Part I

Client Leadership

ONE
Leading Your Clients
Developing Knowledge-Based Client Relationships

In 1980, the U.S. economy was worth $4.9 trillion, producing 1.3 billion tons of goods. Fast forward 20 years to 2000, and the U.S. economy had almost doubled in size to $9.3 trillion, yet the weight of goods produced had only edged up by a few percent to 1.37 billion tons.[1] The economic activity that accounted for this near doubling in size of the economy was associated with almost nothing of substance, nothing that you could see. This massive growth in the economy was driven by information, ideas, services, and knowledge — things that weighed nothing. The value is in knowledge.

At the same time, the most powerful trend in business today is commoditization. This is apparent across every industry in every country, as our connected world enables global search and availability. The one element that really makes a difference is the relationship. Without a relationship you become a commodity. With a relationship, everything is possible. You can create far greater value for your clients than your competitors can, and as a result lock your clients into longstanding, mutually profitable, collaboration.

The heart of being able to create this extremely high level of differentiation is what I call *knowledge-based relationships*. These are relationships founded on knowledge — knowledge of your clients, your clients' knowledge of you, and the ability to create knowledge together. In our increasingly virtualized world, knowledge is the primary source of value.

Professional services provide a sound foundational model for our knowledge-intensive economy. They are based purely on the application of highly specialized knowledge. In Chapter 2 I will explore in detail the nature of professional services, and how the professional services model is applicable across all aspects of the global economy. The key issue is that this deep specialist knowledge is applied to create value for a client. That client can be either inside or outside the organization. Either way, the knowledge is applied within a relationship.

Knowledge and relationships are inextricably linked in today's economy. Understanding that fully and acting on it is essential for success in every aspect of business. Some of the key issues of knowledge-based relationships I examine in this book are

- Why it is an imperative to engage in knowledge-based relationships
- How to add the greatest value with knowledge in client engagements
- How to structure your firm and professionals to develop deeper, more loyal, and more profitable client relationships
- How to shift clients to partners and create maximum shared value

Since the first edition of this book was published in January 2000, there has been substantial progress in the practice of knowledge-based relationships. Professionals have become more externally focused, firms have recognized that they need to transfer knowledge to clients, and most professional firms have invested in shifting their structures, processes, and skills to support more effective client relationships. I hope that these trends will accelerate.

Knowledge-Based Relationships

The guilds of yesteryear are the predecessors of today's professions. Their role was largely to protect the commercial privileges of those who held valuable skills or knowledge. Among the rules protecting elite professionals, who gained their mastery through a long process of apprenticeship, were regulations — sometimes commanding very harsh penalties — against disclosing knowledge to any non-guild members. Although regulations often prohibited anyone outside a guild from practicing a particular profession, the focus was on protecting the specialist knowledge at the core of privileged social positions. Some of the same attitudes have lasted over the centuries, where professionals want to protect their knowledge. However, in a world in which vast amounts of information flow freely this can no longer be the case. Approaches to delivering professional services can be divided into two categories: *black box* and *knowledge based*.

- *Black box:* Many professional service firms deliver services in such a way that the client receives an outcome, but does not see the process involved, and is literally none the wiser as a result of the engagement. These black-box services are opaque to the client. Since the only reference point the client has is the result, it is relatively easy for other firms to replicate that result and then compete primarily on price. In other words, they are commoditizing the service. In addition, the only opportunities for interaction with the client in a black-box engagement are during the briefing and the presentation of outcomes, leaving little scope for personal or organizational relationships to develop.
- *Knowledge based:* All professional services are based on specialized knowledge. When professionals engage with their clients to make them more knowledgeable, they are implementing knowledge-based services. The outcome is that clients are more knowledgeable, are able to make better

> decisions, and have enhanced capabilities. In short, the client is different as a result of the engagement. Professional firms and clients are pooling their capabilities to create results they could not achieve individually. This makes it impossible for competitors to replicate these outcomes. The entire engagement is based on rich interaction, meaning there are many opportunities to develop a valuable and lasting relationship.

An example of the distinction between these two types of relationships we are all familiar with is how your doctor relates to you. When I lived in Japan, I found doctors stuck firmly to the black-box style of interacting with their patients. The culture was one of great respect and deference to doctors, who told their patients what to do but gave no background or information on what was wrong. I was repeatedly dispensed unlabelled drugs without being told what they were or what was wrong with me. I found it a great relief to visit a doctor during a brief return home, who treated me to a long discussion on current medical knowledge on the background and cause of my ailment, and asked if I had any questions for clarification on what I should be doing to get better and how to avoid similar issues happening again. However, in Western medical centers as well (where doctors are rewarded for high throughput), patients end up with prescriptions but no greater knowledge of what is wrong or how to prevent the ailment from happening in the future. The black-box model often prevails, but the ready availability of medical information on the Internet is starting to shift doctors to a more knowledge-based style of interaction. A very similar dynamic is at play in most professions.

Some professions are more compatible with a black-box style of engagement. For example, litigation is often an issue of getting the best courtroom representation. Yet even in this case there can be strategy implications of the process of litigation, and certainly the litigators will be most effective with deep knowledge of their client. More to the point, one of the most valuable services a law firm can deliver to its clients is enabling them to avoid expensive and risky litigation. This requires ongoing knowledge-based interaction with the client in order to shift processes and skills and add knowledge.

More often professional services can be delivered in a variety of ways along the spectrum from black-box to knowledge-based services. The strategy consulting industry exemplifies this. On the one hand you still find firms that quietly gather and digest information about the client's situation, and then deliver their recommendations with great ceremony, leaving the client with the options of either following or rejecting the loftily priced recommendation. Yet there are also firms that engage with their clients purely with the intention of assisting their clients to develop the most effective strategies for themselves, and that design and implement analytical work to provide input to the client's decision making rather than their own.

In every industry across the globe, clients have increasing access to information, are getting smarter, and are more demanding with their professional service providers. The old paradigm of deferring to the superiority of the professional now rarely holds. Clients seek real value to be added.[2]

The Virtuous Circle of Knowledge-Based Relationships

Developing effective knowledge-based relationships with clients is not a one-shot effort. There is no magic wand, no single action you can take, that will transform your relationship, enabling the deeper client knowledge, superior value creation, intimacy, loyalty, and profitability you seek. Rather, it is a process where efforts build on themselves over time to create ever-improving results.

