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Manager Update

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Manager Update helps the general manager keep abreast of the latest articles in specialist management journals. The most useful ideas in the fields of strategy and organisation, marketing, accounting and finance, and human resources management are carefully selected from a wide range of publications with the busy general manager in mind.

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The euro zone and the corporate debt market

The European Union has recently expanded to include many former Eastern Bloc countries. This has led to a decrease in average gross domestic product (GDP) per capita, but an increased overall market. Here, **Roger Mills**, professor of accounting and finance at Henley Management College, explores the consequences of this expansion, with a particular focus on the corporate debt market.

On 1 May 2004, 10 new countries acceded to the European Union (EU). The entry of Estonia, the Czech Republic, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia as well as Cyprus and Malta, increases the number of member states by 66% and the population by 20% (to 447 million). The area's GDP, though, will rise only 4.4% and the average GDP per capita will actually fall by 13%.

Nonetheless, the Economist Intelligence Unit 'CEO briefing – corporate priorities for 2004', among others, commented on the significance of the event:[1] "The absorption of the new members will have several longer term consequences. Purchasing power in the accession countries will rise and business environments will improve. Procurement tenders will become more transparent and spending on infrastructure projects will rise. Labour costs are likely to increase, as will competition. In short, swathes of Central and Eastern Europe will lose the tag of emerging markets".

It is, though, unlikely that there will be a huge rush of investment into Eastern Europe because of accession, as most businesses interested in the potential of enlargement are already there, while various tax breaks for foreign investors ceased on accession. For example, investment surged after the EU's commitment to enlarge in 1993, and also when Latvia, Lithuania and Slovakia started belated entry negotiations in 2000.

Annual investment flows to Eastern Europe more than doubled between 1996 and 2000, to over €22 billion. At over 20% of fixed investment and 4% to 5% of GDP in Poland, Hungary and the Czech Republic, foreign investment levels are already quite high in these countries. Clearly, though, EU accession will ensure that foreign interest continues, even as privatisation programmes in countries such as Hungary have waned.

Enlargement creates a new set of motives in favour of investment in Eastern Europe compared with other global locations including:

EU enlargement creates a new set of motives for investment in Eastern Europe

- reduced risk through a certain level of political and macroeconomic stability;
- lower transaction costs through creating a business environment that is similar to other EU countries and removing remaining trade barriers; and
- opening up of a market of 450 million people, changing the potential of any specific production location.

The prospective impact of monetary union is one important issue that has attracted controversy in recent times and has implications for the new accession countries. Two influential reports have claimed that the single currency has not encouraged either fiscal prudence or attracted extra investment to the region. The first, the World Economic Outlook by the International Monetary Fund, criticises the EU's so-called Stability and Growth Pact because its rules were flouted repeatedly by France and Germany and it has all but collapsed. By all accounts, the pact's strict rules may have perversely encouraged just the type of behaviour it was designed to counter.

Prospective euro zone states practised fiscal restraint in the 1990s

Prospective euro zone states practised fiscal restraint in the 1990s to secure membership, but started to run deficits after the currency was introduced in 1999.[2] The second report, by the United Nations, showed that the introduction of the euro had not led to the hoped-for investment by foreign companies into the euro zone.

Development of corporate bond market

Nevertheless, some commentators say the euro's introduction has boosted the integration of the national markets for corporate bonds, helping them gain in depth and liquidity. Put simply, corporate bonds are debt obligations issued by corporations and are an alternative to offering stock to raise money. Like the majority of municipal bonds and treasury bills, most corporate bonds promise to return their principal when they mature and also pay semi-annual interest. Maturities typically range from one to 30 years. A corporate bond is, then, like an IOU the company gives to an investor when it borrows money. Owners of these IOUs receive fixed interest payments from the borrowing corporation until the IOU is redeemed at the date of maturity.

A corporate bond is like an IOU which a company gives to an investor when it borrows money

The euro's introduction and the integration of the national bond markets has had a marked effect on some corporations in member states. According to the Deutsche Bundesbank, many German non-financial corporations have obtained an increasing amount of their funding through issuing corporate bonds since the euro's introduction. Since the launch of monetary union, there has been a six-fold increase in the German corporate sector's volume of debt securities (including money market paper) outstanding in the euro area.

Among the larger European economies, this dynamic growth has been outpaced only by Italy. However, in terms of their volume, the German and Italian corporate bond markets were long overshadowed by those of other European countries. And, even though German enterprises' combined outstanding amount of bonds has increased to €3,143 billion (September 2003), in relation to GDP (6%) it is still considerably lower than in the US or France where bonds have long played a significant role in corporate financing. Recently, US and French non-financial enterprises' outstanding volume of bonds and money market instruments was equivalent to around one-quarter of their GDP.

The euro has opened up investment opportunities for international institutional investors

The euro's introduction also opened up new investment opportunities for international institutional investors (like investment funds and insurance companies) as it meant the abolition of earlier contractual or statutory restrictions on their involvement in foreign debt markets. Some temporary factors have also recently helped to make corporate bonds more attractive. One was the switch by life insurance companies and pension funds to bonds from equities, leading to great demand for such paper. Lower yields in the market for government bonds have also encouraged investment in more risky corporate bonds which pay higher interest.

As well as the stimulus provided by the euro's introduction, the technology boom of the late 1990s also resulted in a marked increase in the financing needs of the large listed companies, particularly those in telecommunications. This trend was reinforced by the concurrent wave of corporate mergers and acquisitions and following the slump in share prices in 2001, the market for corporate bonds benefited once again from investors switching to investments promising a higher yield.

Factors determining market developments

Theory of mixed financing

Unlike bank loans, issuing debt securities is associated with high fixed costs, such as preparing the prospectus and a 'road show' presentation for institutional investors. For that reason, such financing is mainly considered only by larger businesses requiring a significant amount of cash – smaller firms may simply prefer a bank loan.[3]

Bonds and bank loans aren't just different in cost. There are major differences between the two forms of financing in the event of, say, insolvency or restructuring. If, for example, there is a small number of creditors, it is easier for enterprises to adjust the terms and conditions of lending. Thus, negotiating with a few banks is much easier than holding talks with a large number of bond holders in the event a company is unable to service or pay back its debt.[4]

On the one hand, the possibility of subsequent renegotiation may be advantageous for both sides if this avoids the liquidation of the enterprise. On the other, the debtor might anticipate this and adjust his investment behaviour to the detriment of the lender, ie through making riskier investments. In this context, a mixed use of bank loans and debt instruments may be interpreted as a deliberate self-commitment on the part of the enterprise to restrict the possibility of renegotiation at a later date.

Another approach assumes that, owing to their regular contacts with the debtor and the ongoing monitoring of credit, relationship bankers have better information on their debtors than holders of debt instruments. Holders of debt instruments can dispose of their paper comparatively easily in the event of deterioration in the debtor's credit rating. Despite any price losses, they therefore have less incentives to monitor the borrower carefully than banks, who can only sell their loans on with difficulty.

