of change (business model transformations are complex transformations).
• Considering whether the business partners solution really makes HR strategic – whether for example being embedded in a “component” business affords them access to the true nature of organizational capability that has to be built, or whether it blinds them to the bigger picture of how the component businesses have to be managed as a composite.

• Much of the above is very dependent on line management capability and so the utility, implementation and modification of the HR structure also depends on line capability.

Some innovations around the margin were evident. One organization, for example, split up the HR / line interface to key skill sets so that the business partners are “man marking” the key people managers in any business. At another, the HR unit was split between the team managing “business as usual”, and the group running the change programme initiatives.

We shall continue to explore whether the project has unearthed any evidence of “post-Ulrichian” thinking and structures. We feel that at this point we have not but that some organizations may be very close to moving into new structures and HR philosophies.

Given our argument about the positioning of HR vis a vis the line, what does the data tell us about the main “strategic” areas of HR work? At the top of the list appears to be that of capability.
5. Future-proofing Talent

Headline issue:
To what extent does HR concentrate on strategic capability (as opposed to building its internal talent management practices, functional capability, and knowledge)?

Strategic imperative:
Dealing merely with the HR agenda of competence or talent management fails to engage properly with the immediate issue of strategic capability, which is an organizational characteristic of which the people agenda is only part.

Must-win battle:
The project unearthed a strong level of awareness on the part of senior operational executives that, based upon the now accepted notion of the possession of talent being a key component of competitive advantage, HR made a vital contribution to business model health by establishing and managing a talent pipeline that provided for both present and future business model requirements.

However, future proofing talent requires that HR Directors understand the skill formation process taking place within their organization’s business model, and then take out all options necessary to manage this process.

Or as one Managing Director expressed:
“Where the business model is about differentiation, it is very people dependent.”

“With certain roles you can choose from a wide spectrum of people but when you move to senior management, then the quality of people is crucial, particularly when the industry is made up of companies where a lot of people are pretty average.”

One of the HR Directors interviewed expressed this theme succinctly as “the task is to future proof talent”, and we believe this is apposite to a central concern of many organizations: the building of capability in the organization to support business model change.

We saw three ways of thinking about capability. In terms of:

- the architectural capabilities necessary to future proof the business model
- practices and knowledge associated with specific components of the business model
- individual skills and competencies necessary to deliver threshold business performance.

We devote most discussion to the first thought process. This future-proofing in turn is based on different processes. We observed the necessary capabilities being developed through:
a deep understanding of two or three crucial ingredients – perhaps specific advanced technological skills resident within a handful of highly talented people on which the organization must place a bet or take an option to ensure the success of its business model (an insurance premium, if you like, an option that the organization wishes to take in the talent market, for which it must challenge the HR systems).

• a hybrid skill or insight, created by the bringing together of different component skills. The task for HR is to capture the nature of new insight by being involved in the business dialogues that have helped to articulate it, and to assess the best route to sourcing.

• the transformation or evolution of an existing skill or knowledge base into a new mindset, and it is that new mindset that forms of “glue” that ties together the business model. Often the talent question cannot be separated out from the issue of engagement – and the need to manage the way in which the broader workforce identifies with the new capabilities necessary for the business model. We discuss this issue later.

Future proofing talent therefore requires that HR Directors understand the skill formation process taking place within their organization’s business model, and then take out all options necessary to manage this process.

We referred in the last section to the notion of “architectural capability”. We now define this as firm-wide routines that co-ordinate and combine various functional components of a business model through knowledge of the bigger picture. By its nature, business model change entails building new capability of this type and then “routinising” it so that the capability is greater than any one person, or set of people, in the organization.

This HR Director offers a good example of the “integrating” nature of this type of capability and its link to Business Model Change:

“We realised that supply chain management was a key capability. A lot of people misunderstand what this capability needs. Beyond just having better procurement, you also have to integrate all of your functions together. You have to be able to optimise your assets. It is inventory management that drives the costs and these costs can be predicted when you look forward.”

This is an organizational capability, and our data suggests that HR people have a strategic imperative grasping the nature of this type of capability and how it may be developed.

HR refer regularly of course to the management of “talent”, itself a crucial part of the HR agenda, but this risks confusing organizational capability with something existing at a lower level of analysis: competence, or component capability.

