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• human resource certification preparation

# PHRi<sup>TM</sup> • SPHRi<sup>TM</sup> EXAM PREPARATION 2018 Edition

## UNIT 1 :: STRATEGIC HR MANAGEMENT

**PHRi 02** HR Administration and Shared Services

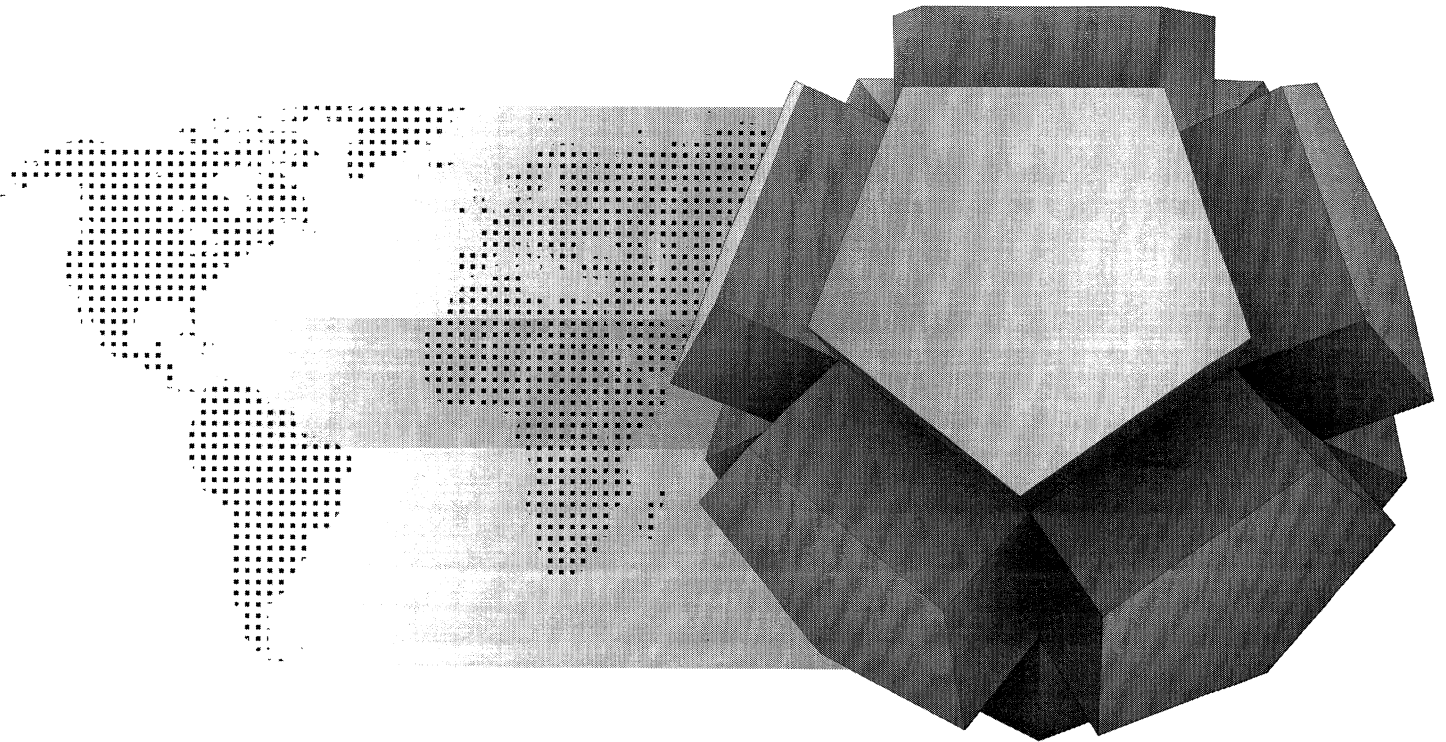
**PHRi 06** HR Information Management

**SPHRi 01** Business Leadership

**SPHRi 02** Talent Development and Management

**SPHRi 03** HR Service Delivery

**SPHRi 04** Measurement and Analysis



**HUMAN RESOURCE CERTIFICATION PREPARATION PROGRAM**

Human Resource Certification Preparation Program: SPHRi™ and PHRi™ Exam Preparation  
2018 Edition

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# PREFACE

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Our mission is to increase the standards of professionalism in the field of human resource management by helping HR managers learn the HR body of knowledge. HR managers perform a vital role in improving the quality of work life and increasing organizational effectiveness. Our desire is to have HR managers perform as true professionals by learning and applying the HR body of knowledge. We believe the human resource certification program plays a valuable role in increasing the level of professionalism. HR managers who consider themselves professionals should become certified to demonstrate their commitment to their profession.

## Notice

The purpose of the *Human Resource Certification Preparation Program* is to help you prepare to take the human resource certification exam. These materials will help you learn the major concepts in the HR body of knowledge. Please be aware, however, of the following:

1. The *Human Resource Certification Preparation Program* does not teach to the test. Although these materials cover all of the major HR topics in each functional area, there is no course and no training resource available anywhere that is guaranteed to cover all of the content tested on the HR certification exam.
2. No training program, including the *Human Resource Certification Preparation Program*, is a substitute for practical experience in human resources. The HR certification exam covers “generalist” knowledge in the field of human resource management. Your success on the exam will depend in large part on your ability to apply HR concepts to practical situations.
3. Because the human resource management field is constantly changing, the HR certification exam must change as well. While we have made an effort to cover the major human resource management topics, there will likely be topics in the exam that are not covered in the *Human Resource Certification Preparation Program*. On the other hand, not all of the material covered in this program will be included in the exam. We have made every attempt to insure that the material in this program is correct and current. However, be aware that errors can occur and laws and practices may change.
4. These materials are intended for use as an aid to preparation for the HR certification exam. Studying these materials does not guarantee, however, that you will pass the exam. This program is not to be considered legal or professional advice.

## International HR Certification Exams

The human resource certification exams are administered by the HR Certification Institute® (HRCI®), which is the credentialing organization for the human resource profession. HRCI has been certifying human resource professionals for more than 40 years. This set of study materials is designed to help individuals preparing for two international exams: the SPHRi and the PHRi.

### SPHRi™ Exam

The SPHRi certification exam consists of 130 multiple-choice questions drawn from four functional areas. The number of questions from each area is determined by the percentage weight assigned to it. The functional areas have the following weights:

Business Leadership	31%
Talent Development and Management	27%
HR Service Delivery	24%
Measurement and Analysis	18%

In addition to passing the certification exam, applicants for the SPHRi must demonstrate knowledge of their local HR laws. The following is a list provided by HRCI of some of the ways this requirement may be fulfilled:

- having a national or local certification (such as PHR, SPHR, GPHR, CHRP, etc.) that includes knowledge of employment laws
- having a bachelor's degree (or global equivalent) or higher in human resources
- completing a university- or college-level course in employment law
- completing a formal training class or certificate program in employment law sponsored by a university/college, HR association or other approved training provider

### PHRi™ Exam

The PHRi certification exam consists of 170 multiple-choice questions drawn from six functional areas. The number of questions from each area is determined by the percentage weight assigned to it. The functional areas have the following weights:

Talent Acquisition	19%
HR Administration and Shared Services	19%
Management and Development	19%
Compensation, Benefits, and Work Experience	17%
Employee Relations and Risk Management	16%
HR Information Management	10%

HRCI's content outlines for the SPHRi and PHRi exams are included at the end of the book.

## **About the Authors**

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## **Acknowledgement**

HRCP, L.C. expresses gratitude to the many individuals who have used our materials to prepare for the certification exams and to the various instructors who have adopted our materials for their review courses; many have provided invaluable feedback.



# UNIT 1: STRATEGIC HR MANAGEMENT

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# UNIT 1: STRATEGIC HR MANAGEMENT

## 1.1 STRATEGIC HUMAN RESOURCE MANAGEMENT

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We live in an organizational world where we interact with organizations as members, employers, customers, and clients; we depend on healthy organizations to provide employment and to supply essential goods and services. Human resource management plays a central role in creating healthy organizations and helping them survive. HR managers are responsible for all of the diverse issues associated with people in organizations. Assisting with the strategic management of a firm is a recent addition to the list of responsibilities for HR managers. They are expected to participate as partners in the organization's strategic planning process by gathering and interpreting information regarding the workforce availability and the business environment.

The participation of HR managers in the strategic management of a firm stems from increasingly complex and competitive organizational environments. In the early Twentieth Century, only a few large companies had "social welfare" departments, and their responsibilities focused mostly on caring for injured employees or their families. Personnel departments, as they were then called, first appeared in significant numbers during the 1940s.

The early personnel departments were primarily responsible for employee selection, training, record keeping, and collective bargaining. These activities are still important human resource functions, but other activities have been added. The most significant change in recent years is a growing recognition that human resource departments are expected to add value to the profitability and purpose of the company. Consequently, in many companies, human resource management assumes a central role by participating in strategic planning and acting as change masters who clarify the organization's culture and help it adapt to an ever-changing environment.

### 1.1.1 Corporate Governance

Corporate governance refers to the systems by which an organization is administered, directed, and controlled. These systems include the rules, practices, regulations, policies, procedures, and processes that govern organizational activities and guide individual and organizational conduct. Corporate governance may include the following principles:

- *Compliance:* The organization should comply with all applicable legislation that relates directly to corporate governance.
- *Integrity and ethical behavior:* The organization should have a code of conduct for board members, executives, and other members of the organization that defines proper business conduct and encourages ethical behavior and decision-making.

- *Rights and responsibilities:* The organization should formally define the rights, roles, and responsibilities of board members, executives, and employees, including the rights and limitations for decision-making in various positions and roles throughout the organization.
- *Interests of stakeholders:* The organization should recognize its legal, contractual, social, and ethical obligations to ensure the rights of its shareholders, employees, investors, creditors, local communities, and customers.
- *Oversight and control:* The organization should establish systems to monitor compliance with established rules, policies, and practices.

Human resource management plays an important role in corporate governance. HR managers should ensure that corporate governance principles include policies that cover important HR issues. Likewise, human resource procedures should align with and support corporate governance policies.

### 1.1.2 Business Strategy

An organization's strategy determines the direction it will go and serves to coalesce the energies of many people and departments in a unified effort. Good strategies help organizational leaders make consistent and effective decisions. They also communicate expectations and coordinate the actions of the members. For example, decisions about product quality and where products and services will be marketed are important strategic decisions. An organization that decides to produce high-quality products and compete in the markets of industrialized nations is pursuing a much different strategy than a company that decides to produce inferior products and sell them in underdeveloped countries. Such was the case with the Korean company Daewoo Group, which decided to focus its markets in developing countries because of criticism regarding its poor quality and poor after-sales service.<sup>1</sup>

Strategy is about winning and succeeding. In a business organization, strategy is about profits; it explains how the firm plans to make money now and in the future. A good strategy helps it to remain profitable and continue to grow. Firms that have a sustained competitive advantage are able to provide above-average profits for their investors; firms that do not have a sustained competitive advantage or that are not competing in an attractive industry earn at best only average profits and seldom survive. Strategies are also important to nonprofit companies, such as hospitals, universities, and government agencies, since they compete with other organizations for clients and resources. Every organization needs to have a strategy that is consistent with its mission. Managers try to position their companies so that they can gain a relative advantage over their rivals. This positioning requires a careful evaluation of the competitive forces that dictate the rules of competition in each industry.

### 1.1.3 HR Functions

The major HR functions include (1) staffing, (2) performance evaluations, (3) compensation and benefits, (4) training and development, (5) employee relations, (6) safety, health, and security and (7) HR research. These functions consist of core HR activities that are vital for

every organization regardless of size and organizational structure. Organizations that are too small to have an HR department may assign these functions to other departments, while large organizations may delegate them to separate departments. For example, a large organization may have a separate safety department, while small organizations delegate safety responsibilities to line managers. Nevertheless, safety programs are important to every organization, and in most organizations the HR department is involved in safety activities.

### **Staffing/Employment**

Staffing, usually called employment, involves three major activities: human resource planning, recruitment, and selection. Typically, anticipating human resource needs is the responsibility of line managers. As organizations grow in size and complexity, however, line managers come to depend more on the human resource department to gather information regarding the composition of the workforce and the skills of present employees.

Although recruiting is performed primarily by the human resource department, other departments may be involved in providing job descriptions and job specifications to assist the recruiting effort. Also, line managers may be asked to make recruiting visits to college campuses.

In selecting new employees, the human resource department typically screens applicants through interviews, tests, and background investigations, then recommends three or four eligible applicants to the manager or supervisor for a final hiring decision. Because of laws prohibiting discrimination, the responsibility of most human resource departments for staffing activities has increased significantly.

### **Performance Evaluation**

The responsibility for evaluating employee performance is generally shared between HR managers and line management. Department managers and supervisors assume the primary responsibility for evaluating subordinates since they observe job performance and are best able to make accurate assessments. However, the HR department is generally responsible for developing effective performance appraisal forms and assessment procedures and for ensuring that performance evaluations are conducted uniformly throughout the organization. The HR department also may need to train supervisors how to establish reasonable performance standards, make accurate assessments, and conduct performance interviews.

### **Compensation and Benefits**

The management of compensation and benefits involves the coordinated efforts of the HR department and operating managers. Typically, line managers are responsible for recommending wage increases, and the human resource department is responsible for developing and maintaining a wage and salary structure. An effective compensation system requires a careful balance between pay and benefits. Pay includes the wages, bonuses, incentives, and profit sharing received by an employee. Benefits include all non-wage items such as medical insurance, life insurance, vacations, and other employee services. HR departments are responsible for making certain that compensation and benefits are competitive with other similar organizations, fair in terms of internal equity, legal, and motivating.

### **Training and Development**

Most of the training that occurs in organizations is on-the-job training through the coaching and counseling of supervisors. The role of the HR department is usually that of helping supervisors become better trainers and conducting separate training and development sessions. The HR department is frequently involved in new-employee orientation training, supervisory-skill training, and various management development activities. The HR department also may be involved in assessing the training needs of the organization and evaluating the effectiveness of the training programs. In many organizations the human resource department also assumes responsibility for job redesign and organizational development. These activities often lead to a major restructuring of the organization or to the resolution of major conflicts within the organization.

### **Employee Relations**

In unionized organizations, the HR department takes an active role in negotiating and administering the labor agreement. Gathering information and helping to prepare the company's bargaining position is normally the responsibility of the HR department prior to negotiations. After an agreement has been negotiated, the HR department typically trains supervisors how to administer the labor agreement and to avoid excessive grievances. A major responsibility of the HR department, especially during the organizing campaign, is to ensure that the company avoids unfair labor practices. When a union is present, this activity is often called "labor relations" or "industrial relations."

HR departments in nonunion organizations also need to be heavily involved in employee relations. In general, employees do not vote to join a union if their wages are fair and adequate and they believe management is responsive to their feelings and needs.<sup>2</sup> To maintain nonunion status, HR departments need to make certain that the employees are treated fairly and that there is a well-defined procedure for resolving complaints. Whether it is unionized or not, every organization needs a clearly defined disciplinary procedure for handling problem employees, as well as an effective grievance procedure to protect employees.

### **Health, Safety, and Security**

Every organization is required to have an ongoing safety program to eliminate unnecessary accidents and unhealthy conditions. Employees need to be continually reminded of the importance of safety and instructed on how to avoid accidents. An effective safety program can reduce the number of accidents and improve the general health of the workforce. It is a major responsibility of most human resource departments to provide safety training, to identify and correct unsafe conditions, and to report accidents and injuries.

### **HR Research**

Human resource departments share a responsibility for improving organizational effectiveness by analyzing individual and organizational problems and making adaptive changes. Countless questions can be asked regarding the attitudes and behaviors of employees and the effectiveness of human resource policies and procedures. Some of the most frequently asked questions concern the causes of absenteeism and tardiness, the appropriateness of recruitment and selection procedures, and the causes of dissatisfaction. HR departments need to participate in data analytics with the emergence of big data that are generated from social media and the transmission of other electronic information. Most

human resource departments are responsible for collecting and analyzing information pertaining to these problems. The results are used to assess the adequacy of present policies and to suggest necessary changes.

### **1.1.4 HR Policies and Procedures**

#### **HR Policies**

Human resource policies guide the actions of an organization toward the achievement of its objectives. Whereas an objective tends to specify what is to be done, a policy explains how it is to be done. Therefore, human resource policies refer to standing plans that furnish broad guidelines and direct the thinking of managers about human resource issues. Some of the most common issues treated in human resource policies are:

- discipline problems, such as absenteeism, tardiness, insubordination, and horseplay
- promotions, transfers, and layoffs
- compensation, pay increases, and benefits
- holidays, vacations, and sick leave
- e-mail, Internet, instant messaging, cell phone, and other uses of technology
- termination

Human resource policies serve three major purposes:

1. To reassure employees that they will be treated fairly and objectively.
2. To help managers make rapid and consistent decisions.
3. To give managers the confidence to resolve problems and defend their decisions.

To achieve these purposes, human resource policies should be written and available for everyone to examine. Written policies are more authoritative than verbal ones and serve as valuable aids in orienting and training new personnel, in administering disciplinary actions, and in resolving grievance issues. Human resource policies are typically formed under the direction of top-level managers; however, since first-level supervisors are involved in administering these policies, input from them is useful in formulating new policies.

#### **Employee Handbooks and Policy Manuals**

Employee handbooks and policy manuals describe the important aspects of the employment relationship that employees need to know. A handbook is not the same as a policies manual, although most employers combine them into one document, especially smaller companies. Most handbooks only contain summary information about things employees need to know regarding their employment relationship with a company. They should be written in a language that is generally understandable and sets the right tone to reflect the organization's culture. Handbooks that are written by lawyers using an excessively legal vocabulary are generally ignored by employees and they are often overly restrictive for employers.

Policy manuals are a compilation of all the policy decisions a company has made. These manuals are usually rather formal and lengthy because they often serve legal purposes.

Consequently, policy manuals are more difficult to read. Large organizations are more likely to have policy manuals.

Organizations have an obligation to follow their written policies. When issues of fairness go to trial, courts expect organizations to behave as they have promised in their policy statements. Organizations that do not have policy statements have greater latitude in acting as they choose, provided their conduct is not outrageous. But organizations that have official policies need to follow them.

When new employees enter the organization they are frequently bombarded with far too much information to assimilate at once. Many organizations effectively use employee handbooks and policy manuals to communicate with employees and help them understand what they need to know by placing this information on a secure site on the Internet.

The most important purpose of an employee handbook is that it provides a central information source explaining what employees need to know about their employment relationship. Handbooks that are available on the Internet are especially convenient for employees and supervisors to review. Employees have an opportunity to learn about the company, what it provides for them, and what it expects of them. Equally valuable is the opportunity to study this information at their own pace. New employee orientations and other training programs help employees know what is expected of them; but they still need access to this information for review.

Most handbooks explain the history and culture of the company and give employees an appreciation of the organization and its mission. Well-designed handbooks help to create an organization's culture. Standards of quality and customer service can become general norms because of statements about the importance of serving customers and the value of quality products. These expectations also help to create a more committed and loyal workforce.

Employers also benefit from using an employee handbook. Many of the questions that employees repeatedly ask can be answered in the handbook, saving countless calls to the human resource department. Employee handbooks and an attractive company web site can also serve as an effective recruiting tool by helping to convince job applicants that the company is a good place to work.

There are no rules about what employee handbooks should contain; however, most handbooks cover the following topics:

- a statement of welcome and an explanation of the handbook's purpose
- a brief history of the company and information about its products and services
- a mission or vision statement
- policy statements on such issues as equal employment opportunity, harassment, affirmative action, business ethics, a drug-free workplace, and the use of e-mail and the Internet
- information about recruitment, promotion, termination, and rehire policies
- compensation information, including employment classifications, work hours, overtime, and pay procedures

- workplace conduct rules including procedures for addressing complaints and resolving disciplinary problems
- information on paid time off, leaves of absence, holidays, and vacations
- summary plan descriptions of benefits such as health insurance and retirement plans
- a description of opportunities for training and professional development
- emergency procedures and contact information
- a brief explanation of procedures for arranging travel and receiving expense reimbursements

Employers need to exercise caution in using employee handbooks to prohibit undesirable behavior, especially with respect to social media. Angry comments posted on electronic sites may be very embarrassing to supervisors or damaging to the reputation of a company, but employer policies designed to protect its reputation should not be so sweeping that they prohibit activities protected by labor law, such as the discussion of wages or working conditions among employees. An employee's comments on social media may be protected if they are work-related and not mere gripes unrelated to group activity among employees.

Employee handbooks and policy manuals do not work well in some countries because of various cultural incompatibilities. Employee handbooks may be viewed as heavy handed by employees and may conflict with local laws. Provisions that may seem unusual or offensive outside the United States include restrictions on co-worker dating, dress codes, open-door policies, smoke-free and alcohol-free workplaces, and nepotism. Other policies may be regulated by local laws, such as recordkeeping, holidays and vacations, leave breaks, overtime, pay periods, health benefits, grievance procedures, hotlines, and grounds for discipline. It has been suggested that multinational companies adopt a global code of conduct that outlines in broad terms the kinds of desirable and acceptable behavior rather than try to publish a one-size-fits-all employee policy manual.<sup>3</sup>

### **1.1.5 HR Generalists and HR Specialists**

A small organization with fewer than 60 to 80 employees usually does not have a human resource department or an HR manager. The functions of recruiting, hiring, training, safety, and performance evaluation (if performance is formally evaluated) are generally performed by line managers. Compensation decisions are normally made by line managers, and the payroll is handled by the finance officer. As the organization begins to exceed 100 to 200 employees, however, a separate staff position is usually required to coordinate the human resource functions.

When the organization becomes too large for one person to handle all human resource functions, separate positions are created and placed under the direction of an HR manager. A typical division of responsibilities for a human resource department would include supervisors in the areas of employment, compensation and benefits, training and development, risk management, and, if a union is present, labor relations.

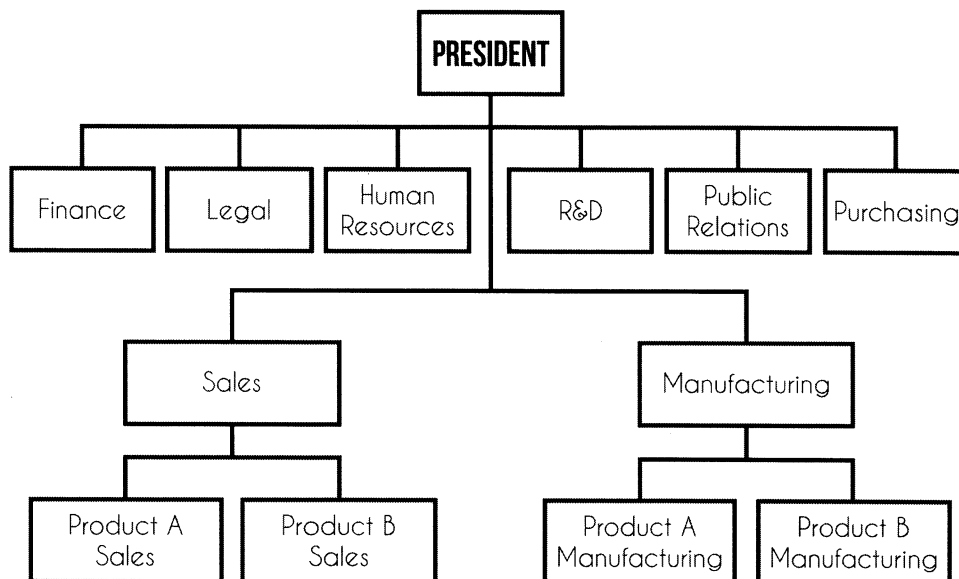
Although human resource positions vary from company to company, three major classifications are usually found: (1) general human resource manager or executive, (2) human resource specialists, and (3) supporting positions.

### Human Resource Manager or Executive

Most human resource departments are led by a person with the title of human resource vice president or director of human resources. Senior human resource executives are usually **human resource generalists** who possess a broad comprehension of all the human resource functions and how they interact with the other departments in the organization.

The operating human resource manager is typically a generalist who administers all of the human resource functions and coordinates them with other organizational activities. In very small companies, the human resource director may be someone hired from outside the company or a line officer transferred from another area of the company. In large corporations, the top human resource positions are usually filled by promoting lower-level human resource specialists. Increasingly, human resource executives have at least some formal training in law due to the growing legalism in human resource management.

