

HUMAN RESOURCES IN THE 21ST CENTURY



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CHAPTER 10



Human Resource Management and Business Performance

Lessons for the 21st Century

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RECENT STUDIES OF human resource management (HRM) and business performance find that certain “high-involvement” HRM practices are, in research parlance, “significantly positively associated” with such measures as market value, rate of return on capital employed, revenue growth, revenue-per-employee, productivity, product/service quality, and even organizational survival.¹ This conclusion is at least partly global; data in the component studies are drawn from business entities in Europe, Asia, and Central America as well as North America.

While there is not complete agreement among researchers or practitioners about precisely what constitutes high-involvement HRM practices, the following are most often cited: employment security; targeted selection; workplace teams and decentralization; high pay contingent on organizational performance; employee training; reduction of status differentials; and business information-sharing with employees.² Often, such practices are said to reflect an HRM strategy of managing people as assets. From this perspective, expenditures on high-involvement type HRM practices should be considered investments in human capital that will (ultimately) yield net economic return (value added) to the entity making the investments.

Given this reasoning, as well as the aforementioned research evidence, we would expect most, if not all, business entities to have adopted high-involvement HRM practices, yet only about one of every eight businesses has done so.³ Some businesses don't believe the evidence about positive effects of high-involvement HRM practices on business performance; some businesses adopt only one high-involvement type HRM practice; and still others adopt the full complement of

high-involvement type HRM practices, but abandon them after significant effects on business performance do not materialize in the short run. Alternatively, others contend that knowledge of the positive effects of high-involvement HRM practices on business performance is only slowly becoming known to business practitioners and is therefore in the early stage of diffusion. This argument implies that rate of adoption of high-involvement type HRM practices by business entities will increase over time as these entities learn more about the positive effects of such practices.

A different line of reasoning, however, and the one advanced here, is that high-involvement HRM practices constitute only one way of managing human resources to enhance business performance. Another way of achieving this objective is to manage human resources as an expense that must be contained or reduced. For this purpose, "low-involvement" rather than high-involvement HRM practices fit best.

A Dual Theory of HRM and Business Performance

To frame this issue more sharply, consider that a business's workforce is comprised of two distinct segments, namely, a *core* and a *periphery*.⁵ The core workforce consists of those who are employed full-time and paid a regular salary or wage. This workforce is covered by fringe benefits; they have training, development, and promotion opportunities along well-defined career paths; and they participate in decision making through organizational decentralization, workplace teams, and other arrangements. Typically, this core workforce is also carefully selected, has employment security, has some pay-at-risk dependent on the performance of the business or a unit thereof, and partakes in the sharing of business information. By contrast, the peripheral workforce consists of part-time, temporary, contract, vendored, and outsourced "employees" who are generally paid a fixed wage, salary, or, in the case of outsourced employees, a lump sum (project-based) cost; are partially or not at all covered by fringe benefits; have little or no training, development, promotion opportunities, involvement in decision making, pay at risk or employment security; and do not partake in the sharing of business information.⁶ Recognizing that most businesses have both core and peripheral workforce segments helps to explain why businesses do not widely or uniformly adopt high-involvement type HRM practices. Furthermore, while the core workforce may be managed primarily as an asset or investment (in human capital), the peripheral workforce is managed primarily as an expense (to be contained or reduced).

Herein lies the foundation of a "dual theory of HRM and business performance." Expenditures on the core workforce should (accounting convention aside) be treated as an investment intended to increase the value added to the business by employees in this workforce segment. Expenditures on the peripheral workforce should (following accounting conventions) be treated as an expense that the business seeks to contain or reduce and, in this way, also add value to the

business. In both instances, the optimization problem facing the business is maximizing the return, or value, over cost. In the ideal, both sets of HRM practices should result in larger profit margins (i.e., revenue less cost) than would occur by following conventional HRM practices in which there are few or no distinctions between core and peripheral employees. Empirical evidence that supports this dual theory of HRM and business performance is summarized in this chapter.