This Transformation Director understands the nature of organizational capability: he considers it a critical risk to the implementation of their new business model of developing sustainable buildings, and doubts HR’s ability to help build it:
“The piece we’re missing is that in two or three critical dimensions we simply don’t have the capability, it’s not about deploying a capability differently, it’s about simply not having it, creating a brand new one. So our facilities management capability is nowhere near what it should be and is certainly not market differentiated. We’ve very clear view on what we’d like to have, but we’re a million miles away from having it.”

At one industrial organization no-one is in any doubt about the challenge of retaining their key capability, which is currently at risk of draining away due to the lack of strategic direction upon which any business model change is predicated:

“It does say in the [regulating authority’s] scope that there’s an accountability for the retention of [key strategic] capability for the UK. They’re starting to make noises in that direction, setting up national working groups, but it’s still very much anchored in the decommissioning agenda. Their remit doesn’t cover new … developments. [I am] not sure if the [authority] would have any involvement at all in a new build programme.”

What becomes clear from the above example is that this strategic capability – if considered purely in people terms – resides chiefly in a small number of specialists, around 100 people, from a total population of about 8,000.

By understanding how skills get formed and converted into deeper organizational capabilities, however, it becomes clear that the strategic capability for managing new developments in the above setting is broader than the capability of these few specialists and would (where it existed) include the combined knowledge and experience of a large proportion of the workforce routinised in standard operating procedures, organizational systems, and learning mechanisms. It is a good example of the distinction between strategic capability (which includes all of these) and capability at the practice level (restricted to a small number of specialists).

One risk, therefore, which we have seen widely in HR literature and practice, is that the process of “talent management” becomes exclusively focused on one small “strategically important” section of the workforce to the exclusion of other areas of talent, and people who might be also an essential – if less high profile – element of strategic capability. New business models change who the corporate heroes are, and understanding the new talent dependencies before the rest of the business does is a crucial HR capability.

We have discussed the alignment of talent with strategic capability mainly in terms of the architectural capabilities necessary to future proof the business model. This is the dominant agenda for HR. However, we briefly mention two other levels at which the issue of capability has to be managed by HR: practice and competence.
The second level of definition of ‘capability’ is at the “practice” level, what we have previously referred to as “component” capability, and it is at this level we hear more from the HR respondents interviewed. This level is not irrelevant to business model change by any means, but it is less likely to offer strategic value if business model change is on the agenda of the Board or the CEO. Here is one example from an HR Director who talks about the need to build capability as “talent in broadband”:

“Another area of HR added value is about building capability. The company is moving into a new area, new markets being created - the multimedia age. A key issue for many of our leaders is how do we transfer our knowledge base from text and voice messaging to this new era - broadband etc? So where is the talent in broadband to support all this stuff?”

The third level of definition is to refer to capability as synonymous with individual competence. Here is an example from an HR Director:

“Performance development is really important in that we truly understand the measure of the capability we've got in the business. Actually people can’t operate at the level required for the job, and rather than trying to fudge that, in a sense, maybe the individual doesn’t have the required skill sets and capabilities and is unlikely to gain them, and we need to treat them fairly, maybe they shouldn’t be at that level, maybe they shouldn’t be in this business”

And another, from a Line Director:

“There are certainly capability gaps in the organization i.e. we might have someone filling a role but is it the right person filling the role, in some cases the answer is ‘no’, they’ve come from a background which is different from the new model. Some will make it and some won’t.”

However, one should not confuse the need to consider capability at the strategic level, with the assumption that these capabilities only actually exist at the most senior level. On the contrary, there is a consistent theme across the data that it is the middle level of the organization that causes most concern. Talent management for executives and Board level members is generally high profile; and the component capability at the lower end of the organization, albeit possibly in scarce supply depending on the nature of the market, receives attention through standard resourcing and development processes. Both tend to be oriented toward individual development. It is in the middle, however, that the strategic capability gap appears to lie. This is a Transformation Director:

“There’s no doubt that the combination, interface of what business model do we want, hasn’t been addressed. Our real skill is project management, and our value is value added project management not the management of delivery staff on site. The real value stuff is in the middle of the pyramid.”

This Business Unit Director has a similar concern for the lack of attention at middle levels:

“There’s a couple of levels here. Group HR are doing a good job at the development of senior levels. So we’re OK at levels one two and three. But I don’t know who’s taking care of consistency of capability across middle management.”
The complexities of business model change involves a change in "mindset" or an employee's "mental model" of exactly what the organization's business model is. There is an essential process of communication and involvement of the workforce which HR can play a leading role in in order to create this mental mobility.

