strategic human resource management

4e

Jeffrey A. Mello

Strategic Human Resource Management

Fourth Edition

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Strategic Human Resource Management, Fourth Edition
Jeffrey A. Mello

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To my amazing daughter Logan
and my equally amazing parents,
Gabe and Lorraine

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PREFACE

Since the publication of the third edition of this text, heightened attention continues to be shown and greater appreciation paid toward the value of strategic human resource management in organizations. Boards of Directors, business owners, stockholders and senior executives are gaining a greater understanding of the relationship between HR and organizational, market and financial performance as cutting-edge research illustrates the connection between HR practices and firm performance.

Scholarly HR-related publications continue to thrive, while practitioner-oriented management publications—traditionally dominated by articles focused on marketing and finance—are publishing an increasingly significant number of articles on human resource management, particularly strategic aspects of HR. Within the academy, there continues to be a significant increase in the number of HR-related articles in journals focused on general management and even those related to strategy. No longer is HR simply relegated to specialized journals that deal with HR. This significant movement toward the publication of more HR-focused articles in both the general management academic and practitioner literatures illustrates clearly that executives are realizing the role HR plays in an organization's success as well as the fact die HR is a general management responsibility and its effective practice a key to successful operating results.

Also since the publication of the third edition, the resources that are available to those of us who teach have greatly expanded. The Society for Human Resource Management, the world's largest HR professional association, has continued to develop programs and materials to support HR education which include 1) curriculum guidebooks and templates for both undergraduate and graduate programs; 2) dozens of cases and learning modules to assist with course design and delivery; and 3) a significant database of the latest research and position papers on critical issues in strategic HR, which allow instructors to remain very current on trends, best practices, and legislative and court activity. Much of this material is available to non-members at the SHRM website, www.shrm.org, under Resources for HR Educators, which is under the Education and Certification tab. In addition, the *Journal of Human Resources Education (JHRE),* continues to publish exciting original work which supports HR education.

Organization and Content

Strategic Human Resource Management, 4e is designed for: 1) graduate students enrolled in survey courses in human resource management who would benefit from a general management approach to strategic HR; 2) working professionals enrolled in specialized HR and executive programs as a capstone offering; and 3) undergraduate students enrolled in a capstone course in an HR degree program or those seeking an advanced level HR course to complement their strategy course.

The text is organized into two sections. The first section, Chapters 1-7, examines the context of strategic HR and develops a framework and conceptual model for the practice of strategic HR. The chapters in this section examine employees as "investments;" explore trends that affect human resource management practice; describe what strategic HR is, particularly in contrast to more traditional approaches to HR; and look at how both the design of work systems and relevant employment laws influence the practice of managing people in organizations. The second section, Chapters 8-14, examines the actual practice and implementation of strategic HR through a discussion of strategic issues that need to be addressed while developing specific programs and policies related to the traditional functional areas of HR. Covered within this section are strategic issues related to staffing, training, performance management, compensation, labor relations, employee separation, and managing a global workforce. Both the integrative framework that requires linkage between and consistency among these functional HR activities and the approach toward writing about these traditional functional areas from a strategic perspective distinguish the text from what is currently on the market.

Chapter Features

All chapters contain the following:

- an opening "in practice" vignette featuring a well-known organization to introduce the chapter topic as well as numerous additional vignettes within each chapter that illustrate pertinent chapter concepts
- carefully selected readings that are integrated within the text discussion
- end-of-chapter discussion questions and exercises designed to apply chapter content and facilitate discussion of issues

New to the Fourth Edition

As the field of strategic human resource management has evolved since the third edition, this text has similarly done so in response. More than 50 percent of the end-of chapter readings are new to this edition. The retained readings are those that have become "classics" and are presented alongside those that represent the latest in thinking and practice in human resource management. There are also numerous new original exhibits that explain chapter concepts; 22 new "in practice" vignettes that describe strategic HR practices in a wide variety of organizations; and 117 new references.

