

Chapter One

Forces for Change

Human resources (HR) departments are at an important crossroads. Large-scale transformation of the HR function is not only desirable; it is necessary. Why? First, the traditional transactional work of HR is rapidly becoming a commodity; at many companies, there are significant cost savings to be realized by treating it in this manner. Top managers are increasingly aware of the efficiencies that new technologies can provide, and they are putting pressure on the HR function to reduce costs as never before. Second, there is a growing demand for expertise regarding the deployment and management of human capital and organizational capability; the HR function can and should provide that expertise.¹ Managers at all levels increasingly need strategic guidance about how they deploy their workforce and build their organizations in order to fulfill company goals.

In order to respond effectively to both pressures, the HR function must simultaneously create transaction efficiencies and transformational changes. But substantive change in the nature of a staff function's work and role is rare. What's more, when such change does occur, it is usually driven by forces outside the department, such as a merger, a divestiture, a technology change, a change in the economy, or a new business strategy. Rarely do staff functions step up to reinvent themselves.

Currently, most HR leaders can still choose whether they will respond to change or whether they will lead change. HR executives still have the opportunity to shape how they and the HR function respond to the demands that their function is experiencing. To us, the path is clear. We believe that HR executives who stick with the

status quo and maintain a focus on transactional work will soon become obsolete. At the same time, we believe that HR professionals who meet the need for strategic expertise concerning human capital management and organizational effectiveness will contribute value that far exceeds the past contributions of the HR function. In the process, they will make themselves indispensable to their organizations.

A Case of Supply and Demand

To assess the nature and extent of the change required of HR, imagine a simple demand-supply model for businesses and apply that model to the future of HR. Start by stepping back and considering the major factors that are placing new or shifting demands on businesses today.² Since top managers grapple with these issues, HR professionals need to understand and respond to them in order to add value and establish their worth:

- *Customer-firm interactions are evolving.* Customers have more access to information and are more informed than ever before. As a result, customer expectations are higher than ever before, and competition for customer share is greater than ever before. Customers expect—and usually get—lower cost and higher-quality goods and services; as a result, they put pressure on organizations to reduce their own costs even as they strive to improve quality.³

HR directly affects operating costs because of the cost of its own operation and because it is partially responsible for a major expense: wages and benefits. In addition, the quality of HR services influences product and service costs and quality because the quality of HR services affects employee behavior and performance.

- *Targeting key customers is increasingly important.* At eBay, 10 percent of the customers purchase 90 percent of the products; in the airline industry, 10 percent of the customers provide 40 percent of revenue and 60 percent of profit. Financial service firms strive for share of wallet; food product firms seek share of stomach. In each of

these cases, new customer realities have established new rules for winning; customer share is now more important in these scenarios than market share.

To gain a critical customer share, companies must build a value proposition uniquely tailored to a particular target customer. Amazon, for example, knows the book buying patterns of those who buy more books and can tailor its offerings to those target customers. General Motors knows the car buying patterns of those who replace cars more frequently with new cars than others and can tailor its offerings to those customers.

Companies must also shift their focus from winning a single customer transaction to winning a lifetime of transactions. Amazon wants not only to sell a book, but also to build a relationship with customers so that they will spend a high portion of their lifetime book buying money with Amazon. As a result, Amazon needs to build a customer share strategy, directed at target customers, through brand loyalty and the kind of exceptional service that can be delivered only by a skilled, committed workforce.

One way to increase customer intimacy in key customer groups is to involve these customers in significant company activities that are designed to improve service levels. By involving customers in HR activities (for example, by participating in the design and delivery of training activities), HR practices may be used to create intimacy with targeted customers. When leaders worry about employees as if they are customers and customers as if they are employees, both customers and employees are more engaged and committed. When HR practices are used to align both employees and customers, both employee and customer share grows.

- *Information technology is continuing to evolve.* As we all know, information is increasingly ubiquitous and also increasingly easier to access and manipulate. This trend has significant implications for business-to-business, business-to-supplier, and business-to-employee relationships.⁴ It is also the foundation of e-business operations. Information technology allows for warehousing the kinds of customer data that enable companies to identify specific customers and determine

their buying criteria. Such data also allow customers to be targeted for life, as companies continually update their knowledge of customers' behaviors and buying criteria.

