CAHRS Working Paper Series

Center for Advanced Human Resource Studies (CAHRS)

3-1-2006

Research Report on Phase 4 of Cornell University/ Gevity Institute Study Human Resource Management Practices and Firm Performance in Small Businesses: A Look at the Effects of HR Practices on Financial Performance and Turnover

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Abstract

In this study, we found evidence that groups of HR practices that represent different strategies for managing employees were significantly related to the financial performance of small companies. In particular, we found that an employee selection strategy based on person-organization fit, employee management strategy based on self-management, and employee motivation and retention strategy based on creating a family-like environment were all significantly related to firm performance in terms of revenue and profit growth. In addition, we found that the relationships between these HR strategies and firm performance were stronger in firms that face greater competition, are pursuing growth strategies, and are larger in size.

Keywords

CAHRS, ILR, center, human resource, studies, advanced, HR practice, managing employees, financial performance, small companies, employee, strategy, revenue, profit growth

Comments

Collins, C. J. & Allen, M. (2006). *Research report on phase 4 of Cornell University/Gevity Institute study Human resource management practices and firm performance in small businesses: A look at the effects of hr practices on financial performance and turnover* (CAHRS Working Paper #06-10). Ithaca, NY: Cornell University, School of Industrial and Labor Relations, Center for Advanced Human Resource Studies.
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Working Paper 06 – 10

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Abstract

In this study, we found evidence that groups of HR practices that represent different strategies for managing employees were significantly related to the financial performance of small companies. In particular, we found that an employee selection strategy based on person-organization fit, employee management strategy based on self-management, and employee motivation and retention strategy based on creating a family-like environment were all significantly related to firm performance in terms of revenue and profit growth. In addition, we found that the relationships between these HR strategies and firm performance were stronger in firms that face greater competition, are pursuing growth strategies, and are larger in size.

Research Report on Phase 4 Of
Cornell University/Gevity Institute Study

Human Resource Management Practices and Firm Performance In Small Businesses: A Look At The Effects Of HR Practices On Financial Performance and Turnover

Introduction

As noted in our previous reports, we are finding that Human Resource (HR) management practices and beliefs play an important role in small businesses. For example, in our second report we found that certain sets of HR practices were positively related to workforce alignment and resulting firm performance. In our third report, we found that effective HR management practices were positively related to important employee outcomes such as higher commitment, trust in management, cooperation, and higher employee effort and involvement in their jobs. Further, we found that these employee outcomes were related to owners' perceptions of how their company was performing relative to their competition.

In this report we build on what we have learned in two important ways.