There is also significant new content in each of the 14 chapters. This includes, but is not limited to, new or greatly expanded coverage of the roles and uses of social networking and social media in strategic human resource management; legal and legislative updates with the latest court rulings on existing laws and coverage of the Dodd-Frank Act, Genetic Information Nondiscrimination Act, right-to-work legislation and same-sex marriage and their implications for human resource management; and competency models, CEO succession planning, sustainability, employment branding, customer relationship management, trust and engagement as components of job satisfaction, "hiring for fit" and alumni relations management.

Instructor's Resources

Also available are an Instructor's Manual and PowerPoint slides to accompany the book which were prepared by the author. They can be accessed visiting www.CengageBrain.com. The Instructor's Manual includes chapter outlines, answers to end-of-chapter content, and suggested topics for student papers, while the PowerPoint slides offers all main text concepts to encourage classroom discussion and classroom engagement.

Acknowledgments

Many individuals were instrumental in ensuring the success of the first three editions of this text as well as the development of this fourth edition. Professional staff members of Cengage, especially Charles McCormack, Joe Sabatino, Mardell Glinski-Shultz, Daniel Noguera, Michele Rhoades and Mike Roche have provided much-appreciated support for this project since its inception. Chris Santos has become a welcome and valued team member in assuming the developmental work for this edition.

I again owe a tremendous debt of gratitude to some close longtime personal friends who have careers in HR—both in academia and/or as senior executives—and have been generous with their time and expertise in allowing me to seek their advice on various ideas I have had for this project. Sincere thanks to Jan Aspelund, David Balkin, Brian Brown, John Cunningham, Jeff Friant and Harsh Luthar with an extra special thanks to Deb Cohen also wish to thank the following reviewers for the feedback and valuable recommendations they provided that greatly assisted me in the development of this edition: Yezdi Godiwalla, University of Wisconsin-Whitewater; Tracy Porter, Cleveland State University; William Kostner, Doane College; Wayne Davis, Webster University; Xuguang Guo, University of Wisconsin-Whitewater; Timothy Wiedman, Doane College; Linda Gibson, Pacific Lutheran University;Jim Maddox, Friends University; Julie Palmer-Schuyler, Webster University.

Finally, heartfelt thanks to my family for the unconditional love and support they provide.

