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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.

Experts in each field explain and discuss the relevance, practicality and usefulness of the key new concepts and ideas, thus enabling the senior executive to keep really up-to-date.

The articles represent the personal views of the authors and not necessarily those of their organisations or of the Faculty. The nature of some subjects will preclude the articles from being definitive or mandatory. Being general in nature, the points made in **Manager Update** may or may not be relevant to specific circumstances.

The Faculty committee intends that **Manager Update** will act as an aide-memoire for members, provide new ideas, and encourage good practice, but cannot accept responsibility for their accuracy or completeness. Responses from the membership will be a very important part of the successful development of the series.

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Developments in e-finance and e-banking

The internet has created new opportunities not only in general retailing and information providers, but also in financial services. E-finance and e-banking have grown rapidly. Internet-based financial intermediaries have developed services for investors ranging from 'seed' financing to initial public offerings. These are internet matchmakers, venture capitalists and investment banks. So far, these have tended to be niche players in the market. Are they now poised to take a much greater share? **Roger Mills** argues that investors face benefits and risks on the internet, and that the same applies to e-banking. Institutions need to take steps to put comprehensive risk management systems in place.

The internet has had an enormous impact on the provision of financial services. For example, according to K Haynes, the average cost of a financial service transaction over the internet is one cent, whereas the average cost of an ATM transaction is 27 US cents, a telephone transaction 54 cents, and a branch visit $1.07[1]. Just as the internet and e-commerce have revolutionised the purchasing of goods and services and how companies do business, internet technology has had an impact on the private equity markets.

Internet based financial intermediaries have developed services that cater for ordinary investors, from 'seed' financing to the exit stage of initial public offerings (IPO). These services have typically catered to a niche group of people, who live in an internet environment but, according to some sources, a number of these companies have prospered yet co-existed with the traditional brokerage houses[2]. An important question remains, therefore. Will the use of the internet in the private equity market take off, or simply stay as an interesting but unimportant niche? This is particularly relevant now, given the depressed state of equity markets.

Internet and the private equity market

The internet revolutionised stock markets through the boom in on-line trading. Some people argued then that the internet would produce dramatic improvements in global consumer access to financial services[3]. New companies sprang up that used the internet's connective power to link idea-rich entrepreneurs with cash-rich investors. Most of these companies sought to facilitate the funding process or become clearing houses of information for angel investing or venture capital.

There has also been tremendous growth in the private equity market. During the 1980s and early 1990s, the private equity market was the fastest growing market for corporate finance. By all accounts, it has grown faster than the public equity and bond markets and the market for private placement debt. Much of this growth could be seen in terms of 'big deals', such as those characterised by the Nomura team in the UK. But there is still enormous potential scope for private equity deals at the other end of the size spectrum. For example, according to Briggs Meyers, there are 400,000 private companies in the US with 10 or more employees that account for $2 trillion in book assets[4].

Yet, when looking to raise between $1 million and $10 million, these smaller firms often plunge into a capital chasm and are forced to scrounge together the needed funds themselves. They often find it difficult to attract qualified investors who are interested in smaller deals, because most venture capitalists and investment banks are looking for large deals, due to the increasingly high costs of managing each investment. The venture funds tend to have limited resources and are under constant pressure to perform – as a result, they try to contain their risks by staking large sums on managers with proven track records, rather than by spreading their money across numerous start-ups.

The internet has had enormous impact on the provision of financial services

New companies used the internet's power to link idea-rich entrepreneurs with cash-rich investors

According to Hoje Jo, changes in the private equity market and the internet opened up many opportunities for alternate business models including:

- internet matchmakers;
- internet venture capital; and
- internet investment banking[5].

Changes in the private equity market and the internet have resulted in new business models

Internet matchmakers
Matchmaker type companies take the lead role in pairing entrepreneurs with investors. These internet matchmakers target the novice entrepreneur who has minimal contacts and experience, and help them turn their business plans into reality.

For the majority of cases, a matchmaker will be involved in the early stages of a project with an entrepreneur. First, the entrepreneur generates a completed business plan for submission to the matchmaker, who reviews the document for completeness. The business plan will then be posted on the matchmaker's web site for all registered investors to review. If the plan is not complete or needs work, the matchmaker will refer the entrepreneur to the many resources and partners that the matchmaker has established, to provide assistance. This is one of the key traits of the matchmaker, the resources are typically concentrated on the front end of the process and are limited to early consultative work.

A search filter is often provided to help investors find plans in which they may be interested. Once this occurs, the matchmaker will step aside and allow the investor and entrepreneur to meet. If they find a match in their mutual needs, then the matchmaker will provide further referrals, for example, to outside legal professionals who can complete the negotiations and provide the documentation necessary for funding the project.

Internet matchmakers, venture capital and investment banking have emerged

Since matchmaker services are concentrated in the early stages of funding (including seed money) and are mostly limited to the review of the business plan and the introduction of the interested parties, the costs can be tightly controlled and minimised. The matchmakers make their revenues through the fees charged for the submission of plans, referrals for services, and dues for use of the service.

Internet venture capital
Internet venture capital companies also match entrepreneurs with investors, but then take the process one step further by providing additional services. These include filtering out the best business plans and then working alongside companies to help them grow and succeed. Financial service companies are looking for smaller deals than larger venture capital or investment banks (between $1 million and $5 million). Additionally, financial service companies target those accredited investors, venture capitalists, corporate investors and fund managers who are willing to make riskier investments to diversify their portfolios, but may not have the industry contacts to find a sufficient range of investment opportunities.

The relationship between internet venture capitalists and their member companies usually lasts from the initial stages to when the last investor exits. One reason for this is because companies that operate this service, like Garage.com, in effect put their stamp of approval on every member company. Consequently, their reputations are on the line to see that member companies are successful and remain successful. And, there is an additional incentive to see these private companies succeed because payment is wholly or partially taken in shares in the business.

Internet investment banking (IB)
On-line investment banks have allowed individual investors, who would not normally be considered qualified, into the initial public offering (IPO) process. Formerly, investment banks would only hand out the highflying new issues to favoured institutional customers before trading began. But, on-line IBs also target the 'ordinary' investor. The on-line IB model does have its drawbacks, however. The individual investor does not have the same kind of access to corporate information. The institutional buyers of IPOs learn most of what they know about new companies in face-to-face meetings with the executives, to which individual investors are rarely invited.

