

Building Strategic Capability:

HR's Role in Building Workforce Competitiveness

A Human Resources Forum and Richmond Events White Paper

*This report is based on the findings from a survey sent to the senior-level human resources professionals attending **The Human Resources Forum** organized by Richmond Events on board the QE2 ocean liner from May 10-13, 2001. This report was prepared by Richmond Events/**The Human Resources Forum** in conjunction with Richard W. Beatty of University of Michigan and Rutgers University, and Craig Eric Schneier of Amos Tuck School of Business, Dartmouth University.*



THE
HUMAN RESOURCES
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I N T R O D U C T I O N

Richmond Events ran its third annual **Human Resources Forum** from May 10-13, 2001 on board the QE2, sailing out of New York City. This year's forum drew over 300 senior-level human resources professionals from Fortune 1000 companies.

The Human Resources Forum addresses strategic issues in a professional environment specifically designed for senior-level HR executives who rarely attend conventional trade shows and conferences. Senior HR decision-makers are brought together for top level discussion, research and debate within the privacy of an ocean liner at sea. During the course of 2½ days they participate in meetings with leading sponsor companies, comprehensive conference sessions, and formal and informal networking opportunities.

Prior to the event, attendees of **The Human Resources Forum** were asked to participate in our research study on strategic capabilities. Through this survey we captured information about the strategic capabilities organizations were pursuing, how HR attempted to impact these strategic capabilities, HR's success in building strategic capabilities, and the financial consequences of these efforts.

We received over 100 responses to our questionnaire, which is the database for this study. We questioned whether or not a firm had a particular practice, and requested an assessment of the effectiveness of the practice. A rating scale ranging from 1 to 5 was used, where 1 indicated that the practice was not at all effective, 3 was effective, and a 5 indicated that the practice was effective to a great extent (i.e., world class).

The data gathered and the writing of this report is a collaboration between Richmond Events/**The Human Resources Forum** and its partners Richard W. Beatty of University of Michigan and Rutgers University, and Craig Eric Schneier of Amos Tuck School of Business, Dartmouth University.



WHAT ARE STRATEGIC CAPABILITIES?

This study is based upon an understanding that there is a significant need for organizations, and especially their Human Resource function, to understand the strategic capabilities that enable an organization's strategic success. This concept of strategic capabilities is similar to the notion of core competencies, as described in Hamel & Prahalad (1994), and as they described initially in their 1989 *HBR* article, "The Core Competencies of the Corporation," the most requested reprint in the history of the *Harvard Business Review*.

Over time, their definition of core competencies has been reassessed, but it appears to now be grounded in the concept of unique bundles of technology, information, and people that enable a firm to create a competitive advantage in its target markets. This concept is quite different from that often used in Human Resources of *individual* competencies. When HR executives use the term competencies, they are most likely referring to individual competencies or capabilities, but this is not what Hamel & Prahalad have intended. To minimize confusion and to better focus on a firm's strategic *and* workforce requirements we have chosen to use the term strategic capabilities. Thus, for us "strategic capability" refers to what enables a firm to create its competitive advantage, including the workforce necessary to make the strategic capability a reality.

We believe this is a most important concept, a concept that should be close to the hearts of all Human Resource professionals. It is the identification of those workforce capabilities that separate your firm from another in terms of competitiveness. Knowing and understanding these and how an organization should deploy its Human Resource tool kit to maximize the investment and utilization of its strategic capabilities—both present and future—is critical for a firm to distance itself from competitors.

