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WORKING PAPER SERIES

Research Report on Phase 5 Of Cornell University/Gevity Institute Study

Human Resource Management Practices and Firm Performance In Small Businesses: A Look At Differences Across Industries

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Working Paper 07 – 10

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Human Resource Management Practices and Firm Performance In Small Businesses: A Look At Differences Across Industries

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March 2006

http://www.ilr.cornell.edu/cahrs

Abstract

In this study, we look at the effects of three HR practice strategies on firm performance and examine potential differences in effects across industries. Overall, we found that employee selection based on person-organization fit, workforce management following a involvement strategy, and employee management and retention practices based on creating a family-like environment were all positively related to revenue growth, profit growth, and employee retention across when looking at all of the companies in the sample. We also found that the three HR strategies were related to higher firm performance when looking at each of the four individual industries in our study. We were surprised to find that the effects of these HR practice strategies were larger in both the retail and low-skilled services industries compared to the professional services and manufacturing industries. We were particularly surprised by these results because much of the popular press writing and conventional wisdom regarding HR practices has stressed the need to manage professional and highly skilled employees because they are potentially harder to find and retain. The specific results for each of the four industries are reported and discussed in the report as are the key takeaways for the study as a whole.

Research Report on Phase 5 of Cornell University/Gevity Institute Study

Introduction

As noted in our previous reports, we are finding that Human Resource (HR) management practices and beliefs play an important role in small businesses. For example, in our second report we found that certain sets of HR practices were positively related to workforce alignment and resulting firm performance. In our third report, we found that effective HR management practices were positively related to important employee outcomes such as higher commitment, trust in management, cooperation, and higher employee effort and involvement in their jobs. In our fourth report we found that particular HR best practices were related to significantly higher performance in terms of one-year revenue and profit growth. Further, we found that the effects of these best HR practices were particularly pronounced for companies pursing a growth strategy and those facing higher competition.

In this report, we build on what we have learned to date and look at differences in the effect of HR best practices across industries. Specifically, we:

1. Examine differences in terms of the use of best HR practices across industries.
2. We test to see if the impacts of HR practices differ across industries in terms of both the effects on employee outcomes and relative firm performance.

The results presented in this study were drawn from surveys of top managers/owners and employees from a sample of 243 small businesses drawn from four broad categories of small business industries: professional services, manufacturing, retail, and low-skilled services. The companies that participated ranged in size from 8 to 600 employees. The average number of employees was 47. We used top manager surveys were used to assess the extent to which the company was using particular HR practices and relative company performance. We used employee surveys to assess employee motivation and turnover.

The results of the study are presented as follows. First, we identify three sets of HR practice strategies that companies can use to manage their workforce, including choices

around: (1) selecting employees based on fit to the company versus fit to the job, (2) managing employee performance through employee involvement versus tight controls, and (3) motivating employee commitment through creating a family atmosphere versus individual monetary incentives. Second, we present and discuss differences in the use of the three HR practice strategies across industries. Third, we present and describe how the strength of the relationships between the HR practice strategies, employee outcomes, and firm performance differ depending industry.

Human Resource Management Practices and Firm Performance In Small Businesses: A Look At Differences Across Industries

As we have reported in previous studies, companies that simultaneously implement each of the three separate components of an Effective System of HR Management practices clearly outperformed companies that did not implement any of the three components of and Effective System of HR Management Practices. Specifically, we found that those that simultaneously implemented employee selection strategies based on person-organization fit, employee management practices focusing on self-management, and employee motivation and retention strategies based on creating a family-like community and environment showed 22% higher sales growth, 23% higher profit growth, and 67% lower employee turnover than did companies that implemented employee selection strategies based on person-job fit, employee management practices based on tight controls, and employee motivation and retention strategies based strictly on providing individual monetary rewards.

Below, we briefly describe the individual practice strategies that make up an Effective HR management system (Employee Selection Strategies, Employee Management Strategies, and Employee Motivation and Retention Strategies) and discuss how each were related to firm performance.

Employee Selection Practices and Company Financial Performance

One important way a company can improve financial performance and lower turnover is by hiring the right types of people in the first place. We examined two different strategies or sets of human resource practices that companies can use when hiring people. First, companies can emphasize person-job fit. Companies that pursue person-job fit seek to match job applicant's knowledge and skills to the requirements of specific job openings and focus on an applicant's ability to perform well right away without extensive training. Second, companies can favor person-organization fit. Companies that pursue person-organization fit focus on how well the individual fits the culture or values of the company, and seek to hire people with the capacity to work well with other company employees.