In addition, for the best companies, an IPO is not only about raising capital, it also involves deploying expertise in public relations. The IPO is a media and marketing event. Chief executives want the rewards that come with an offering from a leading investment bank, not an upstart, and they want well-regarded financial analysts to translate and communicate their corporate image. To give individual investors equal footing in initial offerings, the on-line IBs needed to do more than just make shares available over the internet.

The reality is that institutional investors tend to trust traditional IBs, as they have more experience and successful track records. Internet IBs, on the other hand, fill the gaps by carrying smaller deals in less time, but they often have to partner with traditional IBs to underwrite an IPO.

Global cyber financial intermediaries

Implicit within internet investment banks, sometimes termed 'cyber financial intermediaries', is an obvious venture capital financing mentality. Until recently, though, there has been little such activity except in Canada, Israel and the UK. US institutional investors have, however, been looking at venture capital opportunities outside the US, not least because of the rapid growth in the US venture capital market[6]. In fact, all indications are that the strength of the IPO market is a crucial factor in the determination of venture capital commitments[7, 8].

Venture capital markets in the US, Japan and Europe do differ substantially, both in terms of size and substance. Paul Gompers and Josh Lerner have identified that a critical difference between US venture capitalists (VC's) and foreign venture capitalists is over the commitment to transfer control back to entrepreneurs. This commitment device may not be available in economies dominated by banks, such as in Japan and Germany, where there are not such ready markets for new issues[9].

Another difference between US and foreign VC's is the role of government in creating the infrastructure of the VC community, including cyber financial intermediaries. In most Asian and European countries, the role of government is much more crucial than in the US. For instance, Chinese, German and Korean governments have been actively involved in building the VC sector.

In many cases substantial amounts of public capital have been poured into the VC and IT sectors. Different government policy and regulatory environments can therefore have a dramatic impact on the current and long-term viability of the VC sector[10, 11].

Country-specific banking and security regulations create major hurdles for internet IBs attempting to expand globally. Compared with cyber financial intermediaries in the US, those in Europe and Japan face greater governmental restrictions.

Operational risk in e-banking

In recent years, a much wider array of banking products and services has become accessible to retail and wholesale customers through the electronic distribution channel. But, the rapid development of these e-banking capabilities has also been identified as carrying risks that need to be managed. The Basel Committee on Banking Supervision published their Risk Management Principles for Electronic Banking in May 2001[12]. Of particular concern to the committee were:

> A much wider array of banking products and services has become accessible

- the speed of change relating to technological and customer service innovation in e-banking. Historically, new banking applications were implemented over relatively long periods of time and only after in-depth testing. Today, however, banks are experiencing competitive pressure to roll out new business applications in very compressed time frames – often only a few months from concept to production. This competition intensifies the management challenge to ensure that adequate strategic assessment, risk analysis and security reviews are conducted prior to implementing new e-banking applications;
- transactional e-banking web sites and associated retail and wholesale business applications are typically integrated as much as possible with legacy computer systems, to allow more straight-through processing of electronic transactions. Such straight-through automated processing reduces opportunities for human error and fraud inherent in manual processes; but it also increases dependence on really sound systems design and architecture;
- as e-banking increases banks' dependence on information technology there is greater technical complexity of many operational and security issues. This furthers a trend towards more partnerships, alliances and outsourcing arrangements with third parties, many of whom are unregulated. New business models have been created, involving banks and non-bank entities, such as internet service providers, telecommunication companies and other technology firms; and
- the internet is ubiquitous and global by nature. It is an open network accessible from anywhere in the world by unknown parties, with routing of messages through unknown locations and via fast evolving wireless devices. Therefore, it significantly magnifies the importance of security controls, customer authentication techniques,

> E-banking carries with it risks that need to be managed

data protection, audit trail procedures and customer privacy standards.

Existing risk management principles are applicable to e-banking but must be tailored to the new risks

While not creating inherently new risks, e-banking has intensified and modified some of the traditional risks associated with banking activities. Strategic, operational, legal and reputational risks are involved, thereby influencing the overall risk profile of banking. As a consequence, the Basel Committee argued that while existing risk management principles remain applicable to e-banking activities, they must be tailored, adapted and, in some cases, expanded to address these new risks.

According to the committee, boards of directors and banks' senior management need to review, and modify where necessary, their existing risk management policies and processes to cover their current or planned e-banking activities. The emphasis on planned activities implies a proactive assessment of the risks together with appropriate mitigation actions being in place before the new activities are implemented. Furthermore, the committee believes that the combination of e-banking applications with legacy systems implies the integration of all banking activities within a single, comprehensive risk management approach.

To facilitate these developments, the committee identified 14 risk management principles for electronic banking. In recognition that each bank's risk profile is different, a tailored risk mitigation approach will be required. It needs to be designed for the scale of the e-banking operations, the materiality of the risks present, and the willingness and ability of the institution to manage these risks. This implies that a 'one-size-fits-all' approach to e-banking risk management issues will not be appropriate.

The committee identifies a number of risk management principles covering board and management oversight, security controls and legal and reputational risk. The principles are not proposed as absolute requirements, or even 'best practice', but rather as guidance to promote safe and sound e-banking activities. There is no attempt to dictate specific technical solutions to address particular risks, nor to set technical standards relating to e-banking. It is accepted that technical issues will need to be addressed on an on-going basis by both banking institutions and various standards-setting bodies as technology evolves.

These risk management principles are intended to be flexible enough to be implemented by all relevant institutions across jurisdictions. National supervisors will assess the materiality of the risks related to e-banking activities present at a given bank and whether, and to what extent, the risk management principles for e-banking have been adequately met by the bank's risk management framework. Controlling the risks, whilst also exploiting the opportunities, is a prudent balance to strike in order to get the best value from both e-finance and e-banking. **MU**

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Involving customers with new products

New product development can be rewarding, but it is also risky. Involving key customers in innovation and development can increase the chances of success. They can help in generating new ideas, testing them out and suggesting improvements. And, they can increase the speed to market. There are various ways to organise customers in these processes, from teamwork and practical workshops to developing on-line virtual communities. These methods can bring dramatic results. But, sometimes, according to **Susan Foreman**, the most profitable skill with new projects is to develop the discipline to terminate ideas that are doomed to fail.