This is especially true when there are likely to be relatively few people — especially at the outset of a change — who have really grasped the nature of the change and made the "mental" shift to a new model. This HR Director describes the strategic imperative succinctly:

"This is what we're wrestling with now; the work we're doing is owned by, let's be honest, the CEO, the HR Director, the CIO and [consultancy]. End. That's what we're dealing with. I don't think the organization has talked about what the business model is, I don't think they - I mean if you look at what our business model is it's actually very confused, isn't it."

HR is acutely aware that any change process risks only partial success if employees are too rigidly defined, proving too inflexible to adapt to what the business model demands.

The key challenge for CEOs and HR Directors, however, is that in periods of rapid change, can they take their people with them? We have managed to avoid using the word engagement so far, but we must end with a brief discussion of the challenge.

Many organizations now use engagement measures as part of their KPIs, but do they have a clear business – oriented case, including definitions, criteria and strategic outcomes, for their engagement strategy? The HR Director, or Operations Director, needs to take control of the data, define which aspects of engagement represent the real challenge, and use better analytics to support evaluation.

Our research indicated a stronger focus on the benefits of engagement strategies and policies by the HR Directors than by operational managers, but it is clear that those operational managers who did believe in the importance of engagement were dependent upon the expertise vested within HR to give a clear lead in the introduction of engagement frameworks.

Engagement plays a major role in the thinking of HR professionals interviewed; less so in the discussions with Line people, with one or two exceptions. However what is striking across the data is a wide variety of interpretations of the meaning of "engagement", and the readiness to buy in off the shelf engagement tools from consultants without necessarily first understanding what the measurement criteria and which are specific and relevant to that organization. Particularly in organizations where the philosophy of the service – profit chain is very strong and the links clear, engagement represents the opportunity to HR of gaining proprietorial knowledge which adds value to business model change – at risk if outsourced.
The business case for engagement (for the CEO) is discretionary effort. At this organization, line people are very clear on its value for decision making, or at least decision understanding, at lower levels:

"The engagement piece is very much about every level buying in, understanding, and 5 years hence knowing what sustainable [capability] means, and knowing why, and be firm about it, and the person would know it's the right decision even if not formally authorised to make it, would say 'if you ask me that's the right decision.'"

Within HR ranks however definitions appear to vary widely. At one extreme it is calculative, a measurement of the individual's subscribing (or not) to the direction an organization is taking in its business model change – either the individual “buys in”, or they don't, and if they don't then the consequences are clear:

“One of the elements in the survey showed the engagement level of our people. Now if we could say that retention in the disengaged people has gone down, that's great, those are the people we don't want in our business. But if it's in our engaged population, that's a concern for us as those are the people who like it here, go the extra mile, want to be part of the business going forward.”
Conclusion: The Evolving Strategic Capability of HR

In order to build on the data analysis we ran a Research Interpretation meeting among the Centre partners. This identified seven broad areas of action for senior HR players. We briefly synthesize each theme and raise the questions that should direct the future research agenda.

It is clear from our research that the commitment and effective deployment of talent inside a business drives the economic returns of organizations. Moreover, the spoils of high performance go to those organizations whose HR functions can reverse the arrow and who understand that the viability of the function itself lies not just in world class architecture comprised of systems, people and behaviours but also to those whose functions’ architectures play a central role in enabling the business models put in place to execute overarching strategies. This is far from a straightforward task.

1. Organization Design: The New Strategic Capability

Many leading commentators agree that the Function’s future will be different from its past. Much of what we know today as HR architecture will no longer exist a decade from now. For Pfeffer and Sutton, ‘what actually provides competitive success and what is difficult to copy is not so much knowing what to do deciding on the right strategy but instead having the ability to do it’\(^5\). For Gratton the challenge for HR is one of understanding how to put people at the heart of corporate purpose\(^5\). For Becker and Huselid the challenge is one emphasizing, “the role of HR management systems as solutions to business problems rather than individual HR management practices in isolation”\(^5\). And finally, returning to where it all began, for Ulrich, the challenge facing HR has been and in many ways remains one of delivering value and recognizing the shift in importance from organizational structure to capabilities\(^5\).

