the business impact of effective employee management

A SMALL BUSINESS GUIDE

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executive summary

EMPLOYEE MANAGEMENT AS A DRIVER OF BUSINESS PERFORMANCE

People start businesses for many reasons, but staying in business always comes down to two things — growing revenues and generating a profit. That's why successful business owners are those who know where to apply their resources for achieving the greatest positive impact on business performance. Traditionally, this exercise in strategic allocation of resources has treated employee management primarily as a cost-containment challenge rather than a potential driver of improved profit and revenue. Perhaps this has been because measuring the return on investment in effective employee management practices is more difficult than calculating the savings from, say, reduced paperwork. Over the past 10 to 15 years, however, a growing body of evidence has shown that investing in employee management not only delivers administrative cost savings but is in fact one of the best performance-enhancing investments a company can make.

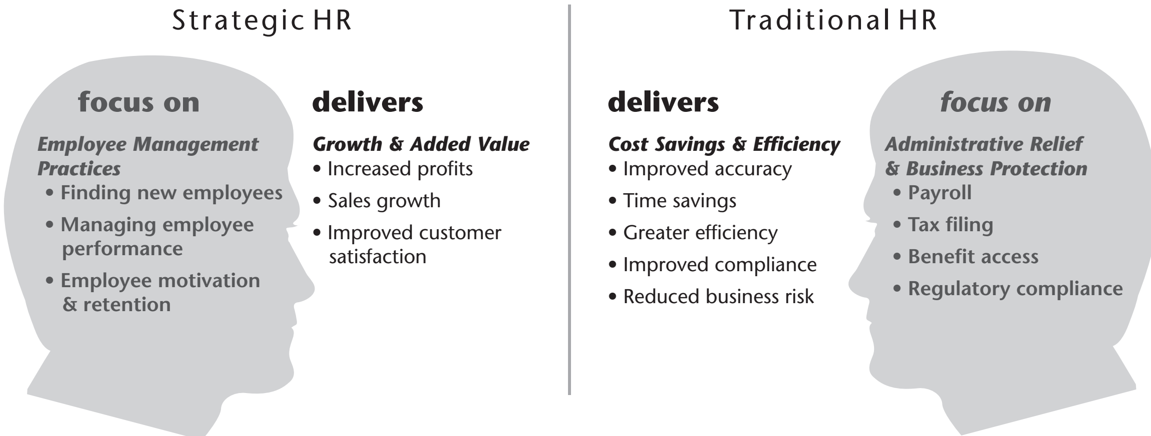
Research overwhelmingly indicates that effective employee management can and does lead to a competitive advantage in the form of a more motivated workforce and, by extension, improved operational and business performance. In research reported recently in a professional journal article, the authors reviewed 68 studies on the role of employee management practices and discovered that every one of the studies found a link between employee management and the performance of the companies studied.[1] Here are some highlights of the findings that have emerged:

Impact of Effective Employee Management Practices

study group	key findings
Banking industry companies [2]	Higher employee productivity Lower employee turnover
Service sector companies [3]	Up to 40% lower employee turnover 16.3% sales growth
Multiple industries [4]	$27,000 average increase in sales per employee $3,800 average increase in firm cash flow per employee $18,000 average increase in company market value.
Auto assembly plants [5]	Greater productivity (hours per unit) Higher quality (defects per 100 units)
Service companies [6]	Higher levels of customer satisfaction
IPO companies [7]	20% greater likelihood of survivability than companies with low emphasis on employee management practices
Veterinary clinics [8]	22% higher earnings among clinics promoting employee retention 15% higher earnings among clinics measuring employee satisfaction 12% higher earnings among clinics with employee rewards tied to client satisfaction

Such findings provide strong evidence of the two sides of human resources investment — one side that focuses on the traditional area of administrative relief and cost savings, and the other that focuses on business growth.

The Two Sides of Human Resources



By sharpening your focus on the relationship between employee management and business performance, you will be better equipped to:

- Identify practices that will maximize the return on your investment in employee management practices and achieve the positive business results experienced by other companies.
- Strengthen the quality of the one business variable that no competitor can duplicate — the quality and motivation of your employees.
- Align your people management practices with your business objectives.
- Set up and track key employee-related performance measures.
- Adopt the tools that are available to you for the managing your employees.