Innovation through product development is at the heart of marketing, but it is costly and not without risk. There is often a high degree of failure and it is usually necessary to generate a high number of product ideas in order to secure one or two successful new product launches. As a result, many executives are disappointed with the new product development process. Innovations may not be radical, instead leading to simple or small improvements to products which then make only a modest contribution to performance[1]. This Update examines new and interesting ways of involving key customers in innovation and new product development. It explores how the market can be used to inject a wide range of new ideas and to increase creativity. Finally, it considers how organisations can develop the discipline needed to terminate ideas that are doomed to fail.

Lead users in idea generation

Idea generation is the starting point of the product development process. Traditionally, ideas have been drawn from a range of sources from both inside and outside the organisation. Views are sought from those close to the customer such as sales representatives, scientists, inventors, service engineers, as well as externally, from competitors, distributors and research organisations. But more importantly, ideas can come from one's own customers. Eric Von Hippel working with other researchers, Gary Lilien, Pamela Morrison, Kathleen Searls and Mary Sonnack, revisits the notion that using customers at the 'centre of the market' only produces limited suggestions for improvements[2]. Admittedly, some customers are limited by their experience and find it difficult to think about products in novel or unusual ways. But those customers who are 'lead users' in the market are more motivated to innovate. They can be attracted by the benefits of innovation. Lilien et al's work on lead users in an experiment at 3M, shows that product ideas generated from such projects are likely to produce results eight times higher than traditional projects. The Lead User generation process has four stages:

1) *goal generation and team formation* – once the 'ideation-goal' has been determined, a small marketing and technical team is assembled to work with key stakeholders in the company to identify the target market and the level of innovation required;
2) *trend research* – the team now focuses on developing a deep understanding of the key market and interviews experts on technical/scientific trends. At the end of this stage the team should be able to identify where the potential sources of value lie in the project;
3) *pyramid networking* – here the team concentrates on networking with those customers who are judged to be at the leading edge of the target market. They are searching for customers who are facing extreme conditions. The team seeks to learn what solutions these particular customers are requiring; and
4) *lead user workshop and idea improvement* – this stage involves about 10 lead users being invited to an exploratory workshop, with a small number of company employees. Working in small groups, they simu-

Traditionally ideas for product development have been drawn from a range of sources, but not from the customer

Some customers find it difficult to think about products in novel/unusal ways. But 'lead users' are more motivated to innovate late the product development process in order to identify viable propositions which can be put to the market.

The lead user process can identify a higher number of potential new products

In assessing this process, Lilien et al found that in addition to the eight-fold increase in forecast sales, this lead user process can yield the identification of a higher number of potential new products than conventional idea generation methods. Furthermore, many of the projects tended to be more inventive and 'new to the world', in contrast to the incremental changes that traditional methods tend to produce.

Open market product ideas

New ideas do not always flow from conventional, in-house new product development processes. The task of increasing innovation sometimes calls for looking outside the organisation. Darrell Rigby and Chris Zook[3] examine a more radical 'free trade' approach. They studied Pitney Bowes, the US postal company, which needed to generate new safety solutions as result of terrorist threats. And, it needed to adopt new approaches particularly quickly. So, it considered generating ideas through strategic alliances, sometimes with competitors, or through licensing or joint ventures. The advantages of this approach are:

Capturing and circulating innovative ideas
It expands the pool of expertise and increases the number of ideas to be worked with. It also helps to control costs and can reduce the time taken to get products to the commercialisation stage.

Exporting ideas
Here, the company presents its ideas to the market at an early stage to see if anyone wants to take on the development of new products. When, for example, Eli offered product development licences to the market the response – whether positive or negative – gave them useful information about their potential in the market. It produces a rough, tough evaluation of ideas.

The task of increasing innovation sometimes means looking outside the organisation

Finance and motivation
Whilst licensing and exporting ideas can be a lucrative source of finance, this strategy also sends signals inside the organisation. It shows commitment to innovation and a desire to bring products to the market. Thus internal innovators are under pressure to develop products or see them licensed to a partner outside.

An open market strategy like this requires conviction, clear judgement and systems to manage the approach. But it can accelerate the number of ideas moving into and outside the business and generate benefits by sharing ideas on a commercial basis. As Rigby and Zook state, 'open market innovation lets companies set realistic market values for their internal ideas, helping them to better define their core business'. In order to capitalise on free market innovation, organisations need to consider developing:

- a centralised organisation in order to increase control and efficiency;
- collaborative research centres with, for example, universities;
- expertise in law, patents research, and in raising capital; and
- formalised decision systems to assess, structure, negotiate and integrate transactions.

Sharing innovations also has its risks, as there is a danger that ideas are passed to others who capitalise on the opportunity at your expense. Nevertheless, Rigby and Zook show that the successful sharing of innovation is achievable when the approach is managed carefully to minimise the risk.

Customers in virtual communities get involved in product development

Many organisations have developed on-line or virtual communities to enable their customers to generate ideas, discuss products, share information and use their knowledge to contribute to new product development. Virtual communities encourage customers to get closer to the organisation and provide opportunities to develop relationships, which in turn helps to create future value for the organisation.

In many respects, creating and maintaining a viable community is reasonably straightforward. But using this resource, deploying it in the organisation and using it to develop products is much more difficult. The first step according to Satish Nambisan[4] is to understand the role customers can play as resources, co-creators and users.

Customers as a resource
As noted above in Lilien et al's work, the customer can often be used as a source of information and ideas. However, customers vary in their ability to provide valuable informa-

tion to support innovation and companies vary in their skill to extract information from them. First, customers need to be identified inexpensively. Second, they need encouraging and incentivising to contribute. Third, knowledge needs to be captured in a usable way.

