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The Human Resource Executive Effect in Initial Public Offering Firms

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Abstract

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Keywords

research, earnings, employee, performance, IPO, human resource, company

Comments

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The Human Resource Executive Effect in Initial Public Offering Firms

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Working Paper 99-03



THE HUMAN RESOURCE EXECUTIVE EFFECT IN INITIAL PUBLIC OFFERING FIRMS

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Please direct all correspondence to Theresa Welbourne.

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THE HUMAN RESOURCE EXECUTIVE EFFECT IN INITIAL PUBLIC OFFERING FIRMS

There is much discussion about HRM becoming strategic, in part by hiring a senior HR executive. This study explores whether that recommendation can help entrepreneurial, growth-oriented companies. By applying organizational inertia concepts, we study whether having a senior HRM executive, reporting to the CEO, affects firm performance in a sample of initial public offering (IPO) firms. Results indicate that smaller and fast-growth IPOs experience the most gain from having a senior human resource executive.

Today's fast-paced, competitive business environment has resulted in "rediscovery" of human resource management as a function that may be able to enhance firm competitiveness and performance by being 'strategic' (Becker & Gerhart, 1996; Dyer & Kochan, 1995; Pfeffer, 1998; Ulrich, 1997). The potential contributions of strategic human resource management (SHRM) appear to emanate from two perspectives. The first focuses on aligning human resource policies and procedures with business or corporate strategies, and the second is an organizational level approach that includes a senior HRM executive on the top management team. Although both perspectives are being discussed by practitioners and researchers, most of the research to date has addressed the first perspective, the effect of various HRM practices on firm performance (Arthur, 1992; Delery & Doty, 1996; Huselid, 1995; MacDuffie, 1995).

Several studies have considered the role of human resource professionals in the business planning process (Huselid, 1993; Martell & Carroll, 1995; Wright, McMahan, McCormick & Sherman, 1996), but research directly assessing the effect on firm performance of having an HRM executive in a senior management position has not been conducted. This is an important part of the strategy equation because the senior HRM executive develops policies and procedures to "match" business strategy and directly influence the development of business strategy. In addition, the senior executive may bring critical resources (funding, people) to the HRM department, thus enhancing the department's ability to implement practices (Abrahamson, 1979; Pfeffer & Davis-Blake, 1987).

While much of the prior SHRM research has focused on combinations of policies and procedures, we aim to contribute to the SHRM literature by studying what we think is an untested assumption. That assumption is that having a senior HRM executive, reporting to the CEO, positively affects firm performance. One possible reason for the lack of empirical research addressing the effect on performance of having a senior HRM executive is that the SHRM literature provides little theoretical guidance to help us understand the conditions under

which having a senior HRM executive will contribute to firm performance. Contingency theory and resource-based theory approaches to the study of SHRM (the most dominant theoretical approaches to the topic) have been limited to the study of HRM policies and practices (Delery & Doty, 1996; Huselid, 1995; Koch & McGrath, 1996; Schuler, 1987; Schuler & Jackson, 1987).

Another possible reason for the relative lack of research on the performance effects of having a senior HRM executive may be the fact that most samples studied (primarily Fortune 500 organizations) have little variance in HRM reporting. Companies studied to date tend to be larger and older, and most have what could be called 'strategic HRM' (at least in terms of HRM executive reporting structure). Deciding whether a senior HRM executive will be part of the top management team is a business decision that represents one of the earliest and most important steps in the SHRM process. Baron, Burton, and Hannon (1996), in an extensive study of Silicon Valley start-ups, found that early decisions about HRM were systematically linked to later HRM practices and major business decisions (e.g. whether a company goes public or replacing the CEO).

Given the need to examine our research question in a sample of firms that has variance in human resource executive reporting, our study is conducted with a group of initial public offering (IPO) firms. These companies are opportune for studying cause and effect because many have recently made important structural and management team decisions (due to their being relatively new firms and entering a growth stage anticipated by the funding acquired in the IPO), they are at a stage where they obtain funding to implement plans specified in their prospectus (the document submitted to the Security and Exchange Commission when they go public), and they experience significant variance in performance soon after the IPO.

Additionally, IPO firms are of considerable interest to business professionals, investors, and politicians. These IPO firms have potential to affect shareholder wealth, economic growth, job growth, innovation, and investment. According to Shane (1996), newer entrepreneurial firms (of which IPO firms are a part) account for 80% of the new jobs created in the United States. A recent *Fortune* article (Wyatt, 1996) titled "America's amazing IPO bonanza" characterized the IPO market as "big, powerful... and reinvigorating the U.S. economy."

In summary, the study that we describe in this paper considers the effect of having a senior HRM executive on the top management team on firm performance. We employ a longitudinal research design that tracks the effect of an early decision regarding the strategic positioning of the HRM function on subsequent performance over a 3-year period of time.

THEORY AND HYPOTHESES

The strategic management field has traditionally studied the link between business strategy and organizational structure (Bruderer & Singh, 1996), and the way the topic has been addressed by HRM researchers has been to operationalize HRM structure as the study of HRM practices (Capelli & Singh, 1992). However, organizational structure also includes reporting arrangements (Bruderer & Singh, 1996), and it is possible that HRM reporting has its own unique effect on a firm's performance.

