PEOPLE MANAGEMENT AND THE BOTTOM LINE

• *Richard Rudman* BA , MPP, LFHRINZ

Abstract:

Good managers have long known that how people are managed has a major impact on the organisation's performance. But it's been difficult to prove. Many studies have described particular management styles and practices which are said to produce more motivated, or satisfied or productive employees. Only recently, however, has research begun to show how people management and employee relations impact on the organisation's bottom line.

It's easy to say that people are our most important asset or the source of our competitive advantage. But it's much more difficult to provide the evidence, especially at a time when cost-cutting, downsizing and other short term interventions have too often held sway over careful and systematic management practice.

However, the past few years have seen the development of a steadily mounting body of research-based evidence which shows that managerialist interventions such as downsizing do not have positive long-term benefits for the organisation (See, for example, Littler, 1998 and Cascio, 1995). By contrast, the research argues, carefully selected human resources management strategies and practices – which are appropriate to both the organisation and its circumstances – do contribute positively to the organisation's performance and probability.

This research, originating mainly in the United Kingdom and the United States, begins to solve a problem which human resources specialists have faced for many years – the problem of how to demonstrate a cause-and-effect relationship between the management of people and the performance of the organisation.

What the researchers are now giving human resources specialists is the hard evidence they need – some of it calculated in dollar terms – to show top managers that people management practices can have positive and profitable outcomes, but that many of them have the opposite effect.

The challenge for human resources specialists is to take notice of the research, adapt and present its data in ways that persuade their management colleagues that people really are 'our most important asset', and use its conclusions to better inform their own decisions and practice.

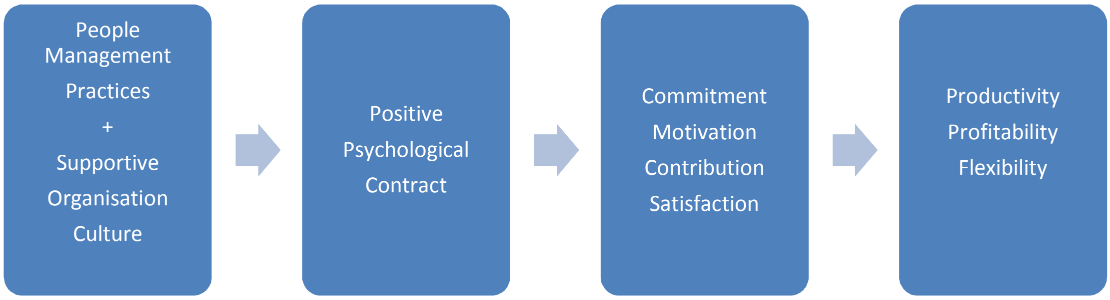
Key conclusions

In summary, the research work led by respected academics like David Guest and John Purcell in the United Kingdom and David Ulrich and Mark Huselid in the United States demonstrates convincingly that selected people management practices, implemented within a supportive organisation culture, lead to a positive psychological contract, with beneficial outcomes for individual satisfaction and organisational performance. Three key conclusions can be drawn from these research studies (Guest and Conway, 1997, Patterson et al, 1997):

1. The key elements of good people management practice are job design, skills development, and a climate of regular, systematic involvement;
2. Good people management practices are associated with a positive psychological contract based on trust, fairness, and delivery of the deal;
3. An organisation culture in which employees believe their employers will look after their interests has positive outcomes for work performance.

We know from research led by David Guest (2000) that managers believe there is a link between their use of human resources management practices and how the business performs. Mostly, managers also agree that the link is not directly causative between human resources management practices and organisational performance, but that it depends on the quality and the commitment of the people doing the work.

In other words, as the diagram shows, human resources or people management practices affect employee quality, commitment and flexibility – and these characteristics are associated with higher productivity and improved products and services, which feed through in turn to the firm's financial results.



People management and business performance

Based on a review of the academic literature, Marc Thompson of Templeton College, Oxford, and Ray Richardson of the London School of Economics concluded (Thompson and Richardson, 1999) that the link between people management and business performance could be summarised in terms of three main theoretical approaches.