All of these authors are united in their view that it is those charged with devising and leading the execution of business models that will ultimately shape the destinies of their organizations. With them lies the responsibility for creating value for those inside the organization (employees) and outside it (customers and investors).

Significantly, and clearly underlined by this report on Reversing The Arrow, has been the clear rise to prominence in the eyes of CEOs and other executives of those who are capable of delivering value being those people charged with leading the HR function. This is not to say HR’s strategic capability is revealed by the HR Director’s having a seat at the boardroom table. On the contrary, it is the close working relationship between CEO and HR Director that will drive the talent and future performance agenda inside organizations.

This close working relationship will centre on the capability of senior HR leaders to identify for themselves and their executive colleagues value releasing and value creating ideas across the business. This new demanding role clearly demands a new cadre of HR executives fluent in business strategy making and execution. It goes without saying that these individuals may not necessarily be those who come from a traditional HR background. A new generation of executives are eying up the growing challenges and concomitant resources of talent within the business with speculative eyes.
The HR executive marketplace will place a high premium on these same individuals who understand the alchemy involved in using OD to catalyze the strategic capability of organizations. These individuals will be capable of engaging in top-table dialogue, business function interchange and reconfiguration, and all the issues from globalization that accompany them, knowledge of their markets, change specialists, evidence-based analysts, and be capable of articulating, perhaps even from time-to-time fighting their corners, for a particular vision of the future strategic direction of their businesses.

In pointing to the overwhelming evidence for the primacy of an OD capability in HR to add value to Business Model change. We have also begun to use the term “Architectural Design” as a label, to put clear water between this capability and the more traditional HR “macro and micro” Organization Design agenda which has a certain – not always positive – resonance with HR and line people.

The precise definition of this new capability, and its implementation in HR structures, is the area of action we have identified. Certainly the centre of excellence – if that is how it must manifest itself – will borrow much of its expertise – and possibly its people - from outside traditional HR areas. Indeed its very strength may be the cross – functional nature of the talent pool from which it draws its complement.

The opportunity for the HR function is to move into entirely new areas of expertise, while retaining control of a capability that is central to the organization’s strategic agenda. The questions which arise are:

- What will be the precise nature and positioning of the AD capability?
- If a centre of excellence, how will its members relate to the wider organization – through the BP, or directly to the line?
- To what degree is it possible for the BP to possess advanced skills in this field?
- What will be the nature of those skills?

And there are two critical, related, risks to explore for the future of the HR function

1. As expressed by one HR Director: “do we want consultants to grab the Organization Design space?”
2. If the answer to this question is “no”, then where will HR recruit and develop the required talent for this new Architectural Design capability, even if it remains an HR function responsibility?
2. From “Silos” To “Strategic Reciprocity”

Simplistic views of strategic alignment paint a linear picture of an HR function adapting to changing strategic imperatives. In our new strategically capable world the function has greater nimbleness and agility but a sure-footed assertiveness to remain in “steady-state” when all else around it melts into air. This reciprocity is reflected in our taxonomies which reveal complementarity, as opposed to co-determinacy in the relationship between corporate business strategies and goals on the one hand, and steady-states of strategic HR deployment on the other.

Strategic reciprocity helps us to understand how HR and its accompanying architecture can be in different states to the emergent overarching strategies and business models of the parent organization. For example, where strategy might be described as emergent, especially fleeting and subject to frequent and radical transformations, HR’s underlying state can, in contradistinction to this, be in ‘steady state’ or incremental in character. A certain calmness presides in one organizational subsystem at the centre of what can easily be depicted as a “strategic storm.”

Similarly, business models can be in an incremental, steady state, whilst the fluid models underpinning HR can be undergoing substantial redesign. Many HR functions struck us as falling into the middle of these two disparate types, hence the other two middle-state taxonomies, which say more about the emergent development of strategy than the tidy and normative, rational and linear world framed in the highly prescriptive classical strategy school textbooks.

HR executives can take comfort from this apparent dichotomy between overarching corporate and HR models. The complimentarity of business model fit does not prescribe a determined end-state of HR, to be read off by HR Directors and their colleagues: this is not a simple, ‘if situation or model x is in operation, we should deploy y version of HR.’ On the contrary, as Quinn has observed, ‘strategic decisions do not lend themselves to aggregation into a single massive decision matrix where all factors can be treated relatively simultaneously in order to arrive at a holistic optimum’.