**Exhibit 1: An Organization Chart for a Company Organized by Function**

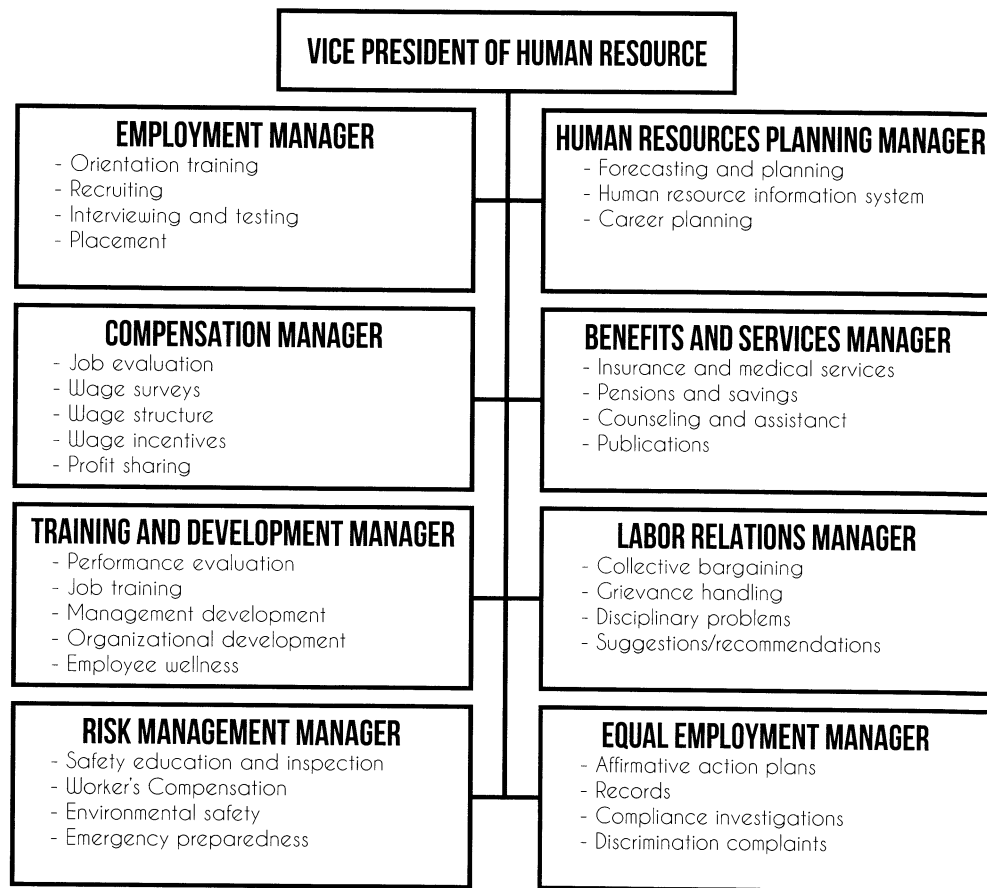


### Human Resource Specialists

The growing importance of human resource management has led to the creation of **human resource specialists**, especially in large organizations. Exhibit 1 represents an organizational chart for a company that is organized by function. The human resource department is headed by the vice president who reports to the president or chief executive officer just like the departments of finance, sales, and manufacturing. The major types of human resource specialists are shown in Exhibit 2, which illustrates an organizational chart for a large human resource department. In a large corporation, the human resource area may consist of separate departments headed by managers of employment, human resource planning, compensation, benefits and services, training and development, employee (or labor) relations, risk

management, and equal employment opportunity. The newest HR specialist position is called a “sustainability officer,” a position that is found in “green” companies to assess and minimize the organization’s environmental impact.<sup>4</sup>

### Exhibit 2: An Organization Chart Showing the Human Resource Department



Human resource specialists are professional and technical people who have special expertise in one functional area, such as staffing, compensation, employee relations, or training. Multiple levels of skill and responsibility are usually found in each of these functional areas if an organization is large enough. For example, an entry-level position in staffing might entail recruiting and interviewing hourly applicants. From that position, the person might be promoted to manage the employment of professional and managerial applicants. This job could be followed by a promotion to the position that coordinates all staffing activities. The job of human resource specialist is often viewed as a stepping-stone to a higher level human resource position, such as general manager or executive.

#### Human Resource Support Jobs

About half the positions in a typical human resource department are support jobs such as receptionist, typist, and other clerical positions. These jobs—which involve record keeping, data gathering, and reporting—are usually filled by graduates of high schools or technical colleges. Unless these employees acquire additional training in human resources, however,

they are not likely to be promoted to a job such as human resource specialist or general human resource manager or executive.

### HR Education

The career paths for HR generalists, HR specialists, and HR support staff are not clearly marked even though they are strongly influenced by different educational degrees. As a general rule, HR generalists and executives are people who obtain a Master's degree in Business Administration, whereas people who obtain degrees in specialty areas, such as organizational psychology or industrial relations, tend to become HR specialists. Countless exceptions can be found to this rule, including the question of whether a graduate degree or even any formal training for that matter is required. Nevertheless, to be a competent HR executive, in addition to knowing HRM, one must have a broad understanding of business fundamentals, especially accounting, finance, marketing, and production management. Good HR executives must know such things as what it takes to produce a profit, how to read accounting reports and where the numbers come from, how to finance a new product, and how to bring it to market. MBA programs are generally viewed as the best academic preparation for learning these business skills. People who want to be an HR specialist usually receive more in-depth training for what they want to do in such programs as an MA in Organizational Psychology, an MS in Organizational Behavior, an MS in Human Resources, or law.<sup>5</sup>

### 1.1.6 HR Roles

Human resource management is expected to contribute to a company's bottom line. Dave Ulrich has developed a useful 2X2 model for examining HR roles that is derived from two central issues: (a) a focus on *processes versus people*, and (b) a focus on *future strategic issues versus day-to-day operational issues*.<sup>6</sup> This model is shown in Exhibit 3. Ulrich identifies four central HR roles from these two dimensions:

**Exhibit 3: HR Roles in the Organization**

	ORGANIZATIONAL PROCESSES	PEOPLE
DAY-TO-DAY OPERATIONAL FOCUS	<b>Role #1</b> Management of Firm Infrastructure (Reengineering Organization Processes)	<b>Role #2</b> Management of Employee Contributions (Listening and responding to employees)
FUTURE STRATEGIC FOCUS	<b>Role #3</b> Management of Strategic Human Resources (Aligning HR and business strategy)	<b>Role #4</b> Management of Transformational Change (Ensuring capacity for change)

#### Role 1: Management of the Firm Infrastructure

This HR role requires HR managers to design and deliver efficient HR processes for staffing, training, appraising, rewarding, promoting, and managing the flow of employees through the organization. This traditional HR role requires HR managers to be administrative experts and has received the greatest attention in HR texts. In helping to manage the firm's day-to-

day operations, human resource managers typically perform three roles: (1) the **advisory or counseling role**, (2) the **service role**, and (3) the **control role**.<sup>7</sup>

*The advisory or counseling role:* In the advisory or counseling role, HR managers are seen as internal consultants who gather information, diagnose problems, prescribe solutions, and offer assistance in resolving human resource problems. This relationship between line and staff is similar to that which exists between a professional consultant and a client. It is the responsibility of the human resource manager to give advice regarding discipline and grievance issues, performance problems, and job redesign. In these situations the human resource department provides input that assists line managers in making decisions.

*The service role:* In this role, HR managers perform activities that can be provided more effectively through a centralized staff than through the independent efforts of several different units. These activities are a direct service for line management or for other staff departments. Recruiting, orientation training, record keeping, and reporting duties are examples of the human resource department's service role.

*The control role:* The human resource department is required to control certain important policies and functions within the organization. This staff role is sometimes called *functional authority*. In performing this role, the human resource department establishes policies and procedures and monitors compliance with them. In exercising this role, the human resource staff members are seen as representatives or agents of top management. Because of legislation, the control role has become increasingly important in the areas of safety, equal employment opportunity, labor relations, and compensation.

### **Role 2: Management of Employee Contributions**

This HR role requires HR leaders to represent and defend employees and respond to their needs. The purpose of this role is to increase employee commitment and competence. In performing this role, HR managers serve as employee champions. The deliverables of employee champions are increased employee commitment and competence. HR managers help employees by providing emotional support, encouraging employee participation, surveying employee attitudes, promoting a work/life balance, encouraging employee communication, resolving employee complaints, and providing employee feedback.

### **Role 3: Management of Strategic HR**

This HR role requires HR managers to interact with other leaders in their organization in aligning HR functions with business strategies. HR managers serve as strategic partners with other corporate executives in executing strategy. The responsibilities of HR managers in strategy formulation and the management of strategic HR are explained later.

### **Role 4: Management of Transformational Change**

This HR role requires HR managers to help the organization respond to an ever-changing environment, which may involve smaller transitional changes, such as revising a company's evaluation and reward systems, or more substantial transformational changes, such as creating a customer-oriented culture.

When human resource managers are called upon to supervise or guide an organizational development intervention, they are filling the role of change agent; because they are

members of the organization, they are referred to as *internal change agents*. In performing this role they can be highly effective because they have the advantage of being familiar with the organization and its members, and they can develop long-term relationships and feelings of trust needed for successful change. However, sometimes human resource managers who assume the role of change agent are seen as representatives of management who are interested in the good of the company, not the good of the workers.

### 1.1.7 HR Competencies

#### The HRCS Model

In 2015 Dave Ulrich and the RBL group released the seventh iteration of the Human Resource Competency Study (HRCS). The researchers collected more than 30,000 surveys which provided competency and performance ratings of more than 4,000 HR professionals. Based on their findings, they updated the HRCS Model. The competencies they identified are summarized below.<sup>8</sup>

The study identified three core competencies:

- **Strategic positioners:** HR professionals need to have knowledge of business context and strategy; they need to be able to apply that knowledge, and they must be able to point people in the right direction.
- **Credible activists:** HR professionals must have relationships of trust and influence with key people within the organization, and they must be able to get people moving in the right direction.
- **Paradox navigator:** HR professionals must be able to navigate the many paradoxical tensions in an organization, such as the tension between long-term and short-term focus, or between centralized and decentralized operations.

The study also identified six enabling competencies:

Three of these enablers focus on building a strategic organization:

- **Culture and change champion:** HR professionals must be an agent for change and must tie change initiatives to culture change.
- **Human capital curator:** HR professionals must be able to care for the talent of the organization by helping individuals and leaders grow, developing individual performance, and increasing technical talent.
- **Total reward steward:** HR professionals must be able to manage financial and non-financial rewards.

The other three enablers focus on tactical delivery:

- **Technology and media integrator:** HR professionals must be able to use technology and social media to create and drive high-performing organizations.
- **Analytics designer and interpreter:** HR professionals must be able to analyze and interpret data to improve decision-making.
- **Compliance manager:** HR professionals must be able to ensure compliance by following laws and regulations.

### The SHRM Competency Model

The Society for Human Resource Management (SHRM) developed a competency model that identifies the knowledge and behaviors expected of HR professionals.<sup>9</sup> This model is based on an extensive literature review with interviews and focus groups of HR professionals in several international countries. The nine competencies contained in the model seem to describe successful HR professionals in all cultures.

SHRM's model includes one technical competency and eight behavioral competencies. The technical competency, *HR technical expertise*, is the most fundamental requirement for HR professionals and includes knowing how to do what HR professionals do. The eight behavioral competencies allow human resource professionals to leverage their technical competence to contribute to organizational success.

1. **Human Resource Technical Expertise and Practice**—the ability to create effective organizations by applying the principles and practices of human resource management. This competency involves knowing the HR body of knowledge, which includes strategic business management, workforce planning, human resource development, compensation and benefits, risk management, employee and labor relations, HR technology, talent management, and change management.
2. **Relationship Management**—the ability to manage interactions with and between others with the specific goal of providing service and contributing to organizational success.
3. **Consultation**—the art of providing direct guidance to organizational stakeholders (e.g., employees and leaders) seeking expert advice on a variety of situations or circumstances.
4. **Organizational Leadership and Navigation**—the ability to direct initiatives and processes within the organization with agility and to gain buy-in from stakeholders.
5. **Communication**—the ability to effectively exchange and create a free flow of information with and among various stakeholders at all levels of the organization to produce impactful outcomes.
6. **Global and Cultural Effectiveness**—the art of managing human resources both within and across borders and cultures.
7. **Ethical Practice**—the integration of core values, integrity, and accountability throughout all organizational and business practices.
8. **Critical Evaluation**—skill in interpreting information (e.g., data, metrics, literature) to determine return on investment (ROI) and organizational impact in making business decisions and/or recommendations.
9. **Business Acumen**—the ability to understand business functions and metrics within the organization and industry.

Being a competent HR professional requires having the requisite knowledge and behaviors that are consistent with one's career stage; more is expected from senior-level professionals than from entry-level professionals. The competency model identifies four career levels and explains what is expected for each competency at that level. The four levels are (1) entry level HR professionals with 0 – 2 years of experience, (2) mid-level professionals with 3 – 7 years of experience, (3) senior-level professionals with 8 – 15 years of experience, and (4) executive-level HR professionals who have 15 or more years of experience.

### 1.1.8 Financial Knowledge

One of the common complaints of executives is that human resource people do not understand the business; they do not know what is required to make a profit or how to speak the language of business. Human resource professionals should be familiar with their organization's financial situation and understand how human resource activities are impacted by and can influence the organization's financial success. Familiarity with financial and accounting terminology can be helpful in communicating with executives and managers. Exhibit 4 lists key terminology from the International Accounting Standards Board.

#### Exhibit 4: Terminology from International Accounting Standards Board

##### DEFINITIONS OF THE ELEMENTS RELATING TO FINANCIAL POSITION

**Asset.** An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

**Liability.** A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

**Equity.** Equity is the residual interest in the assets of the entity after deducting all its liabilities.

##### DEFINITIONS OF THE ELEMENTS RELATING TO PERFORMANCE

**Income.** Income is measured as increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

**Expense.** Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Source: "The Framework for the Preparation and Presentation of Financial Statements," International Accounting Standards Board, 2014 ([www.iasplus.com/en/standards/other/framework](http://www.iasplus.com/en/standards/other/framework)).

### Financial Statements

A financial statement is an official, formal record of an organization's financial activities. The financial information is typically reported in a standard format so it can be compared with past performance and benchmarked against other entities. Financial statements are used by a variety of stakeholders, including the organization's executives, shareholders, potential investors, lenders, and creditors, to guide business decisions. Financial statements typically include the following:

- The **balance sheet** is a statement of financial position that reports a company's assets, liabilities, and equity as of a specific point in time, such as the end of the company's fiscal year. The balance sheet is based on this equation, where the two sides balance each other:  $\text{Assets} = \text{Liabilities} + \text{Equity}$ .
- An **income statement**, also known as a profit and loss statement, reports a company's income, expenses, and profits over a certain period of time.
- A **cash flow statement** reports the flow of cash in and out of a company, showing changes in the balance sheet and how those changes affect the availability of cash.

### Budgets

A budget is a plan that describes expected income and expenses over a period of time. It can include expected sales volume, revenue, expenses, assets, and liabilities. Budgets are used in the strategic planning process to express an organization's plans in measurable terms. Budgets may be created for the entire company and for each organizational unit, as well as for specific projects, activities, and events. Some of the important functions of budgets in the organization are to:

- control income and expenditures
- establish priorities
- set performance goals
- assign responsibilities
- allocate the use of resources
- forecast future needs
- motivate individuals and organizational units
- improve efficiency
- monitor and evaluate performance

The traditional process for creating a budget involves using the previous budget as the basis for the new budget. Adjustments are made where needed based on the organization's actual performance and anticipated future needs. Another approach to budgeting, called **zero-based budgeting**, requires justification for all expenses in the new budget. Rather than assuming that next year's budgets will be similar to this year's budget with minor adjustments, zero-based budgeting starts from zero and requires managers to identify every activity and justify every expense.

**Test Your Knowledge**

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at [www.hrcp.com](http://www.hrcp.com). Log into your account and click on My HRCP to access the practice exams.

1. Can you list and describe the main roles of an HR manager?
2. Can you explain the primary purposes of having established HR policies?
3. Can you list the topics that would typically be covered in an employee handbook?
4. Can you list the nine HR competencies from the HRCS Model and describe the skills and abilities associated with each?

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## 1.2 ORGANIZATIONAL STRATEGY

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As noted earlier, HR managers are expected to interact with other leaders in their organization in developing the organization's competitive advantage and aligning HR functions with business strategies. Organizations operate in a dynamic environment; external and internal forces are continually changing. HR managers serve as strategic partners with other corporate executives in executing strategy.

### 1.2.1 Defining the Organization's Mission

An effective organization begins with a mission that identifies what it is striving to become and a strategy that explains how it plans to succeed. Organizations are created for a purpose, and they function more effectively when all stakeholders clearly understand the organization's mission and strategy. *Strategy* refers to the goals and set of policies designed to achieve competitive advantage in a particular marketplace. *Competitive advantage* refers to the ability to transform inputs into goods and services at a maximum profit on a sustained basis, better than competitors.

The central insight of organizational strategy can be stated simply: to create a successful company you must identify a product or service that you can provide in a competitive market and do it better than your competitors. The probability that your company will be profitable increases as you have a clear vision about the product or service you want to provide and how it will benefit people, other companies, and society; you choose an attractive industry in which to compete; you provide a superior product or service in terms of cost or quality; you have few, or no, competitors; your product or service cannot be easily imitated by competitors; and few, if any, substitutes can replace the demand for your product or service.

#### The Value of Mission Statements

An organization is formed when someone has a vision or idea about the kind of product or service the company ought to provide, and this becomes the firm's mission. Even nonprofit organizations have a shared understanding of what the organization is trying to accomplish and how it will improve the lives of people. The vast majority of organizations are started as small, family-run businesses by a founder who has such a vision. Even large corporations started as small companies with the vision of a founder. Effective organizations depend on the existence of a powerful shared vision that evolves and is refined through wide participation. The power of a shared mission usually does more to inspire and unite people than the charisma of a leader.

Mission and vision statements are similar, but each has a distinct function in the strategic planning process of a company. A vision statement describes the future of the company as a successful organization. Good vision statements answer this question: If the organization were to achieve all of its strategic goals, what would it look like ten and twenty years from now? An effective vision statement creates a mental image of what the organization will be like in the future as it succeeds. A mission statement, however, explains the company's reason for existence. It describes what the company does and what its overall goal is. The mission statement's primary function is to communicate the organization's purpose and

direction to its employees, customers, vendors, and other stakeholders. Internally, a mission statement also creates a sense of identity for employees.

HR managers are normally expected to assist with the creation of vision and mission statements even though the ultimate responsibility for writing and disseminating them rests with top management. A mission statement explains the essence of an organization—why it exists, what it wants to be, whom it serves, and why it should continue. It is based on the organization's assumptions about its purpose, its values, its distinctive competencies, and its place in the world. Effective organizations usually have a written mission statement that defines success for the company. The focus of a mission statement should be realistic and credible, the language should be well-articulated and easily understood, and the direction should be ambitious and responsive to change. It should orient the group's energies and serve as a guide to action. It should also be consistent with the organization's values.

Written mission statements help to focus the energies of their members by answering questions: Why does our organization exist? What business are we in? What values will guide us? Organizational goals and objectives are usually derived from the mission statement, but they are more specific. While mission statements are not measurable, goals and objectives ought to be.

### **Writing Mission Statements**

Although there are no commonly accepted guidelines for writing mission statements, the following elements are usually found in carefully crafted statements:

1. A *purpose statement*: This statement explains what the organization seeks to accomplish and why it deserves the commitment of members and the support of the public. Purpose statements try to answer such questions as "How is the world going to be different as a result of our company?" and "What is going to change?" and "How will things be better?"
2. The *business statement*: This statement identifies the organization's business activities or functions, such as to produce and transport alfalfa (for a ranch) or to construct affordable housing for first-time homeowners (for a construction firm).
3. *Values statements*: These statements explain the values and beliefs that members hold in common and try to follow. These core values are an internalized framework that should guide the thinking and actions of leaders. For an organization to have an effective values statement, it must fully embrace the values and use them to guide its attitudes, actions, and decision-making at all times. Establishing a values-led organization is a difficult process that requires careful contemplation and a stable framework of cultural values and beliefs. Some of the most common values statements include a commitment to customer service, innovation, diversity, creativity, integrity, and personal development.

Useful mission statements should:

1. Identify the purposes of the organization clearly enough that measurable objectives can be derived from them. A clear formulation of the firm's objectives will enable progress toward them to be measured.
2. Differentiate the firm from other companies in the industry and establish its individuality and uniqueness.
3. Define the business of the company with respect to its activities and products.
4. Identify and explain the firm's relationships and obligations to all relevant stakeholders.
5. Explain how it will contribute to society and the betterment of people well enough to be exciting and inspiring.

A segment of Hewlett-Packard's mission statement illustrates these characteristics:

"Hewlett-Packard Company designs, manufactures, and services electronic products and systems for measurement, computing, and communication used by people in industry, business, engineering, science, medicine, and education. HP's basic business purpose is to accelerate the advancement of knowledge and improve the effectiveness of people and organizations. The company's more than 25,000 products include computers and peripheral products, electronic test and measurement instruments and systems, networking products, medical electronic equipment, instruments and systems for chemical analysis, handheld calculators, and electronic components."<sup>10</sup>

### **1.2.2 Selecting a Strategy**

Organizations operate in a dynamic environment; external and internal forces change continually. To use a sports metaphor, both the playing field and the rules of the game are constantly being revised for organizations. Products that were popular yesterday may be obsolete today; reliable customers who were satisfied last week may buy from a competitor this week; and last month's suppliers may have gone out of business.

#### **The Role of Strategy**

Strategy involves the combination of goals and plans to achieve competitive advantage and the methods of implementing them. To use another sports metaphor, a strategy is a game plan. Strategy has generally been used in a military context to refer to the coordinated action plans a military unit intends to use to defeat its enemy. The deployment of troops, the timing of the attack, and the means of deception are all part of military strategy.

Organizations create generic strategies to help them succeed in a dynamic and competitive environment. These generic strategies share several important characteristics:

- They promote the mission and goals the organization is striving to achieve.
- They have a long-term focus that extends beyond the immediate time horizon.
- They define the action plans the organization intends to follow to achieve its mission and goals.
- They recognize explicitly the impact of the external environment, especially the reactions of competitors.

### Imperfect Competition

The goal of strategy is to find a competitive environment where a company has *imperfect competition*. As shown in Exhibit 5, such an environment occurs when there are few, if any, competitors (allowing one firm to operate as a monopoly); numerous suppliers and buyers (making it easy to obtain supplies and sell products at advantageous prices); asymmetric information (preventing the dissemination of information to all parties); heterogeneous products (allowing a firm to specialize in specific products); and barriers to entry (making it difficult for other firms to provide competitive products). Firms that have the good fortune to compete in markets that have imperfect competition are generally able to obtain supernormal profits. This situation is much more favorable than one with perfect competition: numerous sellers and buyers, perfect information, homogeneous products, and no barriers to entry or exit. Firms that compete in conditions of perfect competition have difficulty earning anything more than average or below-average profits.

#### Exhibit 5: The Goal of Strategy: Imperfect Competition

PERFECT COMPETITION	IMPERFECT COMPETITION
numerous sellers and buyers perfect information homogeneous products no barriers to entry or exit <b>average or below-average profits</b>	few competitors, numerous suppliers and buyers asymmetric information heterogeneous products barriers to entry or exit <b>supernormal profits</b>

Wal-Mart has succeeded in earning supernormal profits through imperfect competition with a strategy of locating stores in small towns where customers can purchase many low-cost, high-quality items in one location. Wal-Mart's competitive advantage is sustainable primarily because of its natural geographic monopoly and positioning, and secondarily because of its operational efficiencies. Competitors rationally decline to enter towns where Wal-Mart stores are located because Wal-Mart is already there with an optimally efficient store, there is no feasible way to increase local demand, and a second store would create substantial overcapacity such that neither store would make money.

A fast-food restaurant that sells hamburgers near a college campus would not likely earn above-average profits if there were dozens of other fast-food outlets within a short distance. Although this location might have many potential customers, they tend to be price-sensitive and informed; they will buy wherever they can get the best value for their money. If any restaurant started to earn significant profits, other restaurants would imitate it, and new

restaurants would be waiting to enter the same market. Other competitors also have access to the same suppliers.

### Three Grand Strategies

Michael Porter, one of the leading strategy theorists, has identified three grand strategies to maintain a competitive edge: cost leadership (being the low-cost producer), differentiation (having a unique product in a large market), and focus (having a unique product in a narrow market).<sup>11</sup>

*Cost Leadership:* Gaining a competitive advantage through cost leadership involves selling your products and services at a lower cost. This is usually achieved by technological innovations that improve the efficiency of operations or using low-cost labor that reduces the costs of production. Success with this strategy requires that the organization be the cost leader, not merely one of the contenders for that position. Furthermore, the products and services being offered must be perceived as comparable to or better than those offered by rivals. Companies that have used this strategy successfully include Southwest Airlines, Wal-Mart, and Canadian Tire.

Southwest Airlines has used cost leadership to achieve a significant competitive advantage in the airline industry by offering low-cost fares to customers. Other airlines have been forced to match these low-cost fares, but in doing so they have not achieved the same level of profitability. Southwest has been able to sustain its competitive advantage because it has lower costs (by eliminating reservations, check-in, and baggage handling) and higher revenues per plane (by faster turnaround times that keep the planes flying longer).

*Differentiation:* A differentiation strategy involves providing unique products and services in ways that are widely valued by buyers. This can be achieved by providing exceptionally high quality, extraordinary service, innovative designs, technological capability, or an unusually positive brand image. Whatever attribute the company chooses to establish its uniqueness must be significantly different from what is offered by rivals to justify its price premium. Exaggerated advertising claims and the customary hyperbole that borders on sheer deceit provide evidence that many firms rely on this strategy. Firms that have succeeded in finding a unique differentiating factor include Maytag on reliability, Mary Kay Cosmetics on distribution, and Nordstrom on customer service.

Toyota Motors has succeeded in differentiating itself from its competitors by gaining a reputation of exceptional quality in its cars. The Toyota Camry, for example, is widely recognized as a very well-built car with excellent reliability and dependability. Consequently, it sells at a substantial premium above other cars of similar size, and the depreciation on the price of a used Camry is also much less than normal.

