# OVERVIEW: STRATEGIC HUMAN RESOURCE MANAGEMENT IN FIVE LEADING FIRMS

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*This article synthesizes findings from five case studies conducted in firms known to be leaders in the management of people. We drew three broad conclusions:*

1. *The foundation of a* value-added *HR function is a business strategy that relies on people as a source of competitive advantage and a management culture that embraces that belief;*
2. *A* value-added *HR function will be characterized by operational excellence, a focus on client service for individual employees and managers, and delivery of these services at the lowest possible cost; and*
3. *A* value-added *HR function requires HR managers that understand the human capital implications of business problems and can access or modify the HR system to solve those problems.* *© 1999 John Wiley & Sons, Inc.*

## Introduction

The recent emphasis among practitioners and academics on "people" (and people management systems) as a source of competitive advantage has focused increasing interest on the science and practice of Human Resource Management. Indeed, it would appear that the field of HRM is "coming of age" as the end of the millennium approaches. While academic research has made a number of significant contributions to these developments, Steve Kerr of General Electric has argued persuasively that much of the best work is being done by consultants and professionals in the field (Hodgetts, 1996). In fact, one could make a convincing case that the practice of strategic HRM has outpaced the academic work on this topic. Yet, data on how firms actually manage people to provide a source of competitive advantage are scarce, and studies that compare and contrast human capital management systems in leading firms are even more difficult to find. Indeed, while the empirical literature linking better HRM with firm performance has consistently found that more effective HR management is associated with superior financial performance (see Becker & Huselid, 1998, for an overview), what is missing is a clearer understanding of *how* these processes operate, and subsequently, *how* firms might actually manage their people to help provide a source of competitive advantage.

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In this special issue of *Human Resource Management,* we attempt to provide some insight into the "state of the practice" through the presentation of five detailed



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case studies describing the HRM strategies employed by firms known to be leaders in the management of people. From June through October 1997, we interviewed more than 60 senior executives across these five companies, who came together to form a Partnership through the auspices of the *Global Consulting Alliance*. Partnership firms subsequently shared information and learned from each other about leading edge HR practices. The distillation of these experiences is presented in this special issue.

Using a detailed, structured interview format and extensive evaluation of background data, we spent on average a day and a half interviewing the senior HR and Line leadership in the each of the following Partnership firms:

- Herman Miller,
- Lucent,
- Praxair,
- Quantum, and
- Sears.

***The HRM system that develops and maintains a firm's strategic infrastructure should be considered an investment.***

These data, along with an extensive evaluation of background materials provided by each company, provided us with rich detail on how leading firms use their HRM systems to implement their competitive strategies and to achieve their operational goals. In collaboration with the Senior HR leader in each firm, we prepared the cases that form the basis of this special issue.

This special issue is organized as follows. This overview article provides an outline of theoretical rationale and empirical literature linking HRM systems with corporate financial performance. We next highlight the patterns that emerged from our research in the five Partnership companies. This discussion of patterns is followed by the individual company cases. Wayne Brockbank then provides a "look over the horizon" by discussing the implications of these findings for the practice of HR in the future. This is followed by our interview with Mike Losey, Tony Rucci, and Dave Ulrich that provides a provocative response to this special issue. Finally, Joe Ryan reviews William Joyce's new book, *MegaChange: How Today's Leading Companies Have Transformed Their Workforces.*

## The New Paradigm[2]

For most firms, the traditional path to sustainable competitive advantage has turned on such barriers to entry as economies of scale, patent protection, access to capital, and regulated competition. What might be called a *new economic paradigm*, however, has given rise to a new source of competitive advantage and has challenged much of the conventional wisdom about strategy, the role of an organization's human resources, and HR's relationship to firm performance. As globalization and the accompanying demands for continuous change make innovation, adaptability, speed, and efficiency essential features of the business landscape, the strategic importance of intellectual capital and intangible assets have increased substantially (Pfeffer, 1994; 1998). While these assets are largely invisible (Itami, 1987) and do not appear on the firm's balance sheet, the *sources* of this capital are not.[3] They are found in the human capital of the firm's employees, the capabilities represented by the firm's organizational processes and the value of brands and customer relationships (Svelby, 1997). In the words of James Chestnut, CFO for The Coca Cola Company, the company's phenomenal market value is largely attributable to its brand and its management systems, rather than any collection of tangible assets (Stewart, 1998).