Overall, we found that companies that followed a person-organization fit showed significantly higher firm performance than did companies following a person-job fit strategy. Our results suggest that firms have 7.5% higher revenue growth, 6.1% higher profit growth and 17.1% lower turnover when following a hiring strategy of attracting, finding, and selecting employees that are a fit to the culture and values of the organization.

Workforce Management Practices and Company Financial Performance

A second important way that companies can affect firm financial performance and employee retention is through the HR strategies and practices that they follow regarding workforce management. We looked at two different human resource utilization strategies that companies can use to manage people. First, companies can emphasize tight controls. Companies that rely on tight control closely monitor the day-to-day activities of employees, ensure that managers, not employees determine the pace and schedules at which employees complete their work, and use lots of explicit rules and procedures to manage employee actions. Second, companies can foster employee involvement and self-management. Companies that choose self-management give employees a great deal of discretion to monitor their own performance and trust employees to get the job done right the first time without direct oversight.

Overall, we found that firms following a utilization strategy of involvement and self-management had, on average, 11.5% higher revenue growth, 3.9% higher profit growth, and 15.1% lower turnover than did companies managing employees through tight controls. Thus, our results suggest that firms that follow a strategy of giving greater discretion and using more employee involvement and self-management in setting the pace of work and monitoring employee performance seem to financially outperform and have much lower turnover than do companies that seek to tightly control all aspects of their employees behaviors and work.

Employee Management & Retention Practices and Company Financial Performance

The final way that companies can influence company financial performance and employee turnover is through the HR practices and strategies that affect employee motivation and retention. We examined the effects of two different human resource strategies that companies can use to motivate people. First, some companies seek to improve or affect employee motivation by creating a family-like community and environment. For example, companies that create a family environment seek to create a strong attachment to the company and to other employees through such practices as sponsoring company social events and outside activities so that employees can get to know one another, holding regular company-wide meetings to share information about the company with employees, and providing challenging work opportunities and the chance to learn and grow. Second, many companies seek to affect employee motivation strictly through the use of individual monetary incentives, of course, companies can just show people the money. Companies that use money to motivate people pay higher wages than their competitors. They also use incentives to attract, reward, and retain their people.

Overall, we found that companies that follow an HR strategy of motivating employees by creating a family environment have, on average, 3.8% higher revenue growth, 13.3% higher profit growth, and 19.1% lower turnover than companies following the individual monetary incentive strategy.

Differences in The Effectiveness of HR Strategies Across Industries

The above findings are important in that they demonstrate that implementing effective HR practices have the potential to improve company performance, the findings are limited in that they were based on companies from a wide variety of industries. To provide more detail and a greater ability for firms to benchmark their own companies, we explore potential differences in both the use of and the relative impact of these effective HR practices across four broad industry types: professional services, manufacturing, retail, and low-skilled services. Below we will discuss the frequency with which companies within each industry segment implement the effective HR practices and the extent to which these practices are related to firm performance.

Industry 1: Professional Services

We defined the professional services industry as firms that provide direct services to customers primarily through employees that have higher levels of education and/or are required to maintain professional certifications. Examples of companies included in this industry segment are legal and medical practices, architecture firms, pharmaceutical research firms, information technology consulting firms.

Implementation of Effective HR Practices:

We had a sample of 62 firms that met the definition of professional services. On average, the companies in the professional services industry sample, scored higher than the other industries on the frequency with which they were using all three of the effective HR management practices. Further, we found that there was lower variability in the implementation of the effective HR management practices compared to other industries. It appears that investment in effective HR practices is more standard in this industry, potentially because it is seen as a necessary investment to attract and retained the higher skilled professionals that are the core employees of these firms.

Impact of Effective HR Practices on Firm Performance and Employee Outcomes:

Overall, we found that implementation of the combined system of effective HR practices was significantly related to higher levels of perceived operational performance and customer satisfaction. We found that companies that implemented all three effective HR practices scored 13% higher on our measure of perceived operational performance and 14% higher on our measure of perceived customer satisfaction. Similarly, we found that implementing the combined set of effective HR practices was significantly related to higher levels of employee commitment to the company, job involvement, customer service orientation, and helping behaviors. In addition, companies who implemented the combined system of effective HR practices had 22% lower turnover than did companies not implementing the combined set of HR practices. See Table below for full results.