One of the single most important aspects of developing relationships is understanding that it is a process. There is no such thing as a static relationship. In Chapter Two I will examine some of the industry forces that are continually tending to erode relationships. The result is that if a key client relationship is not moving forward it is going backward. You need to keep building, gradually creating a

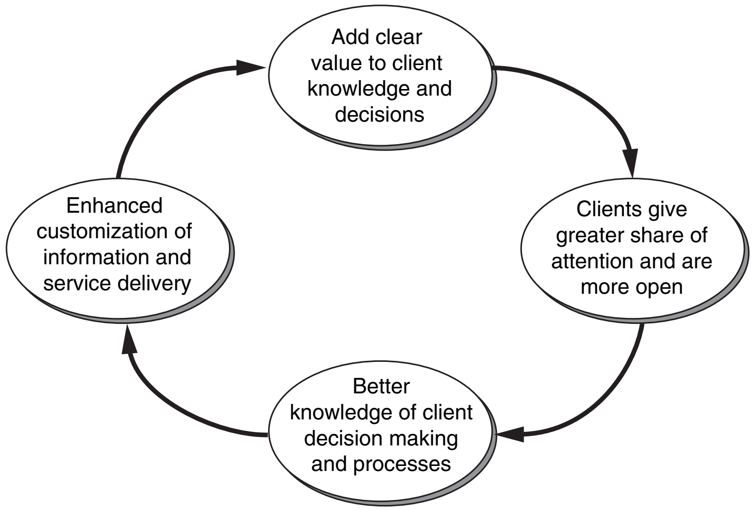

Figure 1–1 *The virtuous circle of knowledge-based relationships.* Copyright © 2004 Advanced Human Technologies. Reprinted with permission.

deeper, more mutually valuable, relationship. This is done through a "virtuous circle," in which you cycle through continuously in deepening the client relationship, as illustrated in Figure 1–1.[3]

The four key components of this virtuous circle are:

- *Adding value with knowledge:* Increasingly, clients value knowledge-based outcomes. They seek to gain greater knowledge, be able to make better business decisions, and to have enhanced capabilities.
- *Client openness:* Demonstrating the ability to add value with knowledge means that clients are willing to give you more of their scarce attention, listen to what you have to say, take your calls, and spend time with you. They are also more open in telling you about themselves, their operations, and their issues and concerns, because you have proven to them the benefits of doing so.
- *Greater client knowledge:* It is critical to use greater client openness not just to sell more projects but to gain a deeper

understanding of their internal processes, how key executives think, and how they use information regarding changes in the business environment to adjust their strategies. You want to understand how they engage with knowledge and the external world in making business decisions.
- *Enhanced customization:* One of the most challenging aspects of the virtuous circle of knowledge-based relationships is applying the deep client knowledge you have gained to customize how you communicate with key clients, how you provide information about projects and issues that are relevant to them, and how you tailor service delivery so that it integrates smoothly into their internal processes. This is at the heart of creating true knowledge-based relationships, closing the loop by demonstrating the ability to create vastly more value with knowledge than your competitors can.

To progress, you must be engaged in the virtuous circle of knowledge-based relationships, gaining deeper client knowledge, and applying it to creating greater value. If you fail to continuously enhance your relationships in this way, increasing competition and transparency will gradually erode them, leaving you struggling as a commoditized provider.

Locking In Your Clients

Wouldn't it be wonderful if you could lock in your clients, making them yours forever? It is a nice idea. However, the reality is that we live in an increasingly open world. Back in the early 1980s, when you purchased a computer application to run your business it was certainly based on a proprietary operating system, which in turn only ran on one company's computer system. If you wanted to keep the same application, you were locked in to that computer vendor. Changing vendors often meant having to reengineer your business around a new application. Today, it is almost impossible to get clients to buy closed systems that would mean substantial switching costs if they choose to move to another supplier. Given a choice, clients will always go for the option that gives them more flexibility. The trick is to create lock-in in a business environment in which systems and standards are more and more open.

In this world, the only way to lock in clients is by consistently being able to create more value for them than your competitors can. This is a positive form of lock-in, in contrast to the negative lock-in of trying to make it expensive for clients to leave you. There are three key foundations for how professional service firms can keep clients coming back through positive lock-in.

- *You know your client better.* It is nothing new for professionals to have to know their clients well. It is just that these days doing this better than your competitors is the primary field of competition. Today, it is important not just to know your client better but to apply this knowledge in customizing your communication and service delivery, as discussed above. If you do, this creates a very powerful form of lock-in through the unique value you can create.
- *Your client knows you better.* If your clients understand the way you work, your people, your processes, and your capabilities, they can get more value from you. They can align their processes with yours, and more easily apply your services internally. In order to switch suppliers, they would have to start from scratch in learning about how another company works to achieve these benefits.
- *You are embedded in your clients' processes.* The fact that business processes can now be readily allocated across organizational boundaries has uncovered a whole new domain for professional service firms to embed themselves in their clients' workflow. Once you have put in the effort required to become an intrinsic part of your clients' work processes, they can experience how much more value you can create for them.

It is not enough to generate these three foundations of lock-in, however. You must take each one that critical step further in creating greater value for clients. For example, some professionals know their clients very well, yet they fail on two scores: first in effectively applying that deep client knowledge to tailoring absolutely every aspect of client interaction and service delivery, and second in continuously working to enhance that client knowledge. As such, their knowledge can have little practical value.

Through this decade, the field of play in professional services will be largely about gaining and applying ever-deeper mutual knowledge with clients. However, now that online technologies increasingly allow professional firms to embed themselves in their clients' processes entirely new ways of creating lock-in and superior value for clients are unfolding. These issues are examined in detail in Chapter 7.

Client Leadership

Knowledge-based relationships are at the heart of being able to create powerful, differentiated relationships with high-value clients. Yet unless your clients recognize the value of this style of working and interaction it has little value. You need to *lead* your clients into these rich, highly interactive, collaborative styles of working.

Relationship Styles

What do you do when a highly desirable client presents you with a tender document, with every issue specified in excruciating detail, and announces that they will engage the firm that offers them the lowest price? At that point there is little you can do other than choose whether or not you want to play on those terms, and if you do go for the business, sharpen your pencil and put in a frighteningly low price. This increasingly common situation represents a commoditized relationship style on the part of the client. It intrinsically believes that the service it is seeking is a commodity, essentially the same from each vendor, and that the lower the price the better.

