EYES TO THE FUTURE

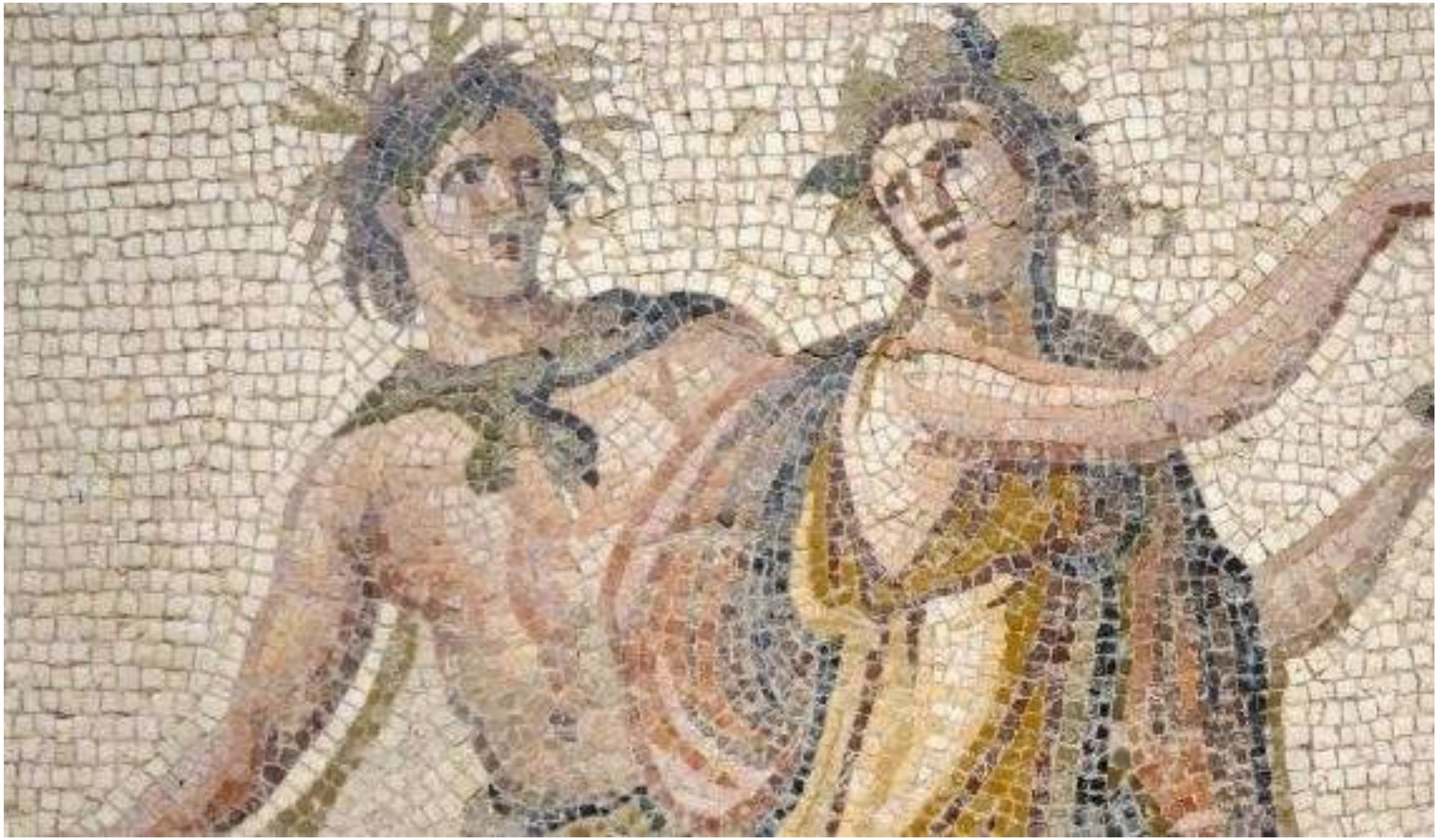
Handbook authors' predictions for 2012

Nielsen, Christian

Published in:
Human Capital Handbook

Publication date:
2011

Document Version
Early version, also known as pre-print



THE HUMAN CAPITAL HANDBOOK 2011

Volume 1, Number 4, Dec 2011

Published by Human Potential Accounting on

THE HUMAN CAPITAL HANDBOOK 2011

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The Human Capital Handbook 2011

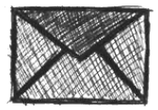
Volume 1, Number 4

Published December 2011

ISBN Number: 978-0-9567311-4-2


humancapitalhandbook.com


alpha.hubcapdigital.com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Don't read this alone.
It's dynamite. Read it out loud, read it with colleagues.

Don't read it before falling asleep.
It will keep you awake.

Don't start on page one.
Hop to the end, skip to the middle, jump from one article to others that intrigue.

Don't keep it to yourself.
Email it to everyone you know, including your boss, unless you are the boss. In which case, don't keep it to yourself. Tell everyone in the office.

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Challenge the authors if you don't agree with them.

Don't think this is it.
It's not. This is a living document. It's designed to grow, and to include your voice too.
editor@hubcapdigital.com

Lastly, human capital isn't an abstract. It's the people in your business.
If you know your people, you know your business. And so do they.

FROM THE DIRECTOR

So there we are then. The fourth and last edition of the year. The Christmas special, so to speak. Perhaps we should have photoshopped a little mosaic mistletoe on the cover?

So which wise men and women have we assembled here to keep you entertained between the mince pies and the sherry? Well, we discuss the dangers of pacesetting expectancy on business leaders (and businesses); make a definitive judgement on the link (or lack of) between pay and performance; look at radical recommendations to rebalance the MBA education 'industry'; and revisit, in a new way, our perennial interest in HCM disclosure to financial analysts.

All great new stuff which we hope you enjoy and share with others (it is Christmas after all). But as the final edition of the year, we've asked some of our previous contributors to also offer a brief Spring-like glimpse at what's next in 2012. Consider them our little Christmas crackers.

Talking of covers, we've been asked numerous times why ancient mosaics were our 2011 theme. The answer is of course because they are intrinsically beautiful. But the real reason was that they speak to an emerging clarity in the way business is beginning to piece together the rich HCM enabled people picture. The question now of course is, what image theme for 2012? We thought you might like to help us on this. So, when you get to the end of this edition, please check out our 2011 collection of artwork and if you feel inspired, send our jolly editor your suggestion. No, Rudolph the Red Nosed Reindeer is hardly a fitting theme. Bah, humbug!

Michael Reddy, Ph.D., AFBPsS, FRSA
Director, Human Potential Accounting

THE HUMAN CAPITAL HANDBOOK IN 2011

Anna Lloyd (Editor)

As we look back on the Human Capital Handbook 2011, and look forward to the Human Capital Handbook 2012, we recognise that we – and our authors – did some valuable work, and we are well placed to continue.

Articles in the Human Capital Handbook 2011 covered a wide range of topics. While I was trying to group the articles into themes, I realised that nearly all of them fall under the umbrella of a journey, from Human Resources to Human Capital. Those that don't can be regarded as map and compass (how to get there from here), and description of weather conditions and terrain (the wider economic, ethical and financial issues) – which any traveller (businessperson) will tell you are vital considerations on a journey. I hope you'll come with me in this analogy.

Image Source

the Human Capital journey

Why Make the Journey?

Strategic benefits of good HCM

Laurie Bassi (February) spoke about the importance of good Human Capital Management for a company's stock price, and announced her then forthcoming book 'Good Company' (reviewed in September), in which she and her co-authors provided evidence that companies who behave responsibly and 'do good', also do well.

M&A negotiations ignore the people factor

Two striking personal experiences of the ways Human Capital issues can be ignored in M&A activities were recounted, with **Don Young**'s story (February) about a reformed company being bought out, destroying all the good work and new management style; and with "**Heisenber**g"'s (February) tale of first-hand involvement in a merger during which the financial figures took precedence over high-level managerial quality and continuity, with a negative outcome.

Waymarks on the Journey

- Organisational Culture
- Leadership and Talent Management
- Diversity
- Human Capital Reporting and Corporate Governance

Organisational Culture

"Heisenberg" was also concerned about the particular type of organisational culture to be found in investment banks; and organisational culture was expanded upon by both **Eric Flamholt**z (June), who identified it as the "ultimate strategic asset", with a strong and 'functional' (as opposed to 'dysfunctional') culture making the difference between success and failure, and **Manfred Kets de Vrie**s (September), whose concept of the "authentizotic organisation" – which possesses both authenticity and vitality – provided an attractive utopia towards which we can strive.

Leadership and Talent Management

Michael Walton (June) warned that destructively unexpected leadership behaviour can occur in any organisation at any time, and **Ian Price** (December) warned against the current apparent preference for the 'Pacesetting' style of leader. **Boris Groysberg** (September) pointed out that so-called 'star' talent is not necessarily located in individuals, but in the relationships between them and their supporting cast, thus making it less easy than some might think for them to migrate between companies. **Steve Watson** (this issue), who sadly died recently, describes the argument for and against performance-related pay, with clear indications of when and why it is useful or useless.

Diversity

Diversity is described as a strategic issue by both Ted Cantle and Morten Kamp Andersen. **Ted Cantle** (June) described how diversity could yield huge benefits for both the nation's economy and its cultural and social life, but could also present managerial challenges and highlight skills gaps in organisations. **Morten Kamp Andersen** (September) reported empirical research that showed clear differences in profitability between the more diverse and less diverse work units in a large organisation.

