# When Intellectual Capital Drives the Business Model, then ...

Nielsen, Christian

*Published in:*
THE HUMAN CAPITAL HANDBOOK 2011

*Publication date:*
2011

*Document Version*
Early version, also known as pre-print

# THE HUMAN CAPITAL HANDBOOK 2011

Volume 1, Number 3, Sept 2011

Published by Human Potential Accounting on



# THE HUMAN CAPITAL HANDBOOK 2011

**Conceived by**
Dr Michael Reddy

**Author Community Host**
Stuart Shaw

**Editor**
Anna Lloyd

**Designer**
Natalia Reddy

The Human Capital Handbook 2011

Volume 1, Number 3

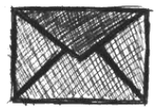
Published September 2011

ISBN Number: 978-0-9567311-3-5




humancapitalhandbook.com


alpha.hubcapdigital.com


editor@hubcapdigital.com


hpa-group.com/blog


@hubcapdigital


linkedin.com/company/hubcap-digital

# CONTENTS



# TIPS

**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.

**Don't keep quiet.**
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

Summer is officially over. The weather has turned. Rain on an almost continual basis. And as the comedian Peter Kay quipped, it's "that fine rain that soaks you through." Perfect weather then to sit back before the first real log fire of the year and browse the latest issue of the Human Capital Handbook.

So what autumnal treats do we have in store?

We have an international cast. And we cover a lot of ground in this issue. Debunking talent myths – which always makes for an enjoyable way to pass the time. Proving links between diversity and the bottom line – welcome now more than ever. Tracing the causes of the current financial crisis to its unexpected source – a link guaranteed to confront everyone. All served up with a heart-warming intellectual capital cocktail.

As Camus said – on one of his better days - 'Autumn is a second spring where every leaf is a flower'. We hope you find a little sunshine on every leaf here.

**Michael Reddy, Ph.D., AFBPsS, FRSA**

**Director,** Human Potential Accounting

# CREATING AUTHENTIZOTIC ORGANIZATIONS: WELL-FUNCTIONING INDIVIDUALS IN VIBRANT COMPANIES[1]

Manfred Kets de Vries

HubCap says:

Do you love your work? Do you believe in the brand? Do you feel that what you do matters? Does the work mean as much to you as family and hobbies? Does it make you smile, or smile through gritted teeth? Are you a cog, or a lynchpin? Few thinkers can lay claim to have led the leadership debate. Few thinkers we know have nailed the psychological contract. Few thinkers have anchored their leadership insights on deep insights into human nature and what we really want from work. Now, more than ever, few thinkers are more needed.

## The Best Companies to Work For

Once a year since 1983, *Fortune* magazine has come out with a "most admired American companies list" list. The editors of *Fortune* poll something like eleven thousand people before compiling their lists: primarily senior executives, outside directors, and investment analysts. The criteria for inclusion on these lists are factors such as quality of management, quality of products and services, innovation, long-term investment value, wise use of corporate assets, financial soundness, and responsibility to the community and the environment. To be high on the list of most admired companies is a great tribute, to be sure; however, admiration does not answer the question, Are these organizations the *healthiest* places to work?

*Fortune* made an effort to answer that question by publishing a "Best Companies to Work For" list. Corporate characteristics such as inspirational leadership, excellent facilities (including those that rank as perks), and a sense of purpose were key traits in those organizations that obtained a prominent position on this list. According to the information given, employees in the winning organizations had a great trust in management, tremendous pride in their work and company, and a sense of camaraderie.

These perceptions arose in part because these companies subscribed to practices such as stock option plans, profit sharing systems, no-layoff policies, non-hierarchical structures, information sharing systems, flexible hours, and casual dress codes. A considerable number of events held in these companies – events such as Friday evening beer bashes, parties to celebrate company milestones, and company picnics – helped in creating a sense of community. Being pioneers in innovative perks also added to this positive picture – perks such as state-of-the-art fitness centres, leisure facilities, on-site clinics, on-site childcare, creative family-oriented extras, great cafeterias with great food, and generous health insurance policies. In short, the companies high on this list went to great lengths to create humane corporate cultures that would positively affect mental health.

But what are the psychological dimensions that make these companies great places to work? How do they tap their human potential?

[1] A longer version of this paper was published in Human Relations, 54(1), 101-111

> **WHAT ARE THE PSYCHOLOGICAL DIMENSIONS THAT MAKE THE 'BEST COMPANIES TO WORK FOR' GREAT PLACES TO WORK? HOW DO THEY TAP THEIR HUMAN POTENTIAL?**

## The Containment Role of Organizations

In the context of providing a stabilizing influence, organizations have always been important orientation points in a sea of change. With life in organizations more turbulent now than ever, the companies listed on the "best to work for" hit parade are more the exception than the rule. In most organizations in this era of business re-engineering and excessive preoccupation with shareholder value, the "psychological contract" – the commitment to reward organizational loyalty with long term employment – has been broken. With loyalty and organizational identity shrinking in importance, the employee has become an independent agent, displacing the "organization man" of yesteryear – that person with great emotional attachment to his or her company

In the past, being associated with a company was an effective way to affirm one's role in the world. Making a commitment of loyalty to the company helped an employee integrate his or her self-experiences; in other words, it contributed in establishing a sense of identity. Affiliation with an organization also helped employees cope with economic and social upheaval, because organizations (whether consciously or unconsciously) played the role of "holding environment," containing anxiety through the agency of senior management (and thereby contributing a measure of stability); that too was part of the psychological contract.

Yet now, in this age of overwhelming discontinuity, employees must do without that traditional pillar of stability. The costs associated with the breaking of the psychological contract are high: as the identification process has weakened, the work situation has become more stressful. This development does not augur well for the mental health of employees. Despite the gloomy outlook, however, organizational leadership can take positive steps to make their companies healthier places to work.

## The "Healthy" Individual

The search for what it is that makes organizations vibrant – makes them great places to work – begins with an understanding of the well-functioning individual. To gain that understanding, we must ask, Under what conditions does a person feel most alive? Responding to this question is easier said than done, however. Definitions of what makes for a "healthy" individual seem to vary depending on the person making the observations.

When psychotherapists are asked what makes for a well-functioning person, they generally say that "healthy" people are those who operate at full capacity. These therapists see their role as encouraging patients to gain insights into their goals and motivations, helping them better understand their strengths and weaknesses, and preventing them from engaging in self-destructive activities. The emphasis is on widening people's area of choice, thereby enabling them to choose freely rather than be led by forces outside of their awareness.

Although this answer has a lot of merit, it needs some elaboration. From my experience in working with large numbers of executives, I have concluded that healthier people possess a common set of characteristics. (I say healthier rather than healthy because health and illness are dimensions on a continuum.) The most salient of these characteristics are described below:

- Healthier people possess a stable sense of identity; that is, they have a good sense of who they are.
- They have a great capacity for reality testing.
- They resort to mature defence mechanisms and take responsibility for their actions, refusing to blame others for setbacks.
- They have a strong sense of self-efficacy, believing in their own ability to control the events that affect their lives.
- They experience the full range of affects; they do not suffer from alexithymia or colour-blindness with respect to their feelings. They live intensely and are passionate about what they do.
- They know how to manage anxiety, and they do not easily lose control or resort to impulsive acts.
- They have the capacity to establish and cultivate relationships, they actively maintain a support network, and they know how to use help and advice.
- They have a sense of belonging and connectedness, viewing themselves as part of a larger group; they obtain a great sense of satisfaction about the social context in which they are living.
- They know how to deal with issues of dependency and separation.
- They are mentally strong enough to deal with the setbacks and disappointments that are an inevitable part of the trajectory of life.
- They know how to handle ambivalence and can see people in a balanced manner.
- They are creative and possess a sense of playfulness and thus have the capacity to non-conform.
- They have a positive outlook toward the world and can therefore reframe experiences in a positive way.
- They have the capacity for self-observation and self-analysis and are highly motivated to spend time on self-reflection.

## Humankind's Search for Meaning

Work holds an important place in humankind's search for meaning. Because meaningful activity at work can contribute to a sense of significance and orientation, work offers a way to transcend personal concerns. In addition, it helps to create a sense of continuity. Leaving a legacy through work is an affirmation of one's sense of self and identity and thus serves as an important form of narcissistic gratification.

Given the importance of basic human motivational needs, organizational leadership has the responsibility to institute collective systems of meaning – a responsibility that is greater than ever in these times of discontinuity. The challenge these leaders face is to recognize humankind's search for meaning and create circumstances that allow people to do tasks in the workplace that are experienced as consequential. Subjective experiences and actions need to be made meaningful. This challenge requires that work be done in ways that make sense to the employees, leading to congruence between personal and collective objectives. Facilitating congruence between the inner and outer worlds of employees will contribute to individual and organizational health.

## Searching for Congruence

So how can ways to meet the motivational needs that underlie humankind's search for meaning be integrated into organizational life? What can organizational leaders do to make workers' existence in their organizations more meaningful? In this age of discontinuity, what can be done to minimize the negative side effects of work? What can be done to imbue employees with the kind of meaning that helps them to feel fulfilled?

An answer to this conundrum can be found if we once more look at Fortune's list of "best companies to work for". An in-depth content analysis of these companies reveals that they are steeped in a number of values that are then also translated into specific forms of behavior – values such as trust, fun, candour, empowerment, respect for the individual, fairness, teamwork, entrepreneurship/innovation, customer orientation, accountability, continuous learning, and openness to change. Although these values, and the practices associated with them, go a long way toward explaining the success of many of Fortune's vibrant organizations, they alone cannot bring about exceptional performance. Four additional conditions are necessary for getting the best out of people.

1. As part of the needs-addressing process, leaders of exemplary organizations must create a sense of purpose for their people. Senior executives must create and articulate a vision of an ideal future state – a vision fleshed out with vivid description of the organization's fundamental purpose and culture, its values and beliefs. This description of the organization's future – if imbued with sufficient meaning – will have connecting value and thus contribute to a group identity. This step addresses workers' attachment/affiliation motivational need system.

2. To address workers' exploration/assertion motivational need system, organizational leadership must create conditions that foster a sense of competence. This goal is reached when organizational participants have a feeling of ongoing personal growth and development. To prevent stagnation, continuous learning is essential. On-the-job growth and development offer a strategy for reaffirming the self and preserving personal equilibrium. When the exploration/assertion motivational need system is blocked, frustration increases and creative actions dissipate.

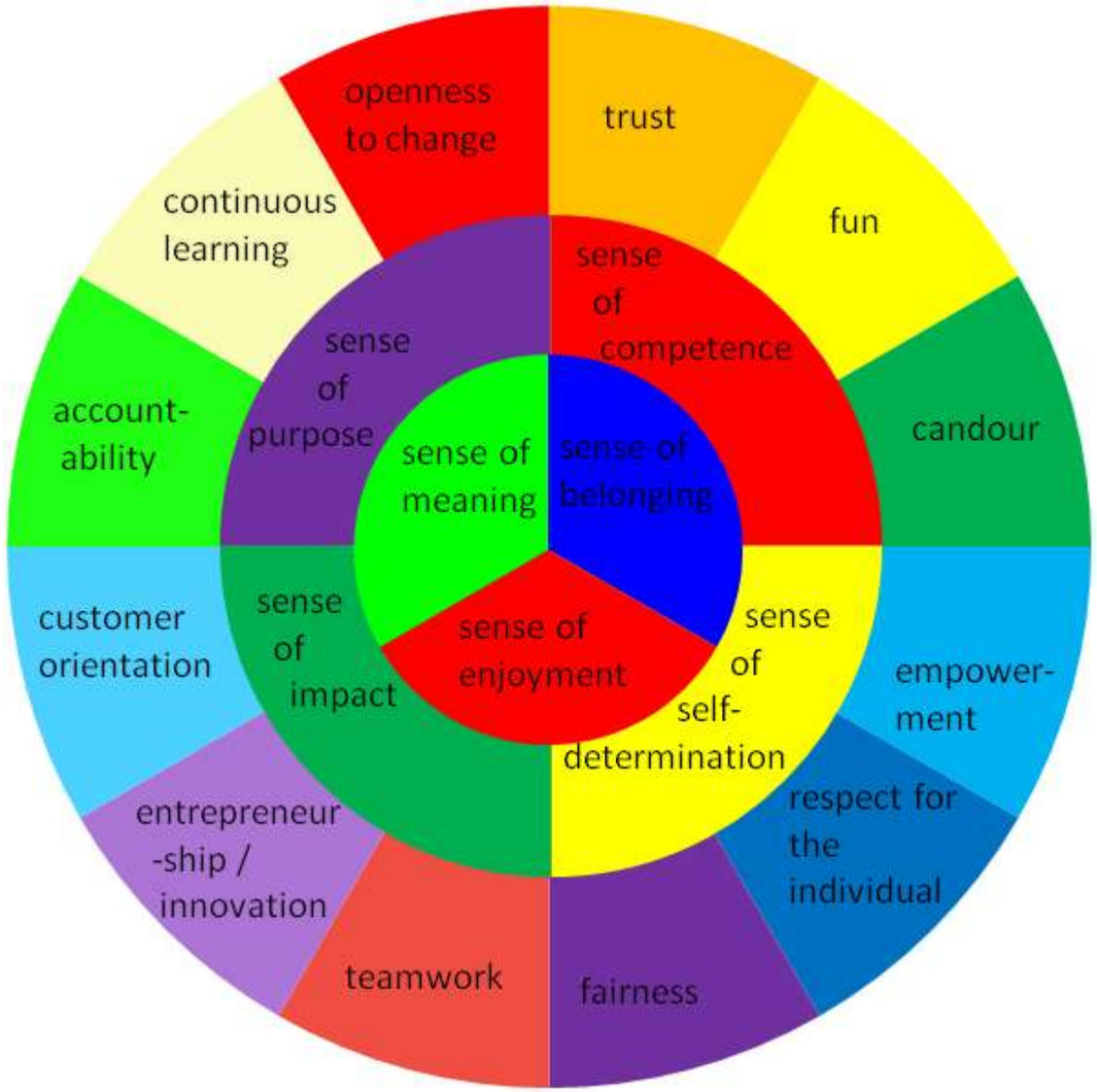
3. In addition, organizational leadership needs to create a greater sense of self-determination among employees. For the sake of organizational mental health, it is essential that employees have a feeling of control over their lives. Conditions should be created whereby employees see themselves not as mere peons in the larger scheme of things but as capable masters of their own lives.