In the mid-1980s, Delta Airlines's market researchers found that customers, particularly business customers, were strongly influenced to choose a particular airline by the airline's frequent flyer program. Consequently, Delta tried to differentiate itself within the airline industry by offering a special program. To motivate customers to choose Delta, they established an exclusive arrangement with American Express that allowed customers to receive triple miles when they flew on Delta with tickets purchased with an American

Express card. Unfortunately, Delta failed to anticipate how easily and quickly this strategy could be imitated by its competitors.

*Focus Strategy:* A focus strategy aims at either a cost advantage or a differentiation advantage in a narrow market segment. Companies that use this strategy select a defined segment of an industry—such as a particular product, a specific kind of end-use buyer, a defined distribution channel, or a limited geographical location—and target its strategy to serve them to the exclusion of others. This strategy is also known as a niche strategy, since the firm seeks to compete primarily in a niche of the larger market. The goal is to exploit a narrow segment of a market by appealing specifically to it. The success of a focus strategy may depend on how narrow the segment is. If the segment is too large, the strategy may suffer because of a lack of focus and uniqueness. But an extremely small segment may limit a company's success until it expands to other segments.

Benmark Inc. of Atlanta, Georgia, specializes in providing unique medical and life insurance benefits for the banking industry, because that industry has liquid assets that can be used advantageously for insurance, tax reduction, and investment purposes. Focusing on one industry allows Benmark to develop targeted services and a social network that facilitates sales. Since bankers tend to know and interact with each other, many sales leads come from referrals. Bank executives tend to make deliberate and rational decisions based on careful cost analyses. Consequently, Benmark uses complex financial data that executives in other industries avoid.

### Four Strategic Types

Another typology of business strategies, developed by Raymond Miles and Charles Snow, is based on the idea that managers seek to formulate strategies that will most closely align their internal organizational characteristics and the external environment. They identify four strategies: prospector, defender, analyzer, and reactor.<sup>12</sup>

1. **Prospector:** The prospector strategy involves innovation, risk-taking, seeking new opportunities, and growth. This strategy is suited to a dynamic, growing environment where creativity is more important than efficiency. In many respects, this strategy is similar to Porter's cost-leadership strategy.
2. **Defender:** The defender strategy is almost the opposite of the prospector strategy. Rather than taking risks and seeking new opportunities, the defender strategy is concerned with stability and even retrenchment. This strategy seeks to retain current customers without having to innovate or grow. The defender is concerned primarily with internal efficiency and control to produce reliable, high-quality products for steady customers. In some respects, this strategy is similar to Porter's differentiation strategy. This strategy is relatively successful when the organization is striving to survive in a stable or declining environment.
3. **Analyzer:** The analyzer strategy tries to maintain a stable business while innovating on the periphery. This strategy is a compromise between the prospector and defender strategies. Some products will be targeted toward stable environments where an efficiency strategy is used to keep current customers. Others will be targeted toward dynamic environments where growth is possible. The analyzer strategy attempts to

balance efficient production of current product lines with the creative development of new product lines.

4. **Reactor:** The reactor strategy is not really a strategy, but a description of what happens in organizations that respond to the environment in an ad hoc fashion. In a reactor strategy, top management has not defined a long-range plan or given the organization an explicit mission or goal. Consequently, the organization takes whatever actions appear to be the most expedient at the time to meet immediate needs. Although the reactor strategy can sometimes succeed, it is more likely to lead to failure.

Research examining the effectiveness of these typologies generally finds that analyzer strategies are the most profitable and viable for maintaining a sustained competitive advantage, while prospector strategies tend to create the greatest revenue growth. As would be expected, reactor strategies, where organizations lack a consistent mission and goals, are the least successful.<sup>13</sup>

### **Competitive advantage and the value chain**

Two books in the 1980s by Michael Porter, *Competitive Strategy* and *Competitive Advantage*, were the first of many business strategy books to explain how companies need to achieve sustainable competitive advantages to help them survive in a competitive environment. Porter used the concept of a **value chain** to explore the competitive advantages a firm might have over its competitors.<sup>14</sup> Human resource activities play an important role in the value chain.

In a value chain analysis, each firm represents a link in a chain of value—it receives inputs from suppliers, adds value to them, and passes them on to buyers. Within each firm this value chain consists of nine strategically relevant activities that accomplish the firm's essential activities, one of which is human resource management. This value chain and its nine activities can be used (1) to analyze the firm's potential to provide a differentiated product and (2) to diagnose the relative costs and value added at each stage of the chain.

Every firm's value chain is composed of nine generic activities that are linked together in a unique way. How they are linked within the firm, plus how they are linked with outside firms, impacts whether a firm will have a competitive advantage that it can sustain. These nine activities include five primary and four support activities. The primary activities are involved in the physical creation of the product or service and its sale and transfer to the buyer. Support activities assist each of the primary activities by providing inputs, technology, human resources, and administration.

Primary activities include:

1. *Inbound logistics:* receiving, storing, materials handling, and controlling inventory
2. *Operations:* transforming inputs into the final product or service
3. *Outbound logistics:* collecting, scheduling, order processing, and distributing the product to the buyer

4. *Marketing and sales:* advertising, promoting, price quoting, selecting distribution channels, and pricing
5. *Service:* installing, repairing, training, and supplying parts.

Support activities include:

1. *Firm infrastructure:* administration, planning, financing, accounting, legal, and quality management
2. *Human resource management:* recruiting, hiring, training, compensating, evaluating, and rewarding the various human resources
3. *Technology development:* improving the firm's products or its processes through improving the ordering process, product design, inventory system, consumer feedback, or customer training
4. *Procurement:* obtaining inputs such as raw materials, office supplies, laboratory supplies, or travel and lodging for salespeople.

The four support activities support each other as well as the primary activities. Human resource management activities, for example, are dispersed throughout the organization because all activities require people who are trained and motivated to perform.

### **Strategy Formulation**

Selecting the right competitive strategy is vital to a firm's success. This decision determines how it is positioned in its industry. Strategy formulation is not a systematic process that advances sequentially from one action plan or objective to another, although it is less chaotic in some organizations than others. Strategy formulation is a dynamic process that is evolutionary in nature and subject to change as external forces change. Since strategy focuses on the future and the future is uncertain, strategy needs to be flexible and ready to respond to revised conditions.

The *strategic management process* involves an analysis of both internal and external factors to identify sources of competitive advantage. This popular approach to strategy development is often called the **SWOT method**, which stands for Strengths, Weaknesses, Opportunities, and Threats. Decision makers should examine the organization's competitive advantages relative to its internal strengths and weaknesses, its external opportunities and threats, and potential competitor actions. The six steps of the strategic management process are illustrated in Exhibit 6.

1. The first step is to identify the organization's mission and decide, "What business are we in?" This step forces management to carefully identify the scope of its products or services. Sometimes it is just as important to know what businesses an organization does not want to pursue as what it does want to pursue.
2. The second step is to analyze the environment and identify the opportunities it wants to pursue and threats it wants to avoid. This process, called **environmental scanning**, involves anticipating and interpreting changes in the environment and usually requires screening diverse information to detect emerging trends. There is some evidence that companies that scan the environment achieve higher profits and revenue growth than companies that do not.

### Exhibit 6: Strategic Management Process



3. The third step is to analyze the organization's resources and identify its strengths and weaknesses. What are its skills and abilities? What unique knowledge and patents does it possess? Has it been successful at developing new and innovative products or services? What is its reputation for quality? Unique skills or resources that give an organization a competitive edge are called its **core competency**. Conversely, those resources an organization lacks or activities the firm does not do well are its weaknesses.
4. The fourth step is to combine the external and internal analyses and formulate an overall generic strategy for the organization to follow, plus functional strategies for each organizational function. These functional strategies need to be aligned with the generic strategy so that the entire organization is united.
5. The fifth step is implementation. Even good strategies must be implemented properly or they will not succeed. Good implementation usually requires competent leaders who have the vision to know which direction to pursue and the trust of the members to encourage their involvement.
6. The sixth step is to evaluate and monitor the organization's results and maintain its competitive advantage. Long-term success with any strategy requires that the advantage be sustainable. That is, it must withstand both the actions of competitors and the evolutionary changes in the industry. This is a difficult challenge since technology changes continually, customer preferences are not stable, and competitors continually imitate successful organizations.

The SWOT approach to strategy formulation assumes that decision makers carefully analyze an organization's strengths, weaknesses, opportunities, and threats as they decide its future. This approach is a very proactive way to develop a strategy, and it appears very clean and logical. However, it is not characteristic of the reactive way most organizational strategies develop.

Rather than creating a unified strategy based on a systematic analysis of the environment, most organizations formulate their strategies in response to problems. For example, a competitive threat, such as the sudden introduction of inexpensive competing products, might first cause a company to reduce its price, then segment itself as a quality producer, then pursue a different product line, or finally seek to enter a different market.

Both proactive and reactive methods of strategy formulation are appropriate depending on the circumstances. In a stable environment, a proactive method can be used effectively to move the organization toward its long-term objectives. In an unstable environment, however, strategies need to be more flexible and responsive to change. There is a fine line between weak strategies that fail to proactively set the future course of the organization versus rigid strategies that are inflexible and unable to reactively adapt to change.

The history of U.S. Steel illustrates how one company failed to adapt to competitive forces. When foreign steel companies began selling cheaper steel in the United States, U.S. Steel adopted a series of strategies to help it survive, but each one failed. First it relied on the loyalty of its customers to continue buying higher-priced steel. Next it lowered its prices. Then it lobbied for protective tariffs and embargoes. Then it tried various cost-cutting and technological improvements. Then it merged with Marathon Oil and became USX, only to be divested. History will tell whether recent mergers, tariffs, and labor force reductions will save U.S. Steel. The fall of U.S. Steel, which reigned for many years in the early twentieth century as America's largest company, represents a significant strategy failure.

### **Strategic Alignment**

For organizations to be effective, all of the human resource functions and other business operations need to be coordinated in ways that support each other. This coordination is called strategic alignment. Like a jigsaw puzzle that forms a meaningful picture when all of the pieces properly fit together, strategic alignment involves selecting the right human resource practices and other business functions and merging them into a coordinated whole.

Effective alignment needs to occur at all levels of the organization, as illustrated in Exhibit 7. The strategies of all business units need to be aligned with the organization's strategic needs, and they also need to be aligned with its subsystem activities, such as production, marketing, finance, and distribution. Likewise within the Human Resource department, the HR functions need to support each other, as well as the organization's corporate strategy. For example, incentive systems that are tied to individual effort, such as commissions and piece rates, are very appropriate for jobs in sales and agricultural harvesting, but they would be quite inappropriate for jobs in a refinery that involve monitoring dials.

Strategic alignment is especially critical to the success of mergers and acquisitions and the problems of misalignment often become quite visible. When one company acquires another or when two companies merge, they face the challenge of combining more than just their

business operations. Creating a united company with shared human resource practices is typically much more difficult than merging the business operations, such as finance, accounting, and production. Unified human resource practices have frequently been mentioned as a potential contributor to the effectiveness of mergers and acquisitions.<sup>15</sup> Managers of acquiring firms report that only about half of their acquisitions could be considered successful when measured against their original objectives.<sup>16</sup> Studies indicate that on average mergers and acquisitions do not create value.<sup>17</sup> Although strategy and finance variables also contribute to failed mergers, cultural differences between the two firms often contribute to such problems as resistance toward sharing vital knowledge, lower levels of commitment and cooperation, negative attitudes, low trust, and high turnover of the executives of the acquired firm.

**Exhibit 7: Strategic Alignment**

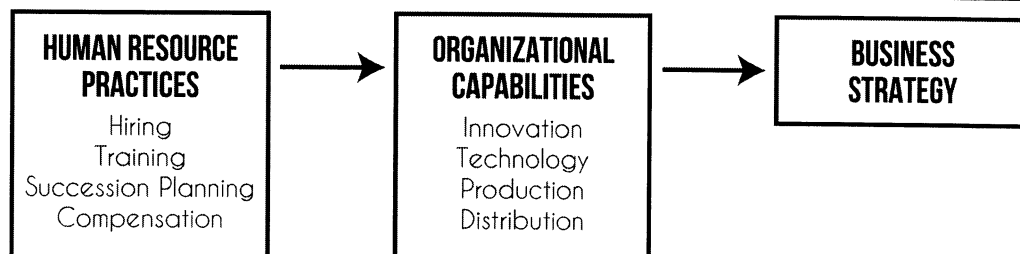


Strategies and tactics of the functional units should align with and support the overall business unit strategy.

**HR Practices and Organizational Capabilities**

The concept of organizational capabilities explains how human resource practices contribute to a firm’s business strategy. **Organizational capabilities** refer to what the organization is able to do with the collection of skills, talents, technology, training, and experience possessed by the members of a firm. Some of the most important organizational capabilities in a competitive environment involve innovation—developing new products, adopting new technology, reducing cycle time, and bringing new products to market. These capabilities allow a firm to implement its business strategy, as illustrated in Exhibit 8.

**Exhibit 8: HR Practices, Organizational Capabilities, and Business Strategy**



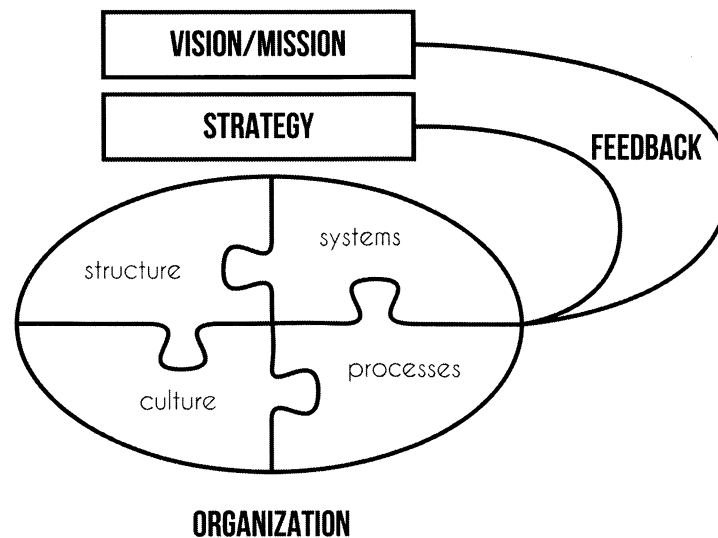
If organizations expect to survive in a dynamic environment, they must have carefully developed organizational strategies to guide them that are supported by consistent human resource strategies.<sup>18</sup> Human resource activities that are excellent or unique can be a source of competitive advantage for an organization. Indeed, many companies have discovered that their human resources represent their most enduring source of competitive advantage because the skills and knowledge of their workers cannot be as easily replaced or imitated as their products and technology. HR practices can contribute to sustained competitive advantage by facilitating the development of competencies that are firm-specific, produce complex social relationships, and generate organizational knowledge.

### 1.2.3 Analyzing the Firm

#### Aligning the Organization

To survive in a dynamic environment, organizations must be prepared to diagnose their opportunities and revise their strategies. Choosing the right strategy usually makes the difference between success or failure. But good strategies depend on good alignment and implementation; new strategies require corresponding changes throughout the organization. Exhibit 9 shows how the events that transpire within an organization are a consequence of its mission and strategy. To make organizations more effective, the mission and strategy must be aligned with four organizational characteristics: structure, systems, culture, and processes.

**Exhibit 9: Designing Effective Organizations**



Many strategies have failed because the organization's structure, control systems, and reward systems were not adequately designed to implement the strategies. The vital relationship between strategy and organizational structure has been recognized at least since 1920, when DuPont and General Motors implemented innovative multidivisional structures that created separate product divisions. Each product division acted like an independent profit center. These multidivisional structures were needed to match the strategic changes in the organizations due to their size, managerial control, and reward systems.

*Structure:* Structure refers to the fixed relationships of the organization, such as how jobs are assigned to departments, who reports to whom, and how the jobs and the departments are arranged in an organizational chart. Strategies and structures must be aligned. An intended strategy has a substantial impact on how a firm is structured, which in turn affects its strategy. For example, a strategy that attempts to diversify responsibility for decision making by creating independent profit centers or autonomous work teams requires a multidivisional structure. However, a multidivisional structure would be highly inappropriate for a firm that had a strategy that required central coordination and tight control. Likewise, a small firm following a single-business strategy requires a simple structure in which the owner-manager makes all major decisions and monitors all activities, while the staff merely serve as an extension of the manager's authority.

*Systems:* Systems refer to the patterned activities that keep an organization operating. As explained earlier with respect to the value chain analysis, these essential subsystem activities include procurement activities, production activities, disposal activities, human resource activities, adaptive activities, and managerial activities. Organizational strategies need to be aligned with their subsystem activities, as illustrated previously in Exhibit 7. The strategy of the corporation must be aligned with the strategies of each business unit, which in turn should be aligned with the functional strategies of each subsystem.

For example, a bank made the strategic decision to change from an institutional bank to a consumer bank. This decision required the bank to establish numerous branch offices in neighborhoods to make banking services more convenient. This generic strategy of growth for the bank had to be aligned with human resource strategies that included aggressive recruiting, careful selection procedures, rapidly rising wages, job creation, and expanded orientation and training.

A tire company discovered that its competitors were manufacturing tires with a new technology that increased productivity, improved quality, and reduced costs. This new technology required fewer workers, which meant that some workers had to be terminated or retired early. But more important, the workers who remained had to be well educated and highly trained. The human resource strategies at this tire manufacturer focused on reducing the size of the labor force and retraining those who stayed. High school and college classes were used to help employees acquire quantitative skills and learn how to operate computers. The compensation system was also revised to pay workers for their knowledge and to reward new learning.

*Culture:* Organizational culture refers to the system of shared values and beliefs that influence worker behavior. Each organization creates its own distinctive culture, much as individual people have distinctive personalities. An organization's culture is based on the values that seem to be widely shared among members of the organization, and they are reflected in the rituals and ceremonies that are held, the traditions that are celebrated, and the stories and myths that are circulated among workers. In times of uncertainty, an organization's culture guides the behavior of members and creates a sense of stability and direction. An organization's culture can have a great influence on its effectiveness.

*Processes:* Organizational processes refer to the interactions among members of the organization. Some of the major organizational processes are the human resource functions

of recruiting and staffing that place the right people in the right jobs at the right time. Other important organizational processes include communication, decision-making, leadership, and power. A major consideration in designing an effective structure is ensuring that these processes be accomplished efficiently. For example, effective methods for collecting and communicating useful information need to be integrated within the organizational structure.

Two electronics firms, N.V. Philips (Netherlands) and Matsushita Electric Industrial (Japan) have followed very different strategies and emerged with different organizational capabilities. Philips used a geographic structure to build a worldwide federation of national organizations that are largely autonomous in each country. Product development and production were based on local market conditions and unique to each country. For example, the furniture-encased televisions sold in the United States were very different in color and style from the TVs sold in other nations. Each national organization took major responsibility for its own financial, legal, and administrative functions.

To overtake Philips as the world leader in consumer electronics, Matsushita maintained a centralized structure and leveraged its highly efficient operations in Japan as it expanded overseas. Matsushita adopted a divisional structure: each product line formed a separate division that operated almost like an independent corporation. Product development and engineering occurred in each of the product divisions, spurred by competition among them. As the company expanded overseas, its production, marketing, and sales facilities maintained the culture of a Japanese firm. The company also relied on hundreds of expatriate managers sent from Japan to facilitate communication and leadership processes in the overseas subsidiaries.

### **Firm Resources and Core Competencies**

Although strategy focuses mostly on the external environment, internal conditions also play a major role in strategy formulation and implementation. This view, referred to as the **resource-based theory of the firm**, provides a very different focus on the sources of competitive advantage. According to Jay Barney, the person most frequently credited for the resource-based view, sustained competitive advantage results from the ownership and control of resources that are rare, nontradable, nonsubstitutable, valued by the market, and difficult or impossible to imitate.<sup>19</sup> Such resources include physical assets, intangible resources, and organizational capabilities.

Some organizations are able to achieve a sustained competitive advantage and earn above-average profits because they possess unique resources, or they have capabilities that provide a competitive edge and cannot be easily imitated. Many inputs to a firm's production process might act as unique resources, such as capital equipment, the skills of individual employees, patents, venture capital, and talented managers. These resources are often categorized as human resources, physical resources, and organizational capital resources. This capability is referred to as the organization's **distinctive competence** or **core capability**.

An illustration of a distinctive resource that is rare, nonsubstitutable, and virtually impossible to imitate is Walt Disney's animated characters. Although competitors have attempted to develop their own sets of animated characters, Mickey Mouse, Donald Duck, and other Disney characters are well-recognized, very distinctive, and highly admired. Furthermore, Disney has exploited its capability to use these resources in producing

universal and timeless entertainment in both animated films and theme parks. For Disney, this capability represents a distinctive competence.

Hayes International is a consulting firm started by Jack L. Hayes, an expert in loss prevention. Although Hayes International hires other consultants and clerical employees, the core competence of this firm is Jack Hayes' 40 years of experience in studying employee theft and designing loss-prevention systems. When Jack retires and wants to sell his firm, the purchase price will depend largely on how much of his knowledge and experience he has been able to transfer to others. The core asset of this company is the intellectual property that resides in its founder.

When an organization considers a diversification strategy, it needs to have a clear understanding of its distinctive competence. If the new diversification is able to leverage an existing skill base, the organization will likely achieve high performance. But if the diversification requires acquiring a significantly different skill and knowledge set, it will not likely achieve high performance.

## 1.2.4 Analyzing the Environment

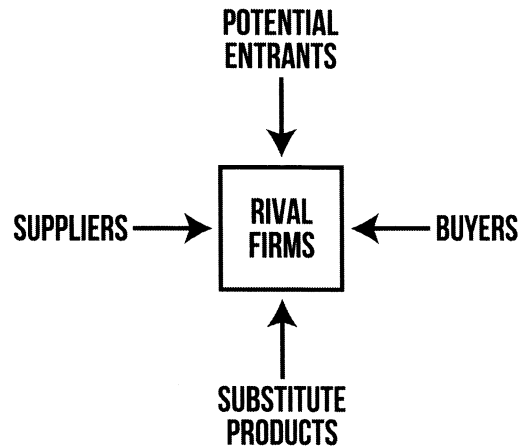
### Industry Analysis

We live in a global economy. Every nation participates in the production and consumption of goods and services that move around the globe—crossing economic, cultural, and political boundaries. Globalization has encouraged international integration. For example, financial resources from one country may be used to buy natural resources from another country to be manufactured in still another country into products that are distributed worldwide. But it has also led to intense competitive pressures for companies everywhere in the world. These conditions force global companies to think seriously about the strategies required to sustain their competitive advantage.

One strategy model focuses on helping firms identify their competitive niche in the external environment by selecting a profitable industry and competing effectively in it. The **industrial organization model**, or I/O model, suggests that the conditions and characteristics of the external environment are the primary determinants of successful strategies that will help firms earn above-average profits.<sup>20</sup>

Firms face the challenge of finding the most attractive industry in which to compete. Because most firms are assumed to have equal access to similar resources that are mobile across companies, competitiveness generally can be increased only when organizations find the industry with the highest profit potential and learn how to use their resources to formulate and implement the strategy required by that industry. Michael Porter has developed a **five forces model of competition** that identifies the major environmental forces of an industry analysis, as illustrated in Exhibit 10.<sup>21</sup> This five forces model suggests that an industry's profit potential is a function of the interactions among these five forces. Organizations can use this analysis to examine an industry's profit potential and to establish a defensible competitive position, given the industry's structural characteristics. The five forces are suppliers, buyers, rival firms, product substitutes, and the threat of new entrants.

### Exhibit 10: The Five Forces Model



Source: Adapted from Michael Porter; *Competitive Strategy*, (New York: Free Press, 1980), 4.

1. *Suppliers:* Firms depend on their suppliers for materials to which they provide added value. The power of suppliers depends on such factors as how many suppliers are available, whether there are satisfactory substitute supplies, and whether a supplier might choose to integrate forward, such as a bakery deciding to open its own retail outlet.
2. *Buyers:* Firms seek to maximize their revenues, while buyers want to purchase goods at the lowest possible price. The power of buyers increases when there are many competing products, when the products are similar, or when only one or a few buyers purchase the entire output.
3. *Rival firms:* Competition among rivals is stimulated when one or more firms identifies an opportunity to improve their market position or when they feel competitive pressures. Since the firms in an industry are mutually dependent on each other, a competitive advance by one (such as frequent flyer mileage in the airline industry) usually precipitates corresponding moves by all of the others. Rivalry is especially strong when most of the firms are equally balanced and feel a need to distinguish themselves, when the market is not expanding and firms fear a loss of market share, or when the products are not unique and can be easily replaced.
4. *Substitute Products:* Firms compete against other firms that offer substitute products. Therefore, substitute products place an upper limit on the prices firms can charge since substitutes will be used whenever the price of the product exceeds the price of the substitute. The threat of substitute products is strong when customers can easily switch to the substitute and when the substitute's quality is high and its costs are low. For example, Nutrasweet is a substitute for sugar, since it performs similar functions, and the price of Nutrasweet provides an upper limit on the price of sugar.

Substitutes do not need to be other products; they can also be other processes or activities that eliminate the need. For instance, the companies that manufacture water meters would discover that the demand for their product could be eliminated if a city

decided to charge users a flat monthly fee rather than according to the number of gallons they used.