1. The best practice approach

This approach holds that a set of people management policies is the key to improved performance in all situations. Jeremy Pfeffer (1998), for example, argues that an organisation's success depends on how it treats its employees. He identifies seven people management policies which "seem to characterise most, if not all, of the 3 systems for producing profits through people" and provides empirical evidence to support the contention that most organisations would benefit from these practices. Pfeffer's 'high performance work system' involves:

- emphasising employment security;
- concentrating on recruiting the right people in the first place;

- using self-managing teams and decentralisation;
- providing high levels of remuneration which are tightly linked to organisational performance;
- spending heavily on training;
- reducing status differentials; and
- sharing information.

2. The Contingency Approach

Advocates of the contingency approach argue that human resources policies and practices must fit with other organisational factors if they are to contribute to improved performance. Randall Schuler and Susan Jackson (1987), for example, have shown that the choice of human resources policies and practices should be influenced by the organisation's market positioning and strategies.

3. The Configurational Approach

This approach emphasises the need for people management practices to fit with each other, as well as with other strategies. It is sometime referred to as 'bundles' theory.

Professor John Paul MacDuffie (1995), for example, has demonstrated how higher productivity and better quality in 62 car assembly plants was associated with internally consistent sets of innovative people management practices. In these plants, productivity rose even higher, however, when the people management practices were used in conjunction with a flexible work system, backed up by quality discussion groups, team working and job rotation.

The Huselid studies

Rutgers University Professor Mark Huselid has probably done more than any one else to provide the research-based evidence of a causal relationship between what he calls 'high performance work practices' and organisational performance.

Huselid's work first came to international attention in 1995 with the publication of a prize-winning paper in the prestigious Academy of Management Journal. That paper (Huselid, 1995) reported research, based on a national sample of nearly 1,000 United States firms, which indicated that high performance work practices have an economically and statistically significant impact on both intermediate employee outcomes (turnover and productivity) and short- and long-term measures of corporate financial performance.

As the basis for his research, Huselid constructed a single measure of sophistication in human resources management practices. This index had two factors:

1. Employee skills and organisational structures, which included a broad range of practices intended to enhance employees' knowledge, skills and abilities and also to provide a mechanism through which employees could use those attributes in performing their jobs;
2. Employee motivation, which covered a more narrowly-focused set of human resources practices designed to recognise and reinforce desired employee behaviours.

Conceptually, employees' core competencies were provided through selection, training and the design of their work (the first factor), and subsequently reinforced through the second factor (employee motivation). Huselid tested this index against staff turnover, sales per employee, and overall corporate financial performance. He found that "the magnitude of the returns for investments in high performance work practices is substantial".

A one-standard-deviation increase in such practices was associated with a relative 7.05 per cent decrease in turnover and, on a per employee basis, US$27,044 more in sales, US$18,641 more in market value and US$3,814 more in profits.

In summary, more sophisticated and innovative people management leads to lower turnover, higher sales, and better profitability.

Human capital architecture

From more recent analysis of his data, Huselid (1999) argues that strategy implementation has a ten times greater impact than strategy content on shareholder value, and that the firm's 'human capital architecture' is a key driver of its strategy implementation. The essential elements of human capital architecture are:

- Careful selection and hiring that is consistent with the firm's competitive strategy and operational goals;
- Reward systems that reflect the elements of successful strategy implementation in appraisal systems and compensation; and
- Development strategies that emphasise training, and performance management systems that are guided by business objectives.

While that might not seem to be new information, what is significant is Huselid's calculation that a 35 per cent improvement in the quality of the human capital architecture is causally linked to a 10-20 per cent gain in shareholder value. In a series of case studies published in the Harvard Business Review, Huselid demonstrates how a number of leading companies – including Sears, Lucent, Kodak and AT&T – have developed their strategic measurement systems and human capital scorecards on the basis of these linkages.

Sheffield Effectiveness Programme

Across the North Atlantic, Malcolm Patterson and his colleagues (Patterson et al, 1997) have drawn on the data from the 10-year Sheffield Effectiveness Programme study to confirm the existence of a strong positive relationship between employee attitudes, organisation culture, human resources management practices and organisational performance.

