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# Believable or Biased? Overestimating the Impact of HR Practices on Firm Performance

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# Believable or Biased? Overestimating the Impact of HR Practices on Firm Performance

## **Abstract**

### **KEY FINDINGS**

- HR and line managers intrinsically believe that high-performing companies have more progressive HR practices and effective HR functions. Likewise, they assume less successful companies have less effective HR functions.
- Experienced people (such as senior executives with long tenure) are more likely to hold personal beliefs about the impact of HR practices on performance (i.e., implicit performance theories) than are less experienced people (such as graduate students).
- These beliefs are likely to result in research that overestimates the impact of HR on firm performance.

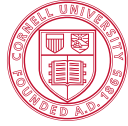
### **Keywords**

HR Strategy, HR Analytics, Research methods, surveys, firm performance

### **Comments**

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# R ResearchLink

No. 7, April 2010

## Believable or Biased?: Overestimating the impact of HR practices on firm performance

### THE TOPIC: HOW PERSONAL BELIEFS ABOUT THE IMPORTANCE OF HR INFLUENCE RESEARCH SURVEY RESULTS

In the past fifteen years, there's been an explosion of published papers reporting a significant relationship between HR practices and firm performance. While HR doubtlessly influences the bottom line, some estimates of that relationship are beyond rational belief—for example, that just a slightly above average use of HR practices would result in a \$20,000 per-employee profit gain.

With few exceptions, this research has relied on surveys in which a sole respondent measures the content and quality of HR practices at his or her firm. Yet that's quite a daunting task for one person to handle. Consider the difficulty for the top HR executive at a 1,000-employee company with three divisions and six job groups to answer the question, "What proportion of the workforce is promoted based primarily on merit (as opposed to seniority)?" That person would have to know the promotion practices for each job in each division and the number of employees in each job in each division. If the response asks for a distinction between exempt and non-exempt employees, further calculations would be required, and this entire process would need to be repeated for each question on the survey.

With more HR practices being administered by corporate specialists and division-specific generalists, it's doubtful that even the top HR person would have that information at his or her fingertips. This increases the likelihood of the respondent answering questions based on previously held personal beliefs—rather than basing them on hard data.

### KEY FINDINGS

- ◇ HR and line managers intrinsically believe that high-performing companies have more progressive HR practices and effective HR functions. Likewise, they assume less successful companies have less effective HR functions.
- ◇ Experienced people (such as senior executives with long tenure) are more likely to hold personal beliefs about the impact of HR practices on performance (i.e., implicit performance theories) than are less experienced people (such as graduate students).
- ◇ These beliefs are likely to result in research that overestimates the impact of HR on firm performance.

In fact, several studies have shown that relying on a single informant in surveys of HR practice/effectiveness makes such measurements susceptible to excessive random error and systematic bias. Systematic bias can occur when responses are based not on valid estimates, but rather on an *implicit performance theory* that the survey respondent already holds.

Implicit performance theory—such as the inherent belief that high-performing firms engage in progressive HR practices, while low-performing firms do not—could produce survey results showing an artificially high positive relationship between HR practices and firm performance. This study examined whether and how this form of systematic bias affects how people rate HR practices when presented with differing information about how a company is performing.

## THE STUDY QUESTIONS

In this study, researchers asked the following questions:

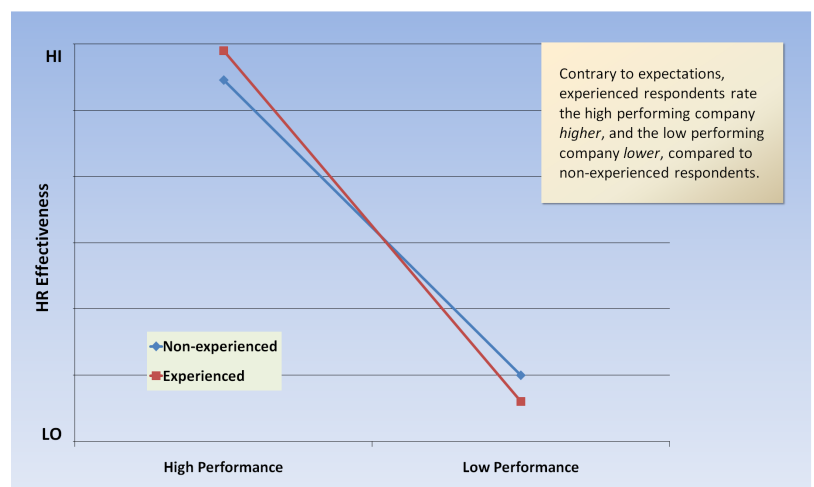
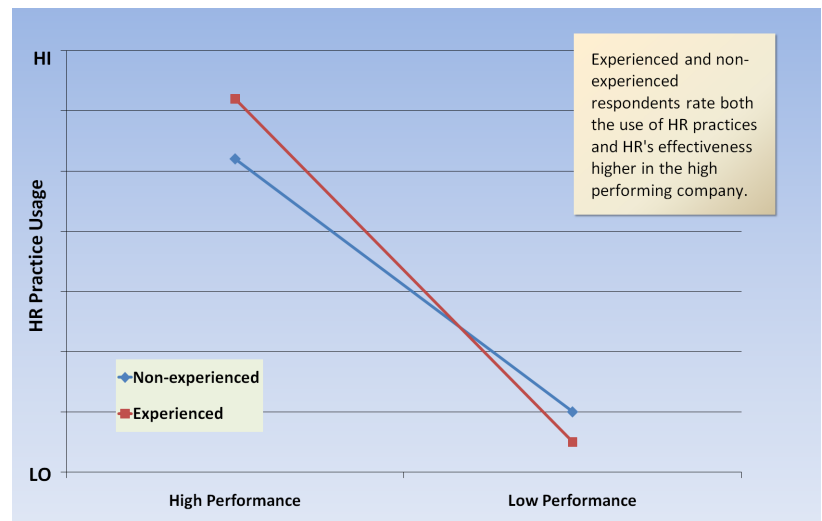
- ◊ Why are estimates of the relationship between HR practices and firm performance inflated?
- ◊ Are these inflated estimates the result of problems with how HR executives respond to surveys?
- ◊ Could part of the problem stem from HR executives' internal beliefs about the importance of HR, leading to biased answers to survey questions?
- ◊ Do people answer surveys about HR practices based on how they think the company is performing?

## THE RESULTS

*In high-performing companies, survey respondents rate HR higher than in low-performing companies.* Performance cues—knowledge of whether a company is doing well or poorly—influenced respondents' descriptions of the rate of HR usage and the effectiveness of the HR function. This supports the idea that many HR managers hold intrinsic beliefs about HR that influence their responses to questions about its effectiveness.

*Survey respondents with less work experience tend to report smaller differences in HR effectiveness between high- and low-performing companies.* This finding was contrary to what researchers expected (i.e., that subjects with little or no work experience would overestimate the impact of HR on firm performance). Surprisingly, it appears they may actually underestimate HR's importance.

*Among experienced executives, little difference was found between HR and non-HR people in terms of how they view HR's affect on firm performance.* Given the frequently heard complaints from HR directors that their line executives don't "get" the importance of HR, researchers fully expected non-HR respondents to be significantly less likely to equate high-performance with HR effectiveness. This simply was not observed.



## ***On the same side: experienced line and HR managers link effective HR to better performance***

There are a few possible explanations for why, among survey respondents with extensive work experience, non-HR respondents reported a strong belief in the role that HR plays in a company's performance.

First, given the human capital shortage that firms face and the importance talent plays in firm success, it may be that line executives are increasingly recognizing the importance of HR practices and activities. Second, perhaps HR people believe that HR practices are driving the firm's outstanding performance—while line people believe that high-performing firms have resources to invest in developing state-of-the-art HR functions.