Figure 1–2 *The spectrum of relationship styles.* Copyright © 2004 Advanced Human Technologies. Reprinted with permission.

Other firms actively seek to build partnership-style relationships with their suppliers. Shell's Clyde Refinery in Australia chose to consolidate its many service suppliers to one firm, Transfield, and built a relationship based on shared value creation. On one key performance indicator, the refinery moved from lowest quartile among major oil refineries to number two in the world, with Shell executives pointing to their collaborative supplier relationship with Transfield as a major driver.[4] Figure 1–2 shows the spectrum of relationship styles that exist between service providers and their clients.

Organizations will demonstrate a certain relationship style with regard to their suppliers, ranging from treating suppliers as replaceable commodities to trying to build true partnerships. This will vary depending on the situation and the supplier, and can change over time. Indeed, organizations are very rarely monolithic, and different people or instances can reflect quite different stances. Yet you can generalize about where organizations stand in any particular context on the spectrum of relationship styles.

Similarly, professional service firms will tend to deal with their clients with a range of relationship styles. All too often, and far more than they believe they are, firms present themselves to their clients as commoditized suppliers. They offer black-box services, and do not seek partnering opportunities and ways of creating value together. Sometimes with a few long-established clients they find themselves in deep partner relationships, while with others they still effectively work as commoditized providers.

The Path of Client Leadership

In 1992, DuPont, tired of dealing with a plethora of legal firms that did not understand its business, established what it calls the DuPont Legal Model. This consolidated its legal firm relationships from several hundred to 35, and provided clear guidelines as to how it would work with them and remunerate them. This single example typifies what has been happening for the last decade: clients are leading professional service firms into new ways of working. Professional firms must turn the tables, and lead their clients.

How the relationship styles of clients and professionals mesh is shown in Figure 1–3. If your client wants a partner relationship and you are acting as a commoditized provider, not actively seeking to collaborate with them, at best you will lose opportunities, and most likely you will lose the client. If your client treats its professional service providers as commodities and you are spending all of your energy trying to work with them as a partner, it will probably be an unprofitable relationship, as you are getting minimal return on a large effort. What professional service firms must do is to *lead* their clients into partner relationships, by over time demonstrating the value of greater interaction and collaboration, where both parties share in the value creation process.

Think of your key contacts at one of your significant clients. Consider where they currently stand in their relationship style relative to your firm, on the spectrum from treating you as a commoditized provider to a partner. Also consider your firm's relationship style with regard to your client. It is important to be honest, because the reality is that the way many firms interact with their clients in fact positions them more as commodities than as partners. If you are not currently

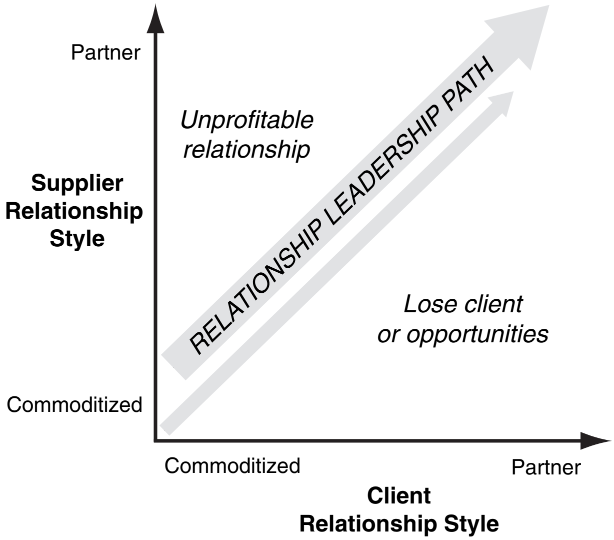

Figure 1–3 *The path of client leadership.* Copyright © 2004 Advanced Human Technologies. Reprinted with permission.

in a true partnership with this client, and would like to be, there are three questions you have to consider.

- Is it possible to lead the client into a partner-style relationship?
- If yes, how much investment of energy, time, and resources is it likely to take to shift the client to a partner relationship style?
- Are the potential rewards of leading the client to a partner-style relationship worth the likely investment?

These are some of the most important questions you can ask in relationship development. The bulk of the rewards is in building true partnerships with your clients, which give you the opportunity to create massive value for you and your clients. However, your client has to be open to this for it to be possible. If your client is likely to continue treating you as a commoditized provider, however much effort you put into demonstrating the value of a more collaborative relationship, there is no point in trying. It is possible to have a worthwhile relationship when being treated as a commoditized provider, but what is critical is recognizing when this is the case, and not wasting a significant investment of resources when there is likely to be no or little payback.

Indeed, *return on relationship investment* is one of the most critical considerations at every level of the firm. From the chief executive to the individual relationship leaders, professionals must consider where their investment of relationship effort will bear the richest fruit. The reality is that relationship investment should not be focused solely on the largest clients who spend the most. If they do not respond to your efforts to lead the relationship into one that is more mutually beneficial, and insist on maintaining you as a commodity, it is preferable to concentrate your efforts on firms that may not be as large or prestigious but are open to giving you greater scope to create value.

A key implication is that clients are often not doing themselves a favor by indiscriminately treating their providers as commodities, for example by using standard procurement procedures across all services. If you are able to create substantially greater value for clients in a more open relationship and they do not respond, both sides lose. Organizations need the flexibility to shift their relationship style, when warranted, to allow collaborative approaches to engagements. Those that do not will find that some of the best providers are not investing themselves fully in developing and exploring those opportunities with them. Although the balance of power usually rests firmly with the client, professional firms should be seeking to position themselves to be able to select their clients.

In the bigger picture, one of the key issues for professional firms is how to balance and integrate commoditized and partner aspects into their portfolio of client relationships. I will cover issues regarding business strategy relative to client relationships in Chapters 6 and 12.

Characteristics of Knowledge

Over the last decade the concepts of knowledge and knowledge management in business have been up and down the sinuous curves of the hype cycle. Now they have settled into an accepted place in business. We have been through the era of generating definitions of knowledge to the point of nausea, appending it to every other term in the business lexicon from *knowledge worker* to *knowledge economy*, and of technology vendors proclaiming themselves to be knowledge management specialists. Now with a more balanced view of where the global economy is going, we can recognize that knowledge as a management theme is a fundamental part of our present and future.