Accordingly, many firms have increasingly broadened their focus from strategy content to strategy implementation. Speed, innovation, and adaptability reflect competencies and capabilities (Hamel & Prahalad, 1994) for strategy implementation that have as their foundation the firm's human capital.[4] This has direct implications for a firm's HRM system and function. Traditionally focused on transactions, practices, and compliance, the HR function was—and often still is—appropriately considered a cost center. In contrast, the HRM system that develops and maintains a firm's strategic infrastructure should be considered an investment. It is an essential element of the infrastructure that supports this value creation process and is a potential strategic lever for the organization.

The appropriate form for this *strategic* HR system continues to be debated. Pfeffer

(1998), for example, argues that a common thread runs through the approach to people management at high performance companies. HR systems in these organizations are characterized by employee security, selective hiring, decentralized decision-making, well-paying jobs, extensive development, reduced status differentiation, and extensive communication and information sharing. We would emphasize that while this provides a useful template as a point of departure, the strategic influence of an HR system requires that it be implemented as an *internally coherent system* that is aligned with the business goals and objectives of the organization. Recalling that the logic for the new strategic role for HR is driven by changing market conditions that highlight the importance of human capital issues, we should keep in mind that entirely new approaches are not the sole source of value creation. Firms have always had a choice to emphasize employee performance in their HR systems, and HR professionals have long known how to implement such a focus. Market conditions, however, often enabled firms to achieve considerable success by giving limited attention to employee performance issues, thinking instead of employees largely as a cost to be minimized. While perhaps not an imperative for every firm, the economic returns to a "high performance" HRM system have increased to the point that what might have appeared a luxury 20 years ago is now a source of competitive advantage.

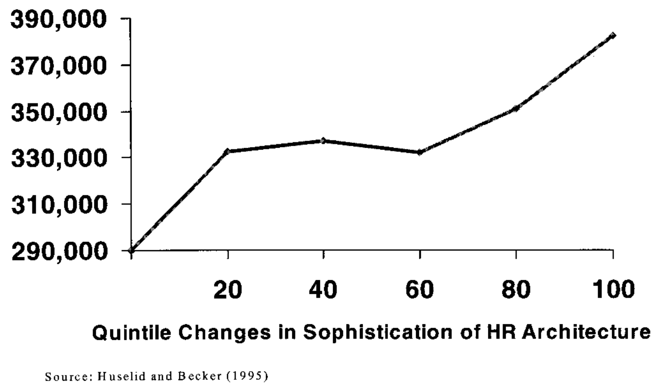


**FIGURE 1 . Dollar change in market value per employee.**

### The Financial Returns to Strategic HR

In the 1990s one of the most exciting new areas of academic research has focused on establishing an empirical link between HR strategies and systems and a firm's financial performance. Studies at the level of the firm, one industry, and multiple industries have demonstrated a strong positive relationship (Becker & Huselid, 1998). Our own work, based on three separate national surveys and the experience of more than 2,400 firms, has repeatedly shown an economically and statistically significant impact of the HRM system on both market-based and accounting-based measures of firm performance. Figure 1 illustrates the relationship between a high performance HRM system and firm market value per employee. In Figure 1 the HR system is measured as an index of attributes that taps the various elements of an HR system that select, maintain, develop, and reinforce employee performance (the x-axis), scaled from zero (the least developed HRM systems in our sample) to 100 (the most sophisticated HRM systems). Firm performance is measured in terms of market value per employee.[5]

The pattern of these results suggests the changing nature of the HR influence on firm performance. The first stage (up to the 20th percentile) could be interpreted as the development of a professional HR capability. This capability has value because it gets the firm "in the game". In the second stage (between the 20th and 60th percentile) the HR function develops operational excellence but does not have a significant incremental influence on firm performance. In the last stage, the HR system once again has a noticeable payoff in terms of the firm's bottom line. For example, moving from the 60th to the 80th percentile improved market value in the average firm by $20,000 per employee, or $200 million in a firm with 10,000 employees.[6] Our experiences with these firms suggest that it is in this third stage that an HR system has achieved *both* operational excellence and is aligned with the firm's strategic goals.

