THE DUAL THEORY OF HUMAN RESOURCE MANAGEMENT AND BUSINESS PERFORMANCE: LESSONS FOR HR EXECUTIVES

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Introduction

Contemporary human resource management (HRM) research, including studies based on North American, European and Asian data, finds that certain "high involvement" type HRM (HIHRM) practices have significant positive effects on such business performance measures as market value, rate of return on capital employed, revenue growth, revenue per employee, productivity, product/service quality, and even organizational survival (see Lewin, 2004). That HIHRM practices "leverage" business performance appears to be well known to human resource (HR) executives.

HIHRM practices, however, constitute only one way of managing human resources to leverage business performance. Another way to achieve enhanced business performance is by managing human resources for expense control. Consequently, certain "low involvement" HRM (LIHRM) practices may best fit some organizations and employees. Taken together, HIHRM and LIHRM practices form the building blocks for a dual theory of HRM and business performance, with consequent lessons for HR executives.

The Dual Theory Elaborated

Consider that a business's work force is comprised of two distinct segments, namely, a core and a periphery (Lewin and Mitchell, 1995). Members of the core work force are typically employed full-time, paid a regular salary or wage, covered by fringe benefits, have training, development, and promotion opportunities along well-defined career paths, and participate in decision-making through work teams and a decentralized organization structure. The core work force is also typically carefully selected, has employment security and some performance-based pay, and is regularly provided information about the business. Far different from the core work force is the peripheral work force, which consists of part-time, temporary, contract, vendored, and/or outsourced "employees" who are generally paid a fixed wage, salary or lump sum, are partially or not at all covered by fringe benefits, and have little or no training, development or promotion opportunities. The peripheral work force also typically does not participate in decision-

making through work teams or organizational decentralization, has little performance-based pay or employment security, and receives little business-specific information.

This core-peripheral work force distinction provides the conceptual foundation for the dual theory of HRM and business performance. Expenditures on the core work force should (present accounting conventions aside) be treated as an investment intended to increase the value added to the business by employees in this segment. Expenditures on the peripheral work force should (following present accounting conventions) be treated as an expense that the business seeks to contain or reduce and, in this way, also add value to the business. In both instances, the key task facing the business is to maximize return, or value, over cost. Ideally, applying HIHRM to core employees and LIHRM to peripheral employees should, for example, result in larger profit margins than would result from following conventional HRM practices in which there few or no distinctions are made between core and peripheral employees. Is there evidence to support this dual theory of HRM and business performance? Yes, as briefly summarized below.

HIHRM/LIHRM Employee Coverage and Business Performance

A recent study that sampled 289 (U.S.) companies, 313 company business units, 457 manufacturing plants, and 249 sales and service field offices of a national insurance company found that HIHRM practices were applied significantly more to core employees than to peripheral employees (Lewin, 2004, 2001b).[1] Among eight specific HIHRM practices—employment continuity, selective hiring, training/development, teams/participation, variable pay, performance management, promotion opportunity, and business information sharing—that provided the basis for this comparison, each was significantly more widely used for core than for peripheral employees. Collectively, these HIHRM practices were two and one-half times more likely to be used for core than for peripheral employees (with means of 4.1 and 1.5, respectively, for “all practices” on a 1 = low, 5 = high rating scale). Therefore and despite variation among the sampled businesses in their uses of HIHRM practices, it appears that peripheral employment is low involvement employment and that core employment is high involvement employment.

This same study also analyzed LIHRM practices for their effects on business performance. In doing so, an index of LIHRM practices was constructed that measured the proportion of an organization's work force consisting of part-time, temporary, and contract employees as well as employees who were placed with vendors and employees leased from outsourcing firms.[2] The data for determining the LIHRM index score at a point in time (1998) and changes over time (1995-1998) came from surveys administered to each company, business unit, manufacturing plant, and sales and service field office. Business performance data were obtained from secondary sources in the cases of the company and business unit samples, and from the surveys in the cases of the manufacturing plant and insurance company field office samples. The variation in performance among each of the four sets of business entities was then subjected to multivariate analysis that included the LIHRM index as the main independent variable and several control variables (as examples, organizational size, capital-labor ratio and unionization). The main findings from this quantitative analysis are as follows.

For the company sample, the LIHRM index was positively associated with return on capital employed, market value, and revenue per employee in the single-year analysis, and with changes in each of these business performance measures in the multi-year analysis. These findings imply that a one standard deviation increase in LIHRM was associated with a significant 1.5 percent increase in return on capital employed, a 2.7 percent increase in market value, and a 3.2 percent increase in revenue per employee. For the business unit sample, the LIHRM index was positively associated with return on capital employed and revenue per employee, both at a point in time and over time. These findings imply that a one standard deviation increase in LIHRM was associated with a significant 2.2 percent increase in return on capital employed and a 4.1 percent increase in revenue per employee in these business units.

For the manufacturing plant sample, the LIHRM index was negatively associated with total labor cost as a proportion of total operating cost at a point in time and with the change in this operating performance measure over time. These findings imply that a one standard deviation increase in LIHRM was associated with a significant 5.8 percent reduction in manufacturing plant labor cost as a proportion of total operating cost. Notably, the LIHRM index was not associated

with productivity or product quality at a point in time or over time. In other words, and contrary to expectations, these manufacturing plants apparently did not experience lower productivity or product quality as a result of employing peripheral workers and managing them with LIHRM practices.

For the insurance company field office sample, the LIHRM index was negatively associated with the ratio of payroll cost to sales revenue, both at a point in time and over time. These findings imply that a one standard deviation increase in LIHRM was associated with a significant 4.8 percent decrease in the ratio of payroll cost to sales revenue in these field offices. By contrast, the LIHRM index was not associated with revenue growth, quality of service, or customer satisfaction. Consequently, and again contrary to expectations, these insurance sales and service field offices apparently did not experience lower revenue growth, service quality, or customer satisfaction as a result of employing peripheral workers and managing them in a low involvement fashion.

