A NEW BOTTOM LINE: UNITY FROM THE OUTSIDE IN

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In a short period of time, we have witnessed the double-edged sword of how business leaders can impact market value. On the one hand, leaders can infuse markets with optimism — most of them honestly — and increase the market value of their businesses. On the other, they can also destroy market value through deceit and mistrust. The new bottom line for business is not just about making money, but also about the intangibles of how money is made and how business is run.

We have learned that the intangibles of business — things like quality of leadership, the ability to make things happen quickly, a clear growth strategy, strong functional competencies, brand recognition, and so on — matter in both bear and bull markets. When the dot-com bubble burst, the recession occurred, stories of dishonesty grew, and some firms’ market value fell more than their peers in the same industry. We believe firms that survived the market credibility crisis did so because their leaders made the intangibles tangible. Intangibles matter most when comparing firms within an industry, not across industries, so the variations in P/E (price-to-earnings) ratios of firms within an industry offer evidence of leadership intangibles in both up and down markets. Intangibles show up in business by boosting — or undercutting — investors’ confidence in a firm’s performance. Baruch Lev, an accounting professor at NYU and a prominent thought leader on intangibles, has shown their importance as indicated through the market-to-book value (the ratio of a company’s capital market value compared to their net asset value) of the S&P 500 from 1977 to 2001. This figure has risen from 1 to over 6 in the last 25 years, suggesting that for every $6 of market value, only $1 occurs on the balance sheet. This data shows that the value of many firms comes as much from perceived value as from hard assets.

Firms like The Coca-Cola Co. and Merck & Co. Inc. have high market value because of branding and patents. Technology-based firms like Amazon and Exult Inc. have high market value with relatively little in the way of either hard assets or patents. And even traditional companies like General Motors Corp. and 3M Co. are increasing market value by focusing on brands, leveraging the Web, and restructuring.

Understanding and leveraging intangibles creates powerful tools for leaders. When intangibles are defined and operationalized, leaders can make choices that affect not only what happens inside their firm, but also how investors value those decisions. Lev has offered more precise financial definitions of intangibles. We define intangibles simply as the value of a company not accounted for by current earnings. This definition gives business a new bottom line. The old bottom line consisted of current earnings or P&L. The new bottom line includes current earnings and the ability to build confidence with investors, customers, and employees that the firm will be able to deliver in the future. Companies with high intangible value have higher price-earnings multiples than their competitors, and like coaches of successful teams, their leaders have earned the perception that they can be trusted to deliver on promises about the future. Companies with low intangible value have lower price-earnings multiples than their competitors in the same industry because of erosion of confidence in the firm and its leadership. The good news is that leaders can build higher intangible value for their organizations in both up and down markets. Intangibles become tangible when they are understood and managed, allowing specific leadership actions and choices to define and deliver them on demand. When this is done, employee commitment, customer intimacy, and investor confidence rise.

The traditionally hard fields of accounting and finance are now coming together with the softer fields of organizational behavior and human resources to help us understand the new bottom line, focused on intangibles and financial results. To illustrate how to build an intangible capability, we will explore the concept of performance culture. We will demonstrate the value of clearly describing what this intangible is and discuss practical ways leaders can build it. In our book Why the Bottom Line Isn’t!, we offer detailed theory and tools for building this and other intangibles that increase organization capability and value.

Building Culture from the Outside In: A Shift in Perspective

Organizational culture is a hot concept these days. Organizational cultures that are entitlement-oriented or too internally focused lack competitive zeal. Most definitions of culture suggest that it is more than random or isolated activities. Your organization begins to have a culture, a unique identity, when its management approaches outlive any one executive and involve more than any single management practice, fad, or era. We prefer to use the term “shared mindset” for this phenomenon because it represents
the essence of what’s really happening. First, “shared” implies common, memorable, or enduring. A “mindset” represents a thought pattern or framework that informs all activities. Therefore, a shared mindset becomes the enduring identity of the firm in the collective mind of employees, customers, and investors.

Why do we include customers and investors in our description of a shared mindset? Our approach to the concept of a shared mindset shifts the traditional focus on culture from inside to outside. Instead of just focusing on the patterns inside an organization that affect employee behavior, we focus on how customers and investors perceive and respond to the culture. For example, Dell Inc.’s commitment to rapid service affects customers as much as employees. Shared mindset also shifts focus to the entity that might exist among employees, customers, and investors, and away from somewhat generic value statements about what executives say is important. A shared mindset exists when customers, outside investors, and internal employees have a common view of the organization’s identity. Merging internal and external views of identity means that customers perceive the firm in ways that match how employees perceive the firm.

What’s In It for Me?: Intangible Value Among All Stakeholders

A shared mindset produces intangible value when it creates an identity or reputation in the mind of employees, customers, and investors that is tied not to a person or product, but to the firm itself. This mindset becomes a self-fulfilling prophecy when it affects how each stakeholder behaves toward the firm.