4. Simultaneously, leadership must create a sense of impact among the employees. In other words, each organizational member must be convinced that his or her actions make a difference, affecting organizational performance. Believing that each member of the organization has a voice is what empowerment is all about.

## Paying Attention to Meta-values

Even these four necessary conditions that help to get the best out of people are not sufficient conditions to create captivating workplaces, however. The best companies possess a set of meta-values that closely echo the earlier described motivational systems and create among their people a sense of belonging (a feeling of community that comes from being part of the organization, addressing once more the attachment/affiliation need), a sense of enjoyment in what they are doing (a feeling that comes from addressing the exploration/assertion need), and a sense of meaning about the activities they are engaged in.

**A Sense of Belonging**. Because attachment/affiliation is a powerful underlying motive in humankind's search for meaning, the first important meta-value contributing to the creation of healthy organizations is "love." Seeing love as a corporate value implies creating a sense of belonging, a feeling of community, which then bears the fruit of trust and mutual respect. A sense of community, with the concomitant preparedness to help others, goes a long way toward creating goal-directedness and a cohesive culture. It also contributes to the emergence of "distributed leadership" – that is, leadership spread out throughout the organization rather than concentrated at the top. It is fostered in organizations whose senior executives obtain vicarious pleasure in coaching their younger executives and feel proud of their accomplishments. This sense of generativity is a source of creativity and contributes to feelings of continuity (as one's efforts continue through the work of successors).




Healthier places to work

**A Sense of Enjoyment**. Furthermore, in highly effective companies employees seem to enjoy themselves. Having fun – the ability to be playful – is an important dimension of both organizational and mental health. In too many companies, however, this sense of enjoyment is completely ignored (or worse, deliberately stifled), resulting in a lack of imagination and innovation. Executives in exemplary organizations are fully alive – and contagiously so: they realize that taking people on an exciting journey while encouraging them to have fun gratifies another essential motivational need, humankind's need for exploration/assertion.

**A Sense of Meaning**. If these basic motivational need systems are addressed in the context of transcending one's own personal needs – that is, if tasks are presented as improving the quality of life, helping others, or contributing something to society – the impact on workers can be extremely powerful. People like to work in organizations that recognize the importance of providing a sense of meaning. It is such organizations that are able to get the best out of their people. In organizations that provide meaning, people put their imagination and creativity to work.

> "WORKING IN AUTHENTIZOTIC ORGANIZATIONS WILL REDUCE ORGANIZATIONAL STRESS, PROVIDE A HEALTHIER EXISTENCE, INCREASE THE IMAGINATION, AND CONTRIBUTE TO A MORE FULFILLING LIFE."

## The Authentizotic Organization

Organizations that meet the human needs discussed above – organizations that will set the standard in the twenty-first century – are what can be described as authentizotic. This term is derived from two Greek words: authentikos and zootikos. The first conveys the idea that the organization is authentic. In its broadest sense, the word authentic describes something that conforms to fact and is therefore worthy of trust and reliance. As a workplace label, authenticity implies that the organization has a compelling connective quality for its employees in its vision, mission, culture, and structure. This means that the organization's leader has communicated clearly and convincingly not only the how but also the why of every job, revealing meaning in each person's tasks.

The term zootikos means "vital to life." In the organizational context, it describes the way in which people are invigorated by their work. People in organizations to which the zootikos label can be applied feel a sense of balance and completeness. In such organizations, the human need for exploration, closely associated with cognition and learning, is met. The zootikos element of this type of organization allows for self assertion in the workplace and produces a sense of effectiveness and competency, of autonomy, initiative, creativity, entrepreneurship, and industry.

It may seem utopian but in the twenty-first century, organizational leaders are challenged to create corporations that possess some of these authentizotic qualities. Working in authentizotic organizations will reduce organizational stress, provide a healthier existence, increase the imagination, and contribute to a more fulfilling life. Because authentizotic organizations help their employees maintain an effective balance between personal and organizational life, these are the organizations we need to hope and strive for.

## Suggested Readings

Bowlby, J. (1969). Attachment and Loss (Vol. 1: Attachment). New York: Basic Books.

Csikszentmihalyi, M. (1990). Flow: The Psychology of Optimal Experience. New York: Harper & Row.

Kets de Vries, M.F.R. (2011). Reflections on Groups and Organizations. London: Wiley.

Lichtenberg, J. D. (1991). Psychoanalysis and Infant Research. New York: Lawrence Erlbaum.

White, R. (1959). Motivation Reconsidered: The Concept of Competence. Psychological Review, 66, 297-333.

## About the Author

Manfred F. R. Kets de Vries is a highly-regarded original thinker, teacher, researcher, consultant and writer on leadership, career dynamics, team building, coaching, executive stress, entrepreneurship, family business, succession planning, cross-cultural management, and the dynamics of corporate transformation and change. He has been rated as one of the world's leading leadership theoreticians by the Financial Times, Le Capital, Wirtschaftswoche, and The Economist, and is both a Fellow of the Academy of Management and a lifetime distinguished member of the International Society for the Psychoanalytic Study of Organizations.

Kets de Vries is Professor of Leadership Development at INSEAD, having previously held professorships at McGill University, the École des Hautes Études Commerciales, Montréal, and the Harvard Business School. He has lectured at management institutions around the world.

He has published numerous books and articles, which between them have been translated into 31 languages, and is a member of 17 editorial boards. In his leisure time he is a keen explorer and outdoorsman.

Consultancy: http://www.kdvi.com
Personal website: http://www.ketsdevries.com

# CASE STUDY: ROI ON DIVERSITY MANAGEMENT MANAGEMENT AT ISS DENMARK

Morten Kamp Andersen


A former award-winning London-based financial analyst, who returned to his native Denmark to complete a five year psychology degree, Morten Kamp Anderson – we think – has the perfect background to advise companies on their human capital strategy. ISS Denmark think so too, especially after his pioneering research into the financial impact and benefits of Diversity Management revealed a much better business case than expected.

What tangible benefits and financial value does a Diversity Management program add? How can this be measured and how is it proven? These were some of the questions ISS Denmark asked as it embarked on a journey to prove that its multi-year effort on creating a diverse workforce had created Shareholder Value.

Measuring the value of HR is a cornerstone of Human Capital for many reasons. One reason is to show that HR is adding Shareholder Value. Most C-suite executives regard HR as a cost center, adding little or no value whatsoever. By showing that HR is creating a high and positive return it is hoped that this perception will change over time. The second reason is to make HR better. By measuring the effect and value of HR it is possible to assess which activities should be terminated, changed or enhanced.

Scanning books, research and case studies it is clear that some HR activities receive more attention when it comes to measuring value. 'Training' is probably the area which receives most attention. Diversity Management has recently been subject to more studies – primarily from the United States – but measuring the effect of Diversity Management is still in its infancy.

ISS Denmark concluded that it had indeed produced Shareholder Value through its Diversity Management initiative. In this article I will show how this was done and which considerations were made along the way. Many important learning points were as much about the process as the results. I hope that this article will inspire others to try to measure HR.

## Background to the project

ISS is one of the largest private employers in the world with more than 535,000 employees in more than 50 countries across all continents. It operates as a Facility Management company and offers services such as Security, Cleaning, Catering, Support Service, Facility Management Services and Property Services. Its headquarters are in Copenhagen, Denmark. It is owned by the equity funds EQT Partners and Goldman Sachs Capital Partners.

ISS Denmark has over 10,000 employees. During the previous three years the company has focused heavily on Diversity Management. It has trained all its managers, changed recruitment and promotion processes, started many initiatives to create and foster a diverse culture, set diversity goals for all

> ROI – IF USED CAREFULLY – IS THE MOST APPROPRIATE METRIC FOR MANY HR INVESTMENTS

management levels and promoted diversity in its communications with all its external stakeholders. ISS Denmark now wanted to find out if all that effort and major investment had also paid off through higher shareholder value.

A Steering Committee was established to oversee the project of measuring the value of diversity and to interpret and direct the project. PwC did the actual collection and measurements, and ensured the statistical solidity of the conclusions. Finally, an innovation expert interviewed a number of managers, employees and customers to add case studies to the numbers PwC produced. I was a member of the Steering Committee.

## Why use ROI?

In the beginning the focus was on both cost and benefits, and ROI (Return On Investment) was selected as the tool to show the possible financial value creation. ROI has become the de facto tool which HR use to show that they are adding value to the company's bottom line. But in addition to the obvious problems in actually measuring the financial benefits of many HR activities, the ROI calculation in itself is also something to be careful about.

During my 11 years as a financial analyst working for investment banks in London, I didn't use ROI that much. I used more “sophisticated” metrics such as Enterprise Value metrics, ROIC (Return On Invested Capital), RoOFCF (Return on Operating Free Cash Flow), CRONCI (Cash Return On Net Capital Invested) etc. What is common about all these ratios is that they recognise that 'return' and 'investment' are quite complex things. ROI on the other hand uses quite a basic version of both concepts.

Why I still believe that ROI has a lot to offer for HR executives is that – if used carefully – it is the most appropriate metric for many HR investments. Below is a quick overview of its advantages and disadvantages.

| Advantages |
|---|
| Easy to understand |
| Focuses on both input and output of HR activities |
| Shows the bottom-line effect |
| Gives HR a language to talk to top management |
| Possible to make better HR investments |
| Connects well with HR Balanced Score Card |

| Disadvantages |
|---|
| Very sensitive to few assumptions |
| Reduces complex things to simple causal relationship and a single number |
| Difficult to see important assumptions |
| Too simple view of ‘investment’ and ‘benefit’ |

## The Business Case for Diversity is Strong

First we looked at the business case for diversity. This was going to help design the measurement project and to steer the data collection process.

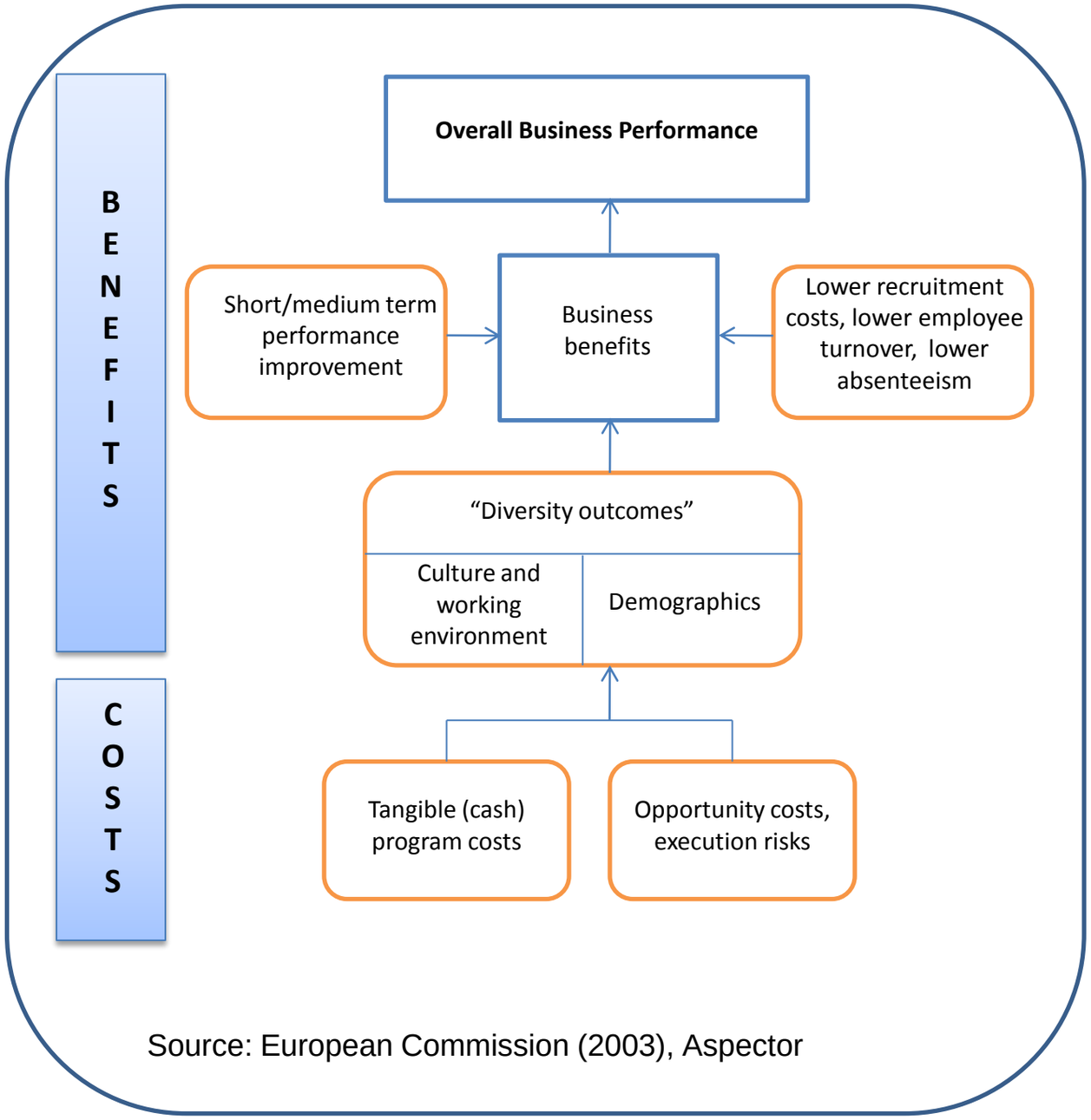
Diversity Management is often criticised for being something companies just do because it is perceived to be the right thing to do, that it is too soft and fluffy to measure, and that it is (too) costly. Research shows however, that companies which create a diverse workplace significantly outperform in financial and performance terms. A few examples:

- A US study found that the average annualised return for the 100 companies that rated highest in diversity management was 18.3% compared to 7.9% for the 100 lowest companies among Fortune 1000 companies (Bagshaw, 2004).
- A study among 679 Fortune 1000 companies showed a high correlation between number of female top management members and (financial) performance (Krishnan & Park, 2005).
- A European meta-study documented that minority groups in general have lower absenteeism and lower employee turnover (Morrison, 1996).

The benefits of diversity can be divided into three categories:

1. Improved performance due to a better talent pool and improved skill base.
2. Cost reduction from lower recruitment costs, lower employee turnover and fewer absenteeism days.
3. Various 'soft' outcomes such as increased learning and innovation, the avoidance of groupthink, higher job satisfaction and an overall better work environment.