This concept is further reinforced by the emergence of the importance of the value of intangibles. This concept is drawn from the research of Baruch Lev (1999) and many others, including those pursuing a concept of intellectual capital, such as Thomas Stewart (1998) and Leif Erickson (1997). It is also supported by the Ernst & Young study, "Measures that Matter" (1998), which demonstrated that both buy-side and sell-side analysts have acknowledged that at least 35% of their evaluation of a firm is dependent upon non-financial factors. Other research has noted that the value of these intangible assets has grown substantially over the last 20 years. In fact, the data indicate that the value of intangible assets as critical to a firm's market value have shrunk from 62% in 1982 to 38%, based on a Brookings Institution study in 1992, and to 15% in 1998, based upon Baruch Lev's research. Further, the largest selling business book of 2001 (so far) is Fred Wiersema's [The New Market Leaders](#), where he demonstrates that the value of the franchise a firm has with its customers is the major determinant of its total financial return. Thus, how a workforce is deployed is critical to the

determination of the strength of a firm’s customer franchise. Intangibles are a potential source of an organization’s competitive success and market capitalization and have substantial implications for how a firm utilizes its workforce and HR function.

This issue has not gone unnoticed by executives, and clearly is becoming one of the things that “keeps executives up at night” – the ability to attract, develop, and retain the brainware that enables a firm to successfully execute its strategy.

THE FUNDAMENTAL QUESTION

We will begin with a very fundamental question, that is, “What is our firm’s *strategic capability* to capture a disproportionate share of the future value that will be created in the next evolution of our competitive market space?”

Strategic capabilities, however, may take various forms. They can be leadership capabilities, as is often cited about General Electric where the impact of GE’s leadership on its financial value is well known (Table 1).

Table 1
Leadership Makes a Financial Difference

		Joined \$	Later \$
Norm Blake	USF&G	\$9.50	\$19.00 one year later
Glen Hiner	Owens Corning	26.25	37.63 one month later
John Trani	Stanley Works	29.38	38.00 one month later
Harry Stonecipher	McDonnell Douglas	19.25	23.50 one month later 76.69 three years later
Stan Gault	Goodyear	13.50	34.13 one year later 68.50 three years later
Larry Bossidy	AlliedSignal	9.72	13.88 one year later 41.50 eight years later
Gary Wendt	Conseco	7.75	19.03 ten months later

What these leaders had in common:

- All came from outside the firm
- All came from General Electric
- All had a remarkable impact on the firm’s measurable success, profitability, competitiveness, and viability

There is no doubt that executive resources are a strategic capability and a source of competitive advantage. However, strategic capability can take other forms, such as R&D, as well as technical talent such as logistics,

distribution, information systems, or whatever the capability that enables a firm to succeed as intended. Obviously firms such as Wal-Mart would be much more dependent upon logistics, distribution, and information systems, whereas Nokia has strategic capabilities in wireless technology, the ability to make technology fashionable, and an ability to market to influential consumers. Enron has strategic capabilities in commodity trading, logistics, distribution, and the speed at which it develops its strategically focused workforce. CapitalOne has strategic capabilities in exploratory marketing, digital technology, and risk assessment. Charles Schwab has built the capability of changing before they have to with its customer-back focus and rapid prototyping and experimentation. Cisco has strategic capabilities in mergers and acquisitions, speed of change implementation, and constant workforce upgrading. General Electric may be the prototypical example of corporate-level strategic capabilities for a diverse firm in building obvious strategic capabilities in executive resources, operational excellence (through the use of Six Sigma), mergers and acquisitions, and mastery of e-commerce.

Thus, the major themes in this study are based upon strategic capabilities, especially leadership as a strategic capability and technical/R&D as strategic capabilities, as well as the impact of strategic capabilities on the financial consequences of the firm.

MAJOR THEMES

- Strategic Capabilities
- Leadership as a Strategic Capability
- Technical/R&D as a Strategic Capability
- Strategic Capabilities and Financial Consequences



THE SURVEY

In our initial data collection efforts, we attempted to focus upon firms and their strategic capabilities. As demonstrated in Table 2, we were interested in determining whether firms had a stated competitive strategy. Ninety-three firms indicated that they did, and that they were somewhat effective (average of 3.5) in articulating and communicating their competitive strategy to the workforce. When asked if they identified organizational capabilities (i.e., strategic capabilities) 79.2% of the organizations so indicated. The level of effectiveness in articulating these strategic capabilities was 3.3. Seventy-nine firms identified leadership as a strategic capability and indicated that the average effectiveness in the implementation of leadership as a strategic capability was not extremely high (average, 3.3). 81.5% of the firms indicated that they had identified technical competencies as strategic capabilities, and the effectiveness in achieving these technical capabilities was somewhat higher than in building leadership capabilities (3.5).