## The Strategic Influence of HR: Lessons from Partnership Companies

The HR strategies described in the accompanying case studies are among the most innovative in the world. They are exemplars of the specific HR systems reflected in the more abstract "60th to the 100th percentile" relationships depicted in Figure 1. Nevertheless, while the HR management systems at the Partnership firms are among the best in the world, all of those interviewed acknowledge that much work remains to be done. The focus of this introduction is to highlight the elements of a *value-added* HR function, as represented in the cumulative experience of Partnership firms, illustrating areas both of considerable progress and remaining challenges. We hope that it will serve as a catalyst for further research and as a "call to action" for those firms wishing to improve their own HR management systems.

There are probably several ways one could organize the foundational elements of a *value-added* HR function, but we focus on three key (and recurring) themes:

- A corporate strategy and management culture that is appropriately aligned and supportive;
- an HR function characterized by operational and professional excellence; and
- HR managers that are effective "business partners" and an HR function structured to support that role.

Each of these elements is a necessary, but not sufficient, condition for HR to play a strategic organizational role. They reinforce one another and leverage the contributions of the other elements. Indeed, in our more recent research we focus specifically on the appropriate alignment between the HR system and the supporting "organizational logic" represented by top management's leadership style, the alignment between HR and corporate strategies, and the effectiveness of the HR function (Huselid & Becker, 1998). We find that when each of these elements is appropriately aligned, the firms average 27% higher gains than they would expect from the "sum of these parts". For the purposes of this article, they are also a convenient framework to integrate the wide range of experiences reflected in our interviews at the Partnership companies.

### Lessons Learned

This section highlights each of the three major foundational elements to a value-added HR role and then develops supporting policies, practices, or strategies that further implement and illustrate those elements. We have attempted to provide a sample of representative illustrations from the cases. The case studies that follow this article will provide a more complete picture of each firm's HR strategy.

***Element #1:* The foundation of a *value-added* HR function is a business strategy that relies on people as a source of competitive advantage and a management culture that embraces that belief.**

***It may be axiomatic, but just as labor is a derived demand in basic economic theory, the demand for a strategic HR presence is derived from the larger corporate or business strategy.***

It may be axiomatic, but just as labor is a derived demand in basic economic theory, the demand for a strategic HR presence is derived from the larger corporate or business strategy. It might be nice to believe that every successful firm is now compelled to rely on people as a source of competitive advantage, but there are in fact very successful firms that have not entirely embraced such a strategy. On the one hand, we have examples such as Quantum, which as a startup in 1980 established its "people" strategy as the first step in its business plan. In the more typical firm, however, a strategic HR presence has been a relatively recent phenomenon. Most Partnership companies tend to fall somewhere in between these experiences, and in general reflect recent converts to strategies that include a "people-based" component. Herman Miller, Inc. (HMI) would be an exception, as their philosophy of employee advocacy and "servant-based leadership" has a very long tradition throughout the firm.

#### *Strong CEO Support and Buy-In from Line Managers*

While HR's role is driven by the underlying firm strategy, the manifestation of that strategic imperative is the commitment of the CEO to realizing a strategic role for HR. Does the CEO really believe that HR can be more than a cost center and that most of the employees are more than an expense to be minimized? It should not be surprising that HR's strategic role will always be limited when the CEO, or senior executive leadership, does not fully embrace such a presence. The majority of the Partnership companies are going through the transition from an operational HR focus to one that is more strategic. These are typically driven by senior business leaders. An exemplar would include Arthur Martinez at Sears who recognized that Sears employees had to "feel comfortable outside a command-and-control environment getting them used to risk taking and innovation."