Wood (1995) noted that firms were successful in implementing high commitment strategies when they integrated their human resource management functions as part of the process. They were able to do this only when the HRM function (or person) was taken "seriously." Being taken seriously is not a construct that has been measured to date in the SHRM literature. However, being taken seriously is linked with departmental and individual organizational power, which is reflected to some degree in its reporting structure (Abrahamson, 1979; Hills & Mahoney, 1978; Salancik & Pfeffer, 1974). Models of organizational power have been proposed for studying human resource management (Ferris & Judge, 1991), and Wright and McMahan (1992) noted that this could be an alternative way to understand SHRM.

Abrahamson (1979) and Pfeffer and Davis-Blake (1987) examined the effects of position criticality (job status associated with title), and using a resource dependence framework, they noted that the position itself was important in obtaining resources (e.g. pay). Position status is a legitimate form of power (French & Raven, 1968), and resources tend to be allocated to those individuals who possess higher levels of power (Pfeffer, 1981). It follows then that the reporting structure of the HRM executive should be important in understanding that person's ability to gather resources for the department.

Resources gathered can include monetary resources and information. If the HRM executive is part of the top executive team, then that individual will also acquire information, which is key for contributing to the performance of the firm. Given that the focus of the SHRM literature has been on fitting HRM practices together (via bundles) or fitting practices with business strategies, it is critical that the senior HRM executive have information to use in developing programs. Thus, reporting structure is important to the traditional SHRM agenda (creating practices that align with each other and that align with business strategy) because information from the top executive team is necessary for alignment and fit (Jackson, Schuler & Rivero, 1989; Miles & Snow, 1984). Researchers, using ideas from the literature on resource-based view of the firm (Barney, 1991), have also noted that reporting structure can be a unique resource. As such, reporting structures (and the firm level strengths that develop as a result of

those management decisions) can create company-specific competitive advantage that is not easy to imitate (Koch & McGrath, 1996).

A more complete management team, with someone responsible for understanding the implications of major business decisions on employees, should result in better business decisions (Dyer & Kochan, 1995; Martell & Carroll, 1995; Mohrman, Lawler & McMahan, 1996). Pfeffer (1998) recently wrote, in a chapter titled "Why smart organizations sometimes do dumb things," that a focus on accounting and finance without equal interest in human resource management can lead to negative results. We argue that having someone on the top management team whose job is HRM should lead to a more complete team and better, more informed decision making.

It appears that reporting structure is a critical decision, and having a senior HRM executive as part of the top management team, for all the reasons cited, should have a positive effect on long-term firm performance. Specifically, we hypothesize that having a senior executive reporting directly to the CEO will have a direct and positive effect on longer-term firm performance.

Hypothesis 1: Firms with a senior HRM executive reporting to the CEO will experience higher long-term performance than those that do not have a person in this position.

Rate of Growth

Two separate literatures suggest that having an HRM executive may be more beneficial for firms that are growing. Kazanjian (1988), expanding the literature on organizational life cycle, noted that specific types of problems occurred at different stages. Those stages may or may not be parallel to organizational life cycle. One of the problems Kazanjian (1988) studied was that of people and employee management. He found that people-related problems were important at two stages: one was the conceptual and development stage, and the second was the growth stage. This conclusion is supported by researchers in the SHRM field who address life cycle and organizational change (Baird & Meshoulam, 1988; Milliman, Von Glinow, & Nathan, 1991).

Contingency theory has been used in the SHRM literature to understand which human resource practices are best for what types of organizations. However, the theory offers little guidance as to the variables one should use in developing contingencies to examine the effect of senior HRM presence in the top management team. An alternative way to address the contingency issue, that builds on Kazanjian's (1988) ideas, is to employ concepts about rate of growth and inertia (Hannan & Freeman, 1977; 1984). Welbourne and Andrews (1996) recently

applied population ecology concepts regarding organizational inertia to develop a series of hypotheses about the effect of human resource value (the degree to which firms value their employees) on firm performance. In their study, human resource value was measured, in part, by examining whether firms had a human resource department. Although they did not consider reporting level, it seems reasonable that having a more strategic approach to HRM (via a senior HRM executive reporting to the CEO) would enhance human resource value, which is defined as “the degree to which firms consider employees important to business” (897).

They noted that structures and systems (such as having an HRM department) that enhance HR value should positively affect firm performance when firms were “moving” rather than “at rest.” The logic behind their conclusion about being “at rest” or “in motion” comes from the definition of inertia (Freeman & Hannan, 1990). According to Welbourne and Andrews (1996: 896), “although inertia conjures up images of stale, immobile organizations, the term does not necessarily mean ‘standing still.’ Newton’s first law of motion states that an object at rest tends to stay at rest and an object in motion tends to stay in motion. This overall tendency to stay at rest or in motion is called inertia....Inertia keeps an organization moving during a change, even though the direction has changed.”

They conclude that organizational processes enhancing human resource value will be positive when a firm is “in motion.” Therefore, rate of change or motion should be a critical contingency variable. Rate of change has not been studied yet in the SHRM literature. Although typologies such as the one proposed by Miles and Snow (1984) discuss innovative, entrepreneurial firms (prospector firms), the focus has been on a “state” (being a prospector vs. an analyzer) rather than on rate of change. Additionally, models of life cycle tend to focus on linking HRM practices with a stage rather than the rate at which a firm is moving through stages (Baird & Meshoulam, 1988).

Concepts of inertia, which focus on motion, provide a way to supplement contingency theory ideas about SHRM and to specifically address the effect of having a senior HRM executive. A strategic approach to human resource reporting (i.e. having an executive reporting directly to the CEO) should be something that enhances human resource value. As a result, having a senior HRM executive as part of the top management team should increase inertia, which will be more positive for organizations as rate of growth increases. We hypothesize that, within our sample of firms, rate of growth will moderate the relationship between having a senior HRM executive and firm performance.

