Management Focus

essential management knowledge for today's leaders

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Welcome to Management Focus

… and welcome to the second edition of 2014

Allocating rewards in a systematic manner is crucial to ensure that employees perceive **pay decisions** as fair and equitable. However, what constitutes a fair pay decision may depend on a multitude of factors. Find out more in our latest issue of ***Management Matters***.

There is a view that **big is wasteful** to some degree. One sees this assumption in all realms of human activity. People buy small cars as they believe larger ones must be less efficient; they buy smaller fridges so as not to waste space. But is **smaller always better?** There has been considerable focus on this thinking in terms of corporate strategy in recent years, particularly in the face of **challenging market conditions** in the wake of the global financial crisis. The **urge to downsize** is of course strong for firms facing these testing times, but there is also a concern that **too many assumptions** are made that simply reducing an operational footprint and lowering a cost base will simply lead to a leaner, more efficiently run business. Our featured article looks at the **"downsizing = efficiency" myth**.

In today's business environment, **change is commonplace**. Volatility is considered "business as usual". And yet, our thinking around strategy remains rooted in an era of stasis and stability. According to Rita Gunther McGrath, **a new playbook is required**, one that throws off the shackles of conventional wisdom, allowing more malleable practices to come to the fore. Rita is a renowned expert on **strategy in uncertain and volatile environments**, and she has written numerous books and articles on the subject. Find out more in our **interview with Rita Gunther McGrath.**

Remember, log on to our website at: **http://first.emeraldinsight.com** to expand on the topics highlighted in this issue of *Management Focus*.

Best wishes,
Debbie Hepton

Contact us

Editor: Debbie Hepton
dhepton@emeraldinsight.com
http://twitter.com/#!/EmeraldEMF

Customer service: emf@emeraldinsight.com

Tel: +44 (0) 1274 777700
Fax: +44 (0) 1274 785201

Address: Emerald Management First
Emerald Group Publishing Limited
Howard House
Wagon Lane
Bingley BD16 1WA
United Kingdom

Management Matters

Incisive commentary on topical business issues

Pay for performance or need – what is fair?

Allocating rewards in a systematic manner is crucial to ensure that employees perceive pay decisions as fair and equitable. However, what constitutes a fair pay decision may depend on a multitude of factors.

Research in cross-cultural psychology suggests that culture can influence what is perceived as a fair pay allocation system. In collectivistic cultures, values of interdependence and in-group harmony generally facilitate a preference towards equality or need-based reward allocation. Conversely, in individualistic cultures, pay-for-performance systems are implemented with the express goal of allocating rewards according to the equity principle or based on performance.

However, differences between individuals within a culture account for a greater portion of the variation in value systems than differences between countries. Indeed, a wide variety of studies have demonstrated that individual, contextual and organizational factors have a greater influence on the values governing reward allocation decisions than the prevailing culture norms, such as the prevalence of the equity principle in collectivistic national cultures or the use of need to allocate rewards in individualistic national cultures. These factors may, in turn, influence perceptions of fairness regarding the way decisions are made or rewards are allocated.

Implications for society

The question of how rewards are allocated within organizations remains today. Evidence demonstrates that the relationship between employee need and reward allocation is only present when an employee frequently communicates with their manager about those needs, such as a sick family member. Therefore, employees who are struggling or wrestling with illness, emergency situations, or difficult family care issues, should express their personal and family circumstances at work.

However, employers are faced with serious considerations in an era of health care reform where the implications of employee health issues are not fully known. Furthermore, with fewer resources, employees are being asked to do more with less, exacerbating stress levels and increasing the likelihood of employee need.

For many organizations, close to 23 per cent of payroll is spent on employee health and absence. In a less favourable economy with the highest proportion of long-term unemployment on record in fifty years, it is timely to try and understand how employee need relates to allocation decisions.

As a result of job losses and foreclosures in the current economy, more employees are facing situations where they are expected to take on domestic responsibilities, not only for the traditional nuclear family, but for extended family members as well. For example, according to a recent analysis of census figures from the Pew Research Center, over the past 30 years, there has been a 33 per cent increase in the number of multi-generational families living together in the USA.

"For many organizations, close to **23 per cent of payroll** is spent on **employee health** and **absence**."