The business case can be illustrated as follows:




Source: European Commission (2003), Aspector

Before the actual measurement began, ISS faced two problems which had to be addressed:

## 1: The Problem With Causality

It is common for many to mistake correlation with causality. We often assume that just because two things correlate then we know how to interpret this connection. Take 'Job Satisfaction' for instance. Most surveys rightly conclude that there is a positive correlation with 'Productivity'. There are however (at least) three ways to explain this correlation:

- The more satisfied you are, the more productive you are in your job
- The more productive you are, the more satisfied you are with your job
- A third element drives both e.g. if the match between job and employee is high then the employee will experience both a higher job satisfaction and be more productive

It matters a lot in everyday practice which of the above is correct. Should you attempt to increase employee satisfaction, productivity or job/employee-fit?

In this case, we had to consider whether Diversity Management programs lead to higher value or whether companies which make a high profit subsequently spend some of it on diversity initiatives. We made a hypothesis that diversity led to higher profits but we had to test this causality as we got the data.

## 2: Thou Shalt Not Measure Retrospectively

Another problem we faced was that we were measuring retrospectively. While it is tempting to measure retrospectively, it is something you generally should stay away from for (at least) three reasons:

1. True evaluation requires a baseline. Any attempt to measure any HR activity should always begin before the activity starts. Measuring and evaluating requires a baseline to assess the impact by comparing before and after.

2. It is too easy to 'adjust reality' when doing it retrospectively. You must be able to accurately reconstruct the true context, behaviour and results from the time before the activity. That is very difficult.

3. Measuring is also about assessing whether the activity should be done or not. Measuring is not an end in itself – it is a means to create better HR. An important benefit of doing all the hard work before the program is to design the process so that it is strategic and creates the most shareholder value.

ISS had not any baseline data so we had to design the measurement so that this weakness could be overcome. Fortunately we had all the important data going back to before the program started and it was statistically possible to re-create a baseline.

## Design

Many of the 'traditional' benefits of diversity were quickly excluded in the measurement project. The two most often mentioned benefits – better innovation and lower recruitment costs (due to the larger talent pool to hire from) – were viewed as too difficult to measure. Innovation is not a major factor for ISS Denmark and lower recruitment costs could not be established from the data available.

Instead the focus turned towards contract profitability. ISS wanted to see if contracts managed by diverse teams were more profitable than non-diverse teams and if so why, by how much, and what led to this higher profit.

During the data collection it was important to strip out general and national effects such as changes in unemployment rates in Denmark, sector differences, economic trends and other factors which affect all companies and contracts. The data had to be 'everything-else-being-equal'.

During the statistical analysis a lot of work went into describing the causal structure (what caused what), a high significance rate was used (95% – so we were fairly confident that the conclusion was correct) and a test for multi-colinearity was carried out (was there a third factor which affects both). Coupled with an analysis of how the introduction of diversity affected the timing of profitability, we concluded that the causal direction in our hypothesis was correct.

7,261 employees in 469 teams were included in the project. All service functions were included: cleaning, security, facility management, real estate management and support services. Diverse teams were here defined as having no more than 70% from the same country, 70% of the same sex and 70% from the same generation. All three criteria had to be met. Also a team had to consist of at least five members. About 25% of all teams were diverse teams.

> "THE CONTRACT PROFITABILITY WITH DIVERSE TEAMS WAS 3.7% HIGHER THAN THE NON-DIVERSE TEAMS – MUCH HIGHER THAN ANY OF US HAD EXPECTED"

## And the Results are in ... a Higher Return Than We Had Expected

The analysis concluded that the contract profitability with diverse teams was 3.7% higher than the non-diverse teams (18.5% vs. 14.8% profit margin). This is an overwhelming difference and indeed much higher than any of us in the Steering Committee had expected. Of the 3.7% improvement in contract profitability, 2.5% could be attributed directly to lower absenteeism and higher job satisfaction. The connection between job satisfaction and profitability was positive for all teams but the diverse teams had a higher job satisfaction.

The study also showed that fewer diverse teams were loss-making than non-diverse teams. Finally the study concluded that top line growth was 4.4% higher in diverse teams vs. non-diverse teams.

Because the improvement of 3.7% represents such a high additional value it was decided not to measure the costs because the benefits would so obviously outstrip the total costs even considering all indirect costs, time and a possible risk involved.

> "THE DIVERSE TEAMS HAD A HIGHER JOB SATISFACTION"

## Learning points

This was an extensive effort to measure the value of an HR initiative. A lot of time was spent on data collection, data cleansing, statistical analysis, interviews, collecting and reading research and case studies, meetings and discussions and not least making sense of the findings. One may ask why so much effort should be put into measuring an activity which had already taken place.

In this particular case ISS had many reasons why this effort made perfect sense. Generally one should always be careful that the measurement does not get its 'own life' and become an end in itself. The effort of measuring should always correspond to the benefit of doing it. Spending too much time on evaluating a training course for five people does not make sense. But in this case, ISS showed that they were earning many millions of Danish kroner each year because of its diversity program. The effort in this case is proportionate to the benefit. Another learning point is that having baseline data and doing all the thinking about business case and causality should be done prior to the activity taking place. It makes measuring and evaluating HR so much more easy and credible. In this case the data availability, the effort spent on this and the capability – especially from PwC – made it possible to re-create a baseline.

Finally, HR does add value! And so much more than most expect. The CEO of ISS Denmark Maarten Van Engeland says that "this survey has given me a lot to consider because it so clearly demonstrates that there is a great potential in linking our business with diversity". Perhaps this link would not have been so clearly understood and accepted without this survey.

## References

Andersen, M. & Vestergaard, F. (2010). Diversity in outsourcing. Aspector & ISS & White Paper. http://www.aspector.dk/White-Papers.105.0.html
Bagshaw, M. (2004). "Is diversity divisive? A positive training approach", Industrial and Commercial Training, Vol. 36 No: 4, pp.153 – 157.
Damodaran, A. (1996). Investment Valuation – Tools and techniques for determining the value of any asset. John Wiley & Sons
European Commission (2003).The costs and benefits of diversity. European Commission
Kearns, P. (2008). Evaluating the ROI from learning – how to develop value-based training. CIPD, London
Krishnan, H.A. & Park, D. (2005) A few good women – on top management teams. Journal of Business Research, 58, 12, pp. 1,712 – 1,720
Morrison, A. (1996) The New Leaders: Leadership Diversity in America, San Francisco: Jossey-Bass

## About the Author

Morten Andersen is founder & CEO of Aspector, a consulting firm that helps organisations work strategically with talent, management & leaders and key employees. For over 11 years he was a financial analyst in London working at Merrill Lynch, Citi Group and Deutsche Bank where he analysed and estimated the financial value of the largest European companies. Through conversations with the top management of companies and deep personal industry knowledge, he advised shareholders about the potential future value of their strategy. He led his own team for 5 years with the title Vice President and was honoured several times – including 'Best Analyst' in Europe in 2001 in the 'New Media & Internet' sector.

Morten uses this knowledge and experience today to advise large companies on their Human Capital strategy and the implementation of strategic initiatives. His approach is characterized by being both a former financial analyst and also a trained psychologist – a combination of 'soft' and hard'. He often works in cross-organisational contexts involving interaction with top management and support functions.

# CHASING STARS: THE MYTH OF TALENT AND THE PORTABILITY OF PERFORMANCE [1]

Boris Groysberg


Since Malcolm Gladwell dared to pull the rug from under the 'war for talent' in 2002, it is surprising that it has taken almost a decade for the empirical evidence to emerge that the real star is the system in which those stars shine. But as the talent war for the first time has replaced risk as the number one boardroom priority, such evidence is needed now more than ever. In his powerful new book, Boris Groysberg offers profound insights into the fundamental nature of outstanding performance and the myth of its portability.

Many knowledge-based firms view their employees as their most valuable resource. At such companies, where it is virtually an article of faith that settling for "B" players is a recipe for mediocrity, managers work hard to attract the best and the brightest. When companies do find first-rate talent, they're often willing to offer those stars huge salaries, signing bonuses, stock options – in short, whatever it takes.

But reliance on stars is a highly speculative managerial policy because we don't really know very much about what drives outstanding individual performance. Little clear-cut evidence supports or refutes prevailing beliefs about why some people excel. Both stars and their employers often assume that outstanding performance is the result of a combination of innate talent and good educational preparation. But is this the entire story? And if not, what is missing?

Another hazard of an unexamined reliance on stars is that the portability of talent – or, more accurately, the prevailing belief in such portability – cuts two ways. The extent to which skills are portable is also a compelling question for individual knowledge workers whose stock-in-trade is information and intellectual activity, whether or not they are stars in their fields.

Are those who excel in the workplace mobile free agents with highly portable skills, or is their performance primarily driven by adept use of the resources of the organization in which they thrive? An answer to this question, even an answer less cut-and-dried than popular wisdom or theoretical formulations, could shed new light on pressing managerial questions about how to hire, develop, compensate, and retain talent. Determining whether the skills of knowledge workers are in fact portable from one firm to another – or to what degree and under what circumstances they are portable – can also potentially shed light on the accuracy of this formulation and the wisdom of building one's career on it.

## The performance pool: financial analysts

The first requirement was shared, objective, and publicly available criteria for measuring performance. We considered a number of professions, including academics, accountants, advertising creatives, architects, athletes, consultants, engineers, inventors, lawyers, money managers, and programmers. But we finally found a suitable labor market on Wall Street.

[1] *Excerpted from Chasing Stars by Boris Groysberg. Copyright (c) 2010 by Princeton University Press. Reprinted by permission.*

Wall Street equity analysts, who follow companies and stocks in particular industries and share their insights with their firms' institutional clients, were the ideal research pool for a number of reasons:

- Since 1972 respected trade journal, Institutional Investor, has compiled and published an annual ranking of the best stock analysts in each industry: rankings viewed on Wall Street and by academics as a reliable proxy for performance
- Research departments collect voluminous data of other kinds about their analysts, as do information intermediaries like Thomson Financial, allowing for simultaneous examination of the impact of various variables on performance
- Detailed data on moves between employers is also readily available for top-rated analysts
- The labor market for analysts, though large enough to produce valid and reliable observations, is small and concentrated enough to lend itself well to study: to be specific, many top stock analysts work in Manhattan
- Finally, belief that individual talent is the prime determinant of performance is deeply entrenched among research analysts and others on Wall Street (85 percent of the individuals we interviewed asserted that analysts' performance is independent of the companies they work for and thus highly portable)

Our research sample consisted of over 1,000 star analysts (ranked by Institutional Investor) at 78 investment banks. For comparative purposes, we also employed data on about 20,000 non-star analysts at approximately 400 investment banks. To shed light on both the mechanics and the culture of the profession, we conducted in-depth interviews with more than 200 stock analysts; with research directors, traders, salespeople, investment bankers, and executives at 37 investment banks; and with the institutional investors who are analysts' clients.

Of course, the investment-banking landscape of 2010, when this book was finished, looks very different than it did in 1988-96, the years of our study. But these tumultuous events do not undermine our findings. If anything, the shifting fortunes of the industry make the book's findings more deserving of attention. The more turbulent the business landscape, the more crucial it becomes to think strategically about performance and talent management.

## The limits of portability and the price of moving on

When a star analyst changes employers, his or her general human capital, their education and innate abilities, general skills and relationships with clients, research and media contacts are readily portable to another employer. But the firm-specific human capital, the supportive relationships and resources at the analyst's former employer, which represent sources of performance-enhancing information and insight, are immediately lost. It is this loss that, overall, leads star performance to decline sharply and continue to suffer for at least five years after moving to a new firm.

> **"THE SUPPORTIVE RELATIONSHIPS AND RESOURCES AT THE ANALYST'S FORMER EMPLOYER ARE IMMEDIATELY LOST. THIS LOSS LEADS STAR PERFORMANCE TO DECLINE SHARPLY AND CONTINUE TO SUFFER FOR AT LEAST FIVE YEARS AFTER MOVING TO A NEW FIRM."**

This evidence refutes the prevailing belief in the industry that analysts' skills are thoroughly portable – independent of the particular firm where they work – and that analysts can move without suffering a decline in performance. What they left behind were the capabilities of the old firm and the seamless fit between their own skills and the resources of the company. An analyst who left a firm where he or she achieved stardom lost access to colleagues, teammates, and internal networks that can take years to develop.

## Exceptions: 'Block trading' and women

There were degrees of performance loss here. Star analysts who moved between firms with similar capabilities suffered an average of only two rather than five years decline in performance, and analysts who moved to a better firm experienced no significant short or long term decline in performance. But only star analysts who moved with intact teams, a phenomenon known as "block trading in people" were able to retain some firm-specific human capital even after moving, with performance-protective effects (no decline in short or long-term performance).

The other group of analysts who maintained their star ranking even after changing employers were women. There were two overarching explanations for women's portability:

First, the best female analysts appeared to have built up their franchises on external relationships with clients and the companies they covered, rather than on relationships within their firms. By contrast, male stars built up more firm- and team-specific human capital, investing more in the internal networks and unique resources of the firms where they worked. Hence, in the course of becoming stars, female analysts' performance became portable in a way that their male colleagues' did not.

"the best female analysts"

Second, although they relied less on firm-specific capabilities and relationships, women were more careful when assessing a prospective employer. They evaluated possible employers more cautiously and analyzed more factors than men did before deciding to uproot themselves from a company where they had been successful. Female star analysts, it would appear, took their work environment more seriously yet relied on it less than male stars did. They looked for an employer that would allow them to continue building successful franchises their own way.

Finding it difficult to build relationships with male colleagues, they instead built networks of external ties to clients and to the industries they covered and forged unconventional boundary-spanning in-house alliances. Aware of the sexism that pervaded investment-banking culture, they took care to ensure that a given bank would provide them the platform they needed to be successful and not hold them back on account of their gender.

Exceptional male performers contemplating changing employers – and hoping to maintain their star performer status – would do well to emulate the approach taken by female star analysts.

## Lessons for employees

The central lesson is that individuals who are stars in the workplace have a strong and persistent – and potentially career-damaging – tendency to undervalue the importance to their success of their employers' capabilities and resources – and their own practiced ability to make use of these resources.

For individuals who intend to stay put at their current employers, coming to grips with this central truth may be a little more than a character-building exercise in modesty and in giving credit where credit is due. And for stars who contemplate switching allegiances, they should carefully weigh an increase in compensation – which is likely to be their prime motivation for changing jobs – against the probability of a future performance decline.