Hypothesis 2: As rate of growth increases, the benefit from having a senior HRM executive, reporting to the CEO, will increase.

Firm Size

One other contingency variable can be studied by applying ideas about organizational inertia that were developed in the population ecology literature. Population ecology relies on the structural inertia model (Kelly & Amburgey, 1991). As such, researchers have developed specific ideas around the concepts of firm size, concluding that structural inertia increases as size increase (Hannan & Freeman, 1984). Although not specifically introduced in the population ecology literature, key to our discussion is the fact that we are differentiating between two different consequences of inertia on organizations, and the consequences depend on the firm's rate of growth. Welbourne and Andrews (1996) alluded to this when they suggested that inertia was "positive" for firms in their sample because the IPO firms were "moving;" however, they did not specifically address rate of growth.

We suggest that inertia can have positive or negative organizational consequences based on whether the firm is 'moving' or 'at rest.' When rate of growth increases, inertia can be beneficial to the organization because it keeps the company moving forward. Welbourne and Andrews (1996: 896), noted that this type of "positive" consequence of inertia is increased by structural cohesion (the result of enhanced human resource value), which they defined as "an employee generated synergy that propels a company forward."

Inertia can also lead to negative consequences that may be harmful to companies. Rather than propelling the company forward, inertia can cause a company to continue to be "at rest." Structural cohesion, when not matched with "motion" can be negative for today's organizations that require constant change. If something in the organization enhances being "at rest," then that factor can have a negative impact on firm performance because it is causing employees to maintain the status quo.

According to the structural inertia model, firm size should be associated with the form of inertia that results in being "at rest." This is consistent with Newton's second law of motion, which states that acceleration decreases as mass increases. When applied to organizations, we can speculate that mass increases when the firm increases in size -- or adds more employees. When this happens, the firm starts to slow down (acceleration is decreased), and it gets closer to being at the 'at rest' state described in the population ecology literature.

According to Hannan and Freeman (1984), forces exerted on organizations when they increase in size result in higher levels of inertia, which are associated with maintaining their status quo. Things like investments in plant, property, and equipment, personnel, development of administrative structures that result in routines, and political efforts aimed at maintaining the status quo all contribute to slowing down the company's rate of growth. This view is consistent

with the life cycle literature, which suggests later stages are associated with stability and a struggle to retain and enhance momentum (Kazanjian, 1988).

The life cycle literature suggests that having a senior HRM executive would be more likely to help an organization as it becomes older and larger (Baird & Meshoulam, 1988). This is because at later stages an organization is more complex and more likely (according to their argument) to benefit from the expense associated with hiring a senior HR executive. Contrary to the traditional life cycle approach, arguments based on the inertia (or laws of motion) logic suggest that HRM can have a negative consequence on firm performance when the firm is larger. If, as we suggested earlier, having a senior HRM executive as part of the top management team increases human resource value, which then enhances inertia, then the positive effect of having a senior HRM executive should decrease as firms become larger and older because it tends to contribute to a continued and more prolonged state of being 'at rest.' And, being at rest, in today's business environment, is associated with negative financial consequences. This is particularly relevant for the firms that we study, which are entering into an increased competitive arena as a result of their being public for the first time.

Hypothesis 3: The effect of having a senior HRM executive reporting to the CEO will be larger in smaller firms (when size is measured by number of employees).

Lastly, we speculate that smaller firms with high rates of growth will experience the most benefit from having a senior level HR executive. Smaller, growth-oriented firms are more likely to benefit from HR executive presence because the HR executive has a 'bigger voice' in the firm. Not only does the smaller size allow the HR executive to have more impact (e.g. less hierarchical layers to work through), but the needs placed on the organization from fast-growth contribute to recognition that the HR executive can play an important role in the success of the firm. Recruitment, retention, and morale are key issues in growth firms, and as a result, the HR executive may command more respect and be able to get more done in a smaller, fast-growth business (Hendrickson & Psarouthakis, 1992).

Expanding the inertia-related concepts, smaller and high growth firms have less mass and are moving forward. This means that they are the least likely group of companies to be experiencing the type of inertia that is associated with being 'at rest.' As a result, they should benefit the most from having a senior HR executive.

Hypothesis 4: Smaller firms experiencing higher rates of growth will benefit most from having a senior HR executive.

METHODS

Our research strategy involved selecting a specific cohort of IPO firms that went public in a given year and then tracking those same firms over time to study the effects of their early decisions regarding HRM reporting structure on their subsequent firm performance. We selected a sample of firms that went public in 1993 so that we could study long-term performance after the IPO (e.g. performance from 1993 to year-end 1996)¹. The number of firms that went public in 1993 and that produced a good or service (we excluded real estate trusts and financial groups with no employees) was 585; of those companies we were able to obtain the prospectuses (which are one of our primary data sources) for 535 firms. Our sample was further reduced to 476 because our dependent variables are stock price and earnings per share for 1996.

As of December, 1996, 59 firms had changed form so that the financial data we needed were no longer available. Of the 59 firms that no longer reported stock price (or earnings), we found that 50 had engaged in a merger or acquisition, 2 filed for bankruptcy, 1 went private, and for 6 no information was available. In order to examine potential survival bias (the firms that dropped out were in some way inferior performers), we conducted an ANOVA to determine how those firms for which we did not have complete data (the 59 that dropped out of the sample) differed from the overall sample. We found that there were no significant differences in any of the variables used in the analyses for this research (e.g. risk factors at time of IPO, age of firm, size measured by sales and number of employees, and net profitability). The lack of significant differences, we speculate, is due to the fact that mergers may be conducted for healthy as well as financially troubled firms, and most of the firms for which we could no longer find data had engaged in a merger or acquisition.

