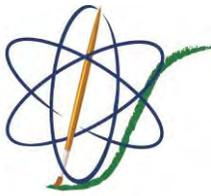


Transformation Capabilities

The Art & Science of Transformation[®] White Paper Series



Harold Schroeder, MBA, FCMC, PMP, CHRP, CHE
President, Schroeder & Schroeder Inc.



*The Art & Science of Transformation™
White Paper Series*

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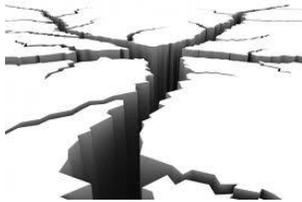
Introduction

This paper is one of a series in which we discuss the importance of organizational transformation for business survival and growth in the current environment. The papers are based on a recommended “Art and Science of Transformation”[®] approach designed to minimize the risks of change and maximise the likelihood of a successful transformation initiative that delivers the intended business benefits.

For most organizations, frequent transformation has become a necessity in order to remain competitive and meet the needs of their clients or customers (Jugdey & Mathur, 2012; Savoleinen, 2013; Zekic & Samarzija, 2012). In a major survey of more than 300 European corporations, 82% of respondents reported that they were conducting at least two major change initiatives every year.

Today’s business environment is characterised by shifting consumer preferences, frequent changes in the competitive environment, rapid technological advances, and increasing regulatory requirements, among other factors which place ongoing pressure on organizations to regularly transform as a matter of survival.

In this context, limited organizational changes are no longer adequate; there is often a need to adopt new business models or carry out extensive restructuring involving all parts of the organization. Moreover, firms are increasingly recognizing the inter-relationships between their organizational structures, systems and cultures and the need for holistic change initiatives that address all of these components.



However, reported success rates for major organizational change projects are low: only around 30% of transformation initiatives usually succeed completely, and 30% typically fail completely, often at significant cost to the organizations concerned (cited in Ward & Uhl, 2012).

The Art and Science of Transformation[®] approach is based on the understanding that any organizational transformation initiative requires the right combination of “art” and “science”. In brief, these are defined respectively as the soft skills necessary for managing the people-related aspects of change, and the effective application of project management tools and techniques. The “Art and Science of Transformation” approach is also both holistic and systematic, as we discuss further in the following section.

Using this approach as a framework, the current paper focuses on “*Transformation Capabilities*”, one of the important components of the transformation process. Along with the organization’s fundamental purpose, core values and defined transformation objectives, these factors play an important role in successful transformation.

The organization’s *Transformation Capabilities*, as we define them in this paper, can be regarded as its “strategic driving force”. This is closely related to the concepts of



organizational competencies and capabilities as set out by previous researchers and discussed extensively in the business literature. However, we propose a broader conceptualization of *Transformation Capabilities*, which incorporates two separate but inter-related dimensions: the organization's "strategic focus" and its "strategic capabilities". These interact in ways that propel an organization forward, facilitating and driving transformation in ways that enable it to achieve and maintain its unique market positioning and competitive edge over time.

In the paper we discuss the transformation process and the role of *Transformation Capabilities* in more detail, and provide practical guidance on how to identify and use these to drive successful transformation in any organization.

The paper has a strong evidence base, being grounded in a literature review of previous research in this area as well as our firsthand experience of assisting organizations of all types to successfully transform. It also has a highly practical focus, with an emphasis on providing readers with understanding and practical guidance on how to identify and use their organization's own *Transformation Capabilities* in ways that enable them to plan and implement successful transformation initiatives.

In section 2 we provide an overview of the Art and Science of Transformation[®] framework within which the concept of *Transformation Capabilities* has been developed. Section 3 discusses the organizational transformation process, our proposed definition of *Transformation Capabilities*, and the role that these play in successful organizational transformation.

In sections 4 and 5 we focus in turn on the two main components of *Transformation Capabilities* as defined in our approach: "strategic focus" and "strategic capabilities". We explore further the meaning of these concepts, drawing on evidence from the business literature, and providing practical guidance on how to define these within any organizational context.

In Section 6, further practical information and guidance is set out as we identify the specific art and science skills involved in identifying and utilising an organization's *Transformation Capabilities* to facilitate and drive successful transformation. The concluding section summarizes the key points of the paper and their significance and provides contact details for further information and resources.



The Art and Science of Transformation[®]

A significant body of research indicates that, when projects fail, this is seldom due to the inadequate use of project management tools and techniques. Instead, projects most often fail because of a lack of attention to the people-related aspects of change, in areas such as leadership, culture and communications (Economist Intelligence Unit, 2008); IBM Corporation, 2008); McKinsey & Co., 2008).

We define the “science” of transformation as the use of change management tools, methods and techniques, such as those set out in the Project Management Body of Knowledge (PMI, 2013) and including planning, resource estimation and risk analysis, for example. We define the “art” of transformation, in contrast, as the softer, people-related skills and attributes that are often personal in nature or develop from experiential learning. These include communications and inter-personal skills, leadership and the types of attributes sometimes referred to in terms of “acumen” or “emotional intelligence”.



Though many sources now stress the importance of people-related skills in organizational transformation, the Art and Science of Transformation[®] approach highlights the importance of applying *both* art and science for successful change: what is important is identifying and achieving the “right” combination of art and science in any project. This often has as much to do with mindsets as with specific skills or expertise: the art and science of transformation[®] requires the application of both “right brain” and “left brain” thinking, In any organizational transformation, it is crucial to achieve the right balance of art and science (Figure 1).

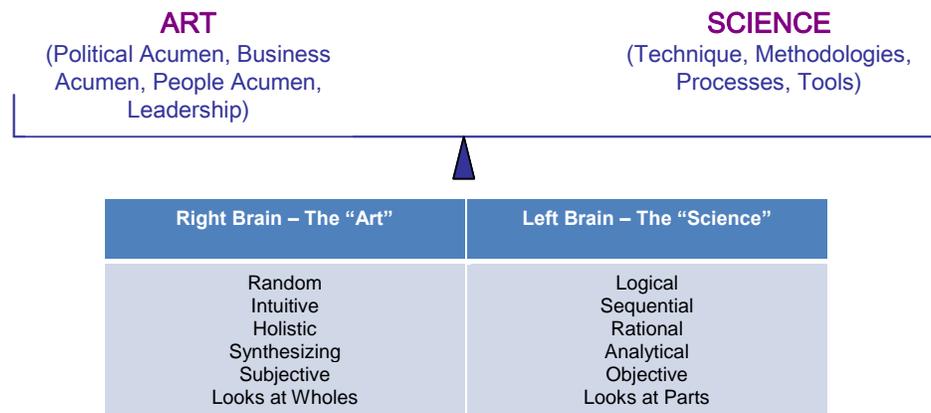


Figure 1: The Art and Science Balance

Successful transformation requires more than the application of particular types of skills and mindsets, however. Based on the research evidence as well as our extensive

hands-on experience of helping diverse organizations through the transformation process, we developed a recommended Art and Science of Transformation[®] approach. This is designed to address and overcome the main reasons why organizational change projects typically fail, and has the following key characteristics:

1. An emphasis on achieving the right balance between “art” and “science” in the transformation process.
2. A holistic approach, which recognizes and addresses the inter-relationships between the organization’s people, culture, systems and processes.
3. A systematic approach, which is fully integrated with the organization’s strategic planning process.
4. An understanding of what needs to change and what must stay the same when transforming an organization, as explained in the following sections.