Customers as co-creators
This role has been common in the business-to-business sector, where customers have been included in the design team. In a similar way, they have also been used at the concept-testing phase in consumer markets. Why do customers choose to get involved? Some customers think they will have important influence in projects, or that their chances of getting customised products will increase. Others may feel that their contribution is valued, thus increasing their own feeling of self-esteem. But for the organisation, this may have some downside. Customer involvement can bring uncertainty. Customers, therefore, need to be integrated into new product development project teams, and support mechanisms provided, for example to enhance customers' technological knowledge and expertise.

The customers as users
A customer's value is not only in testing products, itself a common feature in the new product development process. In some cases, customers can become as expert in the products as the manufacturer. They can then be used to provide technical self-help to other customers, avoiding referring enquiries back to the manufacturer. To gain real benefits from this, manufacturers need to be aware of a couple of potential problems. First, there is a need to get a diverse range of customers to contribute to product testing in a cost-effective way. Second, where customers provide expert support for products, it is sometimes difficult for the manufacturer to provide the means to facilitate customer- to-customer connections.

In each of these circumstances virtual communities among customers could be encouraged and supported. But, investment in virtual communities should only take place after an organisation has considered which of the above roles customers should play in the product development process. Whilst Nambisan is clear that there are benefits to be gained by using virtual communities to bring customers inside the boundaries of the organisation, he states that customer participation can also bring uncertainties and risks.

For instance, unless the process is managed carefully, this involvement can increase the product development times. Creating extra value through virtual communities needs, therefore, to be balanced with the costs involved in implementing the strategy.

Organisations have developed on-line/virtual communities for customers to share information

Emotional commitment to product developments

New product development, as we have seen, depends on generating the 'best' ideas and then efficiently developing products that reach the market quickly. Speed to market is therefore a key driver in this process. An over-emphasis on reducing development time can, though, lead to a high proportion of product failures – failures which could or should have been identified early in the development process. Despite the fact that most processes have opportunities to abandon risky projects built into them, the go/no go decision appears to be one of the most difficult in product development.

Jeffrey Schmidt and Roger Calantone ask why project managers are loath to put an end to new product development projects when the decision to launch a product that eventually fails is extremely expensive. Managers are often advised to ignore sunk costs and make tough decisions. But Schmidt and Calantone suggest that 'the costs may not be sunk psychologically'[5].

The product development processes followed by many organisations normally involve similar stages, each with opportunities to review progress. These provide an occasion to balance opportunities and risks. But the nature of the decision-making at these points has not previously been examined in detail.

Schmidt and Calantone conducted an experiment into new product development decision-making and discovered that commitment intensifies during the process. One of the key reasons for this is personal responsibility. If managers responsible for starting the project do not see or ignore the failure signs, they will continue to support it. Their commitment tends to be higher than managers who take over responsibility part way through projects. Indeed, during the experiment, it was found that managers were also likely to ignore 'bad news' from reliable sources and to continue to support the product through to commercialisation. Schmidt and Calantone also found that products that were highly

Throughout the stages of new product development commitment intensifies, making objective decision making difficult

Practical steps can be taken to deal the psychological aspects of product development

innovative and risky were supported even though the financial returns were no different from less innovative developments.

Scientists and engineers tended to become emotionally attached to some products they had been working on for a long time. In order to deal with these psychological aspects of product development Schmidt and Calantone suggest some practical steps:

1) managers can be rotated. New people bring new perspectives and are not bound by, nor do they have a personal stake in, previous decisions. The disadvantage of this approach is that the role of the product champion can be diminished;
2) introduce incentives and rewards that do not just support success but also recognise that failure is inherent in product development. This, though, can be a time-consuming process that involves the assessment of decision-making processes rather than tangible outcomes; and
3) use a team approach to decision-making, as this may encourage more reasoned go/no-go decisions. The group can call on a wide range of perspectives and on their collective knowledge to help decision-making. Furthermore, the shared responsibility can help to reduce over-emotional ties to previous decisions about the product.

Whether generating ideas or taking hard decisions to terminate projects with uncertain futures, the ultimate aim of the product development process is to generate shareholder value by creating value for customers.

One clear way forward is to involve customers in different ways throughout the process. But this needs to be balanced by clear decision making and an atmosphere of trust, in which the decision to terminate a project is supported as much as the decision to develop a product. **MU**

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The difficult issue of 'trust'

Staff trust in senior management seems to be declining. One reason may be 'flexible capitalism', which emphasises expediency over trust and loyalty in the workplace and, thus, replaces mutual commitment with mutual indifference. Clearly, one reason is the drive to cut costs to maintain performance in flat markets. But, trust normally has beneficial outcomes for the organisation in terms of performance and these are likely to be lost. Here, **Richard McBain** reviews recent research on the nature, drivers and benefits of trust in organisations. Some practical ways to improve trust in organisations is also suggested.

Evidence is accumulating that developing trust within organisations can promote organisational success and employee well-being. This focus coincides with an appreciation of the importance of the 'psychological contract' between employees and their organisation, discussed in earlier Updates. It also coincides with an apparent decline in the perception of senior executives and managers as trustworthy. One factor that may link both of these is the rise of what Rachid Zeffane and Julia Connell[1] term 'flexible capitalism', which emphasises expediency over trust and loyalty in workplace relations and, thus, replaces mutual commitment with mutual indifference.

The challenge for managers and human resource professionals is clear. In spite of increasing threats to the development of trust as a consequence of the stress and uncertainty provided by continuous change, globalisation and restructuring, ever greater effort must be made to improve levels of trust. Trust behaviours are those that build on individual confidence and eliminate fear as an operating principle. Trust also requires mutual feelings of trustworthiness between all parties in a relationship – whether these be individuals, groups of employees or organisations. Evidence suggests that trust is associated with beneficial outcomes at individual, group and organisational levels including:

- more effective communication;
- improved co-ordination and co-operation;
- increased acceptance of organisational authority and control;
- improved motivation, commitment, job satisfaction and enjoyment, leading to increased productivity;
- reduced resistance to capacity for and enhanced change; and
- greater creativity, innovation and risk taking.

This article will examine some recent research on the nature, drivers and outcomes of trust. Some practical ways to improve levels of trust within organisations are also suggested.