Employees will self-select firms where they perceive a fit between their personal hopes, values, and skills and the existing mindset at the firm. Employee commitment, productivity, and behavior both shape and are shaped by the identity of the firm. Employees who choose to work for Marriott Inc. must realize up front that they will be expected to provide exceptional customer service. Once hired, they accept management practices that reinforce the customer service mantra. Employees who don’t fit with the service agenda are likely to leave. A shared mindset changes and reinforces employee thinking and action.

Customers also demonstrate their commitment to a firm’s mindset or identity. When a firm develops a reputation for quality, service, or price, customers begin to rely on this identity and do business with the firm based upon it. This identity of the firm in the mind of its best customers becomes a strong brand and demonstrates the impact of mindset on customer value. Strong brands are not tied to a single product, but to the identity of the firm. Recent research shows that firms with strong and visible brands such as McDonald’s Corp., American Express Co., Harley-Davidson Inc., Herman Miller Inc., and so forth create higher shareholder value in part because they have a positive identity as a firm in both up and down markets. Possessing a strong brand becomes even more important for Web-based sales. Firms on the Internet with a known identity and positive reputation attract customers much more than unknown firms do.

Shared mindset also affects investors in two ways. First, investors have a mindset that defines a company and its overall intangibles. Investors may gravitate toward firms with positive identities (as with the run-up on Cisco Systems Inc. stock in the dot-com bubble), or rush away from those with negative reputations (as with the explosive run-down on Enron Corp. stock). Second, investors may be affected by the extent to which employees have a shared mindset. We have challenged a number of executives to allow financial analysts and investors to visit with any employee and ask any question: Did any take you up on the challenge? What happened? Please tell the whole story, or drop this point. The shared mindset of employees in different functions and at different levels will communicate as much or more to investors as crafted PowerPoint presentations.

Creating a Shared Mindset

How do you create an outside-in shared mindset? We propose a four-phase process that creates a shared mindset and affects employees, customers, and investors:

1. Create the desired identity
2. Make the identity real to customers
3. Make the identity real to employees
4. Build an action plan for implementation

Phase 1: Create the Desired Identity

We have worked with over 100 executive teams to create a desired identity or shared mindset. Some were at the top of an organization, creating a desired identity that related to the entire organization; others represented a division, a plant, or a function. Regardless of scope, the process for crafting a shared mindset is similar.

First, ask each individual to write a response to the question, “What are the top three things we want to be known for by our best customers in the future?” This question turns attention outside rather than inside by allowing them to see the organization through the eyes of customers. It also highlights the best customers, not the average ones. It focuses attention by asking for three answers, not an unlimited number. It emphasizes identity by asking what the unit is known for, not what it does. And it points toward the future, not the past or present.

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Second, collect the responses and categorize them. For example, a team of 10 people will give you 30 total items. Sort the 30 into common answers. This might mean that of the 30, you have seven that add up to “service,” six that comprise “value,” and five that focus on “reliability.” The other 12 won’t fall into these three categories. It is important to sort rigorously. For example, some people will write things like “service, reliability, or ease of doing business” and imply that they all mean the same thing. Not so. At this point in the exercise, the goal is to see the extent to which a shared mindset exists among the top team, which includes rigor of language and ideas.

Third, add the total number of responses in the top three categories (18 in this example) and divide by total responses (30) for a rough measure of shared mindset (67 percent in this case). Our rule of thumb is that a desired level is 80 percent — which is rare in the first round. Generally, even when firms have strong cultures, executives use differing language and even differ in the aspects of the company they regard as crucial to its success when seen through the lens of customers.

Fourth, talk about themes in the results. Cluster and define themes that emerge from the responses and redo the exercise to see if an 80 percent consensus can be reached. Reaching an 80 percent consensus generally takes a couple of hours maximum. After debate and dialogue, the executives can usually agree upon what they want to be known for by their best customers.

Fifth, put the themes into words that resonate with customers. For example, in the early 1990s, we did this exercise with the top 14 executives at Domino’s Pizza Inc. When asked the top three things they wanted to be known for, responses included service, reliability, good products, good value, talented employees, easy access, and many more. The unity score was about between 40 and 45 percent after the second step. After discussion, they agreed upon the themes of quality, service, and talent. Then, they put these themes into customer language: hot, fresh, tasty pizza delivered on time by friendly people who drive safely.

Sixth, check out the articulated mindset with customers to make sure it is right. This final step in building a shared mindset — making sure it resonates with target customers — is probably the most important. If the desired mindset will not cause customers to pick your firm over your competitors, it is the wrong one. This means having executives share their mindset with customers in one-on-one meetings, focus groups, and through other customer contact and research methods to ensure that it will influence their buying choices.
Phase 2: Make the Identity Real to Customers

Given that the desired identity should have meaning and impact for targeted customers, leaders should find ways to make the stated identity real to those customers. Phase 3 describes a concurrent effort to make it real to employees so that they have the right mindset and skills to deliver on customer promises. Making the identity real to customers comes from specifying points of contact — touch points — between the firm and the target customer, then finding ways to make the desired identity real for each one.