This is the overall conceptual framework within which we examine the role of *Transformation Capabilities* in this paper. In the following section we describe the organizational transformation process as conceptualized in this framework, our proposed definition of *Transformation Capabilities*, and the role that these play in successful organizational transformation.



Understanding Transformational Capabilities

The Transformation Process

Understanding the role of *Transformation Capabilities* first requires awareness and understanding of the overall process that constitutes effective strategic transformation of an organization. In our recommended strategic planning framework for organizational transformation we identify four key factors that influence and drive this process, two of which are static in nature and two of which are dynamic, as shown in Figure 2.



We define effective transformation, based on the evidence from research and practical consulting experience, as a continued focus on the organization’s fundamental purpose and core values, while changing the way these are pursued in response to changing market conditions or other drivers in the external environment.

As observed by Collins & Porras (2005) these represent the essence and very identity of an organization, and should be regarded as its “guiding principles” which influence all that the organization does. Fundamental purpose, if correctly defined, should be ambitious and challenging enough that it can never be completely fulfilled but will inspire organizational members to consistently work towards it, in ways that are aligned with the organization’s defined core values.

We discuss the role of fundamental purpose and core values more fully in our white papers on *Organizational Purpose and Transformation* (Schroeder, 2013) and *Cultural Transformation* (Schroeder, 2012). The key points are set out in Section 4 of the current paper, in order to show how fundamental purpose and core values are inter-linked with *Transformation Capabilities*.

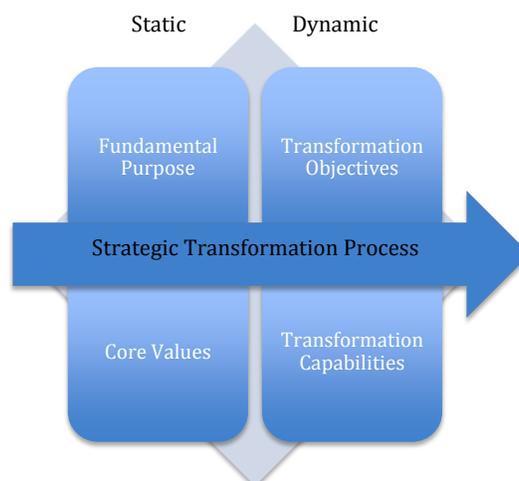


Figure 2: Static and Dynamic Factors in Organizational Transformation

The role of *Transformation Objectives*, and how to define these for successful organizational change is considered more fully in our white paper on this topic. *Transformation Objectives* set out the ways in which it is believed the firm's fundamental purpose can best be achieved given external conditions, such as consumer preferences and the competitive landscape. These are necessarily dynamic, reflecting the characteristics of the current environment and the opportunities and challenges this presents to the firm. They generally fall into two main categories:

- Strategic Performance Objectives are outward-focused, and concerned with realigning the organization more effectively against the exact needs of its target market. Strategic transformation objectives might, for example, include the introduction of a new product or service designed to meet the needs of the market more effectively, or changes in marketing or branding to appeal to a new target market.
- Operational Performance Objectives are concerned with ensuring that the organization's fundamental purpose can be optimally achieved in ways that effectively balance the needs of the market with the needs of other stakeholders, such as employees and shareholders. These relate primarily to the ways things are done within the organization, and are usually concerned with improving efficiency or cost-effectiveness.

Along with *Transformation Objectives*, *Transformation Capabilities* form the other dynamic factor influencing the strategic planning and transformation process. It is the organization's *Transformation Capabilities*, we contend, which facilitate and promote appropriate change in the direction of the fundamental purpose, and which guide the definition of appropriate transformation objectives, as discussed further in the following sub-section. In other words, *Transformation Capabilities* are the "strategic driving force" of the organization and its transformation process.



What are Transformation Capabilities?

Our approach to defining *Transformation Capabilities* builds on but can be distinguished from the ways that previous researchers have defined organizational capabilities and the related concept of competencies. We also take a broader view of *Transformation Capabilities* by identifying two separate yet inter-related components, which combine to give an organization its unique market positioning as well as determining the ways in which it needs to change in order to retain this competitive position over time.

In our experience, the essence of a firm's *Transformation Capabilities* or "strategic driving force" can best be defined based on the answers to two key questions, which enable it to identify its "strategic focus" and "strategic capabilities" respectively:

1. What is propelling the organisation forward? (strategic focus)
 2. What gives the organisation its strategic edge? (strategic capabilities)
-

For example, a statement of *Transformation Capabilities* based on the answers to these two questions might read:

*"ABC is a **client driven organization** (strategic focus) propelled forward by its **unique understanding of innovation and commercialization in the field of medical and assistive technologies**" (strategic capabilities)*



Few organizations formally define their *Transformation Capabilities*, in the way that they define their mission statements, for example. But some company descriptions and mission statements may encapsulate what we refer to as strategic focus and strategic capabilities, along with the company purposes and goals, and can be useful as mechanisms for conveying these concepts to both internal and external stakeholders.

The following real life examples were selected to illustrate this, (taken from website http://www.missionstatements.com/fortune_500_mission_statements.html) with the relevant text emboldened:

*Express Scripts is a pharmacy benefits management company in St. Louis, Missouri, whose aim is **to enable prescription drugs become more available, cheaper and safer to consumers** (the implied strategic focus). **Express Scripts processes pharmaceutical transactions faster and more efficiently than regular pharmacies, with the added online technology giving consumers more benefits and advantages.** (the implied strategic capabilities)*

*The capable team of MetLife's Customer Response Center (CRC) shares a common mission - **that all customers are "Met for Life."** (the implied strategic focus). **By balancing the efficiencies of new technologies with the personal touch of highly trained and motivated professionals, we are able to deliver solutions and services that exceed our customers' expectations.** (the implied strategic capabilities) *We thereby earn their loyalty.**

The strategic focus and the strategic capabilities of an organization combine to define its unique *Transformation Capabilities*. This "organizational transformation capability" in turn, coupled with its *Transformation Objectives*, then:

- Drives and helps to define the strategic choices the organization will make with respect to service offerings and markets it pursues
- Helps to determine the collective organizational capabilities that need to be developed or strengthened to enable the transformation objectives to be effectively achieved

To an extent, therefore, there is a circular relationship between the inter-related factors that comprise a firm's *Transformation Capabilities*. The existing transformation capabilities help to shape strategic focus based on the unique skills and expertise of the organization, but the process of defining strategic focus, in the light of challenges

or opportunities currently facing the organization and its related *Transformation Objectives*, also often reveals a need to modify or improve its strategic capabilities.