Human Capital Reporting and Corporate Governance

Human capital reporting and corporate governance was a major theme in the February issue. **Robin Roslender**, **Dermot Toberty** and **Tim Hoad** gave articles about Human Capital reporting ("Accounting for People"). **Michael Reddy** recounted seven 'Inconvenient Truths" explaining why various elements of the financial reporting landscape are no longer fit for purpose; and **Chris Hodge** described ways in which the Financial Reporting Council, companies and stakeholders can, and should, interact in order to improve the quality and relevance of company reports. **Howard Marks** (June) gave arguments both for and against regulation – a topical question in relation to company reporting.

Business models are important tools as a means of communication between companies and their stakeholders – a point made by **Christian Nielsen** (September), who presented research into new types of business model, while **Ulf Johanson** (this issue) suggests a 'softly-softly' approach which may help to bridge the mindset gap between corporate Heads of Communication and Investment Fund Managers. The better the communication and mutual understanding, the more productive the relationship.

Map and Compass for the Journey

Amy Wilson (June) identified 8 skills and tools that HR managers should acquire in order to play more of a strategic role in the organisation (i.e. turn into HC managers), and **Dave Ulrich** (also in June) emphasised the importance of structured and systematic data in both building a case for strategic HCM-related plans and in supporting HCM.

Michael Reddy (September) suggested five factors on which a company's HCM could be both audited and benchmarked against its peers – people risks, wellbeing, talent management, leadership and Human Capital data management. We think these will help to show the way.

External Factors Affecting the Journey

Last but not least, the bigger picture.

Michael Reddy (September) explained some of the complex linkages between players in the investment industry, which made clear why this is of interest to Human Capital professionals. **Raj Thamotheram** (February) argued that the investment industry would do well to take more account of Human Capital, as was the case with his Human Capital Investment Fund; and he, **Michael Mainelli** and **Jamie Stevenson** (September) outlined ways in which sell-side analysts in the investment world could and should reform their ways in order to provide good value to the large investing organisations, such as pension funds, who use their services. **Carol Royal** and **Loretta O'Donnell** (June) sounded a cautionary note about fund managers who present so-called 'human capital products', without necessarily having appropriate knowledge about, or experience in, human capital management.

Philip Whiteley (February), and **Robert Locke** and **J.-C. Spender** (this issue) both argue against what they see as dangerous and foolish 'cults' – the cult of accountancy (Whiteley) and the cult of managerialism (Locke and Spender). **Ben Dyson** (June) explained in clear terms why the banks have failed us by building up huge quantities of unsustainable debt, and proposed a solution; a theme that is echoed by Michael Mainelli in his predictions for 2012 (December). And **Diane Coyle** (February), author of "The Economics of Enough", highlighted the importance of human capital and social institutions for our future.

Snapshots from the Journey

You will find an index to the Human Capital Handbook 2011 on page 42. We hope you enjoy this souvenir.

Eyes to the Future

Some of our authors have made brave predictions about what might happen in 2012, and they are on various pages throughout this edition. The first, on the next page, is from Michael Reddy.

EYES TO THE FUTURE:

HANDBOOK AUTHORS' PREDICTIONS FOR 2012

MICHAEL REDDY

I think everyone will be surprised by something from left field in 2012, but the tide carrying Human Capital Management forward will undoubtedly quicken. Less certain, though, is what factors will drive the acceleration and characterise the movement towards better recognition of the importance of good HCM. Will it be reporting regulation? M&A specialists? (since it is well known that 60% of M&As fail to deliver real value to shareholders); magic? or something else? I think that, while this year's star themes have been workforce analytics (because it forms the bedrock of information that underpins any relationship between HR and the FD) and organisational culture (because it provides the environment in which people can either sink or swim and their talents can either thrive or die), next year's main theme will be people risks – how unwanted employee behaviours can potentially have a negative impact on the bottom line.

star themes

PERFORMANCE PAY: LEADERSHIP PRESCRIPTION OR CLASS 'A' NARCOTIC?

Steve Watson

Does employees' performance improve if their pay level depends on it? The evidence is equivocal,. and Steve Watson provides a clear summary of both sides of the argument, with clear implications for line managers and HR.

More pay = higher performance: this equation is under considerable scrutiny in many business situations. Steve Watson presents the opposing arguments and provides recommendations for those managing performance.

Over the last few years, the issue of pay has rarely been out of the news. Fairly or unfairly, the bonuses paid to bankers have become the most contentious example.

This is to some degree due to the allegations that broad economic structural damage resulted from their pay schemes, further fuelled by the fact that taxpayers in a number of countries were called on to bail out leading financial institutions. However, other groups, while less frequently cited, are attracting their share of criticism, or at least challenge: CEOs and their pay multiples; the packages of senior public sector managers; and the extent to which French and English national footballers deserved their pay in the face of indifferent pitch performances during the 2010 World Cup.

The topic is formidably broad and complex as it combines the effects of many factors: the role and effectiveness of incentives; motivation and leadership; performance management; base pay versus bonus/variable element; risk-taking; individual versus organisation trade-offs; pay multiples etc. In the eyes of the public it is often about fairness. Anne Sheehan, director of corporate governance for CalSTRS, the Californian state teachers' retirement system, is quoted in Harvard Business Review:

> "I think the matter of pay has moral connotations when you consider that regular working people have lost half of their retirement savings and many have lost their jobs, only to see over the top bonuses paid out to those responsible for the mess."[1]

While perceptions of fairness and morality may affect organisational engagement and effectiveness, the question we focus on in this article, is:

Does pay for performance work?

We shall consider the evidence from laboratory and field studies, business journals, books and other writing.

> "RELATIVELY FEW STUDIES GIVE UNEQUIVOCAL SUPPORT FOR PAY-FOR-PERFORMANCE"

ARGUMENTS FOR

Outside sections of the popular business press and handbooks of celebrity CEOs, relatively few studies give unequivocal support for pay-for-performance. "Anyone reading the literature on this subject published 20 years ago would find that the articles look almost identical to those published today", Herbert Meyer, professor emeritus in the psychology department of the University of Florida, wrote in 1975[2] about the doubts expressed regarding merit pay's efficacy.

The same theme was echoed by Alfie Kohn almost 20 years later[3] and others since (we will come to some of them in the second part of the article).

Alignment to performance

There are some writers, however, who do argue for pay-for-performance. Professor Steve Kaplan, University of Chicago, states "… there is no doubt that strong company performance is linked to realized pay – the sum of salary, bonus, restricted stock and exercise options. Because most of CEO pay is equity-based … a CEO whose stock price increases substantially will take home a lot, while a CEO whose stock price declines will not"[4]. The focus here is on senior management pay and the notion of aligning pay directly to a clear measure of performance. Others extend the argument to all managers. Professor Michael Jensen takes the view that because budgets and targets encourage managers to cheat and 'game' their systems, "the only way to solve the problem is to remove all kinks from the pay-for-performance line – to adopt a purely linear bonus schedule…all rewards must be based purely on actual performance"[5]. Gaming and cheating are arguments that are raised by exponents of both sides of the argument as we will see.

Both Kaplan and Jensen build their arguments on the assumption that performance is clearly and accurately measured – in the case of the CEO, by using stock price as the indicator of performance.

Measurable performance

This critical assumption (the measurability of performance) needs further refining, as argued by Tim Harford in his book The Logic of Life[6]. "When I wrote 'performance pay encourages performance', I was right, but with a crucial hidden premise that performance can be measured."

This theme is developed further by Pfeffer and Sutton[7] where they identify conditions for financial incentives. They argue that they can drive performance when the task is:

- Independent
- Individual
- Measurable
- Straightforward

In another study, a meta-analysis in the public sector[8], the authors concluded that pay for performance had a strong positive effect on non-interesting tasks, but a negative effect on performance in the case of interesting tasks.

The talent argument and the market

Nuno Fernandes of Swiss business school, IMD, takes a different tack. His case includes what is classified as the "talent argument." He writes: "As the saying goes, if you pay peanuts you get monkeys … we must focus on people's aspirations. We cannot prevent rewarding the best."[9]

The talent argument is reiterated by Jeff Immelt, CEO of GE. Referring to the threat of "say on pay" legislation requiring shareholders to sanction pay schemes, he says: "No matter what is decided, I'll work just as hard tomorrow as I work today, but what I have to fight for is the ability to determine how the other 300,000 people in GE are paid"[10]. This is a sentiment which is commonly expressed by top leaders: they claim that they personally do not need the level of pay nor incentives to accomplish their job; they are simply part of a larger market system to attract and retain talent. Cynics may argue that this is easy to say when you've already reached a top position and enjoy a full package of rewards (financial and non-financial)!

Joining or staying

A Towers Perrin Global Workforce Study conducted in 2007 amongst 90,000 employees in 18 countries[11], found that competitive base pay (note: not variable pay specifically) was a key reason people joined firms. However it did not feature in the top ten reasons why they left, nor was it in the top ten reasons for engagement, motivation or performing the job.

A 2009 McKinsey Quarterly survey[12] amongst 1,047 executives, managers and employees found that performance based cash bonuses ranked fourth in their list of effective motivators (fifth and sixth were base pay and stock/stock options respectively). The top three were all non-cash incentives: praise from immediate managers; leadership attention and chance to lead projects etc.