Information about employees allows companies to personalize employee rewards and better understand their employees' expertise, potential to contribute value, and likely career paths. Information warehouses can make it possible for organizations to analyze employee data to determine the costs and effectiveness of their HR practices and the degree to which they support key business strategies.

Information, in other words, increasingly is both a revenue source and a source of competitive advantage. Computer access companies like Time Warner and Yahoo increasingly make money on the information they track on their users. Firms with better information about customers, for example, can make decisions to move into new markets more quickly than their competition. Unilever tracks consumer buying patterns based on a number of demographic inputs such as household income, marital status, size of household, and household gender makeup. Using this information, Unilever targets its marketing not only to a region or geography, but also to a particular household through coupons and advertising. Consumer information becomes a source of competitive advantage because Unilever knows better than its competitors what consumers want and expect.

Similarly, firms with enhanced understanding of their employees' strengths and weaknesses are better able to make strategic decisions that will stick and succeed. A company that understands at the outset whether it has the capabilities to expand into a new market and where it needs to bolster its capabilities has a competitive advantage over companies that do not know themselves as well.

The implications of the growing importance of information for HR are obvious: HR must continue updating its systems and provide current and accurate data on employees, HR practices, and organizational outcomes. HR must also help turn information into informed choices so that data are not just warehoused but used to improve decision making.⁵ HR must help business leaders generate

and use information to help their organizations compete. HR systems must support change, using technology faster and deploying it more routinely.⁶

HR practices also need to adjust to the increasing availability of information technology. Staffing with information technology (such as computer databases and Internet screening of candidates) allows employers to identify and screen a broader array of candidates. Development with information technology (IT) allows for remote learning. Compensation management with technology allows for decisions to be made rapidly and accurately. IT-based self-service, when it comes to HR administration, can reduce the cost of HR as well as provide faster service.

- *Mergers, acquisitions, divestures, alliances, and partnerships are changing the shape of industry at a rapid rate.* Mergers and acquisitions continue to occur, and in some significant cases, they have crossed traditional industry boundaries to create convergence across boundaries.⁷ For example, the merger and alliance activity in the airline industry has redefined the industry. Today, convergence means that airlines sometimes compete with organizations outside their industry. For example, frequent flier programs are key assets to the airlines, but now these companies play in the same competitive arena as retail stores, telephone companies, and restaurants in deploying frequent flier benefits. Similarly, financial service firms worry about customers banking through Internet firms, about supermarkets performing financial services, and about traditional manufacturing firms like General Motors and General Electric performing financing functions.

Industry consolidation also means that products that were once in the purview of only one industry now cross boundaries. Computer monitors may become televisions and vice versa; telephones are now cameras. Vehicle on-line services like General Motors's On-Star make the automotive company a player in communication services; utility firms now offer control services to manage home and commercial temperature; and the electronics inside appliances now allow washing machines, refrigerators, and the like

to be directly connected to central services for maintenance and monitoring usage.

As industries evolve in this manner, leaders seek creative and alternative ways to leverage their organizations' core competencies and organizational capabilities across industry boundaries. At the heart of both are people. HR systems that help people conceive innovative ways to define and navigate industry boundaries can become an important competitive edge.

- *Investors are changing their assessments of value.* Determining a firm's market value has always been important to investors and managers alike. Recent research on market value has shown that the tangible financial assets of a firm predict less of its total market value today than in the past.⁸ A firm's total market value thus increasingly comes from the intangible assets that a firm possesses.

In exploring intangibles, investors look behind the financial numbers to determine the market value of a firm. They examine intangibles that predict future results, and this affects the current market value of corporations. Intangibles such as quality of leadership, speed of response, ability to innovate, capacity to integrate acquisitions, accountability for results, culture, and talent are becoming a central part of a firm's total shareholder value proposition.

Leaders have the primary responsibility for creating sustainable intangible value, but HR professionals can help in shaping intangibles. The goal is to build organizations whose long-term viability is ensured by the way the organization operates internally. HR professionals can contribute by developing HR systems that are designed to attract, deploy, motivate, and engage human capital in ways that create superior intangibles.

Consider that the ethics and values of senior management are among the most critical intangibles. When senior leaders are seen as greedy and excessively self-interested, investors discount the market value of the firm's financial performance. When leaders are forthcoming with problems and honest in assessments—that is, when they operate ethically—investors award firms positive intangible value.