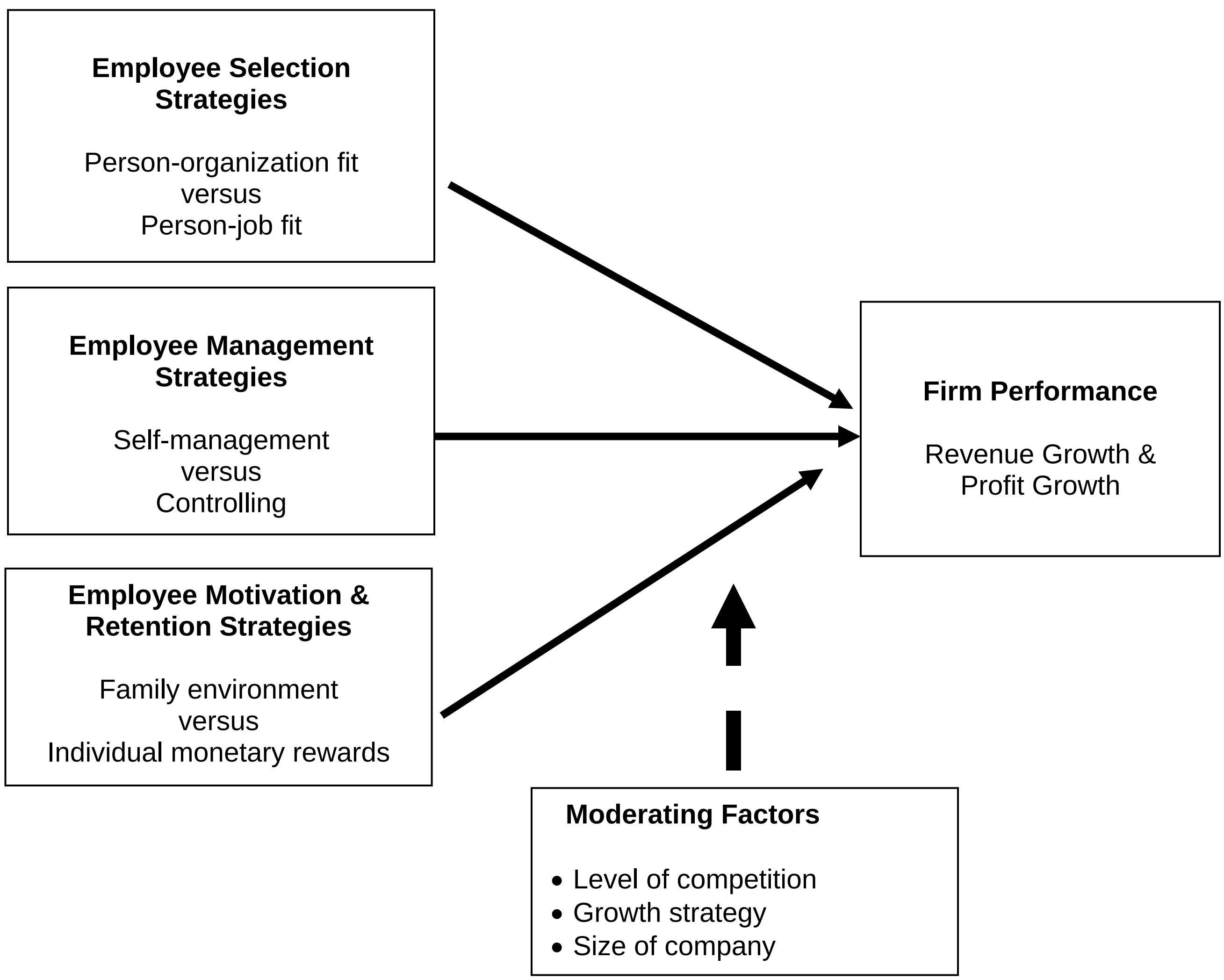
1. We assess the direct effects of HR practices on company financial performance (revenue and profit growth) and employee turnover.

2. We test to see if the impacts of HR practices differ across different types of companies that participated in our study.

The results presented in this study were drawn from surveys of top managers/owners and employees from a sample of 323 small businesses. The companies that participated ranged in size from 8 to 600 employees. The average number of employees was 53. We used employee surveys to assess the extent to which the company was using particular HR practices or strategies, and the top manager surveys were used to assess different organizational and characteristics and company performance.

The results of the study are presented as follows in Figure 1. First, we provide a visual depiction of the study's findings. Second, we identify three sets of HR practices that companies can use to manage their workforce, including choices around: (1) selecting employees based on fit to the company versus fit to the job, (2) managing employee performance through employee involvement versus tight controls, and (3) motivating employee commitment through creating a family atmosphere versus individual monetary incentives. Third, we provide an overview of the direct relationships between HR practices and firm performance. Finally, we describe how the strength of these affects differ depending on the level of competition, size of the company, and company strategy.

Figure 1
Overview of Study Results



<u>Human Resource Practices And Financial Performance</u>

Effective HR Management Practices and Company Financial Performance

We will first discuss the overall effect of an Effective System of HR practices on company performance before providing details on the impact of the different aspects of an Effective HR management system (Employee Selection Strategies, Employee Management Strategies, and Employee Motivation and Retention Strategies).