In a study aimed at determining whether business effectiveness is most influenced by market environment, organisational characteristics or managerial practices, the researchers compared fluctuations in profits and productivity among more than 100 manufacturing firms in the United

Kingdom, and measured the variations in these changes. The variations were then studied in relation to particular managerial practices, leading the researchers to conclude that:

- Job satisfaction and organisational commitment each explained 5 per cent of the variation in profitability and 16 per cent of the variation in productivity;
- Supervisory support, autonomy, training and concern for employee welfare together accounted for 10 per cent of the variation in profitability;
- With regard to profitability, strategy accounted for only 2 per cent of the variation, emphasis on quality less than 1 per cent, and research and development 6 per cent;
- With regard to productivity, strategy accounted for less than 3 per cent of the variation, and research and development 8 per cent.

Most important factors

For the longer term, the research found that 29 per cent of the variation in productivity over a three- or four-year period could be attributed to the human relations dimensions of culture. Concern for employee welfare was identified as the single most important predictor of organisational performance.

This research reveals that "people management is not only critical to business performance: it also far outstrips emphasis on quality, technology, competitive strategy or research and development in its influence on the bottom line" (West and Patterson, 1998).

It seems, however, that 'people management' in this context does not necessarily involve technically sophisticated human resources policies and practices, nor the input of human resources specialists. Half of the firms surveyed did not have an individual in charge of human resources, and more than two-thirds had no written personnel strategy. Managers generally described the approach to training as reactive, and only 6 per cent of the firms had organised training strategies. However, where workforce satisfaction was such an important predictor of future productivity, it was clear also that:

"people management is not just about traditional human resources practices such as recruitment, appraisal and training. It is important to take account of the whole person and address the satisfaction of all employees across a range of areas".

According to West and Patterson, the most enlightened organisations:

"consider many aspects of employee satisfaction, including their needs for growth and development, their sense of security, relationships with colleagues and supervisors, the balance between home and work, and even physical fitness".

More than this holistic approach to employee satisfaction, how employees see their company as a community is an equally important predictor of productivity and profitability. In particular, according to the Sheffield research, the human relations climate of the organisation appears to have a significant influence on performance. A concern for welfare, good communication, high quality training, broad autonomy and respect for employees collectively create a community climate.

Adding sharemarket value

Good management of people can add as much as one-third to the market value of a company, according to the Human Capital Index compiled by management consultancy *Watson Wyatt*. The index was developed by identifying 30 human resources practices grouped into key areas:

- excellence in recruiting,
- clear rewards and accountability,
- flexible workplace, and
- communications integrity.

The use of these people management practices was then surveyed in more than 400 publicly-traded United States companies with a minimum of $100 million revenue. After analysing the relationship between human resources practice and objective financial data, each firm was given a Human Capital Index score between 1 and 100.

Watson Wyatt believe their research has proved the existence of a direct correlation between firms which have good human resources policies and practices and their return on shareholder value. The study found that, over a five-year period, total returns to shareholders were nearly twice as high for high-index companies (103 per cent) as for low-index ones (53 per cent). Excellence in recruiting was found to have the most potential for shareholder gain (10.1 per cent), followed by clear rewards and accountability (9.2 per cent), flexible workplace (7.8 per cent), and communications integrity (4 per cent).

What works best?

All the research shows, writes David Guest (1998), that there is no value in investing heavily in specific practices. Instead, the key is to have the right 'bundle' of practices – and the challenge for human resources specialists is to find the right combination for the particular organisation. In a recent survey of human resources managers in United Kingdom organisations, Guest (2000) and his colleagues at London's Birkbeck College identified 18 key practices that are similar to those identified by Pfeffer and often associated with 'high performance' or 'high commitment' human resources management. These practices are:

- Realistic job previews;
- Use of psychometric tests for selection;
- Well-developed induction training;
- Provision of extensive training for experienced employees;
- Regular appraisals;
- Regular feedback on performance from many sources;
- Individual performance-related pay;
- Profit-related bonuses;
- Flexible job descriptions;
- Multi-skilling;
- Presence of work-improvement teams;
- Presence of problem-solving groups;
- Information provided on firm's business plan;
- Information provided on firm's performance targets;
- No compulsory redundancies;
- Avoidance of voluntary redundancies;

- Commitment to single status;
- Harmonised holiday entitlement.