This positioning of financial rewards on the list, but not at the top, echoes the findings from a 2004 Watson Wyatt survey[13], where high performing employees ranked maintaining a positive reputation as their primary motivation. Expecting a significant financial reward came in at ninth.

Trust

Another factor relevant to the effectiveness of performance pay is the nature of the relationships within the organisation or team, particularly the degree of trust between people. Where there is a lack of trust it would seem people tend to prefer individual performance rewards.

Kimberley Merriman, assistant professor of management and organisation at Penn State University, studied 49 project teams and the study concluded that where the team had less trust in their colleagues' ability, honesty and dependability, they preferred individualised pay.

In summary, the key issues supporting performance pay appear to be: identifying the conditions best suited to its application (such as straightforward nature of the task; recruitment pressures; independence, measurability etc of the job; low level of trust within the team) and noting that even when it is on the list of expressed motivators, it is often not in the top grouping.

ARGUMENTS AGAINST

Short term-ism

One argument levelled against performance pay is short-termism. Alfie Kohn wrote in Harvard Business Review[14]: "Research suggests that, by and large, rewards succeed at securing one thing only: temporary compliance" .

Lucian Bebchuk, professor of law, economics and finance and the director of the corporate governance programme at Harvard Law School, reinforces this view[15]: "Both equity-based and bonus compensation provide executives with substantial rewards for short-term gains. They not only fail to provide desirable long-term incentives but also produce perverse incentives to seek short-term gains even at the expense of long-term performance …"

Individual, team or fortune

Professor Bebchuk continues: "… in addition, both equity-based and bonus arrangements reward executives for gains that are due not to their own performance but to economy-or industry-wide movements."

This is another key aspect of performance pay that merits consideration – the extent to which the performance in question is based on an individual's achievements as opposed to collective work or wider reasons. Matt Bloom writing in the Academy of Management Journal[16] reports that "virtually all of the research in support of hierarchical distribution has sampled work in which only individual performance matters."

A Finnish study[17] found that team-based rewards helped boost productivity – by between 9 and 20% – in three out of the four groups studied, providing the existing team culture and organisation structure were positive. They interpreted their heir findings as capturing the joint effect of teams and performance pay on efficiency and that teams helped to maintain peer monitoring to prevent free-riding. They suggested that if performance pay had been introduced to the previous hierarchical regime, they felt that the performance gains were unlikely to have been achieved.

The need to adapt systems to the organisation's culture was behind a study of a pay for performance scheme introduced and then abandoned in Hewlett Packard[18]. Harvard's Michael Beer wrote:

"HP's culture is one that historically placed more emphasis on management that builds commitment rather than on monetary incentives. Clearly they would be more prone to abandon programs that threatened trust and commitment."

Note the link to trust as previously mentioned.

Performance and the talent myth

"The talent myth assumes that people make organizations smart. More often than not, it's the other way round" wrote Malcolm Gladwell in the New Yorker in 2002[19]. In it he recounts a project at McKinsey & Co in the late 1990s[20]. The project examined how to single out and reward stars, based on the McKinsey philosophy that talent is what ultimately determines success and failure in the corporate world. A company that embraced the McKinsey advice more vigorously than others was Enron. Gladwell wrote: "The broader failing of McKinsey and its acolytes at Enron is their assumption that an organization's intelligence is simply a function of its employees. They believe in stars, because they don't believe in systems."

In his book Chasing Stars[21] Boris Groysberg describes the analysis of over 1,000 star analysts at 78 investment banks, and 20,000 non-star analysts at 400 investment banks. His findings were that "mobile" stars experienced immediate degradation in performance that lasted at least five years. Thus, performance may be more firm-specific than one might think.

Differentials

Opting more for individual performance pay rather than the collective leads us to consider the impact of pay dispersal on performance. A study[22] implied that people were more concerned with their relative pay than the absolute level – in fact the results suggested that they would accept a lower sum than otherwise if it avoided being relatively underpaid.

Pfeffer and Sutton[23] summarised a study of 67 companies[24] which discovered that those with the greatest difference between worst and best paid executives had the weakest financial performance in terms of Total Shareholder Return (TSR). Another study found that the greater the gap between top management and employee pay, the lower the product quality[25].

Matt Bloom in his study of baseball and the impact of hierarchy on player and franchise performance[26] concluded that "… attracting stars creates a more hierarchical pay distribution, which may reduce individual and organisational performance."

Performance goals

The effect of goals, in general, is challenged in Goals Gone Wild [27]. In it the authors argue "… that the beneficial effects of goal setting have been overstated and that systematic harm caused by goal setting has been largely ignored." They describe side effects such as narrow focus, unethical behaviour, distorted risk preferences, corrosion of organisational culture and reduced intrinsic motivation. They ask whether goals are "... benign over-the-counter treatment for motivation … [or] prescription-strength medication that requires careful dosing, consideration of harmful side effects and close supervision."

Financial reporting of performance, which by its nature is based on accounting judgements and subjective valuations, can be tempting to those looking to manipulate their achievements.

A study by the University of Minnesota [28] compared over 400 companies that had to restate their financial statements with those that did not and found that the higher the proportion of senior executives' pay was in stock options, the more likely the company was to have had to restate its results. Another study concluded that incentive pay packets can "create an environment that ultimately leads to fraud."[29]

Stronger language came from Henry Mintzberg writing in the Wall Street Journal in November 2009[30]: "Executive bonuses — especially in the form of stock and option grants — represent the most prominent form of legal corruption that has been undermining our large corporations and bringing down the global economy."

BENIGN OVER-THE-COUNTER TREATMENT?

Image Source

OR CLASS 'A' NARCOTIC?

Image Source

Intrinsic motivation

Many studies note the relationship between rewards and intrinsic motivation. Alfie Kohn wrote[31] "… studies … have conclusively shown that people who expect to receive a reward for completing a task or for doing that task successfully simply do not perform as well as those who expect no reward at all."

In fact, an analysis of three decades of studies[32, 33] concluded that "tangible rewards tend to have a negative effect on intrinsic motivation."

In summary, the key arguments against performance pay are that: it secures only temporary compliance; it may be more suited to team rather than individual rewards and is less suited to collaborative and trusting cultures; talent is not as independent from the organisation and transferable as many believe; it can create damaging differentials; and some believe it can lead to unethical behaviour. Studies reinforce the evidence that reward systems often reduce motivation, do not work in creative and cognitive contexts and in many situations cause performance to fall.

CONCLUSION

The overall balance of the evidence is that pay for performance schemes work in fewer situations than many people think. Line managers and HR professionals should consider some of the pointers from the evidence before agreeing to its use in their organisations.

1. Shared or team rewards might be more productive than individual ones. The evidence suggests that company or team rewards work better than individual ones providing that there is a collaborative and trusting culture supporting the initiative. If that culture does not exist, maybe that should be where management and HR should direct their focus, rather than a potentially divisive pay scheme.
2. Financial rewards seem to work best for non-interesting, mechanical tasks, not complex ones requiring cognitive, creative skills. How many jobs, particularly for the manager population, could be clearly categorised as individual, independent, straightforward, measurable, simple and effort-based rather than complex, requiring cognitive and creative skills, based on a blend of judgement and measurement?
3. The evidence suggests that performance pay creates a market or transactional mindset and this may undermine other management styles/cultures.
4. Introducing a performance pay scheme may reduce people's intrinsic motivation, make them more narrow, short-termist and transactional, and may cause performance to fall. In the face of such evidence the question is raised as to why so many managers deploy pay for performance so readily – and whether it is really used as an inferior substitute for effective leadership?

Experiments

Dan Ariely describes some of his team's experiments in his book Predictably Irrational[34]. A straightforward task where subjects were asked to drag shapes into target areas on a computer was the context. The aim was to drag as many as possible in a given time. When the first group were paid 50c (in total) the average number of shapes dragged came to 101. Those on a higher fee ($5) successfully achieved 159. It would seem from this simplest of studies that if you pay more, you get more.

There was, however, a third group. They were just asked … with no payment! They achieved 168. Ariely distinguishes between two worlds: the market and the social world and raises the question of how performance may be affected by framing tasks in a transactional, market context rather than a more social one. In another experiment his team replaced payment with gifts (more social than market) and achieved similar higher levels of performance where no gifts were involved at all.

In The Upside of Irrationality[35] Ariely shares another set of experiments conducted with fellow researchers Uri Gneezy, George Loewenstein and Nina Mazar in India. Subjects were offered low, medium or high rewards for a range of tasks demanding attention, memory, concentration and creativity. There was little difference in the performance of the groups offered low or medium payments. Those offered the high bonus (and by running the experiment in India they were able to make the bonus significant in local currency terms) performed worse than the others in every task.

They repeated the experiments with groups at MIT and a subtle difference emerged. With mechanical tasks more pay resulted in higher performance, but those that required cognitive skills showed the same result as in India: higher pay meant lower performance. Experiments by Sam Glucksberg (Princeton) and Teresa Ambile (Harvard) suggest creativity can also suffer under reward systems.

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About the Author

Steve Watson, who sadly passed away in June 2011, was the Director of the Finance for Managers programme at Ashridge Business School. With his background in finance and strategy, he worked with various corporate clients across the world and was a Visiting Professor at Mount Eliza Business School in Melbourne, Australia.

“YOU HAVE TO REALISE: IF I HAD BEEN PAID 50% MORE, I WOULD NOT HAVE DONE IT BETTER. IF I HAD BEEN PAID 50% LESS, THEN I WOULD NOT HAVE DONE IT WORSE.”

