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Abstract

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Keywords

human, resource, executive, firm, public, prospectus, companies, stock, price

Disciplines

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Strategic and Administrative Human Resource Management (HRM): A Study of HRM Reporting in Entrepreneurial Firms

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Working Paper 98-20



Strategic and Administrative Human Resource Management (HRM): A Study of HRM Reporting in Entrepreneurial Firms

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This paper has not undergone formal review or approval of the faculty of the ILR School. It is intended to make results of Center research available to others interested in preliminary form to encourage discussion and suggestions.

ABSTRACT

This paper reports the results of an exploratory study examining firm characteristics associated with choosing an administrative or strategic approach to HRM. Strategic HRM is defined as having a senior HRM executive who reports to the CEO, while administrative HRM is defined as having the HRM function report to a Vice President of Administration. Data are gathered from a cohort of firms that went public in 1993. The results show that different sets of characteristics are associated with each HRM reporting form, and analysis of stock price growth after the IPO demonstrates that the strategic HRM companies enjoy increasing stock price, while the administrative HRM firms have decreasing stock price. Implications for new forms of HRM in entrepreneurial firms are discussed.

There has been considerable discussion lately about the advantages of human resource management (HRM) departments being strategic and evolving from an administrative function to a capable business partner (Ulrich, 1997). However, with all the “talk,” there has been little attention given to understanding what types of firms are listening to this “wake up call” and to what sorts of businesses are adhering to the old administrative HRM model. Although there have indeed been case studies and examples of firms that have undergone such a transformation from administrative to strategic (e.g., Alvares, 1997), empirical data that characterize firms in the administrative vs. strategic camp are missing. And, even though there is an overwhelming agenda to change HRM to become more strategic, the administrative role continues to exist (Mohrman, Lawler & McMahan, 1996).

Given recent articles, like the one written by Stewart (1996) suggesting that the HRM department be “blown up” because the administrative focus can negatively affect the organization, one wonders why any company would choose to have an administrative HRM group rather than a strategic HRM function. The goal of this study is exploratory in nature, and it is designed to examine the characteristics of entrepreneurial firms that choose either strategic or administrative HRM. The companies studied represent a cohort of firms from multiple industries that went public in 1993. These companies are part of a large-scale study¹ designed to examine the role that HRM (both formal and informal) plays in the development, performance, and survival of these newer, younger, and growth-oriented firms.

The research presented in this paper examines the determinants of choosing either administrative or strategic HRM. The data used for the study were obtained from the prospectuses of these firms, and although the prospectus does not include specific detail about how HRM is conducted within each organization, it does note whether HRM is considered part of the responsibility of someone in the top management team. For purposes of this study, an administrative form of HRM is defined as having the HRM department report directly to a Vice President of Administration, and being strategic is defined as having a senior HRM executive who reports directly to the CEO.

In addition to being administrative or strategic, firms in the sample noted when HRM reported to other senior executives, such as Chief Financial Officer (CFO), Vice President of Quality, or Legal. The data were not available to determine whether these functions were administrative or strategic in nature. One could envision an HRM function reporting to a high-

¹This study is supported by both the Society for Human Resource Management Foundation and the Center for Advanced Human Resource Studies, Cornell University.

powered CFO as very strategic, or one could imagine an HRM department being very administrative when reporting to a CFO who does not place much value on HRM. Given that the data were not available to make those type of judgement calls, the study presented in this paper only focuses on the two reporting structures that seem to suggest administrative vs. strategic.

THE RESEARCH STUDY

When a company goes public, it is required to provide extensive information on not only its financial position, but its internal structure, to the Securities and Exchange Commission and to the general public. That information is described in the firm's prospectus. Thus, the prospectus is used to obtain archival data about where the HRM department reports at the time of the company's IPO.

A total of 706 firms went public during 1993; however, only 585 of those companies produced a good or service (excluding real estate trusts, etc.) and had employees. Of those firms, prospectuses for 535 were obtained (since the prospectuses were obtained in 1995, some of them were unavailable).

Data Collection and Coding

The primary data source was the prospectus of each firm. 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 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 1993 data. In addition, weekly meetings were held with coders to go over problems and/or inconsistencies in the prospectuses. Finally, coders randomly cross coded prospectuses (every 10th prospectus). For the variables used in this study, agreement was 90% or higher.