The composite nature of *Transformation Capabilities* defined in this way is shown graphically in Figure 3, with the two-directional arrows showing the inter-relationships between strategic focus and strategic capabilities.

In the following two sections, we examine these two key components of *Transformation Capabilities* in more detail and provide further guidance on how to define these in practice, drawing on the organizational literature and selected real-life examples.

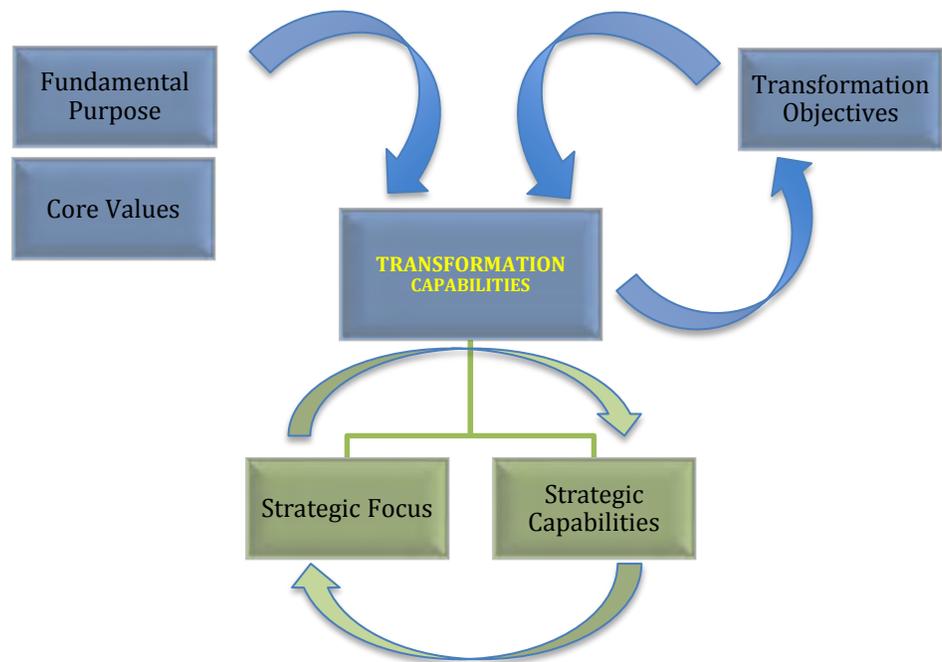


Figure 3: Transformational capabilities and their components



Defining Strategic Focus

The question is, where does the strategic focus derive from? In our transformation framework, we envisage this as being driven by the combined impact of the *Fundamental Purpose* and *Core Values* as well as the way that the organization responds to opportunities and challenges in its environment and as laid out in its *Transformation Objectives*.



The strategic focus is thus seen as the deep-rooted understanding of what the organization does and why it does it, which leads it to seek ways of pursuing this effectively given the environment in which it is currently operating. Strategic focus is also influenced by and in turn helps to shape the organization's strategic competencies, as we discuss a little later.

This component of *Transformation Capabilities* can be envisaged as primarily "outward looking" or client focused in nature, since it relates to the way in which the organization interacts with the outside world in pursuit of its purpose.

If identified and utilized effectively, the strategic focus can be extremely powerful in motivating and inspiring organizational members to work towards achieving this purpose to the best of their abilities. Often, however, organizations fail to develop and define their strategic focus correctly, due to a lack of proper understanding of their fundamental purpose and core values and how to use these in the strategic planning process.

In the following section we explain how the inter-related impact of *Fundamental Purpose*, *Core Values* and *Transformation Objectives*, when used correctly, generate a strategic focus that helps to propel the organization forward, forming one of two main components of *Transformation Capabilities* as defined in this paper.

Fundamental Purpose and Core Values in Transformation

It is first important to understand that it is an organization's *Fundamental Purpose* and *Core Values* that provide it with a unique identity and market positioning. Defined and used in the right way, these differentiate the firm from its competitors and provide a focus of identity and "relate-ability" for employees and customers alike, potentially resulting in more effective team working, sales, brand loyalty and other benefits.

The effectiveness of this strategy is provided by studies showing that the most successful business performers, such as Boeing, Disney and Corning Glass, are those companies that retain a consistent focus on their fundamental purpose over time,

while remaining true to their core values and adapting to changing external condition (Collins & Porras, 2005; Denning, 2012; Kanter, 2011).

Often, changes in the external environment threaten the competitive position of an organization, and there is a need for realignment through a transformation process. This typically involves the adoption of new strategies or ways of operating that enable the firm to position itself most appropriately in the new environment for effective pursuit of its *Fundamental Purpose*, which remains unchanged.

For example, Giesen, Riddleberger, Christner & Bell (2010) define four key elements of an organizational business model which may need to be modified in order to adapt the organization to a changing economic environment:

- What value is delivered to customers (customer segments, value proposition, what is sold and how it is sold)
- How the value is delivered (internal resources and processes; external partnerships)
- How revenue is generated (pricing model and forms of monetization)
- Industry positioning (the organizational role and relationships across the value chain)

The analogy of a ship in turbulent waters can be helpful in explaining this adjustment process: an approaching storm may necessitate mapping a new route to the planned destination; similarly, big changes in the competitive landscape facing a firm will require transformation in how a company operates in pursuit of its purpose, but the ultimate destination remains the same.

The determination of the most appropriate route and new positioning in the business environment should be based on the firm's strategic focus, which is therefore an important aspect of the firm's *Transformation Capabilities*.

A common problem, however, is that organizations cannot effectively develop their strategic focus and therefore their *Transformation Capabilities*, because they fail to properly identify and define their purpose and values. In the following sections we provide guidance on how to approach this.



Defining Fundamental Purpose

Organizational purpose is often confused with income generation or with selling particular types of products and services. When market conditions change and the organization needs to adapt, for example by developing new product lines, a lack of direction and focus can result and the company's fundamental identity can be weakened.