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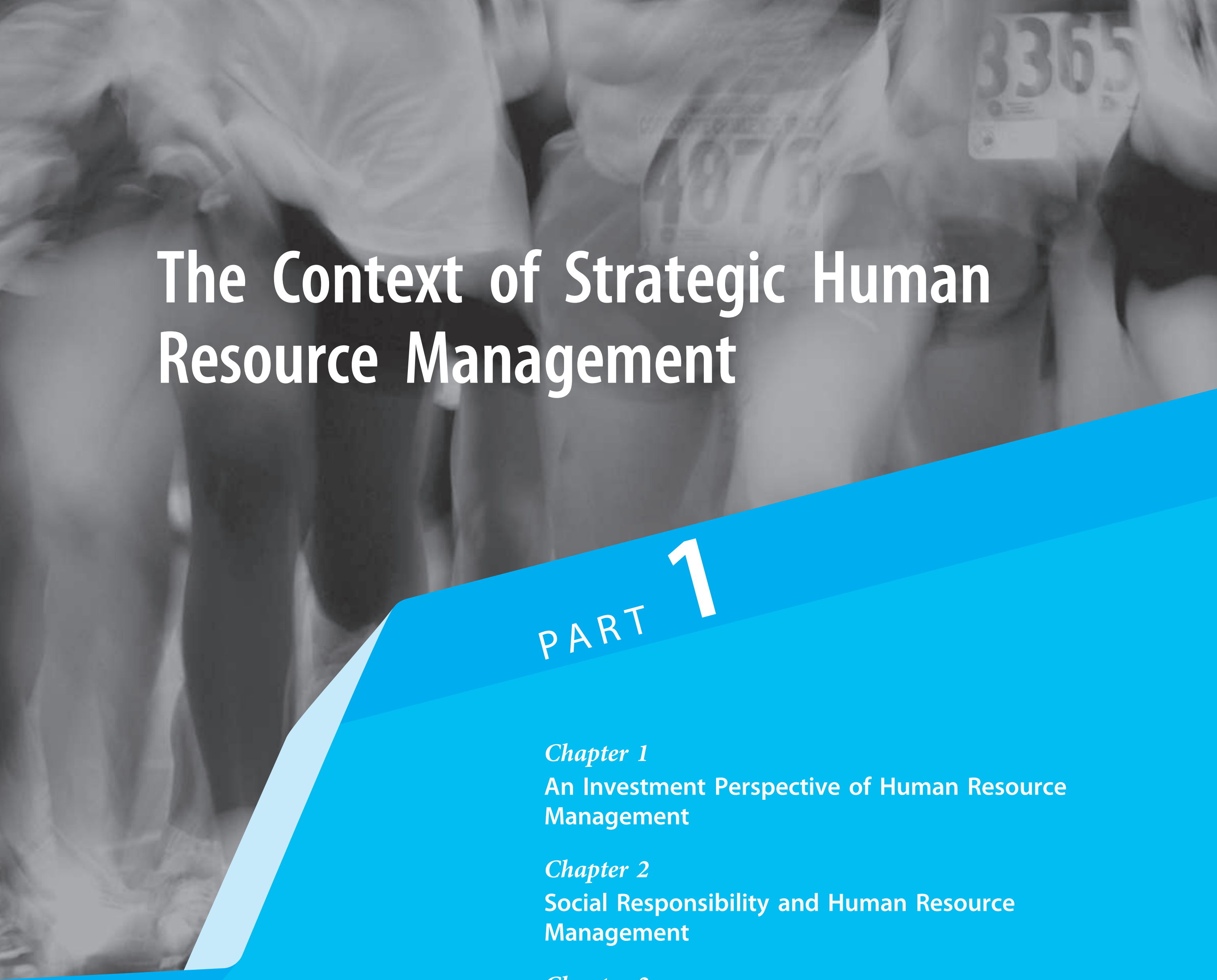


The Context of Strategic Human Resource Management

PART 1

CHAPTER 1

An Investment Perspective of Human Resource Management

LEARNING OBJECTIVES

- Understand the sources of employee value
- Gain an appreciation of the importance of human capital and how it can be measured
- Understand how competitive advantage can be achieved through investment in employees
- Gain an appreciation of metrics, their measures, and their usefulness
- Understand the obstacles that prevent organizations from investing in their employees

Human Resources at Nordstrom

How can a retailer gain a competitive advantage in a cut-throat marketplace? Middle- and high-end retailers generally locate in close proximity to each other and often carry similar—but not identical—merchandise. Consequently their sales and profit margins are usually in tandem. Nordstrom, however, has consistently produced above-industry-average profits and continues to be profitable when its competitors' profits are falling or flat.

The key to Nordstrom's success lies with the different way it manages its employees. Sales employees are known as "associates" and considered the organization's most valuable asset. The company's success is rooted in its strategy of providing superlative customer service. Associates are encouraged to act as entrepreneurs and build strong personal relationships with customers, or "clients." In fact, many clients shop only with a particular Nordstrom associate and call in advance to determine the associates' schedules or to make appointments.

Nordstrom's strategy involves a heavy investment in the organization's sales force. Nordstrom provides associates with extensive training on merchandising and product lines and offers high compensation. Its commitment to its employees is evident from the fact that the company's organization chart is depicted inverse from that of a traditional retailer. Associates are at the highest level on the chart, followed by department and merchandise managers and, finally, executives. This depiction cements the organization's philosophy that the customer is king. All efforts of senior-, middle-, and lower-level managers should support the efforts of the sales force.