Yet we still need to gain clarity on the import of knowledge to business, and as importantly on its characteristics in a pragmatic business environment. The hype and confusion surrounding these topics have muddied the waters, and so it is useful to step back for a moment and see the big picture.

Information and Knowledge

One of the best ways of understanding knowledge is to bring out the distinctions between information and knowledge. The most useful distinction is to note that information is *anything that can be digitized*. As such, if you can store it in a database or attach it to an e-mail it is information.

In contrast, knowledge is *the capacity to act effectively*. In the world of business, knowledge only has any value or meaning if it results in action. Knowledge pioneer Karl-Erik Sveiby offers a working definition of knowledge as "a capacity to act."[5] Similarly, Tom Davenport and Larry Prusak contend that "knowledge can and should be evaluated by the decisions or actions to which it leads,"[6] while Donald Schön notes of professionals that "our knowledge is *in* our action."[7]

This capacity to act effectively in complex and uncertain environments requires the understanding and consideration of a broad array of factors, making effective decisions, and acting on them. For the time being, we can usefully consider this to be the exclusive domain of human beings. As artificial intelligence efforts gain further ground, we may have to readjust this perception, but for now it holds.

Tacit and Explicit Knowledge

Michael Polanyi, previously a fairly obscure philosopher of science, has been rediscovered by the business community over the last years. In 1967, Polanyi offered a distinction between *tacit knowledge* and *explicit knowledge*. Polanyi pointed out that we can know more than we can tell or explain to others.[8] Explicit knowledge is what we can express to others, while tacit knowledge comprises the rest of our knowledge — that which we cannot communicate in words or symbols.

Much of our knowledge is tacit. That is, we do not even necessarily know what we know, and what we do know can be very difficult to explain or communicate to others. I always like using the example of surfing. A surfer's ability to watch the patterns of swells in the ocean, to see where and how the waves are likely to break, and to catch and ride one into shore is based on long experience. Little of that knowledge can be readily captured or communicated to others. Whatever that surfer can capture in a document, description, or demonstration is explicit knowledge. Reading a document titled *How to Surf* gives you information on how to ride waves, but it is completely different from knowledge, in the sense of having the ability to do it for yourself. That requires going out in the waves, experiencing it, and gaining your own skills in action.

The analogy of surfing is in fact very apt in business. Businesspeople endeavor to pick up on emerging trends, catch them as they break, and ride them to a successful outcome. In professional services, we try to help our clients be more effective at riding the rough and unpredictable waves of our business environment.

Explicit knowledge, conversely, can be put in a form that *can* be communicated to others through language, visuals, models, or other representations. Whatever the surfer could say, write, or draw about his knowledge of the wave patterns, or the businessperson could communicate about her ability to write letters, would be explicit knowledge. In most business situations, especially in the professions, the bulk of an individual's valuable and useful knowledge is tacit rather than explicit.

Polanyi's critical distinction was to frame explicit knowledge as that portion of a person's knowledge that *can* be communicated by being made explicit, and tacit knowledge as that which *cannot* be communicated directly. However, when knowledge is made explicit by putting it into words, diagrams, or other representations, it can then be digitized, copied, stored, and communicated electronically. In other words, it has become information. What is commonly termed explicit knowledge is nothing more nor less than information, while tacit knowledge is simply knowledge.

Knowledge Conversion

In the TV series *Star Trek*, Dr. Spock could simply touch someone's temples with his fingers to perform the "Vulcan Mind Meld," directly communicating their thoughts to each other. Until the day when we can all do this, we have to rely on less direct means of transferring our knowledge to others, including written and spoken words, diagrams, and demonstration.

In fact, even if we could transfer our thoughts directly that would not constitute a full transfer of knowledge. Our ability to act effectively in any particular circumstance is based on all of our experiences through our lifetime, and the way we have chosen to make sense of these. Anyone that has not been through the same experiences cannot have exactly the same knowledge and responses. When we acquire new knowledge, we have to relate it to our existing experience and ways of thinking, and integrate it into these models. No two people will understand an idea in exactly the same way, because they interpret it in relation to different sets of experience. The Appendix goes into more detail on how we acquire knowledge in relation to our existing models of understanding the world.

One way we can share our tacit knowledge with others is *socialization*, where we converse directly, share experiences, and together work toward enhancing another person's knowledge. We can also convert our personal knowledge into information through the process of *externalization* — by making it explicit and rendering it as information, as in the form of written documents or structured business processes. However, information in digital form in itself is often words or diagrams in a document. These are meaningless and valueless without a person to use it or make sense of it. This information must go through the process of *internalization* to become part of someone's knowledge, or "capacity to act effectively."[9] Having a document on your server or bookshelf does not make you knowledgeable, nor even does reading it. Rather, knowledge comes from understanding the document by integrating the ideas into existing experience and knowledge, thus providing the capacity to act usefully in new ways. In the case of written documents, language and diagrams are the media by which the knowledge is transferred. The information presented must be actively interpreted and internalized, however, before it becomes new knowledge to the reader.

This process of internalization is essentially that of knowledge acquisition, which is central to the entire field of knowledge management and knowledge transfer. Understanding the nature of this process is extremely valuable in implementing effective business initiatives and in adding greater value to clients. These issues are examined in detail in the Appendix.

Socialization refers to the transfer of one person's knowledge to another person, without being intermediated by captured information such as documents. It is the most powerful form of knowledge transfer. People learn from other people far more profoundly than they learn from books and documents, in both obvious and subtle ways. Despite technological advances that allow people to telecommute and work in different locations, organizations function effectively chiefly because people who work closely together have the opportunity for rich interaction and learning on an ongoing and often informal basis.

The Knowledge Management Cycle

One of the classic ways of thinking about knowledge management is found in the dynamic cycle from tacit knowledge to explicit knowledge and back to tacit knowledge. In other words, people's knowledge is externalized into information, which to be useful must then be internalized by others to become part of their knowledge, as illustrated in Figure 1–4. This flow from knowledge to information and back to knowledge constitutes the heart of organizational knowledge management. Direct sharing of knowledge through socialization is also vital. However, in large organizations capturing whatever is possible in the form of documents and other digitized representations means that information can be stored, duplicated, shared, and made available to workers on whatever scale desired.