In our white paper on *Organizational Purpose and Transformation* (Schroeder, 2013) we argued that purpose can and should only be defined in terms of the fundamental categories of human needs that any organization is ultimately concerned with addressing (either directly or indirectly). We recommended Maslow's Hierarchy of Human Needs (reproduced as Figure 4) as a tool for helping to identify which needs or combinations of needs helps to define the organization's fundamental purpose.



Figure 4: Maslow's Hierarchy of Human Needs

For example, in response to customer preferences, many firms are concerned with providing products that address a basic human need for nutrition or for transportation, combined with a higher-level demand for comfort or luxury. This is a simplistic example; in practice it is the unique ways in which firms address more complex combinations of needs and demands that enable them to effectively differentiate their brand and compete effectively for customers in a particular market niche.

The important thing is to ensure, however, that *Fundamental Purpose* defined in human needs terms is also general enough to remain relevant over time, even when external factors give rise to the need to cultivate new markets, develop new products or services or even implement a whole new business model.

We discuss this more extensively in our white paper on *Organizational Purpose and Transformation* (Schroeder, 2013), where we include the examples of food and beverage companies providing products that not only fulfill basic nutritional (physiological) needs but also appeal to higher level needs and the overall customer "experience":

"To inspire and nurture the human spirit - one person, one cup, and one neighborhood at a time" (Starbucks)

"Delight every customer so they want to tell their friends – with great value through fresh, delicious, made-to-order sandwiches, and an exceptional experience." (Subway)

Identifying Core Values

The organization's culture as a reflection of its *Core Values* is also very important in contributing to its strategic focus, as the *Core Values* underpin the types of choices that are made about how to interact with the external world, including acceptable and desirable ways of interacting with customers, the relative emphasis on social as opposed to purely economic goals, and so on. Core values might include, for example, a focus on collaboration and teamwork, putting the customer first, honesty and integrity or product excellence. Overall, the values and the choices they lead to will help to determine the market position adopted by the firm.

CORE VALUE REVEALED IN

BEHAVIORS

Core Values are the element of organizational culture that should always remain consistent, unlike norms and behaviours that should be modified over time to ensure that they support the desired business strategy and goals. This topic is discussed more fully in our *Cultural Transformation* white paper (Schroeder, 2012).

This is because *Core Values* are integral to the very reason why the organization was established in the first place, and thus represent its essence and what it stands for. As such, they cannot be artificially created, only discovered by a process of reflection.

Once formally defined, however, *Core Values* play an important role, along with *Fundamental Purpose*, in shaping the strategic focus of the organization. Many organizations also use their defined *Core Values* as a marketing or branding tool, which can be very effective as long as the actions and behaviours of their company and its employees are always aligned with the espoused values. For example, the company websites of the following organizations promote their focus on the following core values:

- Accenture's core: "respect for the individual", "integrity" and "stewardship"
- Barnes & Noble Booksellers: "customer service", "teamwork", "empathy" and "quality"
- PricewaterhouseCoopers: "excellence", "teamwork" and "leadership"
- The Coca-Cola Company: "diversity", "collaboration" and "passion"

The importance of having *Fundamental Purpose* clearly defined in human needs terms as well as clear and transparent *Core Values* is especially important in contributing to the organization's *Transformation Capabilities* or "strategic driving force" by providing deeper significance and meaning to the everyday tasks of organizational members, and inspiring them to work to the best of their abilities in pursuit of shared goals.

This is especially important now that many organizations use fluid business models in which their human resources are not necessarily co-located or even permanently employed by the firm. The increasing use of contract workers, virtual project teams and outsourcing means that, more than ever, organizations need to ensure their

members are committed to and working effectively towards shared goals without being able to monitor this on a daily basis.

One of the most effective ways of achieving this is likely to be the definition and clear communication of a *Fundamental Purpose* and *Core Values* that organizational members can identify with.

External Factors as Drivers of Transformation



Having defined the *Fundamental Purpose* and *Core Values*, the key to determining the organization's strategic focus is to consider how these can best be pursued, given the characteristics of the external environment. When determined in this way, strategic focus forms an important dimension of the *Transformation Capabilities* or "strategic driving force" that propels organizational transformation in the right direction for successful market positioning and competitiveness.

In order to achieve this, it is important that a firm is able to identify when changes to their business model or other forms of transformation are necessary. Often, companies retain an existing business model for too long (Kliesch, Koch & Geiger, 2005), and their competitiveness declines as a result. Review of their business model and operational approach has become a frequent or ongoing requirement for most companies as customers become more and more discerning, new markets continually emerge and regulatory environments are more dynamic than ever (Yandeva, 2012).

Giesen et al. (2010) observe that there are four key circumstances in which firms should always make a point of reviewing their business model:

- During times of economic turmoil
- During industry-wide transformations
- In response to changing customer preferences
- In response to internal factors that are driving business model innovation

From our own view of the business literature we identified eight key factors that characterise today's business environment and are driving the need to review and transform organizations, as set out in our *Transformation Objectives* white paper (Schroeder, 2014). In brief, and updated with new citations for the purpose of the current paper, these consist of:

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| Industry competition | New technologies are lowering entry costs in many industries, as well as facilitating the use of new business models. Tapscott (2014) observes for example that the digital revolution and the Internet in particular have radically reduced transaction and collaboration costs, which can now occur in real time on a massive scale. In a recent M Global C-suite Study, 58% of respondents said they expect new technologies to reduce barriers to entry and 69 percent |
|----------------------|--|

expect more cross-industry competition within the next five years (IBM, 2013).

Socio-economic developments

Demographic changes and especially the ageing of western populations means that companies need to adapt their product and service offerings to meet the demands and preferences of older consumers. In the UK, for example, where the 60 plus age group is forecast to grow by 81% between 2005 and 2030, this group is reported to be responsible for 40% of total consumer demand (ActiveAge, 2012). Worldwide, it is forecast that there will be more people older than 60 than younger than 15 by 2047 (cited in ATKearney Inc., 2013).

Transparency

The Internet has brought about greatly increased transparency of information relating to industrial sectors as well as individual organizations, increasing business risks but also facilitating new forms of collaborative business arrangements and stakeholder participation. In *Wikinomics*, Tapscott & Williams (2008) highlight many examples of how successful firms are utilizing these opportunities to capture collective capabilities and ideas and turn these into innovation and business growth.

Relationship capital



Now that it has become easy for most individuals and organizations to develop vast networks of contacts via the Internet and social media, there is an increased emphasis on the ability to develop *authentic trust-based relationships* as a highly significant business performance differentiator. It is reported that total returns to shareholders of "high-trust firms" exceed those of "low-trust firms" by 286 percent (Covey et al., 2012), while consumer survey findings provide evidence that trust drives up to 44% of customer loyalty (Halliburton & Poenaru, 2010).