Moreover, in relationship banking, the financial standing of the debtor has to be monitored only by one institution rather than by each investor separately. This advantage, which is especially relevant to small and medium-sized enterprises, is counterbalanced by the drawback that the intensity of competition is reduced by a fairly strong linkage between the bank and the enterprise.[5] This ultimately strengthens the banks' negotiating power. Consequently, enterprises may try to optimise this conflict of aims by means of mixed financing. This is also apparent in corporate financing reality, which is typically characterised by the use of differing financing instruments.

Structural determinants
The expansion of the market for corporate bonds over the past few years was due, in particular, to the financing behaviour of fairly large companies which have made increasing use of the bond market as an alternative to bank loans and internal financing. This has been facilitated by the complete liberalisation of capital transactions in all countries of the EU, as well as by the fact that there is now no exchange-rate risk following the introduction of the euro, with the earlier segmented markets of the various countries participating in economic and monetary union having become integrated.[6]

For the enterprises, the expanded and, therefore, more liquid market opens up the opportunity to place even large volume issues on favourable terms and conditions. Furthermore, there are indications that the direct issuance costs have fallen owing to keener competition among the investment banks after monetary union.[7] The increasing risk orientation in banks' lending business, too, is likely to have an impact on the market for corporate bonds. The ongoing development of the prudential regulations and especially the planned new Basel Accord (Basel II) have led to the banks improving their procedures for measuring and controlling credit risks. In turn, this has resulted in a more risk-appropriate pricing of loans. As a result, particularly for larger enterprises, there is greater substitutability – and therefore competition – between bank loans and debt issuances.

Finally, the liberalisation of important markets outside the financial sector has also left its mark on the market for corporate bonds. Deregulation in the case of many European enterprises, first and foremost in the telecommunications sector, led to the emergence of a large borrowing requirement that was partially covered by the issuance of bonds.

Deregulation led to the emergence of a large borrowing requirement

Temporary factors
Furthermore, temporary factors have also played a part in the past few years. For example, prior to 1998, German enterprises financed themselves predominantly through retained profits and write-downs, ie internally. Amid the 'technology boom' however, the demand for external funds increased as companies sought financing for mergers and acquisitions and the purchase of universal mobile telecommunications system licenses, stimulating the issuance of corporate bonds by German companies.[8] Acquisitions were not always financed directly by the issue of bonds and, indeed, it was often the case that banks first granted bridging loans.

When equity markets were buoyant there was little incentive to issue corporate bonds, but the weak equity market of the past few years appears to have encouraged the corporate sector. The reality is that this has to be viewed alongside other forms of financing, insofar as borrowing via the bond market offers enterprises an additional option for raising capital.

When equity markets were buoyant there was little incentive to issue corporate bonds

Rating agencies
The role of the rating agencies cannot be ignored when reviewing the development of the corporate bond market, because of their assessment of the default risks and the cyclicality of yields in the secondary market. Both of these have a crucial impact on corporate financing conditions. Excessive yield fluctuations of corporate bonds which clearly go beyond movements in the general interest rate level – plus a premium for the higher credit risks – may lead to over-investment at times when yield premiums are very low and

to under-investment at times when yield premiums are very high. Compared with a financial system which is dominated by relatively steady lending by relationship bankers, a purely market-based system of corporate financing might lead to major fluctuations in borrowing and, ultimately, in real investment as well.

Rating agencies have assumed a more prominent role in the assessment of creditworthiness

In Europe as a whole, rating agencies have clearly assumed a more prominent role in the assessment of creditworthiness since the late 1990s. Their judgement influences not only the investment decisions of potential investors but also the enterprises' decision to issue bonds. That is because the assessment by the rating agencies is reflected in the financial incentive an issuer has to offer and thus influences total financing costs. For example, between April 2002 and January 2004 the average interest rate premium of European corporate bonds with a maturity of seven to 10 years in the highest (AAA) rating grade (compared with government bonds of the same maturity) was around one quarter percentage point.

By contrast, enterprises placed in the lowest investment grade (BBB) had to pay an average interest rate premium of roughly one and three quarter percentage points. Clearly, the interest rate premiums are even higher for issuers who aren't classified as investment grade. For example, taking the average of the past two years, a 'C' rating implies companies must pay a premium of more than 20 percentage points to compensate investors for the higher default risk. Just less than 90% of the corporate bonds outstanding in Europe assessed by Moody's rating agency were classified as investment grade.

Individual enterprises' rating assessments are quite stable over time

Interestingly, individual enterprises' rating assessments are quite stable over time and the long term probability of an enterprise in the Moody's rating category 'Aaa' being downgraded within the space of one year is just over 9%. For a grade 'B' enterprise, the probability of a downgrading within one year is slightly more than 12%. The relative consistency of the rating is the result of the rating agencies' attempt to assess the enterprises, as far as possible, independently of the business cycle (rating through the cycle). Across nearly all rating categories, downgrading was more likely than upgrading.

This may reflect a certain selection process, ie that it is mainly 'good' enterprises which issue bonds or that enterprises choose a point in time to launch a bond issue when they are given a good rating by the agencies.

Despite the medium term orientation of the rating agencies in the business cycle, there are noticeable fluctuations in the ratio of downgrades and upgrades. For instance, the relationship between the number of downgrades and upgrades in periods of economic slowdown tended to be higher (such as in 1993 or after 2000). In periods at the top of the economic cycle, upgrades sometimes exceeded downgrades. In relation to the total number of bonds assessed, the number of rating changes was nevertheless very small. The cyclicality of the default risk assessments therefore affected only a small percentage of corporate bonds.

Irrespective of changes in the rating assessments, there were noticeable fluctuations over time in the interest rate premiums for bonds of certain rating categories. For European enterprises rated BBB, this premium was far more than two percentage points at times in 2002, but the figure had fallen to below one percentage point at the end of 2003. The decline in yields in the case of high-interest debt instruments with a high default rate was even more marked. The interest rate premium of C-rated European bonds declined from over 30 percentage points in 2002 to less than ten percentage points the following year.

The high yield bond market

The pace at which the corporate bond market has grown has varied among the individual credit segments. The distribution of bond holdings across rating categories shows that most paper is classified as 'investment grade' (medium to high quality issuers) by rating agencies. However, the share of speculative bonds – known as 'high yield bonds' – has increased. In the euro area, the volume of such bonds currently amounts to around €550 billion, which is about five times more than at the beginning of monetary union.

The telecommunications sector was initially the dominant force in this field: at the end of 1999 it held a roughly 50% share of the European market for high yield bonds. Consolidation in the technology sector and the increasing involvement of enterprises from other sectors, however, has meant that this share had fallen to approximately 7% by the end of 2003.