Ethics and integrity have become a social agenda that leaders must explicitly acknowledge and manage.⁹ This agenda has a number of dimensions. For example, it encompasses legal issues. When leaders violate the laws that govern organizations and society, either explicitly through their actions or implicitly by turning away from and ignoring others' behavior, they fall into an ethics black hole that results in lost credibility. Customers, investors, and employees lose faith.

Leaders who assume large and visible organizational roles must live to a high standard, their behavior beyond reproach. Even the appearance of misdoing often leads to an erosion of confidence from critical stakeholders. Leaders, because of their status, economic rewards, and opportunities to influence, must be cautious about their behavior and the ways in which others view that behavior.

One important way that organizations shape social values is through their HR practices. For example, rewards often communicate a social value. When the only performance metric is financial returns (such as cash flow), pay for performance becomes a way of signaling what the organization values. If performance includes a more balanced scorecard, then leaders will change their behavior to reflect what is measured.¹⁰

Leaders need confidants who advise them on social issues and offer candid counsel and feedback on their behavior and on how to make informed social choices. HR professionals can be a voice for creating a social agenda and a source of candid feedback on ethical issues.

- *Social trends are affecting product, customer, and employee expectations.* Many social trends affect how leaders and organizations act.¹¹ The recent heightened emphasis on exemplary leadership behavior is one. The widening gap between the haves and have-nots is another. This bifurcation of the population has become more acute with the development of technology. The haves have access to computers and the Web, which leverages their knowledge and breadth of influence. The have-nots have little access to technology, which limits their scope of influence and thinking.

Business leaders often experience primarily the haves in their day-to-day work and may not be sensitive to the have-nots. Sometimes leaders live in “affluence ghettos,” whereby they work with people who are educated, successful, and ambitious; they live in the same neighborhoods as these people; their children attend the same schools; they socialize in the same areas; and they shop in the same stores. An affluence ghetto constrains a leader’s perception of the range of people who might work for or buy from his or her organization and in doing so limits the organization’s potential to grow.

Leaders need to be sensitive to the reality that their background is not always the background of those who buy the company’s products or of employees who make and sell those products. For the benefit of their organizations, they need to seek talented employees from multiple sources and leverage diverse backgrounds into common approaches.

- *Globalization is increasingly affecting organizations.* One of this book’s authors often asks this question in a workshop he conducts for alternating groups of about one hundred people: “What countries have you received e-mails from in the last week or so?” Generally, the count gets to twenty-five or thirty. This simple exercise reflects the increasingly global economy. When information moves across boundaries in “computer time” and when ideas from one country transfer easily to another, we clearly live in a global village. The realities of globalization, with information, ideas, jobs, and people moving readily around the world, create complex leadership challenges.

It is well known that leaders must learn to create global organizations that can both leverage global scale and adapt locally, move information quickly from one site to another, manage the diversity of cultures while maintaining unity of focus, and manage employees in dispersed operations around the globe.¹² It is much less understood that HR issues are often central to global success. Yet knowing how to attract, motivate, and retain talent in one region of the world does not necessarily mean knowing how to do the same in another region. Reward systems may also vary. Being global in business requires being global in organizational design, people, and HR practices.

The new business realities we have reviewed are summarized in Table 1.1. Taken together, they constitute the tremendous amount of change that organizations face today. These changes represent a potential threat to the HR function if it fails to respond to them. But they also represent a profound opportunity for HR to take on a new, more important role because so many of the new imperatives in business are directly related to the expertise and services that the HR profession can offer.

The Supply Side of the Equation

In responding to the demands they face, organizations and their leaders need to do more than craft strategy. Competitiveness requires both strategy and organization. Merely drafting a strategy that declares a new vision is necessary but not sufficient to win. Winning also requires creating an organization that accomplishes stated goals. Organization is more than structure; it is the set of capabilities a firm possesses. Capabilities represent what the firm is able to do well, its culture, and its unique identity. These capabilities derive from an integrated set of HR investments, where HR practices of staffing, training, rewards, communication, organizational design, workplace design, and so forth are aligned around building capability.¹³

The reality of the competitive business environment is that organizations can be successful only when they focus on doing those activities that help accomplish strategic objectives through core competencies and organizational capabilities. If organizations lack all the core competencies and organizational capabilities they need to succeed, they must build relationships with partners who can fill the gaps. The implications of this point are profound: filling gaps in vital capabilities can lead organizations to outsource any number of functions, from manufacturing to staff services such as IT and HR management. The key is ensuring that each partner supplies clear value so that the whole, which can be seen in the value delivered to customers, reduced costs, and ensuing profits, is greater than the sum of its parts.