Finally, the failure to find a significant difference between the way HR and non-HR people relate HR to firm success may be due to the study's methodology. By using a senior-level HR executive as the contact within the organization, the researchers acknowledge the possibility that the line executives asked to participate were those who already held a positive view of HR.

## ***Outside looking in: Inexperience linked to low expectations of HR***

It makes a certain amount of sense that both experienced HR and line executives believe in HR's impact on company performance. After all, these people have been in the organization long enough to participate in and see the successful implementation of people strategies, and most importantly, to benefit from them. This experience can surely influence someone's personal beliefs about HR's effectiveness and relationship to performance.

Then why do inexperienced survey respondents have lower expectations of the impact of HR? The researchers offer some anecdotal evidence to offer insight. In this study, the respondents were MBA and engineering graduate students in a field-based manufacturing management class. Over the course of a semester, they made numerous corporate site visits. By the end of the semester, several students expressed that there was "too much HR," according to one of the HR professors who taught the class.

This professor also reported that during the site visits, managers spoke frequently about issues relating to people, possibly accounting for the perception among some students that HR was overemphasized. This may simply indicate that most real organizational issues are people issues with HR implications, and that students simply can't fully comprehend this reality until they spend a significant amount of time working in an organization.

## **THE TAKEAWAY**

How can this study help researchers more accurately evaluate the effects of HR practice on firm performance, and help HR practitioners with their own survey design and evaluation?

- ◊ **The good news is that most people believe that HR matters. Almost nobody doubts that HR has an impact on the bottom line, including line managers. However, the estimated impact may have been inflated in the past because of the inherent biases of the people responding to research surveys.**

- ◊ **The longer people work at companies, the more they believe in HR's impact on the bottom-line and other performance outcomes.**
- ◊ **Caution should be taken when measuring firms' HR practices, because respondents' answers may be influenced by how they think the firm is performing. In other words, strong firm performance is likely to be attributed to a strong HR function, while poor performance will be attributed to weak HR practices.**
- ◊ **To reduce errors in responses, more than one person per company should provide data.**
- ◊ **At large companies (1,000 or more employees) data should be collected at the division, establishment, or job group level—not at the corporate level. Relying on a single person at the corporate level to complete surveys increases the odds that person will base their responses on intrinsic beliefs. This is because it's extremely hard for one person to locate and collect information about HR practices across multiple groups and divisions.**
- ◊ **Dozens of studies that involve a single respondent's ratings of HR practices and firm performance don't help HR professionals understand how to maximize the impact of HR investments and how they might be most effective. Rather than trying to find the relationship between HR investment and stock price, researchers ought to examine if and how HR practices impact the collective knowledge, skills, behaviors, outcomes, and attitudes of employees, and how all of these factors affect a firm's performance.**

## **THE DATA SOURCE**

Surveys were collected from 26 HR executives, 14 line executives, 42 MBA/graduate engineering students, and 31 HR graduate students. Study participants were asked to read scenarios of two hypothetical companies, one high-performing and one low-performing, and then complete an identical 16-question survey regarding HR practices at each. Two of the sixteen questions specifically assessed participants' evaluation of the HR functions' contributions to firm performance.

## THE RESEARCHERS

This study was conducted by:

- Timothy M. Gardner, Associate Professor of Management, Vanderbilt University
- Patrick M. Wright, William J. Conaty GE Professor of Strategic Human Resources, ILR School, Cornell University

*Gardner, Timothy M. and Wright, Patrick M. (2009). Implicit human resource management theory: a potential threat to the internal validity of human resource practice measures. The International Journal of Human Resource Management, 20:1,57-74.*

◇ Questions about this research should be directed to Patrick Wright at [pmw6@cornell.edu](mailto:pmw6@cornell.edu).