High-Involvement HRM Coverage of Core and Peripheral Employees

If the distinction between core and peripheral employees (and the HRM practices applied to them) is valid, then high-involvement HRM practices should be applied largely to the former, not the latter. A recent study of HRM and business performance that focuses on businesses' use of part-time, temporary, contract, vendored, and outsourced employees sheds light on this matter.⁷ The multilevel samples for this study totaled 289 companies, 313 business units (of companies), 457 manufacturing plants, and 249 sales and service field offices of a national insurance company.⁸ As shown in Table 10.1, high-involvement type HRM practices are used significantly more for core employees than for peripheral employees in these business entities. Indeed, among the eight high-involvement practices—employment continuity, selective hiring, training/development, teams/participation, variable pay, performance management, promotion opportunity, and business information sharing—that provided the basis for this comparison, each is far more widely used for core employees than for peripheral employees. Collectively, the use of this set of high-involvement HR practices is two-and-one-half times greater for core than for peripheral employees (with means of 4.1 and 1.5, respectively, for “all practices” on a 1 = low, 5 = high rating scale). Therefore, and despite the variation in usage of high-involvement HRM practices by the sampled businesses, these data support the proposition that peripheral employment is low-involvement employment—and that core employment is high-involvement employment.

Low-Involvement HRM Practices and Business Performance

This same study attempted to determine if low-involvement HRM practices (applied largely to peripheral employees) are significantly positively associated with business performance. For this purpose, an index of low-involvement work practices (LIWP) was constructed that measures the proportion of an organization's workforce consisting of part-time, temporary, and contract employees, as well as employees who have been placed with vendors and employees leased from outsourcing firms.⁹ The data for determining the LIWP index score at a point in time, 1998, and changes in the score over time, 1995–1998, came from

TABLE 10.1 Extent of High-Involvement HRM Practice Usage among Core (C) and Peripheral (P) Employees, 1998 (Mean Values on a 1 = Low, 5 = High Scale)

Variable	Companies		Business Units		Manufacturing Plants		Sales and Service Field Offices		Total	
	C*	P*	C*	P*	C*	P*	C*	P*	C*	P*
Employment continuity	3.4	1.5	3.2	1.4	3.0	1.6	3.3	1.3	3.3	1.5
Selective hiring	4.3	1.7	4.4	1.8	4.2	1.8	4.1	1.4	4.3	1.6
Training/development	3.9	1.4	4.0	1.5	3.8	1.3	4.2	1.6	4.0	1.5
Teams/participation	4.2	1.3	4.3	1.4	4.0	1.6	3.8	1.3	4.1	1.5
Performance management	4.5	1.6	4.4	1.5	4.1	1.8	4.2	1.6	4.3	1.6
Promotion opportunity	3.9	1.2	4.2	1.4	3.6	1.2	3.8	1.3	3.9	1.5
Variable pay	4.6	1.4	4.5	1.3	4.2	1.3	4.5	1.7	4.5	1.6
Business information sharing	4.0	1.5	4.2	1.6	4.5	1.5	3.8	1.4	4.1	1.5
All practices	4.1	1.5	4.2	1.5	3.9	1.5	4.0	1.4	4.1	1.5
N =	289	289	313	313	457	457	249	249	1308	1308

* All differences between means within pairs of columns significant at $p = < .01$.

surveys administered to each company, business unit, manufacturing plant, and sales and service field office. Business performance data were obtained from secondary sources in the cases of the company and business unit samples, as well as from the surveys in the cases of the manufacturing plant and insurance company field office samples. The variation in performance among each of the four sets of business entities was then subjected to multivariate analysis in which the LIWP index served as the main independent variable and several control variables (as examples, organizational size, capital-labor ratio, and unionization) were also included.¹⁰ The main findings from these regression analyses are summarized next.

For the company sample, the LIWP index is significantly positively associated with return on capital employed; market value; revenue per employee, in both cross-sectional or single-year analysis; and changes in each of these business performance measures in the longitudinal or multiyear analysis. These findings imply that a one standard deviation increase in the LIWP, or proportional increase in peripheral employment, is associated with a statistically significant 1.5 percent

increase in return on capital employed, a 2.7 percent increase in market value, and a 3.2 percent increase in revenue per employee. For the business unit sample, the LIWP index is significantly positively associated with return on capital employed and revenue per employee, both at a point in time and over time. These findings imply that a one standard deviation increase in the LIWP, or proportional peripheral employment, is associated with a statistically significant 2.2 percent increase in return on capital employed and a 4.1 percent increase in revenue per employee in these business units.