Trust can promote organisational success and employee well-being

Involvement, change and trust in management

Change is an ever-present aspect of work and continually presents inherent challenges for maintaining trust. Accordingly, the question of how to implement change whilst keeping trust has become critical. In a study of 2001 workplaces using data from the 1995 Australian national workplace survey, David Morgan and Rachid Zeffane[2] considered the effects of types of change on employee trust in management. They found that any change may reduce trust. However the type of change, perceptions of benefits and the level of employee involvement are important factors. Key findings were that:

- the most significant factors affecting trust are major changes in workplace structures, management and organisation, while changes in plant and equipment do not have any significant impact;
- employees are more likely to react positively to change where it most closely and beneficially affects them, through better promotion opportunities or job satisfaction for example, and where they are motivated to understand the reasons for the change. In contrast, when employees encounter novel

The question of how to implement change whilst keeping trust has become critical

situations that directly and adversely affect their well-being they are more likely to withdraw trust; and
- direct and open involvement in the process of change is likely to improve perceptions of honesty, integrity and trust. Where this involvement is through the formal hierarchy, via consultation with supervisors or managers, employees express greater trust in management. Where consultation is outside the formal hierarchy, or via indirect means, employees' trust in management seems to decrease.

To maintain trust during change requires employee involvement

This study demonstrates the importance of employee involvement and communication between senior managers and employees in the change process. However, another study of the same data, by B Blunsdon and K Reed[3], adds an additional perspective. First, they found different levels of trust in different industries – for example, levels of trust in the health industry were lower than in the retail sector.

Thus, managers have to work within a context which may not be entirely within their control. Second, they found that levels of trust are higher where someone with whom the employee has a face-to-face relationship takes decisions that can seriously impact on the employee. However, trust is lower where frontline supervisors display favouritism. Also, and perhaps surprisingly, where chief executive officers (CEO's) deal directly with employees the consequence may be decreased trust and increased risk. CEO's should, therefore, seek to develop supervisors and managers capable of building trust with employees and who display fairness in their actions.

Emotions, relationships and the organisational context

Where trust combines emotion and rational thought, it is richer and more enduring

Louise Young and Kerry Daniel[4] point out that trust is not just about a rational calculation of benefits, costs and risks. Nor is it purely about feelings, although emotions such as 'affection', 'confidence', 'admiration', 'liking', 'satisfaction' and 'appreciation' can build and sustain trust in relationships. Where trust combines both emotion and rational thinking, it is both richer and more enduring.

In a study of a service organisation, Young and Daniel found that the history of relationships and workplace culture influenced each other. Several factors emerged in this study as key to a vicious cycle of relationship development. Important among them were distrust of management and perceptions of management incompetence. Organisations' culture and institutional norms emphasised a sense of distance as well as feelings of uncertainty. For example, senior managers did not deliver service awards personally, and in one case an employee had to collect an award for good service after work hours to suit the manager. Employees also perceived initiatives as always being 'top down'. This generated feelings of powerlessness and managerial insensitivity, as well as further perceptions of managerial incompetence. They nevertheless found that distrust in management could exist alongside feelings of job satisfaction.

Accordingly, their principal recommendations for building trust relate to communication and personalised relationship development. Managers must provide better information to employees about what is happening in the organisation and better ways of communicating with them. More importantly perhaps, there should be initiatives to develop closer personal links between employees and management. And, at the organisational level, this should involve a greater opportunity for employee contributions to decision making. In addition to ways of encouraging perceptions of managerial trustworthiness, actions should be taken to make employees more trustworthy in the eyes of management.

A further conclusion from this study is that employee empowerment may enhance both trust and performance. Young and Daniel found that the link between employee trust and effective service delivery is complex. Job satisfaction could coexist alongside a distrust of management and so it may be this, rather than trust, that drives service delivery. Empowerment may, thus, be a strategy to build on the foundation of job satisfaction and thereby enhance trust and performance.

Trust — the role of HR management

In their study of two public sector organisations, S Albrecht and A Travaglione[5] found that levels of trust in management were not high. In addition, they found that trust in senior management influences important organisational outcomes, including commitment, positive attitudes to change and the intention to remain with organisation. The most important factors in developing trust from their study seem to be:

- an open climate of communication;
- fairness and equity in organisational politics and procedures;

- perceived organisational support;
- satisfaction with the job; and
- career security.

The authors point out that these levers are within the control of HR managers. Critically, they can influence organisational trust by helping to establish and maintain selection, performance management and promotion processes which are perceived by employees to be fair and equitable. A useful recommendation of the authors is that routine organisational climate surveys should be carried out. These could seek to measure the key factors, such as openness of communication, and establish trends.

Julian Gould-Williams[6] provides a further insight in a study that considers the impact of combinations or bundles of HR practices in public sector organisations in the UK. At the same time, Gould-Williams points out that trust does not tend to feature as a distinct outcome in orthodox HRM models, even though it has been argued that trust is required to provide a link between HR practices and performance.

Specific practices which have been identified as contributing to 'high performance' HR include:

- employment security;
- selective hiring;
- team working;
- performance-related pay;
- training and development;
- egalitarianism; and
- information sharing.

Gould-Williams found a limited application of high commitment practices apart from team working and internal promotion. At the same time, his study identified that both HR practices and the size of departments within the organisations significantly predicted interpersonal trust and trust in the organisation. He argues that these results highlight the role of HR practices in generating superior performance: 'the more HR practices are used within the organisation, the greater the impact on performance'. These operate directly through improving employee commitment and satisfaction. But they can also impact on trust, thus, indirectly, influencing performance.

Interestingly though, Gould-Williams also found that the relationships between trust, individual effort and job satisfaction were not straightforward. Trust in itself does not lead to greater effort, and effort did not have a significant effect on organisational performance. In addition, trust does not necessarily lead to job satisfaction, although interpersonal trust did have a significant effect on organisational performance.

Building and rebuilding trust – the manager's role

One theme in this article is the complexity of trust in an organisational context. In part, this is because trust works at different levels. Robert Galford and Anne Seibold Drapeau[7] identify three different, but interrelated, kinds of trust within an organisation:

The levers of trust are within the control of HR managers

- *strategic trust* – the trust employees have in the executive to make the right strategic decisions;
- *personal trust* – the trust employees have in their managers; and
- *organisational trust* – the trust people have in the company itself.