Table 2

Strategic Capability Responses				
	Organization		Business Unit	
	Yes %	No %	Yes %	No %
Stated competitive strategy	92.5%	7.5%	94.5%	5.5%
<i>Effectiveness 3.5</i>				
Identified organizational capabilities	79.2	20.8	82.7	17.3
<i>Effectiveness 3.3</i>				
Identified leadership as a strategic capability	79.3	20.7	86.3	13.7
<i>Effectiveness 3.3</i>				
Identified technical competencies as a strategic capability	81.5	18.5	82.2	17.8
<i>Effectiveness 3.5</i>				

CAPABILITY DEVELOPMENT PROGRAMS

In terms of capability development programs (Table 3), these firms indicated that 65% had a leadership development curriculum, but rated its effectiveness only 3.3. Only 14% had a chief learning officer, and those that did indicated that the CLO's effectiveness was only 2.5 (i.e., less than effective). 57% had a corporate university and rated it as effective (an average effectiveness score of 3.0).

62.5% of the organizations indicated they were using recruiting ads for entry-level professionals to recruit for the organization and not for a specific job with an effectiveness of 3.0. In regards to recruiting in colleges and universities for leadership talent, only 42.7% of the firms indicated that they were doing so, and their effectiveness was only about 2.8. College student internships seemed to be more popular than recruiting from college campuses, but the effectiveness was still only about 3.2.

59% of the firms indicated that they had development plans, but the effectiveness was only about 2.9. Only 20% indicated they had managerial rotation programs for leadership development with effectiveness of only 2.3, which is basically giving an ineffective grade to their managerial rotation efforts despite research that indicates that 70% of competency acquisition comes from work experience, as demonstrated by the Center for Creative Leadership and others.

This data indicates that there may be several interesting strategic capability issues taking place in organizations. Certainly, the effectiveness of the leadership development and recruiting efforts are not at a level of efficacy needed to build a *significant* strategic capability. Most firms seem to be concerned about leadership, so they attempted to recruit leaders and create initiatives to develop leaders, but the effectiveness in implementing

Table 3

Capability Development Programs				
	Organization		Business Unit	
	Yes %	No %	Yes %	No %
Leadership development curriculum	65.0	35.0	58.6	41.6
<i>Effectiveness 3.3</i>				
Chief Learning Officer positions	14.0	85.0	17.0	83.0
<i>Effectiveness 2.5</i>				
Corporate university	57.3	42.7	47.0	53.0
<i>Effectiveness 3.06</i>				
Recruiting ads for the firm	62.2	35.8	58.6	41.6
<i>Effectiveness 3.15</i>				
College leadership recruiting	42.7	57.3	40.3	59.7
<i>Effectiveness 2.82</i>				
College student internships	66.2	33.7	54.4	45.6
<i>Effectiveness 3.16</i>				
Implementing development plans	58.9	41.1	71.1	28.9
<i>Effectiveness 2.91</i>				
Management rotations	20.3	79.7	19.4	80.6
<i>Effectiveness 2.29</i>				

these programs seemed to be severely lacking. The bad news is that the effectiveness in these areas is not strong, but the good news is there is substantial upside opportunity for firms to become effective and distance themselves from their competition.

In terms of leadership development initiatives, coaching efforts are less than ideal, with a 2.7 effectiveness rating, and mentor programs even less successful, with only a 1.9 average. The percentage of firms with managers on developmental assignments was only 14%, and holding leaders accountable for subordinate development effectiveness was rated at only 2.6. Thus, in terms of leadership development, this population of firms did not believe their organizations were doing very well in the development of this strategic capability and that the programs, whether they be coaching, mentoring, developmental assignments, or holding leaders accountable for subordinate development, were not effective. Again, there appears to be substantial room for the development of leadership effectiveness within organizations, with a substantial upside possibility of leveraging the firm’s competitive advantage and ultimately the market value of the firm. Clearly many organizations had programs but the effectiveness of these programs in developing and delivering leaders appears to be substantially short of what most HR practitioners would consider ideal.