Jeroen van der Veer, Former CEO, Royal Dutch Shell

in “Cheques With Balances – why tackling high pay is in the national interest”

(final report of the UK’s High Pay Commission, 22nd November 2011)

“STOCK OPTIONS LEAD TO EXCESSIVE RISK TAKING BECAUSE THE DOWNSIDE RISK IS ZERO, WHILST THE UPSIDE BENEFIT IS UNLIMITED.

RESEARCH HAS SHOWN THAT WHERE CEOS HAVE THE GREATEST OPTIONS, THERE TEND TO BE MORE LOSSES THAN GAINS FOR THEIR ORGANISATIONS (Rajagopalan & Zhang, 2009).”

from “The Influence of Behaviour and Bias on Corporate Governance”, MSc Dissertation by Daryl Close, University of Westminster, 2010, p.14

EYES TO THE FUTURE:

HANDBOOK AUTHORS' PREDICTIONS FOR 2012

DERMOT TOBERTY

Such a Simple Hypothesis

As we leave 2011 we can expect enterprises of all types to be operating in a sub-optimal economic climate and to be headlined for the wrong reasons – such as declining growth prospects or threats of merger or acquisition.

But we cannot forget that millions of people work in organisations that create value by converting goods and resources into essential products and services. These people want to do well, earn a reasonable wage and lead a good life. Most want to enjoy and be engaged in their work; and every employer wants staff to give that little bit extra and provide the competitive advantage that leads to organisational longevity. The needs of both are aligned.

Such a simple hypothesis – it is incredible that it is not universally supported. There is a high risk that it will be neglected as we concentrate on immediate crises facing our organisations.

We will probably forget that our number one assets, rather than being nurtured, are being enveloped in a simmering cauldron of angst as things are done to them and their thoughts and views neglected.

And as people become disengaged, productivity will fall and absenteeism worsen. Smarter employees will seek new opportunities and deluded employers will naively believe that there are ready-made replacements. If the accountants win, pay cuts and longer working hours will become the norm, and employers' contributions to pension schemes will end.

A doomsday scenario? Who knows? The warning signs are there and we cannot ignore them.

So; what can we do? Well, I think we should truly believe in people and treat them as we would like to be treated ourselves. This will help us guard against the risks we face and protect our organisations' medium to longer term position. We should scrutinise human capital metrics as rigorously as any other business process measure and take action to ensure that whatever happens in the economy in 2012 our people remain engaged with our organisations.

Happy New Year!

> "WE SHOULD TRULY BELIEVE IN PEOPLE"

CONFRONTING MANAGERIALISM: HOW THE BUSINESS ELITE AND THEIR SCHOOLS THREW OUR LIVES OUT OF BALANCE

Robert R. Locke and J.-C. Spender

Business studies now preoccupy one of every five US college students. But is a born-in-the USA MBA a risk to the future of America itself? Are the 'elite' business schools – Wharton, Harvard, Stanford, Columbia, Chicago – responsible for breeding and infesting blue chip boardrooms and – more importantly, Wall Street – with an elite 'greed is good' caste fundamentally disconnected from reality? Does the MB in MBA stand for 'morally bankrupt'?

Confronting Managerialism offers a scathing critique of the crippling influence of neoclassical economics and modern finance on business school teaching and management practice. It shows how business managers, once well-regarded as custodians of the economic engines vital to our growth and social progress, now seem closer to the rapacious 'robber barons' of the 1880s. Brilliantly arguing that today's attempts to 'bolt on' ethics and social responsibility courses are mere window-dressing, it suggests that only fundamental reforms in civil society and business schools can really make a difference. Extracted and reproduced with the author's permission, these reforms are highlighted here.

Guidelines for reforming management

This book considers US managerialism to be a principal cause of wealth maldistribution and a chief promoter of bad management in finance and industry. To counter the effects of managerialism, the analysis the study presents points to a two-pronged reform. First, the position of management in nonfinancial firms must be strengthened in order to protect the firm-entity from outside predators operating out of investment banks and hedge funds. This could be accomplished by adopting a two-tier board system, like the German one, with supervisory boards elected by stakeholders protecting the firm-entity from hostile takeovers and buyouts. Some protection of the firm-entity could also be afforded by limiting the voting rights of institutional investors in matters of mergers and acquisitions and takeovers. In Germany most stockholders have limited voting rights in these matters. The statement on German Generally Accepted Management Principles, moreover, allows managing directors in the firm to carry out a 'protective function' that stops shareholders from making 'exaggerated demands' on the firm (von Werder and Grundei, 2001, 102).

Second, participation in the selection of CEOs and boards needs to be extended to all company stakeholders. Unlike in America, where corporate CEOs often preside over the board of directors, in Germany members of a company's managing board cannot sit on the firm's supervisory board, which sets managing board salaries (von Werder and Grundei, 2001, 103). In big firms the stakeholders could also participate in the election of a compensation committee on salaries and bonuses. With this reform, stakeholders could have a say in how salaries and bonuses are fixed in their firms. There is no guarantee that employee representatives sitting on these committees would curb the excessive claims on a firm's resources from stockholders and upper management, but surely so long as the purse strings remain legally in the hands of stockholders and de facto almost exclusively under management's control, no fair-minded pay redistribution will occur through institutions within civil society.

The proposed legislation would not require great expenditure in public funds that would occasion the creation of massive administrative infrastructure, or progressive taxation to redistribute wealth. Nor would it require government intervention to set or cap executive salaries in ham-fisted bureaucratic interventions. It would simply allow redistribution to occur within firms themselves by stockholders and stakeholders.

Guidelines for reforming business schools

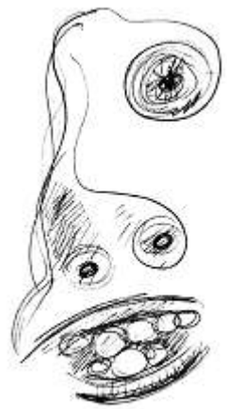
The thrust of business school reform needs to be two-pronged as well. First, business schools' educational programs should serve a broader spectrum of business and industrial trends. Schools have to re-establish the contact with manufacturing that they lost during the Japanese manufacturing challenge in the 1980s. There would have been no need for the automobile and other established industries to suffer so much had the leadership cadres seriously studied and pushed for work process reforms like TQM (Total Quality Management), rather than, as in the business school case, mostly ignoring them. Efforts also have to be made in business schools to respond to criticism of the post-autistic movement in economics, to make study programs reflect realities in practice, rather than the belief of economics and finance professors in the omniscience of their models.

The second prong of business school reform needs to take on managerialism. Business schools should not just serve a management caste, but business and industrial firms as entities. Therefore, they must broaden contacts to all firm stakeholders, including members of trade unions and other non-management employees (as, for example, by teaching courses to employee members of compensation committees). To justify their existence as public institutions, business schools must also be proactive in leading management back to social responsibility, or business schools (instead of arts and humanities programs in universities) should be shut down, since there is ample evidence of the harm they have done, and that other countries have prospered without them.

Can US business schools and the management caste carry through any meaningful reforms along the lines suggested? The answer is no. People in top business schools believe their propaganda; they – perhaps out of self-preservation and certainly out of self-promotion – have not grasped the idea that good management education can occur without business schools or that they should serve broader interests than those of the management caste. Witness the outlook of Harvard Business School's new dean, Nitin Nohria, whose recent leadership handbook promotes the connection between business schools and managerialism (Nohria and Khurana, 2010).

Nor can the US management caste be expected voluntarily to give up its power and wealth. To retain both is why control over executive pay is so important to the caste. Right now management is in the enviable position of setting its own salaries and bonuses, and it will fight in the US and UK to retain this power and to spread it internationally to firms as members of a privileged worldwide executive club. Despite the outrageous spectacle of seeing executives receive huge payouts in failing companies, nothing has been done to stop it, except ineffectual jawboning.

Not much reform can be expected either from the political side of the American ledger. Out-of-balance America has developed into a conflicted society, demoralized, politically paralyzed, bankrupt, and despairing. There is little stomach in the country to raise taxes to avoid deficits, little stomach, on the other hand, to raise deficit spending in order to stimulate the economy; there is no



ineffectual jawboning

Image Source

stomach for a fight to take corporate money out of electoral politics, or to stop the lobbyists from writing the legislation Congress passes, or to halt the endless spending on war and armaments, or to reform seriously any level of the educational system. Americans are transfixed rabbits caught in the glare of onrushing headlights – cynically preaching the saying *Enrichissez-vous*, the nineteenth-century French equivalent of Greed is Good, or repeating the *bon mot* that amused Louis XV's court, in a regime on its last legs: *Après nous le Déluge!*

If people want a solution to the problems that managerialism and US business school education induce, do not look to America. Look outside the United States for impetus and remedy. In the 1990s that would have been impossible. After the fall of communism, the globalization of US managerial, market-driven financial capitalism took on new life. But the recent financial turmoil has turned into a eureka moment in world history, where observers suddenly discovered that the emperor has no clothes. Yukio Hatoyama, just before he became Japanese prime minister, phrased it this way:

> *The recent economic crisis resulted from a way of thinking based on the idea that American-style free market economics represented a universal and ideal economic order, and that all countries should modify their traditions and regulations governing their economies in line with global (or rather American) standards .... Our responsibility as politicians is to refocus our attention on those non-economic values that have been thrown aside by the march of globalism. We must work on policies that regenerate the ties that bring people together, that take greater account of nature and the environment, that rebuild welfare and medical systems, that provide better education and child-rearing support and that address wealth disparities. (Hatoyama, 2009, 1-2)*

Hatoyama is not a radical anti-American venting spleen against the Great Satan. Hardly any Japanese politician is, in a cautious country that still depends on the US for its economic security and military defense. His doubts, therefore, express a growing change in world opinion among moderates who have been shocked by American managerialism's wanton belief that greed is good and profit maximisation is to be sought at all costs, even, if necessary, through what ordinary people would call swindle.