Sustainability

There are greatly increased demands in the current economy for businesses to be socially and environmentally responsible and consider the "triple bottom line", not just value to shareholders. In the U.S., a consumer research study found that consumers are 58% more likely to buy the products or services of a company that is mindful of its impact on the environment and society (Natural Marketing Institute, 2007).

Globalization

To survive in the emerging business environment, many companies need to cultivate new overseas markets or global supply chains. This brings new cultural and linguistic challenges. One source notes that the ability to communicate information in multiple languages has become a critical success factor in cross border mergers and acquisitions; while more than half of consumers surveyed indicated that obtaining information in their own language is more important to them than price (Depaola, 2014).

Complexity

Today's business environment is not only characterized by change but by unprecedented levels of complexity and unpredictability (Liebhart & Lorenzo, 2010). This has brought about the need not

only for greater adaptability and agility but also for new forms of leadership and management, based on empowerment and guidance rather than control of employees. In this way, organizations can become more responsive and proactive to immediate circumstances without being hindered by onerous consultation and decision-making processes. Cultural transformation as well as training and development initiatives are often needed to help ensure an organization can adequately adapt to these new ways of working.

Increased regulation

In many countries, an increasingly strict regulatory environment is requiring organizations to undergo extensive organizational transformations to ensure the requirements can be met. In the U.S. for example, there was a reported 13% increase between 2008 and 2012 in the number of federal regulations affecting small companies (Forbes, 2013).

Determining Strategic Focus - Key Steps



The steps involved in determining the organization's strategic focus therefore, can be summarized as follows:

1. Determine the organization's fundamental purpose, defined in terms of the human needs or combinations of needs that it is ultimately concerned with serving.
2. Identify the organization's core values, through a process of self-reflection and observation.
3. Identify the opportunities and threats in the external environment that influence the ability of the organization to effectively pursue its fundamental purpose, within the context of its goals.
4. Develop strategic goals based on maximizing the ability of the organization to achieve its purpose most efficiently and cost effectively, in the current and foreseeable future business environment.
5. The desired state as set out in the strategic goals and related *Transformation Goals* help determine the organization's "strategic focus" which should guide its transformation process and guide specific transformation objectives.

In chapter 5 we shall return to this process in order to discuss the importance of an "art and science" based approach to identifying *Transformation Capabilities* and to identify the specific types of art and science skills that are needed to achieve this successfully.

Next, we turn to the second main component of *Transformation Capabilities*: the organization's "strategic capabilities" and consider how to identify and define these in ways that enhance the organization's ability to transform in order to achieve and sustain a competitive market position.

Defining Strategic Capabilities

In contrast with the strategic focus, which is concerned with how an organization relates to the outside world, strategic capabilities have an inward focus, and basically comprise the unique combination of abilities that make the organization good at what it does. These have often been defined in previous research as *organizational capabilities*, which are closely linked with and build on *core competencies*, but also incorporate other organizational assets such as capital, technology and established organizational systems and processes.



Along with *Strategic Focus*, *Strategic Capabilities* form a bridge between what an organization wants to achieve (its fundamental purpose, business goals and transformation objectives) and the specific ways it will do so, based on the use of individual and collective competencies, as well as the organizational technologies, processes and systems.

In our transformation model, we distinguish between people-related competencies and non-people related organizational assets, which together comprise the *strategic capabilities* of the organization, and which in turn form the second main component of its *Transformation Capabilities* or “strategic driving force”.

This definition is slightly different from that of some researchers who have used the term “core competencies” in place of “*Strategic Capabilities*” to incorporate the combined impact of people-related and non-people related factors. Regardless of specific terminology, what is important to note is that it is the combined and inter-related effects of various people-related and non-people related factors that are most powerful in facilitating and driving transformation (Leavy, 2013; Prahalad & Hamel, 1990).

In the following sections we discuss these factors in more detail.

Competencies and Strategic Capabilities

The concept of “distinctive competence” was introduced by Selznick (1957) and developed by other researchers into the concept of “core competence”, which has been described as the particular knowledge set which differentiates a firm and gives it a competitive advantage over others (Leonard-Barton, 1992).

This concept may be familiar to readers from the work of Prahalad and Hamel (1990) who, in a widely cited Harvard Business Review article, provided evidence that the “core competences” or “collective learning” of the organization, largely determine its business performance. Many other researchers have since provided further empirical evidence of a strong association between a firm’s core competencies and its business



competitiveness (e.g. Agha, Alrubaiee, & Jamhour, 2012; Bani-Hani & Al-Hawary, 2009; Harvey & Buckley, 1997; Ibraimi, 2014; Javidan, 1998).

Core competencies build on individual level competencies, which can be regarded as the behavioural characteristics that predict performance in a job, or the characteristics or attributes that are important for employees to succeed in their jobs. There are two main categories of individual competencies:

Enabling: These are essential to realizing business strategy or value, and typically consist of critical behaviours and skills that are relevant to all employees. Examples include problem-solving skills, management and leadership skills and knowledge sharing.

Domain: these are required for success in particular types of jobs, and typically involve demonstrated knowledge in a technical, professional or process area. Examples include expertise in the use of a particular IT system; specialist knowledge of specific production processes or human resource management expertise.



The organizational level *Strategic Capabilities* are more than the collective sum of individual competencies, however. The former also incorporate the firm's non-people related assets such as the technological infrastructure, production process and the various systems the firm has developed to manage its operations.

Most crucially, the *Strategic Capabilities* comprise the ways in which the organization has learned to effectively combine and *integrate* people-related skills and expertise with non-people related assets (Uysal, 2010), producing a unique combination of *Strategic Capabilities* that differentiates it from competitors and can be described by the firm in simple terms as "what we are good at" (Figure 5).

As highlighted by previous researchers, a firm needs to focus on developing both individual level competencies and organizational level capabilities, and to ensure that these are well-supported by organizational resources, in order to realize the benefits in terms of competitiveness and business performance (Smith, 2008; Torkkeli & Tuominen, 2002).



Figure 5: Strategic Capabilities

Significantly, empirical research with more than 1.600 companies globally in a range of industrial sectors found clear evidence that "organizational capabilities drive corporate success", and that while behavioural aspects are vital differentiators, these are only effective in driving performance when they are combined with structural capabilities, such as rigorous business process and good organizational design (Boston Consulting Group, 2012).

Defining Characteristics of Strategic Capabilities

Prahalad & Hamel (1990) observed that core competencies (strategic capabilities) have three defining characteristics, which underpin the competitive advantage that they provide:

- They potentially allow the firm to enter a large number and variety of markets
- They are perceived by customers to be the key source of value added to the firms products or services
- They are very difficult for competitors to imitate

The power of *Strategic Capabilities* derives largely from their relevance throughout the firm's value chain, in contrast to individual competencies, which are often specific to jobs or products. Clark (2000) referred to these types of organizational capabilities as "integrated bundles of skills and technologies which are competitively unique and re-deployable" (p.117).