Mark Huselid believes in what he calls 'idiosyncratic contingencies' – a selection of human resources and other management practices which fit with both the organisation's strategy and its culture. The argument against a single set of 'best' practices – especially in a world where competitive advantage is sustained partly by being hard to imitate – is that everyone would adopt the same practices and no one would have an advantage. Thus, the proponents of 'bundles' theory usually argue for strong internal fit, and are wary of external best practice benchmarking.

Cappelli and Crocker-Hefter (1996), for example, argue that the case for a single set of 'best' practices is overstated:

"There are examples in virtually every industry of highly successful firms that have very distinct management practices. We argue that these distinctive human resources practices help to create unique competencies that differentiate products and, in turn, drive competitiveness. Indeed, product differentiation is one of the essential functions of strategic management, and distinctive human resources practices shape the core competencies that determine how firms compete."

The central lesson from the research might be that 'high commitment' and 'high performance' human resources policies and practices are not necessarily the latest 'flavour of the month' sensation. Mostly, they seem to involve the careful and systematic application of tried and true techniques in a planned and integrated framework. The studies suggest that organisations will gain most from putting their efforts into:

- careful work and job design;
- focused recruitment and selection;
- induction and socialisation processes;
- performance management;
- involvement and communication strategies; and
- better targeted rewards and remuneration.

Yet despite the directions pointed by the evidence, David Guest (1998) says "we are still not confident about what should be included in the bundles and about how much choice there is about the distinctive set of best practices".

Distinctive approach

David Francis, of the Centre for Research in Innovation Management at the University of Brighton, believes we can be more definite that successful companies have a distinctive approach to people management (Pickard, 1997). He says the consistency of the picture which emerged from research in 62 organisations in the upper quartile of their business sectors "made an important case for a distinctive paradigm for the management of people".
The findings led to a five-point model of the successful organisation:

- Business planning is shared among all staff;
- A 'win-win', high-energy culture is achieved through developing policies and practices which are felt to be fair, promoting high expectations and celebrating success;
- People are continuously developed, using competencies derived from the company's strategic plan, with a focus on self-awareness, initiative and interpersonal skills;
- Employees work in teams, with co-operation between teams as well as within them;
- Communication is three-way: up, down and across.

This research also shows (Crouch, 1997) that there are stages along each of these five paths – shared goals, shared culture, shared learning, shared effort, and shared information – and that elements of good practice must be established at each of these stages before the organisation can move forward. And the survey companies stress that new practices and attitudes must be allowed time to become established: any attempt to push forward before people are ready can distort the culture of the organisation.

Role for human resources

Human resources specialists need to look closely at the roles they can best play in the 'new' organisation. In recent years, many human resources departments and specialists have opted to take up consultative or advisory roles; others have seen their functions 'devolved' to line managers; some have been outsourced. Like most structural solutions to organisational dilemmas, these may not be the best answers.

As we can see from the work of Mark Huselid, David Ulrich (1997) and others, people management issues need to be integrated totally with the organisation's management and change processes. This suggests that human resources specialists should have wider-ranging roles and more open briefs than might presently be the case. In addition, they need to be linked closely – organisationally, intellectually, and emotionally – to the organisation and its managers.

Indeed, many human resources specialists may need to remind themselves of the profound ways in which 'human resources management' and 'people management' are different. It is true that human resources management is too important to be left to human resources managers. Yet, and at the same time, people managers – those who are in 'line' positions with direct responsibility for the performance of the people they manage – have never needed more support from their human resources specialists. But are they able to provide the right kinds of support?

Perhaps not surprisingly, analysis of Huselid's sample of United States firms reveals that they have higher levels of technical human resources management effectiveness than of strategic human resources management effectiveness.

Other research (Huselid, Jackson and Schuler, 1997) shows that there are significant relationships between strategic human resources management effectiveness and employee productivity, cash flow and market value – but no meaningful relationships between technical human resources management effectiveness and firm performance.

Nevertheless, Huselid found, an increase of one standard deviation in overall human resources management effectiveness corresponded to an estimated increase of 5.2 per cent in sales per employee, 16.3 per cent in cash flow, and 6 per cent in market value. Investments in human resources, demonstrably, can be a source of competitive advantage and better business performance.

David Guest (2000) laments the low 'take up' of the 18 'high performance' human resources practices identified by his research. Only 1 per cent of the respondents to this survey used more than three-quarters of the practices and applied them to most employees. At the other extreme, 25 per cent of firms used fewer than one quarter of the practices.