1993 Sample Characteristics

At the time of its IPO, the average firm in the 1993 sample was 8.21 years old (s.d. 0.42) and employed 911 people (s.d. 1,384). The median firm was 6 years old and employed 341 people. On average, net profit per share was \$0.30 (s.d. \$0.59) and initial offering price

per share was \$12.13 (s.d. \$5.03). Using the classification scheme reported by the Small Business Administration to determine industry, the sample's highest concentration of firms was in manufacturing (46.6%). A total of 20% of the firms was in service industries, while 5.5% were in wholesale trade, 10% in transportation and/or communications, and 9.7% in retail trade. Other industries include .2% in agriculture, 3% in mining, 1.5% in construction, and 3.2% in health care and financial services. Table 1 includes means, standard deviations, and the correlation matrix for all variables used in the study.

TABLE 1
MEANS, STANDARD DEVIATIONS, AND CORRELATION MATRIX FOR VARIABLES USED IN THE REGRESSION ANALYSES

	Mean	St. Dev.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1. Company age	8.21	.42	1.00														
2. Number of employees	911	1384	.13	1.00													
3. Union	.20	.40	.08	.25	1.00												
4. Emp. relations	3.11	.82	.08	.00	-.05	1.00											
5. Ees. imp. for strategy	.82	.39	-.10	-.28	-.35	-.01	1.00										
6. All ees. are key	.09	.29	-.08	-.01	-.09	.003	.15	1.00									
7. Competitive labor mkt	.31	.46	.03	-.13	-.23	.02	.26	.22	1.00								
8. Inexperienced mgt.	.05	.22	-.06	-.05	-.12	.06	.02	.02	.01	1.00							
9. Legal proceedings	.07	.26	-.02	.01	-.03	-.06	-.06	.02	.02	-.03	1.00						
10. Foreign operations	.36	.48	.07	.10	.22	-.003	-.12	.002	.05	-.06	.02	1.00					
11. CEO ownership %	25.89	27.94	-.05	-.02	-.08	-.07	.18	-.06	-.05	-.04	-.05	-.10	1.00				
12. CEO founder	.45	.50	-.05	-.13	-.17	.02	.26	.08	.07	.03	.02	-.08	.48	1.00			
13.VC backing	.29	.45	-.01	-.12	-.19	.05	.17	.15	.30	.06	-.001	.02	-.33	-.08	1.00		
14. Strategic HRM	.07	.25	.03	.10	.12	.08	-.14	-.01	-.06	-.06	.04	.09	-.13	-.12	.04	1.00	
15.Administrative HRM	.04	.19	.12	.18	.08	.01	.01	.01	-.01	.001	.10	-.02	-.03	-.09	-.03	.01	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.

Dependent Variables

Where HRM Reports. Archival data, rather than survey data, were used to obtain the measures of where the HRM department reported. This strategy is limited in that HRM presence is only noted when someone in the top executive team has responsibility for HRM (otherwise, it does not show up in the prospectus). Although a limitation, it provides a more accurate test in that the HRM department is more likely to actually be a department vs. one secretary or administrator who simply “pushes paper.” A total of 82 firms indicated having a human resource function reporting to someone in the top management team. Of those, a total of 19 companies (23% of the 82) had an HRM department that reported to the Vice President of Administration, while 37 (45% of the 82) firms had a Vice President (or Senior VP) of HRM who reported directly to the CEO. The remaining 32% had an HRM function that reported to a specific operating executive (in most cases the CFO, but in a few other instances, HRM reported to the Chief Legal Officer, VP of Quality, or other functional area VP).

Independent Variables

A combination of demographic, employee relations, and management variables (all available in the prospectus) was included in this exploratory study. In terms of demographic variables, company age (1993 - date of incorporation), size (using number of employees), union status (yes / no), and the company’s international status (whether they had international operations) were included. Age was included in order to determine if older firms, which may be more traditional, were more likely to have administrative HRM. Size was included because much of the literature on life cycle and in the human resource management domain suggests that the addition of an HRM department is related to size, and as a company increases size, it also adds people to the top management team and has greater needs in the areas of HRM. Union status was included because the presence of a union creates demand for someone whose job includes management of union relations for the company. International status was included using the logic that firms with overseas operations may have additional demands on the human resource side and require a professional individual to handle the job.