Effective organizations are increasingly realizing that of the varied factors that contribute to performance, the human element is clearly the most critical. Regardless of the size or nature of an organization, the activities it undertakes, and the environment in which it operates, its success is determined by the decisions its employees make and the behaviors in which they engage. Managers at all levels in organizations are becoming increasingly aware that a critical source of competitive advantage often comes not from having the most ingenious product design or service, the best marketing strategy, state-of-the-art technology, or the most savvy financial management but from having the appropriate systems for attracting, motivating, and managing the organizations' human resources (HR).

Adopting a strategic view of HR, in large part, involves considering employees as human "assets" and developing appropriate policies and programs as investments in these assets to increase their value to the organization and the marketplace. The characterization of employees as human assets can have a chilling effect on those who find the term derogatory because of its connotation that employees are to be considered "properly." However, the characterization of employees as assets is fitting, considering what an asset actually is: something of value and worth. Effective organizations realize that their employees do have value, much as the organization's physical and capital assets have value. Exhibit 1.1 illustrates some of the value employees bring to an organization.

EXHIBIT 1.1 Sources of Employee Value

Adopting an Investment Perspective

The characterization of employees as human assets has important implications for the strategic management of HR in that it allows us to consider HR from an investment perspective. Physical and capital assets in organizations, such as plant, property, machinery, and technology, are acquired and subsequently managed most effectively by treating them as investments; the organization determines the optimal mix of high-performance, high-return assets to its strategic objectives. Analyses are made of the costs and benefits of certain expenditures, with judgments made concerning the riskiness and potential returns of such expenditures. Viewing HR from an investment perspective, much as physical assets are viewed, rather than as variable costs of production, allows an organization to determine how to best invest in its people. Furthermore, considering the risk and return on possible expenditures related to acquiring or developing human assets allows an organization to consider how current expenditures can be best allocated to meet long-term performance goals.

In considering whether to undertake the expense of a new training program, for example, an organization needs to consider not only the out-of-pocket costs for the training but also the related opportunity costs, such as lost time on the job, and weigh these costs against the potential benefits of the training, such as enhanced performance, potential increased loyalty, and motivation. The training also needs to be assessed relative to risk because the enhanced marketability of employees makes them more desirable to competitors. Similarly, in considering compensation programs as an investment, an organization needs to consider what it is "investing" in when it pays someone (knowledge, commitment, new ideas, retention of employees from competitors). The potential return on the organization's financial outlay in compensation will determine whether its compensation system is a viable investment strategy.

Taking an investment perspective toward HR/assets is critical considering that other physical assets, such as facilities, products and services, technologies, and markets, can be readily cloned or imitated by competitors.[1] Human assets cannot be duplicated and therefore become the *competitive advantage* that an organization enjoys in its market(s). This is becoming increasingly important as the skills required for most jobs become less manual and more cerebral and knowledge-based in nature.[2] Rapid and ongoing advances in technology have created a workplace where laborers are being replaced by knowledge workers. An organization's "technology" is becoming more invested in people than in capital. Thought and decision making processes as well as skills in analyzing complex data are not "owned" by an organization but by individual employees. This is in stark contrast to traditional manufacturing organizations where the employer usually owns or leases the machinery and production processes, and duplication of the organization's "capital" is restricted primarily by cost considerations.

Managing Employees at United Parcel Service

Although taking a strategic approach to HR management usually involves looking at employees as assets and considering them as investments, this does not always mean that an organization will adopt a "human relations" approach to HR. A few successful organizations still utilize principles of scientific management, where worker needs and interests are subordinate to efficiency. United Parcel Service (UPS) is a prime example of this. At UPS, all jobs from truck loaders to drivers to customer service representatives are designed around measures of efficiency. Wages are relatively high, but performance expectations are also high. This approach toward managing people is still "strategic" in nature because the systems for managing people are designed around the company's strategic objectives of efficiency. Consequently, all employee training, performance management, compensation, and work design systems are developed to promote this strategic objective of efficiency.