World political leaders defend their peoples from the machinations of incompetent and insensitive financial traders in America and Britain. This happened unilaterally recently in the German Bundestag's prohibition of the short selling of bonds, regionally in the euro zone countries' growing refusal to let their currency be ruined by speculators operating outside the euro zone, trading in currency markets located in London and New York, and in Chinese and Japanese decisions to monitor exchange rates rather than leave them at the mercy of US- and UK-based currency dealers (Kaletsky, 2010). The attempt to introduce balance through multilateralism is also gaining ground in the press to expand international economic and financial groupings to include representatives from developing and emerging economies and in efforts to expand participation in the United Nations.

It is also happening in jurisdictions that have been the focus of this study. Probably to non-Americans the most upsetting feature of US managerialism and the US business school outlook is the disregard for the poor. Rich Americans enjoy bounty without responsibility because they have wide spaces to exploit. Distressed Americans have not had to be taken care of; they simply moved out, from the Rust Belt to the South and the Southwest, from the inner-city blight to suburbia, with attending shopping malls. In China, with 1.2 billion people, 800 million of whom are extremely poor peasants, the leadership has few demographic options – least of all because the country has a revolutionary past. That explains their emphasis there on a moral compass.

Image source

moral compass

The ethics of individualism might still resonate in America, although less convincingly than in the past, but it does not make much sense in a country such as China, where the leadership, and the middle classes, are sitting on top of a huge underclass that seeks freedom from want. The leadership class cannot dump its population on empty lands like American leaders; that is why Chinese leadership embraces a moral philosophy that promotes community values and a redistribution ethic. Chinese authorities turned to Kong Fuzi ("Confucius") not to US individualism for their moral compass because they realise that China's leadership class cannot survive if it does not adhere to a broad distribution ethic and turn it enough into a reality to escape social breakdown. Among the rapidly developing BRIC (Brazil, Russia, India, and China) countries, the Chinese government has taken the moral high ground by officially espousing policies that close the gap between the rich and poor and bring a balanced development between poorer and richer regions of the country.

This is occurring elsewhere as well. In Brazil, people now call into question the American-sponsored administrative reforms, with the support of US-dominated agencies such as the IMF that introduced global managerialism into many countries during the 1990s. In Brazil these reforms stress 'efficiency,' and the 'theories and practice of business management,' in a new 'managerialist state,' meant to replace the old, inefficient, 'developmentalist-interventionist state'. The new managerialist state offered a 'friendlier and less contested context for the adoption of more liberal market-oriented policies, while retaining the power and authority of elite politicians and technocrats' (Imasato and Pieranti, 2010, no page numbers). Critics of this international managerialism nowadays dislike the 'managerialist' state in Brazil, for the same reasons Prime Minister Hatoyama gave when condemning US freemarket-style economics in Japan – because it downgraded democratic participation and distracted government from its 'societal roles'.

To defend themselves from the charge of moral bankruptcy, the US management caste and their business school partners customarily switch the subject from ethics to economics – to the superiority of neoliberal market systems as compared to the economic failure of the socialist alternative. Although this might have made sense in the past, persistent US attacks on socialism today add up to beating a dead horse. People everywhere in the Eurasian heartland are in fact busy dismantling socialism, by privatizing enterprises and opening up markets; they are engaged in a rapid expansion of international transportation systems, and in developing multinational trade at a remarkable pace. The building marvels of today are being erected outside America – while America fritters away its resources on lost wars at the cost of repairing its dilapidated infrastructure. The contrast between dynamic American capitalism and stagnant socialism only exists in misinformed American minds; reality now is a decaying US economic structure competing with a dynamic Eurasian continent, as every person who rides the bullet trains in Europe, China, South Korea, and Japan and visits recently constructed coordinated trade centers readily grasps.

Thus, the choice is not between socialism and unregulated US neoliberal market capitalism, but between the latter and an internationally regulated form of dynamic capitalism in which firms are more efficient because of participative management, and the markets function better because of a more equitable distribution of wealth in society. Unless a combination of domestic and international political pressures brings the necessary reforms to managerialism and business schools in the US they will not be part of the solution to current woes but a continued cause of dislocation in American society and in the wider economy.

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EYES TO THE FUTURE:

HANDBOOK AUTHORS' PREDICTIONS FOR 2012

ROBERT LOCKE

We hear a lot about mandatory ethics courses for MBA students but that is less important than making them mandatory for deans and faculty in business schools .

The ethical bankruptcy of some of these academics is a problem, because –

- they are fixated on behavioralist models derived from neoclassical economic orthodoxy which emphasize self-interest;
- they are also fixated on an agency-based conception of professional responsibility that omits consideration of complex social-cultural (community) factors influencing business decisions;
- and they are busy protecting faculty vested interests in conventional topics in the business core curriculum – topics that are without ethical content.

A business school run by such people could not possibly convince students that ethics is a serious part of its educational mission; not if students are taught that a firm is a money mill and profit maximization is its only real aim, or that only selfishness is rational.

Amorality or immorality might be an option for businessmen but they are not options for business school educators. Even if they believe strongly in the profit motive, they cannot advocate individual gain at the expense of the community, or that "efficiency" just means higher profits. That business school deans and faculty have let themselves be seduced by this neoliberal amorality is a recent and dangerous betrayal of the educators' public trust .

To wean business schools from serving the private interests of a management class is an urgent public task, but not an easy one because it requires the re-education of the power brokers that run and support these institutions.

> "THEY CANNOT ADVOCATE INDIVIDUAL GAIN AT THE EXPENSE OF THE COMMUNITY, OR THAT 'EFFICIENCY' JUST MEANS HIGHER PROFITS"

'PACESETTING' LEADERS CAN DESTROY BUSINESS VALUE

Ian Price

HubCap says: We want our leaders fizzing with bright ideas, full of first-in-last-to-leave vigour, determined to change the world? But if the candle that burns brightest also burns out fastest, then what? Ian Price sifts through the ashes of the latest high profile CEO burn-outs to find out what went wrong.

The recent temporary departure of António Horta-Osório from his role at Lloyds Banking Group was unusual in the immediate and prominent use of the 'S'-word – "stress" – in media reports of the bank's announcement [1, 2]. For any number of reasons, leaders, their boards and investors are keen to avoid the word as part of the narrative in a leader's exit. However, there have, in the last year or so, been a number of sudden, unplanned chief executive resignations that the press has attributed – at least in part – to stress. These include Masataka Shimizu of Tokyo Electric Power, Jeff Kindler of Pfizer (more of him later), Mark Tincknell of Connaught and Andy Hornby at Boots.

burn-out for Lloyds' leader?

Image Source

It would be all too easy to succumb to the temptation to talk dramatically of a "stress epidemic" among our CEOs but is there something about the way in which we select, appoint and reward our leaders that makes stress or fatigue more likely? This article will make the argument that the current vogue for high-energy, dynamic leaders – a vogue that flies in the face of the science – is actively driving up fatigue and poor performance. For all the books and articles on leadership, I will argue that the human resources and selection industries are failing leaders, their organisations and investors.

The press never seems to predict sudden CEO exits; instead, its profiles of in situ leaders always tend towards the hagiographic. It was no different with Horta-Osório although even in an interview with him on 10th July 2011 [3] there were signals that his leadership style was going to be difficult to sustain. In what should have been a red flag that the man was taking too much on his own shoulders, the profile was titled: "Lloyds chief Antonio Horta-Osório is working 24-7 to turn around the bank – and the UK economy." The article itself explains:

"What this has meant in practice is a lot of late nights and weekends in the office. Mr Horta-Osório has frequently scheduled meetings on Sundays. "We had more time to think on Sundays about what are our real priorities", he says."

Horta-Osório himself seemed more concerned with the impact on his family than his own resilience. "My family is complaining they haven't seen me very much these last few weeks. I have to make it up to them. It's been a very tough few weeks." The article does not question the CEO's style nor reflect on its sustainability.

However, less than four months later and following Horta-Osório's departure, further details have emerged in the press of "obsession with detail" and "micro-managing matters which most other chief executives would let aides deal with". [4]

Goleman's "Pacesetter" Style

In terms of leadership style, what we have witnessed in Horta-Osório is, in Daniel Goleman's language [5], the "Pacesetter" – the leader that "sets extremely high performance standards and exemplifies them himself. He is obsessive about doing things better and faster, and he asks the same of everyone around him". Of six leadership styles which one might flex according to context, the Pacesetter is the one that seems to be most in vogue among journalists and, I would argue, among selection committees and investors.

There are a number of reasons why the Pacesetting style is an attractive one to have in your leader – for one thing, it offers a reassuring sense of value for money, particularly if a high remuneration package was needed to draw the leader to the role in the first place. We are also naturally drawn to dynamism in our leaders and, in spite of all the research that suggests otherwise, we associate charisma in leaders with effectiveness.