A variable denoting whether the company had legal proceedings against it (involved in a lawsuit) at the time of the IPO (0/1) was also included. Since many of the legal proceedings involved employment issues (25% of those listed were employment related), and because any type of legal proceeding may raise the awareness of legal liability and the potential need for an HR executive to help protect the firm, that variable was included in the analysis. In addition, I

included dummy variables for industry classification because there may be industry trends toward having either form of HRM.

For employee relations variables, several items, some used in prior research on human resource value in initial public offering firms (see Welbourne and Andrews, 1996), were used. They include: the employee relations environment (coded from 1 to 3 with 1 being poor, 2 being average, and 3 being excellent), a variable that notes whether the company cites its employees are an important part of their overall strategy (0/1), another that indicates whether all employees (vs. only management) are key to the company's success (0/1), whether the company is in a competitive labor market (0/1, included in the risk section of the prospectus), and whether they have a risk of having inexperienced management (0/1).

Lastly, three management related factors were included because these conditions may influence not only whether a firm has an HRM department but where it reports. The first two relate to characteristics of the CEO. The first is whether the CEO was the founder of the company, and the second is the percent ownership the CEO had in the business prior to the IPO. The third variable is the presence of venture capital backing. Because venture capitalists are known to have influence over the structure of the management team (making suggestions for changes or additions), their presence may have an impact on the way that HRM is conducted within the top executive group.

RESULTS

Descriptive statistics (means, standard deviations) and correlations are included in Table 1. Two separate logistic regression analyses were run to determine what predicted HRM form (whether strategic or administrative). Logistic regression was used rather than hierarchical regression because the dependent variables are dichotomous (0/1), rather than continuous. The results of the analyses are in Table 2.

TABLE 2
RESULTS OF LOGISTIC REGRESSION ANALYSES PREDICTING WHETHER
FIRM HAS VP OF HRM OR VP OF ADMINISTRATION
RESPONSIBLE FOR HRM FUNCTION (n=450 after accounting for missing data)

DV = VP of Administration with HRM(0=no, 1=yes)			DV = VP of HRM (0=no, 1=yes)	
Variables	beta	s.e.	beta	s.e.
Constant	-10.36	72.31	-14.01	108.39
Company age	.06*	.03	.02	.04
Number of employees	.00	.00	.00	.00
Union (0/1)	1.84*	.80	1.40	.81
Employee relations environment (1 to 3)	-.16	.45	.87**	.35
Employees an important part of the firm's strategy (0/1)	1.15	1.17	-.42	.92
Mention ALL employees are key / important (0/1)	.09	.91	1.79*	.89
Are in a competitive labor market (0/1)	1.28	.78	-.96	.82
Risk of inexperienced management mentioned (0/1)	-6.90	45.18	-7.77	70.29
Currently have legal proceedings against them (0/1)	2.94***	.83	-.30	1.37
Have foreign operations (0/1)	-.87	.72	1.50*	.75
CEO ownership prior to IPO	-.01	.01	-.02	.02
Whether CEO was founder (0/1)	-.99	.77	-.91	.87
Venture capital backed (0/1)	-1.77*	.93	1.10	.85
Chi Square	34.06*		39.79**	
Overall percent classified correctly is	96.09%		95.02%	

*** $p \leq .001$; ** $p \leq .01$; * $p \leq .05$

Note: Industry codes are included in the analyses. None of the industry codes were significant (at the .05 or less probability level) in either equation.

Administrative HRM

The results for the equation predicting administrative HRM show that only four variables were significant. Older, unionized, non-venture capital backed firms that had legal proceedings against them were most likely to have a vice president of administration responsible for the HRM function. Given that much of the HRM literature speculates the way that HRM is run is a function of the life cycle, the result showing that size (number of employees) is not significant is somewhat surprising. In order to supplement the analysis, I substituted number of employees with sales, and the results were the same. Although not

listed in the tables, a set of dummy variables for industry was included in the analysis, and none of them were significant.