For example, at Domino’s Pizza Inc., executives picked four touch points between the firm and the pizza-buying customer: the call, the delivery, the pizza, and the box. To communicate service during the call, they worked to answer it by the fourth ring, give a friendly greeting, use caller ID to verify the name and address of customer, and make sure they thanked customers for their patronage. Deliveries were on time because the drivers had maps and drove in areas they knew, and they were accomplished by friendly people who dressed in clean uniforms, had correct change, and used a positive script in communicating with the customer. The pizza was hot, fresh, and tasty because it was made from quality ingredients, packed in heat bags to maintain warmth, and delivered quickly after cooking. But as executives thought more about customer contact, they realized the call lasted about 30 seconds, the delivery exchange about a minute, and the meal about 10 minutes, but the box often sat around customers’ kitchens for hours (and in many cases, days). So they chose to use the box for advertising their firm’s brand and identity. Rather than merely have the box give their name and say, “Our drivers carry less than $20 in change” — which might communicate an attitude of suspicion toward customers — they placed coupons, slogans, and promises about the quality of the pizza on the box itself.

Phase 3: Make the Identity Real to Employees

Ultimately, employees’ daily actions should reflect the shared mindset. We have found several critical considerations for leaders who want to make the mindset real to every employee, including talent, rewards, and training and development.

A. Talent Flow

The treatment of talent sends messages to employees, customers, and investors. Moving talent into, up, through, and out of the organization communicates the mindset. Hiring new people who embody the mindset and promoting employees who live the mindset — and removing those who don’t — become critical tools for embedding culture. Those who are not hired, promoted, or removed observe what is happening and adapt their behaviors accordingly. Southwest Airlines Co. rigorously screens flight attendants. It looks for employees who have technical skills, but even more it seeks those who are predisposed to engage with pas-
sengers, doing the required job with humor and enthusiasm. This type of screening becomes the most critical decision of a merger or acquisition — for the survival of the combined company, it’s essential to assess talent and ensure that the right talent stays and the wrong talent leaves.

B. Rewards

Reward systems can change and reinforce behavior. The goal of a reward system is to turn goals into measures of behavior and outcomes, and then allocate rewards based on the extent to which employees behave in the right way and deliver the desired outcomes. For a quick appraisal of your firm’s current mindset, take a look at its performance management system. Your observations show what your firm values as defined by what it rewards — that is, its real mindset — which may be quite different from the one fondly espoused in vision statements and other earnest pronouncements. It’s also useful to invite customers to review the performance management process and report the extent to which the behaviors and outcomes on the appraisal document reflect what they as customers want the firm to be known for.

C. Training and Development

Designing and delivering training courses sends messages about what matters. At the same time, it offers leaders skills and tools to act on those messages. An audit of the content of training and development experiences should show that these investments focus on the desired mindset, both conceptually and pragmatically.

Phase 4: Build an Action Plan for Implementation

Shared mindset changes the thinking and action of employees, customers, and investors. When your employees behave in ways that customers would like them to behave, employees, customers, and investors are well-served. In the fourth phase, the ideas from preceding phases translate to action. To be successful, action plans need to be specific, start small, and have leadership support.

We often ask leaders to look at the ways they could make the culture real to customers and employees and pick two or three specific areas they can focus on. Prioritizing a few things and getting them done is more useful than talking about a lot of things and accomplishing little or nothing.

Conclusion

Building a performance-driven culture ensures that every time your employees interact with your customers, their actions are consistent with what is desired. When this happens, customers expect to receive this experience from your company and are disappointed if it does not happen. We have described four steps necessary to achieve this shared mindset: articulate your unity of identity (the desired experience that customers should have);
make this identity real to customers at every touch point; make this experience real to employees through selection, development, bonuses, and performance management processes; and finally, build an action plan for implementation.

When a strong and desired shared mindset exists between your firm and its customers, tangible and intangible value is created. Customers are more likely to do repeat business, the right kinds of employees are most likely to be attracted to your firm, and investors have greater confidence that the growth plans of the firm will materialize in the future.

Our discussion of the shared mindset fits in the context of a new bottom line, one that is focused on both intangibles and financial results. We believe that intangibles can become tangible and that leaders can and should create intangible value. When leaders understand how they can build intangible value, they can begin to identity specific actions they can take to define a new bottom line. We have illustrated how culture can create intangible value. In both bull and bear markets, intangibles have begun to redefine business success. Leaders who adopt this new bottom line will have more success than those who do not.

About the Authors

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