# # #

business growth and employee management: making the connection

What makes some businesses more successful than others? There are many factors, to be sure. But the primary factor is the ability of some companies to acquire and use resources more effectively than their competitors, resulting in a competitive advantage. In other words, to the extent that your company possesses resources that cannot be easily copied or bought by your competitors — and manages those resources to extract their full value — you will have a competitive advantage.

In the presence of quality products and services, well managed people can be the difference between a successful company and one that is not competitive.

This concept is often referred to as the resource-based view of a company[9], and one of the most important resources that any company possesses in its pursuit of competitive advantage is its people. If your company has employees with better skills, motivation, education, and experience than your competitors, you will have an advantage over those competitors regardless of the type of business you operate. What is most important to note in this regard is that your employees — with their knowledge, skills, effort, creativity, service quality and innovation — are the only resource that your competitors can't duplicate.

The purpose of employee management, then, is to solidify and enhance that advantage through a systematic program to find, motivate, develop and retain your employees more effectively than your competitors. If your company adopts employee management practices that are superior to those of your competitors, it is likely that you will always have a higher quality workforce, leading to a sustained competitive advantage. This is not to say that good people who are well managed can overcome poor products or services, but in the presence of quality products and services, well-managed people can be the difference between a successful company and one that is not competitive.

AN EXAMPLE

Take a company that employs salespeople. If the company has a human resource management program in place that consistently attracts people with the best sales skills, motivates those people to perform at their maximum potential, trains and develops them over time, and compensates them in such a way that they do not want to leave, this company will likely have a huge sales advantage over competitors without such a human resource management system. This same scenario can play out for many other types of employees as well.

Once you are convinced that effective employee management can positively impact your company's performance, you must determine which management practices will meet your needs. Obviously, the specific components of human resource management needed for your company are unique to you and your business objectives. But research has shown that it is a set of employee management practices working together, rather than any single practice alone, that leads to higher performance.

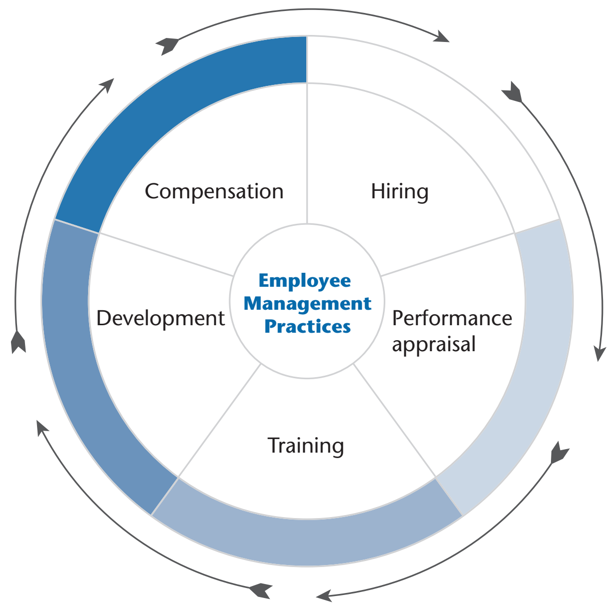
Each of these components of employee management is important, and all of them working together toward the accomplishment of your goals will lead to the best performance outcomes. For example, an initiative to attract high-quality employees to your business will be much more effective if it is coupled with quality training, development, compensation and management once the new hires arrive. Here's how the basic elements of a well-designed employee management program work:

Hiring practices ensure that employees hired for different positions have the necessary skills and background to be successful in their individual jobs.

Evaluation practices ensure that the employees are being provided with useful feedback about their performance.

Compensation practices provide employees with what they consider to be fair pay for their work.

Training and development practices provide employees with opportunities to grow through job training, job rotation and promotions.



THE BUSINESS CASE FOR EFFECTIVE EMPLOYEE MANAGEMENT PRACTICES

The most direct impact that employee management practices have on the performance of a company can be seen at the employee level. Like the effect of a stone dropped into a pond, the positive impact on employees then moves outwardly like a wave to produce benefits at the operational level, at the financial level, and, if applicable, at the market level. Each of these types of performance impacts will be described in the following sections.

Employee performance

Employee management programs are designed to attract, retain, motivate, develop and compensate employees, so it makes sense that the most direct impact of an employee management program will be on employees themselves. When the program is working well, employees will be generally more satisfied with their employment. This satisfaction leads them to be more willing to act in the best interest of the company rather than solely their own best interests. The result is a higher level of discretionary effort — employees being willing to go beyond what you expressly require of them. Overwhelming research data illustrates the employee impact of effective management practices.