Strategic HRM

The results are different for strategic HRM. In this analysis, it seems that companies with a positive employee relations environment that mention all employees as important to their performance, and that have foreign operations (a location overseas) are more likely to have a strategic HRM function (VP of HRM reporting directly to the CEO). Again, size is not important, and neither is age, industry, nor union status.

Relationship to Firm Performance

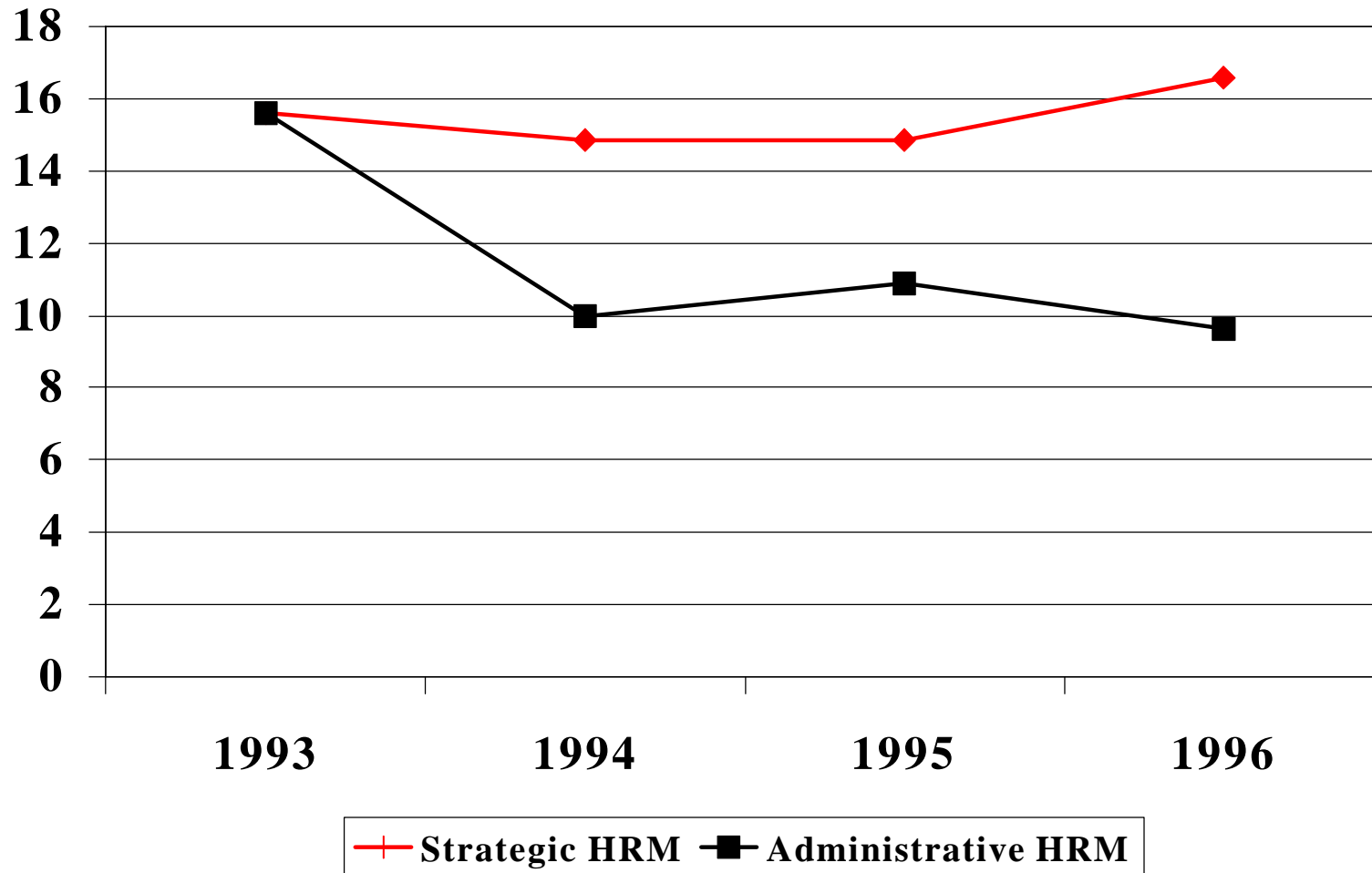
In order to determine how well these companies performed after the IPO, I plotted stock price at the time of the IPO (adjusted for splits, mergers, etc.) and stock price for years ending 1993, 1994, 1995, and 1996. Figure 1 shows a graph of the data. In 1993, both groups of firms had a very similar year-end stock price (strategic HRM was 15.59 while administrative HRM was 15.62), but their stock prices differ starting in 1994, with the mean for those firms in the strategic HRM group being higher. Although this analysis does not prove causation, it does indicate the stock of the strategic HRM firms performed better than the stock for the administrative HRM companies.