Beyond the euro zone and the international market

The biggest influence in debt capital markets globally in 2004 was rising interest rates.[9] The US Federal Reserve raised its key short-term rate (the 'Fed funds' rate) by a total of 1.25% to 2.25% in five separate quarter-point increases during the year. At the same time the Bank of England's monetary policy committee raised interest rates by one quarter of a percentage point on four separate occasions during 2004 to 4.75%. Throughout 2004, the European Central Bank kept its key interest rate unchanged at 2%.

The new issuance of corporate debt after such interest rate increases has been very quiet, around 35% lower in the first half of 2004 compared with the same period a year earlier. One important reason has been the low demand for cash because many companies have sufficient spare to return sizeable amounts to shareholders and bondholders, in the form of stock and bond buybacks, and special dividends.

In the absence of real demand for funding, corporate bond issuance will remain limited. Nevertheless, there's little doubt that further developments in this important emerging capital market will continue within Europe. They have, for example, the potential to offer an attractive option to investors in terms of returns and lower volatility, a point well captured in a recent report by Bayerische Landesbank.[10]

Further developments in this emerging capital market will continue within Europe

Euro-denominated corporate bonds have also recently outperformed euro zone government bonds and European equities. For example, someone who bought investment grade bonds at the beginning of 2004 would have made a total return of 4.74% in the first eight months to September 1. By comparison, the total return on European government bonds was 4.27%. That on European equities was only a miserable 0.8%. **MU**

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Ethically minded marketing

How can reputation impact customer behaviour? And what can a company do to improve its reputation? Is corporate responsibility a costly addition to the marketing process, or can it be a source of competitive advantage? Here, **Susan Foreman**, professor of marketing at Henley Management College, suggests that strategies that put customers at the centre of these processes are more likely to be successful.

While business ethics and corporate responsibility have been on the agenda of many organisations for decades, they have often been low down on the list of priorities. Some, though, like the Co-operative Bank, Johnson & Johnson and Green & Black's have focused their strategies on developing ethically-based products, working with like-minded customers and suppliers and making ethical investments. The issues of good corporate governance and social responsibility have become more acute in many boardrooms after the publicity surrounding the Enron and WorldCom scandals. Stakeholders can play an important role in shaping corporate behaviour by bringing issues to the attention of senior management and society, through, for example, boycotts, that can lead to change.

Issues of good corporate governance and social responsibility have become more acute

Boycotts tend to occur when a group feels that an organisation has engaged in conduct that is strikingly wrong and which has negative and possibly harmful consequences for the environment, the company's workers, or its customers, for example. Clearly, a boycott can have very negative consequences for a business and its reputation.

Competing on your reputation

Organisations pursue different types of reputational strategy, with some focusing on product and others wholly on the organisation as the brand. Competing on corporate reputation does have its risks, and potential rewards, though. When, for example, reputations are positive they provide customers and other stakeholders with an impression of trustworthiness, confidence and dependability. According to Dowling these help build the corporate image and identity of the organisation.[1] After studying disciplines like advertising, marketing, design, accounting, economics etc, he suggests stakeholders judge an organisation based on:

- the character of the organisation;
- the ability of the chief executive;
- leadership in the company;
- competence of the employees;
- the resources in the organisation;
- the nature, quality and value of the product portfolio; and, finally
- business performance and profits.

Whilst these factors are important in developing perceptions of the organisation, the stakeholders' bonds with the organisation are more emotional and much depends on the nature of the relationship customers or other stakeholders have with the business. Relationships are thus at the heart of corporate reputations. Where there is harmony and balance between the partners, trust and confidence can develop. Over time, this can enable organisations to achieve superior profits compared with their competitors.

Reputations can be broad-based, ie there is the perception of a 'good' organisation; or they can be more narrowly defined, like a company which can be well known for focusing on one particular issue or theme. The Co-operative Bank, for example, has developed a broad approach based on seven key stakeholders: shareholders, national and international society, future co-operators, suppliers, customers, employees and their families and the community. All are at the core of their strategy. Whichever route a company decides to follow, reputation needs to be managed both internally and externally. Dowling states that reputation can act as:

- a *signal*, which encapsulates an organisation's 'track record' and can be a useful indicator of future behaviour. For example, a pharmaceutical company with a good reputation for upholding rules and regulations may well be trusted by the authorities to do the same in the future and be given the benefit of any doubt;
- an indicator of *trust*, which is essential to organisations in the early stages of developing relationships;
- *strategic positioning* in the market place. Reputation can be used as a competitive tool. This is typified by organisations like the Body Shop whose proposition is designed to appeal to a specific market segment and its values;
- a *differentiator* for commodity products; and
- a device to help cut though excess *information*. When faced with information overload about similar products, a strong reputation can be the deciding factor for consumers.

Certain organisations, though, try to minimise the presence of the corporate name or brand and choose not to trade on reputation. This, Dowling says, is most prevalent in 'questionable' businesses such as, for example, tobacco. Philip Morris has changed its identity to emphasise its more varied and less contentious businesses in food and confectionery and moved away from the promotion of its tobacco products.

A marketing approach to corporate social responsibility

The debate in the marketing arena about corporate social responsibility (CSR) has been fragmented. According to Maignan and Ferrell,[2] early work in this area in the 1960s and '70s tended to focus on the ethical behaviour of marketing departments. Indeed, much marketing-based research has been narrow and tended to focus on single issues like advertising, the environment, support for the voluntary sector and altruism, rather than developing an organisation-wide understanding of the issue.

As research in marketing is sparse, Maignan and Ferrell have examined the history of social responsibility and the role of stakeholders to get a better understanding of the issues. They identified a number of different perspectives on CSR:

- *social obligation* – organisations have a responsibility to wider society such as through developing economic wealth, acting within the law, keeping ethical obligations to the community and, finally, being benevolent and giving something back to the community;
- *stakeholder responsibility* – here there are limits to the organisation's responsibility. In this perspective, the organisation is only responsible to the stakeholders, the organisation, the community, regulators and the media;
- *ethical behaviour* – this view supports the idea that there is 'right' and there is 'wrong' and is critical of the notion that something is right as long as it can be justified in the eyes of the stakeholders. Here the organisation should "systematically favour decisions and procedures that stimulate equality, liberty and fairness of opportunity for its various partners and associates"; and
- *managerial process* – in addition to having an outward orientation towards social responsibility, it is necessary to look inside the organisation and actually manage the process. Ethical behaviour does not happen automatically. Maignan and Ferrell draw on Ackerman's work and suggest that organisations need to scan the environment to monitor changes.[3] They should also plan and develop strategies to help meet the needs of stakeholders.

In the face of these differing perspectives and the lack of marketing insight, Maignan and Ferrell have built a model based on a stakeholder view that they claim connects the different parts of CSR. They suggest that organisations have shared norms which are both intangible (part of the culture) and tangible (set down in corporate documents). Furthermore, they say, stakeholders also have their own shared values and beliefs and should therefore be thought of as communities rather than individuals. The authors "suggest that an organisation's commitment to social responsibility can be assessed by scrutinising its impact on the issues of concern to the stakeholders."