Besides performance, need is an important basis for allocating rewards in Western organizations. By understanding the factors and values that lead to decisions in the allocation of rewards, we are able to expand the complexity of the performance-reward model as well as position organizations to better respond to their employees' expectations.

These expectations may ultimately change the norms and formal policies that govern even the most individualistic organizations.

This excerpt is taken from "*Organizational rewards: considering employee need in allocation*", which was originally published in *Personnel Review*, Volume 43, Number 1, 2014.

The authors are Jillian Webb Day, Courtney L. Holladay, Stefanie K. Johnson and Laura G. Barron.

To downsize or not to downsize

Does reducing activities actually improve firm performance?

There is a view – which one could almost call human nature – that big is wasteful to some degree. One sees this assumption in all realms of human activity. People buy small cars as they believe larger ones must be less efficient; they buy smaller fridges so as not to waste space; they move to a smaller house when they are older so they are not "rattling around" in too big a house.

But is smaller better? If you need a car to carry large numbers of people around, then it may not be fit for purpose. A small, but overloaded and cheaper fridge can use more energy than a larger, more sophisticated model. And while a larger house with empty rooms might feel wasteful, this is more due to a mindset than anything else; if you want space in your home, why do you need a cosy little cottage if you can afford the detached house with cinema room and sauna?

Big isn't best

There has been considerable focus on this thinking in terms of corporate strategy in recent years, particularly in the face of challenging market conditions in the wake of the global financial crisis. The urge to downsize is of course strong for firms facing into these testing times, but there is also a concern that too many assumptions are made that simply reducing an operational footprint and lowering a cost base will simply lead to a leaner, more efficiently run business.

This concern was shared by two academics in Tawain, Philip Cheng-Fei Tsai and Chih-Ting Shih, whose article, "Responsible downsizing strategy as a panacea to firm performance: the role of dynamic capabilities" (2013), not only looks at the "downsizing = efficiency" myth, but also at what does make a difference when firms do see efficiency gains when they reduce activity.

> "There is a view – which one could almost call **human nature** – that **big is wasteful** to some degree"

Responsible, but dynamic

Two theories at the heart of the investigation encompass what at first sight seem to be opposing forces. On one side there is what has become known as "responsible downsizing", which relates to the measured approach taken by some firms in cutting staff and their activities. This includes an acknowledgment that the strategy is not merely to simply cut costs, but to increase the value proposition to customers through improving overall company performance and taking care of affected employees during the downsizing period.

One aspect of this process is how existing human resources are reconfigured; and their ability to be reconfigured in order to not just improve performance, but also create competitive advantages for the organization. These so-called "dynamic capabilities" will at some stage come into play when firms decide to downsize, and as a result have to restructure their organizations. The question is: do they do this knowing where efficiency gains will be made as a result of better resource management of duty amid capabilities, or just because they believe that smaller is better?

Proof positive

In order to test these ideas, the authors took data from over 150 firms in Taiwan which had undergone some form of downsizing in recent times. Then, information on the dynamic capabilities of the firms was assessed, alongside results of responsible downsizing and, crucially, firm performance over the relevant timescales. The results are quite clear:

- If a firm adopts a genuinely responsible downsizing strategy, it will improve the overall performance of the firm.
- The dynamic capabilities of a firm will relate directly the responsible downsizing strategy and the firm's performance.
- Over half of the improved performance of a firm is directly attributable to responsible downsizing.

It is important to note, however, that these results should not give license for firms to slash overheads safe in the knowledge that with a little lip service paid to their employees who are affected directly by such moves, they will improve company performance.

What the study shows is that a firm should learn to identify and assess the dynamic capabilities of their workforce, and continuously invest in it to improve flexibility and ability to adopt change, so that when the time is right for a downsizing strategy, the workforce will move forward with the firm, rather than be left behind.

People first

It has long been asserted by some that such a people-centric strategy human resource management (SHRM) focus will have considerable benefits for the medium to long term sustainability of firms, and has been used to persuade organizations to lose short-sighted notions that such investment in their workforce does not provide a satisfactory return on investment. Such people-oriented policies are also often first in line to be cut when economic factors provide a downturn in business, and yet as we have seen they should be the very strategies that are kept in place to back up any downsizing strategy when it is implemented.