In a separate study that is part of the overall IPO research project (Welbourne & Cyr, 1998), a more detailed analysis indicated that the administrative form of HRM had a significant and negative effect on growth in stock price from the time of the IPO to year-end 1996. Although not significant, the regression analysis does indicate that the direction of the effect of having strategic HRM on change in stock price is positive. In addition, the strategic form of HRM had a significant and positive effect on change in earnings per share from the IPO to year-end 1995, which in turn, had a positive effect on change in stock price. The authors speculate that strategic HRM may have a positive effect on stock price through the ability of the function to enhance factors that positively affect the firm's earnings. Although preliminary, both analyses (the simple and more complex as noted in the other research papers) seem to show that the administrative form of HRM can have a negative effect on the firm's performance, while the strategic form can enhance the company's financial performance.

FIGURE 1

FIRMS PERFORMANCE FOR COMPANIES WITH ADMINISTRATIVE AND STRATEGIC HRM

STOCK PRICE FROM TIME OF IPO TO YEAR-END 1996



DISCUSSION

The research presented in this paper shows that firms choosing administrative HRM tend to be older, unionized, and currently have legal proceedings against them. In addition, these firms are less likely to be backed by venture capitalists, indicating that they are less likely to be high technology or fast-growth firms. This is consistent with their being unionized and older. The significance of legal proceedings and union status suggests these firms may have added an HRM function to respond to their 'problems' rather than to pursue an opportunity.

The equation predicting strategic HRM shows that these firms have a more positive approach to their employees, indicated by a better employee relations environment and being more likely to say that all of their employees are important to the performance of the firm. In addition, these firms tend to have international operations. It seems that firms taking a more strategic approach toward HRM may be doing so to be proactive. They may be utilizing their HRM function to help with their overseas expansion and to guarantee continued positive employee relations.

The strategic approach to HRM appears to be a more proactive approach toward employee management, and this seems to be associated with higher long-term performance of the firms in the sample. Even though strategic HRM appears to be indicative of being proactive in the HRM domain, the existence of strategic HRM (or any form of HRM) is still very low in the sample of initial public offering firms (6% of the overall sample).

Ideas From The Field: Client Relations in Entrepreneurial Firms

As part of the overall research initiative, I interviewed several CEOs in fast-growth, pre-IPO and post-IPO organizations. Most of them did not have HRM departments or senior executives in HRM. Given the potential contributions that a strategic HRM group may make to a fast-growth company, I asked these CEOs why they did not choose SHRM -- or to add a senior executive to the top management team. In many cases, the CEOs indicated that they were concerned that a senior HRM executive would bring bureaucracy and paperwork, or the types of things that could stifle their entrepreneurial culture. They seemed very familiar with the administrative form of HRM, and that is what they did not want in their firms. However, when I asked them if they understood how strategic HRM was different from "old fashion" HRM, their response was "I have no idea what SHRM means."

Unfortunately, the concept of SHRM is still unclear. Professionals talk about being business partners, being at the table, and being "strategic," but this does not mean much to the CEO of an entrepreneurial firm who wants to know what an HR professional will do. They

want to know what the person in this job will be doing all day. When a company is relatively small and entrepreneurial in nature, how can a senior HRM executive contribute? Before HRM executives can successfully “break into” entrepreneurial firms and make positive contributions, perhaps the HRM language should be altered or maybe the senior level job itself needs to change.