Managing an organization's employees as investments mandates the development of an appropriate and integrated approach to managing HR that is consistent with the organization's strategy. As an example, consider an organization whose primary strategic objective involves innovation. An organization pursuing an innovation strategy cannot afford high levels of turnover within its ranks. It needs to retain employees and transfer among employees the new knowledge being developed in-house. It cannot afford to have its employees develop innovative products, services, and processes and then take this knowledge to a competitor for implementation. The significant investment in research and development ends up having no return. Because the outcome of this expenditure (research and development) is knowledge that employees have developed, it is critical as part of the organization's overall strategy for the organization to devise strategies to retain its employees and their knowledge bases until the "new knowledge" becomes "owned" by the organization itself (through diffusion throughout the organization) rather than by the employee.

This leads to a dilemma involving investing in human assets. An organization that does not invest in its employees may be less attractive to prospective employees and may have a more difficult time retaining current employees; this causes inefficiency (downtime to recruit, hire, and train new employees) and a weakening of the organization's competitive position. However, an organization that does invest in its people needs to ensure that these investments are not lost. Well-trained employees, for example, become more attractive in the marketplace, particularly to competitors who may be able to pay the employee more because they have not had to invest in the training that the employee has already received. Although an organization's physical assets cannot "walk," its human assets can, making the latter a much more risky investment. An organization can certainly buy or sell its physical assets because it has "ownership" of them, but it does not own its human assets. Consequently, organizations need to develop strategies to ensure that employees stay on long enough for the organization to realize an acceptable return on its investment relative to the employees' acquired skills and knowledge, particularly when the organization has subsidized the acquisition. This requires the organization to determine the actual "value" of each employee. Valuation of human assets has implications for compensation, advancement opportunities, and retention strategies as well as how much should be invested in each area for each employee.

Valuation of Assets

Five major kinds of assets or capital that organizations can leverage to aid in performance and add value to operations are financial assets/capital, physical assets/capital, market assets/capital, operational assets/capital, and human assets/capital, as shown in Exhibit 1.2. Financial assets/capital include equity, securities and investments, and accounts receivable. Physical assets/capital include plant, land, equipment, and raw materials. Market assets/capital include goodwill, branding, customer loyalty, distribution networks, product lines and patents, trademarks, and copyrights. Operational assets/capital include management practices, the structure of work, and the use of technology. Human assets/capital include employee education levels, knowledge, skills, competencies, work habits and motivation, and relationships with coworkers, customers, suppliers, regulators, and lenders.

Financial and physical assets/capital are relatively easy to measure via accounting practices. Most of these assets are tangible and have some clear market value. Market and operational assets/capital are a bit more challenging to measure, but accounting practices have been developed that can place a general subjective value on such assets. Human assets/capital, however, are very difficult to measure; attempts to do so are at the forefront of current research being conducted in HR management.

A direct result of this difficulty in measuring human assets is that the valuation of current and future human assets is often ignored from consideration when organizations are facing economic and financial challenges. The media and financial markets usually respond favorably when decision makers announce restructurings or right-sizing initiatives, which reduce the size of the organization's work force, allowing it to reduce short-term costs. Such actions, however, involve the loss of human assets, which have value to the organization, often without consideration of the longer-term impact of such losses on the organization's ability to regain its position in the marketplace. Effective management recognizes that the organization's survival and renewal require the right size and mix of human capital and balances short-term needs to reduce or restructure costs with a clear strategy for the future. The key issue organizations face here is how to leverage the value of the organization's human assets for the good of the organization in the immediate, short, and long-term.