Table 4

Leadership Development Programs		
	Organization	Business Unit
Coaching/development <i>Effectiveness</i>	2.7	3.1
Mentor training <i>Effectiveness</i>	1.9	2.1
Leadership accountability for subordinate development <i>Effectiveness</i>	2.61	2.96
Percentage of Managers on development assignment	14.1%	12.5%

Firms were a little more optimistic about their organization’s current capability strength as is shown in Table 5. The bench strength assessment for leaders was indicated to be 2.7—again less than ideal. The technical bench strength was even less effective, at 2.4. However, the most startling, and perhaps indicative of the problems that Ford Motor Company has had with its “A, B, and C” employee rating programs, is the data concerning the removal of ineffective managers. Again, the effectiveness of these programs is less than what would be expected, at 2.9, although 52% of the organizations indicated that they had such programs. This indicates that it is very difficult or that they are unsuccessful at removing *ineffective* managers.

The acceptance of first choices for leadership and technical positions was only 75%. This indicates that at least a quarter of the top choices escaped these firms, despite many firms citing efforts to attract and retain top-quality talent and acknowledging their efforts to become “the employer of choice.”

Our sample of firms reported managerial turnover less than the industry average. Their perception of industry average was 23.7%, but their average was 13.5%.

In terms of strategic capability resources performing below expectations, interesting results surfaced. A sixth of executives were performing below expectations and an eighth of a firm’s technical talent were under performing. And yet these firms were unable to exit ineffective talent as cited above. Comparing the strategic capability versus the competition, however, the firms believed that they had better talent than their competition, whether it be executive or technical. The strategic capability building practices exercised by the HR function were also perceived as better than the competition. Their perception was that their firms were doing better in most areas of capability development relative to their competition, yet clearly below what is necessary for significant strategic success of their firm.

Table 5

Capability Strength				
	Organization		Business Unit	
“Bench strength” assessment <i>Effectiveness</i>	2.74		3.00	
Technical “bench strength” assessment <i>Effectiveness</i>	2.40		2.74	
Removal of ineffective managers <i>Effectiveness 2.90</i>	YES 51.8%	NO 48.2%	YES 58.8%	NO 41.2%
“First choice” acceptance	75.4%		71.3%	
Unwanted managerial turnover <i>Industry Average 23.7%</i>	13.5%		10.9%	
Strategic capability resources performing below expectations	Exec.	16.2%	Exec.	10.5%
	Tech.	12.2%	Tech.	10.1%
	Other	13.4%	Other	7.8%
Strategic capability vs. competition				
<i>Executive</i>	3.94		3.92	
<i>Technical/R&D</i>	3.87		3.54	
<i>Strategic Cap. Practices</i>	3.70		3.68	

In another area of leadership capability efforts (Table 6), we explored the use of 360° appraisals, the linking of capability planning to business planning, and communicating business results and expectations to leadership, as well as how well firms made the distinction between management and leadership and the time executives

spent on building strategic capability. Only 40% of the firms indicated that they had 360° appraisals, and the effectiveness was less than desired with a rating of only 2.6 on our 5-point scale.

When asked if these organizations effectively linked capability planning to business planning and its effectiveness, the level was 3.0. The same was true regarding the firms’ effectiveness in communicating business results and expected behaviors to leaders. In addition, we asked the firms if they had made a distinction between management and leadership capability and the effectiveness of this distinction. They indicated that they were less than effective, with a 2.4 rating. Finally, the time spent on strategic capability by the CEO and President was indicated to be about 20% of their time.