For the manufacturing plant sample, the LIWP index is significantly negatively associated with total labor cost as a proportion of total operating cost (LABORCOST) at a point in time and with the change in this operating performance measure over time. These findings imply that a one standard deviation increase in the LIWP, or proportional peripheral employment, is associated with a statistically significant 5.8 percent reduction in manufacturing plant labor cost as a proportion of total operating cost. Equally notable, the LIWP index is not significantly associated with productivity or product quality at a point in time or over time. In other words, and contrary to expectations, these manufacturing plants apparently do not experience lower productivity or product quality as a result of employing peripheral workers and managing them with low-involvement work practices.

For the insurance company field office sample, the LIWP index is significantly negatively associated with the ratio of payroll cost to sales revenue, both in the cross-sectional and longitudinal analyses. These findings imply that a one standard deviation increase in the LIWP, or proportional peripheral employment, is associated with a statistically significant 4.8 percent decrease in the ratio of payroll cost to sales revenue in these field offices. By contrast, the LIWP index is not significantly associated with revenue growth, quality of service, or customer satisfaction. Consequently, and again contrary to expectations, these insurance sales and service field offices apparently do not experience lower revenue growth, service quality, or customer satisfaction as a result of employing peripheral workers and managing them in a low-involvement fashion.

High-Involvement HRM Practices and Business Performance

Because high-involvement HRM researchers have generally ignored low-involvement HRM practices, this research on low-involvement HRM practices should not do the same in reverse. Consequently, a high-involvement work practice (HIWP) index consisting of the eight practices shown in Table 10.1 was constructed and measured for each company, business unit, and manufacturing plant included in this study. The insurance sales and service field offices were excluded, because high-involvement work practices in the insurance company are standardized across the entire organization and therefore do not vary among field offices. The main findings from analyzing relationships between

the HIWP index and the various business performance measures for the three other samples of business entities are summarized next.

The HIWP index is significantly positively associated with long-run (that is changes in) company financial performance, short- and long-run business unit financial performance, and short- and long-run manufacturing plant operating performance. These findings confirm the results of other studies showing that high-involvement HRM practices “leverage” business performance. More to the point, however, the LIWP index remains significantly positively associated with the various measures of business performance when these businesses’ use of high-involvement HRM practices is taken into account. Therefore, low-involvement HRM practices can also be said to “leverage” business performance.

Cumulatively, these empirical findings provide strong support for a dual theory of HRM and business performance, especially because high-involvement and low-involvement HRM practices are typically used by a business simultaneously. To illustrate, among all the business entities included in this study ($n = 1308$), more than 95 percent reported having some peripheral employees (in 1998); such employment averaged about 32 percent of total employment. Among these businesses, the mean score on the HIWP index, which range from 8 to 40, was 25.5, and less than 5 percent of them had HIWP index score of less than 15. Hence, most businesses make use of core employees to whom high-involvement HRM practices are applied and peripheral employees to whom low-involvement HRM practices are applied.¹¹ Both types of HRM practices have been shown here to “leverage” business performance, and the positive effects of low-involvement HRM practices on business performance are not vitiated when the effects of high-involvement HRM practices are considered. Thus, it is possible for a business to manage one segment of its workforce by investing in high-involvement HRM practices and obtaining net value added and to manage another segment of its workforce through low-involvement HRM practices that serve to “add value” by containing or reducing labor expense.

Balancing Core and Peripheral Employment

In light of this conclusion, it is appropriate to ask, “Is there a proper or optimal balance of core and peripheral employment for a business?” To answer this question, additional multivariate analyses were undertaken in which the ratio of peripheral employment to total employment for each business entity in each of the four samples served as the dependent variable, and the various business performance measures served as independent variables—in effect, “reverse” regression analyses. (Control variables were also included in both sets of analyses.) The main findings from these analyses are summarized next.

Better performing companies, that is, those with relatively higher return on capital employed, market value, and revenue per employee, make greater use of peripheral employment than poorer performing companies, and also increase their use of peripheral employment significantly more than poorer performing

companies. The same may be said for business units, that is, business units with relatively higher return on capital employed and revenue per employee make greater use of peripheral employment than poorer performing business units, and also increase their use of peripheral employment significantly more than poorer performing business units.