Taking the Principle to Extremes

The example of Jeff Kindler at Pfizer offers a number of parallels with that of Horta-Osório. When Kindler's departure was announced in December 2010, he had the following text inserted into the release at his own insistence: "The combination of

> "THE PACESETTING STYLE DESTROYS CLIMATE"

meeting the requirements of our many shareholders around the world and the 24/7 nature of my responsibilities has made this period extremely demanding on me personally." Like Horta-Osório, Kindler took the principle of leading from the front to extremes as is evident from an extensive analysis by Fortune magazine of his style. [6] Prior to being appointed CEO, his role as vice-chairman included oversight of the company's communications department. When one press statement was being prepared, he astounded his media team by appearing in the press room and typing the statement muttering "I've got to do this myself".

Kindler held conference calls on weekends and reportedly bombarded his deputies with voicemails and emails at all hours of the day and night. Ultimately, the style contributed to his burning out but also, crucially, lost him the support of his key executives and directors who, as at Lloyds, resented Kindler's micromanagement. The classic apologia for the style of Kindler and other Pacesetters can be found in a revealing quote that Fortune acquired from a former colleague of his when he was at McDonalds where he was known to work longer hours than anyone else. "He's very demanding," said the former colleague, "but he demands less from others than he would from himself." It is as if the words were lifted from Goleman's definition of Pacesetting.

Corrosive Aspects of Pacesetting

But the Pacesetting style (which for Horta-Osório, like Kindler, included holding strategy meetings at weekends) has implications not just for the leader's personal sustainability but also for the performance of the organisation as a whole.

As Goleman points out, "the pacesetting style destroys climate". Of the six leadership styles identified, only two correlated negatively with organisational climate. The other styles, for completeness, are Coercive, Authoritative, Coaching, Autocratic and Democratic. Drawing on the research of David McLelland at Harvard University and its continuations by his team at Hay/McBer, Goleman showed that the Pacesetting and Coercive styles correlated negatively with climate. One might ask the question whether climate matters if the leader still gets results.

McLelland's 1998 research [7] demonstrated that climate accounts for 20 to 30 percent of the variance in an organization's performance. And since the leadership style accounts for 53 to 72 percent of the variance in organisational climate, we should be concerned about the vogue for Pacesetting, not just for the leader's personal wellbeing but also with organisational performance in mind.

When one reads the anecdotes that emerge after the event from companies such as Lloyds and Pfizer, it is possible to see how a frenetic, micro-managing style can inhibit employees' clarity about mission and values; if, as Kindler did, the CEO is prone to fire out aggressive emails and leave voicemails for employees late at night expressing dissatisfaction, that behaviour is likely to recur and cascade down the organisation as the leader's impact as a role model takes effect.

It seems as if the most corrosive elements of the Pacesetting style – the long hours, the working across weekends and holidays, the punishing travel schedule – are now hard-wired into the leadership role in a way that simply wasn't the case thirty or so years ago. Why might this be?

corrosive

Image Source

Causal Factors in the Drive for Pacesetting

I believe there are three causal factors:

(1) the enabling technologies (conference calls, email and mobile devices) that mean the barriers to Pacesetting work have been removed; for example, secretaries who have gone home, executives on the move and out of contact, the difficulty of global travel. A global air industry and the advances in communications technology are such that the twenty-first century leader can work continuously.

(2) the death of hierarchy – as we have stripped organisations of the traditional indicators of seniority (private dining facilities, corner offices, company drivers) so we have conflated activity with status – the busier we are, the more important we must be.

(3) the distortion of the Protestant work ethic into something more aggressive which assumes that a punishing work schedule is a pre-requisite for leadership success.

Hinterland and Recovery Time

Indeed, it now appears to be widely accepted that corporate leadership in the twenty-first century requires a level of sustained personal commitment that means one can no longer assume that the traditional non-work dimensions of life will continue to exist. CEOs on the threshold of acceding to a leadership position use language that suggests some sort of Faustian pact. In "The Secrets of CEOs" by Steve Tappin and Andrew Cave [8], more than half of the CEOs interviewed said that they have little time for family or personal interests and passions, "such are the demands of being the boss".

In fact, what the twenty-first century organisation needs is leadership that is more nuanced and reflective of our changed environment. Exactly what this leadership needs to look like has also been well-established by the science. Manfred Kets de Vries built his Global Executive Leadership Inventory (GELI) on the back of 360 degree feedback of several hundred CEOs who went through his leadership programme at INSEAD. [9] What emerged was an inventory of twelve dimensions of leadership. Many of these are precisely the leadership qualities that suffer in the frenetic, "too-busy" world of the Pacesetting leader: Work-Life Balance, Resilience to Stress, Empowering, Envisioning, Team-Building, Emotional Intelligence, Energizing, Rewarding/Feedback. [10] What emerges clearly from the portraits of burnt-out leaders such as Kindler and Horta-Osório is a punishing personal work schedule combined with a reluctance or unwillingness to delegate.

So, far from crowding out time spent with family and in leisure pursuits, the leadership role should build in a hinterland and recovery time to make the role sustainable and allow time for critical thinking. While there is a time and place for rolling up one's sleeves and leading from the front, the leader in the large organisation of the twenty-first century will achieve success in no small part down to his or her ability to delegate effectively and leverage the organisation by painting a vision that others would like to follow.

Burn-Out

However, my experience of working with boards, selection professionals and recruiters is that these qualities are rarely sought at all, let alone tested. Instead, we appear to seek dynamic, high-energy leaders who are subsequently profiled admiringly in the press for exactly the qualities that may contribute to their subsequent burn-out.

At the time of writing, Lloyds Banking Group insists that the door remains open for its CEO to return by Christmas, following a much-needed break [11]. My guess is that, in a tough economic climate, we will see more Pacesetters drop out of the race.

About the Author

CEO turned business psychologist, Ian Price is the author of "The Activity Illusion: Why we Live to Work in the 21st Century and How to Live Instead". Through his consulting firm Grimsdyke Consulting, he helps organisations and leaders achieve more by doing less. He has appeared on ITV 1's Tonight Programme to talk about work life balance and is a member of the British Psychological Society's Work Life Balance Working Group. He is also a member of the Association of Business Psychologists.

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EYES TO THE FUTURE:

HANDBOOK AUTHORS' PREDICTIONS FOR 2012

MICHAEL WALTON

In many ways 2011 has been a year characterised by eruptions of frustrations from the many, about how they have been treated and exploited by the few, and where reputational damage – either to a Brand or to a prominent personality – has disrupted the revenue flow or damaged the image of the business. It remains to be seen how these trends will develop but both constitute significant reputational and revenue risk and highlight the critical role of employees generally.

A more genuine engagement and valuing of employees would begin to counter emergent internal revolutions, especially if combined with less tolerance for egotistical, narcissistic and self-serving executive behaviour. Will such a pincer-movement happen? We can only wait and see.

> "THE CRITICAL ROLE OF EMPLOYEES"

LEADERSHIP - FROM THE OUTSIDE IN

"WE HAVE IDENTIFIED FOUR KEY PRINCIPLES AND QUESTIONS THAT DERIVE FROM AN OUTSIDE/IN, BUSINESS VALUES-DRIVEN LEADERSHIP APPROACH:

1. CLARIFY WHY LEADERSHIP MATTERS:
   WHAT ARE THE OUTCOMES OF GOOD LEADERSHIP?

2. NAIL THE BASICS:
   WHAT MUST EVERY LEADER KNOW, DO AND BE?

3. CREATE A LEADERSHIP BRAND:
   HOW DO WE DEVELOP LEADERSHIP (NOT JUST LEADERS) FROM THE OUTSIDE/IN?

4. ENSURE LEADERSHIP SUSTAINABILITY:
   HOW DO LEADERS MAKE LONG-TERM CHANGE REALLY HAPPEN?"

From "What is Leadership?"
ebook by Dave Ulrich and Norm Smallwood, HRMagazine 12 Dec 2011

DO INVESTORS REALLY CONSIDER HUMAN CAPITAL DISCLOSURE?

Ulf Johanson

Persuading businesses to see the value of reporting their human capital potential is increasingly like preaching to the converted. The question that remains is how to convert investors to want what you're selling. If putting everything on display isn't working, is it time to get to really know your customers?

Human capital disclosure has been a key issue for decades not only for firms, researchers, and consultants but also for policy makers (e.g., EU, OECD and UN as well as governments in for example the UK, the Nordic countries, Japan, Germany, Australia). Apart from non-financial information, human resource accounting and social accounting were at first suggested as useful models that would make a difference to stakeholder behaviour. These suggestions were followed by numerous other models such as e.g., Investors in People and Intellectual Capital. Even Corporate Social Reporting and the most recent suggestion Integrated Reporting address human capital. The target audience differs between the models but the financial market is certainly regarded as a main receiver of the information. However to what extent is the financial market really interested in human capital information?

According to different studies, in general the actors in the financial market do not demonstrate a strong, robust and sustainable interest in human capital disclosure. But numerous experiments have revealed that human capital information does make a difference to investors' decision-making. However, this body of behavioural accounting research has a major shortcoming which affects the usefulness of the results; normally they focus on just a limited number of questions and on specific information that is easily defined. In addition substitutes (usually students) are used instead of e.g., practitioners from the financial market. This means that the social context is not considered. To get the full picture of the benefits of human capital information there is an urgent need for social studies on the relevance of human capital disclosure. A minor Swedish study reveals some surprising results.