Table 6

Leadership Capability Efforts				
	Organization		Business Unit	
	YES	NO	YES	NO
Use of “360° appraisals” <i>Effectiveness 2.61</i>	41.9%	58.1%	40.6%	59.4%
Linking capability planning to business planning <i>Effectiveness</i>	2.97		3.00	
Communicated business results and expected behaviors to leaders <i>Effectiveness</i>	3.00		3.26	
Make distinction between management and leadership <i>Effectiveness</i>	2.42		2.61	
Time spent on strategic capability	CEO Pres.	19.7% 20.4%	Bus. Leader Sr. Mgrs.	21.9% 73.8%

FINANCIAL IMPLICATIONS & SUMMARY

Perhaps the most interesting findings are the financial implications of the strategic capability efforts on these firms. The first question concerned the financial success of the firm (Table 7) relative to its competition (again on a 1 to 5 scale). These firms on average indicated that they were effective (3.8) in terms of financial success compared to their competition. This put them in the top 40th percentile of financial success.

The items which correlated with financial success were 1) identifying leadership as a strategic capability, 2) the leadership curriculum, 3) the use of corporate universities, and 4) holding leaders accountable for subordinate development. In fact, it is interesting that all these areas seem to have a substantial impact upon the financial performance of firms, yet were not necessarily effective (or widely practiced) by the firms in our study. What is most notable is that the highest correlation is with leadership accountability for subordinate development, a practice that was deemed one of the least effectively implemented by the firms in the study. Thus, the implication must be that those who have done a good job in holding leaders accountable for subordinate development appear to work for firms which are more financially successful, which would seem to corroborate the Ernst & Young study on the “Measures that Matter.”

Another set of findings had to do with bench strength. Again, bench strength correlated strongly with firm financial strength, whether it is leadership bench strength or technical bench strength, which would support the success of General Electric’s efforts in executive development as cited in Jack Welch’s latest book, Jack: Straight from the Gut.

Finally, the effectiveness of strategic capability efforts correlates higher with the financial success of firms than any of the correlations discussed above. That is, if the strategic capability practices were deemed to be effective, whether it was for executive capabilities or technical capabilities, there were significant correlations with financial success. In fact, the strategic capability building practices correlated with financial success were the highest, especially at the organizational level.

This latter set of findings clearly demonstrates the importance of effectively identifying and managing strategic capabilities. This is especially true because of the impact that these have on factors that seem to influence the financial success of firms, such as leadership capability. These practices, such as having a specified leadership curriculum, a corporate university, and especially holding leaders accountable for subordinate development, when done effectively, appear to have a substantial impact upon a firm’s financial success. Bench strength,

whether it is leadership or technical, again has substantial impact on financial success. And, HR practices to enhance these capabilities—whether directed to executives or for technical resources—when effectively executed, also have a substantial impact upon the financial success of these organizations.

In conclusion, there appears to be a substantial finding that strategic capabilities are important to organizations and to organizational success. And, that when the human resources community engages in effective practices, these practices are strongly related to a firm’s financial success. This is indeed heartening for the Human Resource profession. At the same time, these correlations are not necessarily causal in the sense that strategic capability building efforts do not necessarily cause the financial success of a firm. This will remain to be an issue which we will pursue in additional studies of this nature—yet, these results are indeed encouraging.

Table 7

Financial Implications		
	Organization	Business Unit
Financial success of your firm relative to competition	3.76 (top 40%)	
Correlations with financial success		
• Identified leadership as strategic capability	.28 (p ≤ .14)	
• Leadership curriculum	.22 (p ≤ .13)	
• Corporate university	.22 (p ≤ .0001)	
• Leadership accountable for subordinate development	.40 (p ≤ .003)	.15 (p ≤ .001)
• Assess leadership bench strength	.30 (p ≤ .01)	.27 (p ≤ .0008)
• Assess technical R&D bench strength	.26 (p ≤ .0004)	.19 (p ≤ .00004)
• Strategic capability practice effectiveness		
	Organizational	Business Unit
<i>Executives</i>	.53 (p ≤ .12)	.38 (p ≤ .5)
<i>Technical</i>	.45 (p ≤ .39)	.22 (p ≤ .24)
<i>Practices</i>	.51 (p ≤ .003)	.38 (p ≤ .08)

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