In reality, strategic reciprocity releases HR from a number of ghosts that have dogged the function’s development over the last two decades. First, where there is new found confidence from boardroom discourse, this can free HR from the performance debates which were threatening to drag HR into a battle with the accountants not of its own making. HR was always likely to lose such a battle.
3. A Post-Ulrich Agenda?

HR might possibly be moving out into what might be described as the Post-Ulrich agenda. New forms of modularity have released HR from the drudgery of transactional services. What has been described throughout this report as the “3-Box model” of HR has in some instances metamorphosed into a 2-Box model comprising strategic facing business partners and supporting HR experts who can live with the new and fast-moving world of strategic capability.

Each of our sponsors is thinking deeply about the structure of the HR function. This is taking them beyond the standardized prescriptions of widely disseminated theoretical models. They are, of course, in different places on this journey, but the destination appears to be the same: HR structures which respond closely to the requirements of unique, sector-specific business models.

We have seen some early signs of these “post – Ulrich” structures emerging in our current research. One, we mentioned above. Advanced structures have moved entirely beyond transactional HR work, which has been outsourced, resulting in something more akin to a “two box” model. A Business Partner (BP) is one side of the model, and we have seen this role encompassing work far broader than that normally prescribed in a Strategic HR textbook, or a CIPD qualification, to the extent that “HR” is no longer an adequate label. We deal with this role in more detail in a separate theme, below.

The other side of the model comprises the HR expert who offers value – adding HR consultancy services either to the HR BP, or directly to Line Managers. In certain areas of expertise – notably Organization Design or Transformation, Engagement, and Talent Management, a Director may be appointed, temporarily or permanently, to galvanise HR’s effort in that area.

However, the devil, as one HR Director pointed out, is in the detail; and it is the detailed planning and implementation of these new structures that will engage the Centre partners over the next phase of research. One such area of detail is the increasing importance of Organization Design work.

The next steps must now be to identify the new principles on which these HR structures can be based, and to understand their characteristics:

- why do they vary?
- what business drivers lead to these variations?
- how might these new structures capture and retain value for the business?
4. Remodelling the Business Partner role

The move out of HR into the line represented by the HR consultant and now business partner role required a transformational shift in the minds of those embedded in the world of HR transactions. A new transformation from business partner to strategic partner is now well and truly underway which pulls together the skills and capabilities of business generalists as well as HR careerists to construct and deploy new people-specific solutions.

A successful business model change demands a great deal from the HR BP. The HR Director leads the way, adding value to the strategic decision making process by advising on people related elements, and facilitating the senior team through Business Model Transformation. Knowledge of the competition, key markets, service – profit chain, capability management, and financial structures become as much a part of the BP’s portfolio as their HR expertise. Further down the organization, BPs at every level need to mirror this breadth of knowledge in their own Business Units.

Using the distinction we made earlier in the report between component and architectural knowledge, there is an argument that many existing role specifications for HR BPs provide a façade of strategic integration. BPs may only be able to embed HR into one component of the new business model, and whilst these individuals have general HR responsibility within that component, they are neither true HR generalists nor might they understand how all the pieces of the business model fit together. A priority for HR functions is to engineer multiple connections into the line, with BPs being one important such connection, but one with limitations.

Several questions remain, however – all of them raised by our Centre partners during the first phase of our research.

- To what extent has the BP role moved entirely away from HR and into another capability domain altogether?
- What are the consequences of this move for the HR function?
- Is it possible to “map” more precisely the capabilities of this new role and to establish charters for its governance?
- Is it possible to develop a typology of different BP roles according to the nature of a particular business, or its stage of transformation?
5. Talent-Proofing The Organization

Our findings reveal to us three particularly important “must win” battles facing the deployment of the future strategic capability of the function. The first is represented by the challenge of human capital strategy essentially mapping the future talent requirements of the business both in the short- to mid-terms, and a longer, more strategic view of the required future leadership pipeline of the business. Second, given the emerging evidence underpinning the performance case of “engaged” employees the continuing challenges of maintaining their discretionary effort will be met by those organizations who understand best the demands of their talent and provide competitive advantage through unique employee value propositions. Third, a function rising to the OD challenge prescribed by this new strategic capability will require an HR workforce with a new and highly demanding set of skills well beyond the capacity of current supply.