However, the manager or leader may begin with some straightforward principles of behaviour and action. As Galford and Drapeau state, the 'building blocks of trust are unsurprising: they're old-fashioned virtues like consistency, clear communication and a willingness to tackle difficult issues'. Managers must also recognise some potential enemies of trust:

- inconsistent messages;
- inconsistent standards and favouritism;
- misplaced benevolence and ignoring problematic behaviours;
- false or dishonest feedback;
- failure to trust others;
- pretending problems don't exist;
- failure to provide information;
- consistent corporate underperformance.

In a similar vein, Patrick McKenna and David Maister[8] identify five elements of trust and offer some suggestions about promoting them in order that a manager may foster team cohesiveness, creativity, commitment, professional satisfaction and, therefore, improved performance:

Potential enemies of trust need to be recognised and elements of trust promoted

1) *sharing* – making personal disclosures and taking risks moves trust to a deeper level;
2) *following through on commitments* – commitments should be documented to prevent 'memory lapses', guidelines should exist to prevent commitment from becoming an inconvenience, contingency arrangements should be in place, and group members should be allowed to take on only those

assignments they have voluntarily agreed to implement to avoid changes of heart;
3) *letting people know if you can't do something* – be open with people;
4) *keeping people informed after asking for advice* – give people feedback so they don't feel excluded or that they have been treated unfairly; and
5) *fostering constructive disagreement* – if you disagree with a view, acknowledge this openly and address the issues.

Where trust has broken down, a manager must own up to its loss and rebuild it

However, there are times when managers face a crisis or even a breakdown in trust. Galford and Drapeau suggest that in such times, managers need to think carefully about what they say and, especially, how it comes across – they will be remembered for what people think they said. In cases of extreme stress they should also acknowledge the need to get help from others, for example to check their perspective. They should resist any temptation to withdraw from a situation. Leaders must remain physically and emotionally accessible to the people around them. Moreover, when trust has broken down, a manager must first figure out what has happened and the extent of the loss of trust. But then they should own up quickly to its loss and identify what must be done to rebuild it.

Conclusion – HR and 'trust engineering'

Trust, or the 'employee's willingness to act on the basis of words, actions, and decisions of senior management under conditions of uncertainty or risk' (the definition of Albrecht and Travaglione) is emerging as an important aspect of organisational effectiveness. As Galford and Drapeau argue, 'building it, maintaining it, and restoring it when it is damaged must be at the top of every chief executive's agenda'. The individual manager too has a role to play.

Managers must consider their own behaviour and, in particular, the development of trust through consistency and integrity. This article has also indicated a role for the human resource manager. The importance of developing and maintaining trust in an organisation needs to be a central aspect of the HR agenda of every organisation, although 'trust engineering' at the organisational level is clearly not a simple matter.

Once achieved, trust may be an important means of generating organisational effectiveness – but once lost it can be difficult to recover in a vicious cycle of degenerating relationships and performance. **MU**

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Does leadership matter?

Charismatic leaders may not always be the best choice for a chief executive officer (CEO). They can have a destabilising, as well as a rejuvenating, effect. And leading revolutionary strategies may as often fail as succeed. So, how do you deal with a competitor hell-bent on revolutionising your industry? What strategies should you adopt? **Ian Turner** says that, while we may hope that strategic decision-making by top management really does make a difference, it may be that timing is all important. Timing can change the rules of the game.

These are tough times for leaders in business. The days when business leaders were hailed for transforming businesses and achieving seemingly superhuman feats of performance have now been superseded by a more sombre mood. Chief executives are in the firing line over claims of excessive compensation and financial irregularities. Business leaders who attained near-mythical status in the 1990s like General Electric's Jack Welch or ABB's Percy Barnevik have now departed the scene with some of their lustre gone.

Meanwhile, business writers like Harvard Business School's Rosabeth Moss Kanter seem to be backtracking a little: 'if the expectation is that a single leader can do it all, then it is unrealistic. But, it is also interesting how much a single leader can set in motion. In turnarounds it is quite striking how much fresh leadership can accomplish by unlocking talent which was already there in the organisation but which was stifled by rules, regulations and bureaucracy'[1]. Individual leaders and leadership are still important, according to Kanter, but successful leadership often depends on creating coalitions of support. 'Leaders also need to be good at articulating the will of the group'[2].

Kanter's colleague at Harvard, Rakesh Khurana, goes one step further. He maintains that charismatic leadership styles associated with some prominent business leaders have distorted our view of what leaders can achieve and what qualities they need to possess. In large complex organisations few chief executive officers (CEO's), he believes, are capable of making the sort of impact attributed to such leaders. Moreover, selecting leaders on the basis of charisma has its own dangers. Charismatic leaders may not be the best choice for the job. They can have de-stabilising as well as rejuvenating effects upon organisations. Moreover, in the quest to find charismatic leaders, organisations may be neglecting other candidates who – whilst not exuding the force of a powerful personality – may, nevertheless, have important leadership qualities[3].

Appointments of external charismatic leaders can have destabilising as well as rejuvenating effects

Khurana believes that we traditionally attribute too much credit (and blame) to top management leadership for the performance of a company. Most of the variation in company performance, he claims, can be attributed to industry effects, changes in the economy and organisational capability. It is irrational, therefore, to over-praise or vilify executives for periods of high or low organisational performance. The assumption that leadership makes the difference is seen as one of the main drivers in shortening the tenure of business leaders and shifting board preferences from internal to external leadership succession.

Indeed some of the best performing companies are run by insiders with little or no public profile

Khurana is not the first writer to point out the weaknesses in the rationale for appointing outsiders as CEO's. In their well-known book, 'Built to Last', James Collins and Jerry Porras[4] compared exceptional companies across a range of industries with satisfactory performers in the same industry. They found that hardly any of the exceptional performers relied on external appointments. Indeed, some of the best performing companies were run by company insiders with little or no public profile (as Collins and Porras put it: 'who remembers the name of the chief executive of 3M?'[5]).