In the case of manufacturing plants, those with a relatively lower ratio of total labor cost to total operating cost make relatively greater use of peripheral employment than poorer performing manufacturing plants, and also increase their use of peripheral employment significantly more than poorer performing manufacturing plants. Similarly, better performing sales and service field offices, that is, those with a relatively lower ratio of payroll cost to sales revenue, make greater use of peripheral employment and increase their use of peripheral employment significantly more than poorer performing field offices.

These findings do not mean that business entities should simply or linearly continue to increase their ratios of peripheral employment to total employment, however. This is because when the company, business unit, manufacturing plant, and sales and service field office samples were separated into quartiles based on changes (during 1995–1998) in one or another measure of their financial or operating performance, the top-performing quartile in each sample had a significantly higher ratio of peripheral employment to total employment than the bottom two performing quartiles, but a significantly lower ratio of peripheral employment to total employment than the second (best-performing) quartile. Specifically, the top-performing quartile of business entities had an average ratio of peripheral employment to total employment of .34 compared to ratios of .17 for the bottom or poorest performing quartile, .26 for the third or second-worst performing quartile, and .40 for the second or second-best performing quartile. Stated differently, on average, the gain in business performance associated with increasing use of peripheral employment is sharpest when the ratio of peripheral employment to total employment rises from about one-quarter to one-third. Increases in the ratio beyond this point are associated with declining business performance. Thus, from a business performance perspective, a balance of one-third peripheral employment and two-thirds core employment seems “optimal.”¹²

Implications for Globalization, Organizational Change, and the HR Function

When added to extant high-involvement HRM-business performance research, the findings from this study have some implications for globalization, organizational change, and the HR function. Regarding globalization, there are many countries in which certain high-involvement HRM practices apparently don't fit because they run afoul of cultural values, custom, history, and legal constraints.¹³ Variable pay, business information sharing with employees, and decentralized, team-based work are among such practices. Similarly, certain low-involvement

HRM practices, such as part-time, fixed contract, and outsourced employment don't appear to fit well with many nations. Yet, it was only a short time ago that these (and other) high-involvement and low-involvement HRM practices were virtually unknown in the United States, where individually designed work for a fixed rate of pay in a high control organization predominated. The lesson here is that these historical U.S. practices were substantially altered by market globalization (among other factors) and that further globalization will, in turn, alter HRM practices elsewhere—especially if business practitioners pay closer attention to research findings about the effects of high-involvement and low-involvement HRM practices on business performance.

Regarding organizational change, researcher and practitioner attention has focused predominantly on external environmental factors such as technology, deregulation, customers and competitors as key drivers of change—global drivers, to be sure.¹⁴ But from time to time, new ideas and new evidence about human behavior at work can drive organizational change. Historical examples include the emergence and expansion of “free” labor markets in the 19th century, the scientific management and Hawthorne-inspired human relations “movements” of the early 20th century, and the total quality and work process re-engineering innovations of the late 20th century.¹⁵ Each of these developments brought about major changes in the design of work and the management of people at work, that is, major organizational change, both in the United States and abroad. From this perspective, the dual theory of HRM-business performance and its supporting evidence should cause executives and managers worldwide to rethink the doctrine that, when it comes to managing people, “one size or set of best practices fits all.”

Regarding the HR function, its dominant role in the business enterprise has frequently changed to emphasize, as examples, social welfare services, union avoidance, organizational rule enforcement, compliance with regulation, and record keeping.¹⁶ Only relatively recently has the HR function's principal role been characterized as a business partner or change agent.¹⁷ The capability of the HR function—of HR executives and professionals—to serve either or both these newer roles, however, is called into question by the creation of organizational learning functions and executive positions by several prominent businesses. In these businesses (and perhaps others), the HR function is viewed not as a key business partner or change agent but, instead, as largely fulfilling one or more of its older, traditional roles. For the HR function to turn around in the 21st century and fill the role of business partner and/or change agent, HR executives and professionals would do well to master the dual theory of HRM-business performance and the supporting evidence presented here. By doing, so they will be better able to demonstrate how it is that certain HRM practices positively affect business performance, and to significantly influence their organizations in determining the balance between, on the one hand, high-involvement HRM practices and core employment and, on the other hand, low-involvement HRM practices and peripheral employment.