5. *New entrants:* New entrants threaten existing competitors by providing additional production capacity. Unless there is a corresponding increase in the demand for additional production, there will likely be price cuts and a corresponding loss of revenues and profits for all firms. Existing competitors try to develop barriers to new entrants, while new entrants seek markets where the barriers are relatively weak. Some of the most challenging entry barriers are inefficient economies of scale for new entrants (small operations do not benefit from large production runs), unrecognized product differentiation (customers are not familiar with the new product), insufficient starting capital (significant funds are needed for a firm's initial resources in physical facilities and inventory), limited access to distribution channels (new firms do not have established relationships with distributors), and historical cost disadvantages (the established competitors have already acquired the most favorable locations, proprietary product technology, and favorable access to raw materials).

### Competitor Analysis

In addition to analyzing the overall industry, firms also need to analyze each company with which they directly compete. This assessment, called a **competitor analysis**, is especially critical for firms facing one or a few powerful competitors. In the airline industry, for example, each airline is vitally interested in what other airlines are doing. Are they changing their routes or prices, are they purchasing new planes or increasing their workforce, and are they providing new or improved services or benefits?

Successful companies perform a competitor analysis for each competing firm in their industry. This analysis involves examining each competitor's future objectives, current strategy, assumptions, and capabilities. The kinds of questions involved in this analysis include.<sup>22</sup>

1. *Future objectives:* How do our goals compare to our competitors' goals? What will we emphasize in the future? What are our attitudes and the attitudes of others toward risk?
2. *Current strategy:* How are we currently competing? Does this strategy support changes in the competitive structure?
3. *Assumptions:* Do we assume the future will be volatile or stable? Are we operating under a status quo or are we advancing? What assumptions do our competitors hold about the industry and about themselves?
4. *Capabilities:* What are the strengths and the weaknesses of each competitor? How do we rate compared to our competitors?

An effective competitor analysis requires gathering needed information and data, referred to as **competitor intelligence**. Information needs to be obtained about each competitor's customers, distribution channels, marketing, sales, advertising, finances, operations, organizational structure, research and development, and strategic plans. Analysts have an

obligation to obtain this information in ways that are ethical. Stealing drawings or documents, eavesdropping, and trespassing are unethical and illegal methods of collecting information. However, techniques that are generally considered both legal and ethical include (a) obtaining publicly available information, such as court records, help-wanted ads, annual reports, financial reports of publicly held corporations, and government filings, and (b) attending trade fairs and shows to obtain brochures and advertisements, view the exhibits, and listen to discussions about competitors' products.

The ethics of several intelligence-gathering techniques are questionable even though they are technically legal, such as paying someone to serve as an impostor (such as a student, a management consultant, or a reporter) to obtain inside information, conducting job interviews for jobs that don't exist in hopes that a competitor's employees will apply and volunteer inside information, hiring a competitor's key employees to obtain knowledge about technological innovations, and purchasing a competitor's trash to obtain documents and other inside information. As a general rule, information-gathering techniques ought to respect the right of competitors not to reveal, or have disclosed, information about their products, operations, and strategic intentions that they do not want divulged. When evaluating the ethics of such cases, the Golden Rule serves as a useful moral guideline.

### 1.2.5 Writing a Business Plan

After a company has formulated a strategy for how it plans to compete successfully within its industry, it needs to prepare a business plan to help it acquire the needed resources. A well-written business plan will also provide a blueprint of the essential steps that it needs to take to move forward. Although business plans are typically prepared by entrepreneurs when they are starting a new company, these plans are also useful to established companies that need to clarify their operations and procedures. Such plans can serve both internal and external publics.

There is no single template for writing a business plan. Plans that are written to obtain financing need to provide an extensive financial history, while plans that are written for investors should focus more on the qualifications and experience of managers. Good business plans that are clear, specific, and realistic lead to successful implementation.

Some of the common components found in most business plans include

- An executive summary
- A description of the company and its history
- A description of its products and services
- A market analysis and a marketing plan
- A description of the management team
- A budget and a financial analysis showing both resources and needs
- An operations plan describing responsibilities and actions with timetables and realistic, measurable goals.

**Test Your Knowledge**

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at [www.hrcp.com](http://www.hrcp.com). Log into your account and click on My HRCP to access the practice exams.

1. Can you explain the role of a mission statement in an organization and describe how mission statements might be developed?
2. Can you define the term “strategy” and describe its role in an organization?
3. Can you list and explain the Three Grand Strategies?
4. Can you explain competitive advantage and the value chain?
5. Can you explain how strategies are formulated?
6. Can you describe why an organization’s structure, systems, culture, and processes must support its strategy?

~Notes~

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## 1.3 HR CONTROL AND EVALUATION

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### 1.3.1 HR Budgeting Process

A budget is an itemized estimate of the operating results of a company for a future time period. The major difference between a budget and a financial statement is that a budget is based on planned operations for a future time period, while financial statements are based on actual results of past operations.

Budgets have three major purposes:

1. **Coordination and integration:** The budgeting process requires establishing objectives in advance and identifying the steps by which they will be accomplished.
2. **Motivation:** The budgeting process involves goal setting and feedback, and these activities serve to increase motivation.
3. **Control and evaluation:** A budget is an important management tool for monitoring the performance of a business unit and controlling its actions.

Surveys indicate that companies vary dramatically in how they assign HR activities to different departments and how the costs are budgeted. Depending on the company, the responsibility for various human resource activities may be assigned to the HR department, assigned to another department, or shared. For example, the responsibility for payroll administration is assigned to the HR department in about one third of the companies, while it is assigned to another department in about half of the companies, and shared or outsourced in the remainder.<sup>23</sup>

When the HR department is responsible for an activity, the budget for that activity is typically under its control. In some organizations, however, the costs for some activities are allocated to the operating departments, and HR contracts with them to provide the services the department requests. For example, supervisory training, management development, career planning, and productivity enhancement programs are occasionally budgeted to the operating departments, and the HR department contracts with them to perform these services. Experience and anecdotal evidence suggests that this arrangement, which treats the HR department as a profit center, tends to reduce the frequency of these programs, especially in difficult economic times.

### 1.3.2 HR Metrics: Evaluating HR Effectiveness

HR activities should contribute to the financial success of an organization. Although some HR activities, such as preparing EEO and safety reports, do not add to the profitability of a company, other HR expenses, such as training and employee assistance programs, add importantly to profitability. HR metrics, also called workforce analytics, allow managers to evaluate the important dimensions of success with respect to people—how they are recruited, trained, retained, and terminated. Good metrics help managers make continuous improvements in how people are treated and often dispel myths and incorrect assumptions.

For example, a company that assumed its high turnover was due to low hourly wages was surprised to learn that the turnover was caused more by the fact that part-time work failed to provide enough hours of work. Another firm was surprised to learn that the long-term career success of its employees was stimulated more by a variety of job experiences within the company rather than specializing in just one area.<sup>24</sup>

Measures of HR effectiveness have included (a) subjective attitudinal measures, (b) statistical measures, (c) human resource accounting, and (d) economic cost accounting measures. Some of these measures tend to focus on evaluating specific HR activities, some assess the performance of the HR department as a whole, and others measure the impact of HR programs on the economic success of the organization.

### **Subjective Attitudinal Measures**

The value of an HR activity or the performance of the entire HR department can be assessed with subjective behavioral measures. This assessment is sometimes called an HR audit. The advantage of using these measures is that they are always available, they are easy to obtain, and they seem to measure what leaders think is important.

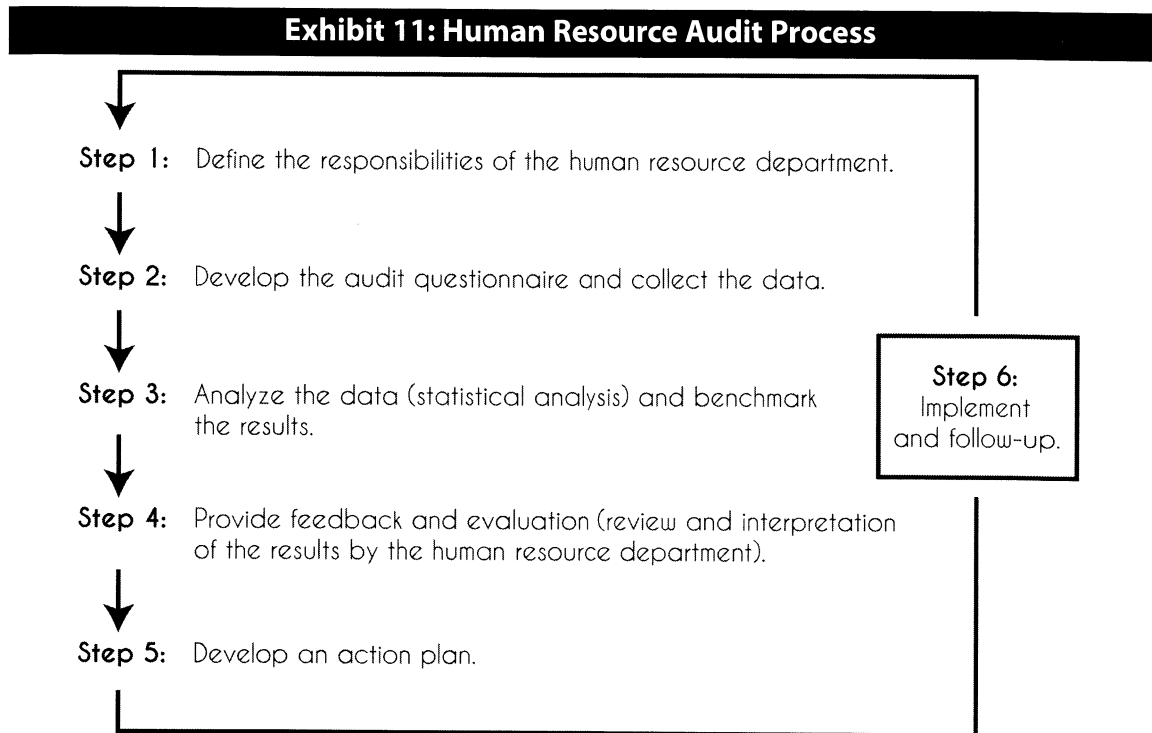
A **human resource audit** evaluates the effectiveness of the human resource department.<sup>25</sup> How well do the policies and programs sponsored by the human resource department meet the needs of the employees and the company? Most HR audits rely on the subjective judgements and candid feedback of line managers or the professional opinions of external experts.

External experts who are qualified to conduct a meaningful audit typically come from public accounting firms with HR practices, HR consulting firms, and other professional services firms with HR expertise.<sup>26</sup> The audits they conduct are generally either compliance audits or value-added audits. A compliance audit focuses on risk mitigation issues, such as the firm's diversity measures, pension plan participation, payroll accuracy, and other aspects of compensation and benefits. Compliance audits are often performed after an alleged violation to ensure that the current policies are appropriate and if they are being followed. A value-creation audit focuses broadly on how well the HR policies and programs correlate with the business priorities and whether the HR activities can be performed more efficiently. A full audit would examine all HR functional areas, including staffing and recruitment, job analysis and descriptions, compensation and benefits programs, performance management, training and development, employee relations and policies, and HR metrics.

The first step in an audit, as shown in Exhibit 11, is to clarify the objectives of the audit and to define the responsibilities of the department. Ambiguous responsibilities and uncertain objectives become apparent at this point. Is the department responsible for safety? Who is responsible for scheduling campus recruiting interviews? The outcome of this step should be a comprehensive list of the HR department's responsibilities and objectives.

The second step is to ask people both inside and outside the department how well they think the department is performing. Useful information can be obtained either from interviews or a carefully constructed questionnaire.

When the data are analyzed in step 3 of Exhibit 11, the strengths and weaknesses of the department are identified. The attitudes of people inside and outside the department ought to be analyzed separately to provide greater meaning when the data are reported back to the HR department in step 4. If those responsible for administering the audit successfully elicit the cooperation of those who completed the survey, the results provide useful information for redesigning and altering the department in steps 5 and 6.



### Statistical Benchmark Measures

Numerous statistical measures are used to assess HR activities, such as ratios, percentages, averages, and correlations. Some of the most frequently used statistics include the following:

#### Employee measures

- Job satisfaction and measures of company morale
- Organizational commitment and involvement
- Turnover and retention rates
- Absenteeism rates and days of sick leave taken
- Grievance rates
- Exempt terminations as a percent of exempt employees
- Nonexempt terminations as a percent of nonexempt employees

#### Productivity measures

- Output/input ratios
- Revenue per employee
- Cost per employee
- Units produced per employee

- Profit per employee
- OSHA incident rates
- Cost of a new hire
- Time to fill vacant positions
- Worker Compensation cost per employee

#### HR process measures

- HR department expense as a percent of operating expenses
- Ratio of total employees to HR staff employees
- Compensation as a ratio of company operating expenses
- Benefits as a percent of payroll or a percent of operating expenses
- Training expense per employee
- Cost per hire
- HR department expenses per employee
- Compensation as a percentage of revenue
- Retiree benefit cost per retiree
- Ratio of offers made to acceptances—yield ratios

These statistics provide a valuable tool for assessing the performance of HR activities when there is a foundation for comparing them. Two ways to make sense of these statistics are (a) to compare them with comparable companies and (b) to compare them with the company's historical performance by examining changes over time. Benchmark data can be purchased, and firms can use these data to compare their ratios with other firms according to industry, size of company, region, and growth rate.<sup>27</sup>

The limitations of both approaches, however, are that the comparisons are never stable or direct. Other companies are never exactly comparable because each organization is unique and even the historical data for a single company are influenced by many uncontrolled fluctuations. HR managers should use both of these approaches to interpret their metrics since the information from just one source can be biased by many factors, including industry, size of company, economic conditions, and organizational structure.

Before relying on benchmark data to make important decisions, managers need to make certain that the data are meaningful and accurate. The companies that sell benchmark data do not use identical formulas and definitions to calculate their ratios.

The sharing of HR metrics information has been facilitated by the work of a consortium of firms, called the HR-XML Consortium, that has standardized the electronic exchange of information. Standards have been developed for storing information regarding such HR functions as assessments, staffing, recruiting, payroll, benefits, training, and workforce management. These standards provide an important tool for employers, government agencies, and HR vendors to access and integrate HR data directly from different computer systems. The ability to obtain metrics data directly from HR systems in real time provides many benefits. For example, employers and background checking vendors can share information more quickly and less expensively; employers can provide government agencies with more timely and convenient reports, and benchmarking organizations have the ability to collect more timely information and provide more meaningful and complete reports.

### Human Resource Accounting

Human resource accounting refers to the process of identifying and measuring HR data and communicating this information along with financial data to interested parties, especially investors and managers. This information is especially valuable for managers of service firms where people are the key assets of the firm, such as public accounting firms, management consulting firms, and sports teams.

The purpose of human resource accounting is to improve the quality of financial decisions affecting human resource activities. Better methods of evaluating the value of human resources are needed because of the distortion that occurs when conventional accounting practices are used. For example, conventional accounting practices treat a company's training and development expense as a cost that reduces the company's profit. Therefore, training and development expenses appear to be unnecessary. However, managers tend to place a higher value on training when the cost is treated as a capital expenditure that increases the productivity of their assets in the same way that money spent to overhaul a piece of equipment or to renovate a building is treated as a capital expenditure and depreciated over the asset's useful life.

Managers typically receive extensive information concerning the firm's financial resources, but relatively little information about its human resources. Therefore, human resource accounting is an attempt to provide information that will help managers make accurate decisions about recruiting, hiring, training, supervising, evaluating, developing, and replacing personnel. Studies have shown that human resource accounting information has influenced managers making layoff decisions and has altered the investment decisions of investors.<sup>28</sup>

Several human resource measures have been proposed to help managers make better-informed decisions. The development and reporting of multiple measures has been recommended to provide a broad perspective of the value of human resources. Three of the most frequently recommended measures include outlay costs, replacement costs, and human resource value.<sup>29</sup>

1. *Outlay cost*: The **outlay cost** is also referred to as the historical acquisition cost. This measure represents the value of "human capital" and includes all of the costs associated with recruiting, selecting, training, and developing employees for a firm. It has been suggested that these costs should be capitalized and treated the same way as costs for capital equipment, which are depreciated over the expected useful life of the assets.
2. *Replacement cost*: The **replacement cost** is an estimate of how much it would cost to replace a firm's existing human resources. Included in this estimate is the cost of recruiting, hiring, training, and developing capable replacements. The total replacement value includes not only the current replacement costs but also the opportunity costs of lost income that would be incurred while the replacements were developing the same level of proficiency as existing employees.
3. *Human resource value*: The **human resource value** represents the expected contribution to the firm's net income for individuals at each level in the firm. This

value is estimated by calculating the net present value of each person based on the person's expected future services and probability of staying with the firm.

In spite of their value, human resource measures have not been developed or used by very many companies. A committee established by the European Communities recognized the benefits of human resource accounting, but concluded that there are immense problems to overcome before a coherent and reliable measuring technique is established that is

### **Costing HR Activities**

In the world of business, success is typically measured in dollar terms rather than in perceptual ratings. Therefore, a superior way to evaluate the value of human resource activities is through a careful cost accounting process that actually calculates their financial contribution to the organization. Managers are usually surprised to discover the financial costs of employee problems, such as absenteeism, tardiness, turnover, alcoholism, smoking, and grievances. Managers also tend to underestimate the financial contribution of HR activities such as training, career counseling, employee assistance programs, and test validation.

Human resource costing information influences management decisions about human resource activities. Pressures to produce may increase short-term profitability, but this pressure may reduce long-term profitability because of employee resentment and turnover. On the other hand, the development of human resource systems and the creation of an effective management team require outlays of time and money that reduce the short-term profit. Conventional accounting methods understate profits during periods of human asset building and overstate profits during periods of human resource liquidation.

A cost accounting framework has been developed by Wayne Cascio for assessing human resource costs.<sup>30</sup> Cascio provides formulas and examples for calculating the costs of turnover, absenteeism, sick leave, smoking, employee assistance programs, employee wellness programs, programs to improve employee attitudes, labor contract provisions (including wages, benefits, vacations, overtime, shift differentials, holidays, and pensions), the use of employee selection tests, the use of assessment centers for selection or training, the dollar value of job performance, and the utility of training programs.

For example, Cascio's framework can be used to evaluate how much it would cost a company if a supervisor thoughtlessly criticized an employee and the employee decided to quit. The cost of turnover consists of four major cost categories: (1) separation costs, which include exit interviews, administrative functions, separation pay, and unemployment taxes; (2) replacement costs, which include the cost of recruiting and hiring a replacement; (3) training costs, which include orientation and on-the-job training; and (4) lost performance, or the difference in performance between the person who leaves and the replacement.

Similar cost accounting can be used to evaluate other employee behaviors. For example, the cost of hiring employees who smoke can be assessed by combining the costs of absenteeism, medical care, premature mortality, insurance, on-the-job time lost, property damage and depreciation, maintenance, and involuntary smoking. Using conservative estimates, the incremental cost to business of hiring a smoker is about \$12,000 USD per year.<sup>31</sup> Companies

should consider this information as they design their policies and employee assistance programs.

### 1.3.3 Key Performance Indicators (KPI)

To evaluate its performance and make strategic adjustments, organizations need useful human resource metrics that measure both efficiency (time and cost) and effectiveness (return on investment and profitability). **Key performance indicators (KPI)** refer to specific measures of human resource activities that contribute importantly to the efficiency and effectiveness of a company. The purpose of key performance indicators is to provide a company with quantitative measurements that can be used to monitor the events that contribute importantly to its long-term success.

#### Leading and Lagging Indicators

To accurately interpret and use human resource metrics it is essential to distinguish between leading and lagging indicators. A **leading indicator** is a measure that precedes, anticipates, or predicts future performance. An example of a leading indicator is the amount of time required to fill key vacancies (time to fill) since having qualified employees is essential to a company. A **lagging indicator** measures the results of a process or a change, such as sales, profits, and customer service levels. The average number of units produced per employee is an example of a lagging indicator that measures how well a company is increasing employee productivity. Lagging indicators often receive the most attention since they reflect the bottom-line success of a company and executives rely on them to gauge their success. In general, however, the most useful measures for making managerial decisions are leading indicators, since they predict future performance.

#### Scorecards and Dashboards

The process of collecting HR metrics and presenting them to managers in a useful format is referred to as an HR Scorecard, or sometimes as an HR Dashboard. Documenting and tracking defined metrics allows managers to justify investments in human capital and other HR expenses. A meaningful scorecard serves as a key management tool to strengthen HR's strategic influence in an organization. A carefully designed scorecard includes four perspectives: (1) a strategic perspective that measures progress in achieving major strategic initiatives, (2) an operational perspective that measures the effectiveness of HR processes, (3) a financial perspective measuring the financial contribution of HR activities, and (4) a customer perspective measuring how well HR activities serve both internal and external customers.<sup>32</sup>

The primary benefit of an HR scorecard is that it allows managers to assess HR's contribution to strategy implementation and to the bottom line. Many HR metrics represent leading indicators that can be shown to have a positive impact on the profitability of a company if they are carefully measured and displayed. Furthermore, HR scorecards increase HR's ability to control costs and create value. A useful scorecard reinforces the distinction between HR "doables" and HR "deliverables" and draws attention to the results that human resource activities are intended to produce.<sup>33</sup>

In 2012, a nonprofit organization called the Center for Talent Reporting (CTR) was formed to promote the adoption of reporting standards for human capital similar to the accounting

profession's Generally Accepted Accounting Principles (GAAP). This organization has defined over 500 measures and 60 statements regarding talent development reporting principles. These standards provide measures of efficiency, effectiveness, or outcomes for six human resource capital functions: talent acquisition, leadership development, learning and development, total rewards, performance management, and capability management. The goal of this organization is to create world-class reporting standards for all human capital processes in cooperation with other standards-setting organizations. The CTR is funded by memberships, and members have access to a library of electronic measures that provide the definitions, formulas, and references for each measure as well as identical and similar measures.

### Primary HR Metrics

More than a hundred different metrics have been proposed for HR scorecards and companies need to decide which metrics are their key performance indicators, their best measures of both efficiency and effectiveness. Key performance indicators will not be the same for all companies and all industries. The following metrics represent some of the most common performance indicators that can be benchmarked across companies or over time. Efforts to standardize the formulas and define the terms for these metrics have contributed to their usefulness.

1. *Revenue Factor*, (or Revenue per FTE):  $\text{Revenue} \div \text{Total Number of FTE}$

This metric is often used as the primary measure of effectiveness of a company since it represents how much revenue is generated by the average full-time equivalent (FTE) employee.<sup>34</sup> This metric views employees as a capital investment rather than as an expense. Part-time employees are included in the FTE count proportional to the hours they work.

2. *Revenue per Labor Costs*:  $\text{Revenue} \div \text{Total Labor Costs}$

This metric has been recommended as a better measure to track than revenue per FTE since it motivates managers to reduce costs rather than FTEs.<sup>35</sup> When companies focus on revenue per FTE, managers are motivated to use expensive overtime to meet production deadlines rather than less expensive contingency hiring that increases the number of FTEs.

3. *Human Capital ROI*:  $[\text{Revenue} - (\text{Operating Expense} - (\text{Compensation cost} + \text{Benefit Cost}))] \div (\text{Compensation cost} + \text{Benefit cost})$

This metric measures the return on investment ratio for employees and is frequently mentioned as the prime measure for analyzing HR practices, such as recruitment, training, and incentives. Changes in this metric are carefully examined with respect to changes in HR practices to test for causal relationships.

4. *Human Capital Value Added*:  $[\text{Revenue} - (\text{Operating Expense} - (\text{Compensation cost} + \text{Benefit Cost}))] \div \text{Total Number of FTE}$

This metric represents how much value is added to the company from the average employee and is interpreted as the value of the workforce's knowledge, skills, abilities, and performance.

5. *HR Expense Factor*:  $\text{HR Expenses} \div \text{Total Employees}$

This popular metric, also called HR cost per employee, represents the average cost of providing human resource services to the employees in a company. This metric can be benchmarked using surveys that show the average for all responding companies, plus the average HR expense for different industries and companies of different sizes. Two other popular HR cost metrics are HR cost as a percent of revenue and HR cost as a percent of total operating costs. A study found that "world-class HR" organizations have a 23 percent lower cost of HR per employee than typical HR organizations.<sup>36</sup>

6. *Absence Rate*:  $[(\text{Number of days absent in the month}) \div (\text{Average number of employees during month}) \times (\text{Number of workdays})] \times 100$

This metric is the standard measure of absenteeism and can be benchmarked with other absenteeism surveys, which show the rates for different industries and companies of different sizes. Benchmark data can indicate whether a company has a serious absenteeism problem. This metric can track the effects of changes in attendance policies, attendance incentive programs, and other interventions.

7. *Turnover Rate*:  $[\text{Number of separations during the month} \div \text{Average number of employees during month}] \times 100$

This metric is the standard measure of turnover; it measures the rate that employees leave a company and is usually divided into voluntary and involuntary reasons before examining potential problems in HR policies.

8. *Cost per Hire*: The cost per hire (CPH) metric measures the costs associated with the sourcing, recruiting, and staffing activities borne by an employer to fill an open position. It can be used in all industries in both the public and private sectors.<sup>37</sup> The formula for this metric is  $(\text{external costs} + \text{internal costs}) \div \text{number of hires}$ .

The external costs include all recruiting costs, such as third-party agency fees, advertising costs, job fair costs, and travel costs. The internal costs include the salary and benefits of the recruiting team plus fixed costs such as the physical infrastructure. The number of hires includes both temporary and full-time employees for a given time period.

This metric measures only the costs of hiring a new replacement and not the entire cost of turnover. This measure is used to examine changes in recruitment and retention policies. Other metrics that are used to evaluate the effectiveness of "onboarding" include first-year retention rates, time to complete training, time to receive equipment and tools needed to do the job, and time to achieve full productivity.