Here are just a few of the study results:

- A study of banking industry firms discovered that effective human resource management was associated with higher employee productivity and lower employee turnover.[10]
- Among service sector companies, effective employee management lowered turnover by up to 40%, according to a study.[11]
- Another study also found that higher levels of effective human resource practices resulted in as much as a 29% improvement in employee effort.[12]

Operational performance

While the impact of employee management practices on the operations of a business is less direct than the impact on employees, it is nevertheless tangible and measurable. The operational benefits result from better-qualified and more highly motivated employees being able to perform their jobs more effectively than less-motivated and less-skilled employees. The discretionary effort cited previously also results in higher productivity and, hence, improved operational performance.

Higher discretionary effort by employees leads logically to improved operating performance. Satisfied employees are more likely to give "discretionary effort" beyond what is expressly required.

Once again, the research is overwhelming. Effective human resource management has been associated with improved operational productivity, customer service, quality, efficiency, customer satisfaction and safety.

- A study of automobile assembly plants found that effective human resource management systems led to higher productivity measured by the number of hours required to build a vehicle as well as higher quality as measured by defects per 100 vehicles coming out of those plants.[13]
- A study of service companies found that effective human resource management created a positive climate in the companies, which in turn led to higher levels of customer satisfaction.[14]

Financial performance

Given the operational outcomes cited above, it is not difficult to see how companies with higher productivity, quality and customer service are able to transfer these positive impacts into improved financial performance. For example, higher quality or customer service leads to higher sales, higher numbers of referrals and repeat business — all of which impact the bottom line performance of the company. In addition, higher quality and efficiency lead to lower costs, which has a further positive effect on the bottom line. In this way, companies with effective human resource management should experience higher performance than companies with less effective employee management programs, both through increased revenues as well as reduced costs.

Due to the importance of financial results on the success and even survival of businesses, this aspect of the impact of employee management practices has received the most attention from researchers. Multiple studies have found a positive relationship between effective employee practices and outcomes such as profit, sales, revenues, sales growth, profit growth, profit margin, return on assets, and cost reduction.

- A previously cited study in the employee outcomes section found that in addition to lowering turnover rates, service companies with effective employee management programs also experienced higher sales growth. Specifically, implementing well designed employee management programs resulted in an increase in sales of 16.3%.[15]

- Another study cited previously for its effect on turnover also found that significantly improved employee management practices resulted in an average increase in sales per employee of about $27,000, an average increase in firm cash flow per employee of about $3,800 and an average increase in the market value of the firm per employee of about $18,000.[16]

Among the financial areas positively impacted by well-managed employees are profit, sales, revenues, profit margin, return on assets and cost reduction.

Management Tip — The most important conclusion to be drawn from these findings is that good people management is not just about employee satisfaction. Effective employee management programs have the potential to impact the bottom line performance of a company, which is vital for any business operating in the current competitive environment.

Market performance

Although most small businesses are not publicly traded, it is nevertheless instructive to note that research also has demonstrated a connection between effective employee management practices and market or stock price performance. The improved operational and financial performance resulting from effective management practices leads to a positive perception by the market, which increases stock price and other stock-based measures of performance.

INDUSTRY SECTOR CASE STUDY

A study of small veterinary clinics provides a powerful example of the ability of employee management practices to impact the performance of small businesses.[17] In this study, owners of veterinary clinics rather than researchers, set out to discover what made some clinics more successful than others. These owners identified a set of 19 general management practices that when used by clinic owners tended to increase the performance of veterinary clinics. The practices ranged from marketing to financial management to human resource management.

Of the 19 practices examined, the three that contributed most to an improvement in owner earnings were all human resource management practices. They included:

Promote employee longevity — **22% higher earnings than those clinics not using this practice**

Measure employee satisfaction — **15% higher earnings than those clinics not using this practice**

Employee rewards tied to client satisfaction — **12% higher earnings then those clinics not using this practice**

EMPLOYEE MANAGEMENT AND SMALL BUSINESSES

Most of the research performed to date on the role that employee management practices play in company performance has focused on large organizations. While it is reasonable to assume that small businesses could experience many of the same benefits described by the research, company owners may nevertheless question whether their results will be as overwhelming positive. The answer is resoundingly "yes." Although limited, recent research into the relationship of employee management practices to small business performance has been exceedingly positive. Among the research that supports the beneficial impact of employee management practices in small businesses are these examples:

- A study found that small, fast-growing high tech firms with a senior human resources manager performed better than similar firms and were more likely to survive.[18]

- Similarly, another study found that placing higher value on employees in initial public offering companies was positively related to the companies' survival over time. Specifically, IPO firms with a high value placed on human resources were up to 20% more likely to survive than firms with a lower value placed on human resources.[19]

- Preliminary results from a joint study between the Gevity Institute and researchers at Cornell University have shown that balancing the alignment and the adaptability of a company's human resources in small firms led to higher levels of financial performance. In this study, alignment refers to having the right numbers of people in the right place at the right time, and adaptability refers to a company's ability to change to meet the shifting business environment.[20]

All of this evidence points to the fact that human resource management should be at least as important in the success of small firms as it is in larger organizations. In fact, it is likely that it is even more important in smaller companies.

First, small companies operate in a turbulent environment and, because of their size, the impact of changes in the environment or competition has a greater impact on a small business than it would on a large organization. These changes to the environment have a big impact on employees, resulting in a potentially unpredictable workplace. Effective employee management, therefore, is an important strategy for helping to alleviate some of these pressures by demonstrating to employees that they are valued. This in turn leads to improved commitment from employees and a greater likelihood of quality work and lower turnover. In addition, small businesses do not have the ability, as do larger firms, to spread their risk across a large organization. Because of this, the potential impact of an employee management mistake is much bigger. For example, hiring the wrong salesperson or losing a key person could severely impact sales results in a small businesses, whereas a large business could absorb such a loss with a much bigger sales staff. This inability to spread mistakes across a large employee population means that small businesses need to be much more careful in their people management. Effective human resource management in this situation can help alleviate this concern by giving small businesses the tools to avoid costly mistakes in the first place.

Management Tip — The same issue of size that gives small businesses a disadvantage in absorbing an employee management mistake is an advantage when it comes to implementing change. A smaller, more nimble organization, can make changes to its people management practices much more quickly than larger firms. At the same time, they are able to see improvements in their people, operational, and financial performance more quickly.

HOW SMALL BUSINESSES VIEW AND USE EMPLOYEE MANAGEMENT PRACTICES

A study of employee management practices in small business produced three general conclusions:[21]

- Employee management practices are being used in a relatively small number of businesses.
- When used, employee management practices in smaller organizations are similar to those used by larger organizations but much less sophisticated.
- Managers and owners of small businesses consider the management of their people to be of vital importance, but despite this concern, they are not always using the practices they should to improve business results.

Despite these findings, another survey indicated that people management issues are second only to general management in importance to small business owners, even when included with such issues as marketing and finance.[22] These findings indicate that employee management matters for small businesses in much the same way that it does in larger organizations.

conclusion

As a business owner or manager, you are always looking for a way to increase your employees' motivation and effort, improve your company's productivity, and boost your financial performance. The most effective resource for achieving all of these objectives is your workforce, and the most effective method for tapping this resource is a well-designed employee management program. In looking to your people for improved results, you must remember to:

- Gain an understanding of the different people management practices and people management knowledge that are available to you.
- Focus on improving the whole human resource management program rather than single practice areas.
- Align your human resource practices with your business objectives.
- Set-up and track key employee-related measures so that you can see the benefits of your efforts and find avenues for additional improvement.

Successful companies have long recognized that effective people management can be more important to increasing their business performance than many other strategies, including marketing and financial management, which tend to receive more attention. Now, the overwhelming evidence of human resource studies is proving them right.

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THE GEVITY INSTITUTE: KNOWLEDGE AND APPLICATION

The Gevity Institute was established to identify and quantify the link between people management practices and small- and medium-sized business performance.

The Institute's goal is to establish an ongoing stream of information, data and recommendations focused on effective people management for smaller companies. The Institute sponsors research at leading universities and business organizations.

Gevity will apply knowledge gained from Gevity Institute research to practical solutions that help small- and medium-sized businesses to improve profits, productivity and longevity.

ABOUT GEVITY

Gevity helps clients increase profits, grow sales and improve customer satisfaction through our comprehensive employee management solution. We serve as the insourced *human resource department to small- and medium-sized businesses nationwide.*

Our unique approach integrates three key drivers of business success: workforce alignment, administrative relief and business protection. We deliver our solution through our innovative people, processing and portal approach, combining the resources of our highly skilled human resource consultants and our scalable, Web-enabled technology platform.

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