> "If a firm adopts a genuinely **responsible downsizing** strategy, it will **improve** the overall **performance** of the firm"

The authors also note that among several key implications for managers, they should think in a more open, interdisciplinary way when it comes to downsizing. Rather than a cost-cutting, or even workforce training exercise, it should be regarded simply as part of effective resource management practice. One aspect of this, which if for firms themselves to respond to, is how they assess internally exactly what their dynamic capabilities are, and to what extent they can be improved. Different firms in different industries will have a wide range of these capabilities, and only when they truly understand them and how they can be enhanced will they improve their ability to create major efficiencies when choosing to downsize. Indeed, one downsize does not fit all

This is a shortened version of "*Responsible downsizing strategy as a panacea to firm performance: the role of dynamic capabilities*", published in the *International Journal of Manpower* Vol. 34, No. 8, pp. 1015-1028, 2013.

The authors are Philip Cheng-Fei Tsai and Chih-Ting Shih.

How sustainable competitive advantage may be a thing of the past

An interview with Rita Gunther McGrath

Interview by: ***Gareth Bell***

Rita Gunther McGrath is a professor at Columbia Business School and a renowned expert on strategy in uncertain and volatile environments. She has written numerous books and articles on the subject, the most recent of which, *The End of Competitive Advantage: How to Keep Your Strategy Moving as Fast as Your Business*, is available now through Harvard Business Review Press.

In today's business environment, change is commonplace. Volatility is considered "business as usual". And yet, our thinking around strategy remains rooted in an era of stasis and stability. According to Rita Gunther McGrath, a new playbook is required, one that throws off the shackles of conventional wisdom, allowing more malleable practices to come to the fore.

Q Your new book, The End of Competitive Advantage, promises to be a "new strategy playbook". Could you explain why this is the case?

A lot of ideas in strategy come from a time when things were more stable. Also, the intellectual heritage of strategy, in the academic world, is economics. Economics assumes periods of equilibrium as the base state and everything else is an aberration. A lot of the industries in which strategy was first developed are relatively slow-moving, asset-intensive industries.

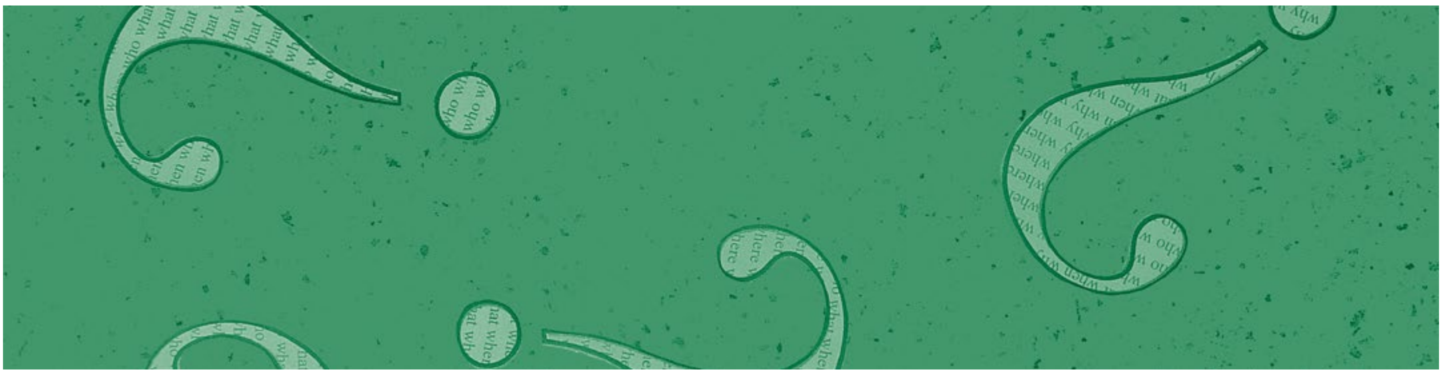
The kind of strategy work developed at that time was based on analytics, and the importance of market share. The trouble with that is a lot of sectors in which companies are forced to compete today simply don't have those conditions, so we see competition moving much faster, we see temporary and transient advantages becoming more the norm, we see industries competing with industries, all of which means we need a new playbook for thinking about strategy. My argument is that surely strategy should have something to say to non-stable, volatile industries where there isn't a lot of market share to count on.