As a result, in a rapidly changing business environment these *Strategic Capabilities* or core competencies, underpinned by strategic focus, are especially important in enabling an organization to adapt quickly to new opportunities or challenges (Prahalad & Hamel, 1990). Research by Dannels (2002) demonstrated this by showing how competitiveness was enhanced by the dynamic relationship between competencies (capabilities) and product innovation.

The ability to develop *Strategic Capabilities* is also strongly influenced by corporate culture. Agha, Alrubaiee & Jamhour (2012) demonstrated, based on empirical research with a sample of manufacturing companies in the UAE, that firms possessing shared vision, co-operative working and employee empowerment are most successful in developing organizational capabilities that contribute to business performance. The types of competencies and capabilities that develop in an organization over time will be influenced by a number of factors including:

- The organisation's service/product concept
- The class of "customers" the organisation serves
- The market category the organisation targets
- The technological aspects of the product or service
- The organisation's delivery capacity
- The organisation's "sales & marketing" methods
- The organisation's pursuit of size and growth

Strategic Capabilities are therefore unique to each organization, determining its market positioning and giving it a competitive edge over others in this market place. Certain capabilities have been shown, however, to be critical success factors in

business performance, such as knowledge management and innovation creativity (Godbout, 2000).

Company Examples

There are many case studies in the business literature of the “core competencies” or “*Strategic Capabilities*” that have been important in propelling leading business performers to success, and acting as an important source of differentiation from other firms in their market niche.

In their article “The Core Competence of the Corporation”, Prahalad & Hamad (1990) include the examples of:

- Casio, which was able to use its combined capabilities in miniaturization, microprocessor design, material science, and ultrathin precision casing and apply these to a range of successful products including calculators, pocket TVs, digital watches and car dashboard systems.
- 3M, whose expert capabilities in areas such as adhesives, coatings and substrates have been successfully applied to diverse product areas such as sticky tape, magnetic tape, photographic film and Post-It notes.

Some more recent examples which meet the criteria of facilitating access to multiple and diverse markets, being seen as a key source of value added to products and services, and being difficult to emulate include:

- Apple – “Making user friendly interfaces and design”
- Walmart – “Low-cost retail”
- Google – “The understanding and development of algorithms”
- Netflix – “Content delivery to the home”

Strategic Capabilities in Transformation



Some researchers have taken a somewhat static approach to identifying *Strategic Capabilities* and investigating their impact on business performance. In contrast, we would emphasize that it is the dynamic, evolving nature of *Transformation Capabilities* that helps drive successful transformation and the ability to remain competitive over time. As Prahalad and Hamel (1990) pointed out with regard to the similar concept of “core competencies”:

“Competencies are the glue that binds existing businesses. They are also the engine for new business development. Patterns of diversification and market entry may be guided by them, not just by the attractiveness of markets.” (pp. 5-6)

Once developed, *Strategic Capabilities* form an important component of the organization's *Transformational Capabilities* or "strategic driving force", but must continually evolve and develop in line with business strategy and objectives (Kliesch, Koch & Geiger, 2005).

This dynamic approach to understanding organizational capabilities is what makes the concept so relevant to the current business environment, which is characterised by ongoing change, flexible business models and the increasingly important role of intangible assets (Augier & Teece, 2009) such as tacit knowledge and the ability to effectively network and form trust-based relationships. These types of organizational assets are explored more fully in Schroeder & Schroeder Inc.'s *Relationships in Business* white paper series.

In today's business environment, therefore, there is a continual need to identify the critical *Strategic Capabilities* required for sustained business performance, and review the organization's current *Strategic Capabilities* to identify any gaps or capability surpluses that need to be addressed to improve performance.

Some existing capabilities may no longer be necessary for sustaining a competitive advantage, for example if related to the use of out-dated technologies. Entry into new markets or developing innovative products and services to meet new customer preferences may require the development of new capabilities. The process of identifying and implementing these changes will thus strengthen the "strategic driving force" necessary for successful transformation.



Key Steps in Identifying and Improving Strategic Capabilities

1. Based on the identified "strategic focus" identify the required capabilities (competencies, systems, resources etc.) needed to support this and the related strategic goals.
 2. Identify capability gaps and redundancies, using appropriate tools and techniques such as the organization capability assessment method illustrated in Figure 6. The types of questions that should underpin this process include:
 - What does the organization need to do to successfully achieve its transformation objectives?
 - How capable is the organization of doing these things at present?
 - What are the gaps between the current situation and the desired situation?
 - Where there are gaps, why and what is needed to fill them?
 3. Translate capabilities into specific competencies that can be delivered by individuals and teams. It is important to involve employees in the process of translating organizational capabilities to their own areas of work to determine the
-

required competencies to support these, as well as seeking expert input and advice or even the views of customers. Interviews, workshops, focus groups and other data collection methods can be used for this process.