Table 1.1 Challenges Facing Organizations

Area	Issues	General Manager Questions	Human Resource Questions
Customer	<p>Cost/quality: Customer expects continuous improvement in quality and cost share of customer versus market share—for example, Coke wants “share of stomach” versus market share</p> <p>Disintermediation: New channels to go to customers—for example, Amazon sells book over the Web</p> <p>Information: More informed customers—for example, consumers go on-line to study health options</p> <p>Brand: Building firm equity—for example, some firms (Coke, Intel, Nike) have powerful brands</p> <p>Consumer: More informed (literacy), disposable income, more sophisticated with choice, demanding—for example, buyer power</p>	<p>How do I target key customers and develop intimacy with them?</p> <p>How do I measure share of customer?</p>	<p>How do we reduce the cost of HR services and improve quality?</p> <p>How do we use HR practices to build relationships with targeted customers?</p>
Information technology	<p>Digitalization: Rapid change in technology and information access (miniaturization)—for example, telephones, TV, washing machines</p> <p>e-business: New channels, customer intimacy, Web strategy</p>	<p>How do I make information technology investments that will create value?</p>	<p>How do we get the right people and processes to ensure information technology advances?</p>

Table 1.1 Challenges Facing Organizations, Cont'd.

Area	Issues	General Manager Questions	Human Resource Questions
Investors	Value: Defining value as shareholder return, not cash Intangibles: Importance of intangibles and how to identify, measure, track—for example, market value Diversification of capital markets: 1979 = 524 mutual funds; 1999 = 7,791	How do I identify, build, and communicate intangibles?	How do we create intangible value through HR practices?
Business structures	Mergers: Consolidation, alliances, partnerships Divestiture: Break-up of firms, start-up firms, niche players, new players (for example, Jet Blue)	How do I position my organization within a changing business landscape?	How do we adjust HR practices to core competency needs?
Social	Haves versus have-nots: Widening gap of those who have and those who do not—a global issue Economic uncertainty: Dealing with ambiguity about the future and rapid pace of change	What social responsibility do I have?	How do we modify HR practices to deal with different employee needs?
Global	Virtual organization: Networked, dispersed organization Global leverage: Learning to leverage global enterprise with local autonomy Managing at a distance: Keeping common identity	What are the global implications for my business?	How do we adapt HR practices to global conditions?

Table 1.1 Challenges Facing Organizations, Cont'd.

Area	Issues	General Manager Questions	Human Resource Questions
Organization	New organization structures: Flatter, horizontal, shared services Employee expectations: Next-generation employees, free agent employees (low loyalty), work-life balance issues, desire for challenging work	How do I build an organization that helps me win?	How do we modify HR practices to new organizational forms to build competencies and capabilities?
Leadership	Leadership: Relying less on authority, need for better leaders	How do we lead effectively in today's competitive environment?	Do our HR practices attract, retain, and develop effective leaders?

Organizational forms are changing. The traditional hierarchy governed by rules, roles, and responsibilities is often not the best way to manage. Instead of rules that govern how employees behave, more and more employees do what they do because of unity of interests. Management by mind-set, or common goals or values, often needs to replace management by objectives. Employees need to focus on getting the work done regardless of formal roles, and managers need to encourage and facilitate such independent and responsible behavior. Because of these changes, new organizational forms (which go by many names, including *horizontal*, *alliances*, *networks*, *boundaryless*, *lateral structure*, *lateral*, and *shared services*) need to be used.¹⁴ Leaders need to allocate critical tasks to individuals rather than relying on an organizational chart. Instead of responsibilities laid out in job descriptions and profiles, employees need to join and work in task forces to define and deliver work.