> "We now understand that you **can't leave innovation out of strategy** in today's environment or you're going to **get left behind**."

Q You suggest that the idea of sustainable competitive advantage is out-moded, and that companies should organize to take advantage of waves of transient advantage instead. How did you arrive at this conclusion?

It's the product of years of looking at pieces of the problem. When I first started in strategy I was mainly an innovation person – at that time strategy was seen as north and innovation as south, and never the twain shall meet. Strategy was all about industry analysis, and proxies for market share and growth rates. Innovation was unpredictable, coming up with new things, and thinking of things that were highly uncertain. Over many years of work, those two worlds have converged.

We now understand that you can't leave innovation out of strategy in today's environment or you're going to get left behind. I began by putting together pieces of the problem, and the ideas eventually synthesized themselves in this book. You need to think about innovation as much as disengagement, you need to think about where your next advantage will come from, even as you're pulling resources out of old advantages, and you need to have different investment logic. You can't just be thinking about net present value; you also have to be thinking about option value



Q The transient-advantage economy seems to give rise to companies with transient assets, people with transient careers. What does this mean from a talent management point of view?

For me there are two facets to this: talent development at a personal level, and talent management at a firm level.

First, a huge premium will be placed on people's networks – networking has always been important, but this importance will radically increase, because it will be one of the few things that last. I also think the premium on skills will be significant – do you have a diversity of skills, do you have personal options, so that if one avenue fades away you have other things you can deploy? At a personal level, it is almost like each of us has to be our own entrepreneur – you're going to have to be continually creating opportunities for yourself because there is no guarantee an organization is going to do it for you.

> "You need to **think about innovation** as much as disengagement, you need to think about where your next advantage will come from, even as you're **pulling resources** out of old advantages, and you need to have different **investment logic**."

Talent development at a firm level gets really interesting, because you have two kinds of talent to consider: those whom are perceived as the "core" talent, and those outside of the core.

Core talent is that which you want to keep, preserve and nurture for the future. In the book I place huge emphasis on providing executive education and developmental opportunities, ensuring people feel deeply connected to the firm.

Then, unfortunately, you have the dilemma of all those people you may or may not think are critical to the future of the firm. Unfortunately, a lot of firms are beginning to treat those people as disposable talent. I think our society has not yet cracked that second problem, because we currently don't have any sanctions in place for companies who just hire and fire, and treat people as though they are units of production.

I don't have an answer for that at the moment – perhaps that'll be the next book. It is a huge issue, because many of our systems in society are premised around the idea that firms are going to last for a long time – the tax system for example. In most countries you have progressive taxation, which applies to the income you make over a year. If your income one year is $100k, $20k the next, and $170k the year after, the whole principle of graduated taxation and progressive tax begins to fall down. There are a thousand systems and processes like that, that embed into them this notion that organizations are going to be relatively enduring, and that we're going to be able to use them to tackle many of the issues that societies need addressing.

Q What do you see as the future of strategy?

The first thing we need to do is get clear about our boundary conditions. There are still places where the old rules and ideas apply, but there are many places where they don't.

We need a different set of lenses for thinking about how we want to compete strategically. We're going to have to start thinking about pattern recognition and intuition as valid approaches. You're never going to analyse your way to a complete solution – you're going to have to look at weak signals, at early warnings, and think about what patterns really matter in this particular context, and you're going to have to do that fast.

In a way it opens up strategy to a whole lot of new ideas. For example, by combining neuroscience and strategy we're starting to think about how our brains work when presented with certain types of information, how that either enhances or detracts from our ability to make intelligent choices. For me, we really haven't had a new big idea in strategy since the introduction of the resource-based view of the firm. This could possibly open up a whole new area for strategy thinkers to explore.

This is an abridged version of "*The end of the strategy world as we know it?: Rita Gunther McGrath on how sustainable competitive advantage may be a thing of the past*", which originally appeared in *Strategic Direction*, Volume 29, Number 8, 2013.