Maignan and Ferrell have built a model based on a stakeholder view that connects parts of CSR

The authors also attempt to understand the relationship between the organisation and the community of stakeholders. Two key issues emerge from their research: power and co-operation. Stakeholders can have an impact on organisational performance, since they have certain powers which can affect the organisation's ability to survive and prosper. For example, if the organisation infringes a stakeholder norm or belief, they may have the power to retaliate, using the law, as some customers have, to fight for compensation against the organisation. Alternatively, stakeholders may withhold resources or services if

Stakeholders can have an impact on organisational performance

Conflict can lead to stakeholder 'disidentificat-ion' including reduced support and resources

the organisation they work with acts in a way that is contrary to their values. Thus, in Maignan and Ferrell's terms, the negative impact of conflict leads to stakeholder 'disidentification' and reduced stakeholder support and resources.

The strength of the stakeholders' network beyond the organisation is also important in shaping corporate responsibility. Maignan and Ferrell indicate that co-operation with other stakeholders can add to their power and influence. Where different stakeholder communities have different beliefs and values, they say, co-operation is unsurprisingly limited. For example, the controversy about genetically modified crops has put different stakeholder groups at odds with each other. In this case, co-operation is unlikely as some groups favour the introduction of genetically modified crops, arguing they can help eradicate world hunger, while others oppose them for what they say are environmental concerns. This division means a combined force can't be effectively directed towards any organisation.

Openness is crucial when stakeholder groups are in agreement on an issue

Openness with each other is also crucial to being effective when stakeholder groups are in agreement on an issue. The more they co-operate and share information, the stronger the stakeholders become and the weaker the power of the organisation. Maignan and Ferrell use the Shell Brent Spar crisis as an illustration of the potential power stakeholders can wield through co-operation. This work links a number of issues and raises many questions and opportunities for further investigation. Maignan and Ferrell argue we need greater understanding of how stakeholders' norms, values and beliefs influence business practices and how internal processes stimulate CSR. They also ask how the organisation and stakeholders can communicate their perspective on CSR most effectively.

Advertising ethics

In the marketing area, advertisers are often 'in the front line' when faced with ethical dilemmas. Their work is visible and in the public view at all times. At times, they can find moral and ethical controversies even when they are not looking for them. In recent research into morals and ethics in the advertising world, Drumwright and Murphy found a number of interesting dilemmas.[4]

Moral blindness

They discovered that a number of the advertising practitioners did not always see the moral dimension of their activities. Agencies emphasised the strength of the consumer and their good judgement to such an extent that they felt that it was not their role to evaluate the ethics underpinning the advertising message. In some respects, they felt that they were not influencing society – merely reflecting what already exists – and that individuals in society should moderate exposure to advertisements. Ultimately, though, many advertisers said that if something was legal it was also moral. Drumwright and Murphy and Preston say if that is indeed the position then moral decisions are not being made at all and that "ethics never really start."[5]

Moral muteness

Drumwright and Murphy make the distinction between moral 'blindness' and 'muteness'. The latter, they say, is where people see an ethical dilemma but do nothing about it and find various ways to rationalise their decision. Indeed, advertising practitioners seem to separate their working and personal lives to such as extent that the convictions they have out of work aren't always translated into the work arena. They excuse their behaviour by putting creativity or business objectives first.

Many advertisers, to some quite rightly, also state that the client comes first. Unfortunately, they seem to respond to clients' requests without challenge and as Drumwright and Murphy indicate, this makes them "yes persons" rather than business partners. In this respect, they pass the buck and do not feel accountable for the negative impact of the advertisements. Ultimately, the business imperative dominates, while morals and ethics are seen to be a constraint on creativity.

Moral imagination

Some employees, in small agencies in particular, did debate ethical issues in the organisation. Such agencies tended to have a culture that supported an ethical or moral approach to business. In their work, these agencies clearly communicated with new clients the need to work with like-minded organisations and stressed the ethical dimension to their work. Indeed, they also had the ability and the nerve to say 'no' to business. According to Drumwright and Murphy, this requires 'moral imagination' from management who can see the problems which the 'unethical' business might create in the future. Such management has the creativity to substitute a 'dubious' contract with alternative work which matches the ethics of the organisation.

Clearly, there is sometimes tension between the clients' wants and creative advertising decisions. For some, meeting the clients' needs is a moral imperative in itself. Drumwright and Murphy suggest that agencies need clear leadership on ethical issues while employees need development and training – the cultural norms on ethical and moral issues need to be clearly communicated inside the agency.

When corporate actions lead to a consumer boycott

Thus far we have looked at an organisational view of corporate social responsibility. However, stakeholders and the wider public are also important influences in this area. Since the public expects organisations to conform to accepted beliefs, norms and expectations, they feel that they have a right to voice their views when they think this isn't the case. Indeed, according to Klein, Smith and John "as a result of greater public attention to corporate and social responsibility and increased vulnerability of brands and corporate reputations, boycotts have become ever more relevant for management decision making."

Boycotts are one of the most extreme forms of consumer behaviour, and are often triggered by social, moral or ethical issues. Those who take part generally want to change some aspect of the organisation's conduct or activities, through ceasing to buy their products or services and through publicising what they see as its deficiencies. Research by Klein, Smith and John carried out in the US concentrated on a high-profile boycott of a European company.[6] It seems participants tended to take part in a boycott if they felt that the cause was worthy and the company's action was in some way disreputable or shocking, such as, for example, the use of child labour. People take part in boycotts when they can see personal benefits in participation through, for example, increased self-worth or personal enrichment. On the other hand, consumers may be reluctant to participate, despite agreeing with the issues, if they feel they will not benefit personally.

People take part in boycotts when they can see personal benefits in participation

The lessons for management are significant. Klein, Smith and John show that boycotts can be a useful mechanism for holding firms responsible for apparent CSR problems. The message is clear: where sufficient numbers of customers act together they can have enough power to both hold organisations accountable for their actions and help change their behaviour. The authors use both Shell and Nike as examples of organisations that have yielded to the power of the customer. They agree with Smith when they say that boycotts that lead to increased customer sovereignty create a wave of support and a "business case for CSR".[7] **MU**

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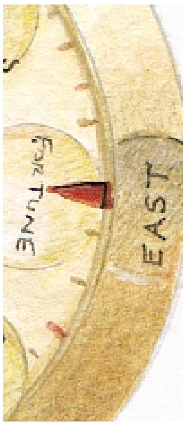

Developing organisational citizenship behaviour

What makes employees go the extra mile? To work longer hours if their organisation needs them to? To behave ethically even when there are real opportunities and benefits from taking advantage of their company? And what makes them take care of their fellow workers? Here **Richard McBain**, director of distance learning programmes at Henley Management College, explores the concept of organisational citizenship behaviour (OCB) and outlines what organisations can do to encourage it.