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

Performance when using Effective System of HR Management Practices

Revenue Growth	**22.1% higher revenue growth**
Profit Growth	**23.3% higher profit growth**
Turnover	**66.8% lower turnover**

While the above findings represent the differences in financial and organizational performance between companies that implemented each of the three effective HR management strategies versus companies that did not implement any of the effective HR management strategies, our findings suggest that companies can benefit through the implementation of each individual strategy. In the following pages, we highlight the relationship between the individual HR management strategies and company financial and organizational performance.

Employee Selection Practices and Company Financial Performance

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

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

Performance when using Person-Organization Fit Employee Selection Strategy

Revenue Growth	**7.5% higher revenue growth**
Profit Growth	**6.1% higher profit growth**
Turnover	**17.1% lower turnover**

Employee Management Practices and Company Financial Performance

A second important way that companies can affect firm financial performance and employee retention is through the HR strategies and practices that they follow regarding workforce management. We looked at two different human resource utilization strategies that companies can use to manage people. First, companies can emphasize tight controls.

Companies that rely on tight control closely monitor the day-to-day activities of employees, ensure that managers, not employees determine the pace and schedules at which employees complete their work, and use lots of explicit rules and procedures to manage employee actions. Second, companies can foster employee involvement and self-management. Companies that choose self-management give employees a great deal of discretion to monitor their own performance and trust employees to get the job done right the first time without direct oversight.

Overall, we found that firms following a utilization strategy of involvement and self-management showed significantly higher revenue growth and employee retention than companies following a tight control strategy. Companies following the involvement and self-management approach also showed higher profit growth, but our results were not statistically significant. Thus, our results suggest that firms that follow a strategy of giving greater discretion and using more employee involvement and self-management in setting the pace of work and monitoring employee performance seem to financially outperform and have much lower turnover than do companies that seek to tightly control all aspects of their employees behaviors and work.

Performance when using Involvement Employee Management Strategy

Revenue Growth	**11.5% higher revenue growth**
Profit Growth	**3.9% higher profit growth**
Turnover	**15.1% lower turnover**

Employee Management & Retention Practices and Company Financial Performance

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

Overall, we found that companies that follow an HR strategy of motivating employees by creating a family environment have significantly higher profit growth and employee retention than do companies following the individual monetary incentive strategy. These companies also had slightly higher levels of revenue growth, although this relationship was not statistically significant.

Performance when using Family-Like Community Motivation HR Strategy

Revenue Growth	**3.8% higher revenue growth**
Profit Growth	**13.3% higher profit growth**
Turnover	**19.1% lower turnover**

Do Business and Industry Factors Enhance the Effects of HR Strategies?

While the HR strategies of hiring based on **person-organization fit**, workforce utilization based on **involvement and self-management**, and employee motivation based on creating a **family-like community and environment**, we wanted to examine if these practices work equally well for all companies or if some companies get an added boost for implementing these HR strategies.

We found that these three strategies generally were positively related to firm performance and employee retention across all the firms in our study. However, the effects of these practices were enhanced to the extent that companies were **(1)** pursuing a growth strategy, **(2)** were larger in size, and (3) were competing in highly competitive industries.

High Growth Goals

Companies have different goals in terms of growth, with some companies and owners content with flat or small growth, while others are actively pursuing high growth goals. It is likely that the effective HR management practices identified above will be even more important to companies that put stress on their organizations and workforces by pursuing high growth goals. We asked top managers to asses the extent to which profit and revenue growth was a goal that the company was actively pursuing.

In our analyses, we found the relationships between the HR strategies and firm performance was larger when the company representative said that growth was an important goal and a key metric to assess how the company was performing year to year. As we noted above, the benefits of using HR strategies of hiring for person-organization fit, utilization based on involvement and self-management, and motivation by creating a family environment are all greatly enhanced for companies that were pursuing a growth strategy.