The field of knowledge management encompasses all of the human issues of effective externalization, internalization, and social-

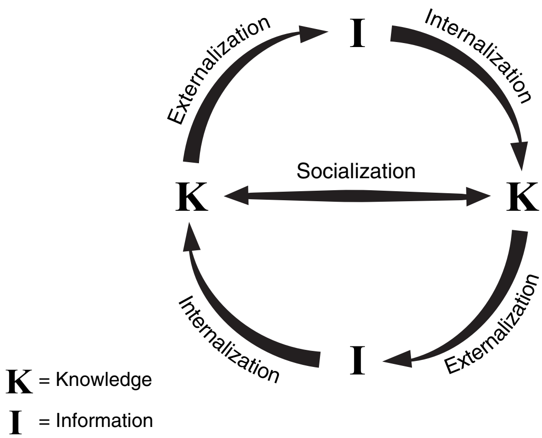

Figure 1–4 *The knowledge management cycle.* Copyright © 2004 Advanced Human Technologies. Reprinted with permission.

ization of knowledge. As subsets of that field, information management and document management address the middle part of the cycle, in which information is stored, disseminated, and made easily available on demand. It is a misnomer to refer to information-sharing technology, however advanced, as knowledge management. Effective implementation of those systems must address how people interact with technology in an organizational context, which only then is beginning to address the real issues of knowledge.

Knowledge Transfer

The idea of knowledge transfer sounds fairly straightforward: knowledge is transferred from one person or organization to another. However, as we have seen, knowledge depends on its context. There are two key types of knowledge transfer.

- *Knowledge communication:* This refers to what most people think of as knowledge transfer. It suggests that a person or group has knowledge, and communicates that knowledge so that another person or group has the same or similar knowledge. We have already seen that because personal knowledge is necessarily intermediated by our communication and interaction, the knowledge received will never be the same as the knowledge transmitted.
- *Knowledge elicitation:* This describes assisting others in generating their own knowledge. It suggests that the potential for knowledge is inherent in clients, and that specific types of interaction can result in their creating their own knowledge and understanding its value. This happens more often than many people realize. Attempts to communicate knowledge often result in insights and learning, just not those that were intended! Increasingly, clients value suppliers that can help them generate their own knowledge and learning.

We acquire knowledge throughout our lives, both on the basis of reflecting on direct personal experience and by learning from others. Sir Isaac Newton did not acquire knowledge about gravity from outside when the proverbial apple fell on his head. He generated it by combining a new perspective with his existing understanding. It is not just through the communication of existing knowledge that we can add value.

Knowledge transfer is often considered an issue of sending documents. This is certainly one component of knowledge transfer. However, this means that the knowledge — the capacity to act effectively — has to go through the medium of information. For this *intermediated transfer* to work, it requires that the original knowledge be effectively and as completely as possible externalized into information, and on the other side that the information be internalized into more effective thinking and business processes. If either of these elements is not effective, knowledge transfer cannot be successful. When knowledge transfer is not intermediated through the medium of information, you are using *socialized transfer*, which requires direct personal contact and interaction.

Both methods of knowledge communication have advantages and disadvantages. I will cover these in more detail in chapters 3 and 7. Knowledge communication is necessarily mediated either by information or personal interaction, and any comprehensive strategy for knowledge communication will include both approaches. Effective communication must be based on a solid understanding of the dynamics of externalization, internalization, and socialization.

One illustration of this principle is found in management games, which are intended far more to get participants to gain insights and think in new ways about their particular situation than to impart specific knowledge or information. Another example is the tendency of fund managers to deliberately seek out research and opinions on financial markets that challenge their thinking. Even if they disagree with the conclusions of the research, they can find the logic or analysis behind it valuable in developing their own thinking, and they are usually more than willing to pay for stimulating ideas.

Effective knowledge communication and knowledge elicitation are based on rich two-way interaction and dialogue. Engaging in discussion — essentially a process of socialization — is central to the process of knowledge communication, which can rarely be accomplished effectively through the mere exchange of files or documents. Knowledge elicitation is even more dependent on interaction. People generate their own knowledge most effectively in a stimulating environment involving discussion of ideas and perspectives. To a great extent the value and quality of knowledge transfer is a function of the richness of interactions with clients. Alan Webber, founding editor of *Fast Company* magazine, writes in *Harvard Business Review* that knowledge workers create relationships with customers through conversations.[10]

In communications technology, bandwidth refers to the amount of information that can be communicated in a given period of time. The growth of the Internet, for example, is predicated on steadily increasing bandwidth, allowing the flow of richer forms of information (such as sound and video) rather than just text and pictures.

The concept of bandwidth is also applicable in interaction between people. Telephone conversations allow for the expression of subtleties of emphasis and emotion far exceeding that of the content and meaning of the words themselves, though this can be limited by the relatively low audio quality of the connection. Video conferencing, in turn, gives far greater bandwidth in interaction between people, by allowing visual as well as auditory information to be conveyed. Even so, the bandwidth achievable by any current technology — in terms of information flow between participants — is many orders of magnitude less than that of face-to-face meetings. Despite the very rapid growth in quality and uptake of videoconferencing, business travel is not likely to diminish. There is no substitute for being in the same room.

In practical terms, maximizing bandwidth means developing the greatest degree of interactivity with clients, by engaging in dialogue through all available means of communication. This principle is vital, not just in individual interactions with clients but in designing the overall structure of client relationships, as you will see in chapters 7 and 8.

Knowledge in Relationships

A large natural resources company drilling for offshore oil and gas was seeking a contractor to design, build, and operate platforms to exploit the large reserves under its control. However, there were a number of new and specific challenges in the project the company had not encountered before. In its request for tender for the contracting services, it specified knowledge transfer as a key element in the decision process. It wanted to be sure that the knowledge generated in the course of the project would be captured and available to be applied in future projects, and that the skills of its contractor would be effectively embedded in its organization at the end of the multi-year multi-billion-dollar project.

It is an increasing characteristic of professional services that clients are explicitly demanding knowledge transfer. Firms that wish to compete for this work have to respond. More generally, differentiation between competitors is frequently centered on effective knowledge transfer. As you have seen, black-box services are readily commoditized. Knowledge-based relationships enable and encourage the rich interaction out of which deeper, more valuable, and more profitable relationships emerge.

These issues of knowledge in relationships are increasingly important across every type of business-to-business relationship. Clients not only seek to maximize knowledge transfer from their suppliers but want to assess what knowledge they need to make available to suppliers to ensure best value and effectiveness.