9. *Turnover Costs per Employee:* (Separation Costs + Replacement Costs + Training Costs + Lost Performance) ÷ Number of Replacements

This metric measures more than just hiring costs; it includes all of the costs associated with turnover and represents the average cost of replacing an employee who quits or is fired. Separate metrics can be calculated for different divisions, different jobs, and different job levels. These costs provide a significant motivation for examining and improving HR practices that reduce turnover.

10. *Time to Fill:* Total days elapsed to fill requisitions ÷ Number hired

This metric counts the number of days from which job requisitions are approved to the new hire starting date. It measures the average time required to fill job openings and reflects the efficiency of hiring practices. Other key recruiting effectiveness metrics include time to start, response time, offer acceptance rate, and quality of hire.

11. *Training Investment Factor:* Total Training Costs ÷ Headcount

This metric represents the training cost per employee. As this metric changes, there should be corresponding changes in other metrics tied to training effectiveness, such as reductions in accidents following safety training.

12. *Health Care Costs per Employee:* Total cost of Health Care ÷ Total Employees

This metric measures the per capita cost of employee health care benefits. This metric is an important number during labor union negotiations and in communication with employees. Employees need to know how this metric has changed over time and what they can do individually to reduce it.

13. *Employee Benefits as a Percent of Payroll:* Total employer benefits payments ÷ Total gross payroll

This metric, sometimes called Total Benefit Cost, measures the cost of benefits as a percent of payroll and is one of the most-frequently used metrics for comparing the cost of benefits within one's industry and over time.

14. *HR-to-Employee Ratio:* (Total number of HR FTEs ÷ Total Number of FTEs in the Organization) × 100

This metric provides a useful way to compare HR staffing levels between organizations. It represents the number of HR staff per 100 employees and has remained relatively stable over the past fifty years. Surveys show that the ratio of HR staff relative to total employment is about 1:100 for most companies. Small companies with fewer than 100 employees have ratios of about 2.5:100, while large companies with more than 2500 employees have ratios of about 0.5:100. About 70 percent of HR staff members are exempt professional employees and the other 30 percent are nonexempt clerical or office staff. Finance institutions tend to have slightly higher ratios (1.1:100) while health care organizations tend to have lower ratios (0.5:100).

### 1.3.4 Effects of HR Practices on Business Performance

HR managers are frequently criticized for proliferating programs that require the addition of new HR specialists, that waste the time of operating managers, and that fail to add value to the firm. Human resource activities are expected to contribute to a firm's profitability; however, this expectation has been based more on reason and logic than on empirical measurement. Actual demonstrations that HR practices contribute to the financial profitability of a firm have seldom occurred. Nevertheless, some efforts have been made to measure the financial contribution of HR practices and most of the published reports have shown that they do make a measurable difference.

A review of the major research studies regarding the relationship between HR practices and firm performance and concludes that the following variables were associated with high-producing firms: employee involvement in decision making, incentive compensation practices that include profit sharing and gain sharing, training programs, and a constellation of high-performance practices.<sup>38</sup>

Studies suggest that certain high-performance HR practices can have a significant effect on a firm's financial performance, and these results seem to hold across a wide range of industries, firm sizes, and geographic regions.<sup>39</sup>

#### HR and The Balanced Scorecard

Firms are required to balance the expectations of their stakeholders and often the interests of these groups are incompatible. For example, stockholders and owners expect an organization to be run profitably, using sound management practices. Moreover, they expect all human resource activities to be cost-benefit effective—everything should contribute to the profitability of the organization, including training and development activities, bonuses and benefits, and employee relations programs. Stockholders and owners may question the value of programs designed to help employees with alcoholism or financial problems, since such programs do not contribute directly to the profitability of the organization.

Customers and clients, on the other hand, believe the organization should provide useful products and services and also act in a socially responsible way by improving the quality of society. To fulfill its social responsibility, an organization is often expected to recruit and train disadvantaged members of society and to provide a work environment that contributes to the overall quality of life for all employees. Customers and clients also demand high-quality products and competent service.

Balancing the demands of different stakeholders requires a great deal of skill. Human resource managers may be forced to justify their strategies in terms of how they will affect future profits. This may require managers to demonstrate the financial impact of their programs. Human resource managers also may be expected to prove that their activities are socially responsible in contributing to the quality of work life for employees.

The **balanced scorecard** involves analyzing the performance of an organization from multiple perspectives. It recognizes that there are three important stakeholders for every company—the stockholders, the customers, and the employees. Therefore, the balanced scorecard involves analyzing the traditional human resource measures concurrently with

performance metrics from other perspectives—financial results, customer satisfaction, and internal business processes.<sup>40</sup> This concept explains what it takes for a company to succeed, and there are two key premises underlying it: (1) for businesses to succeed in the long run, the expectations of all three stakeholders need to be simultaneously satisfied and (2) the interests of all three stakeholders are interrelated. Employee attitudes and behaviors impact the level of customer satisfaction and retention. In turn, customer attitudes and behaviors influence shareholder satisfaction and retention since customers are essential to profitability. Shareholder satisfaction affects employee satisfaction through bonuses, stock options, and further investment in employee growth and development. Although a business may succeed in the short run if it ignores the expectations of one of the stakeholders, in the long run, its business performance will suffer.

### 1.3.5 Outsourcing the HR Function

A significant trend for many companies is to pay outside specialists to perform some of their human resource functions. This strategy, called **human resource outsourcing** (HRO), can be a cost-effective method for companies to operate because (a) outside experts can use economies of scale to perform the HR functions more efficiently, (b) outside experts can use their expertise and a broader perspective to do the functions better, and (c) outside experts are better prepared to keep abreast of technological advances and new legal requirements.<sup>41</sup>

The HR functions that are the most likely candidates for outsourcing include:

- Payroll administration
- Benefits administration
- Record keeping and information systems
- Retirement counseling
- Outplacement and relocation
- Health and wellness programs
- Testing, including drug testing and psychological testing
- Training and development, called learning system outsourcing (LSO)
- Recruitment, called recruitment process outsourcing (RPO)

Although outsourcing can relieve HR managers from routine administrative activities, it places a greater responsibility on them to manage what is outsourced and assess its effectiveness. Ensuring good quality requires good metrics to monitor what is happening. For example, recruitment process outsourcing (RPO) can be measured by such metrics as number of hires, time to hire, cost to hire, source of hire, interview-to-offer ratio, hiring manager satisfaction, candidate satisfaction, and new-hire retention and performance after six months.

Some companies outsource all of their human resource functions to a single vendor in an arrangement called HR business process outsourcing (HR BPO); all HR services are managed by a single contract. Although these contracts were quite popular after the turn of this century, vendors found that creating them was more costly and time consuming than anticipated and companies found that implementing and managing them were more difficult than expected. Consequently, most companies have found that outsourcing single services with separate vendors has served their needs better, and the most frequently outsourced functions are payroll (about 55%) and benefits administration (about 20%).<sup>42</sup>

Although some have suggested that all HR functions could be performed better if they were outsourced, most companies are reluctant to relinquish total control. HR managers are encouraged to carefully examine which HR functions can be performed better by outside specialists and which are part of the company's central core.<sup>43</sup> Companies should retain control of the HR functions that contribute to their competitive advantage. For example, none of the functions listed above have much potential to produce a competitive advantage for a company except possibly training and development. Therefore, they could be considered candidates for outsourcing.

Companies that want to outsource all of their human resource functions can do so with the assistance of a **professional employer organization (PEO)** or through an **employee leasing** arrangement. These companies contract with employers to manage almost all human resource functions and claim to provide an integrated and cost-effective approach to managing employer liability by contractually assuming substantial employer rights and responsibilities. While some employee leasing companies hire an employer's employees and lease them back to the employer, a PEO typically co-employs the workers under a contractual relationship that shares the management responsibilities. A typical contractual relationship between a PEO and an employer allows the PEO to:

- co-employ workers and assume legal responsibility for specified human resource functions for those workers;
- reserve the right to direct and control the employees and share this responsibility with the employer consistent with the employer's responsibility for its product or service;
- pay wages and employment taxes of the employees out of its own accounts;
- report, collect, and deposit employment taxes with state and federal authorities;
- establish and maintain an employment relationship with its employees which is intended to be long term and not temporary; and
- retain the right to hire, counsel, and fire the employees.

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### Test Your Knowledge

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at [www.hrcp.com](http://www.hrcp.com). Log into your account and click on My HRCP to access the practice exams.

1. Can you describe the purpose and process of an HR audit?
2. Can you list and explain the methods of human resource accounting?
3. Can you explain the primary HR metrics?
4. Can you define and explain the balanced scorecard?
5. Can you explain the benefits of outsourcing HR functions?

~Notes~

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## 1.4 HR TECHNOLOGY

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The development of new technologies has dramatically changed the way many HR practices are performed. Portals allow employees to manage their own benefits without relying on HR specialists, communication devices allow employers to communicate with each employee in a variety of ways, and team members can work together in virtual teams from multiple places around the globe. New technology provides tremendous benefits that make many HR activities much more efficient and convenient, but it also creates new problems that have to be managed.

### 1.4.1 Human Resource Information System (HRIS)

A **human resource information system (HRIS)** is a collection of information about the people working for the organization. An HRIS can be as simple as a sheaf of papers in a filing cabinet or as complex as a fully-integrated, multi-lingual, computerized human capital management system. The HRIS is often part of an organization's **enterprise resource planning (ERP)** system, a computer-based system that integrates the various processes throughout a business, such as inventory control, order management, production, customer service, accounting, and human resources. The purpose of ERP is to bind the different computer systems together so they can share information and make the organization more efficient. The organization's HRIS is often a key component of its ERP.

A carefully designed HRIS that is current and reliable can assist managers in many ways. The major uses of an HRIS include the following:

1. Human resource planning: to anticipate replacements and promotions
2. Diversity reports: to know how many employees of each sex and ethnic group are employed in each job category
3. Compensation reports: to obtain information regarding how much each employee is paid, the overall compensation costs, and the financial costs of pay increases and other compensation changes
4. Personnel research: to conduct research into such problems as turnover and absenteeism, or to discover the most productive places to look for new recruits
5. Training-needs assessment: to analyze the performances of individuals and to determine which employees need further training

#### Selecting an HRIS

An HRIS should be designed to meet the strategic objectives of the organization, and its functionality should be based on the organization's specific needs. Implementing an HRIS can be expensive and time-consuming. Going about it in a careful, organized manner can save valuable resources. The human resource department generally plays a key role in the selection and implementation of an HRIS. Selecting an HRIS may include the following steps:

1. *Assemble a committee.* A project team or committee may be formed with stakeholders representing various areas of the organization. The team may include the following:
  - the HR director/manager, or a designated representative
  - an information technology representative, or possibly multiple specialists representing software, hardware, database management, information security, networking, and web development
  - a payroll/accounting representative
  - an operations manager to represent the day-to-day impact of the HRIS on employees
  - HR specialists representing recruiting, compensation and benefits, training, and career development
  
2. *Conduct needs assessment.* As with any project, the first step in implementing or replacing an HRIS is to assess the organization's needs. A careful analysis should identify
  - the problems the system would be expected to solve
  - the information people need to successfully perform their roles
  - the individuals who need access to the information
  - how the information will be collected

In analyzing the organization's needs, the HR department must also consider and account for the organization's strategic plans. For example, if an organization is expecting substantial growth, the HRIS would need to be expandable. If mergers or acquisitions are forthcoming, the system may need to integrate with other existing systems.

The needs assessment should also take into account the individuals who will be accessing the HRIS, what types of functions they need to perform, and their skill level using technology. These users include

- employees who will use the system to access and update their personal information
- managers and supervisors who will update information based on personnel decisions and will access data for making decisions
- HR analysts who will compile data and generate HR reports
- technicians who will maintain and update the system

The most basic HRIS is simply a database of information about the members of the organization. However, most systems include additional functionality that allows them to efficiently perform a large number of human resource activities. These more comprehensive programs are sometimes called **human resource management systems (HRMS)**. The needs assessment may include an analysis of the organization's requirements relating to the following functions:

- applicant tracking
  - integration with payroll system, or built-in payroll functionality
  - benefits management, including employee elections
  - attendance tracking and time-keeping
  - HRD management and tracking, including integrated training and education
  - performance management
  - career planning
  - succession planning
  - employee communication
  - legal compliance reporting
3. *Define selection parameters.* At the conclusion of the needs assessment, the constraints upon which a decision will be made should be established. These parameters should include:
- detailed functionality requirements based on the needs assessment
  - the budget for program implementation and maintenance
  - the technological resources required
  - the project timeline
  - guidelines for evaluating the options (criteria weighting)

An organization may elect to build its own custom HRIS. This is a costly and time-consuming option, but for large organizations with available resources, it may be preferable, especially if the organization has unique needs. Another option is for the organization to install an open-source HRIS program. Open-source software is free and its source code is accessible via the Internet. This software is available under a no-fee license that permits users to download, modify, and improve the software, and to redistribute it in its modified form. Anyone who wants the source code can get it and adapt it to a specific situation with the expectation that it will then be placed in the public domain for others to use. This collaborative process allows for continuous improvement in the code; as the user base grows, new developments are added, and errors are detected and fixed more quickly. As one might expect, consulting organizations are available (for a fee) to help companies install their free open-source software.

Free HR software programs and Internet-based HRIS systems are also available. Many commercial providers have both free and paid versions. The free versions typically have limits on the number of users and may restrict availability of certain software features. Free software may adequately meet the needs of some organizations, however, and can often be scaled up to more robust functionality as the organization grows or its needs change. While the price tag on free software may appear attractive, free HR software is not really free to the organization. There is still a cost for implementation and maintenance. The time employees spend configuring the software, entering data, and maintaining the system add to the cost of the HRIS, and often organizations require the assistance

of a paid consultant. The computer system or server used to run the software, whether it is on-site or cloud-based, also represents an ongoing cost.

4. *Create a list of available HRIS products.* A wide variety of HRIS products are available. The selection team should compile a list of all viable options. The list may include the possibility of continuing to use the current system.
5. *Evaluate options against criteria.* One approach for doing this is to create a spreadsheet table that lists the program needs and desires in the left column, with additional columns for the HRIS options. Each HRIS is evaluated on each criterion and the result is recorded in the appropriate cell on the table.
6. *Narrow down the options.* Using the selection parameters previously defined, the committee compiles a list of the most promising systems. If an HRIS doesn't meet the organization's basic functionality needs or if it exceeds the budget, it should be eliminated from further consideration. The remaining systems are then evaluated using the criteria weighting established earlier. The list is narrowed down to between five and ten options.
7. *Request bids from vendors.* After narrowing down the list, the vendors with the top systems are contacted and asked to make a bid for the project. This may be accomplished by developing and submitting a **request for proposal (RFP)** to each of the vendors. Sending an RFP is a formal, standardized method of requesting bids. It comprises a document that explains the scope of the project and asks for a bid from vendors with an interest in procuring the job. The RFP should include the following:
  - a description of the organization, including its size, the number of anticipated users, the technological resources, the objectives of the project, and any other information the vendor would need in order to understand the organization's situation
  - a list of system requirements and a request that vendors respond regarding their ability to meet each requirement
  - a request for pricing from the vendor based on measures that could be compared with other vendors (such as price per user or cost of each module)
  - an explanation of the bid procedure, the selection process, and the timeline
  - the bid submission deadline
8. *Ask for a demonstration from the top vendors.* After bids have been collected, the committee can identify the top several candidates and ask for a demonstration of their HRIS. The committee should provide the vendors with a prepared list of the required features it would like to see demonstrated. The committee members should have a standardized method, such as a checklist or scorecard, to evaluate what they like or dislike about each HRIS. The demonstration should include the

system interface for various types of users, access options (personal computer, kiosk, mobile device), data entry functionality, report generation and customization, search features, and on-screen help for users and administrators.

This meeting also provides the opportunity to collect more information from the vendor. Here are some critical questions to ask:

- What new clients have you added in recent years?
  - What is the future direction of the products and how well can you support previous releases? How often are products upgraded and when do clients need to migrate?
  - What percent of revenue goes back into research and development?
  - How are product enhancement requests incorporated into future releases? What is the typical time frame for implementation of requested enhancements?
  - How customizable is the application? (menus, screens, source code, etc.) How do customized applications affect upgrades?
  - How many live installs have you had on the products you are demonstrating?
  - How is the software sold and supported?
  - What is included in the software maintenance fees?
  - What is the standard implementation time frame? How many resources are required?
9. *Check references.* Vendors should be asked to provide a list of current clients who are using the HRIS the organization is considering. Committee members contact these references to verify the functionality of the HRIS and the vendor's service claims. Where possible, committee members should visit the references on-site to see the HRIS in action and to ask questions.
10. *Select a system.* After observing demonstrations and checking references, the committee should be prepared to make a final decision. The systems are compared objectively using the previously-established selection parameters, with the focus on the most highly-weighted criteria.

### **HRIS Implementation**

After an HRIS vendor has been selected, the organization and the vendor should sign a contract detailing the scope and cost of the system. The contract should detail an implementation plan and timeline, as well as provisions for ongoing maintenance, software updates, changes in compliance needs, and hardware upgrades.

An HRIS implementation team should be assembled. It may include members of the HRIS selection committee, representatives from the system vendor, and representatives from the various stakeholders within the organization. The team prepares an implementation plan, which details the schedule, as well as roles and responsibilities. The team should consult with

various user groups and functional areas to ensure alignment with their needs and with established procedures.

After the system's initial installation and configuration, the employee data must be migrated to the new system. This is frequently an automated process, but sometimes manual data entry is required. In either case, the integrity of the data must be verified, so the implementation plan should include provisions for testing data integrity. An HRIS is only as useful as its data is accurate.

The plan should also include system testing to ensure that everything functions the way it should; that users have the proper level of access; that data can be queried, sorted, and displayed; and that employee portals are working properly. It is very important to have the new system functioning properly before abandoning the prior system. This process, called **parallel testing**, involves operating both systems simultaneously for a period of time, perhaps for a month, a quarter, or maybe an entire year, before discontinuing the former system. Inconsistencies between the two systems need to be resolved to make certain that the new system is operating as expected, especially when unique situations arise, such as overtime calculations that include production bonuses, benefits changes, reimbursements for unused vacations, and intermittent leave calculations.

Switching over to a new HRIS can be stressful for employees and managers alike. Organizations must provide proper training for everyone who will use the new system, as well as user manuals and "help" functions. Allowing employees to connect to the old system for a period of time can help assuage stress and anxiety until they are comfortable with the new system. Employees should be encouraged, however, to learn the new system. Sometimes the HRIS team needs to "sell" employees on the advantages and features of the new system and encourage them to embrace the new system well before their access to the old system is terminated.

### **HRIS Maintenance and Evaluation**

Once an HRIS is installed it cannot be left to run on its own. It requires continual intervention. Data in the HRIS needs to be updated regularly, especially as employees join and leave the organization or make transitions within it. The following types of information can help keep an HRIS up-to-date:

- *Employment application.* Virtually every organization collects information as part of its hiring process. The application ought to be designed in part to collect the information needed for a human resource information system. This information includes educational level, skills, and other pertinent biographical data. Some organizations prefer to keep their initial application simple, asking only for information that will help them decide whether an applicant is a desirable job candidate. After a candidate is selected for employment, he or she is then asked to provide more detailed information for the HRIS.
- *Performance evaluations.* Information should be updated periodically regarding the employees' skills and talents, present levels of performance, and potential for growth.

- *Personnel change notices.* Since personnel changes occur throughout the year, this type of information needs to be updated frequently. Changes to an employee's status, such as a transfer, termination, promotion, or upgrading of job duties should be updated in the HRIS.
- *Disciplinary actions.* Information regarding formal disciplinary action should be included in the HRIS. As with other sensitive data, disciplinary information should be protected so only those who have a legitimate need to see it have access.
- *Payroll data.* Human resource information systems often contain each employee's salary history, including base pay, percentage increases for each year, and any bonuses and special awards that have been given.

In addition to keeping employees' data up-to-date, HRIS administrators must maintain the system itself so it remains current. Many systems require periodic updates to account for operating system and internet browsers upgrades. System security is an ongoing concern, and administrators must be vigilant to avoid data breaches.

The HR department should also continually assess whether the HRIS is meeting the needs of the organization. Organizations are not static; they are constantly evolving, and the HRIS needs to evolve as well. For example, when a new company program is implemented or new government reporting regulations are established, the HRIS should be modified or upgraded to support these new needs. It is best to assess the organization's changing needs in a systematic way. One method for accomplishing this is through the use of **gap analysis**, which consists of comparing the current situation to the desired situation and identifying the "gap," or the changes required to reach the desired state. Gap analysis can be used to ensure that the HRIS is meeting the needs of the organization. For example, an HR manager might write a description of the current functionality of the HRIS and then describe the organization's ideal HRIS. Between the two is the "gap," representing the changes that need to take place for the HRIS to meet the organization's needs. The manager develops an action plan to address the required changes.

### 1.4.2 HR Portals

HR portals allow employees to access their own personal information and other company resources either from their own computers or mobile devices, or from kiosks placed in convenient locations. These portals have the advantage of allowing employees to access information whenever they want without having to bother the HR department. Although employees will still call HR when they have difficult questions, much fewer calls are received and many of them can be quickly answered by directing employees to the correct place on the company's website.

HR portals also allow managers to review and approve basic personnel actions, such as terminations, relocations, and salary changes. Managers usually appreciate this self-service arrangements since it allows them greater flexibility and quicker decision-making. These online self-service programs allow managers to have more control over transactional HR tasks, such as reviewing and approving merit bonuses and incentives, learning management

activities, and recruitment functions, including opening requisitions, reviewing resumes, and evaluating candidates.

Many companies centralize their HR functions using a **shared services model**. This model is designed to promote HR expertise and deliver improved companywide services for large diversified companies by administering HR activities that involve interacting with employees through a service center. These service centers provide a central unit for HR-related administrative and transactional tasks that employees, retirees, and business unit managers are able to access through online portals and phones. Effective service centers provide competent HR staff to answer questions and easy-to-navigate information centers that provide immediate information. The benefits of the shared services model come from having standardized services for all business units that can be administered uniformly from a central service center. Although these shared services can be provided in-house, many companies choose to outsource them.

Numerous software programs have been created to provide a variety of HR services and they can be included on a company's HR portal. These programs provide the following kinds of services for employees:

- Personal information, such as skills and work history, can be stored in the company's human resource information systems (HRIS), and employees can access relevant information and update it periodically.
- During the open enrollment period for employee benefits, employees can examine the information regarding their benefits options and make their own decisions. Effective portals provide personalized information to help employees evaluate the options and make informed decisions.
- Employees can access their retirement and savings accounts and manage their investments.
- Employees can participate in wellness and engagement surveys and receive targeted information regarding events and programs of interest to them.
- Training courses can be provided through eLearning modules that track each employee's training history and mastery scores.
- Employees can record their work hours on electronic time sheets.
- Employees can search for applicable HR policies and review the company's employee handbook.

These software programs have traditionally been purchased by employers and loaded on their hardware. The employer is responsible for implementing, customizing, and maintaining the program and the employer controls the data. When there are updates or problems, the employer's IT staff has the responsibility of handling them.

An alternative arrangement, called software-as-a-service (SAAS), is for vendors to make software programs available to employers for an annual fee. The vendor operates the application, maintains the database, and handles updates and security. The employer owns the data and accesses the program through the Internet with a web browser. These arrangements, also called “cloud computing,” allow businesses to escape the high cost of buying software and storing confidential employee information. A major benefit of SAAS arrangements is that they can be installed and updated more quickly because they provide a standardized service for multiple users. The disadvantage is that if they are standardized they cannot be customized for each employer. To the extent that they are customized, the benefits of rapid implementation and updating are lost.

### 1.4.3 Employee Communications

The biggest problem with employee communications is that employees fail to read them, often because they are too time consuming. Elaborate and carefully-written communications often sit untouched on employees’ desks or in mail boxes, and employees claim they were never informed about important information. The likelihood that communications will be read increases, however, when they contain valuable information and they are easy to understand.

Some suggestions for making communications readable <sup>44</sup>

- Use simple language that can be understood by all employees.
- Keep sentences short, normally less than 20 words.
- Keep discussion of each issue to less than one page.
- Use wide margins on all sides.
- Use a graphic whenever it contributes to the explanation.
- Keep the communications short. Handbooks, for example should normally be less than 30 pages. Memos should begin with an executive summary that is less than one page. Additional information should only be added if it is needed. Bulletins need to have clearly-worded headings to let employees know if they should read the subsequent section.

Employers use a wide variety of communication devices, including written memos, bulletin boards, e-mail messages, voice mail messages, and newsletters. An advantage of voice mail and e-mail messages is that they can be simultaneously transmitted to a list of individuals. This list can be edited so that only the designated people receive the targeted information. The disadvantage is that the ease of transmitting information tends to increase the likelihood of communication overload.

An informal communication process over which employers have only limited control are employee blogs (“web logs” containing comments that are posted on an Internet site). Blogs produce a very rapid flow of information, both good and bad, but generally more negative and critical than positive. Companies ought to have a blogging policy; but there is not much they can do. Employers can prohibit employees from blogging during working hours or using the company’s servers to post their blogs, but that does little to prevent employees from posting messages on other servers. It is reasonable for employers to prohibit the posting of

blogs containing trade secrets or client lists. And it is also appropriate to prohibit blogs that harass or demean others. But they cannot prohibit all blogs because that would abrogate their employees' free-speech rights. Information on a blog that disparages the company's products, especially regarding safety concerns, could be construed as protected whistleblower activity or as concerted activity. Therefore, it may not be legal for employers to squelch such communications. Rather than prohibiting blogs, employers may want to read and respond to them. Many creative ideas and opinions are freely expressed there and companies can benefit from them.