Results for Professional Services Industry
Performance when using Effective System of HR Management Practices

Operational Performance	13.1% higher perceived operational performance
Customer Satisfaction	14.2% higher perceived customer satisfaction
Employee Commitment	16.2% higher employee commitment
Job Involvement	12.1% higher job involvement
Customer Service	12.7% higher customer service orientation
Helping behaviors	14.2% higher helping behaviors
Turnover	21.8% lower turnover

We were surprised to find that the impact of the effective HR management practices on firm performance was lower in the professional services industry than either the retail or low-skilled service industries. We were particularly surprised because much of the popular press writing and conventional wisdom regarding HR practices has stressed the need to manage professional/highly trained employees because they are harder to find and potentially more able to find alternative work. As noted above, professional service firms are much more likely to implement the effective HR management practices, so it is likely that the smaller impact is the

result of more companies using these practices. In other words, implementing effective HR practices might be more of a requirement for professional services firms rather than a large differentiator that leads to greater company performance compared to companies not implementing these practices.

Industry 2: Manufacturing

We defined the manufacturing industry as firms that take raw materials and create either finished products to be sold to end consumers or components to be sold to other businesses. Examples of companies included in this industry segment are tool and die companies, paper and wood products companies, automobile parts, plastics, medical equipment and devices, packaging, and petrochemicals.

Implementation of Effective HR Practices:

We had a sample of 72 firms that met the definition of manufacturing. On average, the companies in the manufacturing industry sample, scored higher than retail and low-skilled service industries and lower than professional services on the frequency with which they were using all three of the effective HR management practices. Further, compared to other industries, we found that there was lower variability in the implementation of workforce management practices based on involvement and self-management, potentially because there has been an increase in manufacturing of using self-management teams or implementing greater amounts of employee involvement.

Impact of Effective HR Practices on Firm Performance and Employee Outcomes:

Overall, we found that implementation of the combined system of effective HR practices was significantly related to higher levels of perceived operational performance and customer satisfaction. We found that companies that implemented all three effective HR practices scored 15% higher on our measure of perceived operational performance and 10% higher on our measure of perceived customer satisfaction. Similarly, we found that implementing the combined set of effective HR practices was significantly related to higher levels of employee

commitment to the company, job involvement, customer service orientation, and helping behaviors. In addition, companies who implemented the combined system of effective HR practices had 19% lower turnover than did companies not implementing the combined set of HR practices. See Table below for full results.

Results for Manufacturing Industry
Performance when using Effective System of HR Management Practices

Operational Performance	14.9% higher perceived operational performance
Customer Satisfaction	10.1% higher perceived customer satisfaction
Employee Commitment	17.0% higher employee commitment
Job Involvement	10.3% higher job involvement
Customer Service	9.2% higher customer service orientation
Helping behaviors	15.1% higher helping behaviors
Turnover	19.4% lower turnover

We were surprised to find that the impact of the effective HR management practices on firm performance was lower in the manufacturing industry than either the retail or low-skilled service industries. We were particularly surprised because previous research on the effects of HR has primarily focused on manufacturing firms and found that implementation of effective HR practices has a large impact on performance in manufacturing firms. As noted above, manufacturing firms are much more likely to have implemented the effective HR management practices, so it is likely that the smaller impact is the result of more companies using these practices. In other words, implementing effective HR practices is more common for manufacturing firms and a good number of companies in the sample are seeing benefits from the use of these practices, because the use of these practices is less of a differentiator between firms the use of these practices has a lower affect on performance across the industry. In the end, however, firms that implement these practices perform better and score higher on the employee outcome measures that do firms that do not implement these effective HR management practices.

Industry 3: Retailing

We defined the retailing industry as firms that sell goods manufactured by other organizations directly to end consumers. Examples of companies included in this industry segment are lumber and construction supply, computers and computer parts, clothing and accessories, automobiles and auto parts, and sporting goods.