These four analyses were then extended to include an eight-item HIHRM index, which was found to be positively associated with long run (that is, changes in) company financial performance, short and long run business unit financial performance, and short and long run manufacturing plant operating performance. Most important, and in each case, the LIHRM index remained positively associated with business performance measures when these businesses' use of HIHRM practices was taken into account. Therefore, it appears that LIHRM practices also "leverage" business performance.

Lessons for HR Executives

These empirical findings support the dual theory of HRM and business performance, especially because HIHRM and LIHRM practices are typically used by a business simultaneously. To illustrate, among all the business entities included in the aforementioned study (n = 1308), more than 95 percent reported having some peripheral employment (in 1998), and their average score on the HIHRM index, which ranged from 8 to 40, was 25.5. Therefore, most businesses make use of core employees to whom HIHRM practices are applied and peripheral employees to

whom LIHRM practices are applied. Since both types of HRM practices have positive effects on business performance, an important lesson for HR executives it that a can business manage one segment of its work force by investing in HIHRM practices and obtaining net value added, and also manage another segment of its work force through LIHRM practices that serve to "add value" through labor expense control.

Given this conclusion, one can ask, "Is there an optimal balance of core and peripheral work force segments for a business?" To answer this question, additional quantitative analysis was undertaken in which the ratio of peripheral employment to total employment for each business entity in each of the four samples served as the dependent variable, and the various business performance measures served as independent variables—in effect, "reverse" regression analyses. The findings showed that better performing companies, business units, manufacturing plants, and insurance company sales and services field offices, made greater use of peripheral employment than poorer performing companies, and also increased their use of peripheral employment significantly more than poorer performing companies.

These findings do not, however, mean that business entities should simply or linearly continue to increase their ratios of peripheral employment to total employment. This is because when the company, business unit, manufacturing plant, and sales and service field office samples were separated into quartiles based on changes (during 1995-1998) in their financial performance, the top performing quartile in each sample had an average ratio of peripheral employment to total employment of .34 compared to ratios of .17 for the worst performing quartile, .26 for the second-worst performing quartile, and .40 for the second-best performing quartile. In other words, the gain in business performance from increased use of peripheral employment was greatest when the ratio of peripheral employment to total employment rose from about one-quarter to one-third; increases in the ratio beyond this point were associated with declining business performance. The lesson for HR executives, therefore, is that a balance of one-third peripheral employment and two-thirds core employment appears "optimal."[3]

The findings from LIHRM-business performance research also provide lessons for HR executives about globalization, organizational change and the HR function. Regarding

globalization, there are many countries in which certain HIHRM practices apparently "don't fit" because they run afoul of cultural values, custom, history and legal constraints. Variable pay, business information sharing with employees, and decentralized, team-based work are among such practices. Similarly, certain LIHRM practices, such as part-time, fixed contract and outsourced employment, don't appear to fit well with many nations. Yet it was only recently that these HIHRM and LIHRM practices were virtually unknown in the U.S., where individually designed work for a fixed rate of pay in a high control organization predominated. The lesson here for HR executives is that these historical U.S. HRM practices were substantially altered by market globalization, and that further globalization will likely result in businesses outside the U.S. making greater use of LIHRM practices.

Regarding organizational change, researcher and practitioner attention has focused predominantly on such global environmental factors as technology, de-regulation, customers and competitors as key drivers of change. But from time to time, new ideas and new evidence about human behavior at work can drive organizational change. Historical examples include the emergence and expansion of "free" labor markets in the 19th century, the scientific management and Hawthorne-inspired human relations "movements" of the early 20th century, and the total quality and work process re-engineering innovations of the late 20th century (Lewin, 2001a). Each of these developments brought about major changes in the design of work and the management of people at work, that is, major organizational change, both in the U.S. and abroad. Hence, the dual theory of HRM and business performance offers to HR executives worldwide the lesson that, when it comes to managing people, one size or set of best practices does not fit all.

Finally, the dominant role of the HR function in the business enterprise has frequently changed to emphasize, as examples, social welfare services, union avoidance, organizational rule enforcement, compliance with regulation, and record keeping (Lewin, Mitchell & Zaidi, 1997). Only relatively recently has the HR function's principal role been characterized as that of a business partner or change agent. The capability of the HR function—of HR executives and professionals—to fulfill either or both of these newer roles, however, is called into question by the creation of organizational learning functions and executive positions in several prominent

businesses. In these businesses, and perhaps many others, the HR function continues to be viewed not as a key business partner or change agent but, instead, as largely fulfilling one or more of its older, traditional roles. Thus, the key lesson here is that in order to lead HR functions that occupy the role of key business partner and/or change agent, HR executives must grasp and especially apply the knowledge of LIHRM and HIHRM practices derived from the dual theory of HRM and business performance.

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ENDNOTES

[1]Additional detail about the study design, surveys and sampling frames is provided in Lewin (2004, 2001b).

[2] For the four samples as a whole, peripheral employment accounted for just under 32 percent of total full-time equivalent employment in 1998, closely approximating the extent of peripheral employment at that time in the U.S. economy more broadly. Between 1995 and 1998, peripheral employment increased by about 14 percent in the company sample, 15 percent in the business unit sample, 16 percent in the manufacturing plant sample, and 15 percent in the insurance sales and service field office sample. For further details, including changes in specific categories of peripheral employment in these four samples of business entities, see Lewin (2004).

[3] Not included in this "calculation," however, is the potential or hidden cost to a business if its (relatively low cost) peripheral work force becomes so large that it seeks to become part of its (higher-cost) core work force.