Because of the importance of organization as a source of competitive advantage, companies need expertise in organizational effectiveness. They need to develop new designs and determine how

to develop the competencies and capabilities they require in order to implement their strategies. HR can play an important role both in developing strategies that are based on competencies and capabilities and helping organizations and their leaders develop the right competencies and capabilities.

Success in today's business environment requires leaders who are not only aware of but also sensitive to the many changes and demands that organizations face. Managers need to learn to influence less through formal position and more through relationships. If leaders fail to respond to these increasing demands, they will be replaced by executives who do.

The well-chronicled, increasing rate of CEO failure often can be traced to their inability to respond to one or more of the new demands. Sometimes failed CEOs were unable to anticipate technology or customer change, sometimes their actions violated social and legal norms, and sometimes they failed to engage their employees in the process of change. The need for effective managers and leaders at all levels is being felt by virtually every organization. HR is clearly well positioned to help organizations meet this need, and its future undoubtedly will be significantly influenced by how effectively it helps organizations meet it.

HR's Optimal Response

We have mentioned in brief the ways in which HR professionals and the HR function at large can help organizations meet the new demands of doing business. We now consider in greater detail the opportunities HR professionals have to create value for employees, customers, investors, and their organization.

Value for Employees

Many employees want opportunities to learn and to grow. HR professionals need to build a new employee value proposition that both increases and clarifies what employees should give to their organization and what organizations should give to their employees.¹⁵ The

new business realities require employees who are able to contribute more productivity, knowledge, and skill than ever before. And when employees make these contributions, they must get more back from the firm. As employee demographics shift, what employees get back may be more focused on accomplishment and development. Employees may get opportunities to learn and grow, a chance to work for an organization with a significant purpose or meaning, a team of peers who share values and offer a cohesive community, access to information about where the organization is headed and why, and flexible policies and practices that adapt to each employee's personal life.

HR professionals can play a major role in crafting HR practices and employee policies that simultaneously articulate what employees are expected to contribute and to receive. HR practices should also be customized to support the business strategy of the organization. Finally, HR can help make a workplace more employee-friendly by offering high-quality user-friendly administrative services.

Value for Customers

In the new business realities, customer share often becomes the dominant criterion.¹⁶ Customer share represents the percentage of total volume a customer does that is garnered by one firm over the lifetime of the customer. Customer share requires that leaders identify target customers—those customers who have both scale (because of their volume of purchases) and opportunity (because of their potential for growth). Once leaders identify target customers, they are able to work to gain share of those customers.

Gaining customer share with targeted customers comes when leaders know how to build more intimate connections with customers. Some connection may come from involving customers in strategic and product decisions by using focus groups, market research, or strategic planning. It may come by using technology to directly link to customers. eBay tracks the buying patterns of its frequent customers (time of day, time of month, type of good purchased, and other parameters) to target key customers. Customer

connection may also come from including customers in HR practices of staffing, training, compensation, and organizational design. Target customers can participate in staffing by recommending or screening candidates, in training by delivering or attending the training activity, in compensation by evaluating performance, and in organizational design by participating in task forces.

HR contributes to customer share when HR practices are explicitly linked to meeting the requirements of target customers and when target customers actually participate in defining those HR practices. For example, one hotel chain uses a group of customers in defining the competencies required of its hotel management. These frequent guests of the hotel could articulate what they as target customers wanted to experience in their travels. By working with these customers, the HR practices for hiring, training, and rewarding were defined according to customer requirements.

This hotel chain, in fact, often includes customer input when implementing HR practices. Customers are among those who interview candidates for key positions. They present a portion of an orientation or training seminar. They offer data about their experiences that become part of the appraisal process. The goal of these activities is that the hotel chain will have actions aligned with target customer expectations so that target customers will consistently select this hotel.

To meet the customer share demand and focus HR practices on customers, HR professionals must look beyond HR administration and become much more customer sensitive. They need to know who the target customers are, why they chose one vendor over another, and how existing HR practices can be tweaked to serve customers better.

Value for Investors

Investors increasingly are looking beyond and behind the financial numbers to intangibles, which may range from more visible issues such as brand and research and development investment to organizational capability issues such as quality of leadership. With intangible assets, leaders may create a “story line” for investors that increases

credibility and confidence. As a result of this confidence, market value goes up. For example, Herman Miller has more than double the market capitalization than Steelcase, a firm about twice its size, because Herman Miller has known organizational capabilities that give it a higher intangible value in the eyes of investors.