Top leaders in all walks of life assume charisma by virtue of their trappings

Of course, there can be good arguments in favour of appointing external candidates to top management positions, particularly if the organisation is ripe for radical change. But if Khurana's argument is not new, his perspective on this is fresh and insightful.

As he explains, we normally assume that charisma is something which is inherent in an individual's personality. But he maintains that it is more of a social than an individual characteristic. Top leaders in whatever walk of life assume charisma by virtue of their trappings, office and appearance. Thus, in business, Khurana points to chief executives who are appointed on the basis of 'charisma by association'.

This is particularly marked in the case of General Electric's top management which has populated many of the Fortune 500 companies with CEO's, on the apparent assumption that anyone who has worked for Jack Welch must somehow have imbibed his charisma. Many boards of US companies have been anxious to recruit from GE or IBM even though, ironically, companies like GE have traditionally appointed their own CEO from inside.

Part of the reason for this faith in external appointments is the assumption that such individuals – particularly those who have gained celebrity status in the industry – will be able to shake up the organisation.

So powerful is this belief, according to Khurana, that even internal candidates aspiring to the top job within large organisations have to cast themselves in revolutionary mould in order to achieve appointment. However, as Khurana points out, deliberately de-stabilising the organisation to achieve radical change is not always the best approach in business.

Today's extraordinary trust in the power of the charismatic CEO resembles less a mature faith than it does belief in magic

In the case of Ford's Jac Nasser, for example, he may have done more harm than good, whilst in the case of Enron (transformed by an internal appointment – Jeff Skilling) it was certainly calamitous. 'Time and again over the past 20 years, corporate boards have seen the superstars they had hoped would be saviours turn into black holes that suck the energy and purpose out of their organisations……Faith is an invaluable – even indispensable gift in human affairs... But today's extraordinary trust in the power of the charismatic CEO resembles less a mature faith than it does a belief in magic'[6].

From hyper competition to counter revolution

Richard D'Aveni is perhaps best known for his work on hyper competition[7]. His book on this subject, and the works of others in the same vein, like Gary Hamel[8], pointed out that many industries were now susceptible to radical structural change and urged bosses to lead the revolution rather than be consumed by it. But, as D'Aveni now reflects rather ruefully, 'many of my clients, it turned out, wanted not to join revolutions but to end them'[9]. Clearly, we are all wiser in retrospect. In the 1990's it was not difficult to be impressed by the potential for small start-up companies with new business models to adopt revolutionary strategies. Perhaps we overlooked, at the time, the fact that only a few revolutions are truly successful. Indeed, as D'Aveni points out, when revolutions fail, they are generally relegated to the category of rebellion, civil war or mutiny, thus making all revolutions appear to have been successful from the start.

In studying the strategies of over 100 so-called incumbents, ie established players in industries faced with revolutions in their industries, D'Aveni has developed an anatomy of counter-revolution with five stages for 'leading the fight back'.

The first stage is 'containment strategy'. If you can spot the early signs of a revolution then it should be possible to contain it and stop it developing into a major revolutionary threat. The major thrust of such a containment strategy is to prevent existing customers defecting by locking them in, either positively, eg loyalty schemes, or negatively, eg raising their switching costs. In this phase businesses can launch 'blocking brands' and try to create confusion and uncertainty in the consumers' minds, eg Kodak's launch of the Instamatic camera to block the threat from Polaroid. At the same time, incumbents can often try to de-legitimise the revolution, perhaps by casting doubt on the technology. This was the approach used by the established tyre makers in the 1960s when faced with the threat from radial tyres.

When this approach no longer works, one can adopt a 'shaping strategy'. Having recognised that the new threat is not going to go away, incumbents need to shape it in ways that allow it to grow without endangering their existence. Investing in the new technology via research, influencing the setting of standards for new innovations by industry bodies, and offering to supply the challengers with raw materials or other critical resources are all ways in which existing industry players can influence the shape of this new challenge.

If shaping does not work, the next stage is to adopt an 'absorption strategy'. At its most basic, an absorption strategy can involve the acquisition of the challenger by the incumbent. However, as D'Aveni points out, challengers can be encouraged to cooperate in absorption strategies if existing businesses can secure for themselves preferential access to distribution or supply channels, making it unlikely that the challenger will be able to succeed without their help. This was the case in soft drinks, where established companies like Coca Cola were able to absorb the threat of so-called 'new age beverages' in the 1990's.

The fourth stage in the process of counter revolution is 'neutralisation'. If the challenge has been detected too late or has spread too widely to be ignored or coped with through the preceding strategies, incumbents can seek to block the challenge through legal means, as happened in the case of the MP3 revolutionary Napster, or by giving away the benefits offered by the revolutionaries as part of a bigger bundle of products or services as was the case with Microsoft's successful neutralisation of Netscape.

Finally, if neutralisation fails, a company can always resort to 'annulment'. This is the last resort because it can involve the incumbent in launching a revolution itself to respond to the challenge posed by the initial revolutionary threat. In this stage, incumbents either seek to leapfrog the revolution by themselves, introducing a revolutionary new technology which will negate the challenger, eg Gillette launching their Sensor razor to annul the impact of disposable razors, or they can try to sidestep the revolution by moving into associated services, as IBM did in the 1990's by moving from hardware into consultancy. 'Not every firm', D'Aveni points out, 'is well constituted to be a revolutionary. So, sensible industry leaders do not lead revolutions' he claims, 'they lead counter revolutions'[10].

The effect of time on firms' survival

Of course, all of this assumes that strategic decision making by top management really does make a difference. As Rajshree Agarwal et al point out, a company's long-term survival may depend more on timing than anything else. 'Time conditions', they write, 'time changes the rules of the game'[11]. In their work on corporate survival, Argarwal et al draw on three separate, but linked, sources:

- *evolutionary economics* – which derives from the work of the Austrian economist, Joseph Schumpeter, who wrote that industries evolve through waves of 'creative destruction';
- *technology management studies* – which look at the impact of different types of technological change (competence enhancing vs. competence destroying) on the pattern of competition in industry; and
- *organisational ecology* – which looks at how industry structures and competition interact. For example, a new industry will attract new entrants, but as more firms come in competition will become more intense. As a result margins will shrink and the weaker firms will not survive.