The role of knowledge has come to the forefront in outsourcing. The first major wave of outsourcing business processes began in the mid 1990s. At this time, decisions were made to place business functions outside the company without considering the role of knowledge. In the process, many firms lost valuable people and their knowledge, and established systems in which they were not able to tap the knowledge generated in business functions close to their core processes. In all types of business-to-business relationships, there are five key aspects of knowledge flow that need to be considered.

- *Knowledge to:* Knowledge being transferred from your firm to another firm, often a client or alliance members
- *Knowledge from:* Importing knowledge from other parties, such as suppliers or research and development partners
- *Knowledge about:* Gaining deeper knowledge about clients and other partners that enables more effective service and interaction
- *Knowledge blending:* Bringing together existing knowledge from your firm and other firms to create business value
- *Knowledge cocreation:* Creating new knowledge in collaboration with others that has value in tangible intellectual property or enhancing capabilities

Each of these issues will be addressed through this book. The primary focus of this book is on client relationships, which means that the most important of these five aspects of knowledge flows are *knowledge to*, *knowledge about*, and *knowledge cocreation*. However, all five issues are potentially relevant in all relationships. As such, executives dealing with supplier, alliance, and outsourcing relationships need only slightly adapt the content of this book for it to be directly relevant to their situations.

Adding Value with Knowledge

Professional services firms, by their very nature, add value to clients through their knowledge. The central issue for these firms is how to apply this knowledge to create the greatest value for clients and to build the deepest, most differentiated, relationships in the process. There are three key ways to apply knowledge to add value to a client.

- Providing high-value information
- Enabling the client to make better business decisions
- Enhancing the client's business capabilities

These topics are dealt with in depth in Chapters 3 through 5 respectively. However, I will introduce them here to provide a preliminary frame for these ideas.

High-Value Information

When the Internet grew to become a standard medium for business communication by the mid 1990s, people proclaimed that information would no longer have any value. It would flow freely, and no one would be prepared to pay for it anymore. The last decade has given the lie to that idea. Certainly many classes of information have become highly commoditized, and that trend will continue. However, there remain many types of information that retain very high prices. The critical issue is identifying information that is relevant to the user.[11] If information is highly relevant to an individual's or organization's pressing concerns and issues, and can be readily internalized as useful knowledge, it will be valuable, and price will not be an issue. This is primarily generated through the process of customization. Information must be customized to individual clients, both in content and delivery. These issues are covered in more detail in Chapter 3.

Better Decision Making

Making decisions and implementing them is where the greatest value is created in an organization. Information and knowledge have value only insofar as they result in better business decisions, in terms of increased shareholder or stakeholder value, or alternatively increased profitability with lower risk. Decisions are the final and critical step in the chain of adding value to information and knowledge. For the purposes of a service provider adding value from outside, decisions in an organization can most usefully be classified into strategic, line, and portfolio decisions.

- *Strategic decisions:* Strategic decisions are those that determine the direction and positioning of the organization. Unless prescribed by the organization's charter, there are no boundaries on strategic decision making. Although there is often input from many levels of the organization, these decisions are usually made by the board of directors or most senior managers, and are based on the broadest scope of information and knowledge about the organization, its business environment, and the relationship between them.
- *Line decisions:* Line decisions can be made at any level of the organization, from top executives to production workers. They are distinguished from strategic decisions in that they are made within a bounded scope, determined at the strategic level by the allocation of responsibility within the organizational structure. All knowledge workers make line decisions in performing their functions.
- *Portfolio decisions:* Portfolio decisions are those made in the ongoing management of a portfolio of assets, liabilities, or risks. This set of decisions most obviously applies to financial markets, though it is also relevant to a host of corporate-level functions.

Enhanced Capabilities

An organization's competitiveness is based on its business capabilities. That is, how well it performs the activities that impact its performance. Those capabilities are based on a fusion of effective business processes and skills, both of which are forms of knowledge. An organization's processes are an institutionalized form of knowledge, sometimes partially documented but more typically simply "the way things are done." Individual skills are also critical in effectively implementing processes, and developing specific skills within the context of an organization's capabilities can add substantial value. Firms that can effectively contribute to enhanced capabilities in their clients are in a prime competitive position.

The concept of knowledge transfer to clients can be expressed in many ways, and is by no means a new idea. In 1982, Arthur Turner of the Harvard Business School identified eight levels of value in consulting engagements. The top two levels were permanently improving organizational effectiveness and facilitating client learning.[12] Another formulation is found in differentiating between prescriptive and facilitative consulting. Prescriptive consulting is telling clients what to do, while facilitative consulting is helping them to do it for themselves. Demand for the latter is increasing.

Internal Clients

While knowledge-based relationships are usually associated with external organizations, the concept is equally applicable internally. One of the strongest shifts in organizational practice over the last decade has been for the support divisions of companies — such as information technology, finance, human resources, and internal consulting — to be chartered with providing services to clients in other parts of the company. These relationships mimic external commercial relationships to varying degrees. These divisions usually charge or allocate costs to their clients, and it is common to implement service-level agreements (SLAs) that specify acceptable levels of service. Sometimes the divisions are profit centers, and also provide services to clients outside the firm. It is not at all unusual for company divisions to have the choice of using the internal service provider or going outside the firm.

As such, virtually all of the issues of knowledge-based relationships covered in this book apply equally to servicing internal clients. The key dynamic here is that clearly the internal service division should have significantly greater knowledge of its clients than external providers. The issue is applying this greater knowledge to create differentiated service. An internal service division will rarely have the breadth of expertise of a large external firm. However, if it uses its knowledge advantage effectively it can provide in most cases significantly greater value to its clients.

THE FOUR STAGES OF RELATIONSHIP DEVELOPMENT

In my work with professional services relationship leaders, perhaps the most common problem I encounter is the mentality that a significant client relationship is going just fine and does not need further development. The reality is, if a relationship is not progressing it is going backward. To improve their client relationships, professionals need to understand that relationships are never static but are a process. Solid forward momentum is the only way to stop a client relationship eroding, driven by manifold pressures, including ever-stiffer competition.

Imagine a path leading over a hill, with a ball that has been rolled up the hill to be perched right on the crest. One way or another, it is not going to stay there, comfortably perched in stasis. Either it will start to roll forward along the path, picking up pace as it goes and gaining momentum, or it will start to roll back down the hill from where it came. Client relationships are the same. They will not remain static. They will always have some type of momentum, either positive or negative. The relationship leader's role is to ensure that relationship momentum is positive. In building positive relationship momentum, it is valuable to recognize the four stages in the client relationship development process, as shown in Figure 1–5.