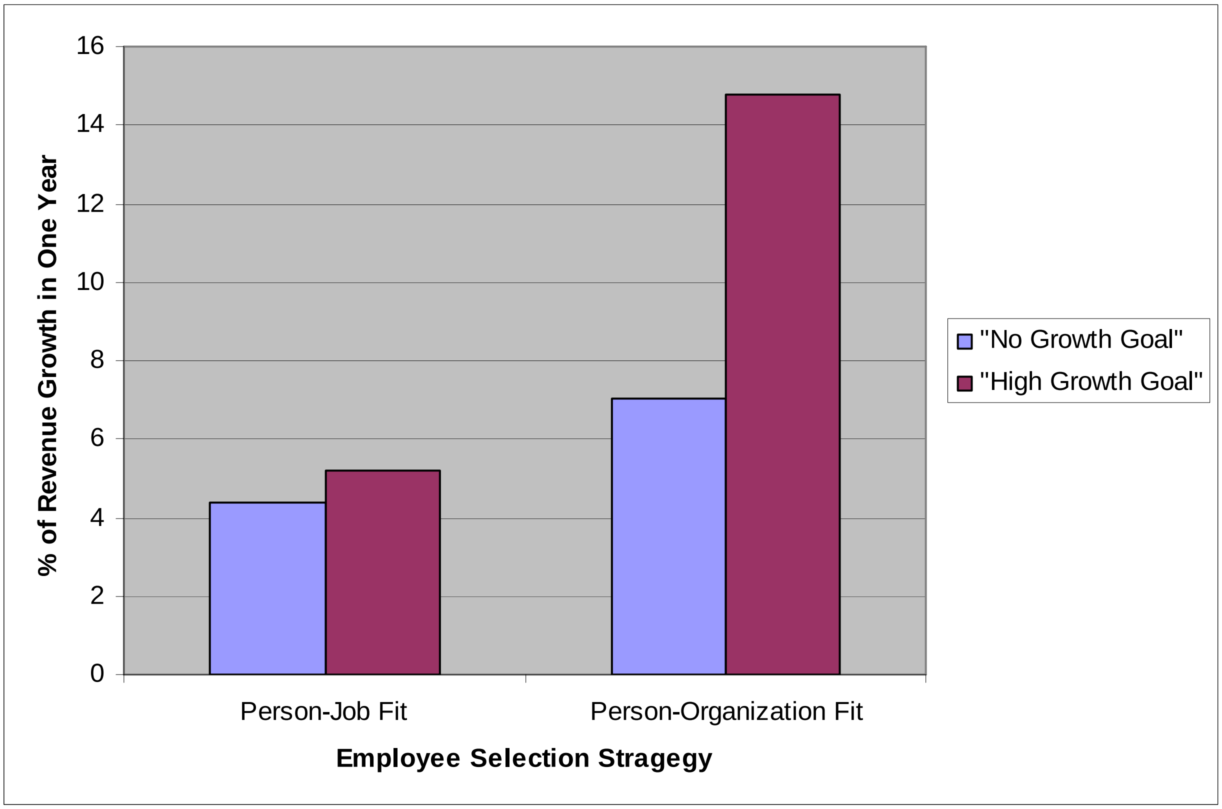
Employee Selection Strategies: We found that companies with high growth goals that used a person-organization fit selection strategy had over 10% higher one-year revenue growth than companies following a person-job fit selection strategy. The high growth goal companies that used a person-organization fit selection strategy also showed a 7% higher one year profit growth than did companies using the same selection strategy but with no or low growth goals. We also found that companies with high growth goals that used a person-organization fit selection strategy had over 17% less turnover than did companies following selection strategies based on person-job fit.

Employee Management Strategies: We found that companies with high growth goals that used an involvement and self-management strategy for managing employees over 12% higher one-year revenue growth than did companies following a tight controls employee management strategy. The high growth goal companies that used an involvement employee management strategy also showed an 8% higher one year profit growth than did companies using the same employee management strategy but with no or low growth goals. We also found that high growth goal companies using an involvement employee management strategy had over 14% less turnover than did companies following an employee management strategy of tight controls.