Organisational citizenship behaviour can be described as discretionary or 'extra role' behaviour that goes beyond the stated requirements of a job description. Although it is not formally rewarded by an organisation, it can have a number of important efficiency and effectiveness benefits for an organisation and contribute to competitive advantage, according to recent research. Consequently, organisations may want to pay careful attention to promoting such behaviour.

OCB can exist at an individual, group or organisational level

OCB can exist at an individual, group or organisational level and has a number of aspects. Schnake and Dumler identify five of the dimensions that are most frequently examined by researchers:[1]

- *altruism* – helping behaviours directed at individuals in the organisation;
- *conscientiousness* – behaviour which benefits the organisation and not specific individuals or groups;
- *civic virtue* – responsible participation in the political processes of an organisation;
- *sportsmanship* – tolerating the inconveniences and annoyances of organisational life; and
- *courtesy* – preventing problems by keeping others informed of your decisions which may affect them and passing information on to those who find it useful.

Bolino and Turnley note that existing research has identified a number of factors to promote OCBs.[2] These include job satisfaction, transformational leadership, organisational support and justice. They also name certain employee characteristics such as conscientiousness and extroversion. This article will consider recent research into the antecedents and influences on organisational citizenship behaviour, including team-member dissimilarity and interdependence, job embeddedness, job status, and customer orientation, as well as ways in which an organisation can promote and encourage OCB.

Developing OCB in multidisciplinary teams

OCB can enhance team effectiveness at work by, for example, freeing up resources for more productive activities, improving coordination and enabling team members to adapt more effectively to environmental changes. These benefits may be particularly important in multidisciplinary teams, which are typically characterised by a diverse or specialist membership and by complex and dynamic tasks. In such teams, it can be difficult to specify and control individual behaviour.

Accordingly, it is important to know what factors promote or hinder the development of OCBs in multidisciplinary teams. Van der Vegt and his colleagues have examined whether the dissimilarity between team members, in terms of their education level or background and functional specialisation, and the type and degree of task and goal interdependence, was related to team identification and the occurrence of OCB.[3] Their research focused on two elements of OCB: helping and loyal behaviours.

Their study of 20 multidisciplinary teams in a Dutch telecommunications company found that the relationship between the educational and functional dissimilarity of members and OCB depends on the degree and type of intrateam interdependence. Where task and goal interdependence are congruent, that is either high or low, the dissimilarity between members was unrelated to OCB. A low-low combination of task and goal interdependence requires little interaction between members and thus dissimilarity is unlikely to matter. In contrast, high-task and high-goal interdependence requires that members work together to achieve common goals – the interpersonal 'helping' and co-ordination that is likely to arise here may lead to any dissimilarities being ignored.

However, the researchers also found that where there are high-low or low-high combinations, the impact of dissimilarity on both team identification and OCB is significant and negative. Where goal interdependence is high, but task interdependence is low, there is the possibility of non-participation by some. Where task interdependence is high and goal interdependence is low competitiveness and individual interests may be encouraged. In both of these situations, dissimilarity is likely to have an adverse impact on the development of OCB.

The main implication of this research for multidisciplinary teams is that where team members are dissimilar, it is important to create a work situation in which task and goal interdependence is congruent. This can be achieved by distributing tasks and responsibilities to promote task interdependence, and by formulating joint group objectives and giving group feedback to foster goal interdependence.

The effects of job embeddedness on OCB, turnover, absence and performance

'Job embeddedness', which reflects the extent to which people are connected in a social web either in an organisation ('on-the-job') or in a community ('off-the-job'), has three aspects according to Lee et al:[4]

- *links* – the extent to which people have links to other people or activities;
- *fit* – the extent to which their jobs and communities fit other aspects of their 'life spaces'; and
- *sacrifice* – the ease with which links could be broken.

In a study of 829 employees at a regional operations centre of a large international financial institution, Lee and colleagues found that the two components of job embeddedness ('on-the-job' and 'off-the-job') had different effects. Off-the-job embeddedness predicted voluntary turnover and absences, while on-the-job embeddedness did not. In contrast, on-the-job embeddedness predicted organisational citizenship and job performance, but off-the-job embeddedness did not.

This research demonstrates that job embeddedness can help us to understand the process of employee resignations, as well as the linkage between retention and performance. It also provides a mechanism for understanding the development of OCB. Job embeddedness overall can be established through building community, developing a sense of belonging, establishing deep ties among employees, and by deepening social capital. More specifically, on-the-job embeddedness can be developed through promoting teamwork and long term projects (links), matching an employee's knowledge, skills, abilities and attitudes with a job's requirements (fit), and by connecting job and organisational rewards to longevity (sacrifice).

> Job embeddedness can help us to understand the process of employee resignations

Equally important, managers can increase off-the-job embeddedness by providing people with information about the community surrounding their workplace and offering social support for local activities and events. By promoting job embeddedness, an organisation may increase retention, attendance, job performance and, of course, organisational citizenship behaviours.

> By promoting job embeddedness an organisation may increase retention

OCB and job status

The previous research indicated that OCB is likely to increase as job embeddedness increases. Does that mean, then, that the permanent employees of an organisation are more likely to be embedded within an organisation than temporary employees and thus demonstrate more OCB? Not necessarily. Feather and Rauter's investigation of the impact of permanent or temporary job status on OCB in a sample of 154 school teachers indicates, for example, that employee goals must also be taken into account in the performance of such behaviours.[5]

Contract teachers, unsurprisingly, reported more job insecurity and less opportunity to influence their work environment, utilise their skills and obtain variety in their jobs than did permanently-employed teachers. More surprisingly, though, they also reported more OCB. Indeed, for contract teachers, the greater the perceived job insecurity and the lower the opportunities to influence and use their skills, the greater the level of OCB reported. In contrast, for the permanently employed teachers, opportunities for skill utilisation and variety in work situations promoted OCB. The greater the level of OCB, the greater the level of commitment and organisational identification. For both permanent and temporary teachers, OCB and organisational commitment were positively correlated.

The greater the level of OCB the greater the level of commitment and organisational identification

Clearly, the results of this study seem counterintuitive and inconsistent with the findings of other studies in that, for example, no evidence was found to suggest that permanently-employed teachers show more commitment and identification with their school. However, the study also supports the importance of understanding the goals of different employees in performing OCB. Thus, workers on short term contracts may perform more OCB to enhance their image as valued employees and increase their chances of permanent employment within the organisation.

In addition, the performance of OCB may also allow them to achieve variety and influence in their work and to use skills not possible in their temporary jobs. For permanent employees, performing OCB is clearly related to other goals. Thus, OCB may have different functions for permanently-employed and contract staff. The main implication of this study, then, is that an organisation that is seeking to promote OCB must understand what role it fulfils for employees.