In addition, we were unable to obtain sales data for year-end 1992 (which is required to calculate rate of growth) for all firms in the sample (it was not reported by some firms). After deleting firms that were extreme outliers on both size and age² and including only those firms for which we had complete data (including 1992 sales), our final sample was 360 organizations. An ANOVA comparing the final sample of firms (the 360) used in the analyses with those firms that

¹ Researchers in the area of finance who have done work on IPOs suggest three years as a measure of long-term performance, see Ritter, 1991.

² There were three extreme outliers that were not included in this analysis; however, when the analysis was run with those cases included, the results did not change. Inclusion of those cases artificially inflates means and standard deviations; therefore, the results reported here exclude the extreme cases.

were not included in the study (175) showed no significant differences for any of the variables (from the time of the IPO that were in the prospectus) that we included in our study.

Data Collection and Coding

The primary data source was the prospectus of each firm. The prospectus is the document provided to the Securities and Exchange Commission (SEC) prior to the public offering, and it is also the document circulated by the underwriter to assess demand for the firm's stock. The SEC requires that firms follow strict guidelines in the format. In fact, the firm is legally liable for any information that might mislead investors (O'Flaherty, 1984). As noted by Beatty and Zajac (1994), top management is accountable to the SEC and to stockholders regarding the contents of the prospectus. The Securities Act of 1933 sets the requirements for the prospectus, thus assuring consistency in the type of information that is included in the document. The typical prospectus writing process involves at least three lawyers (one for the company and one for each of the investment bankers), two investment banking firms, and at least one certified public accountant. Each party has a vested interest in providing the public with an honest view of the company. Thus, we can be reasonably assured that the prospectus is a useful data source (Marino, Castaldi, & Dollinger, 1989).

Our coding strategy was developed and refined based on earlier research on IPO firms (see method used by Welbourne and Andrews, 1996). Code sheets and a coding handbook were given to each coder after each individual attended an initial training session. A total of five coders worked on the data. In addition, weekly meetings were held with coders to go over problems and/or inconsistencies in the prospectuses. Finally, we randomly cross coded prospectuses (every 10th prospectus). For the variables used in this study, agreement was 90% or higher among the coders. Financial data were also obtained from COMPUSTAT, Going Public: The IPO Reporter (for financial data at the time of the IPO), and from a database obtained from the Securities Data Corporation.

Sample Characteristics

At the time of its IPO, the average firm in the sample (n=360) was 7.06 years old (s.d. 7.07). The median firm, however, was 6 years old, and the range was from 1 to 47 years old, with most of the firms (80%) being less than 10 years old. Given that the age data were skewed, we logged the variable for the analyses reported in this paper. The average firm in the sample employed 786 people (s.d. 1,485). The median firm had 207 employees, with a range from 1 to 13,235. Given the skewed distribution on size, we logged number of employees for the analyses. As a supplement to our analysis, we restricted the sample on both age and size (firms with between 10 and 10,000 employees that were between 1 and 20 years old), and we

obtained the same pattern of results (beta coefficients). Given the similarity in results and that we had no theoretical reason for restricting the sample (and due to the fact that we tested an interaction with size and wanted variance in those terms), we decided to report the equation using the larger sample and the logged variables.

On average, net profit per share was \$0.17 (s.d. \$0.55), and the initial offering price per share was \$10.20 (s.d. \$7.27). Using the classification scheme reported by the Small Business Administration to determine industry, the sample's highest concentration of firms was in manufacturing (50.6%). A total of 19% of the firms were in service industries, while 5.2% were in wholesale trade, 7.4% in transportation and/or communications, and 8.2% in retail trade. Other industries include .2% in agriculture, 3% in mining, 1.9% in construction, and 4.4% in health care and financial services. Table 1 provides a summary of the means, standard deviations, and medians for variables used in the analyses.

TABLE 1: Descriptive Statistics and Correlations for Variables Used in the Regression Analyses

	Mean	Standard Deviation	Median	1	2	3	4	5	6	7	8	9	10	11	12
1. Senior HRM executive (0,1)	.07	.26	.00	1.00											
2. 1996 Stock price	11.63	10.13	9.00	.14	1.00										
3. 1996 Earnings per share	-.13	1.57	.15	.12	.35	1.00									
4. Change in sales (92 to 93)	.86	4.58	.29	-.04	-.08	-.01	1.00								
5. Change in sales (92 to 95)	2.70	7.68	1.08	-.06	-.08	-.14	.82	1.00							
6. Initial stock price (at IPO)	10.20	7.29	9.75	.16	.09	-.11	.001	-.05	1.00						
7. Age of company (log)	1.76	.93	1.94	.04	.10	.11	-.09	-.14	.09	1.00					
8. Number of employees (log)	5.29	1.73	5.41	.26	.39	.34	.02	-.07	.27	.21	1.00				
9. Risk factors	3.88	1.50	4.00	-.19	-.15	-.19	-.003	.17	-.15	-.07	-.41	1.00			
10. Net income per share (IPO)	.17	.55	.24	.07	.35	.32	-.11	-.15	.17	.18	.47	-.29	1.00		
11. Union presence (0/1)	.20	.40	.00	.16	.22	.21	-.07	-.10	.22	-.006	.43	-.25	.24	1.00	
12. Beta (year end 1996)	.87	1.06	.86	-.01	.16	.16	-.003	.01	-.002	.03	.02	-.006	.04	-.03	1.00

All correlations above .08 are significant at the .10 level; above .10 are significant at the .05 level, above .12 are significant at .01 level, and above .17 are significant at the .001 level.