The theoretical rationale behind the Swedish study is that most of the research on communication between companies and the financial market has been characterized by assumptions, grounded in financial theory, about rational agents and information asymmetry. Actors in the financial market are supposed to be profit-maximizing "economic men". The ability of the financial market to value assets and liabilities of a company is supposedly a function of the efficiency of the information market.

However the assumptions of an efficient market for information can be questioned from a social systems perspective, in which it is suggested that people are part of many different social systems and are therefore influenced by different logics. By applying their own specific logic, some social systems are re-created and grow stronger with time. Just like any group in society, analysts and investors develop, and are limited by, their own social environment. By this is meant collective ideas and opinions that are rather stable over time and thus hard to change. This resistance to change is enhanced by groups often being unaware of the social logic that affects their values, thoughts, and actions. Social logics render the understanding of certain phenomena simpler or possible, but make the understanding of others more difficult or even impossible, for example when it comes to the role of human capital in a company's generation of value.

Based on a system-theory perspective Henningsson (2009) seeks to gain insights into how fund managers are affected by social forces when they interpret information about intangible resources at companies. Fund managers become "cultural observers" when they interpret information from companies. Henningsson shows that a number of social forces, variable as they are, have considerable influence on how institutional investors treat the information they get from the companies. These social forces are:

1. The ability of financial theory to explain share price fluctuation. Investors tend to trust in share prices being determined on a rational basis: 'in the end, the market is always right'. Most of the time, they search for logical explanations for fluctuations on the market.

2. The evolution of general opinions (stories) concerning some companies. These stories have an effect on what investors consider important information.

3. Involvement by the internal organization. Investors are affected by the way their own organization gets involved in their investment decisions. Investors' independence varies greatly, and sometimes the logic and culture of the organization can have a big impact on individual investment decisions.

Using the same theoretical perspective an additional study was performed, this time addressing the role of human capital and sustainability reporting in the interaction between firms and fund managers. Two focus groups were invited to separate group discussions. One group consisted of fund managers working at major institutional investor firms in Sweden, the other of company heads of communications who were responsible for investor relations in big international Swedish listed companies. (To provide opportunities for a rich debate only five persons in each group participated. In addition three researchers were present. One of these acted as chairman whereas the other two kept silent and took notes. The focus groups were also video-taped.) The aim of these discussions was to illuminate the differences between the two groups of professionals and their ways of reasoning. To limit but also to trigger spontaneous comments and discussions in the groups, three quotes and some questions were chosen in advance.

The findings support the suggestions by Hopwood (2009) that a social study of both accounting and finance demonstrates differences between them in understanding what is important in company information for the financial market. The Swedish study provides further indications that when considering not only information suppliers (i.e., reporting from firms) but also the information users (i.e., financial market actors), other issues with respect to disclosure of factors such as human capital will emerge. Whereas the heads of communication wanted to provide a detailed picture of the company the fund managers reduced the information.

For example, a head of communications said:

"The financial market has a tendency towards … some degree of tunnel vision; they look at their stuff and have difficulty seeing beyond it … I also think that they have an exaggerated belief in their own understanding of what is going on. … When seeing figures, they think they can analyze a company, but they can't because they don't know how it is out there… . If you don't provide a context, they'll make one up or put things into a context that is inaccurate, and you have to control that."

while a fund manager said:

"If it is a well-known company, an entity that you know well, you already know most things. Then you know what to look for, what sections are interesting … It's a way to rationalize… . And then, in a factory or something, you often feel the mood in the air in some way. How it is when the bosses walk by and what it looks like and how people are perceived. It's hard to hide such things."

"THEY ARGUE WITH 2 DIFFERENT TYPES OF SYSTEM BLINDNESS AND HAVE DIFFICULTY SEEING THE COMPLEXITY OF THE OTHER SYSTEM"

Detailed information about employee competencies, working environment or sustainability issues was not regarded as interesting unless these kinds of issues were regarded as high risk factors. Fund managers relied upon company management to take care of these matters. Further, fund managers developed their own stories about different firms. These stories were built on trust in top management.

It is entirely natural that the different social environments create different stories and that the companies try to influence the financial market with their versions. This is like a contest for the context, the context in which the information is to be interpreted. The financial market simplifies while companies see nuances. The two social forces struggle on the basis of two logics, with the decisive difference that the companies are open to complexity while the financial market is much less so. So how do the logics, or the purposes, of the two systems differ? The financial market tries to penetrate that which isn't mentioned. There is also a reluctance to switch stories, partly because everybody wants their own sustainable story and partly because they want to rely on a robust and sustainable cash flow logic. Financial market actors come up with different stories about management culture, and the importance of the role of top management. In this way, they recreate their own social logic of reducing complexity to a question of management. Investors identify with the boss, to some extent.

The financial market representatives want to see connections between intangible resources on the one hand and productivity/profitability on the other. This is a core element of financial market logic and dominates its social system. Without an attempt to make such connections, information in this respect is of no interest to the fund managers.

A head of communications said:

"Discussions of increased energy efficiency have an impact, but not, for example, issues related to employees. The reason is that the market has difficulties translating personnel issues into money. It is not realized, for example, that high levels of sick leave are of great importance for a company's profitability."

A fund manager said:

"What we would like to see is a connection to results. That this has also led to a better … to reduced costs or increased sales…… is nothing that leads to the kind of economic decision that you invest or don't invest."

It was easy for the heads of communications to simplify and to some extent even ridicule financial market logic. For example, a head of communications said:

"These players have rarely worked on an operative basis in the company and have a very poor understanding of how it functions in practice, many times. They absorb this information and then they make sweeping comments about the company, how it works and what it's like. They are employees who don't invest a single krona themselves, but play with other people's money, if one puts it a little sloppily."

Nor is it unusual for society at large to make a caricature out of the financial market. It is, so to say, gratifying and fits easily into a general description. Conversely, the fund managers occasionally expressed themselves condescendingly about the companies' inability to see obvious connections. This is a reflection of the fact that both groups are representatives of different social cultures who thus simplify their surroundings, in this case the other system. They argue with two different types of system blindness and have difficulty seeing the complexity of the other system. Seen from such a

Image Source

perspective, it is not difficult to see that social communication barriers arise and live on when the different systems reinvent themselves and confirm themselves vis-à-vis others. But how can two different social systems communicate with each under the circumstances, and what can one expect?

two viewpoints

The fund managers think that the financial market creates a space, a context adapted to its purpose. The space is created no matter if information is available or not. The information is not key – the context is. They also think that the conclusions drawn by the financial market are based on history. One knows a company and is thus able to draw far-reaching conclusions based on relatively little information. By creating solid narratives about a company, on the basis of financial market logic, one does not have to worry about the inherent complexity in an organization.

A fund manager said:

> *"It didn't exactly come as a surprise that SKF made an appearance here. They've really taken a stance and made a name for themselves in this context with good info – interesting. … Obviously this is good for their business. … It actually feels as if they have a consistent strategy to maintain good quality there at SKF. It feels like … as if this isn't just a fad. Good thing with the youth drive, too. So this is something all companies need to think about."*

Since financial market actors reduce the complexity in company information, this presupposes that they can trust that information. That's why they chase that which is honest, and regardless of whether it is good or bad, they want to be able to rely on the information. If the management of a company is lying, intentionally or not, they will be punished, according to the fund managers. In this way, they often relate to an illusion of naked, clean, honest communication.

In the Swedish study the importance of calculability is obvious in the way that the cash flow logic, and thereby numbering phenomena, were regarded as a very strong social force.

The cash flow logic has a performative function on the fund managers. To fit the cash flow models information needs to be reduced to an extent that the company representatives find far too simple. But calculability facilitates communication and circulation of stories about the firms.

Companies may have to get used to the idea that the financial market will not understand or even be interested in understanding a company as a whole, with all its complexity. In its capacity as a social system, the financial market is more or less forced to simplify and create its own logic, in order to define itself socially vis-à-vis its surroundings. But social systems are not static. They can change and do so over time. Those who are blind can learn to see, even though it requires understanding, reflection and re-evaluation. Maybe limited and focused human capital information can have a potential effect on the evolution of company stories in the financial market. The time has come to do this kind of long-term investigation.

The Swedish study complements other studies into obstacles in the communication between companies and financial market actors. It provides a more nuanced picture of the reality that companies encounter when they are to report on their intangible resources. The financial market is based on cultural patterns from which it has difficulty to free itself. However, the Swedish study also differs from other earlier studies in that it does not regard the information between firms and investors from an efficient market perspective.

two views

Image Source

Given the contradictory findings about the interest in and decision usefulness of human capital information, and because of the tremendously increasing interest in corporate social as well as intellectual reporting (where human capital is one element), further understanding of the role of human capital reporting from a social systems perspective is important. In addition there is an apparent need for developing theories that are useful in praxis. Because practice can't wait, a method of 'successive approximation to the truth' or 'decreasing abstraction' could be used when 'core theory and bridging assumptions' are developed.

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About the Author

Ulf Johanson is Professor Emeritus at Mälardalen University, Sweden. Previously he worked at Uppsala University and Stockholm University, and has been a visiting professor in Germany and Japan. He has authored a large number of publications and given many conference presentations.