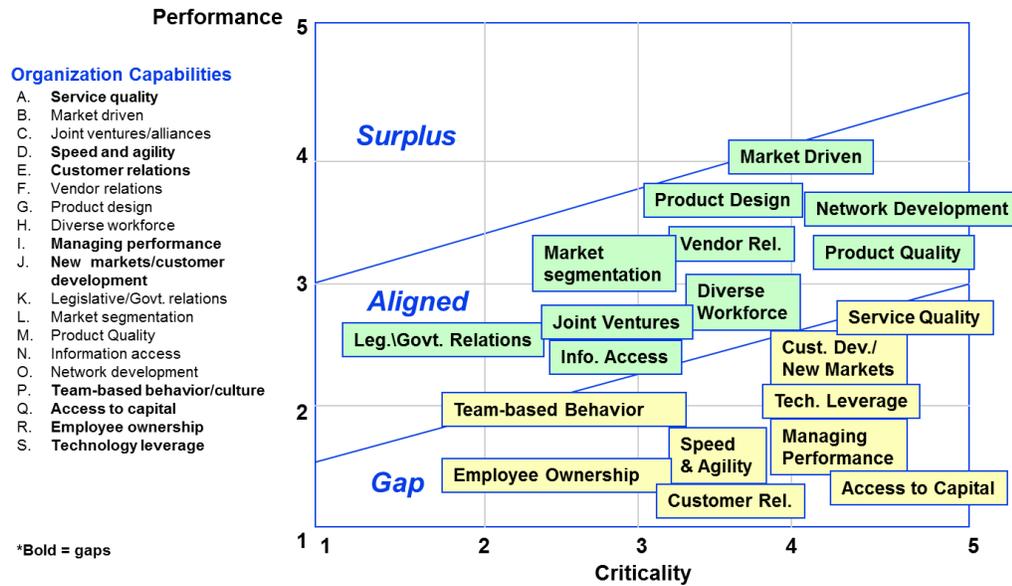
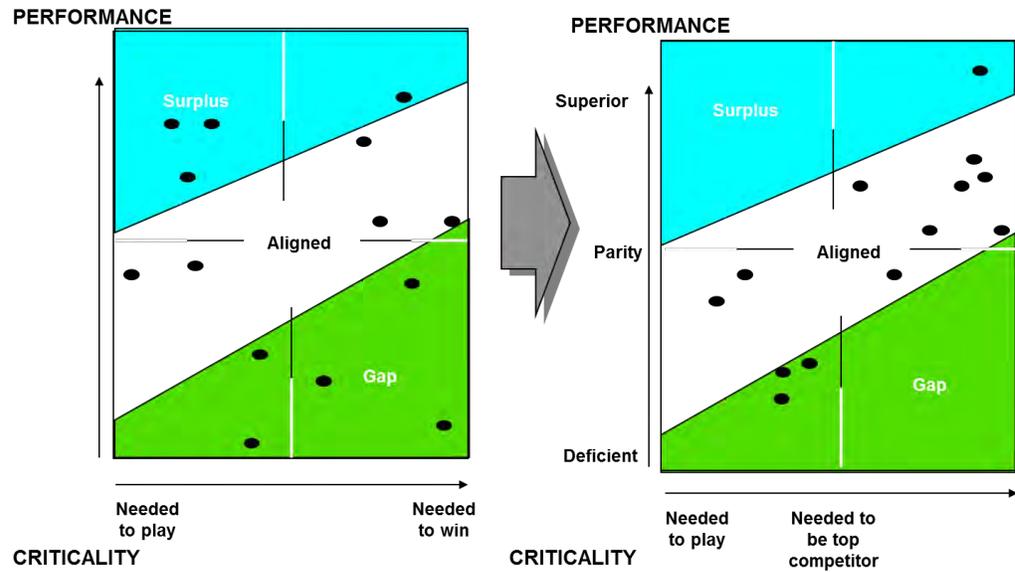


Figure 6: Example outputs from an organization capability assessment

Some examples of *Strategic Capabilities* within specific categories, and the types of individual competencies that contribute to these, are shown in Figure 7:

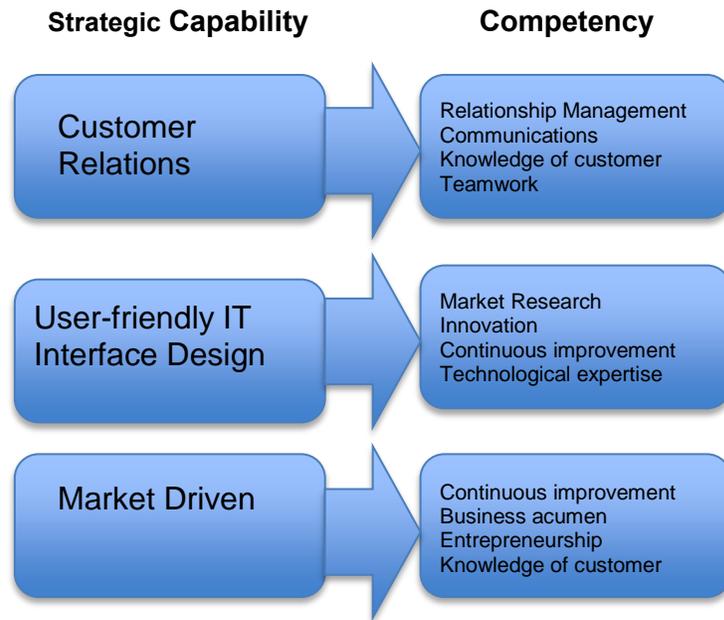


Figure 7: Examples of Strategic capabilities and corresponding competencies

4. Develop proposals and plans to address the capability gaps and surpluses, for example through:



- Training and development
- Performance management
- Career management/succession planning
- Recruitment
- New technology adoption
- New system or process development

5. Implement proposals and plans for addressing capability gaps and surpluses, for example:

- Ensure that human resource management is competencies-based, and that these are used to guide recruitment, selection, training, performance management and compensation practices.
- Ensure that adequate resources are allocated for the purchase and roll out of any required new technologies or other operating systems, and to underpin the development of new competencies through training, recruitment etc.
- Identify and make arrangements to source and implement new technologies and systems to address identified non people-related capability gaps.

- Ensure that new competencies and non-people related capabilities are properly aligned and integrated in order to secure the anticipated performance benefits. This may require, for example, training in the use of new systems and technologies.
- Conduct an organizational culture review to ensure that organizational norms and behaviours are properly aligned with the required new organizational capabilities, and if necessary implement a cultural transformation initiative, as described in our Cultural Transformation white paper (Schroeder, 2012).



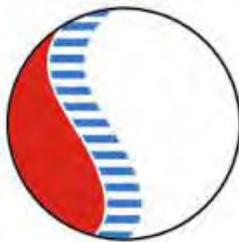
The Art and Science of Transformation Capabilities

In this section, we set out practical guidance, based on our recommended Art and Science of Transformation[®] framework to help organizations properly identify and utilize their *Transformation Capabilities* – consisting of strategic focus and strategic capabilities. Used within the overall Art and Science of Transformation[®] approach, the ability to effectively identify and draw on their *Transformation Capabilities* will represent a powerful strategic driving force for successful organizational transformation and strong business performance.

To recap from Section 2, the *Art and Science of Transformation[®]* framework has four main features:

1. An emphasis on achieving the right balance between “art” and “science” in the transformation process.
2. A holistic approach, which recognizes and addresses the inter-relationships between the organization’s people, culture, systems and processes.
3. A systematic approach, which is fully integrated with the organization’s strategic planning process.
4. An understanding of what needs to change and what must stay the same when transforming an organization, as explained in the following sections.

Throughout the paper, we have addressed feature 4 by highlighting the ways in which *Transformational Capabilities* must change over time, along with *Transformation Objectives*, while *Fundamental Purpose* and *Core Values* should remain consistent and act as “guiding principles” in the transformation process.



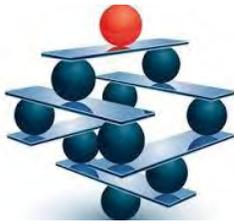
Features 1 to 3 are inter-related: the holistic approach to transformation reflects the application of appropriate “art” skills, while the systematic approach reflects the application of “science”.