- *Engaging:* In this stage the firm and client begin to engage and explore the potential benefits of a deeper relationship. This is usually characterized by initial contacts and

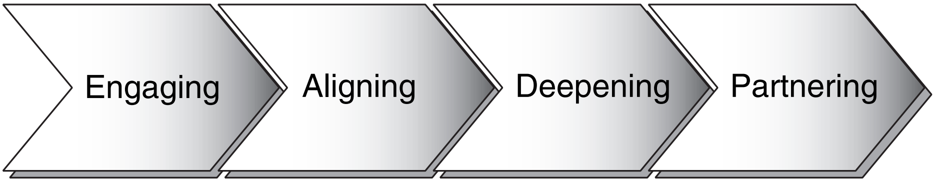

Figure 1–5 *The four stages of relationship development.* Copyright © 2004 Advanced Human Technologies. Reprinted with permission.

discussions, qualifying, proposals, and possibly small-scale engagements.

- *Aligning:* The next stage is for firms and clients to begin to align their objectives, relationship styles, processes, language, and culture. Knowledge about clients is applied to customizing interaction and service delivery. Discussion of high-level relationship objectives shifts the basis for the relationship.
- *Deepening:* Here firms focus on both deepening and broadening the relationship; gaining more client contacts across levels of seniority, functions, divisions, and locations; and introducing more of its executives to create a true organization-wide relationship.
- *Partnering:* A small proportion of business-to-business relationships move beyond the buy/sell relationship to one of partnership. This entails jointly creating and sharing value, and is characterized by value-sharing contracts, deep mutual disclosure of objectives, and joint initiatives that draw on the resources of both organizations.

Typical activities of each of the stages of relationship development are shown in Table 1–1. These activities will vary depending on the particular industry and type of relationship. Details regarding the variety of relationships are explored in Chapter 2. Relationship leaders must identify at which stage they are with any specific client, and how to take the relationship to the next stage. If you are not actively

Table 1–1 *Typical activities at each stage of the relationship development process.*

Engaging	• **Initial contact** • **Explore compatibility/qualifying** • **Proposal** • **Provide ideas** • **Small-scale engagements/transactions**
Aligning	• **Align technology** • **Establish objectives, expectations, parameters** • **Discuss relationship strategies** • **Map a path forward** • **Establish a trust development program**
Deepening	• **Develop deeper client knowledge** • **Gain varied mutual experience** • **More diverse projects and lines of business** • **Broader contacts across both organizations** • **Knowledge transfer and sharing**
Partnering	• **Process integration** • **Value-based pricing** • **Share exclusive information** • **Joint development and marketing of intellectual property** • **Joint ventures**

working to move the relationship to the next stage, it is in strong danger of moving backward.

These relationship stages can be applied equally to other types of business relationships, including supplier and alliance relationships. The alliance process is one of moving to partnership, where firms jointly create value. This is often not an immediate process. To unlock the potential of an alliance, trust and value creation need to build over time. It is only then that the greatest potential benefits of combining the firms' resources and assets come to light.

Indian technology services company Satyam Computer Services began working for equipment manufacturer Caterpillar in 1993. The following year Satyam executive Bipin Thomas was assigned full time to coordinate the many projects being run for the client. The relationship gradually developed, and by 1998 Satyam was performing $2 million of work annually for Caterpillar, and had 38 employees working on its projects. This is when Thomas began to apply in earnest the client knowledge and solid relationships he had developed over the years working with Caterpillar. Thomas approached Caterpillar to propose working more collaboratively, providing a sophisticated framework for how they could work together. The trust developed over five years of working together made Caterpillar very receptive.

A key platform for moving the relationship forward was a joint IT strategic planning process. Out of this came a framework that clearly identified the competencies required to assist Caterpillar to achieve competitive advantage, and a host of associated initiatives, including jointly established key performance indicators for the relationship. Over the next four years, Caterpillar's business with Satyam leaped to $16 million annually, with 230 Satyam employees working on the account and measures such as responsiveness and customer satisfaction reaching record levels.[13] Thomas never rested on his laurels, however, and continually pushed to take the relationship further.

The Imperative of Knowledge-Based Relationships

In my experience, the importance of knowledge-based relationships is by now fairly broadly accepted by professionals. There has been a strong shift in even the last five years, since the first edition of this book came out, and older styles of professional relationships are gradually eroding. However, there is still substantial push-back, and the reality is that stated acceptance of the ideas may bear little correlation to actual behaviors in client meetings and engagements. There remain some key issues that need to be understood and addressed in order to obtain traction within organizations.

Doing Great Work Is Not Enough

"Do great work, and your clients will come back." Undoubtedly you have heard this axiom or some variation on it, as it is often repeated by professionals and their advisors. This is a half-truth. It is essential to do good or even outstanding work in order for your clients to come back. However, it is no longer enough. Clients' expectations have changed. They now want service providers that can create exceptional value, make them more knowledgeable, and be true partners.

When you examine the manifold surveys of how clients perceive their professional services providers, a pattern often emerges. There are many leading professional firms that are rated very highly by their clients in terms of technical expertise, but rather poorly in terms of their capabilities at relationships, including understanding their clients business, communicating effectively, being a pleasure to deal with, and creating broad business outcomes. These same clients indicate that the importance of these relationship factors is increasing. Even if they are seeking the professional with the best technical expertise, this is by no means the only criterion, and if they do not have the same knowledge of the client as their competitors or the ability or inclination to apply it to provide differentiated service they increasingly lose the business. In short, doing great work is not enough.

Professional Knowledge Cultures

In his novel *The Bonfire of the Vanities*, Tom Wolfe brought to life the "Master of the Universe" syndrome.[14] Professionals pride themselves on their knowledge, their talent, and their power of influence. Indeed, the advice and action of top professionals can sometimes change the shape of industries or entire economies in massive transactions. The result is that the leading professions are known as much for the massive egos of their key players as for the work they do.

Without underplaying the talent and value of the best professionals, it is important to see the trap. Clients want the best expertise applied to their situation, but they do not appreciate the attitude that often goes with it. Professionals sometimes think that their clients want them to be clever. They do, but this is not enough. They must be willing to engage with their clients in a way that can create mutual value. Chris Argyris' classic *Harvard Business Review* article

"Teaching Smart People How to Learn" is essential reading for professional services leaders.[15] It uncovers how incredibly bright and successful professionals very often have problems relating to clients and shifting to a position of joint engagement on an issue.