## Lessons for employers

Even though there are lessons from experience and observations that address how to make good hiring choices, how to think about compensation and integration, how to mentor and train stars, how to promote collaboration, and how to elicit loyalty, their applicability depends on the particulars of an organization's orientation and mission. If not firm-specific, they are at least relevant to particular types of enterprises, with particular orientations and missions.

The broadly applicable lessons that we can specify have largely to do with hiring. Our evidence strongly suggests the wisdom of hiring from firms with similar orientations and of hiring from firms of lesser or equivalent quality. Hiring from organizations far more resource-rich than one's own increases the likelihood that the incoming star will suffer a performance decline and prove to be a disappointment. Our findings also argue for being frank and thorough in presenting the firm to prospective candidates in the interest of maximizing goodness of fit.

## Portability and the talent myth

A cascade of articles and books proclaims the existence of a war for talent and asserts that the increasingly sophisticated technological and knowledge-based tilt of advanced economies is creating a more efficient labor market and an army of footloose free agents with portable skills.

Some writers declare that a large-scale paradigm shift is occurring from long-term to short-term employment, and that the most talented employees move most often. A logical corollary of this hypothesis is that the kind of company-specific knowledge that was once valuable to employer and employee no longer retains much value for either party. Because talent is flighty, the argument goes, managers need to get talented employees up to speed fast so they can begin contributing to the firm. An alternative scenario asserts that firms should lure stars with attractive offers and retain them with individualised career customisation. Few of these prescriptions are based on empirical evidence.

The initial premise that post-industrial economies are increasingly dominated by knowledge-based work has been amply demonstrated. It is thus rational for companies whose services or products are knowledge-dependent to stake their competitive advantage largely on the talents of their employees, but the evidence generated by our study suggests a set of very different conclusions about how to pursue competitive advantage in a knowledge-based field.

## About the Author

Boris Groysberg is a Professor of Business Administration in the Organizational Behavior unit at the Harvard Business School. He currently teaches the Managing Human Capital course in the second year elective course of the MBA program and in several Executive Education programs.

Professor Groysberg's research focuses on the challenges of managing professional service firms. In particular, his work investigates how a firm can be systematic in achieving a sustainable competitive advantage by leveraging its employees. In a number of related papers, he examines how firms develop, hire, retain, and utilize star knowledge workers. By focusing on the performance of these highly skilled professionals, his research contributes to the human capital theory, the theory of allocation of talent, the theory of labor market competition, and human research management studies.

You can purchase the book from the Princeton University Press or from Amazon.

# HUMAN CAPITAL MANAGEMENT

Michael Reddy


Has the whole intangibles/human capital reporting project been looking in the wrong place – namely at people? With all the latest evidence (see the previous piece by Boris Groysberg) pointing away from star individuals to the firm's star system, should we instead be focusing on and accounting for star-making people practices? Dr Michael Reddy thinks so. We do too.

## Introduction

Words can be overused to the point of losing useful meaning. "Human Capital" has already joined the array of expressions such as "engagement" and "talent management", or "people are our biggest asset" that have been pressed into service so often, in so many contexts, and for so many different purposes, as to have become in many cases more a matter of sound-bites than real meaning.

"Human Capital" encounters a second hazard in the attempt to measure it, because in most instances this can only be fruitless. At the macroeconomic level it could be useful (see, for example, the Lisbon Council study) but my focus is on human capital at the level of the organisation.

And while it is true that in the case of exceptional individuals – such as an unusually creative software designer or a gifted investment fund manager – huge financial gains can legitimately be ascribed to them, this particular case only goes to underline the proposition that individual human capital is unmeasurable. When the star individual was hired his or her talent was still only in potential, not as capital. Nor is there any guarantee that such talent is repeatable. The value of human capital is too volatile, too diverse and too variable in relation to its context to be subject to predictable values.

For these if for no other reasons we can still find no place for human capital on the asset side of the balance sheet, a situation that has already been described as "inconvenient" (see Human Capital Handbook vol.1 no.1, Feb 2011). Paradoxically, though, it may be possible for human capital to appear on the balance sheet as a liability; while, for most organisations, their 'biggest asset' is its people, it is equally true that its people are also its biggest liability and biggest risk. In fact they are both risk and cost, the 'cost' part of the equation being reflected, partially and wholly inadequately, on the P&L. We have pointed out before that 'cost' is an equally inconvenient rubric for an 'asset'.

A counsel of despair then? Forget about human capital in accounting terms? Not at all, or at least 'not accounting as we know it, Jim'. The fact that human capital cannot be reflected in numerical terms is a fact of life. However what can be measured and compared, business with business, is the skill in managing it. On this quality, businesses can be ranked, from top to bottom.

## Measuring Human Capital Management

It can be taken for granted that some businesses are better at managing their human capital than others. Some are good at it, some not so good, and some are poor enough to fail. Some are so good (in a wide range of industries) that they may be too far

ahead of the field to be caught this year or next, even if part of what they do is as much intuitive as fully articulated. Some are so bad they don't realise how bad they are (and won't, even when the share price has collapsed).

> "SOME BUSINESSES ARE GOOD AT IT, SOME NOT SO GOOD, AND SOME ARE POOR ENOUGH TO FAIL"

Five questions are sufficient as a starting point: how well are you managing your ...

- Talent?
- Well-being Proposition?
- People Risks?
- Leadership Role?
- Data?

## 1. How well are you managing your talent?

I do not mean simply the steps you are taking to recruit the talent you need but what processes are you using to manage it. And by 'talent' I do not mean the high flyers, big earners, star performers. Or rather I do mean these exceptional individuals who in some sectors are key critical, but talent exists at every level of the organisation. Not that everyone is talented because clearly they are not, but some talented team individuals are usually needed to make the top performers shine, individuals who are not always recognised for their worth.

## 2. How well are you managing your 'well being proposition'?

A well being 'proposition' necessarily means consideration for both the physical and psychological health of employees, but more than that it means the creation of a physically and psychologically healthy working environment. More than that again, it means that the well being proposition is two-way. We live in an age where individual choices between healthy and unhealthy lifestyles are open to many employees. To what extent therefore are employees required to live their lives so as to turn up fit for work?

## 3. How well are you managing your people risks?

Risk managers are commonplace in industry these days though their remit rarely includes (certainly not explicitly) the management of people risks, which are mostly beyond the range of insurance and are often felt as too difficult to control. Peoples' behaviour is a key critical factor in every aspect of business life today – their skills, their personal attributes, including their motivation and ability to work with others – all of them impacting directly on the P&L and the balance sheet. The list of particular people risks is daunting though not extensive:

- unwarranted and sometimes persistently poor attendance
- unwanted and sometimes unannounced departures of valuable human capital
- conflict... human capital is unlike any other (company cars aren't unpleasant to each other)
- dishonesty of all kinds: fraud of course and in difficult times many mundane behaviours
- mistakes and poor decisions due to the stress of increased workload with fewer resources
- poor health and unhealthy lifestyles

Most managers feel themselves to be poorly equipped to deal with psychological issues.

## 4. How well are you managing your leadership role?

Leadership from the perspective of good human capital management is understood from the wider perspective of distributed rather than heroic leadership. An organisation that scores well on this factor will be allowing individuals to adopt a leadership role in many situations, often on a impromptu basis and irrespective of formal responsibilities. A curious corollary of such leadership is its capacity to engender "followership".

## 5. How well are you managing your data?

The depth and quality of people data that businesses are capturing and putting to use these days is miles ahead of what it used to be. HR metrics by the ton and eye-watering performance management dashboards are commonplace. The problem is not the amount of data but the fact that it is often left "inert", not interrogated or analysed further; nor does it often reach the Board in a form and in a language that would excite the FD.

## If we build it ...

This is not just a thought piece: we're actually building the indices by which a business can self-audit its Human Capital Management maturity; and by which financial analysts can audit its HCM maturity from an outsider's point of view. But to do this, we'd like to hear from you. In particular, what do you think of this shift of emphasis from people to practices? Where should the focus be: talent, risk, data, leadership, wellbeing? Any companies you know or work for that are – or aren't – exemplars of good or bad HCM standards?

Click here to join the discussion and share your thoughts. More than that though, carry this thinking into how you look at your business.

## About the Author

Dr Michael Reddy was the Founder and Executive Chairman of ICAS, which he ran for 20 years and brought to international status with 17 offices overseas. He is a Chartered Clinical and Occupational Psychologist, an Associate Fellow of the British Psychological Society and a Fellow of the RSA. He is the Director of human capital consultancy, Human Potential Accounting.

# WHEN INTELLECTUAL CAPITAL DRIVES THE BUSINESS MODEL, THEN ...

Christian Nielsen


With a lot of discussion out there about dispersed business models based on social media, virtual collaboration, and innovation-ability, the question for analysts and companies is how business models can take Human Capital into account in a clear, readable and useful way. Christian Nielsen offers some timely and innovative clues.

## Introduction

A business model driven by intellectual capital may in some ways differ from business models driven primarily by other factors, such as financial capital or natural resources. When intellectual capital drives the business model of a company then competitive advantage may be particularly high, margins high and corporate flexibility good. However, there may also be drawbacks; competitive advantage may be easily erodible, margins may be highly unstable and the management of knowledge resources and intellectual capital can be difficult.

From an external perspective, evaluation of such businesses will likewise be more difficult than for those that have more traditional business models. This article illustrates possibilities for enhancing the evaluation of business models that are driven by intellectual capital. There are few, if any, easy pickings: analyzing, evaluating and measuring the performance of business models is difficult enough already, and for business models driven by intellectual capital it is even more difficult.

A business model is in essence a sustainable way of doing business – because it stresses the ambition to survive in the long run and thus also the ability to stay competitive. So a business model is not a static way of doing business. It must be continuously developed, nursed and optimized so that the company can meet changing competitive demands; it undergoes continual innovation.

## The Business Model Concept and its Coupling to Intellectual Capital

A business model is never only a new pricing strategy, cost cutting exercise or customer retention strategy, but a way in which a bundle of such strategies constitute a unique business formula.

DEFINITION: *A business model describes the coherence of the company's strategic choices which makes possible the handling of the processes and relations that create value on the operational, tactical and strategic levels in the organization. The business model is therefore the platform which connects resources, processes and the supply of a service which results in the long-term profitability of the company.*

A business model is concerned with the strategy and value proposition of the company; but how is it leveraged? We need to identify the most important performance measures that relate to the overall value creation story.

> THE BUSINESS MODEL IS THE PLATFORM WHICH CONNECTS RESOURCES, PROCCESSES AND THE SUPPLY OF A SERVICE AND RESULTS IN THE LONG-TERM PROFITABILITY OF THE COMPANY

We want to illustrate the flows of value creation by linking indicators to strategy and by providing a context-giving narrative. Mouritsen & Larsen (2005) call this a process of "**entangling**" the indicators [although we might call it interlinking and integrating], arguing that individual pieces of information and measurements by themselves can be difficult to relate to any conception of value creation. So we are concerned with identifying the knowledge resources that drive value creation – rather than assigning a monetary value to them.

The problem with trying to visualize the company's "business model" is that it can very quickly become a generic and static organization diagram illustrating the process of transforming inputs to outputs in a chain-like fashion. The reader is thus more often than not left wondering how the organization actually functions. Hence, the core of the business model description should be the **connections** between the different elements that the management review is traditionally divided into, i.e. the **actual activities** being performed in the company. Companies often report a lot of information about activities such as customer relations, distribution channels, employee competencies, knowledge sharing, innovation and risks; but this information may seem unimportant if the company fails to show how the various elements of the value creation collaborate, and which changes we should keep an eye on.

This is where the intellectual capital perspective becomes imperative. When we perceive relationships and linkages, they often reflect some kind of **tangible transactions**, i.e. the flow of products, services or money. When perceiving and analyzing the value transactions going on inside an organization, or between an organization and its partners, there is a marked tendency to neglect or forget the often parallel **intangible transactions and interrelations** that are also involved.

"a new cocktail of tools"

## The Intellectual Capital Cocktail

At the Center for Research Excellence in Business modelS (CREBS) we have recently analyzed how existing "models" or "tools" perceive transactions and relationships, and we have found that **they generally lack a conception of intangible transactions, which in many cases are the very key to understanding the value logic of a business model.**

So, to create a more meaningful analysis and understanding of a business model, we need to assemble a new cocktail of tools including, as essential ingredients, intangible transactions and relationships. Although our work has so far been primarily focused on network-based business models, the conclusions seem easily generisable to other settings.

The problem – as well as the prospect – with business models is that they are concerned with being different; the business needs a unique selling point. So the bundle of indicators on strategy, intellectual capital, and so on, that will be relevant to analysis or disclosure will differ from firm to firm. The information needs to be communicated – in the firm's strategic context, as this would show its relevance to the company's value creation process. It does not make sense to insert such information into a standardized accounting regime. We would point out that if it is difficult for the company itself to conceptualize the business model, then it will probably be even more difficult for external parties to analyze it. At present there exists very little literature on the different aspects of analyzing business models.

In order to analyze the interrelations of the business model it is possible to apply the ideas of a strategic narrative as presented in the Intellectual Capital Guideline (Mouritsen et al. 2003a). Like all other stories, this narrative has a beginning, an action and an ending – i.e. resources, activities and effects. This conception makes it possible to **mobilize a series of questions to identify the key indicators of the business model**, based on an understanding of the company's strategy and the key management challenges facing the executive management. Evaluating the business model can therefore be done in a series of steps.

1. Evaluate the identified indicators in a scorecard-like fashion in relation to a set of expected targets for each indicator.
2. List the indicators in the analytical model presented below, which links evaluation criteria with knowledge resources.
3. Re-evaluate the indicators by asking which ones affect each other.
4. Check whether some of the 12 boxes have missing indicators.

| Evaluation criteria / Knowledge resources | Effects<br>What happens | Activities<br>What is done | Resources<br>What is created |
|---|---|---|---|
| Employees | • • • | • • • | • • • |
| Customers | • • • | • • • | • • • |
| Processes | • • • | • • • | • • • |
| Technologies | • • • | • • • | • • • |

*The Analytical Model (Mouritsen et al. 2003b)*

5. Management should then ask themselves how all these indicators fit into the story of what the company does and how it is unique. In this manner, management is gradually moving closer to its business model narrative being supported by performance measures.
6. In order to assess if the composition, structure and use of the company resources are appropriate, it is necessary to consider the development of the indicators over time.
7. Finally, the company may pursue relative and absolute measures for benchmarking across time and across competitors.

