

KNOWLEDGE, LEARNING AND COMPETITIVE ADVANTAGE

WHAT KIND OF MANAGEMENT EDUCATION DO WE NEED?

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In today's knowledge economies, companies increasingly differentiate themselves by their employees' expertise and know-how. This article examines the competitive advantage of managing human capital and its implication for the organization in terms of staff commitment and development.



"TODAY'S COMPANIES MUST RELY MORE ON INNOVATION BECAUSE PHYSICAL ASSETS ARE RARELY A DIFFERENTIATING FACTOR, THUS ENHANCING THE IMPORTANCE OF HUMAN CAPITAL AND KNOWLEDGE."

Developing and effectively using a company's own knowledge, or idiosyncratic knowledge¹, is increasingly vital in developing sustainable competitive advantages in today's "knowledge economies." We have moved away from the "traditional" manufacturing company, which was focused on tangible assets and the consequent importance of scale, vertical integration and a high degree of control over employees.

In this type of company, the separation between owners and executives gave rise to the "agency problem," approached from the hypothesis that people (owners, executives and employees) are selfish beings driven by a desire to maximize their material benefit (*homo economicus*)².

In contrast, today's companies must rely more on innovation because physical assets are less of a differentiating factor, thus enhancing the importance of human capital and knowledge. It is also commonly accepted that when this knowledge is specific and rooted in the corporate culture and values, its potential to generate differentiation, results and "inimitability" is even higher. This knowledge exists naturally only in the company that has cultivated it and its value is not transferable.

KNOWLEDGE AND LEARNING

Developing and using knowledge, however, always entails learning, especially *individual learning* and therefore *individual effort*³. Committing effort to learning involves a decision that each person must make. Within an organization, this also involves basic factors in business management, such as compensation and motivation. Today, for the reasons mentioned above, this is increasingly prominent on managers' agenda. We view this as a fortunate circumstance because, as we shall see below, it requires us to (re)consider the essence of the profession and effective practice of management.

From the *homo economicus* perspective, we can deduce that in reaching a decision about making the effort to learn, employees would do well to "protect themselves" from the companies' likely opportunistic behavior. Furthermore, companies should try to "convince" employees that they are not going to engage in such behavior. Eventually, some employees will be willing to personally invest in acquiring knowledge, accepting the risk of not leveraging its full potential.

In any event, management is responsible for designing its competitive position and for "making it work" in order to get "superior sustainable results." In today's competitive setting, this means making sure employees learn so that they can develop idiosyncratic knowledge. Since the nature of this knowledge means it cannot be "bought on the open market," this responsibility affects a series of basic considerations, such

as how the company's goals fit in with its employees' values and rights. The question is not detached from the personal and professional development of those who work with the company at all levels. And, as we shall argue below, it requires the company to go one step further than the concept of *homo economicus*.

THE EFFORT OF LEARNING AND ITS COMPENSATION

Why should employees be willing to contribute to the development of their companies' idiosyncratic knowledge? Some use the "employability" argument. In other words, "this will give you more chances in the job market should things go badly." Generally speaking, this argument is not very logical because in fact it prepares the employee to leave the company after it has invested resources in the employee's training. And it is particularly inappropriate in the case of idiosyncratic knowledge.

In short, if the knowledge to be acquired is important because it will help the company develop competitive advantages, for these advantages to become a reality, employees must *remain* in the organization. This leads to the issue of compensation in the broad sense. What can be done to compensate employees to do their part in the learning process and remain in the organization?

There are several problems with an exclusively monetary compensation in keeping with the *homo economicus* hypothesis. This thesis implies, for instance, that the "level of investment" in idiosyncratic assets that an employee decides to make depends exclusively on the income they expect to "appropriate" in exchange, which brings us to the realm of incentives. According to this hypothesis, any incentive designed to encourage an employee to invest in this type of asset must be in line with what the employee perceives to be the risk of the expected result of the investment. The outcome is that rewards designed to compensate the employee for this risk are:

1 For our purposes, the "peculiar character and temperament of an individual" ("Casares), or "features, temperament, character, etc. distinctive and inherent in an individual or group (RALE Dictionary).

2 To the extreme that suggesting this perspective, as it became widespread in both the professional setting and in academia, might have also been the cause of this selfish behavior, thus reinforcing a self-fulfilling prophecy (Ferraro, Pfeffer and Sutton 2005) in which considerations of honesty, veracity or equity were solely used to achieve the ultimate goal of material gain, manipulating personal interactions and forcing them on the side of whomever had the most power.