Knowledge-based relationships require an underlying attitude of client respect. Without respect for your clients, it is impossible to work collaboratively with them and to tap their knowledge of their business to create outcomes for them. The antithesis of client respect is arrogance. No client will seek out arrogant professionals. Not only is it an unpleasant experience to deal with them but it makes them incapable of moving beyond a black-box relationship. The essence of arrogance is an unwillingness to learn from others.

The other key cultural issue is that professionals see their knowledge as their source of wealth. They are very reluctant to part with it, and eager to promote themselves as experts for hire.[16] Knowledge management is largely about getting people to *want* to share knowledge. It is useless putting in elaborate intranets and other sharing technology and systems unless users are motivated to share their knowledge. Considering the difficulty in getting people to share their knowledge inside their organizations, it is not surprising that many professionals are reluctant to share knowledge with their clients.

Why Should I Teach My Clients to Do What I Do?

The great fear of professionals is that if they make their clients more knowledgeable they are giving away their key productive asset from which they make money. In many instances this is a misunderstanding of the nature of knowledge-based relationships. This is often not about teaching your clients to do what you do but making them better at what they do, which is very far from doing yourself out of a job.[17]

In other cases, it is true that knowledge-based relationships result in clients becoming more self-sufficient. In some situations it is possible that this means they will rely less on you in the future. More often their increased self-sufficiency will allow you to move to higher value and more profitable types of engagements.

Either way, refusing to engage in knowledge-based relationships with clients is an unsustainable position. In professional services, the far greater risk is that competitors will offer more value to your clients than you do, so that you will lose all their business. In the past, most professions have effectively closed ranks to ensure none of their members revealed professional secrets, and they maintained their hermetic and privileged knowledge. Today's competitive pressures mean that there will always be participants who break ranks to make clients more knowledgeable, and win business away from others. Those are the firms that will build sustained client relationships. Black-box relationships are quickly commoditized, and increasingly mobile clients will gradually navigate their way to firms that engage in true knowledge-based relationships, based on transparency, development of mutual knowledge, and the uncovering of opportunities for superior value creation.

Summary: Knowledge and Client Relationships

Commoditization is a powerful driver in today's economy. For professional services firms, continuing to provide black-box relationships to clients, in which services are provided at arm's length, will simply aggravate this trend. The only sustainable way to escape commoditization is to engage in what I called knowledge-based relationships, in which knowledge exchange is the foundation of the relationship. Creating a self-reinforcing circle of knowledge-based relationships, involving deeper customer knowledge, greater openness, and service customization, can enable positive client lock-in through superior value creation.

While this approach can create greater value for clients as well as their service providers, clients need to have the benefits of these approaches shown to them. Professionals must demonstrate leadership to take their clients on the challenging journey into deep, knowledge-based relationships. It is critical to understand the distinction between information and knowledge in developing client relationships, including considering how knowledge is applied to create value for the client.

Professionals must focus on getting positive momentum in their client relationships. Those firms that do not successfully engage in knowledge-based relationships will find business very challenging moving forward. Building on the idea of the knowledge-based relationship, in Chapter 2 I will explore the quintessential knowledge organizations — professional service firms — and the challenges they are currently facing.

Notes

1 GDP figures in constant 1996 dollars. Based on information in Chris Meyer, "What's the Matter?," *Business 2.0*, pp. 88, April 1999, and from the U.S. Department of Commerce.

2 See G. C. Shelley, "Dealing with Smart Clients," *Ivey Business Quarterly*, Autumn 1997, pp. 50–55.

3 Liedtka et al. make a similar point that in professional service firms there is a "generative cycle" of employee and client development (i.e., knowledge and relationships), but they implicitly treat client relationships as black boxes. See Jeanne M. Liedtka, Mark E. Haskins, John W. Rosenblum, and Jack Weber, "The Generative Cycle: Linking Knowledge and Relationships," *Sloan Management Review*, Fall 1997, pp. 47–58.

4 Brian Cotterill, "*How Outsourcing Helped Shell Achieve World's Best Practice*," Competitive Advantage from Best Practice Outsourcing: The Untold Success Story Conference, University of Technology Sydney, Sydney, Australia, June 24, 2004.

5 Karl-Erik Sveiby, *The New Organizational Wealth: Managing and Measuring Knowledge-Based Assets*, San Francisco: Berrett-Koehler, 1997, pp. 29–38.

6 Thomas H. Davenport and Laurence Prusak, *Working Knowledge*, Boston: Harvard Business School Press, 1998, pp. 1–12.

7 Donald A. Schön, *The Reflective Practitioner: How Professionals Think in Action*, New York: Basic Books, 1983, pp. 49. Italics in original.

8 Michael Polanyi, *The Tacit Dimension*, London: Routledge & Kegan Paul, 1967, p. 4.

[9] The concepts of socialization, externalization, and internalization are drawn from Ikujiro Nonaka and Hirotaka Takeuchi, *The Knowledge-Creating Company*, New York: Oxford University Press, 1995.

[10] Alan M. Webber, “What’s So New About the New Economy?,” *Harvard Business Review*, January-February 1993.

[11] See Lisa Galarneau’s blog on relevancy at *www.oddwater.com/relevancy*.

[12] Arthur N. Turner, “Consulting Is More Than Giving Advice,” *Harvard Business Review*, September-October 1982.

[13] Joseph Sperry, “Turning Innovative Account Management into Dollars: The Satyam-Caterpillar Story,” *Velocity*, Q4 2003, pp. 31–34.

[14] Tom Wolfe, *The Bonfire of the Vanities*, New York: Bantam, 1988.

[15] Chris Argyris, “Teaching Smart People How to Learn,” *Harvard Business Review*, May-June 1991, pp. 99–109.

[16] Quinn et al. comment on the challenges of getting professionals to share knowledge, as well as the exponential benefits of companies learning from outsiders. See James Brian Quinn, Philip Anderson, and Sydney Finkelstein, “Managing Professional Intellect: Making the Most of the Best,” *Harvard Business Review*, March-April 1996, pp. 71–80.

[17] As Arthur Turner points out, consultants who facilitate client learning will have satisfied clients who will recommend them to others and invite them back the next time there is a need.