Unlike an accounting system, the analytical model is not an input/output model. There is no perception that any causal links exist between, say, actions to develop employees (e.g. increase employee satisfaction) and effects in that area. But the effects of such actions may appear as customer effects: for example the employee becomes more qualified and capable of serving the customers better. The task of the analysis is thus to explain these 'many-to-many relations' in the model. The classification itself does not explain the relations; an additional narrative is required.

## Next Step: Performance Measures

It is essential to support a company's business model story with performance measures. While it may be acceptable for some companies merely to state that one's business model is based on (say) mobilizing customer feedback in the innovation process, excellence would be achieved by explaining by what means this will be done, and even more demanding is justifying the effort by indicating: 1) how many resources the company devotes to this effort; 2) how active the company is in this matter, and whether it stays as focused on the matter as initially announced; and 3) what the effect has been, e.g. on customer satisfaction, innovation output etc. According to Bray, "relevant KPIs measure progress towards the desired strategic outcomes and the performance of the business model. They comprise a balance of financial and non-financial measures across the whole business model. Accordingly, business reporting integrates strategic, financial and non-financial information, is future-performance focused, delivered in real time, and is fit for purpose" (2010, p.6).

From an accounting perspective the question of how to capture value creation and value transactions when value creation to a large extent goes on in a network of organizations and not inside an organization as traditionally perceived is problematic. Also, from a management perspective, the question of how to produce decision-relevant information is seriously challenged by business model innovations and the advance of new types of business model ecologies, e.g. based on social communities, virtual collaboration networks and a competitive landscape based on business model "innovation-ability".

**Perhaps understandably, the accounting and finance professions have not been able to keep pace.** With inspiration from the fields of business model innovation and developing business ecologies, it might be meaningful to attempt business model (e)valuation by incorporating 5 different archetypes of performance measures:

1. Measures of present strength and resources
2. Measures of resilience
3. Measures of changeability and flexibility
4. Measures of activity and output
5. Measures of impact, both financial and societal

## In Conclusion – the Business Model has a Communicative Role

The business model may thus also be perceived as a model which helps the company's management to communicate and share their understanding of the company's business logic with employees, business partners, and external stakeholders. But if it is incomplete, so is the reader's potential perception of the company. In general, the potential benefits of learning how to analyze and evaluate business models are considerable and this is an area that many sectors, ranging from investment banks to consulting companies and policy-makers should engage in.

## References

Allee, V. (2011), Value Networks and the true nature of collaboration. Free ebook accessible from www.valuenetworksand collaboration.com (Accessed May 20, 2011)

Boulton, R.E.S., B.D. Libert & S.M. Samek. (1997), Cracking the Value Code: How successful businesses are creating wealth in the New Economy. New York: Harper Collins Publishers.

Bray, M. (2010), The Journey to Better Business Reporting: Moving beyond financial reporting to improve investment decision making. KPMG Australia.

Mouritsen, J., Bukh, P.N., Flagstad, K., Thorbjørnsen, S., Johansen, M.R., Kotnis, S., Larsen, H.T., Nielsen, C., Kjærgaard, I., Krag, L., Jeppesen, G., Haisler, J. & Stakemann, B. (2003a), Intellectual Capital Statements – The New Guideline. Copenhagen: Danish Ministry of Science, Technology and Innovation. (www.vtu.dk/icaccounts)

Mouritsen, J., Bukh, P.N., Johansen, M.R., Larsen, H.T., Nielsen, C., Haisler, J. & Stakemann, B. (2003b), Analysing Intellectual Capital Statements. Copenhagen: Danish Ministry of Science, Technology and Innovation. (www.vtu.dk/icaccounts)

Mouritsen, J. & Larsen, H.T. (2005), The 2nd wave of knowledge management: The management control of knowledge resources through intellectual capital information, Management Accounting Research, 16(4), 371-394.

## About the Author

Christian Nielsen is Associate Professor at Aalborg University in Denmark and Director of CREBS (Center for Research Excellence in Business modelS), the world's first interdisciplinary research center focusing on business models.

Christian has previously worked as an equity strategist and macro economist specialising in integrating Intellectual Capital and ESG factors into business model valuations. His Ph.D. dissertation of 2005 won the Emerald/EFMD Annual Outstanding Doctoral Research Award, and in 2011 he received the Emerald Literati Network Outstanding Reviewer Award. Christian Nielsen has a substantial number of international publications to his credit and his research interests concern analyzing, evaluating and measuring the performance of business models.

"I have been involved in M&A as an HRD from the commercial side – that is, leading it, or part of the team doing the deal. I am amazed how often HR is left out, or brought in at the last moment.

Reasons go from secrecy to lack of trust in the function's ability to understand the commercial realities – but who is to blame for that? Bankers, lawyers and other advisers don't want another agenda at the table, but it is the people agenda that is needed most urgently, as the synergies are about clients, staff and assets – and intellectual capital is vital to retain and grow the existing base and use the diversity to expand.

HR must insist on being there early to help create the internal PR, the ongoing value creation and retention of critical talent, besides the analysis of complex issues such as pensions, global remuneration and engagement.

I always wanted to know the other party and get a feel of their culture and talent – and which issues lay in ambush. The numbers show that the deals are not working..."

**Jose Santiago:** letter (print version) in response to "Mergers and Acquisitions: Is HR being locked out on done deals?" by David Woods in HR Magazine, 1st Aug 2011

"In a knowledge-based economy, much of the value in a business lies in its people. It is therefore essential that HR directors sit at the top table from the outset of any consideration of future strategy and organisation – perhaps especially in terms of M&As where the actual value added by people at all levels must feature as a critical element in the cost and benefit analyses."

**Andrew Ades:** comment in response to "New Rules on Acquisitions put HR Issues into the Spotlight" by David Woods in HR Magazine, 20th Sep 2011

# SELL-SIDE RESEARCH: THREE MODEST REFORM PROPOSALS

**The reasons why sell-side research has failed to deliver on its analytical promise and the measures needed to release that potential**

Michael A. Mainelli, Jamie Stevenson and Raj Thamotheram[1]


High profile sell-side analysts are paid (handsomely) and given unfettered behind-the-scenes access to the businesses they research and publicly recommend. And yet, more often than not, they miss the mark. Here we find out why, and just as importantly how they might finally fulfil their potential. Something we could all benefit from.

## Executive Summary

Investment banks ("sell-side") spend several $billion[2] per annum globally on equity research sold to investment clients ("buy-side"). Even after cutbacks in recent years, sell-side equity research remains a well-funded and high-profile activity. It ought therefore to be adding significant value to investors' understanding of quoted companies. And, since sell-side analysts disseminate their research widely, it should also improve the all-round quality of market information. Yet despite these sizable resources and high rewards (unmatched in any other field of analytical research) and powerful advantages, sell-side research has been clearly and consistently shown to:

- Miss most of the major insights or turning points in company analysis[3]
- Err persistently towards Buy recommendations and stances supportive and uncritical of current company management policies and or management fads[4]
- Follow consensus (and company guidance) forecasts and views, rather than construct independent earnings models and opinions
- Prioritise daily client marketing contact over long term development of fundamental research
- As a consequence, focus on short to medium term valuation formulae at the expense of examining in depth the extra-financial and operating issues which impact the long term sustainability of business models and company performance

The reason for these failures can be traced to the lack of transparency in commercial relationships between sell-side and buy-side. This lack of transparency arises because:

- Buy-side institutions are loath to make open, direct and significant payments for specified research services
- Instead, they opt for a maze of commercial contracts – across the corporate, new issue and market-making functions as well as commission – which mask their true dealing costs whilst providing broad research cover to defend their decisions
- This reluctance to pay full dealing and research costs has shifted focus and power within investment banks towards corporate fee and proprietary trading income
- Which in turn has exacerbated the conflicts for equity analysts between research for clients and making a contribution to corporate and trading income

There have been three very different attempts to address these weaknesses. Each has had some positive impact but none have significantly altered the status quo.

The Spitzer settlement in December 2002[5] aimed to eliminate these conflicts of interest and create a level playing field in

which buy-side could access sell-side research on a transparent basis. It has improved the system of research disclosures (to the displeasure of many analysts who complain about 'red tape') but failed to alter the preponderance of Buy recommendations and favourable research on each bank's own corporate clients.

The launch of the Enhanced Analytics Initiative (EAI) in Europe in mid-2004 sought to encourage research beyond the limits of short term financials. Its radical idea of linking income (5% of participating institutions' annual commission total) with a public ranking of sell-side competency in this new type of research started to attract significant research efforts from a dozen or more bulge bracket and other leading banks. But the project struggled against the domination of fully bundled corporate, trading and commission packages and in late 2008, it merged into the Principles of Responsible Investment initiative leaving unanswered questions about how to keep pushing for change[6] Ironically, the banking crisis of 2008 (itself a classic example of a fundamental event which ESG research would have been better placed to identify) has led to retrenchment by investment banks from research in general and from ESG research in particular.[7]

> "IT IS ARGUABLE THAT ONLY LEGALLY ENFORCED SEPARATION OF CORPORATE, TRADING AND BROKING FUNCTIONS COULD ACHIEVE FULL TRANSPARENCY AND INDEPENDENCE IN THE SUPPLY OF EQUITY RESEARCH ."

A similar fate awaits post-Spitzer initiatives in 'unbundled' research from non (or less) conflicted boutique broker-banks. The logic of quality research standing apart from corporate client and proprietary trading pressures is flawless. It has to be the logical way to raise equity research quality and independence. Yet few firms offering earmarked, unbundled research services have succeeded beyond the specialist boutique level.

The weight of existing relationships between buy-side and sell-side militates against such initiatives. It is arguable that only legally enforced separation of corporate, trading and broking functions (i.e. break-up of integrated investment banks) could achieve full transparency and independence in the supply of equity research. In the absence of political support for radical reform, the following three manageable steps would improve research quality:

- Full disclosure by sell-side and buy-side of all commission contracts
- Compulsory publication by sell-side of their recommendation balance (Buy/Hold/Sell) for (a) all covered stocks, and (b) corporate client stocks
- Naming and shaming of corporate managements who deny access to non-favourable analysts ('analyst freeze-out')

These are modest steps and simple to implement. They would not eradicate the failings of sell-side research at a stroke but they would at least make it harder for corporates and investment banks to conspire in neutering the analytical edge of equity research. And they might encourage buy-side to see their long term advantages in paying directly for less conflicted and more deeply questioning sell-side research. Given the persistent failures of the voluntary approach, such measures need to be supported by regulation or at least the imminent threat of it, in the absence of industry proposals with teeth.

## 1. The Strengths of Sell-side Research

Sell-side and credit research agencies have the potential to play a significant, positive role in enhancing the quality of equity market analysis and awareness.

In theory, these agencies are a hugely efficient centralised resource, motivated to gather and to share investment relevant information. Like their buy-side clients, sell-side and credit research analysts have powerful incentives to be right – perhaps even more so than the buy-side given the smaller job market in which they work and their higher profile. Even after recent cutbacks, sell-side analysts remain significantly better paid than those undertaking similar work in health, education, civil service, academia, politics, the media, mainstream corporate careers and even the law, accounting and consultancy.

Being associated with brokerages, sell-side researchers are motivated to be public, if not loud, about their opinions. In contrast the buy-side has much less to gain from sharing data with others and is motivated to keep information secret. Sell-side research is pushed through the financial system. Sell-side researchers have a large effect on market perceptions about particular stocks. In fact, one interpretation of a sell-side brokerage is that it is a research (or publicity) machine with a brokerage attached.

Theoretically, sell-side research makes a vital contribution to market efficiency: the collective intelligence of the market, aggregating divergent opinions into price setting. The sell-side provides shared learning about stock price formation that is widely available at low cost. And this learning is built upon a statistical framework of quantitative income, cash flow, balance sheet and financial ratio modelling which has grown exponentially in technical sophistication over the past two decades. The intellectual capacity of today's sell-side analyst to

> "THE INTELLECTUAL CAPACITY OF TODAY'S SELL-SIDE ANALYST TO CRUNCH COMPLICATED NUMBERS AND VALUATION FORMULAE THROUGH FAST, REAL TIME, INTERACTIVE SPREADSHEETS IS LIGHT YEARS AHEAD OF THE EQUIVALENT IN THE 1980s."

fast, real time, interactive spreadsheets is light years ahead of the equivalent in the 1980s.

Similar advances have been made in the technical efficiency of corporate communication to investors and analysts. None of the insider benefits which were routinely exploited a quarter-century ago by market professionals are now so easily available. Tighter rules on parity of disclosure and instant electronic data communication have eliminated the low hanging fruit of old-fashioned insider dealing.

Investor relations (IR) has grown up into a genuine professional skill. The processes of announcement, presentation, Q&A, conference calls, investor 'one-on-ones' etc have developed from sporadic initiatives into standardised, measurable and accountable units of IR activity. Managements will always use the tricks of spin, slant and data overload to push-and-pull analysts in their direction, but the latter can no longer complain that they lack the informational tools to execute their scrutinising and valuation tasks.

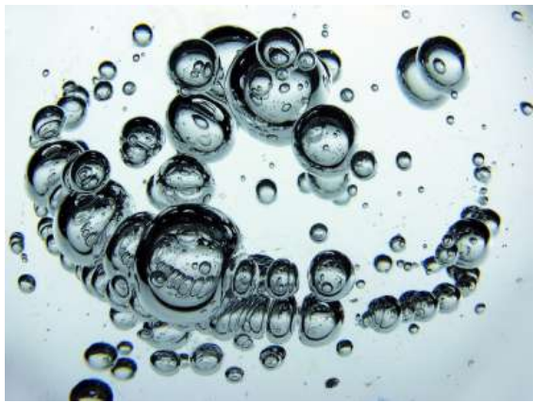
## 2. The Failures of Sell-side Research

Yet sell-side research has manifestly failed to deliver on this potential. Bar a few brave outliers, most of its vast daily e-mail and printed output recycles published data and promotes bland, consensus views with a bias towards Buy recommendations and uncritical views on current management policy or current management fads[8]. Where critical views are expressed, they mostly follow a copycat cycle of clichéd invective ("lacking vision", "poor investor relations") for currently unfashionable companies. The underlying cause of this empty approach is the opaque and inadequate payment structure between sell-side and buy-side.