Independent Variables

Senior HRM Executive. We coded from the 'Management' section of the prospectuses whether or not each firm had a senior HRM executive as part of the top management team (i.e. VP of HRM who reported to the CEO). Thus, our variable of interest was dichotomously measured with "1" representing those firms that reported having a senior HRM executive and "0" representing those firms without a senior HRM executive. A total of 37 (7%) firms from the overall sample of 535 and 26 out of the smaller sample of 360 (7.2 %) were coded as having a senior HRM executive reporting to the CEO.

Rate of Growth and Firm Size. We obtained sales data for years 1992 and 1993 and from 1992 and 1995 (from COMPUSTAT), and we calculated the percentage change in sales for those years. We included the first measure of rate of growth (from 1992 to 1993) in order to be consistent with the other data (all obtained at the time of the IPO). However, because we expected low variance in rate of growth prior to the IPO (firms go public in order to obtain the cash to grow and because one year is a limited period of time), we supplemented the study with the second measure, rate of growth from 1992 to 1995. Company size (also obtained from the prospectus) was measured as number of employees at the time of the IPO.

Dependent Variables

Given that the primary reason investors choose to put money into an IPO is to make money when the firm's stock price increases over time, we examined measures related to stock price growth. This is consistent with recommendations of researchers who suggested future strategic HRM studies should include measures of shareholder wealth and stock price (Abowd, Milkovich & Hannon, 1990; Gerhart and Milkovich, 1990). In addition, market-based measures represent the most prevalent and relevant firm performance measures in the IPO literature (see Ibbotson and Ritter, 1995 for a review). Thus, our primary dependent variable of interest is year-end 1996 stock price. After controlling for initial stock price (adjusted for splits, buybacks, and any other changes that affected unit price), this should reflect the increase in value of the firm in the first three years following the IPO.

In order to supplement our study, we also predicted year-end 1996 earnings per share. Earnings per share (EPS) is a measure of internal performance that is often used by analysts and investors to assess future value of the firm. In the EPS analyses, we included earnings per share at the time of the IPO as a control variable. By conducting the analyses in this way, we eliminate measurement issues surrounding the use of change scores. However, we did run the analyses with change scores (percentage change from IPO to year-end 1996 as dependent variables), and the patterns of results (including significance levels) did not change.

Control Variables

Several control variables, selected based on a review of both the strategic human resource management and initial public offering literatures (e.g. Beatty & Zajac, 1994; Huselid, 1995; Welbourne & Andrews, 1996), were used in the analyses. Net profit per share at the time of the IPO was included as a performance measure. In addition, we coded whether the firm was unionized or not. We thought that this was an important control because a union presence may affect management decisions regarding the hiring of senior HRM staff (Huselid, Jackson, & Schuler, 1997). We included company age (calculated as 1993 - date incorporated) as an additional control because firm age may be related to characteristics of the management team and growth rate. Nine (one is omitted) industry classifications, based on categories reported by the Small Business Administration, were used for the analyses.

Although our sample of IPO firms consists of companies that are considered to be higher risk investments than companies currently in the public market (due to their having no prior stock price history), we expect that each firm will be subject to varying degrees of risk. Therefore, an additional control variable (logged) indicates the level of risk faced by each firm. Each prospectus contains a section listing all risk factors faced by the firm. These risk factors must be disclosed to meet the requirements of the Securities and Exchange Commission. The presence of the following risk factors were included in this measure: new product, few or limited products, limited number of years in operation, inexperienced management, technical risk, seasonality, customer dependence, supplier dependence, inexperienced underwriters, competition, legal proceedings against company, liability, and government regulation. The summated risk measure ranged from 0 to 9, with a mean of 3.88 and a standard deviation of 1.50. Prior research on initial public offering firms found that this measure was a useful way to code risk (Beatty and Zajac, 1994; Rasheed and Datta, 1994). Finally, to control for the firm's sensitivity to overall market movements (important because we are predicting stock price growth), we included beta as of year end 1996 (obtained from COMPUSTAT for the period ending 1996) as a measure of systematic risk. Given that beta is not reported until a firm has been public for two years, we could not obtain beta for the companies at the time of the IPO³.

RESULTS

Table 1 includes the bivariate correlations for the variables in the analyses. The results show that having a senior HRM executive is positively correlated with 1996 stock price (.14) and

³ The analyses, without beta, result in the same pattern of results, including significance levels.

earnings per share (.12) in addition to initial stock price (.16) and union presence (.16). The strongest relationship is with size (.26), indicating that larger firms are more likely to have a senior HRM executive reporting to the CEO.

Tests of Hypotheses

We tested the hypotheses by running a series of ordinary least squares (OLS) regression equations. The analyses were conducted in three steps, where in the first step we entered all of the control variables and the independent variables of interest. In the second step we entered the two-way interaction terms, and in the last step we entered a three-way interaction (between rate of growth, firm size, and HR executive presence). Additionally, we ran the analyses using two different measures of rate of change (growth in sales from 1992 to 1993 and from 1992 to 1995).

Effects for Stock Price. Table 2 includes results of the OLS regression analyses predicting future stock price. Our test of hypothesis 1, which proposed a direct effect for having a senior HRM executive, was not supported. Although Table 2 reports the equation with all interaction terms, the results (i.e., the non-significant betas on the HR executive variable) were the same in the regression without the interaction terms (i.e., step 1). There was no significant effect for having an HR executive on either dependent variable (stock price or earnings per share).