OCB may have different functions for permanently-employed and contract staff

Leadership and procedural justice climate as antecedents of unit-level OCB

For Erhart the "topic of organisational citizenship behaviour has breathed new energy into researchers perplexed by the seemingly weak relationship between job attitudes and job performance. By moving the definition of performance away from the 'core' task behaviours and into the realm of behaviours that support that core, OCB researchers have demonstrated that, in fact, job attitudes do relate to job-relevant behaviours" (p61-62).[6] He notes that most research on OCB has focused on the individual level of analysis. Little, he says, is known about unit or department-level OCB. Accordingly, he sets out to examine the impact of two variables at unit level that predict OCB at an individual level. Specifically, these are fairness perceptions and leadership. OCB was defined in terms of helping behaviour (altruism) and conscientiousness. Unit-level OCB was measured by aggregating individual ratings of the overall level of OCB performed in their unit, as well as by supervisor ratings of the unit's OCB as a whole. Leadership was conceptualised in terms of servant-leadership, which recognises the moral responsibility of the servant-leader not only to the success of the organisation but also to his or her subordinates, the organisation's customers, and other organisational stakeholders.

The study involved employees of 249 grocery store departments. Overall, the results support the relationship between both servant-leadership and procedural justice climate with unit-level OCB, as well as the relationship between servant-leadership and procedural justice. Departments where members are treated fairly are characterised by higher overall levels of helping and conscientiousness behaviours and seem to be related to unit-level OCB. In departments where the leader acts in ways to benefit subordinates – that is, to help them grow and develop – department members are more likely to act in ways to benefit other department members (helping) and the organisation in general (conscientiousness).

Service-worker customer orientation and OCB

The link between service-worker customer orientation (CO) and performance outcomes is well established. Donavan and fellow researchers have built on prior research to examine the relationship between service-worker customer orientation and other important job responses, including perceived job fit, job satisfaction, commitment to the firm, and organisational citizenship behaviours, focusing on altruism.[7] They argue that customer orientation should be viewed as a trait, though customer-oriented behaviour results from the fit between personal characteristics (such as personality and goals) and the environment (including the nature of the job).

Across three studies in two distinct service industries (a bank and two restaurant chains), they found that COs affect performance and have strong effects on several employee job responses. Thus, CO positively influences job satisfaction, commitment, and the performance of OCB. These outcomes are important both for the motivational well being of the service employee (in terms of satisfaction and commitment) as well as for the successful operation of the services organisation (ie OCB). The results also indicate that service workers who have higher levels of CO thrive in service settings that allow for a high degree of contact time with customers. CO (a personal variable) and contact time (a situational variable) interact to predict job satisfaction and commitment.

The first important implication for managers seeking customer-oriented employees is that they should recruit with this personality trait in mind. According to this research, it will not develop over time in response to job satisfaction and commitment since the findings suggest that satisfaction and commitment result from CO, rather than cause it. Second, however, employing highly customer-oriented people does not necessarily produce the most committed (or satisfied) employees, since the job environment (degree of customer contact) and thus the person-job fit must be taken into account.

Risk preference, pay for performance and OCB

The final example of the influences on the performance of OCB is that of employee risk preferences. Organisations are moving away from traditional compensation programmes toward more flexible pay systems that are strategically aligned with complex, changing business environments. Pay and performance are thus linked more tightly, and the variability of pay is increasing. While pay for performance (PFP) is intended to align (and thus control) the interests of employer and employee, it inherently involves risk. Deckop et al have investigated whether employee risk preferences impact upon the relationship between the extent to which employees are motivated by PFP (ie controlled by pay) on the one hand, and turnover intentions, pay satisfaction and OCB on the other.[8]

In a study of 127 employee-supervisor dyads, they found that employee risk preferences did affect the relationship. More specifically, the more risk averse the employee, the higher the likelihood of turnover intentions and the lower the level of OCB where the extent of control-by-pay is greater. On the other hand, for the less risk averse employees, the more positive is the impact of PFP on pay satisfaction and OCB.

The authors suggest that risk preferent employees are more likely to see PFP as an aspect of value alignment between themselves and their organisation, contributing to a social exchange relationship between them. This research suggests that organisations should consider employee risk preferences when considering implementing, developing or assessing the effectiveness of a PFP plan, whether at executive level or more broadly in the organisation.

Furthermore, risk preference should be identified in the selection process where a PFP scheme is in place and employers should incorporate pay system information into their realistic job preview. It is important to communicate the degree of compensation risk both to existing and to potential employees. In addition, knowledge of employee risk preferences may have an impact on an employer's choice of pay level and compensation expense.

Cultivating and managing OCB in the organisation

Bolino and Turnley argue that OCB can be a key asset for an organisation that can be difficult to imitate.[9] OCB may contribute to the creation of social capital, based on strong interpersonal connections between employees, both directly and indirectly, through their impact on commitment, for example. In addition, OCB, or employee citizenship behaviour, can provide a source of long term competitive advantage. Accordingly, it is important to consider how an organisation can promote OCB at the individual and organisational level. A number of antecedents of OCB have been considered earlier in this article, but the authors identify a number of actions that an organisation may take to foster organisational citizenship. The first three are clusters of key HRM practices while the remainder are more informal systems:

OCB can be a key asset for an organisation that can be difficult to imitate

- recruitment and selection – for example, selection procedures that can predict citizenship, such as situational interviews and validated tests to identify applicants willing and predisposed to engage in OCB;
- training and development – to promote teamwork, organisational justice, and relationships;
- performance appraisal and compensation/benefit – reward OCB, link to organisation-level outcomes, initiate family-friendly and flexible benefits that show appreciation of employees and make it easier for them to go 'beyond the call of duty';

Performance appraisal and compensation/benefit reward OCB

- develop a culture that promotes going the extra mile for customers, colleagues or the organisation itself;
- place new employees whenever possible into work units or groups characterised by high levels of OCB;
- remember that managers who expect their employees to go above and beyond the call of duty have to set an example by being willing to also do so themselves; and
- recognise that organisations wanting loyalty and sacrifice from their employees should act in ways that make them deserving of such contributions.

However, the authors also note potential pitfalls associated with promoting employee citizenship behaviours which employers need to remember. To begin with, citizenship behaviours may be used for 'impression management' and can lead to the politicisation of the workplace. In addition, citizenship has potential costs. If OCBs are performed at the expense of required duties, it may also be a signal that the organisation is under-resourced. Finally, there is the danger that promoting citizenship behaviours may lead to competition between workers, endanger relationships and lead to higher stress and turnover levels.

Citizenship behaviours can lead to the politicisation of the workplace

Conclusion

OCB is a set of behaviours that are not captured within traditional role definitions or job descriptions. They represent 'extra effort' by employees that is nonetheless essential for the effectiveness of the organisation, especially where organisational performance is dependent on the interconnectedness and social networks of its people. The recent research considered in this article suggests that a number of personal and situational factors influence the development of OCB, and suggests ways in which organisations may promote them.