EXHIBIT 1.2 **Types of Organizational Assets/Capital**

Ease of measurement

Easier ↕ **More difficult**

	Examples
• Financial	• equity • securities and investments • accounts receivable
• Physical	• plant • land • equipment • raw materials
• Market	• goodwill • branding • customer loyalty • product line • distribution networks • patents, trademarks, copyrights
• Operational	• management practices • structure of work • technology
• Human	• education • knowledge • skills • competencies • work habits and motivation • personal relationships

One model of employment that can provide valuable lessons in the valuation of and appreciation for human assets is that utilized in India. Reading 1.1, "The India Way: Lessons for the U.S.," illustrates how Indian organizations are able to integrate investing in their employees with their missions without compromising their commitment to either.

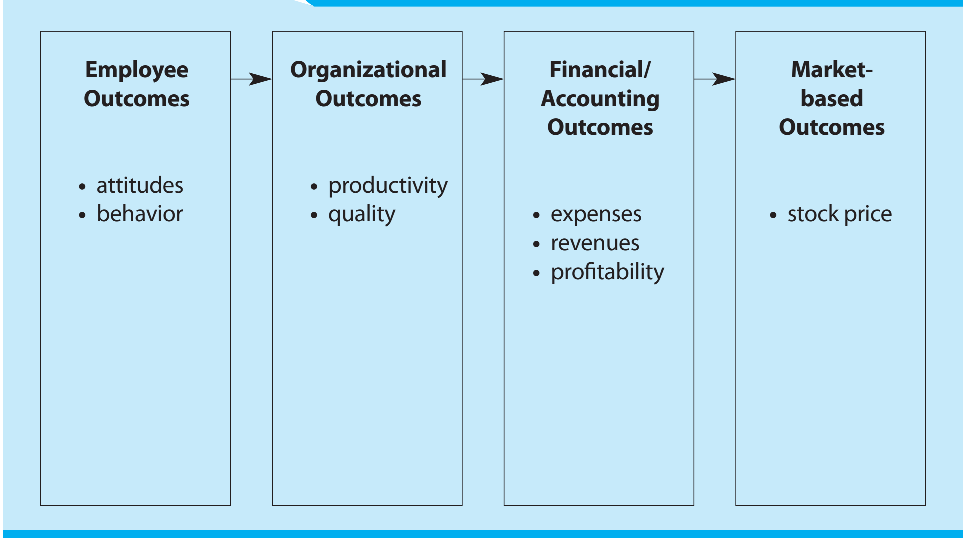
Understanding and Measuring Human Capital

Given that employees and their collective skills, knowledge, and abilities represent a significant asset for organizations, a critical issue for organizations becomes measuring this value as well as its contribution to the organization's bottom line. One of the first studies that successfully demonstrated this relationship was conducted by Huselid in the mid-1990s. This study identified what were called "high performance work systems" (HPWS) and demonstrated that integrated, strategically focused HR practices were directly related to profitability and market value.[3] A recent study by Watson Wyatt Worldwide found that the primary reason for organizational profitability is the effective management of human capital. This involves, in part, providing employees with rewards that are commensurate with their contributions and ensuring that investments in employees are not lost to competitors by actively managing employee retention.[4] Another study found that effective, integrated management of human capital can result in up to a 47 percent increase in market value.[5] A landmark study conducted by Becker, Huselid, and Ulrich that examined a variety of HR management quality indices found that the top 10 percent of organizations studied enjoyed a 391 percent return on investment (ROI) in the management of their human capital.[6]

Extending these findings, Dyer and Reeves attempted to define what can be called the HR "value chain."[7] They argued that performance could be measured via four different sets of outcomes: employee, organizational, financial and accounting, and market-based. More importantly, they proposed that these sets of outcomes had a sequential cause-and-effect relationship, as indicated in Exhibit 1.3. Each outcome fueled success in a subsequent outcome, establishing a causal link between HR practices and an organization's market value.