Because of the growing misuse of electronic devices and the potential liability accompanying their misuse, employers need to create policies covering the use of technology and consistently enforce them. Examples of inappropriate technology uses include accessing inappropriate web sites at work, sending spam e-mails, violating someone's privacy using a cell phone camera, wasting time surfing the Internet, and playing computer games or gaming. E-mail messages are never permanently deleted and some companies have found that thoughtless e-mails have served as "smoking guns" to incriminate them in harassment suits. The following are some suggestions for a technology use policy.<sup>45</sup>

- Clearly state that all electronic communications are subject to being monitored.
- Explain that all electronic devices and equipment provided by the employer are to be used for business purposes and establish guidelines on inappropriate use.
- Explain that the privacy of electronic communications cannot be assured even with passwords and encryption.
- Establish limits regarding the personal use of technology during work hours, especially regarding texting, Twitter, Facebook, and other social media.
- Establish guidelines on the proper use and dissemination of confidential data.
- Provide guidelines regarding the rights to privacy and how they can be violated.
- Describe the consequences of misusing technology and require employees to sign a statement acknowledging that they understand the policy and agree to have their electronic communications monitored.
- Help employees understand that they are ambassadors for the company's brand and what they write on social media sites may be distributed to the world even if they only share it with "friends."
- Encourage employees to think twice before posting comments that would be embarrassing when read by their CEO, spouse, or family members.
- State that when an individual's employment is terminated, his or her personal devices can be wiped clean of all company data.

#### **1.4.4 Virtual Teams**

Technology makes it possible for groups of people to effectively work together without being in the same location; thus they are called virtual teams. These teams have become increasingly popular among multinational companies who have employees located in distant locations around the globe. The primary advantage of global virtual teams is the company's ability to leverage competencies and skills from all parts of the world. These teams are seen as having the ability to solve very complex problems and create innovative solutions.

Three factors that are essential to the success of virtual teams are effective leadership, motivation, and the ability to communicate. Competent leaders are required to promote trust and maintain effective working relationships among virtual team members. Leaders must create the guiding principles and structure to ensure that the group efforts are coordinated. They also have to identify and define the roles and responsibilities for team members and motivate them through meaningful recognition and rewards. Team members must feel accountable to each other as well as to the leader.

The technologies that allow virtual teams to share information include e-mail, intranets and the Internet, video conferencing, teleconferencing, webcasts, shared electronic whiteboards, and groupware. Shared project management tools can be used to ensure that documentation is consistent and relevant across all team members and enable real-time updates and changes. Instant messaging and text messaging allow all team members to be in constant contact regardless of their locations and time zones. A world clock helps members identify the most convenient times for conference calls. Voice over IP and video chats provide inexpensive ways for team members to communicate and feel a sense of community as they work together.

An effective method for collaborative teams to communicate is through a wiki on the company intranet. A wiki is a knowledge-based site that serves as a repository for existing text documents, spreadsheets, graphics, and other materials that can be accessed and edited by each team member and shared by other team members in a virtual workplace. Wikis are far more efficient than e-mails with attachments for project teams that want to elicit input from each member since the most recent revision is continually available. Although wikis are not appropriate for personal private information, they are ideal for developing shared documents such as strategy documents, job instructions, institutional knowledge, books, and research articles.

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### **Test Your Knowledge**

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at [www.hrcp.com](http://www.hrcp.com). Log into your account and click on My HRCP to access the practice exams.

1. Can you describe the purpose of an HRIS?
2. Can you explain the process for selecting an HRIS?
3. Can you explain the maintenance required for an HRIS?
4. Can you describe the uses of employee portals?
5. Can you explain the use for virtual teams?

~Notes~

## 1.5 ORGANIZATIONAL ENVIRONMENTS

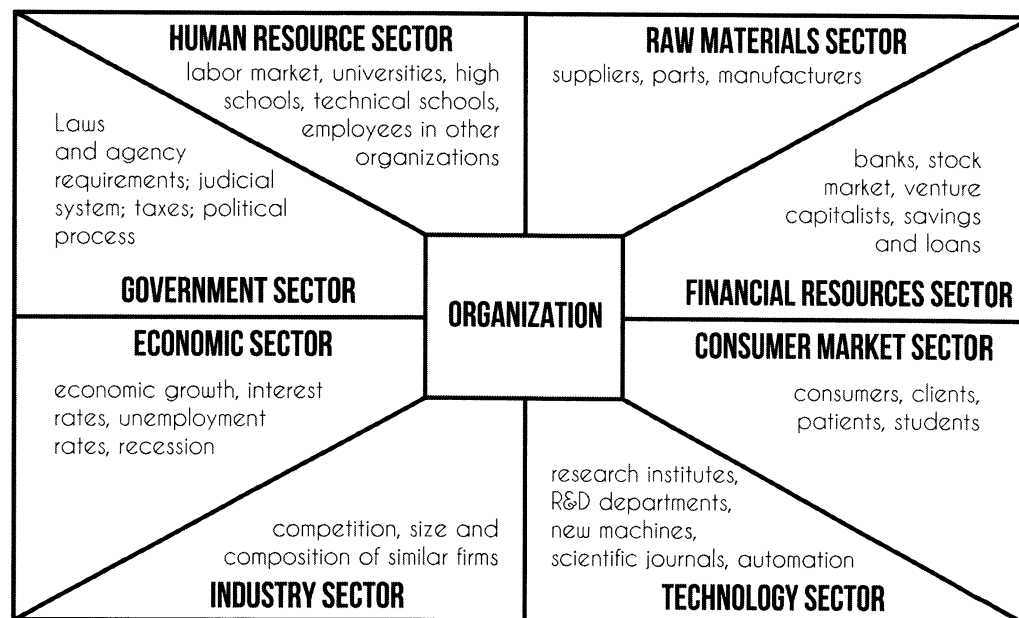
### 1.5.1 Environmental Sectors

All organizations are required to interact with their environment. Organizations depend on their environment to provide the necessary resources and to consume their products. The products must be acceptable to society, and organizations need to obtain a favorable exchange so that they can recycle their products and convert them into new resources.

The survival of an organization can be threatened by public disapproval. An organization can be terminated, or drastically restricted, if society disapproves of its products, the way they are produced, or its failure to comply with social expectations—such as safety requirements, environmental pollution standards, tariff agreements, and other legal requirements. The environment of tobacco companies, for example, has become increasingly hostile because of adverse scientific research, changing social customs, and anti-smoking laws.

In a broad sense, an organization's environment is infinite and includes everything outside the organization. This is called the organization's domain, and it can be divided into sub-environments or *sectors* that contain similar elements.<sup>46</sup> Each environmental sector represents an important segment of the environment that has the potential for influencing the survival and effectiveness of the organization. Eight of the most important sectors are shown in Exhibit 12. In strategic planning, managers need to examine each of these sectors to discover any competitive advantages they can exploit or weaknesses they should avoid.

**Exhibit 12: The Environmental Sectors of an Organization**



1. *Human resources sector:* The human resources sector includes the labor market and all the sources from which potential employees may be obtained, including employment agencies, universities, technical schools, and other educational institutions. Employees can also be enticed from other organizations. Having a thorough understanding of this sector is an HR manager's primary responsibility when participating in strategic management.
2. *Raw materials sector:* Raw materials must be obtained from the external environment. These materials include everything from paper and students for a university, patients for a hospital, iron ore for a steel mill, and insecticide for a farm. The raw materials sector for the auto industry includes a large number of suppliers and parts manufacturers.
3. *Financial resources sector:* Money is an essential input for most organizations and an especially crucial input for a new company. The financial resources sector includes places where needed money can be obtained, such as banks, savings and loan institutions, stock markets, and venture capitalists.
4. *Consumer markets:* The outputs produced by the organization must be consumed by customers who purchase the goods and services. This market sector includes the customers, clients, and potential users of the organization's products and services. For example, hospitals serve patients, schools serve students, supermarkets supply homemakers, airlines move travelers, and government agencies serve the public.
5. *Technology sector:* Technology is the use of available knowledge and techniques to produce goods and services. The technology sector includes scientific research centers, universities, and the research and development efforts of other organizations that contribute to new production techniques and the creation of new knowledge.
6. *Industry sector:* An industry encompasses all the organizations in the same type of business, most of whom act as competitors to an organization. The size of the industry and the number of other competing firms create a unique industry sector for each organization. An industry dominated by one or two major corporations, such as heavy-equipment-manufacturing, is much different from an industry characterized by hundreds of small companies, such as the fast-food industry.
7. *Economics sector:* Organizations are not isolated from economic conditions. The success and effectiveness of an organization is influenced by the health of the overall economy and by such factors as whether the economy is expanding or contracting. Some of the most important aspects of this sector include economic growth, unemployment rates, recessions, inflation rates, and the rate of investment.
8. *Government sector:* The government sector includes all the laws and regulatory agencies that administer these laws and the judicial system that resolves disputes. This sector also includes the country's political system and anyone who tries to change the laws and obtain favorable legislative treatment. An important HR role is influencing proposed legislation that will impact the organization, where appropriate.

### 1.5.2 Environmental Scanning

Environmental scanning involves examining the economic and social forces influencing the organization, especially the long-term composition of the labor force and the future availability of employees. To meet their staffing requirements, organizations depend on the availability of talent. For HR managers, environmental scanning requires a careful examination of all relevant external factors. These factors can be summarized in what is known as a **PEST analysis**, which stands for political, economic, social, and technological:

- **Political** factors refer to the involvement of the government in the organization's environment. The government's influence on employment law, education, tax policy, trade restrictions, public health, infrastructure, and political stability all impact the organization's human resource functions.
- **Economic** factors include the unemployment rate, competition, economic growth, interest rates, and inflation. These factors affect the availability of labor and how businesses operate.
- **Social** factors include the size and composition of the population, immigration, attitudes about careers, work-life balance, and health and safety. Organizations may need to change HR strategies to adapt to various social factors.
- **Technological** factors include advances in technology, innovation, and automation. These factors influence the type of employees needed and the training that may be required.

Each organization is different and the various factors are more or less important depending on the organization's situation, its industry, and its products or services. Some of the most important aspects of environmental scanning are described below in more detail.

#### **Economic Conditions**

Strategic human resource planning is influenced by the overall state of the economy. Interest rates, inflation, fiscal policies, and even the stock market can have a significant impact on a firm's human resource activities. Therefore, human resource managers need to forecast the state of the economy and anticipate how the economy will affect their strategies. Like weather forecasts, economic forecasts are not always accurate; nevertheless, they can be useful for strategic planning. Important economic factors for human resource managers to consider include unemployment levels and inflation.

#### **Unemployment**

Unemployment rates have a dramatic impact on human resource strategies. A labor surplus caused by high unemployment tends to make several human resource functions easier to perform. When there are more workers than jobs, recruiting costs are minimal. Prospective employees readily apply for scarce positions, and employers can choose from a large pool of qualified applicants for each position. Those who are hired during periods of high unemployment tend to be more committed to the company and to quality performance than those who are hired in periods of low unemployment.

A labor surplus also tends to discourage employees from pressing for compensation and benefit increases, since employees are aware that other qualified people are available to take their positions if their requests are unreasonable. For the same reason, disciplinary problems,

absenteeism, and turnover are likely to decrease and equal employment opportunity goals may be easier to reach. Turnover rates and the effects of job dissatisfaction are closely tied to the rate of unemployment. When unemployment rates are high, turnover rates are low because workers are reluctant to leave their jobs, even if they don't like them.<sup>47</sup>

### **Inflation**

Inflation is another variable that has a major impact on human resource strategies. Managing a compensation program is especially difficult during periods of high inflation. Companies in countries with rampant inflation are required to revise their salary schedules weekly or even daily.

When interest rates go up, the cost of capital increases, which reduces the amount of business investment. Therefore, high interest rates tend to reduce employment levels. Employment in the construction and auto industries is especially hurt by high interest rates because consumers use loans to purchase houses and cars.

Inflation is disruptive to an economy and can create severe personal inequities if it gets out of control. Runaway inflation creates as much managerial chaos as it does economic chaos, since wages, salaries, budgets, and human resource planning are severely disrupted.

### **Competition**

Competition occurs in both public and private organizations. In industry, competition occurs when firms vie for a customer's business. For example, when two gas stations are located at the same intersection, price pressures usually result since motorists generally buy more gas from the station with lower prices. Similar pressures also exist among organizations such as hospitals, colleges, and government agencies, where there is competition for scarce resources or clients.

Economic pressure from competition forces organizations to change their human resource strategies. As competitiveness increases, organizations offer fewer rewards to employees. In competitive industries, only the highly successful firms are able to offer high wages and benefits and favorable working conditions. Less effective firms may be severely limited in the wages and salaries they offer, which means they may experience difficulty recruiting and hiring skilled employees. The less successful firms also may not be able to maintain positive worker attitudes, and they may experience higher absenteeism, turnover, and greater pressure from their employees to organize a union than the successful firms.

International competition results in similar job movement, and increased international trade has stimulated foreign competition. Many companies have been forced to close because of their inability to compete successfully with foreign competitors, and many other companies have been struggling to survive.

### **Technological Advances**

Improving productivity is an important human resource strategy in most organizations. One of the most effective ways to increase productivity is through technological advances. Recent decades have seen technological advances in virtually every aspect of business. Automation has transformed the production and transportation of materials. New power tools, assembly equipment, lift trucks, conveyers, automated material management systems, lasers, and

alloys have virtually revolutionized production and distribution. The development of jet freight transportation, containerized shipping, pipelines, and supertankers has changed the way raw materials and goods are moved. Computers are drastically changing almost every aspect of an organization's functioning. Computers acquire, store, manipulate, interpret, and display selected information. Television, fax machines, the Internet, teleconferencing, and the use of microwave and satellite transmission have changed the fundamental patterns of communication in business and government. The use of robots in production activities has changed from fantasy to reality.

The growth of technology and attempts to achieve higher productivity will continue to influence human resource strategies in the future. Many jobs will become automated, and as a result, new jobs will be created to build and service the automated equipment. Training for greater productivity also will create more favorable attitudes among employees and increase their commitment to pride and craftsmanship.

Productivity rates largely determine how effectively companies and nations compete in international markets. **Productivity** is the total goods and services produced by society divided by the total number of employee hours required to produce them.

Productivity improvements have a major impact on economic prosperity. Productivity changes are closely tied to changes in real compensation, which impact a country's standard of living. Increasing productivity is the only sure way a nation can afford to raise wages while

### Labor Force Trends

In many countries, significant shifts in the composition of the population have had a profound effect on the composition of the labor force and the supply of labor. Some futurists have predicted that current social trends, especially declining **birthrates** (number of births per 1,000 population), will lead to severe labor shortages in future years.<sup>48</sup> A severe labor shortage would significantly alter all human resource functions—especially recruitment, selection, training, compensation, and employee relations. It is by no means certain, however, that these shortages will occur. Many forces—especially birthrates, participation rates, education, and immigration—influence the size and composition of the labor force. Disasters such as war and disease are possible influences as well. A change in the death rate would also influence the size of the workforce

Because everyone who will be in the total workforce for the next 20 years has already been born, human resource managers can examine this demographic information to determine its effects on employment patterns. Changes in the **participation rates** can also have a significant impact on the size of the labor force. Participation rate refers to the percentage of people in a specified age and gender category participating in the labor force. Many countries have experienced a rise in participation rates for women, which has led to several other significant social changes. Marriage and childbearing have been postponed, and family income has risen due to the growing proportion of two-income families. A large increase in the number of working women creates a need for innovative human resource programs. Because of family responsibilities, many employees have requested greater flexibility in work schedules.

The long-term availability of labor is influenced by **education** and training levels. Having a labor force with the necessary skills and education is essential for organizations to function.

The availability of skilled labor strongly influences human resource practices. For example, in areas with high illiteracy rates, companies are compelled to provide basic skills training to their employees in order for them to meet the minimum requirement of their jobs.

The size and composition of the labor force is also impacted by a country's **net migration**, which is the number of immigrants who have entered the country minus the number of emigrants who have left. When more people enter a country than leave, a country has positive net migration. Negative net migration means that more people leave than enter. Positive net migration can lead to higher levels of unemployment if the country's labor market remains steady and cannot supply jobs for the increased number of workers. Negative net migration can lead to labor shortages, which can be particularly acute when those leaving tend to be highly-skilled and well-educated.

### **Government and Regulatory Agencies**

An easily overlooked consideration in environmental scanning is the impact that government and regulatory agencies might have on the availability of labor, especially the effects of educational programs and immigration. Laws act as constraints on what human resource managers can do. For example, labor relations laws allow employees to organize unions and require employers to bargain with them in bilateral decision making. Compensation and safety laws regulate the hours and working conditions of employees. Discrimination and disability laws require employers to consider hiring individuals who have often been denied employment and make reasonable accommodations for them to work. Companies that violate the law can be forced to pay expensive fines, promote certain individuals, and change their employment practices to correct past errors.

## **1.5.3 Aligning HR Functions with Organizational Contexts**

Organizational strategies help organizations adapt to the specific demands they face in their environments. However, all organizational environments are not the same, and different environments call for different HR strategies. Some organizations enjoy a fairly stable world while others face growing uncertainty. Environmental uncertainty stems from two variables: (a) the complexity of the environment and (b) how rapidly the environment changes.

### **Environmental Uncertainty**

Organizational environments can be complex or simple. In a complex environment, the organization is required to interact with numerous external elements, such as suppliers, vendors, customers, community groups, regulatory agencies, financial institutions, labor unions, and former employees.<sup>49</sup> Simple environments contain very few external elements. An example of a simple environment is a family-operated chicken farm that sells most of its eggs to one food chain. Automobile companies, however, have very complex environments because they interact with hundreds of external vendors, suppliers, dealers, customers, and partners that often cross national boundaries.

The rate of change for an organization may be fast or slow, depending mostly on technological advances and consumer preferences. Some organizations, such as universities and paper products companies, have a rather stable environment because they have provided the same services or produced essentially the same products for decades. Other

organizations, such as electronics companies, experience multiple product changes each year and have highly unstable environments.

The combination of complex versus simple environments and fast versus slow change produces four different organizational environments, as shown in Exhibit 13. These environments create different kinds of organizations that can be called institutional, entrepreneurial, flexible, and proprietorship. These four environments require very different human resource management practices.

**Exhibit 13: Organizational Environments**

<b>RATE OF CHANGE</b>	Rapid	Entrepreneurial Organizations	Flexible Organizations
	Slow	Proprietorship Organizations	Institutional Organizations
		Simple	Complex

**ENVIRONMENTAL COMPLEXITY**

*Institutional Organizations:* Large organizations that have many external contacts, but are not subject to rapid change, are called institutional organizations. Most bureaucracies are institutional organizations because they create stable policies and procedures that members are expected to follow. If they are effective, stable policies and procedures help the organization interact with its multiple external elements and improve the organization’s operating efficiency.

Stable human resource functions are appropriate for stable bureaucracies. Formal programs for recruitment, selection, evaluation, promotion, compensation, and discipline are appropriate for institutional organizations. These human resource activities tend to be rather elaborate and sophisticated because they are carefully developed over time and they do not change much because of the stable environment. The policies and procedures are normally written in an employee handbook.

*Entrepreneurial Organizations:* When they are first created, many entrepreneurial firms enjoy a relatively simple environment with limited external relationships. Even though their environments are changing rather rapidly, their limited number of external contacts provides an element of stability and predictability that cushions them until they become much larger.

Because they are small, most entrepreneurial organizations have informal human resource functions, including informal hiring, compensation, and evaluation. People hire their friends, pay them whatever it takes to attract them, and tell them when they make mistakes. These decisions are usually made by supervisors and managers without the aid of consistent

policies, which eventually leads to enormous discrepancies that call for uniform procedures to establish equity and consistency.

*Flexible Organizations:* Flexible organizations have to survive in chaotic environments filled with complex relationships and rapid change. Most large corporations that compete in international markets have been forced to become highly flexible. To facilitate innovation and stimulate the implementation of creative ideas, flexible organizations are moving toward more decentralized decision making by groups of workers who work in teams.

Flexible organizations require flexible human resource functions that allow employees to work in teams and be selected, evaluated, and rewarded as a group.

*Proprietorship Organizations:* Many small organizations have a simple environment that is relatively stable. These organizations include family businesses, local merchants, shopkeepers, repair garages, franchise operations, and crafts shops.

The human resource functions in small proprietorships are usually very informal, if they exist at all. Some human resource decisions may be based on criteria that are not related to work. In family businesses, for example, decisions about hiring, compensation, discipline, and promotion are usually based on family considerations rather than work performance. In small family businesses these practices are usually considered acceptable. Small businesses with less than 15 employees are even exempted from most state and federal employment laws.

### **Reducing Uncertainty**

Because uncertainty threatens organizational survival and reduces its effectiveness, organizations use a variety of strategies to reduce environmental uncertainty. Most of these efforts focus on gaining greater control over environmental resources. The first two strategies listed here, however, involve internal changes within the organization.

1. *Changing the organizational structure:* As the environment becomes more complex, the organization needs more buffering departments and boundary spanners. In a stable environment, the internal structure can be centralized and can operate according to fixed rules and procedures. When the environment is unstable, however, the organization's structure must be informal, decentralized, and coordinated by the efforts of many individuals whose specific responsibility is to facilitate this control.
2. *Planning and forecasting:* Organizations can increase their capacity to respond to an unstable environment by forecasting environment changes and creating contingency plans. Planning can soften the adverse impact of external shifts. Organizations that have unstable environments frequently create separate planning departments to help the organization adapt successfully. For example, economic forecasting may not change the economy any more than weather forecasting can change the weather. However, a good economic forecast may be as helpful to organizational planning as a weather forecast is for scheduling a company picnic. An interesting paradox regarding economic forecasts is that their accuracy increases as the environment becomes more stable, but their usefulness increases as the environment becomes more unstable. Although forecasts in an unstable environment are not as accurate,

- they are nevertheless more useful because they identify the important contingencies and the relationships between them. Furthermore, forecasts can always be updated.
3. *Mergers and acquisitions:* An effective method of controlling environmental resources is to buy a controlling interest in an upstream or downstream company that serves as a supplier or consumer. If there is uncertainty about the source of a crucial raw material, this uncertainty can be removed by buying the supplier. For example, steel companies have acquired iron and coal mines, and soft drink manufacturers have acquired bottle makers. A similar method of controlling environmental resources is through joint ventures and contracts that create a legal and binding relationship between two or more firms. In a joint venture, organizations share the risks and costs associated with large projects. Contracts are designed to provide long-term security for both the supplier and the consumer of raw materials by tying the consumer and the supplier to specific amounts and prices. For example, McDonald's Corporation will sometimes acquire an entire crop of potatoes to be certain of its supply of french fries.
  4. *Cooptation:* **Cooptation** is any strategy of bringing outside people into the organization and making them feel obligated to contribute because of their organizational involvement. Cooptation occurs when leaders of important environmental sectors are brought into the organization by having them serve on an advisory committee or a board of directors. Cooptation explains why organizations in more uncertain environments tend to have larger boards of directors—a larger board can reduce uncertainty to a greater degree.<sup>50</sup> Some organizations reduce their resource uncertainty by creating a formal linkage called an interlocking directorate in which the members of the board of directors of one company sit on the board of directors of another company. These individuals influence the policies and decisions of each organization in ways that guarantee their cooperation. Another form of cooptation is to recruit executives from another interdependent organization. For example, companies in the aerospace industry hire retired generals and executives from the military to help them obtain better information about technical specifications and to improve their chances of obtaining defense contracts.
  5. *Public relations and advertising:* Organizations spend enormous amounts of money to influence consumer tastes and public opinion. Advertising and public relations activities are designed to reduce uncertainty by providing a stable demand for the company's outputs or a constant level of inputs. Press reports and other news media shape the company's image in the minds of suppliers, customers, and government officials. Organizations use public relations and advertising in new ways or amounts when such methods seem capable of producing better results. Hospitals, for example, have begun to advertise their services to attract more patients.
  6. *Political activity:* Since laws and government enforcement can exert such a powerful influence on organizations, many of them spend a considerable amount of money trying to influence those who make the laws. They try to protect the interests of the organization by making members of governing bodies aware of the interests of the organization and the consequences of a proposed law. Many organizations have formed trade associations for similar purposes. By pooling their resources,

organizations expect the associations to have a larger voice in laws and influencing new regulations, developing public relations campaigns, and blocking unfair competition.

7. *Illegal activities:* Although it is wrong, many organizations resort to illegal activities to control environmental uncertainty. Scarce environmental resources and pressures to succeed, especially from top managers, often lead managers to behave in illegal ways. Some examples of illegal behaviors include bribes and payoffs, illegal political contributions, promotional gifts, illegal kickbacks, price fixing, illegal mergers, franchise violations, refusals to bargain in good faith with a union, and espionage in market development and innovations.

Although organizations usually try to adapt to the environment, some try to change and control the environment. This is especially true of large organizations that command large resources. The environment is not fixed. Organizations can adapt when necessary, but they can also neutralize or alter a problematic sector in the environment. Although the potential of significantly influencing the environment is small when organizations act alone, a group of organizations can make a noticeable change within the environment when they act in concert.