Additionally, a holistic approach to identifying *Transformation Capabilities* and determining how to strengthen these, which considers all aspects of the organization and its value chain, and focuses broadly on the overall environment in which it operates, is important because:

- There are many inter-relationships between the organization’s people, culture, systems and processes, as well as its external stakeholders, which need to be identified and investigated in order to determine the right strategic focus for the firm at any time, and to properly understand its unique strategic capabilities.
- The full range of external opportunities and threats facing the organization are likely to include both qualitative and quantitative factors, and will only be identifiable if a holistic approach to reviewing this external environment is adopted. For example, relevant factors that can be quantified will include competitor performance data or consumer spending in the organization’s industry

sector; qualitative factors may include brand perceptions or opportunities for collaboration with firms sharing the organization’s values or having a complementary purpose.

- When determining strategic focus and the desired strategic capabilities to support this, it is crucial to achieve the right balance between the ability to achieve short-term goals and the ability to function and thrive in the longer-term competitive landscape (Yandeva, 2012).



A systematic approach is necessary in order to ensure that the environmental review and identification of strategic focus and strategic capabilities is based on a comprehensive identification of all relevant factors and the development of a robust evidence base.

It is also important to ensure that best practice tools and techniques are applied to all stages of the work in a well-ordered, systematic way and that these are fully documented, to provide an audit trail and add to the organization’s transformation management knowledge base for future reference and use.

Finally, in the table below we identify types of art and science skills that are important at each major stage of identifying and using strategic focus and strategic capabilities. These are by no means comprehensive lists, but are intended to highlight the importance of the Art and Science of Transformation[®] approach in determining and using *Transformational Capabilities*, as well as providing practical examples to help organizations consider how to approach this aspect of the transformation process.

| Example Art Skills in Determining Strategic Focus | Example Science Skills in Determining Strategic Focus |
|--|---|
| <ul style="list-style-type: none"> • Ability to identify and define the organization’s fundamental purpose, based on serving particular human needs • Use of reflection and observational techniques to identify the organization’s core values • Ability to articulate and clearly communicate fundamental purpose and core values and effectively in strategic planning discussions • Ability to identify qualitative or intangible factors likely to affect business competitiveness and assess the expected impact of these • Strong leadership skills – important for motivating and inspiring executives and other organizational stakeholders to focus on defining strategic focus | <ul style="list-style-type: none"> • Systematic review and analysis of threats and opportunities in the external business environment, based on analytics and business intelligence and modelling techniques • Use of forecasting techniques to predict likely future threats and opportunities in the external environment • Use of risk analysis methods to determine likely impact of identified factors on business competitiveness • Business modelling to determine likely impact of particular business models or strategies |

| Example Art Skills in Determining Strategic Capabilities | Example Science Skills in Determining Strategic Capabilities |
|---|--|
| <ul style="list-style-type: none"> • Ability to understand how value is created through the combination of competencies and non-people related capabilities, requiring a holistic approach • Ability to identify art as well as science related skills and attributes that contribute to organizational capabilities and value creation • Understanding of qualitative forms of business value (e.g. brand loyalty; employee engagement) and the factors contributing to these | <ul style="list-style-type: none"> • Systematic approach to identifying and documenting all relevant capabilities (people and non-people related) • Use of analytical techniques to understand the ways in which value is created through capabilities, and to identify the most important differentiators • Ability to develop or apply techniques for assessing capabilities and identifying gaps and surpluses • Ability to convert qualitative value into measurable indicators for inclusion in analysis and modelling to identify key capabilities |

| Example Art Skills in Translating Capabilities into Competencies | Example Science Skills in Translating Capabilities into Competencies |
|--|---|
| <ul style="list-style-type: none"> • Ability to identify art as well as science related competencies relating to particular capabilities, including those based on personal attributes as well as formal learning • Ability to design and communicate a simple and understandable competencies model for use throughout the organization • Ability to effectively communicate the reasons for and expected benefits of adopting new competencies in order to engage organizational members in the process • Participatory leadership and management styles that involve and empower employees in the process of competency development • Ability to understand the links between organizational culture and competencies development, and to design and implement cultural transformation initiatives | <ul style="list-style-type: none"> • Ability to design a comprehensive competencies model that is well integrated and aligned with defined strategic competencies • Application of resource estimation and budgeting techniques to ensure development of <i>Transformation Capabilities</i> is adequately resourced. • Human resource systems design expertise, to ensure that recruitment, training, performance management and compensation and reward systems are fully integrated and competencies-based. • Development of an integrated communications strategy and methods for information about new competencies |

Summary and Conclusion

In this paper we have highlighted the role and importance of *Transformational Capabilities*, defined as the organizational “strategic driving force” that facilitates and propels successful transformation so that a firm can maintain its competitiveness and market positioning in response to external threats and opportunities.



Transformational Capabilities, within our recommended *Art and Science of Transformation*[®] framework, comprise one of four key inter-related factors contributing to effective transformation. Two of these, *Fundamental Purpose* and *Core Values*, are static factors that should form the guiding principles that determine the desired ultimate destination and how to reach it, in broad terms. *Transformation Capabilities* and *Transformation Objectives*, in contrast, are dynamic factors which reflect the current and expected future state of the external environment, and should be modified to ensure that the organization is able to maintain its competitive position.

Transformation Capabilities have two inter-related components: strategic focus, which is the desired direction of transformation based on the defined purpose and values of the organization and the characteristics of its external environment, and strategic capabilities, or the unique know-how of the organization resulting from the combined effect of its collective competencies and other organizational assets. There is also an important circular relationship involved: the existing strategic capabilities of the firm help to shape the strategic focus by ensuring that this builds on what the organization is already good at, and the process of developing the strategic focus helps to identify capabilities that should be developed or strengthened so that it can perform even better in the current competitive environment.

In summary, the three major stages of defining and using *Transformational Capabilities* in the *Art and Science of Transformation*[®] process are:

1. Determine and define the strategic focus, based on the organization’s fundamental purpose and core values, and current opportunities and threats in the external environment.
2. Based on the identified “strategic focus”, identify the required capabilities needed to support this intent, in pursuit of defined transformation objectives, and review the organization’s current capabilities to identify strengths, gaps and redundancies
3. Translate capability requirements into specific competencies that can be delivered by individuals and teams, as well as specific non people-related capability requirements, and develop and implement plans to develop these.

The application of this approach will help to ensure that *Transformational Capabilities* are properly defined and utilized to drive and propel change in ways that help ensure that that a firm can achieve and sustain its optimal market positioning for business performance.

Other Schroeder & Schroeder Inc. white papers focus on different aspects of the transformation process, and expand on many of the issues covered on in this paper, such as identifying an organization's *Fundamental Purpose*, setting *Transformation Objectives* and conducting cultural transformation. These and other information relating to the Art and Science of Transformation[®] approach can be obtained on request from harold@schroeder-inc.com.



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