Given this proven link between integrated and strategic HR practices and bottom-line performance, HR practitioners have been faced with the task of developing appropriate HR metrics, which specifically illustrate the value of HR practices and activities, particularly relative to accounting profits and market valuation of the organization. This task has proven to be far more complex than anticipated, given the difficulties of measuring human assets/capital. One study concluded that 90 percent of *Fortune* 500 organizations in the United States, Canada, and Europe evaluate their HR operations on the basis of three rather limited metrics: employee retention and turnover, corporate morale and employee satisfaction, and HR expense as a percentage of operational expenses.[8] Such "staffing metrics" simply document the extent to which HR performs traditional job functions without necessarily illustrating how HR impacts company profits and shareholder value. Moreover, a focus on such staffing metrics involves a demonstration of how employees can be treated as expenses rather than as assets that can be managed, invested in, and leveraged for profit.

EXHIBIT 1.3 HR Value Chain



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Senior HR executives in these organizations stressed that they lacked accurate and meaningful methods that measured performance, despite the fact that human assets/capital can account for as much as 80 percent of the value of an organization.[9] One reason is that most accounting valuation methods stress the past and current value of assets. Much of the value of human assets/capital rests with the value of an organization and its ability to proactively meet challenges that lie ahead, relative to responsiveness to changing economic, political, and market conditions. As a result, valuation of human assets/capital and analysis of human capital investments can be value-laden, subjective, expensive—and, hence, ignored.

Measuring Human Assets/Capital at Dow Chemical

Dow Chemical has been a leader in forging the frontiers of measuring human capital. Dow has attempted to develop a reliable measure to help calculate each employee's current and anticipated future contribution to the financial goals of the business. A pilot project is currently being tested in a single business unit; it examines employee performance on project assignments by using two specific metrics: expected human capital return (EHCR) and actual human capital return (AHCR). EHCR involves a calculation of the break-even point of investment in an employee, above salary and additional outlays, such as recruiting and training expenses. AHCR involves a calculation of the "value created" by the employee based on the projects he or she was worked on. This metric considers the skills and knowledge of each employee relative to the net present value of a specific project. The desired outcomes of these measures are assisting managers with matching employee talents and project needs, identifying employee development opportunities, and creating a more efficient and effective means for project team staffing. Although the program is still in the pilot stage, with validation studies in progress, Dow anticipates rolling out the metrics to other business units in the very near future.[10]

Given the complex nature of measuring human assets/capital and return on such investments, where does an organization begin in assuming such an undertaking? One helpful model has been developed by Mercer, which can allow those concerned with measuring HR performance and documenting the value added by specific initiatives to demonstrate to senior management the value added and bottom-line impact.[11] This model involves six steps: (1) identify a specific business problem that HR can impact; (2) calculate the actual cost of the problem to the organization; (3) choose a HR solution that addresses all or part of the problem; (4) calculate the cost of the solution; (5) 6 to 24 months after implementation, calculate the value of the improvement for the organization; and (6) calculate the specific ROI metric.

One caveat should be obvious from not only Mercer's approach but also that currently being employed at Dow Chemical. Unlike the returns on other types of assets/capital, the ROI in human assets/capital are often not realized until some point in the future. Key decision makers need to be patient in waiting for these results, and HR also needs to subsequently take interim measures and provide status reports to senior management that illustrate preliminary beneficial results. HR needs to move away from mere data collection, however, and perform more comprehensive analysis of performance measures that relate to the critical metrics for which operating divisions are held accountable. Toward this end, HR needs to partner with chief financial officers to understand the language of investment and asset management. If HR continues to be seen as a cost center, it will be the primary target during cost-cutting operations, given that labor is the primary cost incurred in the service- and information-intensive sectors that are fueling the growth in our economy. One study places the relative expenses for human capital as high as 70 percent of overall expenditures.[12] Hence, the challenge for HR is to provide senior management with value-added human capital investments backed by solid and meaningful financial metrics.