This in turn arises from the criteria under which investment funds (buy-side) are themselves evaluated and how these drive their research appetite and payment structure. Investors tend to evaluate buy-side performance over benchmark periods shorter than the life of a typical fund, e.g. quarterly for a 30 year pension fund. All buy-side positions are constantly subject to second-guessing ex post. This creates a defensive culture in buy-side firms and a ready market for sell-side research recommendations which can be used to support almost any position. A preponderance of Buy recommendations fills their need to justify poor investments – "I bought Vodafone and lost a lot on that position, but it was recommended by Mega-Broker's investment researchers". This buy-side need reinforces the internal pressure on sell-side analysts for positive recommendations to placate fee-paying corporate clients.

Investors also evaluate buy-side performance in terms of fees, typically excluding brokerage costs. Therefore, the buy-side strongly prefers that its costs somehow find their way into brokerage costs. Not surprisingly, a variety of costs has found its way into brokerage fees, such as 'softing'. This has accentuated the resistance within sell-side research to the concept of 'unbundling'.

This emphasis on controlling reported costs by buy-side firms tends also to reduce their own in-house research resource and increase their reliance on the sell-side research which is circulated to them (and all other brokerage clients) 'free'. Already concerned to avoid significant quarterly under-performance risks, such buy-side clients are naturally prone to converge around the consensus of this corporate-filtered, uncritical and dealing-biased research. This convergent behaviour in turn creates and exacerbates bubbles.



## 3. Conflicts of Interest within Integrated Investment Banks

The steady dismantling in the US of the provisions of the Glass-Steagall Act (resulting in its final repeal in 1999) and the UK's Big Bang in 1984 have created today's global integrated investment bank model. Its inherent conflicts of interest are almost too obvious and well documented to bear repeating. No amount of internal compliance rules and Chinese Walls can airbrush out of reality the inconvenient truth that executives operating for the same ultimate paymaster in the triple functions of corporate advisory, proprietary trading and equities research cannot ever act in a truly independent manner for their client.

And, to misquote Jane Austen, it is a truth universally acknowledged that a banker in possession of a good corporate client (or indeed a trader in possession of a sizable long or short position) must be in want of a co-operative research analyst.[9] In short, the dice are loaded against independence and integrity in the equity research division.

The analysts in sell-side and credit research agencies are fully aware that they work in a conflicted business model and that, since the demise of equities commission rates in the wake of de-regulation, their own funding depends on corporate and trading income. Spitzer (see 10 below) may have broken the direct, formal link between corporate income and research rewards, but the invisible link is more powerful than ever. For most normal people, this inevitably leads to self-censorship, a process which is generally insidious and rarely explicit. It does not take more than the occasional analyst to be made "an example of" – i.e. who says something negative about an important client, doesn't retract/apologise and who then is "let go" – for the message to get through to most analysts. Why risk a highly paid position for a concept of integrity which the system neither recognises nor values? This informal system of self-imposed control augmented with the occasional action *pour encourager les autres* is thus highly effective.

Within the investment banking system, the power hierarchy is clear – research analysts are not the top dog. Some of these top dogs (e.g. M&A deal makers) react very badly to upset corporate clients. Other top dogs (e.g. proprietary traders, sales staff) dislike market efficiency – a former corporate governance analyst at one bank was criticised internally for making available governance scores to buy-side clients who didn't pay as much as hedge funds for the same data. The problem is even worse in CRAs since unless the client likes the report, they may not pay for it. Conflicts of interest become entrenched and no amount of Chinese Walls, commitments to internal integrity and internal processes such as whistle blowing can reverse their negative impact. The disinclination of sell-side analysts to identify laggard companies – as opposed to leaders – in any field exemplifies this mind-set. The fact that most analysts do not see this as important shows how institutionalised individuals can become in the goldfish bowl of investment banking.



Jane Austen: "it is a truth universally acknowledged"

> "IN SHORT, THE DICE ARE LOADED AGAINST INDEPENDENCE AND INTEGRITY IN THE EQUITY RESEARCH DIVISION"

## 4. Corporate Management Pressure on Analysts

US academics have shown that US executives have been able to secure more favourable research ratings for their companies from investment banks by bestowing professional favours on Wall Street analysts. The study, carried out by Michael Clement of University of Texas and James Westphal of University of Michigan, found that by offering analysts favours, ranging from recommending them for a job to agreeing to speak to their clients, sharply reduced the chances of a downgrade in the aftermath of poor results or a controversial deal. The research, carried out on some 1,800 equity analysts and hundreds of executives, suggests that radical regulatory reforms of recent years have failed to eradicate conflicts of interest on

Wall Street. Analysts' representatives said that accepting favours such as those described in the study – which also include putting analysts in touch with executives at other companies and advising on personal matters – was unethical. However, according to the study nearly four out of six Wall Street analysts admitted receiving favours from company executives. The frequency of favours increased in line with the shortfall between the company's earnings and market expectations – a crucial determinant of analysts' stock ratings.[10]

The converse to such charm offensives by corporate managements towards analysts is, of course, the "stick" of punishing critical analysts with a reduction or even cessation in contact, information flow and response to questions. This is the corporate version of the standard device regularly and (till they lose office and popularity) successfully deployed by government ministers and spin-doctors to manipulate journalists.[11] This "freeze-out" of an inconvenient analyst stops one step short of the less frequently used nuclear option of a formal complaint by the company to his paymasters. Ironically, the former lower level option is the more insidious and usually more effective one. Subject to the all-important proviso that no corporate fee is at risk (see 4 above), being the subject of a formal complaint from a covered company can be turned by a confident analyst into an honourable war wound signifying valour. The less glamorous inconvenience of losing regular contact for those minor but vital daily details of data feedback is more likely to wear down the analyst's resistance and what is left of his independent spirit.

## 5. Dearth of "Main Street" Experience Amongst Analysts

Excess trust in efficient market theory was one of the (if not the) defining self-deceptions in the run-up to the 2008 crisis. It is now more than ever clear that markets do not tend systemically towards an equilibrium around an efficiently filtered discounting of all known and knowable information. Instead, they fluctuate violently around massive mis-readings of fundamental trends at macro and company levels. Animal spirits play their part but equally deficiencies in the market professionals' analytical toolkit contribute to the market's errors of judgement and pricing.

No system is foolproof against corporate misdeeds, self-deception and cover-up on the scale of those perpetrated in the global banking sector and debt markets over the first decade of the new millennium.

Yet it is arguable that a greater depth of experience and operational knowledge amongst professional analysts at the centre of equity market valuation could have improved awareness – as well as providing critical feedback to corporate managements as to what was (un)acceptable to shareholders. These two qualities – depth of experience and operational knowledge – do not feature on the tick-lists of investment bank recruiters in the 21st century. Their selection system is more rigorous, fair and competitive than at any time in the history of banking. Sell-side firms attract the brightest and the best (first and upper second class) honours graduates and MBAs from the leading universities and business schools across the US, UK and Europe. They train them in the disciplines of CFA and other financial analysis courses to high levels of spreadsheet modelling and ratio crunching ability. Intellectual and analytical rigour are paramount and have played their part in raising technical standards of equity research since the 'amateur' 1980s. Yet few analysts can claim any operational or hands-on experience outside these narrow confines of tracking the reported and forecast financial performance of their sector companies. And that sector choice itself tends to be a serendipity outcome from the first postgraduate year rather than a reflection of special interest or knowledge. This focus on excellence in financial modelling at the expense of hands-on operational insight generates two negative side-effects. It reinforces the disinclination amongst analysts to examine extra-financial issues such as environmental impacts or corporate governance (see 8 below) which affect the long-term sustainability of a company's business model. And when an analyst's

excellence in pure financial modelling and valuation is endorsed by high status survey recognition (Institutional Investor, Extel) and the pursuit of head hunters, it often isolates him on a pedestal of self-belief and resistance to queries and ideas emanating from outside the bubble of financial market numbers and gossip.

Such a mindset becomes suspicious of new approaches to investment analysis and loyal to the apparently proven formula of crunching the income, cash flow, balance sheet and valuation numbers. Doing things differently risks being seen as unprofessional if not illegal. Whether this risk is in the heads of practitioners or 'real' doesn't matter – it has the same effect. Work on building a new theory of investment is only just starting and the component parts[12] have yet to be linked in a coherent way. There are, however, encouraging moves by CFA Institute[13] and EFFAS[14] but it is early days. It would need a significant change in buy-side demands to shift sell-side research analysts out of their existing comfort zone of excess reliance upon financial modelling. The time investment required for sell-side to embrace fully the extra-financial issues would be seen as an unjustifiable risk unless endorsed by a widescale buy-side shift towards measures such as the Enhanced Analytics Initiative.

> "IT WOULD NEED A SIGNIFICANT CHANGE IN BUY-SIDE DEMANDS TO SHIFT SELL-SIDE RESEARCH ANALYSTS OUT OF THEIR EXISTING COMFORT ZONE OF EXCESS RELIANCE UPON FINANCIAL MODELLING"

## 6. Flight from Small Cap to Higher-Fee Large Cap Coverage

Before addressing the neglect of extra-financial issues and the struggles of EAI to correct this, it is worth noting another negative side-effect from the pressure on sell-side research to justify its costs to its investment banking paymaster. According to Reuters Research, there was a 13 percent increase in the number of US companies that lost sell-side coverage completely between 2002-4. Anecdotally, the growing struggles in recent years of many quoted UK companies in the £100m-£300m market cap range to attract coverage beyond the one committed appointed broker analyst and desultory interest from a couple of smaller sell-side firms illustrates this same point. As the senior editor of CFO.com notes: "…analysts who work for the sell-side research units of large brokers and investment banks are heading en masse for the economic shelter of large-cap companies. The reason for the exodus? Large-caps boast heavily-traded stocks – and their whopping fees – as well as the potential for profitable investment banking business."[15] Such harsh economics will be accentuated through the credit crisis.

## 7. Neglect of Extra-Financial and Sustainability Issues

We have alluded at various points in this paper to the minimal attention directed by sell-side analysts towards 'extra-financial' or Environmental Social & Governance (ESG) issues. This term refers to the range of forces outside the company's immediate operations which are unlikely to influence its three-year earnings and cash flow forecasts (i.e. the daily working tools of an equity analyst) but which will drive its long term performance and even existence. With few exceptions, sell-side researchers do not generally pay due attention to the extra financial performance of the companies.

This observation was endorsed in a recent study of banking sector sell-side analysts, whose authors conclude[16]:

*"Corporate governance reporting (mandatory under listing rules under UK 'comply or explain') was usually unread because governance in UK banking was generally trusted by the analysts. Social and environmental reporting was universally considered irrelevant and incapable of influencing a financial forecast. It was rarely read by analysts and any suggestion that the environmental reporting might contain disclosure germane to the he description of secondary (i.e. loan book) environmental risk was dismissed."*

This systemic blind spot in the coverage of commercial research providers has a double impact on the capacity of fund managers to address these long term fundamental issues in their investment decisions.

Firstly, the neglect of extra-financial issues in the mainstream of commercial sell-side research has a 'permissive' effect in skewing the market consensus away from the long term fundamentals. This acts as a disincentive to contrarian behaviour, as and when the buy-side may consider taking a bet against their benchmarks and the herd. The absence of credible external data or research to back them up implies an extended period of exposure to risk as it takes time (often several years) for the market to understand the true implications of that extra-financial insight. Companies (and whole sectors) can mask serious underlying problems for several years before being forced to acknowledge the impact in their reported numbers. The unlucky demise of some bearish analysts during the lead up to the 2000 dot.com bubble showed how hard it can be to sustain a contrarian stance against the herd in the absence of a serious mainstream body of extra-financial research.

> **"THIS BLIND SPOT HAS A DOUBLE IMPACT ON THE CAPACITY OF FUND MANAGERS TO ADDRESS LONG TERM FUNDAMENTAL ISSUES IN THEIR INVESTMENT DECISIONS.**

In that instance, it would only have required three or four major sell-side firms to set aside research resource into the exaggerated economics of valuations based on "£X,000 per subscriber" to cap the bubble early and thus defuse and dilute the subsequent volatility. The relevant research work would have been detailed, onerous and time-consuming. In order to pinpoint and "prove" the bubble's over-valuation of dot.com stocks, researchers would have needed to look beyond individual companies towards the whole "new economy" and construct a model aggregating the "value per subscriber" for the sub-sector. Such research was eminently do-able but would have taken many analysts away from daily client contact for a couple of months or more.

Secondly, the vast majority of buy-side firms do not have the internal capacity and resources to operate complex comparative models of the kind that sell-side houses do. Thus, only a few of the biggest buy-side firms have the ability to do in-depth primary investigation, comparing ESG performance of different companies in the same sector, and then bring it into a systematic model. In the same way the buy-side pay the sell-side to produce earnings estimates, so most buy-side firms need a similar service on the importance of ESG performance.

## 8. False Signals Between Sell-side and Corporate Management

The exchange between sell-side and corporate management is a two-way street. It is not just confined to the kinds of carrot-and-stick pressure applied by the latter to the former, as described in 5 above. The approach of sell-side analysts sends signals back to management about equity market priorities and likely reactions. The broad perception amongst CEOs and CFOs is that mainstream analysts rarely initiate discussions of corporate responsibility or governance nor of environmental and safety issues, except when these are seen as posing specific and immediate threats to financials and value (e.g. the US refinery problems of BP in 2006). With buy-side analysts having only an hour with senior management, it is perhaps understandable that priorities have to be tightly set.

But the top half dozen sell-side analysts in any sector have greater access to management, extending up to two days per visit and a week for overseas trips. Their inclination to deal with extra-financial issues only en passant or not at all during such visits gives a clear, and negative, signal to corporate management.

There are several anecdotal examples of this. As noted commentators Michael Jensen and Robert Fuller say: "Enron in its heyday owned significant assets, made true innovations in its field and had a promising future. Its peak valuation required the company to grow extremely vigorously….

To its detriment, it took up the challenge. The company expanded into areas in which it had no specific assets, expertise or experience… Had management not met Wall Street's predictions with its own hubris, the result could have been different."[17] Few CEOs are spared the pressure: "The investment community has no sense of social responsibility. And when I say 'no', I can't use smaller words than that." The fact that this was said by Chuck Prince is particularly telling.[18]

The question has also been considered by Duke University economists who found CFOs had a strong propensity to trade off productive expenditure (see below) in order to "meet the number".