Employee Motivation and Retention Strategies: We found that companies with high growth goals that used a family-like community employee motivation strategy had over15% higher one-year profit growth than companies following an employee motivation strategy based only on providing individual incentives. The high growth goal companies that used a family-like community employee motivation strategy also showed a 6% higher one year profit growth than did companies using the same employee motivation strategy but with no or low growth goals. We also found that companies with high growth goals that used a family-like community employee motivation strategy had over 22% less turnover than did companies following an employee motivation strategy based solely on individual incentives.

These patterns of relationships can be seen clearly in Figure 2 below – while the figure below depicts the differences in revenue growth for different employee selection strategies for companies with different growth goals, the general pattern was the same across the other HR strategies and measures of company performance. The chart below shows that companies following an employee selection strategy based on person-organization fit outperform companies following a person-job fit selection strategy, and the effects of following a person-organization fit strategy are most powerful for companies that are pursuing a high growth goal.

Figure 2



Actual Numbers:

Person-Job fit with no growth goal = 4.3% revenue growth
Person-Job fit with High growth goal = 5.2% revenue growth
Person-Organization fit with no growth goal = 7.1% revenue growth
Person-Organization fit with High growth goal = 14.7% revenue growth

Size of Company

All of the companies in our sample were small companies by the traditional Small Business Association definition, but still ranged in size from very small to 600 employees in size. Based on discussions with owners and top managers, we noted that it becomes increasingly difficult to manage the behaviors and actions of all employees as the company gets larger. In particular, we found that, as companies grow larger than 50 employees, managers have a difficult time monitoring and knowing all of their employees. It is likely that as a company gets larger than 50 employees, effective HR strategies will have a larger impact on performance. We measured size of the company by asking the owner/top manager to identify the number of full-time employees.

As with high growth goals, our findings showed that companies following the HR strategies of hiring for person-organization fit, utilization based on involvement and self-management, and motivation by creating a family environment tended to outperform those companies not following these strategies. Further, the impact of these HR strategies was greatly enhanced for larger companies (defined as those companies larger than 50 employees).

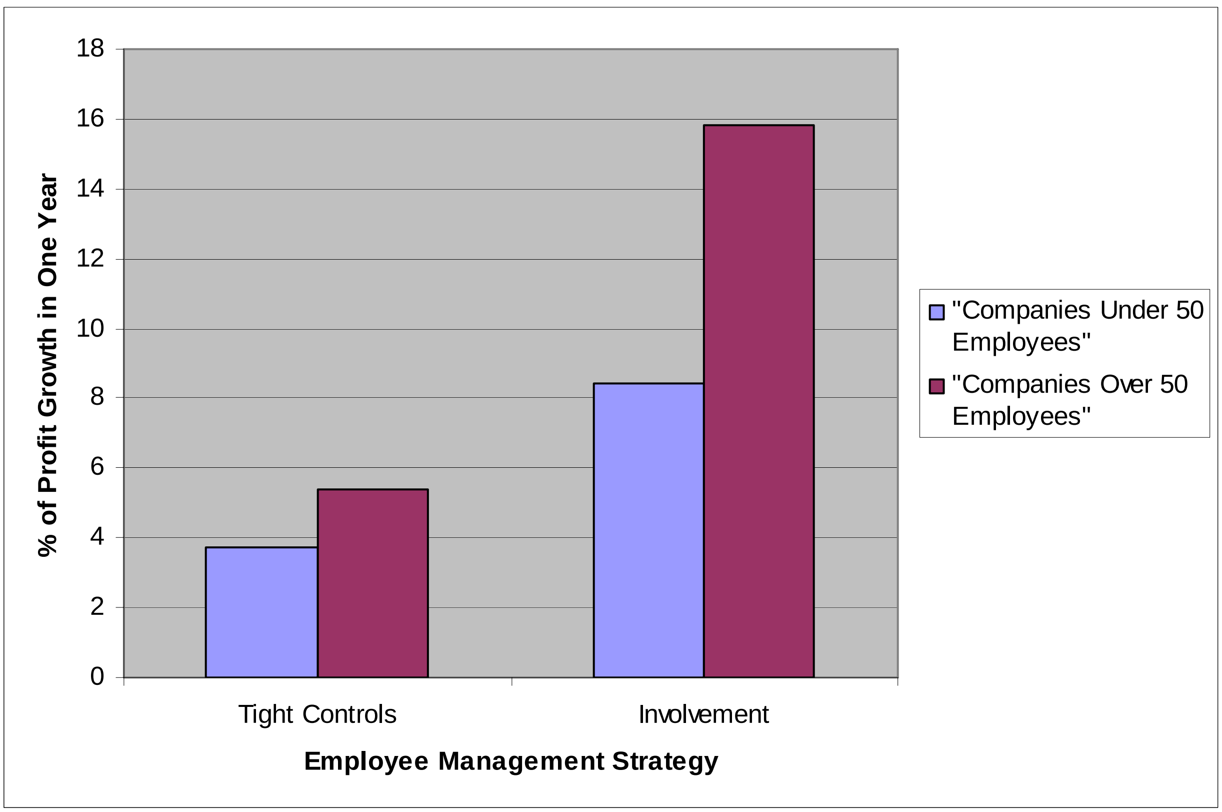
Employee Selection Strategies: We found that larger companies that used a person-organization fit selection strategy had over 7% higher one-year revenue growth and 6% higher one-year profit growth than did companies following a person-job fit selection strategy. We also found that larger companies that used a person-organization fit selection strategy had over 14% less turnover than did companies following selection strategies based on person-job fit.