The research has shown the importance for HR Directors of second-guessing the talent requirements of their business going forward. In many ways this traditional form of HR has evolved into the new “Dark Arts” of human capital strategy and talent management. This is an art form requiring the “Janus-like” qualities of being able to service talent requirements in real time, while developing future pipelines of talent at all levels of the business and covering the different types of knowledge we have drawn attention to. It also requires being able to advise on capability matters during strategic debates, new models of delivery and retaining enough workforce agility for future reconfigurations should these debates require changes. This is the world of changing the engine while the plane is still in the air.

Strategic capability takes as read people strategies that accommodate models, systems and processes to drive a disproportionate amount of discretionary effort from employees. This is the world of retaining people through maximizing their chances to leave, boardroom transparency and concomitant exposure to the importance of employee engagement scores reported in company annual reports alongside the soon-to-be-legal obligation of quantifying the people value proposition for the forthcoming legislation surrounding the Operating and Financial Review people accounting criteria.

If all this were not enough, a recent report from McKinsey menacingly entitled The Dearth of HR Talent has predicted a shortfall in the supply of people with the requisite skills to support the world we have unpacked in Reversing The Arrow. Indeed, there is evidence to suggest it is already happening, with the salaries of HR directors climbing at multiple levels of underlying inflation no easy task at the time of writing as organizations and their boards recognize the value of talent’s talent who can recruit, retain and add value to the business68. The McKinsey report sets out the challenge:

“At first glance, this model may appear to be fine, but the lines have not been drawn clearly enough when it comes to execution. To deliver on what the business needs, HR must put its own house in order, starting with the skills and capabilities of its staff69.”
The analysis in this report of the complex business model changes that face organizations, the observation that these models require transformations in the types of knowledge needed, that this in turn alters the strategic currency associated with a range of different capabilities, but that amongst all this turmoil a number of HR systems can represent an oasis of stability should give heart to the function. A range of intervention tools and techniques flow from the analysis in this report and these can address the challenge noted above.

6. Risks and Opportunities for Developing the HR Talent Pipeline

Each of these themes returns inexorably to the development of future talent in the HR function. Although we have not dealt directly with this issue in our research to date, it emerges as a central concern.

At the heart of the concern is, quite simply, the revolution entailed in the range of capabilities now expected of HR people if they are to be able to add value in the emerging business environment. Let us not forget this is a challenge faced by almost any significant function inside organizations. However, as one CEO commented to us, it is very rare to find an HR Director who possesses the required breadth of competencies to perform an advanced BP role at a senior level. We can be sure that the same comment is likely to apply at lower levels in the HR function; the level of expertise may change but the breadth remains the same.

We have also pointed to the expansion of HR capability entailed by the increasing demand for Architectural Design capability. Naturally, the opportunity is to transform the function by attracting a broader range of talent. One possibility is to make it “normal” practice to have a much freer transfer of talented people into, and out of, the function from other disciplines at both junior and senior levels. Several questions arise:

- Is the HR function attracting the kind of talent necessary to fill these new roles?
- Does the usual suite of CIPD or related qualifications deal sufficiently with these new demands?
- Are the development processes of young HR professionals entering the profession sufficient?

The consensus answer to these questions is: “no”, or not to the degree necessary to guarantee the future of the function. How can the function respond to this talent gap? At least part of the challenge appears to be the perennial problem of the negative – or, more charitably, perhaps – incorrect perception of HR by people outside the function, and, occasionally, by those inside.
7. Rebranding HR

The last area of action therefore concerns the poor image of the HR function. One cannot help but be struck by the large cognitive gap between the findings of the research (which demonstrates the centrality of the function to adding value to business model change) and the low level of interest in HR from current general management students, who still treat the strategic HR agenda as very much secondary to the “usual suspects” of strategy, finance, and marketing.

There are signs of response to this challenge. Some organizations are beginning to talk about “people strategy”, and not “HR strategy”. “HR Directors” are becoming known as “Talent Directors” or “Transformation Directors”. There is perhaps an argument to suggest that the “HR” label should disappear with outsourced transactional services.

Back in the 1980s the move from Personnel to HRM was criticised for in many instances simply putting old wine into new bottles. Our research here shows that once again there is a need for substantive change in the role of the people making up the HR function. As we have said elsewhere, this may ultimately also reflect the demise of the function as we know it today.
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