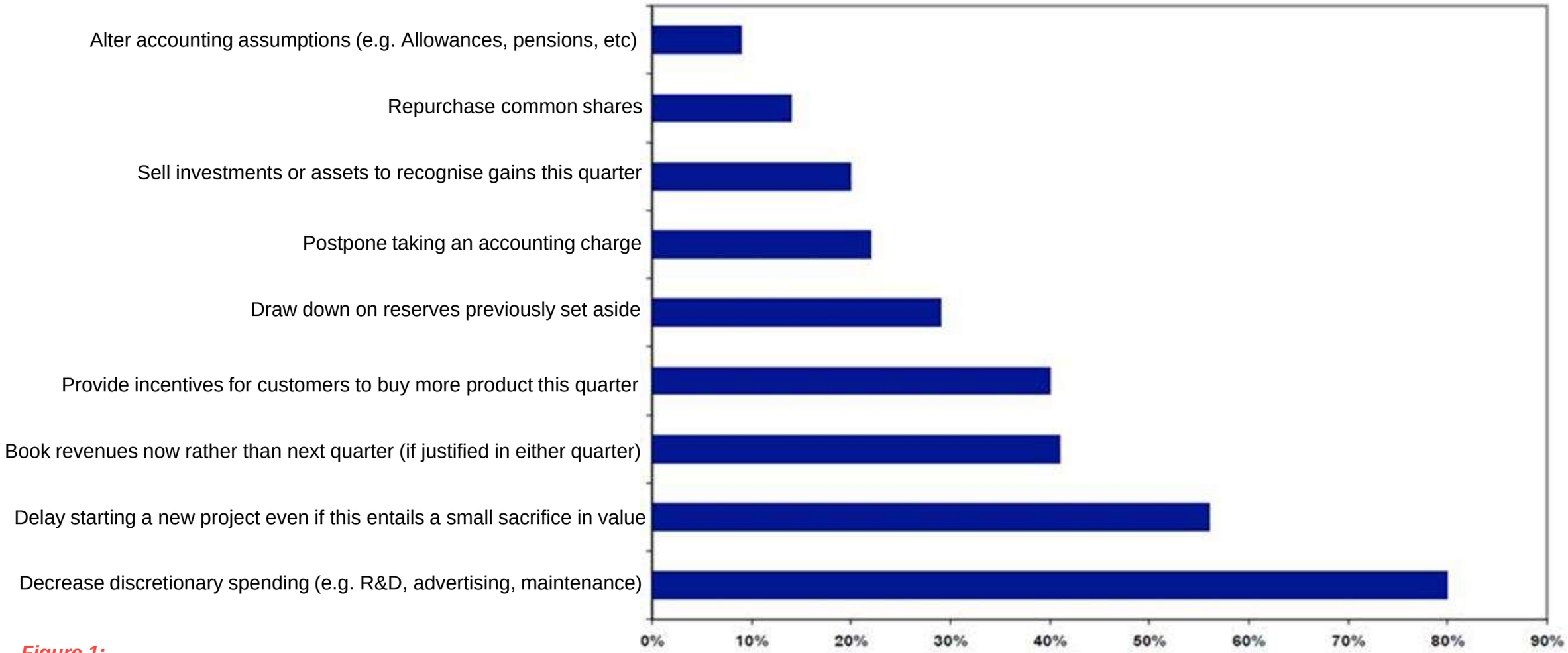



***Figure 1:***
*Taken from Graham, John R., Harvey, Campbell R. and Rajgopal, Shivaram, "Value Destruction and Financial Reporting Decisions" (September 6, 2006).*

## 9. Three (Struggling) Initiatives to Raise Research Quality

Our exposure here of the flaws in sell-side research is neither original nor controversial. Few participants on either buy-side or sell-side disagree with the broad observations about conflicts of interest and lack of transparency in the payment structure. Defenders of the existing system used to rely instead on the pragmatic argument that with the gradual waning of Glass-Steagall and introduction of Big Bang the global economy had enjoyed a quarter-century of unprecedented and almost uninterrupted growth in wealth and GDP from 1982 to 2007. If it ain't that broke, why fix it?

The credit crunch of 2008 took the wind out of that argument's sails but articulate proponents can still be found for the plausible pragmatic line that in a free market economy money attracts quality. Thus the bulge bracket banks – with all their flaws – will continue to enjoy the most brilliant concentration of analytical brainpower and only their integrated model can afford to fund that brainpower from its mix of corporate, trading and commission income.

Three attempts over the past decade to challenge that domination of the integrated model are worth highlighting:

- The Spitzer settlement of 2002
- The Enhanced Analytics Initiative
- Unbundling initiatives by independent research houses

### 9.1.The Spitzer Settlement

Elliot Spitzer, then Attorney General for New York state, agreed in December 2002 to drop a series of indictments for fraudulent misuse of research against several of Wall Street's top sell-side firms such as Merrill Lynch and Citigroup in return for fines totalling $1.4billion and agreements to separate and ringfence their research activities from the corporate, trading and other functions of the investment banks.

Spitzer justified his decision to drop the indictments (which were supported by unequivocal evidence of research deception by Wall Street analysts to protect corporate clients) on the grounds that his main objective was to resolve the banks' conflicts of interest. But as Robert Kuttner prophetically wrote in Business Week at the time,

*"Will the settlement do that? By requiring analyst compensation to be based solely on analyst performance, and by erecting a management wall between research and investment banking, the deal does make it much harder for research analysts to illegally promote stocks that their investment banker colleagues are underwriting. However, the other major element, the promise to stop spinning IPOs, is voluntary for now. An official regulatory ban awaits SEC rules. The nub of the problem is that Wall Street and its regulators remain far too clubby. Self-regulation is delegated to the NASD, the stock exchanges, and the accounting profession, which lack the appetite to go after the conflicts that enrich their brethren. The opportunities for insiders to profit from conflicts of interest are pervasive."*[19]

The Spitzer settlement led to furious activity by investment banks to be seen to be strengthening their Chinese Walls. These included a series of moves to tighten up disclosure in research publications on:

- Any actual or potential corporate income interest which the bank held in any of the companies covered by the research note
- The historic timing and performance of stocks against their recommendations
- The balance of the firm's stock recommendations between Buy, Hold and Sell.

That these changes had made some impact is evidenced by that most reliable of indicators – the rumbling of complaints by analysts against 'red tape'. Procedures are undoubtedly tighter than a decade ago and analysts more circumspect and careful

1. SPITZER SETTLEMENT
2. ENHANCED ANALYTICS INITIATIVE
3. VOLUNTARY UNBUNDLING

in their handling of data and recommendations. Yet the preponderance of Buy recommendations (running at four to five times Sell recommendations) is unchanged, as is the favoured treatment of corporate stocks. The disclaimers on corporate involvement are of the lengthy catch-all variety which reveal little insight. Every research note into almost every company carries a similar disclaimer as to the possibility that it might provide revenue to the bank's corporate division.

Spitzer and its descendants may have tightened up investment bank procedures but they have not shifted the balance of power away from the corporate and trading divisions of the bulge bracket firms. Even the credit crisis has not achieved that since, although some names have disappeared and the investment bank model has suffered the mother of all PR disasters, the show will roll on under new ownership (part Fed, part Bank of America, part HM Treasury, part sovereign wealth funds) and, as the resurgence of many Lehman mover-and-shakers under the Nomura label illustrated, the same internal dynamics will re-assert itself over independence and integrity in research.

## 9.2. Enhanced Analytics Initiative

The EAI is a voluntary initiative which was started in mid-2004 by European pension funds and fund managers. It aimed to encourage the sell-side to invest in quality, long-term research which would consider material extra-financial issues. The Initiative set up two incentives for research providers to compile better and more detailed analysis of extra financial issues within mainstream research. These were a commitment to allocate 5% of broker commissions to those brokers who did good ESG work, and publicity for the best performers by naming and acclaiming the winners (and using this winning list to concentrate the payment so making it meaningful). Over a four year period, EAI grew to include twenty members and acted as the catalyst for several sell-side firms developing in-house ESG capacity.[20]

EAI was a highly innovative and, in its own terms, successful project. The project has now merged with the PRI whose much greater funds – $15 trillion – expand the potential impact, provided they make use of the following lessons from the experience of implementing the EAI.

It is important that PRI members do more than they currently have committed to do on encouraging sell side research on material ESG aspects of corporate performance – i.e. allocate credible amounts, be transparent, institute benchmarking process which will drive this upwards, and prioritise within their evaluation process, the "mainstreaming" of ESG analysis and not niche report production.

We hope this will happen as a result of the learning and stronger leadership post this crisis but we aren't confident it will.

Therefore we are proposing regulator nudges which will shift the culture of interactions between buy and sell side and which should make it possible for buy side and asset owner leadership to emerge.

*Sell-side reaction to EAI showed that:*

- There is weak engagement of analysts in North America, Australia and Emerging Markets, the former being most important given most global firms have their HQ there. The global reach of even bulge bracket firms is found wanting when seeking to spread awareness of corporate governance and extra-financial issues against the grain of local worldviews.
- Sell-side firms found it easier to write specialist SRI/ESG research notes for new clients than to integrate the insights into the mainstream notes which have much more market impact.
- Sell-side firms found it easier to comment on climate change than corporate governance. Similarly coverage of the financial sector was very weak and shown minimal grasp of the corporate governance and risk issues leading up the credit crisis.

*From the buy-side firms who did not join EAI and did not do something comparable on an independent basis, it became clear that:*

- The gap between funds' espousal of long term responsible research and their giving a financial commitment to reward such research is large and widespread
- Fear of internal debate and tension in part explains buy-side firms' reluctance to make formal commission allocations to specified kinds of extra-financial research
- This is accentuated by the dispersal of decision-making over sell-side research to many individual fund managers, which tends to endorse existing favoured practice
- This leads to the chicken-and-egg argument that ESG related research lacks the quality to justify taking 5% of the commission budget – which in turn deprives it of the extra funding which would help to deliver that quality
- It is hard to innovate in such a regime dominated by suspicion of new, untried methods and preferring a known formula

*From those buy-side firms who did join EAI and try to support this initiative, it became clear that:*

- It is hard to take a leadership position when the rest of the market, especially clients and investment consultants more or less ignore a voluntary initiative – eventually energy fades and senior management attention drifts. Whilst it may be true that "we cannot have sustainable retirement income without sustainable financial markets",[21] pension executives do not have, as part of their day to day priorities, the task of looking after the long term health of the economy as a whole.
- Although firms made the commitment to join, there were questions from sell-side participants about whether the commitment was actually translated into practice. It would not be surprising if the factors referred to in the above paragraph were not also, to some degree, present amongst EAI members since the commitment to join comes from the CEO/CIO and the implementation mechanism for commission happens far below him or her.



In summary, it is certain that a project like EAI can act as the catalyst for innovation. It is unlikely that such a project, by itself, can cause systematic change in how sell-side process ESG issues, not least because of the challenge of changing the way buy-side actually allocate commissions in the absence of either client or regulator interest.

## 9.3. Voluntary Unbundling

The debate around Spitzer and conflicts of interest did generate an upsurge of interest in the concept of "unbundled" research and a series of start-ups. These were based either on well known sector analysts marketing exclusively specialist research or on enterprising boutique brokers latching on to the independence & integrity argument as an ideal marketing tool to sell their agency services (trading as well as research) against the more opaque product of the integrated investment banks.

Several firms in both these categories have flourished during the 2003-07 bull run in equity markets but not on a broad enough scale to make a dent in the domination of research from the integrated houses. Despite the intuitive arguments in favour of such independent research during the radical re-shaping of values which has occurred through the credit crisis, there is little evidence to suggest that these unbundled sell-side boutiques are likely to hold up better during the downswing of the cycle.

## 10. Three Simple Proposals for Modest Reform

Two radical measures could eradicate most of the flaws in sell-side research which have been identified in this report. First, the buy-side could fund the creation of a wholly independent financial analyst profession. Excellent advances have been achieved over the past decade by the Chartered Financial Analyst (CFA) Institute in this direction, but this remains a voluntary regime largely funded by the sell-side.

Second, the integrated structure of the sell-side could be forcibly unbundled via legal break-up of the corporate, trading and investment advisory functions.

The latter is frankly too radical a measure for politicians and regulators in the USA or Europe.[22] Today, such change is described as "too risky" given financial markets. And when markets are doing well, such change is "patently unnecessary". Sell-side break-up combined with the creation of an independent analyst profession, accountable to the buy-side, may be the only route towards root-and-branch reform of current research constraints and distortions. Yet in the absence of what is needed, there are three much simpler and easier-to-implement measures which could at least reduce the scope for undermining analyst independence.

### 10.1. Full Disclosure of Research Payment Contracts

Currently, the buy-side is effectively paying for research using client money and there are serious questions to be asked in terms of value for money. As recently stated by respected commentators Integrity Research: "*the buy-side's reliance on sell-side firms for access to company management seems to us to be a rather suspect part of the value proposition of their research offering. Not only is it unclear how one can argue that management access is actually research, but it is also surprising that large buy-side firms continue to pay for a 'concierge service'. Large buy-side firms should be able to get access to most company management teams they want to meet, thereby eliminating the need to pay so much to the sell-side to arrange these meetings.*"[23]

Moreover: "*Numerous studies in recent years have shown that the value of traditional research reports has been on the wane, while other factors, including direct analyst service and management access are becoming the core source of value for the buy-side. However, the continued production of research reports by most sell-side and alternative research providers suggests that many have not understood this dramatic shift in perceived value.*"

Put simply, clients have a right to know how their money is spent. Hence regulators should require all buy-side firms report to their clients: what goes to research/company access/trading and how it spread between sell-side firms. In addition, buy-side should disclose any related business arrangements with sell-side firms (eg stock lending, prop trading etc). As with the sell-side, associations representing buy-side should be given an opportunity to develop a standardised and appropriate framework but if this cannot be done in due time, the regulators should make clear they will define such a framework for the sector.