So why are organisations slow to heed the loud signals of a causal link between people management and performance? In a presentation to the 1999 National Conference of the Institute of Personnel and Development, Professor Guest offered these possible explanations:

1. The message is not being heard by human resources managers. If the message were getting through, it would be heard in particular by the more 'professional' human resources specialists. Yet there is no evidence that more human resources practices are applied in workplaces where more sophisticated human resources management is in place.
2. The message is not believed. Investment in human resources will not fit a culture which emphasises cost control. The evidence is inconvenient and, therefore, dismissed. Unfortunately, human resources specialists do not yet live in a world where research findings are used as a justification for action.
3. Human resources managers believe the message but cannot sell it. Even if the evidence is credible to human resources managers, they may not be willing or able to convince others to take it seriously. This seems an increasingly untenable proposition because of the growing body of positive support for the effectiveness of human resources management.
4. Human resources managers don't know how to introduce human resources management. All the writing about appropriate 'bundles' of human resources practices makes it difficult to know how to start. It is much easier to focus on one or two practices at a time.
5. Human resources managers are too busy managing turbulence and change to develop a sustained human resources strategy. With organisational change and uncertainty rife, the search for consistency may appear unrealistic. The message about people management and performance may be appealing, but it is not feasible in the current organisational whirl. Maybe when things have settled down ...
6. Academic messages are muddled and contradictory. Some researchers advocate the use of 'high commitment' or 'high performance' work practices in all organisations, while others argue that there is strategic choice. This second line of argument suggests that there is not a general case for adopting selected practices, but that it all depends – usually on the fit with business strategy.

While the research evidence, inevitably, covers a wide variety of situations and hypotheses, there appears to be an emerging consensus that there is a demonstrable, measurable and reliable causal relationship between the state of employee relations and the practice of human resource management and the performance of the organisation. This paper has attempted to describe that consensus.

Theory into action

Friedrich Engels said "an ounce of action is worth a ton of theory". The challenge for human resources professionals is to take the evidence of the research and apply it to the realities of their particular organisations or workplaces. So how do you encourage the organisation to view investment in people as a source of competitive advantage?

The environment of the organisation is an obvious starting point. Similarly, there probably needs to be a shared understanding of the respective roles of line managers and human resources specialists. Douglas Anderson (1997) suggests:

"There must be a congenial corporate culture, capable and assertive human resource leadership, and truly supportive top management. ... Like the other essential business tasks, human resource management is the responsibility of operating management, not of the human resource department. Still, human resources practitioners must take a leadership role in identifying the people issues and opportunities that face the organisation and the specific initiatives that will support the business strategies and objectives."

The work of Patterson et al (1997) might have reached what they describe as "dramatic" conclusions about the impact of people management practices on business performance, but their report concludes with seven straightforward recommendations:

1. Senior managers should regularly review people management objectives, strategies and processes and make changes or introduce innovations accordingly.
2. Senior managers should monitor employee satisfaction and commitment on a regular basis using standardised surveys.

3. Senior managers should monitor employee perceptions of the organisation’s culture – examining, for example, the extent to which employees feel they are able, supported and equipped to do their work.
4. Organisational changes should be made to promote job satisfaction and employee commitment.
5. Human resources management practices should be reviewed in the areas of recruitment and selection, appraisal, training, reward systems, job design, and communication.
6. Senior managers should receive training and support which enables them to provide effective vision and direction for the organisation’s ‘people management’ strategies.
7. The central element of each organisation’s philosophy and mission should be a commitment to the skill development, well-being and effectiveness of all employees.

At the same time, says Dave Ulrich (MacLachlan, 1998), human resources people :

“should continually be asking: is my company really building the policies, the practices and the procedures that would make this an organisation everyone is delighted to work for? Because if we don’t, we are not only hurting the company, we are hurting the profession as a whole”.

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Author - Richard Rudman is a Wellington-based consultant and writer. He is a former National President of the Institute of Personnel Management New Zealand (the forerunner to the Human Resources Institute) and was made a Life Fellow of the Institute in 1986. His books include Human Resources Management in New Zealand (Longman, 3rd edition, 1999) and the new Guide to New Zealand Employment Law, to be published by CCH New Zealand Ltd in October 2000.