Employee Management Strategies: We found that larger companies that used an involvement and self-management strategy for managing employees over 11% higher one-year revenue growth than did companies following a tight controls employee management strategy. The larger companies that used an involvement employee management strategy also showed an 8% higher one year profit growth than did smaller companies using the same employee management strategy. We also found that larger companies using an involvement employee management strategy had over 13% less turnover than did companies following an employee management strategy of tight controls.

Employee Motivation and Retention Strategies: We found that larger companies that used a family-like community employee motivation strategy had over 10% higher one-year profit growth than companies following an employee motivation strategy based only on providing individual incentives. The larger companies that used a family-like community employee motivation strategy also showed a 4% higher one year profit growth than did smaller companies using the same employee motivation strategy. We also found that larger companies that used a family-like community employee motivation strategy had over 20% less turnover than did companies following an employee motivation strategy based solely on individual incentives.

These patterns of relationships can be seen clearly in Figure 3 below – while the figure below depicts the differences in one-year profit growth for different employee management strategies for companies with different growth goals, the general pattern was the same across the other HR strategies and measures of company performance. The chart below shows that companies following an involvement employee management strategy outperform those companies following a tight control strategy, and the effects of the involvement employee management strategy is most pronounced for companies larger than fifty employees.

Figure 3



Actual Numbers:

Tight controls for smaller companies = 3.7% profit growth
Tight controls for lager companies = 5.3% profit growth
Involvement/self-management for small companies = 8.4% profit growth
Involvement/self-management for large companies = 15.8% profit growth

Competitiveness of Industry:

Companies face widely different market conditions in terms of the amount and degree of competition that they face on a day-to-day basis, ranging from companies that face relatively little in the way of direct competition to those facing a large number of direct and fierce competitors. As the level of competition increases, companies increasingly depend on employees to help create and maintain competitive advantage, increasing the likelihood of the impact of the HR practices above on company performance. As with growth goals, we asked top managers/owners to identify the extent to which they face fierce competition in their market.

Our findings strongly suggest that companies facing intense competition get the most return from implementing the following HR strategies of hiring for <u>person-organization fit</u>, utilization based on <u>involvement and self-management</u>, and motivation by creating a <u>family environment</u>.