I have been working with a group of CEOs to develop ideas around a new type of HRM function. A senior executive in this new role could be hired much earlier in the firm’s life cycle because the individual would have duties that all in the executive team view as significantly contributing to the “bottom line” of the business. The concept necessitates reorganization of the HRM function in a way that is consistent with many of the moves toward outsourcing evident today. Rather than adding an HRM department or HRM executive, the company would hire a Client Relations Executive. The “administrative” part of HRM would be placed in the accounting department; that includes duties like benefits administration, compensation administration, EEO reporting, etc. The client relations function would then take on the ‘relationship’ part of HRM in addition to public relations and customer relations. In this way, a smaller company could benefit from addition of a professional ‘relationship’ manager earlier in its life cycle. Small companies can benefit from proactive client, public, and employee relations, but they do not usually have an executive whose prime responsibility focuses on maintaining and enhancing these critical relationships.

The individual in the client relations job would learn about the company’s products, markets, and its employees. The person in this job would be a critical part of the top management team, with a focus on understanding how business decisions affect the people constituencies in the firm. In terms of human resources, the individual would have responsibility for employee relations, employee communications, recruiting, selection, design of new compensation systems, training, and development. But with a knowledge of the customer (because the ‘job’ is also responsible for customer relations), the more traditional human resource functions would be done with a much broader knowledge base. Employees in the department would learn public relations, marketing, and human resources. The underlying “competency” would be knowledge of the business, communications, and people relations.

Two other duties are critical to CEOs in entrepreneurial firms. The first is helping develop the leadership team, and the second is sustaining the company’s culture. Both of these functions would be part of the responsibility of the senior client relations executive, and

both would be highly valued by the executives in the management team, and in particular, the CEO.

This new executive job would require a somewhat different set of skills. The reorganization of the HRM function in this way suggests two different HRM professional routes, where one necessitates knowing HRM and accounting, and the other requires knowledge of HRM and marketing (client relations and public relations). In fact, these 'other' skills could greatly enhance the individual's ability to conduct the HRM part of their job. The individual doing compensation administration would be someone who *really* knows accounting, and the person doing client relations would *really* understand marketing. The implications of this type of structure for early HRM education, training of HRM professionals, and for larger companies should be explored.

Given the potential negative firm outcomes associated with having administrative HRM, perhaps it is time for larger companies to give consideration to an altered way of doing HRM. It may be that the department doing the policing work (or administrative work) cannot be the same department that is responsible for leadership development, advising the top executive team, and the relationship or marketing side of HRM. How many HRM executives are having difficulty moving toward the 'strategic' form of HRM because they must also enforce the accounting part of HRM? How many staff members are simply not qualified to do the relationship or marketing part of the job because their expertise is in the more administrative or accounting fields? Perhaps a clear differentiation between accounting and marketing / relationship HRM would aid our understanding of the types of HRM activities that enhance firm performance vs. those that create barriers to entrepreneurship, which is something that both large and small firms today are attempting to sustain.

Conclusion

The results of the exploratory study presented in this paper show that firm characteristics are associated with a firm's decision to utilize administrative or strategic HRM. At the same time, interviews and work in the field suggest that the overall low presence of either form of HRM may be due to the inability of more traditional forms of HRM to meet the needs of the entrepreneurial firm. If HRM executives want to play a significant role in entrepreneurial firms, they need to be creative in the way they organize their responsibilities. Many entrepreneurs do not want the "administrative" model of HRM, but they do not understand the strategic version of HRM. And, to date, most definitions of SHRM do not

provide much guidance as to what the HRM executive would do to help the smaller, entrepreneurial business.

Functions that reduce entrepreneurial behaviors among employees, that create excess paperwork, and that remind CEOs of their “old, bureaucratic” companies will not be successful in an entrepreneurial firm. Unfortunately, some of the paperwork needs to be done. But, can HRM be the keeper of the “paperwork” and the keeper of the company “culture” at the same time? The CEOs who have been involved in this study think that is unlikely. When you take away the “administrative” part of the HRM function, what’s left when one works for a smaller, entrepreneurial firm? Perhaps the formation of the Client Relations Department in entrepreneurial firms is a start in a new direction that can allow HRM executives to be a true business partner.

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