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### Test Your Knowledge

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at [www.hrcp.com](http://www.hrcp.com). Log into your account and click on My HRCP to access the practice exams.

1. Can you list and describe eight important environmental sectors?
2. Can you describe environmental scanning and the factors that are typically analyzed?
3. Can you explain what organizations can do to reduce uncertainty?

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## 1.6 ORGANIZATIONAL DESIGN AND DEVELOPMENT

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As part of their responsibility for the management of strategic human resources, HR managers are expected to play an important role in making organizational design decisions and knowing how to redesign ineffective structures. How organizations are designed has an enormous influence on their efficiency and effectiveness and the quality of life for their employees.

Organizational structure refers to the relatively fixed relationships that exist among the jobs in the organization. The process of creating this structure and making decisions about the relative benefits of alternative structures is called organizational design.

**Efficiency** refers to how well an organization creates products from the materials and energy used to produce them—it is a ratio of inputs to outputs. **Effectiveness** refers to the entire cycle of obtaining inputs, transforming them into useful products, selling them, and obtaining more inputs. Effectiveness includes the efficiency of internal processes and how well the organization interacts with its environment in selling products and winning public acceptance.

The creation of an organizational structure requires an organization to respond to two basic issues: (a) *differentiation*, or how to divide the work into specialized jobs, and (b) *integration*, or how to coordinate what has been divided. Therefore organizational structure examines the manner in which an organization divides labor into specific tasks and achieves coordination among these tasks.

Five design decisions are involved in creating an organizational structure. These design decisions involve (1) departmentalization, (2) the delegation of authority, (3) coordinating mechanisms, (4) division of labor, and (5) span of control. A matrix structure is usually a unique combination of two forms of departmentalization—function and product.

### 1.6.1 Functional Versus Product Departmentalization

#### Functional Departmentalization

All of the jobs associated with performing a particular function can be grouped together into the same department. For example, all of the jobs associated with accounting such as general ledger accountant, accounts payable clerk, accounts receivable clerk, and cost accountant could all be combined into an accounting department. All of these jobs perform similar activities and are related to a similar function that requires training in accounting. Organizing the departments by function would be a homogeneous form of departmentalization since everyone in the department shares the same specialized skills. Other forms of departmentalization tend to be market-based and are more heterogeneous.

Functional departmentalization is the most widely used scheme in organizations because of its efficiency. This explains why a manufacturing company is typically departmentalized according to production, marketing, finance, accounting, research and development, and human resource departments. Most hospitals are departmentalized in terms of such functions as surgery, nursing, psychiatry, pharmacy, human resource, and housekeeping.

The functional basis of departmentalization contains both advantages and disadvantages. Perhaps the most significant advantage is that it promotes skill specialization by having people who face similar problems and opportunities work together. The functional form also permits the maximum use of resources and encourages the use of specialists and specialized equipment thereby eliminating the duplication of equipment and effort. Communication and performance are usually improved because superiors share expertise with their subordinates.

The disadvantages of functional departmentalization are that it reduces communication and cooperation between departments and fosters a parochial perspective. This narrow orientation limits managers' capacities for coordination and encourages a short time horizon. Functional departmentalization has often led to a problem referred to as *suboptimizing*. Suboptimizing is said to occur when one department pursues its own goals and tries to look good at the expense of other departments or the organization as a whole. Suboptimizing is particularly critical when departments are rewarded for achieving their own goals. Although departments should be rewarded for helping other departments, many departmental goals can be achieved better by each department pursuing its own selfish interests. Custodial departments, for example, could keep the buildings cleaner if no one used them. Likewise, the accounting and human resource departments could generate better reports if managers spent all their time completing lengthy forms. Coordination and support across functional departments often become difficult because departments are separated both geographically and psychologically and members come to view problems only from their limited functional perspectives.

### **Product Departmentalization**

Product departmentalization consists of combining jobs that produce similar products into a department. This type of departmentalization typically occurs in large firms when it becomes difficult to coordinate the various functional departments. A product-oriented department allows its employees to develop greater expertise in researching, manufacturing, and distributing a specific product line. Managers have better control over the success or failure of each product if the authority, responsibility, and accountability are assigned according to products. This type of departmentalization is illustrated by the "brand management" structure that Proctor and Gamble uses with its major products.

The product basis of departmentalization also includes both advantages and disadvantages and is often contrasted with functional departmentalization. The major advantage of product departmentalization is that it creates greater interdepartmental coordination and focuses the efforts of the department on producing an effective and useful product. Companies organized by product are generally more customer-oriented and their employees tend to be more cohesive and involved in their work.

The major disadvantage of organizing by product is that the resources and skills of the organization are not fully utilized unless the organization is extremely large. For example, a computer-driven lathe machine that is only used for one product and sits idle much of the time represents an inefficient use of capital resources. Another disadvantage is that product-oriented departments usually lead to increased costs because of the duplication of activities, especially staff functions.

### 1.6.2 Centralized Versus Decentralized Decision Making

The issue of centralization versus decentralization concerns the delegation of authority and how broadly it is distributed through the organizational hierarchy. Decentralization refers to the extent to which various types of power and authority are extended to supervisors and the production employees at lower hierarchical levels of the organizational structure. The more decentralized an organization, the greater the extent to which the rank and file employees can participate in and accept responsibility for decisions concerning their jobs and other activities of the organization. The amount of authority delegated to subordinates can vary along a continuum from highly centralized to highly decentralized.



Most of the literature discussing the delegation of authority emphasizes the advantages of a decentralized structure. Increased decentralization often leads to greater organizational effectiveness since it allows for greater autonomy and responsibility among employees at lower levels in the hierarchy, thereby utilizing more effectively an organization's human resources. Supervisors in decentralized organizations typically report higher levels of job satisfaction and involvement, and they tend to be more productive because of increased autonomy and responsibility.

Companies that have allowed operating divisions to make more decisions have often found that this strategy contributes to significantly higher earnings and the development of new products. Decentralized decision making also encourages managers to improve their professional competence and makes the organization more responsive to customer needs.<sup>51</sup>

In spite of the benefits of decentralization, however, it is not universally superior and does not always contribute to greater organizational effectiveness. Several weaknesses of decentralization have been noted, suggesting that centralized decision making is sometimes superior.

1. Decentralization makes it more difficult for certain shared functions, especially staff functions, to be executed.
2. Decentralization can create jurisdictional disputes and conflicts over priorities since each unit essentially becomes an independent area.
3. Decentralization requires greater competence and expertise on the part of decision makers and requires greater commitment and involvement on their part.
4. Decentralized decisions made by many lower level managers create difficult problems of coordination and integration. An organization may become completely ineffective due to a lack of high level coordination and integration.

To avoid the disadvantages of decentralization, organizations can either impose centralized, standard operating procedures or rely on organizational culture to maintain control. A strong organizational culture creates a homogeneous set of assumptions and decision premises that





### 1.6.5 Span of Control

The span of control issue asks how many individuals should be placed in a group under one supervisor: What is the appropriate size of a work group? The number of subordinates assigned to each supervisor could vary along a continuum from few to many.



The span of control decision has a major influence on the organization's shape and structure. Organizations that use a broad span of control are flat, having relatively few hierarchical levels because many people work under the authority of a single supervisor. Where the span of control is narrow, however, each manager supervises only a few subordinates, thereby creating a tall organizational structure.

A tall organizational structure with a narrow span of control allows for closer control over subordinates and greater personal contact between manager and subordinate. The risk, however, is that a manager with a narrow span of control comes to know only two or three subordinates very well and fails to become acquainted with others in the hierarchy. Consequently, tall organizations often inhibit interpersonal communication within the organization.

During the 1940s and 50s several management scholars were interested in prescribing the ideal span of control. One scholar calculated the geometric increase in the number of relationships a manager must supervise as the span of control increased and concluded that the maximum span of control should never exceed three or four subordinates.<sup>53</sup> In actual practice, however, several organizations had spans of control that exceeded 20 subordinates, and they seemed to manage them effectively. Consequently it was concluded that the appropriate span of control should vary with the nature of the tasks being performed.<sup>54</sup> Although a range of between four to six subordinates is often recommended, a much larger span of control may be appropriate depending upon four situational variables.

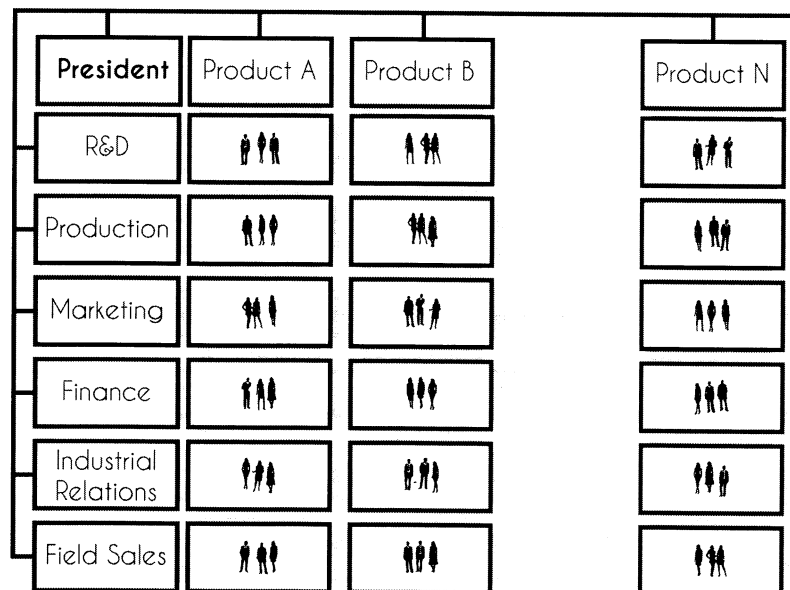
1. *Contact required:* Jobs that require frequent contact and a high degree of coordination between superior and subordinates should use narrower spans of control. For example, jobs in medical technology and research and development often require team members to consult frequently with a supervisor; therefore, a large span of control would preclude the necessary sharing of ideas and information that typically occur on an informal basis.
2. *Level of subordinate education and training:* The skills and competence of subordinates influence how much supervision they need and whether the span of control should be broad or narrow. Highly skilled employees and professionals who are well trained generally require less supervision because they know their jobs well and they largely supervise themselves.

3. *Ability to communicate:* Instructions, guidelines, and policies can be communicated to employees in a variety of methods. If all of the necessary instructions can be written and then disseminated, it is possible for one manager to supervise a large group. However, as communication becomes more difficult and job-related discussions become more important, a narrower span of control is appropriate to avoid overloading a supervisor.
4. *Nature of the task:* Jobs that are repetitive and stable require less supervision and are more amenable to wide spans of control. For this reason some field supervisors are able to supervise as many as 60 to 75 field hands in harvesting agricultural crops. However, when tasks are changed frequently a narrower span of control is appropriate.

### 1.6.6 Matrix Structures

Many organizations have found that a combination of functional and product departmentalization provides the best reporting relationships and horizontal linkages enabling them to achieve their organizational goals. This dual structure simultaneously organizes part of the organization along product lines and part of the organization along functional lines to gain the advantages of both. The simultaneous overlapping of these two functions is referred to as a matrix organizational structure. Although other types of departmentalization could be used to form a matrix organization, the most typical type of matrix structure is a combination of function and product as illustrated in Exhibit 14.

**Exhibit 14: Matrix Organizational Structure**



In a matrix organization, each department simultaneously reports to both product and functional managers. The product managers and functional managers have equal authority within the organization and employees report to both of them. For example, a member of the legal department may be assigned to assist with the development of a specific product and

assume the responsibility for all of the legal activities associated with the development, production, and distribution of this product. This individual would report to both the product manager and the supervisor of the legal department.

Although a dual hierarchy may seem awkward and unusual, it represents an effective structure in some situations. A matrix organization can quickly create new products or new responses to improve technical quality, while retaining the benefits of its product and functional basis of organization. Consequently, a matrix structure is particularly effective when environmental pressures create a demand for both technical quality (functional) and frequent new products (product). These dual pressures require a balance of power which calls for a dual authority structure to reflect the environmental pressures. A matrix structure is particularly useful in an uncertain environment. Frequent external changes and high interdependence between departments require effective linkages between departments within an organization.<sup>55</sup>

The disadvantage of a matrix structure is that it increases role ambiguity, stress, and anxiety by assigning people to more than one department. These disadvantages have been referred to as a “matrix tax.”<sup>56</sup> Matrix structures violate the principle of unity of command. The employees who work in a matrix structure often feel that inconsistent demands are made upon them, causing unproductive conflicts and short-term crisis management. Occasionally employees abuse the dual authority structure by playing one manager against another to generate excuses for their incompetence or inactivity.

### 1.6.7 Evaluating the Effectiveness of an Organization’s Structure

#### Line Versus Staff Functions

When examining different organizational design decisions, a distinction is made between line and staff activities. *Line activities* refer to functional activities directly related to the principal work flow of an organization. In a manufacturing firm, for example, all production-related activities—such as engineering, stamping, assembling, painting, inspection, and shipping—are considered line activities. *Staff activities*, however, are supportive activities that provide service and advice to line personnel. These activities include the human resource functions, in addition to the activities of the legal and accounting departments.

As a staff function, human resource activities have a responsibility to support the line activities. All of the line departments must be fully staffed with people who are adequately trained and compensated. Their performances must be evaluated and employee relations problems must be solved. It is the responsibility of the HR department to perform these activities.

How a human resource department should be organized to provide these activities must be determined by the structure of the organization and the demands placed on it by its environment. There are no universal prescriptions regarding the best way to structure either an organization or the HR activities within it. The best design depends on the amount of uncertainty and the technological demands placed on it by its environment.

### **Mechanistic Versus Organic Structures**

Two significantly different organizational structures are called mechanistic and organic structures. A *mechanistic structure* would be considered a bureaucracy that is characterized by homogeneous functional departmentalization, centralized decision making, formal rules and control mechanisms, and highly specialized jobs. A mechanistic structure is the ideal structure for an organization in a very stable environment that mass produces products or services that seldom change. It is also appropriate for large stable bureaucracies, such as some government agencies.

An *organic structure* is much more flexible and is characterized by heterogeneous product departmentalization, decentralized decision making, informal rules and control mechanisms, and highly enlarged jobs. Organic structures do not have rigid lines of authority or reporting relationships; people work largely unsupervised, either alone or in groups. An organic structure is ideal for an organization that has a very unstable environment with rapidly changing consumer preferences and markets. As explained earlier, bureaucratic and organic structures call for significantly different HR strategies.

The central issue in evaluating how well an organization is designed is to examine how well the structure processes the information it needs to function effectively. Information flows into the organization from various environmental sectors, and the organization must respond and adapt to this information. The more rapid the changes in the external environment, the greater the necessity for incoming information.

The consequence of environmental uncertainty on managers is an increase in the flow of information that leads to a communication overload. In essence, the organization becomes inundated with exceptional cases requiring individual attention. As a greater number of non-routine demands are made on the organization from the environment, managers are increasingly required to be more involved in the day-to-day operations. Problems develop as plans become obsolete and the various coordinating functions break down. An effective organization requires a structure that allows it to adapt to such situations.

Organic structures are able to deal with greater amounts of uncertainty than mechanistic structures. Organic structures have more highly connected communication networks that permit the efficient use of individuals as problem solvers and increase the opportunity for feedback. Because highly connected networks are relatively independent of any one individual, they are less sensitive to information overload or saturation. But while organic structures are able to deal effectively with greater amounts of uncertainty than mechanistic structures, there are costs associated with being able to process more information. Organic structures consume more time, effort, and energy and are less subject to managerial control. Thus the benefits of increased efficiency and capacity to process information must be weighed against the costs of less control and greater effort and time.

Organizations in a dynamic and complex environment cannot rely on traditional information processing and control techniques where all information is communicated through a chain of command. Changes in market demand, uncertain resources, and new technology disrupt the organization's plans and require adjustments while the task is being performed. Immediate adjustments to production schedules and task performance disrupt the organization. Coordination is made more difficult because it is impossible to forecast operations or revise

standard operating rules or procedures: Organizations must acquire information that reflects the environmental changes.

The basic idea is that organizations face different amounts of work-related uncertainty. To be successful, they must match their information processing capacity to their information processing requirements. Since different structures have different capabilities for processing information, organizations must deal with this uncertainty by creating appropriate structural arrangements. Organizations with modest demands for processing new information should adopt a mechanistic structure while organizations with extensive information processing requirements and communication overloads should adopt an organic organization.

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### **Test Your Knowledge**

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at [www.hrcp.com](http://www.hrcp.com). Log into your account and click on My HRCP to access the practice exams.

1. Can you compare and contrast functional and product departmentalization?
2. Can you explain division of labor and span of control?
3. Can you describe the matrix structure and explain the advantages and disadvantages to this structure?

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## 1.7 ORGANIZATIONAL CULTURE

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Organizational culture consists of those socially acquired rules of conduct that are shared by members of the organization. Some researchers believe that some aspects of an organization's culture are so intangible and pervasive that even the members of the organization cannot be expected to describe them accurately. Nevertheless, an understanding of organizational culture is essential to building effective organizations. Like the powerful undercurrents of ocean tides and rivers that move mighty ships, or the hidden icebergs that can destroy these ships, an organization's culture affects the entire organization. Human resource activities play a central role in creating and maintaining an organization's culture.

Culture defines the basic organizational values and communicates to new members the correct ways to think and act and how things ought to be done. Culture enhances the stability of the organization and helps members interpret organizational activities and events. The focus of culture is to provide members with a sense of identity and to generate within them a commitment to the beliefs and values of the organization.

### 1.7.1 Climate versus Culture

Each organization has its own unique constellation of characteristics and properties that comprise its culture and climate. Although these terms are used interchangeably and refer to similar phenomena, a subtle distinction is often made regarding their permanence: **culture** generally refers to organizational rules and beliefs that are relatively enduring and resistant to change, whereas **climate** describes characteristics that are temporary and capable of being changed. The weather has been used as a popular analogy to explain these differences. Like daily weather patterns, organizational climate (employee attitudes) can fluctuate from time to time because of organizational changes. Culture, however, is like the seasons of the year; the seasons change slowly over time and are associated with stable and enduring weather characteristics that transcend daily variations. Climate typically refers to people's attitudes and how they feel about the organization. While climate can be measured quantitatively by asking employees to complete a climate survey, culture is usually measured qualitatively using the ethnographic research methods from anthropology. Most of the opinion surveys that are administered by human resource managers would be considered climate surveys.<sup>57</sup>

### 1.7.2 Levels of Organizational Culture

Organizational culture is difficult to understand because it includes virtually every aspect of the organization and the most important elements of culture are not visible. Culture can be studied from four very different levels of analysis: artifacts, norms, values, and underlying assumptions.

**Cultural artifacts** are tangible aspects of culture – the behaviors, language, and physical symbols – that we can perceive with our senses and that reflect the rules and core beliefs of the organization's culture. Many of these symbols are readily apparent to anyone who visits an organization and observes its surroundings, such as the furnishings in the buildings and the dress and grooming standards of the employees. Ceremonies and rituals are also illustrations of cultural artifacts that reflect the rules governing behavior in the organization.

**Shared norms** are the situation-specific rules that are often not directly visible but can be inferred from the organization's artifacts. Key norms can often be determined by the degree of consistency in how group members act. For example, if the majority of team members report to committee meetings five or ten minutes late, we can infer that being on time is not an important norm. Some norms are explicitly defined in employee manuals along with penalties for violating them.

**Cultural values** represent the collective beliefs, ideals, and feelings of members about the things that are good, proper, valuable, and right. Unlike the situation-specific nature of norms, values are broader rules that are applied across situations. Values are often identified in statements of corporate values or management philosophy.

Companies have multiple values and four criteria are used to examine their usefulness: values should be viable (feasible in the current business environment), balanced (relative to the importance of each other), aligned (consistent with each other), and authentic (sincerely and genuinely espoused). If a value, such as "respond immediately to every patient request" is not feasible, then it is not viable. If undue emphasis is placed on it while other values are suppressed, it is not balanced. If it is inconsistent with other values, it is not aligned. And, if no one really believes in it, it is not authentic.<sup>58</sup>

When members behave in ways that are inconsistent with the organization's values there is a discrepancy between the "ideal values" and the "real values." This discrepancy may be so great that it causes people to become disillusioned with the organization and has a negative impact on morale. For example, employees experience cynicism and low morale when a company publicly says that it values "serving the customer" but fails to provide employees with the necessary training or resources to serve customers well.

**Shared assumptions** provide a foundation for how people think about what happens in organizations and represent the deepest level of culture. These assumptions represent beliefs about reality and human nature that are taken for granted and are deeply embedded in the way we understand and interpret daily life. Consequently, shared assumptions are the most difficult to study. Some examples of shared assumptions are whether we think people are basically good or bad, whether we think relationships should be hierarchical or equal, and whether we think we are masters of our environment or we should live in harmony with the environment.

Human resource policies are a reflection of these shared assumptions. For example, when HR managers assume that the employees are lazy and can't be trusted to do their work, they rely on a variety of control mechanisms, such as time sheets, spot checks, and harsh punishment for mistakes. These artifacts reflect norms and values of distrust and high control on the part of the HR manager. The culture of a firm would be quite different, however, if it were based on the assumption that all employees could be trusted to work hard and make significant contributions to the organization. Uncovering these tacit assumptions is an important part of cultural analysis.

### 1.7.3 Development of Culture

Since culture involves a complex configuration of shared artifacts, norms, values, and assumptions, it cannot simply be dictated by top management. Indeed, many researchers argue that the pronouncements and speeches of top management have a very small impact on the real things that reflect an organization's culture – its ceremonies, stories, symbols, and slogans.<sup>59</sup> An organization's culture is not created by any single person or event, but by a complex combination of forces that include the visions of the founders, the expectations of leaders, the contributions of organizational members, and the way the organization has historically responded to problems of internal integration and external adaptation.

#### Expectations of Founders and Leaders

Founders have a large influence on the culture of an organization, especially in the beginning. Their expectations, their decisions, how they treat people, how they spend their time, and what they value have a major impact on what employees value and how outsiders perceive the organization. Unless the founder's influence becomes institutionalized, however, the impact of a founder diminishes as the organization grows.

Later in the life of the organization, its culture will reflect a complex mixture of the assumptions and values of the founder as well as other early leaders. Current leaders can also have a significant impact on creating or changing an organization's culture, especially by the example they set. Because leaders are so visible, their actions and comments are observed by people both in and out of the organization. The leadership style of a CEO is often imitated by other managers and supervisors throughout an organization. Great transformational leaders have the capacity to create a new vision and inspire members to change how they think about the organization.<sup>60</sup>

#### Member Contributions

The members of an organization bring with them their own personal cultures which come from their families, their communities, their religions, any professional associations to which they belong, and their nationalities. Since the actions of members impact an organization's culture, it is constantly changing in small ways as people come and go. Some individuals are cantankerous, unhappy souls who find endless opportunities to complain. These people create an unpleasant work environment that is very destructive and difficult to change as long as they are there. Other individuals are unselfish and altruistic and find genuine satisfaction in performing random acts of kindness. These people create a happy and satisfying work environment that is contagious and spreads to other coworkers.

#### Historical Accommodations

Every organization has to confront two major challenges that impact the development of its culture: (a) external adaptation and (b) internal integration.<sup>61</sup> **External adaptation** refers to the way an organization survives by coping with a constantly changing external environment. Some of the most important issues that demonstrate external adaptation are: What major crises has the organization confronted and how did it deal with them? How has the organization changed its strategy, structure, technology, or leadership to accommodate external changes? How did these changes affect the organization?

**Internal integration** is concerned with establishing and maintaining effective working relationships among the members of an organization. Internally, organizational culture helps to define the criteria for the allocation of power and status. Every organization establishes a pecking order and rules for how members acquire, maintain, and lose power. These rules help members manage their expectations and feelings of aggression. The criteria for allocating rewards and punishments are also defined by the organizational culture. The legends and myths let members know which behaviors are heroic or sinful – what gets rewarded with status and power and what gets punished through withdrawal of rewards or termination.

### 1.7.4 Maintaining Organizational Culture

Organizational cultures are maintained by a combination of many forces, especially (a) the selection and retention of employees, (b) the allocation of rewards and status, (c) the reactions of leaders, (d) the rites and ceremonies, (e) the stories and symbols, and (f) the reactions to crises.

#### **Employee Selection and Discipline**

Organizations tend to hire people who match their culture; they want employees who will fit in and adapt to the organization's culture. Recruitment and selection procedures are designed to identify not just the specific skills and talents of job applicants, but also their personalities and interests. The organization then maintains its culture by disciplining or even terminating employees who consistently deviate from accepted norms and practices. Thus, discipline procedures also become an important instrument for maintaining cultural values.

Other human resource practices also help to reinforce the organization's culture. For example, the values of a company can be controlled by those who establish the criteria for evaluating employees, decide which managers get promoted, set the standards that determine how pay increases are granted, and present the orientation training. These practices become known throughout the organization and serve to maintain or change an existing culture.

#### **Reward and Status Allocation**

An organization's reward system can either maintain or change its culture. The rewards and punishments attached to various behaviors convey to employees the priorities and values of both individual managers and the organization. A dramatic change in an organization's reward system can make a significant change in its culture almost overnight.

#### **Leader Reactions**

Although it is rather subtle, what managers pay attention to is one of the more powerful methods of maintaining organizational culture. Administrators perform a variety of symbolic activities that influence the power relationships in organizations. The following is a list of symbolic actions that explain what leaders can do to increase their personal power and exert greater influence in an organization.