Employee Selection Strategies: We found that companies facing highly competitive environments that used a person-organization fit selection strategy had over 8% higher one-year revenue growth than companies following a person-job fit selection strategy. The companies facing a highly competitive environment that used a person-organization fit selection strategy also showed a 7% higher one year profit growth than did companies using the same selection strategy but facing less competitive business environments. We also found that companies facing highly competitive environments that used a person-organization fit selection strategy had over 19% less turnover than did companies following selection strategies based on person-job fit.

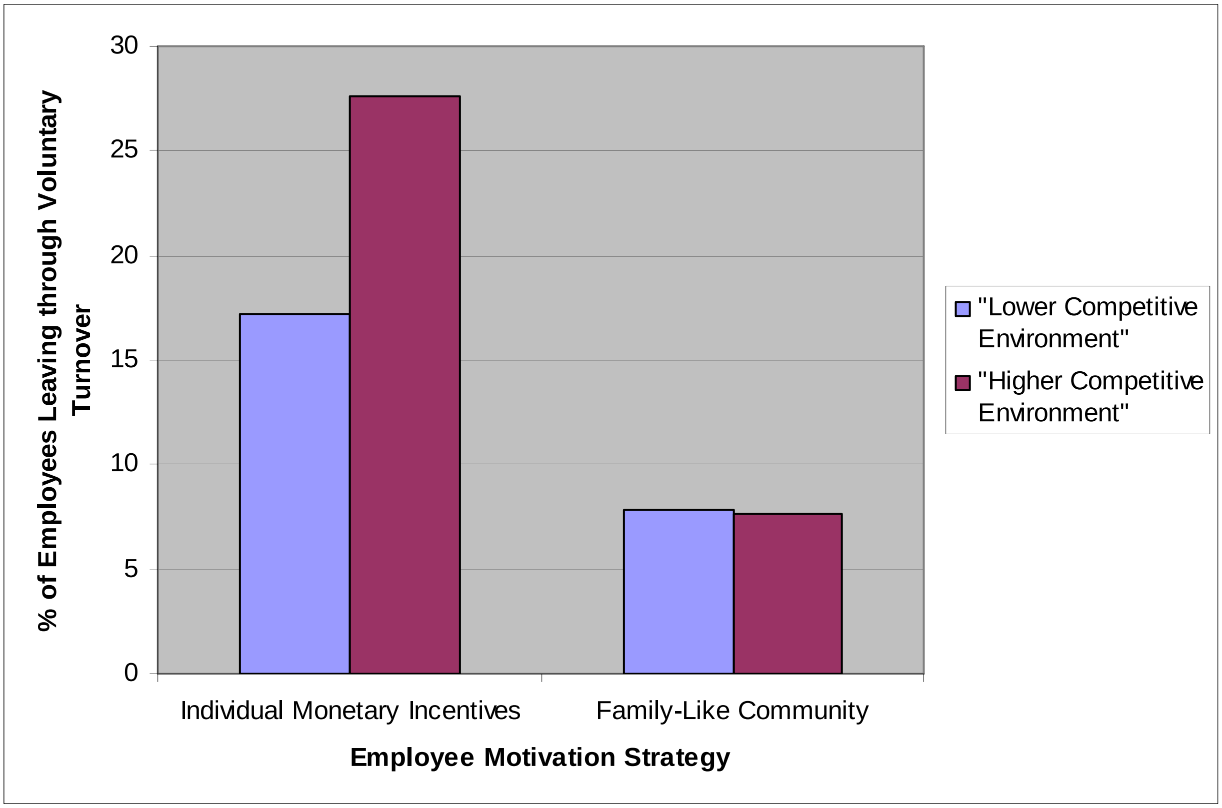
Employee Management Strategies: We found that companies facing highly competitive environments that used an involvement and self-management strategy for managing employees over 9% higher one-year revenue growth than did companies following an employee management strategy based on tight controls. The companies facing highly competitive environments that used an involvement employee management strategy also showed a 5% higher one year profit growth than did companies using the same employee management strategy that faced less competitive environments. We also found that companies facing highly competitive environments that use a family-like community employee motivation strategy had over 20% less turnover than did companies following an employee management strategy of tight controls.