To test hypotheses 2 and 3, we calculated interaction terms that crossed the senior HR executive variable with rate of growth and firm size. The change in R^2 associated with the second step was significant using both measures of rate of growth ($p \leq .01$), and the only interaction term that was significant in that equation was change in sales and HR executive presence. This provides support for hypothesis 2. However, hypothesis 3 was not supported for stock price. Lastly, the three-way interaction (between change in sales, firm size, and HR executive presence) was not significant.

We plotted the data for the significant interaction using the constant and unstandardized beta coefficients for change in sales (we used the 1992 to 1993 rate of growth measure for the plot) and HR executive presence (at 2 standard deviations above and below the mean) in the analysis (Cohen & Cohen, 1983). Figure 1a shows those results. As predicted in hypothesis 2, firms experiencing a higher rate of growth improve their stock price performance when they have a senior HRM executive reporting to the CEO. However, among low-growth firms, there appears to be a negative effect for having an HR executive.

As a further test of the significance of the interaction terms, we tested for the significance of each coefficient (slope of Y on HR executive presence at different levels of rate of growth) by

calculating the slope and the standard error associated with the slope (see method described in Jaccard, Turrisi, and Wan, 1990) at the two levels of rate of growth used in the plot of interaction terms (low and high levels based on standard deviations). The results of the follow-up tests indicate that the effect is significant at both low and high values of rate of growth. This means that HR executive presence significantly and positively affects fast-growth firms, and it equally significantly and negatively affects low-growth firms in terms of stock price growth.

TABLE 2: Regression Analyses for Year-End Stock Price and Year-End Earnings Per Share (1996)

Variables	Stock price, 1996		Earnings, 1996	
	Sales change data used		Sales change data used	
	92 to 93	92 to 95	92 to 93	92 to 95
	Beta	Beta	Beta	Beta
H1: HRM Executive (0/1)	-.05	-.13	.08	.05
Change in sales	-.03	.02	-.02	-.04
Initial offering price	-.43***	-.42***	-.54***	-.54***
Age of company (log)	.05	.05	.11*	.10*
Size (number of employees)	.43***	.42***	.46***	.46***
Risk factors	-.26***	-.27***	-.20***	-.20***
Net income per share	-.09	-.09	-.17***	-.17***
Union presence (0/1)	.10*	.10*	.16***	.16**
Beta (year end 1996)	.11**	.11*	.14***	.14***
Change in R ² - Step 1	.44***	.44***	.48***	.48***
H2: Change in sales & HR executive	.16**	.23**	-.01	-.006
H3: Firm size & HR executive	-.04	-.03	-.14*	-.16*
Change in R ² - Step 2	.02**	.02**	.01*	.01*
H4: 3-way interaction (change in sales*size*HR)	-.10	-.10	-.03	.02
Change in R ² - Step 3	.003	.002	.000	.000
TOTAL R ²	.46	.46	.49	.49
F	13.92***	15.87***	12.40***	13.98***

*** p ≤ .001 ** p ≤ .01 * p ≤ .05 + p ≤ .10

Standardized beta coefficients are reported. Industry codes, although not reported, are included in the analyses.

FIGURE 1: Plot of Interaction Terms

Figure 1a

Predicting 1996 year-end stock prices:
Interaction of HR executive presence
and change in sales (1992 to 1993)

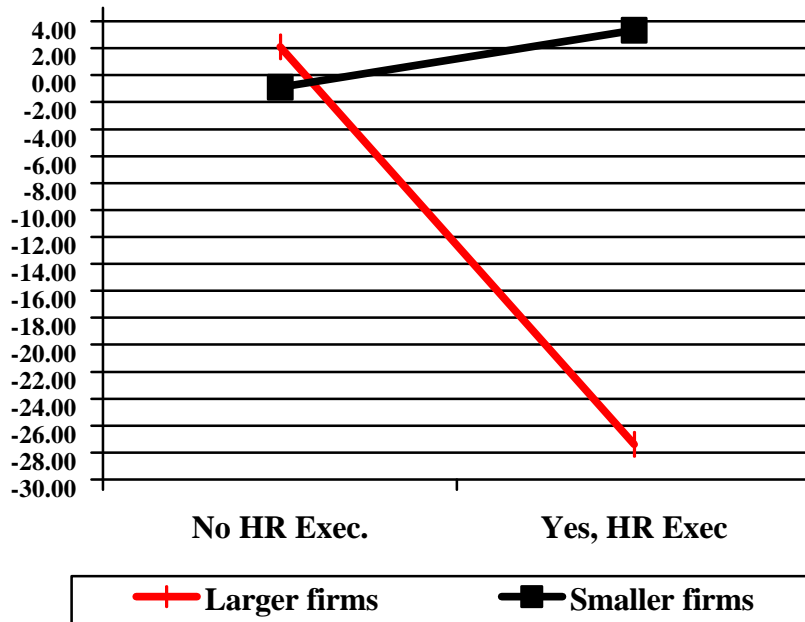
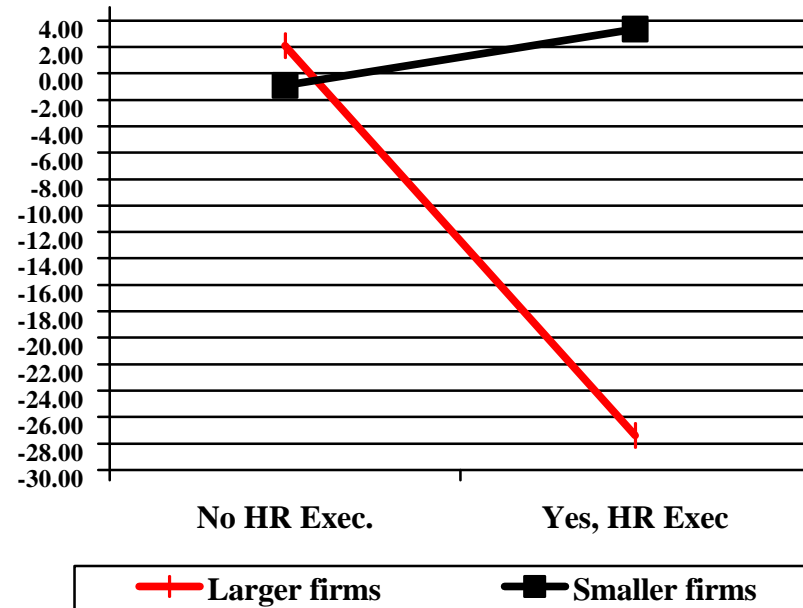