1. *Spend time on activities that are important.* The amount of time an administrator spends on an activity communicates a message regarding the importance of that goal or function.
2. *Change or enhance the setting.* A new setting conveys the feeling that something new is happening. An enhanced setting with more elaborate furnishings generally means that the activity is more consequential and important.
3. *Review and interpret history.* Events have meaning only through our interpretations of them. The most important interpretations are those derived from a historical analysis that demonstrates a consistent line of meaning and direction. If current events appear to be consistent with historic trends, it is easier to obtain a consensus on a chosen course of action. For example, wage cuts and extra hours are more acceptable if it can be shown that the employees have always responded with loyalty and sacrifice during hard times.
4. *Establish a dominant value expressed in a simple phrase.* A simple phrase, one that reflects a dominant value and is easily remembered, can influence the behavior of organizational members by creating a consensus about appropriate behavior. For example, a simple slogan such as "Pride in performance brings excellence in service" can mobilize support for greater organizational commitment and dedication to work.

### **Rites and Ceremonies**

Rites and ceremonies provide opportunities to reward and recognize employees whose behavior is congruent with the values of the company and they are conducted for their benefit. They are also special occasions when managers can reinforce specific values and beliefs. These occasions provide an opportunity to recognize heroes and induct them into the organization's hall of fame.

### **Stories and Symbols**

Organizational stories have a profound impact on culture regardless of whether they are true or false. Most stories are narratives based on true events that are shared among employees and told to new members to inform them about the organization. Some stories are considered legends because the events are historic, but may have been embellished with fictional details. Other stories may be **organizational myths**: not supported by facts, but directionally consistent with the values and beliefs of the organization. Stories are important because they preserve the primary values of the organization and promote a shared understanding among all employees.

A symbol is something that represents something else. In one sense, ceremonies, rites, and stories are symbols because they represent the deeper values and assumptions of the organization. Physical symbols are often used in organizations to represent and support organizational culture because they focus attention on a specific item and because they are so powerful. Recognition awards, for example, are much more valuable than their economic value because of what they symbolize. The value of physical symbols is that they communicate important cultural values. If the physical symbols are consistent with the ceremonies and stories, they are a powerful facilitator of culture.

### **Reactions to Problems**

The way managers and employees respond to a crisis reveals much about an organization's culture. When problems arise and employees do not have standard operating procedures

telling them what to do or an opportunity to consult upper management to seek direction, they are forced to rely on their understanding of the organization's culture to do what they think is best.

The way managers and employees respond to a crisis also has the potential to create or change an organization's culture. The way in which a crisis is handled can either reinforce the existing culture or generate new values and norms that change the culture in some way. For example, a company facing a dramatic reduction in demand for its products might react by laying off or firing employees. This reaction would communicate an important message that people are not very highly valued, regardless of how reasonable the terminations were or how well they were explained. Or the company might reduce employee hours or pay and ask employees to sacrifice temporarily while the company experienced an economic correction.

### 1.7.5 Changing Organizational Culture

Most cultural interventions are actually attempts to clarify the culture of the organization. These interventions are typically conducted with top-level managers in the organization in a series of group discussions that focus on such questions as "What is our unique mission?" "What do we want to be known for?" and "What are the ten commandments of this organization?"

Changing an organization's culture is considerably more dramatic and difficult than modifying other parts of a system. Acquiring new artifacts and symbols may not be too difficult; it may even be possible to change some group norms and patterns of behavior. But at the deepest level, a culture change requires alteration of the basic assumptions of the organization in its essential character. The following steps have been suggested for changing an organization's culture.<sup>62</sup>

1. *Conduct a culture audit.* The first step involves diagnosing the culture and subcultures within the organization. What are the current values and behaviors and are there discrepancies between espoused beliefs and actual behavior? The goal of the diagnosis is to develop an accurate "map" of the culture, which generally requires extensive interviewing rather than written surveys.
2. *Assess the need for change.* Change is needed if the current culture is not solving problems of integration or adaptation, or if it is harming people in the organization. As organizations grow and evolve, their cultures may become incompatible with the changing circumstances. Values and beliefs that may have been appropriate for a smaller company may be dysfunctional in a larger company.
3. *Unfreeze the current culture.* Change efforts are much more successful when there is a perceived need for change that compels people to consider something new. Most instances of significant cultural change are not planned; they accompany sudden and cataclysmic events, such as the death or retirement of the founder, a decision to merge or sell the business, dramatic changes in growth or profitability, major technological changes, or fundamental changes in the strategy or structure. These events tend to "unfreeze" or destabilize the entire cultural system and prepare it to consider a major restructuring of the assumptions, values, and beliefs.

4. *Elicit support from the cultural elite.* Top management and other opinion leaders compose the “cultural elite” in an organization; they are the ones who interpret events for members and establish the rules of conduct.
5. *Implement an intervention strategy.* Possible interventions include team-building meetings, revising the training and development activities, installing new reward systems, changing the organizational structure, rewriting the mission statement, creating new group norms, developing a new language and metaphors, and negotiating new roles. The replacement of key individuals who hold the “old” beliefs may also be necessary.
6. *Monitor and evaluate.* Cultural change is incremental and rarely occurs quickly. A system for monitoring and evaluating the transition to a new set of values and beliefs can provide an ongoing process of transitional change.

### 1.7.6 Creativity and Innovation

Every organization requires creativity and innovation to avoid becoming stagnant and obsolete. Organizations that resist innovation and change are doomed to fail, regardless of how successful they are in the beginning. As the environment changes, organizations require new ideas and creative insights to adapt. Creativity is also a vital part of international competition; U.S. companies rely on creativity and innovation to compete successfully in the world economy.

Creativity is defined as an ability to produce original, inventive and valuable ideas or concepts. Innovation refers to the process of making these ideas useful. So whereas creativity may result in new approaches to solving problems, innovation is the process of turning them into products and services that will actually be used.

#### The Creative Process

We often make the mistake of assuming that creativity is the result from sudden flashes of insight that come to a few highly intelligent people. Experience indicates, however, that creative insights do not come to just highly intelligent people; creativity seems to be widely distributed throughout the general population. Although some people have more creative talent than others, apparently everyone has some degree of creativity and it is a talent that can be developed.

Experience also indicates that creativity seldom comes from sudden flashes of insight that occur without any preparation or contemplation. The creative process involves the cognitive manipulation of elements already known to the individual. This cognitive manipulation involves the nonverbal association of symbols in ways that produce unique combinations. Four phases are typically observed in the creative process.

1. **Preparation.** Creative insights do not simply flash unexpectedly like bolts of lightning. Instead, creativity is usually preceded by much hard work in collecting information and studying the situation. Many creative insights are a combination of two or more bodies of information that become associated in new and unique ways. Unless individuals have thoroughly mastered these bodies of knowledge, they are not prepared to combine them in new and insightful ways. Creativity requires a high degree of motivation because of the necessary preparation.

2. **Incubation.** The period of incubation is described as a period of relaxation or withdrawal from the intense preparation period. This period has sometimes been considered a period of unconscious thinking where the person is actually thinking without being aware of it. After being so intensely immersed in technical details during the preparation period, the person now stands back and tries to gain a clearer perspective.
3. **Insight.** Insight occurs when people begin to discover new associations and patterns that provide a useful solution to a problem. Occasionally insight comes as a sudden flash of inspiration in which the solution to the problem is obvious. More frequently, however, the creative insight comes from a partial solution that motivates the person to pursue the problem until it is completely solved.
4. **Verification.** Verification involves testing, refining, demonstrating, and communicating the creative ideas following the insight period. Additional insight frequently occurs during verification as the initial insight is tested for accuracy and usefulness and is translated into a form that allows it to be shared with others.

Although these four phases are described as a sequential process, there is usually an interaction between them. Partial insights frequently occur during the preparation phase as new ideas are stimulated and possible associations are conceived. Insights are further refined during the verification as the person realizes that alterations and revisions are necessary.

### **Stimulating Creativity**

One way to increase creativity is to hire people with a history of creativity. Another way is to train current employees in the creative process. Both of these methods have produced mixed results. The best way to increase creativity appears to be creating a supportive climate that fosters exploration and rewards new insights. A supportive climate is essential for creativity to flourish. Reasonable time constraints and deadlines also contribute to creativity and often produce a flurry of creative ideas as the deadline approaches. Occasionally, tight deadlines force people to make rash decisions and an extension of time may generate a better solution.

On the other hand, creativity is inhibited by defensiveness, fear, and anxiety; few creative ideas will likely occur in an oppressive climate with punitive supervision and excessive criticism of mistakes. If the organization ignores, belittles, or punishes creative expression, then creative abilities will not be manifest.

While an oppressive climate inhibits creativity, a stimulating and supportive climate can facilitate creativity by providing the flexibility and autonomy needed to explore ideas and test them. Knowing that new ideas are valued and will be tried is a great stimulus to employees to express their ideas. Creativity can also be stimulated by forming heterogeneous work teams with diverse backgrounds. The organization should provide opportunities for the members to meet and share ideas. Conferences, luncheons, and informal gatherings allow members to interact, explore new discoveries, and share information.

The Center for Creative Leadership provides these tips for developing a more innovative organization: <sup>63</sup>

- Create a mandate for change and back it with a strategy that embraces innovation.
- Model the behaviors and activities necessary for a more innovative organization.
- Communicate challenging strategic issues as a way to promote collaboration and seek creative ideas.
- Create highly diverse teams to develop novel ideas.
- Give people access to tools, methods, and experiences that help them think differently about problems and solutions.
- Design and build systems that nurture innovation.
- Champion innovative ideas that push internal barriers.
- Remove hurdles to innovation, including internal policies and destructive criticism.

### 1.7.7 Developing a Culture of Inclusion

According to a recent study, organizational goals for diversity, which are often established in response to claims of discrimination or as part of an affirmative action plan, can actually be destructive to the very individuals these goals are intended to help.<sup>64</sup> Diversity programs seek to improve the representation of groups that are currently underrepresented in the organization. The programs may include training opportunities, targeted recruiting, and preferential treatment for these groups. While these programs may improve the representation of women and minorities in the organization, they can also have unintended consequences. Other employees may infer that women and minorities are less qualified for positions that they hold and that they represent unfair competition for positions and promotions. As a result, minorities and women may feel excluded, disliked, or unwanted.

In the absence of a culture of inclusion, employee groups targeted by diversity initiatives may fail to fully integrate into the organization, which can prove counterproductive. Studies show that when diversity is sought for the sake of diversity, with no regard for inclusion, companies have lower revenue, lower performance, poorer employee morale, increased conflict, and higher levels of absenteeism. But when diversity initiatives are combined with a culture of inclusion, diversity leads to higher performance, lower absenteeism, better customer satisfaction, and higher levels of innovation.<sup>65</sup> That said, inclusion is often a difficult goal. While diversity, or the lack thereof, can be measured, and deficiencies can be addressed by policy changes at a departmental or organizational level, a culture of inclusion is difficult to quantify and often requires changes in individual attitudes and behaviors.

Many diversity initiatives include training that focuses on teaching employees to avoid overt discrimination, actions that are illegal, or behaviors that may be considered offensive. While these are important issues, this type of training can lead to behavior that feels mechanical, forced, or inauthentic, where the focus is on avoiding offense rather than behaving in a way that makes others feel wanted and valued. Diversity and inclusion interventions that focus

on self awareness help employees recognize their own biases and their behaviors that may be perceived as exclusive rather than inclusive.

The Equality and Human Rights Commission describes the characteristics of an inclusive workplace:<sup>66</sup>

- There is a welcoming workplace culture where everyone is treated with respect and dignity and everyone feels valued.
- Policies are in place concerning equality and human rights, working conditions, dignity at work, employee welfare, and fair recruitment and procurement practices.
- Members of staff at all levels are aware of the inclusive values of the organization and are actively consulted and involved in policy development.
- The workforce is representative of the local community or customers (or if not, under-represented groups are encouraged to apply).
- All employees are encouraged to develop and progress, and any barriers faced by specific groups are identified and action taken to address them.
- Unnecessary hierarchies and occupational segregation, where groups of employees are congregated into certain areas, are discouraged.
- The organization is aware of any potential tensions within the workplace, and takes action to anticipate and address them.
- Inclusive strategies are fully supported and promoted by senior staff.

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## Test Your Knowledge

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at [www.hrcp.com](http://www.hrcp.com). Log into your account and click on My HRCP to access the practice exams.

1. Can you explain the difference between organizational climate and culture?
2. Can you list and explain the four levels of organizational culture?
3. Can you describe how an organizational culture develops?
4. Can you list the forces that contribute to maintaining an organization's culture?
5. Can you describe the steps for changing an organization's culture?
6. Can you explain the difference between creativity and innovation?
7. Can you list and describe the four phases of the creative process?
8. Can you explain how an organization can stimulate creativity among its members?
9. Can you describe the characteristics of an inclusive workplace?

~Notes~

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## 1.8 GLOBAL HR MANAGEMENT

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The world is shrinking. Due in large part to technological advances, the economies of individual countries have become increasingly integrated. Organizations of all types are influenced by the global economy. As organizations become more globalized, human resource practices within those organizations must adapt to the global environment. Human resource managers play a key role in global business by helping their organizations develop global business strategies based on strategic analyses such as SWOT and PEST, define the organization's unique global competencies, and formulate sound global human resource policies and practices.

### 1.8.1 Globalization of Business

The United Nations estimates that there are 100,000 multinational enterprises (MNEs) worldwide, with more than 890,000 foreign affiliates. These multinationals employ more than 200 million people around the globe.<sup>67</sup> Almost all organizations are influenced in one way or another by globalization.

Many factors contribute to the growing globalization of business:<sup>68</sup>

- *Trade agreements.* New markets have continued to open as trade restrictions have been eliminated and international trade has been supported by tax incentives and free trade zones.
- *Search for new markets and reduced costs.* Companies that desire to expand their reach often find new markets in other countries.
- *Rapid and extensive global communication.* The development of the Internet and mobile phone technology have made it possible to communicate farther, faster, and cheaper with employees, affiliates, subsidiaries, and suppliers all around the world. Mobile and satellite communications have advanced rapidly into areas where traditional telecommunications technology infrastructure has not reached.
- *Rapid development and transfer of new technology.* The development and sharing of new technology increase demand for products and possibility for production in an ever growing number of locations.
- *Improving global education and global talent pool.* As access to education increases, companies are able to find the talent necessary to produce their products across the globe.
- *Increased travel and migration.* Greater opportunities for travel have increased awareness about goods and services available elsewhere, which has increased global demand. As individuals migrate to other countries for work, they take their unique skills and abilities with them into other labor markets.

- *Knowledge sharing.* As companies increase their global reach, they share their philosophies and values, as well as their products, services, and technologies.
- *E-commerce.* Using a company website, organizations can sell their products to customers all over the world who have access to the Internet.
- *Homogenization of culture and consumer demand.* While countries and regions retain their unique cultures, global demand has increased for certain products and services, and some aspects of culture have integrated around that demand.

### 1.8.2 Stages of Global HR Management

Human resource managers usually don't jump head first into global HR management; the process comes in stages. International HRM depends greatly on a company's degree of globalization. Companies with very limited foreign involvement do not have the same complex HR policies that global corporations have. The human resource policies and programs in each company need to coincide with its degree of globalization. At least three distinct phases of globalization can be defined with their respective international HR practices.

#### **International Import-Export Firms**

The first stage of globalization is when a firm simply moves products across national boundaries. It does not employ people in other countries, except for a few managers who are responsible for negotiating business agreements. These agreements usually involve buying or selling complete products or services. Import-export firms are required to understand the cultures of their trading partners and usually they have to overcome communication barriers to negotiate agreements. Negotiations are usually done by expatriate representatives, but the use of expatriates is rather limited. HR policies and practices remain relatively unchanged from their traditional home base practices.

#### **Multinational Enterprises (MNEs)**

The second stage of globalization is when a firm has strategic corporate units located in foreign countries. Part of its goods or services may be produced in one country, then possibly moved to another country for additional assembly, and ultimately distributed to other countries to be sold by employees of the firm.

MNEs typically require extensive use of expatriate managers who are sent from headquarters to oversee foreign operations. Expatriate managers play important strategic roles. They coordinate between subsidiaries and headquarters, implement strategy, ensure the quality and effectiveness of organizational control systems, manage global information systems, and gain expertise in international business skills that are crucial to ensuring that top executive positions are filled by competent replacements who have the necessary international experience and perspectives.<sup>69</sup>

Hiring workers in foreign countries requires multinational enterprises to create and administer HR practices that are adapted to each country. Some of the most significant HR issues for MNEs are hiring and training a foreign workforce, complying with the foreign

country's employment laws, monitoring labor costs, and selecting expatriates and helping them and their families succeed in the new assignment.

### **Global Firms**

The final stage of globalization is when a firm has strategic corporate units in multiple countries that interact both with the headquarters and with each other. Specialized functions may be performed in different countries, such as engineering in one country, research in another country, and production in another. People and products are moved extensively across national boundaries to meet the demands of the firm.

Global firms have a moderate use of expatriate managers. Other professional employees may also be asked to relocate. Expatriate managers provide leadership and continuity in the various divisions and these foreign assignments help managers in their career development. Foreign assignments are considered essential for progression to higher levels of leadership.

Global firms attempt to create a global culture that ties people to the organization and helps to coordinate the dispersed elements. Consequently, global firms try to establish global HR policies with a minimum of country-specific adaptations.

### **1.8.3 Other Global HR Structures**

Although many organizations become increasingly global by moving through the stages described above, several other approaches to globalization are possible.

#### **Born Global**

Some organizations are **born global**, meaning that rather than progressing through the stages of globalization, they are formed as global firms from the outset. These organizations, also called global start-ups, are often in the information technology industry, where their products are web-based and involve global networking. Human resource functions in these organizations may involve the acquisition of global talent, the management of international travel, and the coordination of teams comprised of members from diverse countries.

Skype is an example of a company that was born global. It was founded in 2003 by Niklas Zennström, from Sweden, and Janus Friis, from Denmark, with software that was created by Ahti Heinla, Priit Kasesalu, and Jaan Tallinn, from Estonia. Skype is headquartered in Luxembourg, but has 500 employees in offices around the world. Skype is designed to provide an Internet-based platform for video chat, voice calls, and text messages. It comes bundled with dozens of languages, and the system can manage tens of millions of concurrent users online. Skype is now owned by Microsoft.

#### **Off-shoring**

Off-shoring is when an organization relocates one or more of its processes to another country, usually to save on costs. The off-shore entity is fully owned by the company, but it is staffed by local employees. Often some employees from the home country, usually managers and technical or operations experts, are relocated, at least initially, to help the foreign entity get up and running. The HR department will need to perform all of the same functions as before the move, but with the added challenge of operating under a different country's legal system

and managing employees from another culture. HR managers will also need to manage expatriate assignments and coordination with the head office.

For years, companies have been moving operations to other locations to find less expensive labor in countries such as Taiwan, South Korea, China, India, and Singapore. Over the last couple of decades, however, the cost of employing unskilled labor in these Pacific Rim countries has increased. Meanwhile, the cost of unskilled labor in Mexico has actually declined. Many multinational companies have opted to build plants along the 2,000-mile border shared by Mexico and the United States. These plants, known as maquiladoras, provide both cheap labor and convenient access to the United States. But along with their benefits, maquiladoras also provide some significant human resource challenges.

Strategically staffing a maquiladora is difficult in spite of the fact that unskilled labor along the Mexican/US border is abundant. If 50 job openings are announced on Friday, 500 people apply by Monday. But turnover is very high, as much as 30 percent per month in some maquiladoras. Many of the workers come from the interior and quit work to return home to deal with family problems. Family-related issues are the most common reason given for turnover and absenteeism. Two-thirds of the maquiladora workers are young women between the ages of 16 and 25. Many work only until they marry and start a family. A number of the male workers are only using the maquiladora as a stopover on the way north. Most employees have no previous manufacturing experience, so training can be costly in a workforce that has an extremely high rate of turnover.

To take advantage of the low wages, maquiladoras must be able to contain the costs of turnover and training. The first step is to develop a recruiting plan that increases the qualified labor pool instead of relying on employees to refer friends or family, or posting notices outside the buildings.

Most maquiladoras base the employment decision on one interview. Those that are the most successful in managing the turnover rate, however, use a more comprehensive screening process, including physical examinations, intelligence tests, and dexterity tests. High performers are channeled into positions for which they are best suited.

### **Global Outsourcing**

Global outsourcing is similar to off-shoring in that one or more processes is moved to another country. The difference is that with outsourcing, the firm contracts with a foreign company to perform the process, rather than relocating an entity owned by the firm. Some companies outsource the entire production process of their products. Others outsource just a portion of their process, such as customer service or computer programming. In an organization utilizing outsourcing arrangements, HR may be called upon to administer the contract; HR managers would need skills and experience in managing international contractual arrangements and navigating cross-cultural relationships.

When Nike was founded in 1964, only four percent of footwear sold in the United States was imported. Nike's founder believed that the company could find cheaper labor overseas but still provide a quality product. That model has proven effective. All of Nike's shoe manufacturing is outsourced to companies in other countries, principally in Asia. Other shoe companies have taken note. Today, 98 percent of footwear sold in the U.S. is imported.

Contracting with foreign manufacturers, however, has not been without its problems. Nike has been severely criticized because of the labor practices of some of the factories that produce Nike merchandise. In order to repair and maintain its reputation, Nike has enforced child labor restrictions and safety standards in the factories with which it contracts.<sup>70</sup>

### 1.8.4 Approaches to Global HR

The leadership philosophy and expectations for employee conduct in a multinational enterprise are strongly influenced by the orientation and strategic direction embraced by the organization's headquarters. The degree to which the organization's headquarters dominates and directs the activities of its subsidiary units, which may be located in many other countries, can be described by the following concepts:

#### **Ethnocentric Approach**

Ethnocentrism is the mindset where the organization's managers and executives use the standards and practices of the organization's home country as the prime reference for governing and guiding the organization's international activities. Often this outlook lends itself to highly centralized decision-making and strong, detailed control over distant operations. Managers with an ethnocentric mindset are prone to implement an international business strategy in which the parent-firm maintains centralized control, where key leaders and managers share a common ethnic background, and where the organization's headquarters seeks to incorporate and replicate the systems, values, procedures, and structure of the parent-firm in all their subsidiary units abroad.

An ethnocentric approach enhances a singular corporate culture and a unified way of doing business. It may also enhance the transfer of knowledge or key competencies into foreign countries and may compensate for a lack of qualified employees or managers in a foreign operation. This ethnocentric approach, however, may limit career advancement for citizens of the host nation—leading to attrition, lack of motivation, or lessened productivity. It may also create resentment or inefficiencies where the unit fails to “fit” with the complexities and nuances of the host country in areas including culture, marketing, and legal matters.

#### **Polycentric Approach**

Polycentrism is the mindset where the organization's managers and executives increasingly use the standards and practices of the host countries where their subsidiaries are located as key references for governing and guiding the organization's international activities. Often this outlook lends itself to decentralized decision-making, even to the degree that wholly owned subsidiaries may be participating in autonomous functions or unique operations. Managers with a polycentric mindset are prone to have an international business strategy that encourages coordination between, and similarities in management and structure among, units of the organization that are located in adjacent countries, countries with cultural similarities, or countries in the same region.

#### **Regiocentric Approach**

Regiocentrism, a concept closely related to the idea of polycentrism, is when organizations group subordinate units geographically (Pacific Rim, Central America, East Asia, etc.) such that coordination between and communications within these regional subgroups is more

frequent, and often more important, than communications between any of these subsidiaries and the parent-firm or the organization's headquarters.

A polycentric or regiocentric approach may provide opportunities for better integration of the business into the host country, including attracting talented local employees and the reducing operational costs because there is less need to relocate managers from the country where the business is headquartered. Such an approach, however, can lead to limited opportunities for employees, beyond senior positions in their own subsidiary, and the danger of an eventual cultural or communication gap developing between outlying entities and the organization's headquarters or the central leadership of the organization.

### **Geocentric Approach**

Geocentrism is the mindset where the organization's managers and executives develop a transnational strategy that is adapted to and adopted in each of the regions or countries where the organization is based. Instead of mandates and conformity, individual units are more individualized and have greater freedom to implement best practices and standards from the area where they are based, ideas from other units of the business (regardless of their location), or even from other entities. Managers with a geocentric mindset are prone to see themselves as part of an integrated network, or a multi-faceted team, that transcends national borders or regional constraints.

A geocentric approach enhances the ability of an organization to integrate the best person for the job anywhere in the organization, and, over time, can lend itself to the creation of experienced and well-seasoned global executives who are capable and comfortable working in a number of different countries and cultures. There are drawbacks, however, including the increased costs (and potential employee dissatisfaction) associated with relocating employees, as well as the legal, social, and tax implications of employees immigrating to foreign countries where they are assigned.

The spectrum from ethocentrism to polycentrism/regiocentrism to geocentrism moves from centralized control and imitation, to regional morays and adaptation, to interdependence and innovation.

## **1.8.5 Impact of Globalization**

Globalization is having a large impact on human resource functions. The increased flow of consumer goods across international boundaries has produced a similar flow of human capital across national boundaries in the form of immigrants and knowledge workers. The globalization of consumer and labor markets has compelled businesses to respond more quickly to change.

Labor flows across international boundaries, especially from developing countries to industrialized countries, are influenced by both economic conditions and global demographics. High levels of unemployment, especially among young workers, lead many of them to immigrate to countries with better job opportunities. Poverty, likewise, prompts many to leave for better conditions, unless they are too poor to gather the resources needed to move.