Agarwal et al's contention is that these three schools of thought all point to a similar conclusion about how industries and competition evolve over time. In any industry the number of firms will initially grow slowly, the increase will then gather pace until the number of firms reaches a peak. From that point onwards the process will reverse and, even though the industry continues to grow in terms of volume of output, the number of competitors in the industry will decline and a few large firms will come to dominate the marketplace.

A company's long-term survival may depend more on timing than anything else

In the mature phase of an industry, therefore, the large incumbent companies should be able to reinforce their dominance by virtue of superior resources, economies of scale, reputation advantage, etc... Interestingly, there is also agreement in the literature that it subsequently becomes easier for challengers because these dominant firms eventually become complacent. Similarly, the framework allows for the continued survival and growth of small companies that adopt niche strategies.

In general, in strategy it is rarely possible to make precise predictions about which strategies will or will not be successful under certain conditions. Nevertheless, it is important to have empirical research which at least gives us some general guidance to probabilities and patterns of success and failure. Agarwal et al tested their propositions in an impressive piece of empirical research involving over 3000 US companies tracked over a period from 1908 to 1991. What can we tell from all this research?

Early entry into a new industry is associated with improved survival rates but with disadvantages during the mature phase

The first point is that you are more likely to succeed as a challenger entering a new industry if you enter during the growth phase rather than in the mature phase. This is because during the growth phase the playing field is more level and the expertise needed to compete effectively often lies outside the established routines and practices of incumbent firms and may be easier for the new entrants to absorb and deploy. Moreover, during this phase in the development of an industry, benchmarks and standards have yet to be established, there is less consensus over correct technological solutions and business models and the importance of track record and reputation is less marked.

In the mature phase, smallness becomes more of a liability. Industry standards are established and dominant designs emerge[12]. When the performance parameters have been established in an industry, reputation and quality become all important. Innovation becomes more incremental, and process improvements help to sustain the dominance of existing companies over new companies. Clearly, even if a small challenger successfully enters the industry during the growth phase, it needs to grow rapidly in order to acquire the size and presence in the marketplace needed to compete successfully with larger incumbent companies when the industry moves into maturity.

On the other hand, the research does suggest that small specialised entrants can successfully enter mature markets and co-exist symbiotically with larger, more generalist, companies. Such small companies rarely pose a threat to the larger companies and, in any case, structural inertia in the incumbent companies can make it difficult for them to exploit all the opportunities available, thus leaving opportunities for more nimble competitors to occupy niches.

Multinational companies should aim to leverage globally-distributed capabilities under one company

There is, as we have noted before in these pages, an extensive literature on the subject of first mover advantages. Agarwal et al contend that early entry into a market during the growth phase of an industry is associated with improved survival rates but is disadvantageous during the mature phase. This is because early entrants in the mature phase will typically be entering during a period of transition or shakeout. This period is often characterised by the exit of companies that have entered in previous periods and are no longer able to master the dominant technology. Incumbents at such a point often enjoy strong patent protection and have built up networks in their industry which new entrants can find difficult to penetrate – 'the battle for survival during the shakeout is fierce and scarce resources tend to coalesce around likely winners. Entrants during the mature phase are likely to suffer from a high failure rate. This effect is likely to diminish over time however, thus increasing the survival rate for the later entrants'[13]. So if you want to survive, timing is everything – try to enter a growth industry early and grow fast – or wait until the mature phase and pick your niche carefully.

Globalisation and capabilities

In previous issues of Manager Update we have often discussed the so-called resource-based school of strategy with its emphasis on distinctive capabilities and core competences. We have also reviewed in these pages work on international strategy and structure and, in particular, on what is referred to as the transnational model – think globally, act locally – which writers like Ghoshal and Bartlett have developed. Now Stephen Tallman and Karen Fladmoe-Lindquist[14] have sought to combine these two perspectives to produce a framework for how multi-national companies should structure themselves, not just to penetrate international markets, but, perhaps more importantly, to leverage globally-distributed capabilities and integrate them into one company.

These authors distinguish between two levels of organisational capabilities: first, business-level capabilities, which typically revolve around process skills and technical know-how and, second, corporate level capabilities. These latter capabilities are to do with how the corporation leverages and integrates its resources to provide organisation-wide synergies. Wal-Mart and MacDonalds are cited in this context as companies which possess strong corporate capabilities. In such companies, these capabilities tend to be the product of its history and legacy of past investments and successes. In both cases – business level and corporate level capabilities – the authors distinguish between approaches designed to leverage existing capabilities versus approaches to build new capabilities – the process of generating new sources of competitive advantage as older sources of advantage become eroded or compromised.

The model differs from existing models of international strategy and structure in that, increasingly, multinational companies are seeking to build capabilities around the world based not on the command of natural resources or other so-called locational assets, but on tapping into sources of knowledge or expertise which can be developed into a firm-wide competitive advantage. Building on the work of Porter and others into competitive industry clusters, the authors advocate international expansion through acquisitions or alliances in order to tap into expertise or sophisticated markets. 'Multinationals are no longer doomed to possess only technical or technical-competitive advantages developed back in the home market, but can uncover and incorporate new component capabilities from abroad'[15].

In order to gain advantages from their capabilities on a global basis, multi-national companies need to integrate their activities at the same time as they delegate authority. As with the trans-national model, authority is no longer centralised but instead distributed throughout the organisation to those subsidiaries or divisions that have world-class capabilities. The corporate centre shifts from a 'command and control' role to one of 'coordination and coaching'.

Interestingly, the authors recognise that for this integration to work, knowledge – particularly tacit knowledge – needs to be shared across national boundaries. They believe that this is possible, though not easy, and requires significant investment by companies into formal and informal mechanisms for sharing knowledge. This level of investment is not to be under-estimated and suggests there are considerable overhead costs involved in global integration which have to be set against the potential benefits. Interestingly, they conclude that in more mature, cost-competitive industries, the cost inherent in setting up such structures may not be justifiable and that each company and each industry needs to make up its own mind just how international or global they might want to be. **MU**

Knowledge needs to be shared across national boundaries

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