### 10.2. Analysis of Recommendation Balance

One consequence of the Spitzer deal is that all sell-side firms now report, in some way, on the independence of their recommendations. At present, most brokers simply give the percentage of investment banking clients in each of the categories they monitor (generally buy, sell and hold). The only way to confirm, at least statistically, that their research and investment banking divisions are indeed independent of each other is to see if the proportion of investment banking clients in each category is about the same. Comparison between brokers, on the other hand, is not always possible, and even when it is, this information is never explicitly presented and requires some amount of calculation. What would be much more useful to the readership of these reports would be a common standard to bring some uniformity, and hence better comparability to their disclosures. Morgan Stanley comes closest to this recommendation, in that it provides the number of companies in each category for companies covered as well as investment banking clients, and is the only broker to show explicitly the contrast between the buy:hold:sell numbers for all companies and those for

investment banking clients. There should also be a historical track record: currently brokers provide only the latest statistics. **Since this is likely not to be quick or easy for brokers to agree on an entirely voluntary basis to do what they would prefer did not happen – i.e. easy comparisons – regulators in key markets should jointly give brokers a reasonable time period in which to deliver an acceptable reporting framework, or face an imposed one**.[24]

### 10.3. Naming-and-Shaming of Corporate "Freeze-out" Tactics

One of the many things that now out-going SEC Chairman Christopher Cox indicated that his agency's staff would look into and fully intended to 'tackle' was the problem of company's freezing out analysts that wrote negatively about the company, a goal which remains unmet. As David Weild IV, a former official at Nasdaq, notes, analyst freeze-outs remain "the rule rather than the exception."[25] Such freeze-outs have a negative impact on the firm's ability to deliver access to senior management, something which the buy-side are increasingly wanting. It also reduces the analyst's knowledge of sensitive news.

***Regulators should require all research firms, as a condition of their license to operate, to report companies which do this. Firms that do not report such freeze-outs should be fined.*** Such action would soon expose company management who take these decisions to scrutiny from board directors, media and investor scrutiny: bullying is harder in the open. In advance of such regulation, investor trade associations could play the same role but as always with voluntary whistle blowing initiatives, they will not be adequate in all countries and in all situations, so hence the need for regulatory action. What, for example, would a trade association do if it had to embarrass one of its own powerful members?

## 11. Post-Script on the Real Purpose of Regulation

Regulation cannot change culture by itself but it can trigger governance changes within organisations and between clients/suppliers. What is needed is a 'nudge' approach to regulation which triggers new behaviours.[26]

For instance, promoting disclosure of comparable buy:hold:sell ratios would cause management to be interested in their relative performance on this issue and to monitor this indicator over time. As part of a balanced scorecard approach, it could lead to greater introspection and accountability than there has been to-date, not least because clients, and potentially regulators could ask outliers to explain. And it provokes a TQM Improvement approach by harnessing market forces. For example, the average buy:hold:sell ratio is about 49:39:12 [27]. It is unclear why any house should think there are more buying opportunities than selling, and it is even more unclear why all houses should think this. Transparency and competition could well bring the ratio to more what it should be if long-term investment is the primary purpose of markets – namely mort holds and equivalent numbers of buy and sell.

This is just one example of how well crafted regulation can result in behaviour and culture change. That change has to be grounded in a new way of working which has many dimensions including: a different, more discerning type of board director; design of compensation which places greater focus on the longer term and on risk; stronger human capital management culture[28] – put simply, a greater focus on an integrated approach to sustainable financial markets.[29] The ideological 'voluntary only approach' has been singularly ineffective in general and particularly so in terms of the market failures in investment research supply.[30] So too has old style punitive regulation. It is high time we learnt to use regulation more effectively and more quickly. Given the future role of Cass Sunstein in regulatory cost-benefit analysis in the US[31], there are grounds for optimism that these three proposals could soon be put into effect, especially if asset owners and opinion-shapers make clear their support and regulators take a longer-term and systemic approach to evaluating costs and benefits and learn the lessons of regulatory capture.

## Notes

1 The authors are participants in the Network for Sustainable Financial Markets www.sustainablefinancialmarkets.net and are writing in their private capacity. Please send feedback to jamieroger.stevenson@virgin.net
2 Global investment banking revenue estimates vary between US$42bn and US$83bn. Even if only 10% is spent on equities research, this amounts to between US$4bn and US$8bn annual global research spend.
3 Examples of significant missed turning points include widescale earnings manipulation in the 1980s, dotcom bubble in the 1990s, Enron and other off-balance sheet scams, BP's safety exposure, dividend cuts in the early 1990s and now again in 2008/9, bank balance sheet failures etc
4 Are security analysts fashion victims? The Core Competence Case, Ann-Christine Schulz and Alexander Nicolai, University of Oldenburg, 2008
5 New York State Attorney General Eliot Spitzer agreed to drop cases against major Wall Street banks for fraudulent research in return for $1.5bn fines and agreements to separate research functions more clearly from trading and corporate, and to make more transparent statements about conflicts of interest
6 What's the future for ESG broker research, Hugh Wheelan, www.responsible-investor.com, 22/12/08
7 Sell side firms who closed their ESG units in 2008 include Citi, Deutsch Bank and JP Morgan.
8 Are security analysts fashion victims? The Core Competence Case, Ann-Christine Schulz and Alexander Nicolai, University of Oldenburg, 2008
9 "It is a truth universally acknowledged that a single man in possession of a good fortune must be in want of a wife." Opening lines of Pride and Prejudice, Jane Austen (1821).
10 "Study reveals cosy relations between chiefs and analysts", Financial Times, Francesco Guerrera, Ben White and David Wighton (27 July 2007)
11 Immortalised in the telephone reply to former New Statesman editor John Kampfner from Tony Blair's communications director Alistair Campbell, "Shut up and take this down, if you want any more from where this is coming from."
12 See for example, Keith Ambachtsheer's work on "Integrative Investment Theory", Andrew Lo's work on "Adaptive Markets Hypothesis", Woody Brock's work on "Endogenous Risk", Avinash Persaud on new risk thinking.
13 The CFA Institute has always had a focus on personal ethics, although this personalised approach may have hindered focus on the systemic faults. CFA has broadened its focus to include corporate governance analysis and has further expanded this by considering compensation and ESG analysis: http://www.cfainstitute.org
14 The EFFAS has set up a commission on ESG which is seeking to define key indicators and also produce a training programme: http://www.effas-esg.com/
15 The Flight of the Sell-side Analyst, Marie Leone, www.cfo.com (8 July 2004)
16 Analysts' perspectives on the materiality of voluntary narratives in annual reports. Dr David Campbell, & Richard Slack, ACCA (November 2008)
17 Joseph Fuller and Michael Jensen: "End the Myth-Making and Return to True Analysis," The Financial Times (22 January 2002)
18 *Business Leadership in Society", M Blowfield & B K Googins, The Centre for Corporate Citizenship, Boston College, October 2006
19 Robert Kuttner, Business Week, (May 2003)
20 Other key drivers have been the voting surveys like Institutional Investor and Thomson Extel (which define bonuses)
21 Quote from Keith Ambachtsheer in Pension funds could show the way, Pauline Skypala, Financial Times, (4 January 2009)
22 A Tame Regulator for the SEC, Robert Kutner, www.prospect.org, (18 December 2008)
23 The Changing Value of Investment Research, Integrity Research, (29 July 2007)
24 The precedent has been set in recent Government/Finance sector discussion in many countries. For example, according to Bloomberg, the Federal Reserve gave U.S. futures exchanges less than a week to present written plans on how they would make the $55 trillion credit swaps market less risky (28 October 2008).
25 Coming Distractions, John Goff, www.cfo.com (1 April 2006)
26 http://www.nudges.org/
27 Unpublished analysis, Shaunak Meweda, AXA IM (2008)
28 It is almost unimaginable that McKinsey reports – accurately in the authors' experience – that banks face a talent shortage! Given the compensation packages paid, this highlights the huge weaknesses at the core of the sector's approach to sustainable value creation: A Talent Shortage for European Banks, McKinsey & Co Quarterly, July 2008
29 www.sustainablefinancialmarkets.net
30 Self-Regulation Means No Regulation, William Buiter, Financial Times (10 April 2008)
31 The Sunstein Appointment: More Here Than Meets the Eye, www.progressivereform.org, (9 January 2009)

## About the Authors

Jamie Stevenson worked for over 20 years as an Equity Research Analyst and Manager in the City of London. For ten consecutive years between 1988 and 1997, he was voted number one Building Materials Analyst in all four major investor surveys (Extel, Reuters, Institutional Investor and Greenwich). Between 1997 and 2003, he was Head of Equities Research for Dresdner Kleinwort Wasserstein. Jamie is now a part-time Teaching Fellow at the Xfi Centre for Finance and Investment at Exeter Business School, and a Director at both the building contractor Interior Services Group plc and Norcros plc.

With a career beginning as a research scientist in aerospace (rocket science) and computer graphics which led him to starting companies in seismology, cartography and energy information, Professor Michael Mainelli FCCA FCSI co-founded Z/Yen, the City of London's leading commercial think-tank, in 1994 to promote societal advance through better finance and technology. Michael is also Professor Emeritus of Commerce and a Fellow at Gresham College and visiting Professor at the London School of Economics Department of Management Information Systems & Innovation Group.

Raj Thamotheram is a thought leader in the field of long-term and responsible investment and has held senior positions in the City, starting at the Universities Superannuation Scheme before moving to AXA IM where he helped launch the AXA WF Framlington Human Capital Fund. He has been nominated twice (by Global Proxy Watch) as "one of the 10 most influential figures in the corporate governance field", most recently for his role with the Network for Sustainable Financial Markets. He is currently completing a book, Preventable Surprises, and launching a network for 'positive deviants'.

This paper has been prepared by the authors as individuals and not as representatives of any entity or organization. Affiliations are given only for identification purposes.

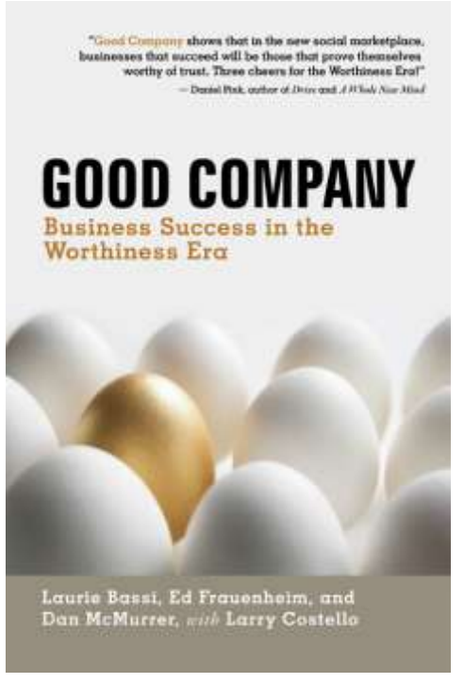
Information about the Network for Sustainable Financial Markets is available at www.sustainablefinancialmarkets.net.

> “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.”

**Henry Mintzberg: No more executive bonuses! Wall Street Journal, November 2009**

# BOOK REVIEW: "GOOD COMPANY"

Anna Lloyd




HubCap says: Our Director has a long-standing friendship with Laurie Bassi and has nothing but admiration for her work. We felt it was important to draw attention to this new book here, and to wish it well.

Good Company: Business Success in the Worthiness Era.
by Laurie Bassi, Ed Frauenheim, and Dan McMurrer, with Larry Costello
San Francisco: Berrett-Koehler Publishers, Inc, 2011

This is an optimistic book. It describes how companies can, do, and will change for the "better" – as employers, sellers, and stewards – and also do better financially while they are about it. While there will inevitably be nay-sayers and setbacks along the way, the authors put forward the view that the improvements are, in the long term, both inevitable and unavoidable for companies if they are to prosper, for there are implications for their financial success and indeed their very survival if they take no heed.

The book is packed with references in support of its points, while the few opposing views or pieces of contrary evidence mentioned are countered. Whether the readers are from business, journalism, investment, academia, government, or the general public, they will find a wealth of convincing evidence, from reputable sources, that companies do well by being good. The sheer number of references to research in support of the book's argument build up a convincing and 'hope*full*' (authors' emphasis) case.

There are four sections, each of two to four chapters, and 11 chapters in total. Each chapter is followed by a useful summary.

The four chapters making up Part I, 'The Worthiness Era', define worthiness and good companies, and why both are becoming more important in the current economic, social and political climates.

Part II provides the central body of evidence that shows why goodness matters, and chapter 6 in particular might be regarded as its main feature; it describes the Good Company Index (a trademark of McBassi and Company, Inc.), an objective system of ranking companies as employers, sellers and stewards. Not only does this index identify which organizations are already behaving as good companies and which have a long way to go, but the intention is to also track progress in the years ahead. Initial work has used multiple sources of readily-available information to index the 94 publicly traded companies in the US's Fortune 100, and there are plans to expand this to a much wider range of companies – see the Good Company Index website for up-to-date information.

Part III of the book explains, with striking examples, how companies can become good employers (chapter 7); good sellers (chapter 8); and good stewards (chapter 9). Part IV provides an outlook – and hope – for the future.

There are extensive notes and references for further reading, and the Appendix provides scoring and sources for the Good Company Index.

A thoroughly recommended book.

# THE PUBLISHERS

The third HUMAN CAPITAL HANDBOOK 2011 is part of a continuing series, some free and some by subscription, of specialist publications on all aspects of human capital measurement.

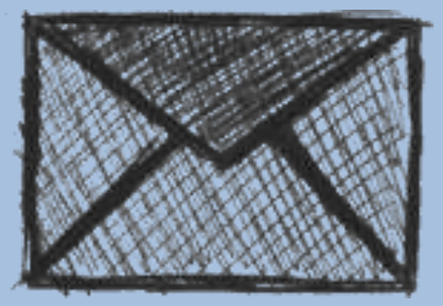
It is sponsored by HUMAN POTENTIAL ACCOUNTING (HPA), a UK leader in HCM analysis and research that helps business leaders and financial analysts assess the sophistication and maturity of companies' human capital or talent management strategy and practices.


The series is published on the HPA sponsored interactive library and discussion platform, HubCap, where a further 150+ articles by leading academics and business leaders can be freely accessed. It is also available on the dedicated Handbook microsite.


Handbooks blend heavyweight articles, some specially commissioned, some republished or extracted with permission, together with cartoons, illustrations, soundbites and linked snippets designed to enrich the collection, encourage further reading, or just have some fun along the way. They deliberately avoid repeating received wisdom, preferring to lead and bolster calls for change, debunk prevailing assumptions, and shine lights into areas of much needed future enquiry. But they are also designed to accelerate the exchange and application of practical HCM insights between business and academia: they are Handbooks after all.

If you would like to contribute, please email editor@hubcapdigital.com

## Comments about previous Handbooks



# SHARE

email the Handbook link

# ENGAGE

discuss this ebook on HubCap