While an ill-considered promotion of OCB may lead to potentially dysfunctional outcomes, there seems little doubt that they can also contribute to improved organisational performance and help develop an organisation's social capital and competitive advantage. **MU**

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Creating sustainable advantage

How can organisations develop strategies that are successful and sustainable over time? How can they avoid adopting strategies that will dissipate their advantage? In the final article of this *Manager Update,* **Ian Turner**, professor of management studies and director of graduate business studies at Henley Management College, reviews literature that suggests that a focus on human and technological resources holds the key to sustainable advantage.

In this article, I discuss some recent contributions to the subject of competitive advantage. In particular, I look at the resources – human and technological – that underpin sustainable advantage and ask how we create them, what practices sustain them, and how technology can dissipate them.

Linking strategy and strategic HR management

A new approach to human resources (HR) management began to emerge in the 1990s. As Dave Ulrich, the main originator and proponent of strategic human resource management, said in a *Harvard Business Review* article, HR managers would have to redefine their role or become redundant.[1] After all, he said, couldn't many of the traditional activities performed by HR and personnel departments, the so-called transactional processes, be either outsourced and/or automated?

Ulrich and his colleagues thus defined a new role for HR that both elevated its status and brought it closer to the heart of business. According to this new 'strategic' HR, group HR managers would work closely with line managers who themselves would ultimately take responsibility for HR policies. HR managers would thus position themselves to have a more strategic input, becoming experts in change, advisors on organisation structure and process, and builders of organisational capability.

At about the same time, Jeffrey Pfeffer, another well-known US business guru, was articulating a set of universal principles for strategic HR.[2] Pfeffer believed that all companies would have to embrace common principles and practices in human resource management to become world class. The agenda he set covered:

- employment security for employees;
- selective hiring to recruit high-potential employees;
- self-managed teams/team working;
- high compensation contingent on organisational performance;
- extensive training and development opportunities;
- reduction of status difference between different professional groupings; and
- sharing information and creating a knowledge-management culture.

Of course, not everyone agreed with Pfeffer that it was possible to embrace a universal approach to HR policies and practices. Other writers stressed that what would work in one context probably would not work in another. Not least, they said, the legal context within which companies and their HR practices functioned varies significantly around the world.[3]

Despite this continuing debate around strategic HR, economic trends and influential management writings over the last decade have emphasised that the effective management of employees is critical to the firm's long term success.

The effective management of employees is critical to a firm's long term success

Thus, the preoccupation with organisational learning, and subsequently with knowledge management, reflected the transition to a knowledge-based economy, which in turn has reinforced the central importance of people.

Strategic HR and the resource-based view of strategy

Coincidentally, at the same time that HR specialists were redefining their role, a new school of thought was emerging in the strategy field – the so-called resource-based view of competitive advantage. It is arguably the most influential approach to strategy in the last fifteen years, signalling as it did a backlash against the dominant emphasis on external positioning of the company – articulated by those such as Michael Porter – towards a more internally-focused approach. In essence, the resource-based view (RBV) holds that sustainable competitive advantage depends upon a firm possessing resources, capabilities or assets, which have certain properties that make it distinctive. Specifically, they should be valued by customers, rare, durable, not easy to copy and not easy to substitute. RBV advocates argue that the most enduring sources of competitive advantage are those that are socially complex and path dependent, ie they are built on a series of decisions historically that generate capabilities or behaviours leading to success.

RBV is arguably the most influential approach to strategy in the last fifteen years

As Barry Colbert points out in a recent article,[4] the RBV has a key role in understanding the importance of strategic HRM. Perhaps understandably, however, whilst the RBV emphasises the importance of human resources to strategy, it offers little guidance on how an organisation should manage people. Colbert believes that there are opportunities for exploring the implications of RBV for human resources much further. In particular, he focuses on four key aspects. First, the link to creativity and adaptability – the focus of HR should, at a strategic level, be to both help the organisation implement the strategy and make optimal use of the organisation's talent to help it to adapt and compete.

RBV offers little guidance on how an organisation should manage people

Second, the centrality of organisational complexity and 'causal ambiguity': at the nub of the RBV is the notion that things that are difficult to understand, because the precise nature of cause and effect are not easy to unravel, are frequently the most durable sources of competitive advantage. (This, paradoxically, is also the feature that is most difficult to manage directly because this very causal ambiguity makes operationalising it so difficult!) Colbert himself says "the question for managers is how to act in that complexity so that the organisation is encouraged to thrive, without having to unravel the codified, myriad causal effects at play in the socio-dynamic of the firm."[5] Thirdly, the importance of dynamism and path dependencies: the point here is that many strategic assets or sources of advantage – reputation, for example, or complex craft skills – are difficult to acquire on the open market and must generally be built up over time. This 'dynamic capabilities' view has implications for HR in that it suggests specific organisational processes will lead to the creation of competitive advantage over a long period of time.

The fourth and final implication of the RBV for HR is the importance of system level resources, variously characterised in the RBV as core competencies or organisational capabilities, which are based upon relationships and embedded in systems. This characteristic of complex sources of competitive advantage leads to 'imperfect mobility'– the idea that it is difficult to disaggregate specific sources of advantage from a complex system. This, then, has clear implications for strategic HR practices; for example it relates to the currently fashionable notion of 'human capital' management – the idea of regarding human resources from an investment perspective.

Complexity and the resource-based view

In Colbert's view, the missing link between the RBV and strategic HR practices can be found within the area of complexity theory. Essentially, complexity theory posits that complex adaptive systems, like animal or reptile species in nature and firms and markets, are characterised by a complex web of relationships and inter-dependencies. Such complex systems are never stable but constantly adapting and emerging. Although there is no overall conscious design in the way that these systems act, order does, nevertheless emerge from this evolutionary process.

Given that the RBV lays such emphasis on the importance of complexity in sustaining competitor advantage, there seem obvious opportunities to bring together the RBV and complexity theory. Building on the work of Kelly and other complexity theorists, Colbert attempts to identify some broad principles for how complexity theory can inform strategic HR, and in the process cultivate the kind of sustainable sources of advantage implied by the RBV.

Complexity theory suggests that centralised control is anathema to effective organisational adaptation. Thus, many of the organisational practices suggested by complexity theory tend to be bottom up – creating self-organised units, growing by 'chunking,' cultivating the fringes, constant experimentation and pursuing multiple goals, etc. Although Colbert goes on to identify specific HR practices that flow from these high-level principles, he tries not to be too prescriptive. Indeed, seeking to apply complexity theory to practical HR policy is problematic. On the one hand, the principles may appear too vague to be of much help to practicing managers.

Thus on pursuing multiple goals, Colbert advises "a complicated structure has many masters, none of them can be served exclusively. An adaptive system must trade off between exploiting a known path to success (optimising the current strategy) and diverting energy to exploring new paths (by wasting energy and efficiency)." This, while neatly encapsulating the dilemma facing all strategists in organisations, does not offer much guidance on whether focusing on the core business or innovating in new areas is the best course of action.