3 As a result, in order to analyze the phenomenon we are concerned with we must consider specific individuals and their interactions in the setting of the organization, understood as "the formal and informal allocation of decision (or property) rights and the mechanisms that enforce such rights" (Jones 1983). This is impossible when undertaken from the perspective of "market transactions", which are anonymous by nature, as is customary in most executive action theories.

"MOTIVATING AND COMPENSATING THE LEARNING OF IDIOSYNCRATIC KNOWLEDGE SOLELY VIA MONETARY INCENTIVES IS NOT SUFFICIENT. THE CULTURE AND VALUES OF THE COMPANY MUST BE EXPLICITLY TAKEN INTO ACCOUNT."

- a) difficult to implement, because it is virtually impossible to quantify the associated risk;⁴ and
- b) a source of additional cost for the company which rises with the risk; this can deter companies from assuming this cost and thus being unsuccessful in getting employees to assume the risk.

Exclusively monetary compensations also have more fundamental difficulties. One is that adopting them implies accepting that everything can be reduced to monetary terms. But when investing in idiosyncratic knowledge, employees will end up comparing their values with the "essence" of the company. Reducing this to monetary terms is not very realistic. In fact, we recognize this when we use "compensation packages" that try to "reward talent" by including aspects that cannot be converted into an "equivalent" monetary value⁵.

That is, if we talk about developing idiosyncratic knowledge, we cannot compensate the associated learning effort simply through a monetary bonus, precisely because the learning target is not neutral or bias-free but something strongly aligned with the essence of the company. For this reason, the employee's values and principles are relevant. Because, as Hartman says, "One way to choose to be a certain sort of person is to choose to be in a certain sort of community", indicating that people decide to join certain communities (in particular, a company) partly because they want to develop certain personal values. And they are willing to incur opportunity costs to achieve this ("honesty entails opportunity costs," in Hartman's words). Or to put it differently, an employee will decide whether or not to incur these personal costs based not just on a monetary bonus. Depending on their personal circumstances, they will try to ensure that at least part of the knowledge acquisition is consistent with their values, regardless of the size of the bonus⁶.

Therefore, we can conclude that motivating and compensating the learning of idiosyncratic knowledge via monetary incentives is not sufficient. The culture and values of the company must be explicitly taken into account, because they at least partially determine the decisions that employees will take. As a consequence, this issue becomes a truly genuine responsibility of the management profession.

Below we propose an incentive scheme that makes it easier to reconcile the organization's values with those of the employees. The result yields a virtuous circle, increasing commitment and trust, which in turn can increase the company's performance in the long term through its enhanced knowledge-based potential.

The scheme also suggests a way of reconciling the employees' interests and those of the organization. Naturally, this shifts

the traditional, economics-oriented conception of the company to a more humanistic vision that is consistent with the ideas of Prof. Juan A. Pérez López.

THINKING ABOUT SOLUTIONS

If exclusively economic incentives are not enough, what do we need?

One obvious way of tackling the problem consists of trying to attract, hire and develop employees whose values are consistent with those of the company (and vice versa, as will tend to occur). This has implications for the hiring process, for professional development and for career planning.

An alternative consists of explicitly recognizing a richer motivational scheme, and to link the incentives to learn with the results derived from exploiting the resulting idiosyncratic knowledge, *before turning them into financial results*⁷. Thus, an employee might have access to the results "at origin," check their consistency with their own principles and values, evaluate their "quality," and therefore reinforce (or not) their willingness to continue being a member of the organization and continue to learn because "they perceive that it helps them progress and become 'the type of person' they want to be."⁸ From the operational standpoint, this idea might be implemented in several ways, with the common feature of contributing to improve what could be called employees' "quality of corporate life."

An example might help clarify what we mean. Imagine an incentive to improve the company's relations with its suppliers. In this case, we could allow certain employees to develop these relationship from a *personal* perspective ("delegating" them, in other words, yet not just for reasons of short-term efficiency but also to develop the quality of long-term relationship). Or, if the improvement consists of saving time in a process, we could compensate the employees involved with part of this time for them to use as they wish, thus improving (via access to the results "at origin") what we call their "quality of corporate life."

4 Especially if one tries to do so by drawing up specific, detailed contracts, which at least partly contradicts one of the basic reasons for "getting people on board a company project as members of the organization" instead of searching in the market and getting their knowledge based on standard transactions, something intrinsically impossible with idiosyncratic knowledge.

5 Dimensions, it is understood, different from the ones that are justified simply because they enable one to have a higher purchasing power based on aggregating the employees' individual needs, or benefiting from some type of tax perk which is by nature artificial and arbitrary. We are referring to "interdependent components of a compensation package via the motivational and preferential structure of each individual".