Figure 1b

Predicting 1996 earnings per
share: Interaction of HR executive
presence and firm size (number of
employees)



Effects for Earnings Per Share. Table 2 also includes the results of the regression analyses for earnings per share. Again, we found no significant effects for having a senior HRM executive. Thus, we find no support for hypothesis 1.

The change in R^2 associated with the interaction terms being added to the equation was again significant ($p \leq .05$); however, in these analyses the interaction terms for firm size and HR executive were significant. This provides support for hypothesis 3 but not hypothesis 2. Figure 1b includes a plot of the interaction, and it indicates support for hypothesis 3. Smaller firms benefit from having someone in the HR executive role; however, it appears that larger firms (in our sample these tend to be mid-size firms) seem to experience a negative effect on earnings per share from having an HR executive on the top management team. The three-way interaction term had no significant effect on earnings per share.

Again, we tested the significance of the interaction terms for both the low and high levels of firm size. The results indicate that the interaction effect is significant at both low and high values of firm size (measured as number of employees). Thus, HR executive presence significantly and positively affects smaller firms, and it significantly and negatively affects larger organizations (with earnings per share as the dependent variable).

DISCUSSION

Our hypotheses for the direct effects of strategic HRM, or for having a senior human resource management executive reporting directly to the CEO, were not supported for either stock price or for earnings per share. The results for interactions of HR executive presence with rate of growth and firm size were supported, although we obtained different results for our two dependent variables. The overall pattern of findings suggests that HR executives can have a positive effect on stock price growth for fast-growth firms, and they can also have a positive effect on earnings growth within smaller firms. In addition, the results indicate that the HR executive is associated with lower stock price performance for low growth firms and lower earnings per share for larger (in our sample, mid-size) organizations.

Contrary to hypothesis four, the three-way interaction between rate of growth, firm size, and HR executive presence was not supported. This may be due to the relatively small number of HR executives in the sample or some other uniqueness associated with the particular sample studied. However, as the research now stands, we cannot interpret our results as suggesting that small, growth-oriented firms benefit from having a senior HR executive. We seem to be obtaining two separate and distinct effects, at least when related to our sample and the dependent variables that we studied.

Our findings may be related to the types of goals that small vs. fast-growth firms are attempting to achieve, or they may be associated with the unique context of the IPO. Fast-growth firms may hire a senior HR executive because they are more oriented toward stock price growth as a strategic goal (many fast-growth firms have investors who want to 'cash out' when the firm goes public or soon after the firm conducts its IPO). These organizations may set stock price growth as a goal for the executive team, including the HR executive. At the same time, smaller firms (which may not have as many outside investors since they may be going public at a relatively early stage in their life cycle) with an HR executive may be more focused on earnings growth.

The IPO is a critical change event for organizations, and the effects of the IPO on employees and the management team have not been investigated in depth. Perhaps the demands of the IPO (e.g. being in the public eye, stock ownership for many employees, management being busy with investor relations, etc.) are particularly difficult for smaller and fast-growth firms, and these problems can be mitigated by the presence of an HR executive. It may also be the case that investors know the value of a senior level HR executive, and the presence of this individual at the time of the IPO helps increase investor interest in the firm, thus spurring stock price growth.

The pattern of findings supports the idea that rate of growth matters, and rate of growth interacts with having a senior HRM executive to affect firm performance. Additional research on the effect of rate of growth as a contingency variable, perhaps focusing on the more traditional SHRM agenda (i.e. human resource practices) would be useful. Given the general mixed results obtained from contingency theory work in SHRM (Delery & Doty, 1996), studying rate of growth may shed new light on these studies. In addition, given the importance of change to large firms, it is quite possible that rate of change, or ability to change, will be an important construct to include in studies of SHRM within larger firms.

Moderating Effect of Firm Size

The importance of understanding rate of change seems particularly salient given our results for firm size. The human resource management department is under considerable pressure today to become more strategic and to be a business partner. But for firms in our sample (which is notably a limited segment of the population of organizations), we find a negative effect on performance among larger firms that report having a senior HRM executive. It is important to note, for purposes of interpretation, that the larger firms in our study are actually mid-size firms. It is quite possible that the negative effect for the senior HRM executive is linked to the fact that mid-size firms have special challenges associated with lacking flexibility

and resources. Perhaps they are not as nimble as they once were, yet they do not enjoy the substantial resources of being a large firm; they may be precariously “stuck in the middle.”