Implementation of Effective HR Practices:

We had a sample of 53 firms that met the definition of retailing. On average, the companies in the retailing industry sample scored the lowest of all the industries on the use of workforce management based on involvement and self-management and retention and motivation through a family-like environment. Retailing companies, on average, also scored lower on selection based on company fit than did firms from the professional services or manufacturing industries. Further, compared to other industries, we found that there was a great amount of variability in the implementation of each of the effective HR management practices, with few companies in the sample implementing each of the three HR practice strategies.

Impact of Effective HR Practices on Firm Performance and Employee Outcomes:

Overall, we found that implementation of the combined system of effective HR practices had very large impact on perceived operational performance and customer satisfaction. We found that companies that implemented all three effective HR practices scored 24% higher on our measure of perceived operational performance and 20% higher on our measure of perceived customer satisfaction. Similarly, we found that implementing the combined set of effective HR practices was significantly related to higher levels of employee commitment to the company, job involvement, customer service orientation, and helping behaviors. In addition, companies who implemented the combined system of effective HR practices had 75% lower turnover than did companies not implementing the combined set of HR practices. See Table below for full results.

Results for Retailing Industry
Performance when using Effective System of HR Management Practices

Operational Performance	24.3% higher perceived operational performance
Customer Satisfaction	20.1% higher perceived customer satisfaction
Employee Commitment	31.4% higher employee commitment
Job Involvement	34.6% higher job involvement
Customer Service	25.5% higher customer service orientation
Helping behaviors	27.8% higher helping behaviors
Turnover	74.7% lower turnover

We were surprised to find that the impact of the effective HR management practices on firm performance was much higher in the retailing industry compared to either the professional services or manufacturing industries. We were particularly surprised because much of the popular press writing and conventional wisdom regarding HR practices has stressed the importance of HR for skilled rather than unskilled workers. However, employees in the retailing industry have direct, face-to-face interactions with customers and few companies in the retailing industry implemented each of the three effective HR management practices. It is likely that implementing the HR practices is a competitive differentiator that helps to create a more skilled and motivated workforce which leads to better customer interactions and service which leads to longer term financial gains for the company. Our evidence suggests that firms in this industry may expect to have a more motivated workforce that stays in the job longer and contributes more discretionary effort potentially because the employees see the difference in the way that they are treated compared to jobs in other retail companies that do not implement these more effective HR management practices.

Industry 3: Low-Skilled Services

We defined the low-skilled services industry as firms that provide services directly to end consumers based primarily on the tasks performed by employees with relatively low levels of education, low or non-existent levels of professional certification, or generally lower skills. Examples of companies included in this industry segment are restaurants and food service,

lawn and landscaping services, hospitality, laundry and dry cleaning, cleaning, and transportation.

Implementation of Effective HR Practices:

We had a sample of 57 firms that met the definition of low-skilled services. On average, the companies in the low-skilled services industry sample scored the lower on the use of the effective HR management practices than any industry except for retailing. Similar to the findings with the retailing industry, we found that there was a great amount of variability in the implementation of each of the effective HR management practices, with few companies in the sample implementing each of the three HR practice strategies.

Impact of Effective HR Practices on Firm Performance and Employee Outcomes:

Overall, we found that implementation of the combined system of effective HR practices had very large impact on perceived operational performance and customer satisfaction. We found that companies that implemented all three effective HR practices scored 21% higher on our measure of perceived operational performance and 26% higher on our measure of perceived customer satisfaction. Similarly, we found that implementing the combined set of effective HR practices was significantly related to higher levels of employee commitment to the company, job involvement, customer service orientation, and helping behaviors. In addition, companies who implemented the combined system of effective HR practices had 58% lower turnover than did companies not implementing the combined set of HR practices. See Table below for full results.

Results for Low-Skilled Services Industry
Performance when using Effective System of HR Management Practices

Operational Performance	21.4% higher perceived operational performance
Customer Satisfaction	26.2% higher perceived customer satisfaction
Employee Commitment	38.2% higher employee commitment
Job Involvement	30.1% higher job involvement
Customer Service	24.3% higher customer service orientation
Helping behaviors	28.8% higher helping behaviors
Turnover	57.9% lower turnover

We were surprised to find that the impact of the effective HR management practices on firm performance was much higher in the retailing industry compared to either the professional services or manufacturing industries. We were particularly surprised because much of the popular press writing and conventional wisdom regarding HR practices has stressed the importance of HR for skilled rather than unskilled workers. However, employees in the retailing industry have direct, face-to-face interactions with customers and few companies in the retailing industry implemented each of the three effective HR management practices. It is likely that implementing the HR practices is a competitive differentiator that helps to create a more skilled and motivated workforce which leads to better customer interactions and service which leads to longer term financial gains for the company. Our evidence suggests that firms in this industry may expect to have a more motivated workforce that stays in the job longer and contributes more discretionary effort potentially because the employees see the difference in the way that they are treated compared to jobs in other retail companies that do not implement these more effective HR management practices.