6 Obviously assuming that they do not have an overwhelming need for the bonus; that is, that the company does not have them "enslaved".

"A GENUINE RESPONSIBILITY OF THE MANAGEMENT PROFESSION IS TO DEVELOP THE ORGANIZATION'S MEMBERS LEARNING IN THE BROADEST SENSE, INCLUDING THE INTERACTION BETWEEN THEIR VALUES AND THE COMPANY'S, ESPECIALLY WHEN DEALING WITH IDIOSYNCRATIC KNOWLEDGE."

This approach has another consistent property. In order to benefit from this type of incentive, employees must *remain* in the company, which then closes the circle. Employees join a company because they anticipate a good fit with its values, and by participating in activities that reinforce this fit, they realize that they can improve it if they remain in the organization and persevere with the associated learning process. The result, then improves

- a) the development and use of the corresponding idiosyncratic knowledge, yielding as a result competitive advantages based on this very knowledge, and
- b) the company's appeal to employees, thus closing the circle.

IMPLICATIONS AND CONCLUSIONS

We can glean at least two implications from the above discussion. One is well known but important. A genuine responsibility of the management profession is to develop the organization's members learning in the broadest sense, including the interaction between their values and the company's, especially when dealing with idiosyncratic knowledge.

The second is perhaps even more basic. Unless the knowledge attained is coherent with the employees' values (and even more so in the case of idiosyncratic knowledge), generally speaking we cannot assume that they will be willing to even consider making the personal investment to learn. However, if it is coherent with their values, they will most certainly make the investment. And the result will be better for everyone than if we "force" the investment by power, coercion, manipulation, trickery or other means.

Furthermore, it is clear that we are not talking about *operational* learning but the kind that develops commitment and trust, which has a great deal to do with the value fit that we have discussed and with the employees' resulting personal development and growth. (Without this personal growth, employees will probably leave the organization and seek better alternatives). Within Prof. Pérez López's conceptual framework, this is congruent with the idea of "developing the unity of the organization," and it underscores managers' responsibility for their employees' development in terms of the values that make the entire system develop in the same direction.⁹

To sum up, let us once again consider the reason for developing idiosyncratic knowledge. It lays the foundations for sustainable competitive advantages. Behind this goal is a fundamental issue of the personal development of those who invest the effort to gain this knowledge. When this development is consistent with the values of the people involved, a

virtuous cycle is started that increases commitment and trust, thus making the company even more competitive and enhances its potential for achieving results in the long term.

This argument is not new. But taking into account the competitive pressures of today's companies, which must increasingly seek differentiation through its knowledge base, we reach the interesting conclusion that we must recover the essence of the *management profession* and what it means to exercise it effectively and responsibly. It is also wise to do this because it is actually consubstantial with the quality of the management process, necessary for working as a manager in the best way possible with the goal of achieving these results.

WHAT ABOUT BUSINESS SCHOOLS AND IESE IN PARTICULAR?

The above, of course, has implications for those of us with the vocation of educating future business leaders. IESE has always taken this approach into account in its mission. Today, many are moving in the same direction. Leavitt, for example, underscores this in a recent article:

"Currently, our business schools encourage students – implicitly and sometimes quite explicitly – to envision the treasury troves of wealth, status, and "success" that await them out beyond their degrees. But shouldn't we teachers and trainers also be forewarning them of the enervating, often disillusioning psychological traps that lie out there? Shouldn't we be pointing out, too, the perhaps irreconcilable conflict between those organizations' values and the ones our parents taught us? Our universities purport, after all, to be truth-seeking institutions, not pre-recruiters for corporations. Sooner or later, our students will surely encounter a host of organizational situations that will try their souls and test the depth of their decency – unless our systemizing

7 The most common scenario when talking about incentives is linking them to financial results (which, tellingly, are simply called "results", as if they were the only ones). If we consider another type of result, we are acknowledging that a company might have goals that are not strictly economic or "on the short-term profit-and-loss account". By setting goals in terms of, for example, the development of idiosyncratic knowledge on which future competitive advantages can be based, one can think about getting long-term economic results (otherwise, the very concept of strategy would be meaningless).

8 A fundamental issue underlies this, even though it falls outside the scope of this article: It has to do with how human beings develop moral virtues, which includes the discovery of how good (or bad) an action is after doing it and experiencing its consequences, in the sense of "giving rise to a 'better person'" according to each individual's values.

9 There is another underlying core issue here related to the "quality" of these values which falls outside the scope of this article. However, it is closely related to what "improve as a person" means to each individual, which ultimately and inevitably leads to ethical and moral considerations, as mentioned above.