Professor Johanson has been co-ordinator and/or participant in international research projects such as MERITUM and E*Know-Net, and at the OECD, EU and the Brookings Institution. He is a former member of the board for a number of Swedish Consultancy Companies, the former managing director of IPF, an Uppsala university owned company, and the former owner, managing director and consultant in various consulting companies. In his early career he was an accountant and then an HR manager.

His current research interests are in –

- Accounting and management control: behavioural accounting, sociology of accounting, human resource costing and accounting, human capital disclosure, intellectual capital, balanced scorecard, policy implications;
- Finance: sociology of finance, policy implications;
- The role of universities: cooperation between universities and surrounding society, research and pragmatism.

EYES TO THE FUTURE:
HANDBOOK AUTHORS' PREDICTIONS FOR 2012

CAROL ROYAL AND LORETTA O'DONNELL

Now that it is clear that the global economy is increasingly vulnerable to major disruptions and discontinuities, regulators and institutions, including universities and professional bodies, need to rethink how they train financial analysts to predict the future value in listed firms. As we saw in the Lehman collapse, regulators, financial analysts, banks and investors all need to be able to diagnose the role of human capital in creating and destroying value.

> "REGULATORS, FINANCIAL ANALYSTS, BANKS AND INVESTORS – ALL NEED TO BE ABLE TO DIAGNOSE THE ROLE OF HUMAN CAPITAL IN CREATING AND DESTROYING VALUE."

EYES TO THE FUTURE:

HANDBOOK AUTHORS' PREDICTIONS FOR 2012

CHRISTIAN NIELSEN

At the Center for Research Excellence in Business Models (CREBS), we are preparing a series of 2012 research projects on business models for the internationalization of small and medium sized companies. We are also addressing problems of accountability and valuation in new types of business model. We hope to provoke new ideas in our "Accounting for New Business Models" symposium at the 2012 European Accounting Association Congress.

Whoever thought that the financial crisis was over has been proven wrong. National banks, governments and corporations world-wide now have increasingly less room for maneuver, and weaker tools for creating financial stability and growth as the crisis moves into new phases. So in 2012 more citizens will be questioning not just the future of the financial sector of the western world, but also the sustainability of industrialized western society as a whole. On the one hand, pressure from under-burdened western society taxpayers (voters) who crave an average working week of 35-37 hours and retirement 20-30 years before their death will be on the rise. On the other hand, eager hardworking Asian and Indian consumers with well-educated workforces will lead us to question our chances of economic survival in a truly globalized world.

triple helix

One possible answer to this problem is to recognise that we need to rely more on human capital in the quest for private sector value creation and competitiveness. However, human capital alone will not be enough. Only when complemented by triple-helix based innovation structures, creativity and unique business models that commercialize innovation and human capital, will this be an avenue to future sustainability.

Finance needs to start understanding new types of business model and hence also new ways of using information. Environmental, Social and Governance (ESG) information is a good example. It is today used by the buy- and sell-side solely in an *ex post* (retrospective) audit screening manner. We need to ambitiously pursue *ex ante* (anticipatory) screening as a first step and then quickly move to actual active use of ESG information and information pertaining to sources of value creation in investment decisions.

Will we be seeing the first modules on analyzing business models and ESG information at postgraduate, MBA and CFA levels in 2012? For the sake of sustaining our society as we know it, I hope so!

> “FINANCIAL ADVISORY FIRMS THAT PLACE A PRIORITY ON HUMAN CAPITAL FUNCTIONS … ACHIEVE SIX TIMES MORE REVENUE, AND FIVE TIMES GREATER OPERATING PROFITS, THAN FIRMS THAT DO NOT FOCUS ON THESE AREAS. ACCORDING TO FINDINGS RELEASED TODAY … THE TOP 25 PERCENT OF ADVISORS IN THE STUDY, AS MEASURED BY OWNER INCOME, OUTPERFORMED THEIR PEERS IN ALL FINANCIAL CATEGORIES AND ALSO DEMONSTRATED SUPERIOR PERFORMANCE ACROSS METRICS RELATED TO THEIR FIRM'S HUMAN ASSETS.”

PRNewsWire, 31st May 2011

> “U.K. TAXPAYERS “HAD A RIGHT TO BE ABSOLUTELY FURIOUS” WITH REGULATORS OVER THEIR SUPERVISION OF ROYAL BANK OF SCOTLAND GROUP PLC BEFORE ITS NEAR COLLAPSE IN 2008, THE FINANCIAL SERVICES AUTHORITY’S CHAIRMAN SAID TODAY”

Bloomberg Businessweek, 12th Dec 2011

EYES TO THE FUTURE:

HANDBOOK AUTHORS' PREDICTIONS FOR 2012

BEN DYSON

I'm afraid we can expect to see further deterioration in the ongoing financial crisis. It's clear that the authorities and policy makers are no clearer on how to solve the crisis, despite having had 3 years to think about it! The fundamental issue – the creation of almost all our money by banks when they make loans – has barely even been discussed, and the solutions proposed amount to solving a debt crisis with more debt. In the meantime, it's real, productive businesses that suffer, as only 8% of bank lending actually goes towards productive enterprise while the rest goes towards property and speculation.

On the plus side, there's a growing awareness that this crisis isn't a temporary blip but evidence of a fundamental flaw at the heart of the debt-based financial system, and that might lead to some real calls for change. The sooner we do change, the sooner we can redirect investment back to real businesses and get the economy moving again.

> "AWARENESS THAT THIS CRISIS ISN'T A TEMPORARY BLIP ... MIGHT LEAD TO SOME REAL CALLS FOR CHANGE"

EYES TO THE FUTURE:

HANDBOOK AUTHORS' PREDICTIONS FOR 2012

MICHAEL MAINELLI

"If you want to make God laugh, tell him your plans", I was reminded this week by Baron Harries of Pentregarth. Few bishops always have such wise words to hand as Richard, but in foolhardy stubbornness I shall try and state what I think to be the important issue of 2012 – not global warming, not recession or depression, but rather whether people are prepared to try and build a sustainable financial system.

Without a sustainable financial system wider definitions of sustainability on human capital or the environment aren't achievable.

What might constitute such a financial or monetary system?

Many of our basic concepts of money are dangerous or wrong. A fundamental rethink of money would lead many to consider credit and debit systems not based on tax-based fiat currencies or fractional reserve banking. A direct credit system would be boring, yes, but also less volatile and prone to bubbles.

- Money that didn't rely on leveraged debt wouldn't encourage people to take crazy risks, yet would also encourage them to lend to small businesses.
- Money that couldn't be created by banks would mean that banking was boring and less guaranteed to make an easy living from leverage except when bailed out by taxpayers.
- Money that didn't guarantee a long-term store of value would require people to invest in productive assets and not count on capital to sustain them over the long-term.

These are heretical, but inevitable, reflections on the financial crises since 2007 for those who don't want to return to boom and bust. People in the **Long Finance initiative** believe that the key question for these times is "when would we know our financial system is working?". I agree.

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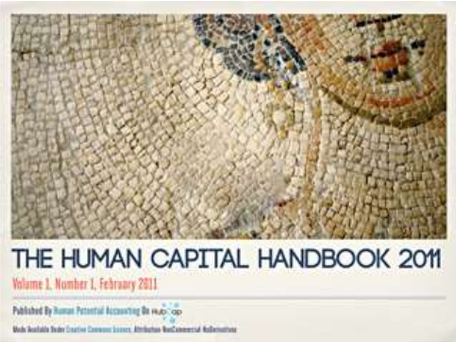

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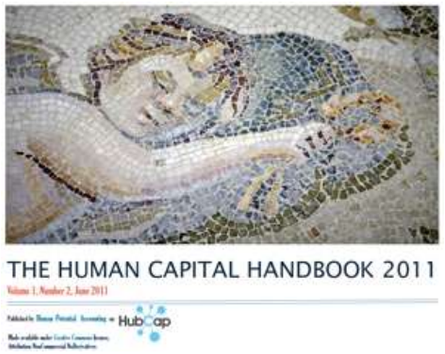

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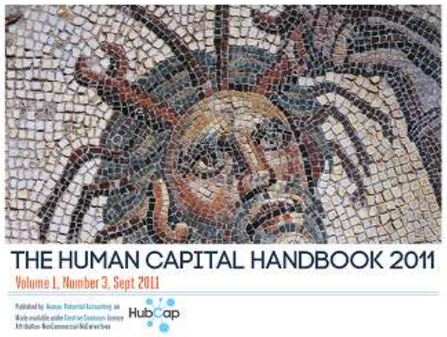

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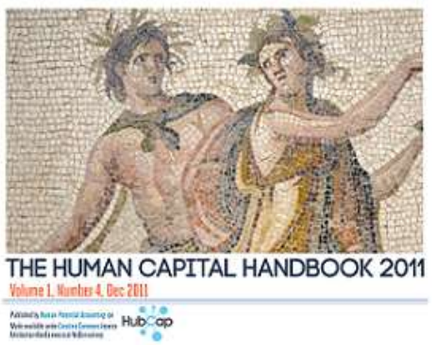

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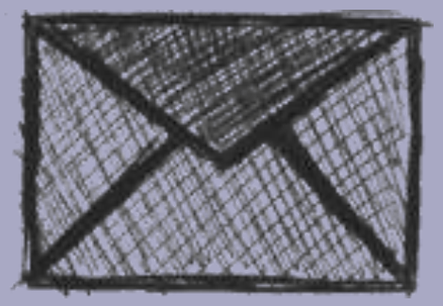

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