Key Takeaways

The results of this study offer three key takeaways for managers interested in improving the performance of their small businesses.

(1) Choice of HR Strategies is Related to Company Financial Performance and Employee Outcomes. Across industries, companies that implement more effective HR strategies for hiring, workforce utilization, and employee motivation have higher performance in terms of relative operational performance and customer satisfaction. In addition, companies that implement the more effective HR management practices tend to have a workforce that is more committed to the company and see personal value in their job, who give more effort in terms of customer orientation and helping co-workers, and who are less likely to quit. The analyses reported here control for many factors that could also influence company performance levels, including company industry, company age, company size (in number of employees), the speed of change present in the external environment, and business strategy. This means that our findings are quite robust. Our findings strongly support the conclusion that firms have higher performance when they more effectively manage their employees through an HR hiring strategy based on person-organization fit, an HR utilization strategy based on employee involvement and self-management, and an HR employee motivation strategy based on creating a family environment.

(2) Implementation of effective HR Requirement not Differentiator in Professional Services and Manufacturing. As with the overall sample, we did find significant relationships between the implementation of effective HR practices and performance and employee outcomes in our samples of professional services and manufacturing. However, the overall size of the impact of HR on these outcomes was smaller than the relationships we found in other industries. Further, we found that a higher percentage of firms in these industries currently implement effective HR management strategies. Our interpretation of these results is that it might be a requirement of firms to implement these practices in order to attract, retain, and motivate the key employees as these employees are more likely to expect these practices based on their experiences with other employers or based on what they have seen other companies doing in terms of employee management practices.

(3) Companies in the Retailing and Low-Skilled Services Industries Benefit More from Effective HR Strategies. While companies that implement effective HR strategies in general outperform companies that implement less effective HR strategies, small companies in both the retailing and low-skilled services industries benefit more than companies from other industries Therefore, while we would recommend that all small companies should implement and are likely to benefit from the use of these effective HR strategies, we especially recommend that companies implement an HR hiring strategy based on person-organization fit, an HR utilization strategy based on employee involvement and self-management, and an HR employee motivation strategy based on creating a family environment if they are from one of these two industries. Our results suggest that these effective HR management practices are a real differentiator that are likely to drive greater effort and performance from employees and lead to better overall firm performance..

Average Scores Across Industry Sectors

Study Variable	Professional Services	Manufacturing	Retail	Low-skilled Services
HR PRACTICES				
Selection based on fit to company	3.59	3.49	3.34	3.36
Involvement	3.47	3.04	2.94	3.15
Family-like environment	3.65	3.53	2.97	3.20
WORKFORCE OUTCOMES				
Commitment to company	3.81	3.51	3.32	3.69
Job involvement	3.34	3.18	3.22	3.19
Trust in management	3.55	3.33	3.15	3.36
Turnover intentions	2.33	2.61	2.81	2.64
Number of Companies per industry	62	72	53	57

Examples of Best Practices

Person-Company Fit Employee Selection:

We believe that new employees should be selected primarily based on their ability to work effectively given the other employees and culture of the company.
We select individuals based on their overall fit with the company's values.
Our hiring practices focus on how well the individual fits to the culture of the company.
We only hire people who will work well with rest of the employees in this company.

Employee Management Strategies based on Self-Management

Managers empower employees to monitor their own work and performance
Managers in this company assume that employees are experts who will get the job done right the first time without oversight.
We trust employees to monitor their own performance and get their jobs done right.
Employees are trusted to get the job done right the first time without direct oversight.
Employees in this company are given the opportunity to complete their work however they see fit

Family-like Community for Fostering Employee Motivation

We work hard to create a family-like environment that creates and emotional attachment to the company.
We sponsor company social events so employees can get to know one another
We offer employees profit- or gain-sharing pay
We regularly hold company wide meetings to share information about the company with employees
We work hard to create a strong social environment at work.