8.5: Capabilities - Activities You Are Good At

Capabilities are especially powerful drivers of performance for businesses and many other kinds of organization (Hamel & Heene, 1994; Schoemaker, 1992; Stalk, Evans, & Schulman, 1992). They are the factors that determine how well groups achieve tasks that are critical. For our strategic architecture of resources, the most critical tasks include building and retaining resources. First, let us remind ourselves how capabilities differ from resources:

- Resources are useful *items* that you own or can access.
- Capabilities are *activities* that your organization is good at performing.

Capabilities are important because they determine how effectively your organization builds, develops, and retains resources. A more capable organization will be able to build resources *faster* and hold resource losses to a *slower* rate than a less capable organization. Capabilities, like intangible resources, are abstract and ambiguous items that are difficult to measure and manage. Nevertheless, they are important drivers of performance through time, so some attempt must be made to understand and manage them.

There are three useful reference points to bear in mind when you assess the strength of your capabilities for building resources:

1. **The maximum rate of resource building or retention.** For example, given good products and attractive prices, perfect sales capability would show up as a 100% hit rate in new customer acquisition.

2. **Best practice within the organization.** For example, if all our regional sales teams could build sales per customer as fast as region X does, how quickly would we grow sales?

3. **Benchmarks from firms in comparable sectors.** For example, if all our regional sales teams could build sales per customer as fast as competitor Y does, how quickly would we grow sales?

A team’s capability is the ratio between the rate at which it is *actually* achieving tasks and the best rate that we can imagine, given one of the benchmarks above.
Skills Versus Capabilities

Do not confuse team capabilities with individual skills. If you wanted to evaluate the total skills of a group and assess its overall average skill at individual tasks, then you would use the idea of attributes from Chapter 6. Clever organizations manage to take relatively unskilled people and generate outstanding performance. Consulting firms take newly trained professionals and enable them to deliver sophisticated business solutions; fast-food firms take unskilled staff and produce highly consistent products and service; call centers take people with little understanding of an organization’s products and clients and produce excellent customer support; and so on.

Clearly such organizations achieve much of this performance by training people: in other words, by adding to their individual skills. But they do more: They develop, test, and operate proven procedures. Team capability, then, reflects the combination of individual skills and these effective procedures.

Such procedures add up to a library of instructions for completing specific activities quickly and reliably. This library is effectively a resource, something useful that you own, and like any resource it is built up over time. It is also kept up to date by the removal of obsolete or ineffective procedures and the addition of new ones. One of the clearest examples you are likely to find concerns the franchise manuals used by firms like McDonald’s to both train their staff and control their franchisees. Such manuals cover everything from cleaning the fryers, to checking the inventory, to sorting the garbage.

Capabilities Accelerate Resource Development

As I have stressed before, if capabilities are to influence performance then it can only be by improving the organization’s success at developing resources, whether it be winning them in the first place, promoting them from state to state, or retaining them. For example,

- a highly capable human resource (HR) team wins the people that the organization needs quickly, efficiently, and with the greatest likelihood that they will stay;
- a highly capable product development group turns out products quickly and cheaply that satisfy customers’ needs;
- a highly capable customer support team ensures customers are content with the organization’s products and services, thus preventing customer defection.

There is a limit to what capable teams can accomplish though if they do not have the resources to do their job. Even the best customer support group will struggle to keep customers if the products they are supporting are inadequate.

Learning, Capability Building, and Resource Development

The last mystery we need to resolve about capabilities is where they come from. Team capabilities are built up by being used, much as individual skills are. Procedures and methods for getting things done are available to be recorded whenever they take place. So techniques have been developed in many sectors for achieving a sale to a new customer, for example. Indeed, many of these techniques are common to multiple markets and embedded in sales force training systems. The procedures for managing products through a research and development (R&D) process similarly arise from companies’ experience of actually carrying out that activity.
Clearly the more chances the team has to practice its winning, developing, and retention of resources, the more opportunities arise to test, improve, and record the procedures that work best. The bottom line is that the rate of resource flows determines the rate at which capabilities can be improved. If we add the earlier observation that capability levels drive resource flows, we have a simple and direct mutual reinforcement between each capability and the resource to which it relates. There are some cases where capability does not relate directly to a specific resource flow, but they tend to be less influential on long-term strategic performance than are these tightly coupled pairings of resource and capability.

Action Checklist: Managing the Impact of Intangibles on the Resource System

This chapter has explained the importance of intangible factors, given examples of simple measures for them, and shown you how they operate. Here are some techniques to ensure your intangibles are healthy and working well with the rest of your business system:

- **Identify the important intangibles.** Since your performance comes from concrete resources, start with these and ask whether an intangible factor is likely to influence your ability to win or lose them. However, do not go on an exhaustive search for as many soft factors as possible; each part of your strategic architecture will probably be most strongly influenced by one or two intangibles.

- **Be clear which of these soft factors genuinely accumulate through time and which are simply varying features of your organization.** “Quality” often reflects immediately the balance between what has to be done and what is available to do it, in which case it does not accumulate. Reputation, motivation, commitment, and perception, on the other hand, are built up and drain away over time in response to an entire history of events.

- **Specify intangibles carefully and identify the best measure.** What exactly is it that drives the choices of each group? That will be the measure that matters. Our IT service firm’s current clients, for example, were strongly influenced by the error rate they experienced, while potential clients responded to the firm’s reputation.

- **Identify the events causing each intangible to fill up and drain away.** This is the same bathtub principle we have used before, so remember that different items may be featured on either side of this question.

- **Look for places where you can strengthen intangibles.** If you were to lose some of your client relationship managers, for example, what could you do quickly to keep your reputation strong with the wider market and sustain the morale of your other staff?

- **Watch out for negative resources.** What can you do to slow down the unfortunate events that are filling up these negative feelings? Is there anything you can do to actively dissipate them?

- **Build intangible measures into your performance tracking system.** Reporting systems now commonly incorporate soft measures from various parts of the organization, recognizing that they are crucial to an effective system.

- **If you do not know, do not ignore the issue!** Soft factors are influencing your organization, continually and strongly. Remember that if you choose to ignore them, you are not actually leaving them out. Rather, you are assuming that they are OK and unchanging. This is unlikely to be the case, so make your best estimate and start tracking and understanding them.