For example, the senior HRM executive in a mid-size firm may not have a staff that is adequate to meet the challenges faced by the firm at this stage. It is highly likely that the executive at this stage is just starting to face challenges that did not exist when the firm was smaller (e.g. lawsuits, need for hiring HR staff, etc.). In addition, as the firm expands, it is likely to have multiple HR strategies (Boxall, 1993). If the HR executive is unwilling to diversify the HR system (which means giving up power), then he/she could be contributing to the firm's inability to change. It is also possible that the senior HRM executive at this stage is willing, but not qualified, to handle a more diverse organization with multiple HR strategies (Wright, et al., 1996). At the same time, the HR executive may be willing and professionally able but restricted from action due to organizational bureaucracy that often accompanies being a larger firms.

Studies that focus on the effects of having a senior HRM executive as part of the top management team in small, mid-size, and large firms are needed to clarify the issues raised in our study. The firm size effect may have implications for large firms as they begin to transform their HRM departments. There has been an ongoing debate in the SHRM about the need for fit versus flexibility (Morris & Jones, 1993; Wright & Snell, 1998). Perhaps the negative effect of having a senior HRM executive in the larger firms is due to the firm's attempts to obtain “fit” at a time when the firm still needs to be nimble and flexible. Our results could also be interpreted as suggesting a need for strong HRM leadership at the business unit level rather than at the organizational level. The business unit is most likely to be similar to the smaller firms in our study.

Implications of Firm Growth

Our results suggest that other factors designed to enhance human resource value (e.g. training, compensation, etc.) may increase firm performance as companies engage in change. However, the results also suggest that doing things to inflate human resource value (the degree to which a firm values people), at a time when a firm is at rest, may not necessarily lead to positive consequences for firm performance. This is due to the fact that higher levels of human resource value at this stage may encourage employees to stay where they are (become inflexible) rather than to change. And in today's work environment, change appears to be critical for maintaining one's competitive position and long-term viability (Eisenhardt & Brown, 1998).

Our findings suggest that rate of change may be an important construct for theory development and for expanding studies that have considered stage of growth. In an effort to

understand the formation of new firms and firm growth, several life cycle or stage models have been suggested (e.g. Kimberly & Miles, 1980; Starbuck, 1971). However, these models tend to be static. Additional conceptual work that examines the pace at which firms travel through various stages should be developed to enhance our understanding of firm growth. As the stage models suggest, each stage brings with it a new set of problems. However, if rate of change is escalated, we may find that preparation for those problems at an early stage is more important for firm survival and performance. The human resource factor, which is the focus of this paper, is only one of a number of issues that can be examined more adequately by introducing rate of change.

Our study may have important implications for development of the management team for fast-growth firms. Perhaps as rate of growth escalates, the ability of the CEO to delegate duties to a team of experts is even more critical. Where in a lower growth firm the CEO may have time to learn and adjust to the needs of the new stages of his/her organization in addition to getting out in the company and talking to employees to acquire information, this may not be the case in a fast-growth organization. The human resource executive, or someone who serves a similar role, may be particularly critical because as rate of change increases, the leadership team may have less time to make decisions. Perhaps the HR executive is in a better position to acquire and aggregate information from all employees in the organization.

When the organization begins to 'slow down,' once again the top team members have a chance to take stock, learn, and they may, at times, become just a little too confident in their own abilities. If this were the case, top management (including the CEO) may begin to listen less to employees, the HR executive, or other experts in the organization and instead rely on themselves. This type of behavior may contribute to the cycle of being 'at rest,' or executives may be simply making mistakes due to their having incomplete information. Although these ideas are grounded in theory and the results of our study, they are speculative and need to be further developed. Additional work, addressing the needs of fast growth firms, both from theoretical and empirical perspectives, are needed.

Limitations

As already noted, even though our research enhances the SHRM literature by studying a topic that has not received attention in the past, our inability to complement the study with more traditional SHRM work somewhat limits the interpretation of our data. Future work should include measures of both aspects of SHRM: policy and reporting structure. In addition, more detailed work on how the senior HRM executive assists and complements the top management team in non-HRM issues will be critical for understanding their true effects on performance.

Our study focuses on the profile of the firm at the time of the IPO; as a result, we do not have data on changes in senior HRM executive reporting from the time of the IPO to 1996. It is quite possible that firms that did not have a senior executive when they went public added a senior HRM executive subsequent to their IPOs. This is another area that warrants further investigation. Lastly, we are unsure how generalizable our results are to non-IPO firms. If the underlying theory that we used in our study can be applied to any type of organization that is growing or going through a major change initiative, then the results of our study may apply to larger firms and to non-IPO firms.

Conclusion

The results of our study add to the growing literature in the field of SHRM by expanding the work to a new sample of firms (initial public offering firms) and by empirically assessing the effects of having a senior HRM executive on two measures of firm performance (long-term stock price and earnings performance) that are not often included in this type of research. In addition, we supplemented the SHRM research by introducing a new contingency variable, rate of growth, and by further developing the implications of organizational inertia for researchers in the field of HRM. Our findings suggest that smaller and fast-growth firms can benefit from having a senior HRM executive as part of their top management team. Although consistent with theory, this finding may come as a surprise to many people who work with smaller, entrepreneurial firms (e.g. investment bankers, venture capitalists, CEOs). The expense of hiring a senior HRM executive is more than likely something that many young firms would prefer not to incur; however, if they plan to grow rapidly, our research suggests that adding a senior HRM executive at an earlier stage may be a wise choice.

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