Employee Motivation and Retention Strategies: We found that companies with high growth goals that used a family-like community employee motivation strategy had over14% higher one-year profit growth than companies following an employee motivation strategy based only on providing individual incentives. Companies facing a highly competitive environment that used a family-like community employee motivation strategy also showed a 9% higher one year profit growth than did companies using the same employee motivation strategy but facing a less competitive business environment. We also found that companies facing a highly competitive business environment that used a family-like community employee motivation strategy had over 20% less turnover than did companies following an employee motivation strategy based solely on individual incentives.

These patterns of relationships can be seen clearly in Figure 4 below – while the figure below depicts the differences in turnover rates for different employee motivation and retention strategies for companies with different growth goals, the general pattern was the same across the other HR strategies and measures of company performance. The chart below shows that companies following an employee management strategy based on creating a family-like community and environment outperform those companies following an employee motivation strategy based on individual monetary incentives, and the effects of the family-like community employee motivation strategy was most powerful for companies facing highly competitive business environments.

*** Note that the chart representing employee turnover is the opposite of those depicting revenue and profit growth because lower numbers for turnover are better – that is, the lower numbers represent a lower percentage of employees leaving the organization.*

Figure 4



Actual Numbers:

Individual incentives in low competitive environments = 17.2% turnover
Individual incentives in high competitive environments = 27.8% turnover
Family-like community in low competitive environments = 8.1% turnover
Family-like community in high competitive environments = 7.9% turnover

Key Takeaways

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

(1) Choice of HR Strategies is Related to Company Financial Performance. Overall, companies that implement more effective HR strategies for hiring, workforce utilization, and employee motivation have higher performance in terms of revenue growth and profit growth. The analyses reported here control for many factors that could also influence company performance levels, including company industry, company age, company size (in number of employees), the speed of change present in the external environment, and business strategy. This means that our findings are quite robust. Although it is impossible for our study to compare the benefits of investing in people management strategies to the benefits of other company investment opportunities, our findings strongly support the conclusion that firms have higher financial performance when they more effectively manage their employees through an HR hiring strategy based on person-organization fit, an HR utilization strategy based on employee involvement and self-management, and an HR employee motivation strategy based on creating a family environment.

(2) Choice of HR Strategies Matter for Retention of Employees. As was the case with financial performance, companies that implement more effective HR strategies have substantially lower turnover of employees than do companies that implement less effective HR strategies. Again we controlled for other factors that may affect turnover such as industry, geographic location, and size of the company increasing the certainty of the conclusions that we can draw from our findings. Thus, our results overwhelmingly suggest that firms a much more like to reduce unwanted turnover when effectively managing their people through an HR hiring strategy based on person-organization fit, an HR utilization strategy based on employee involvement and self-management, and an HR employee motivation strategy based on creating a family environment..

(3) Some Companies Benefit More from Effective HR Strategies. While companies that implement effective HR strategies in general outperform companies that implement less effective HR strategies, small companies that have a goal of high growth, that are larger than 50 employees, and that face extremely competitive environments benefit the most from implementing these strategies. Therefore, while we would recommend that all small companies should implement and are likely to benefit from the use of these effective HR strategies, we especially recommend that companies implement an HR hiring strategy based on person-organization fit, an HR utilization strategy based on employee involvement and self-management, and an HR employee motivation strategy based on creating a family environment if they (1) have a goal of high growth, (2) are larger than 50 employees or will soon look to expand to this size, or (3) face a high degree of competition for customers.

Examples Of Best Practices

Person-Company Fit Employee Selection:

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

Employee Management Strategies based on Self-Management

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

Family-like Community for Fostering Employee Motivation

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