Intangible value comes when investors know about and have confidence that the infrastructure of the firm is able to ensure future earnings. Many of the intangibles investors value come from HR practices. When a firm has a reputation for better talent, faster time to market, more innovative products and services, better collaboration, more ability to learn and share information, and accountability for results, investors value the firm more highly. HR professionals face the demand of performing so that their work adds to the intangible value of their organization.

In order for HR professionals to meet investor demands, they must become knowledgeable about who the firm's investors are, what investor expectations are, and how to communicate to investors the intangibles that matter most. HR professionals may also provide intellectual leadership in performing intangible audits where the intangibles are identified and evaluated and plans made for improvement.

Finally, HR costs are part of the total expenses of doing business. Controlling and getting a good return on investments in training and other HR programs can contribute to the bottom line of a corporation.

Value for Organizations

Some leaders have taken a balanced scorecard approach to measuring organizational effectiveness by focusing on employees, customers, and investors.¹⁷ They believe they can “succeed” by focusing on these three stakeholders. However, we do not think so. The organization is a critical, separate, and independent stakeholder. It has a culture or personality that endures beyond any single leader and any single program. Organizations have enduring patterns that take

on a life of their own. These patterns cause some employees to join and others to leave. These patterns become expectations of old customers and attract new customers. They give investors confidence when they support a credible business strategy.

These patterns or culture become the capabilities embedded within an organization. Most successful organizations have something they are known for that defines them; for example, Southwest Airlines is known for service and Disney theme parks for family entertainment. Firm identity should come from HR policies and practices. It needs to be developed based on a business strategy that recognizes the importance of shared culture.

A firm's identity should focus HR work on deliverables more than doables, from activity to outcome. For example, traditional measures of training are activity based (say, the percentage of managers who received forty hours of training last year) and cost based (how much was spent on training). Obviously, the more appropriate issue is what the impact was of the training received last year and its return on investment. Deliverables become the outcomes of HR activity and thus the capabilities of the organization.

In both talent-rich and talent-poor markets, HR professionals can make a major contribution by ensuring a constant flow of the right talent to the right place at the right time. HR professionals need to ensure that employees are both competent enough to do their job and committed enough to do it well. Ensuring talent requires innovative HR practices tailored to the needs of the individual employees and fair and equitable HR practices ensuring that employees who give more value get more value in return.

Organizational capabilities represent the things an organization is good at doing. With the new business realities, companies will have to identify and create new capabilities to enable them to succeed. These organization capabilities should be the deliverables of HR. They also become the intangibles that investors and customers value.

With a definition of *organization* as a set of capabilities, HR professionals can partner with line managers to assess which capabilities are critical to a firm's success. They can also help audit what the

firm is and should be doing to augment these capabilities. Thus, HR professionals can play a role in deciding how the presence or absence of capabilities influences the corporation business strategy. They also can play a key role in deciding how to build new capabilities and competencies.

Performing organizational audits places new demands on HR professionals. HR professionals who established careers in a particular functional area of expertise, such as benefits or compensation, may need to learn to rethink and expand their work to focus on capabilities. As capabilities and intangibles become part of the competitive reality, HR professionals can contribute more value. They can measure their success by business success; their deliverables become the capabilities and intangibles of the firm; they can participate in key business forums where their ideas move the business forward.

Conclusion

HR is at a crossroads. There are unmistakable increased demands and opportunities for HR to add value in today's business world. HR professionals who want to add value to employees, customers, investors, and the organization must rethink their roles. The demand for HR to do more and to do different things has come about not only because HR professionals are calling for it, but also because business conditions require it. Organizations that invest in the right type of HR work will see enormous returns in terms of employee, customer, investor, and organizational results. Those that do not will have difficulty being competitive.

Because of new business realities and the need to develop a new HR value proposition, the field of HR is in flux. The rhetoric of being a business partner is being replaced by the reality that HR must add value or be eliminated. HR professionals need to focus on the ways in which this function can add value to employees, customers, investors, and the organization. This reality, which should challenge and engage HR professionals, represents a tremendous opportunity that can lead to a transformational restructuring of the HR profession and the role of HR in organizations.

Notes

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