Even when complexity theory appears to offer solutions, these could be construed as the kind of universalistic model that Colbert and other writers have criticised. To be fair, Colbert himself acknowledges these problems, and by raising them in this way has at least pointed to ways in which the types of prescriptions suggested by complexity theory can be tested through empirical research.

Where do resources come from?

The resource-based view of strategy holds that sustainable competitive advantage comes from the identification and exploitation of distinctive resources, assets and capabilities within the organisation. It says that companies possess different combinations of assets and resources by virtue of their history and past performance. Yet this starting assumption – dubbed 'resource heterogeneity' by the resource-based writers – is taken as a given when little research has actually been undertaken on the origin of such resources.

To be sure, some writers refer to prior commitments, managerial capabilities and even initial endowments of assets as helping account for the evolution of companies' resources. Ahuja and Katila, though, have recently sought to investigate more systematically the origin of resources.[6]

The authors argue that heterogeneous resource positions are created by companies in response to so-called idiosyncratic situations. In their study of the global chemicals industry, they identify two specific types of situation: 'technological exhaustion' and 'market expansion.' Companies seeking to innovate in areas where the technology is already well-explored, they say, are driven to search more widely for additional scientific knowledge to acquire fresh raw material on which they can build distinctive positions. Similarly, companies that explore new international markets may also be led to explore new avenues of innovation and to investigate the application of technologies that would not necessarily be present in their traditional markets. This, they say, is because companies operating internationally will have to cope with variations in areas such as user needs, processes and raw materials availability, for example.

Ahuja and Katila identify two specific situations: 'technological exhaustion' and 'market expansion'

So which sort of firms are likely to be most successful in building up heterogeneous resource bases: those, for example, that are searching within their scientific areas for new knowledge to combine with existing practices or products in innovative ways? Or companies which successfully build on their international positions so that they become aware of concentrations of local expertise and can create multiple regional networks of knowledge internally?

However, as Ahuja and Katila make clear, this is likely to be true only up to a point. Such searches involve a cost – and, in fact, searching too broadly and trying to undertake over-ambitious integration of internationally-dispersed knowledge can overburden the company and lead to strategic drift or even paralysis. The result of their research indicates that, particularly as far as geographic search is concerned, the process in most cases is very much one of trial and error: in striving for the optimum balance between being too inward-looking and too externally-focused, companies frequently undershoot or overshoot.

As the authors comment, this supports the arguments of complexity theorists who maintain that innovative organisations operate at the 'edge of chaos', where the system is characterised by experimentation and trial and error: "in a context of technological

Complexity theorists maintain that innovative organisations operate at the 'edge of chaos' capability acquisition... the emergence of resources was inherently an evolutionary process: idiosyncratic, inertial; yet path-breaking on occasion; and prone to mistakes."[7]

Does IT matter?

Whilst Ahuja and Katila concentrate on trying to define the origin of resources, Nicholas Carr seems to be more interested in how competitive advantage is eroded, not least by technological developments.[8]

He rose to fame when his article, published in the *Harvard Business Review* in 2003, asked the provocative question 'does IT matter?' Carr's basic thesis was that information technology, particularly as a result of the internet, has become a commodity.[9] In future, he says, the IT industry will simply be viewed as another utility, such as electricity generators are today. Thus, instead of having to invest capital in fixed assets, corporate clients will simply choose to pay for the IT services they use. Perhaps understandably, this analysis found few supporters either among the IT industry or proponents of information management.

Carr says that in future the IT industry will be viewed as another utility

Carr has since developed his argument. Not only, he believes, will IT in most cases not be a source of competitive advantage, but technological developments, like the growth of the internet with its open systems and transparency to customers, will cause competitive advantage to rapidly erode. Carr sees this as particularly applying to businesses that involve the automation of transaction-intensive activities, and warns that as companies in such industries continue to look to outsourcing or offshoring relationships, competition will be increasingly homogeneous. Bill Gates and others have described the internet as a foundation stone for a new 'friction-free' capitalism that will drive markets closer to perfect competition. But, as Carr points out, "when it comes to markets, friction is often just another word for profit."[10]

Is the internet a foundation stone for a new 'friction-free' capitalism?

Despite Carr's bleak picture of companies' inability to sustain competitive advantage through IT, his message is not that companies should simply ignore strategy and focus on the ability to respond adroitly to changes in the market place. Put simply, Carr's point is that as IT becomes more of a commodity, strategy, paradoxically, becomes more important. Take, he says, two businesses that by any definition are long term success stories – Dell Computers and Wal-Mart. While both have used IT to good effect, the use of technology is the source of neither's competitive advantage. Both Wal-Mart's logistics system and Dell's direct sales model pre-date the internet. Clearly, both used IT to buttress their position but their competitive edge was based on first-mover advantages and scale, rather than superior use of IT.

Of course, as Carr recognises, not every company can be a Dell or a Wal-Mart. In most industries that are technology intensive, the process of homogenisation will ensure that sustainable advantage is rare. He believes we need a broader definition of competitive advantage that includes what he terms a "transient leverageable advantage." These are less durable than sustainable advantages and may provide only fleeting benefit in the market place, but, according to Carr, they could provide a stepping-stone to a more privileged competitive position.

He illustrates this with reference to Apple and the development of the iPod and shows how the launch of this product led Apple into music retailing with the launch of its on-line music store, iTunes, which in turn further increased the demand for iPod devices. According to Carr, the iPod is successful because Apple returned to the original sources of its competitive advantage: "a flair for design, tight integration between hardware and software, a strong and meaningful brand and exuberant dedication to product innovation."[11]

This notion of 'leverageable advantages' echoes Hamel and Prahalad's 'core competencies', and even Porter's notion of activity systems, since Carr maintains that whilst individual transaction-intensive processes will rarely confer competitive advantage, more complex combinations of capabilities, which involve multiple processes and technologies, will be more resistant to imitation and homogenisation.

Perhaps Carr's writing simply heralds a change in the way that we view information technology. Investment in IT over the last 10 years has been so enormous and the pace of change so rapid, that it is impossible not to be impressed by the impact of digital technology upon the way that we do business. Just as quality started off as a differentiator and moved over time to being a qualifier to becoming almost a hygiene factor, so as IT becomes pervasive and its advantages are widely disseminated, the ability of companies to build distinctive and defendable positions will decline. Given the time and resources invested in IT, such a conclusion will be irksome to some executives. But once the dust has settled around the IT revolution, it may be that those companies which embrace more traditional concepts of strategy are best able to survive and prosper. **MU**

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7 Ahuja, Gautam and Katila, Riitta, op. cit. p903

8 'The corrosion of IT advantage: strategy makes a come-back'
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9 'Does IT matter?'
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