Buy-in from line managers is necessary for HR to serve as a business partner because line managers have to accept and participate in this new role. Aside from the firms where HR has played this role from the inception of the company, the experience among the Partnership firms is mixed. On the one hand there are firms like Praxair. Considerable support and communication during the development of their "visioning" process, along with the development of specific, actionable goals at each level of the business were key features. The result was more rapid strategy implementation and a greater sense of "mental ownership" among Praxair's employees. On the other hand, line managers at some of the other Partnership firms have taken a "wait-and-see" attitude while clinging to the traditional relationships. Clearly, line managers are going to be more supportive of this new role where they understand the business case for such a change. This can occur at two levels. First, there are companies that have attempted to articulate the role HR or people issues serve as performance drivers in the implementation of strategy. More elaborate are balanced scorecard models like the one used at Sears, where there are clearly defined and empirically verified relationships between individual sales associate behaviors, customer satisfaction, and ultimately financial performance. In short, for the senior leadership outside of HR to buy-in to a broader HR role, the business case for investments in human capital must be clearly articulated. This requires more than "hand waving" and slogans. It requires a common understanding of the firm's strategy and the role HR issues play in the value chain that implements that strategy. As respondents in several companies noted, it is also a two-way street. HR has to show that it can provide some leadership around these business issues and be aggressive in getting that message out. At Lucent, one of HR's strategic goals is to motivate change by aggressively sharing this story of their new role. In their words, "We can't mumble our way to 50 percent growth."

Buy-in from line managers and the centrality of a people-based competitive strategy is also reflected in the extent to which the company is willing to share "confidential" information that, on the one hand, may have proprietary value, but on the other, is essential if employees are to understand the strategic significance of their jobs and their performance. There were several examples of this type of communication, but a useful exemplar is Herman Miller. HMI believes that participation in decision-making is a crucial ingredient in the process of facilitating "ownership" among employees. Thus, HMI gives their owner-employees a significant amount of information about the ongoing financial condition of the business; their recent adoption of the Economic Value Added (EVA) framework is an important additional step in this direction. In fact, HMI uses the EVA framework (and the resulting communication process) as the basis for driving "lean thinking" throughout the organization. Communication is further facilitated by quarterly meetings, town hall meetings, and a variety of more informal brown bag lunches to transmit financial and operational information throughout the firm. In addition, they have a group called the Monthly Business Exchange or MBX, which is a meeting of the 350 team leaders who gather every month to exchange information and ideas. These meetings are videotaped for later distribution, and the team leaders go back and pass out information to the rest of their team members.

***In fact, HMI uses the EVA framework (and the resulting communication process) as the basis for driving "lean thinking" throughout the organization.***

Buy-in also means that line managers are held accountable for HR issues in their performance reviews and bonus plans. Most of the Partnership firms are beginning to move in this direction, but it remains one of the more challenging points of change. A good example in this regard is Quantum, where "building a company with an extraordinary work environment" is one of three strategic goals. To this end they have identified nine *Value Behaviors* that contribute to the quality of the work environment, as well as their goals to increase market share and firm value. This is more than a management by objective (MBO) program; fully 50 percent of a manager's bonus is based on these behaviors which emphasize *how* work is done as much as *what* is achieved. In their words, "You can't simply 'get results' too often while leaving a pile of dead bodies behind you."

***Relying on competencies as a source of competitive advantage raises some interesting questions.***

*Competing on the Basis of "People Quality" Means Developing an Understanding of the Underlying Competencies Required and Aligning the HR System to Build Those Competencies*

Competency based models, if not a best practice, are certainly a common practice. The majority of the Partnership firms have developed—in one form or another—a set of core leadership competencies that are the basis for targeted selection processes, performance management, development, and in some cases, compensation policies. The integration of competency models into the larger HR system is a potentially important element in the transition of HR to a more strategic player. In principle, it is an affirmation that "who you hire in a wide range of jobs really does make a difference", suggesting that the firm's future is dependent on more than a handful of senior executives. Moreover, the breadth of the competencies have tended to highlight and reinforce the role of human capital issues in the successful performance of all managers. For example, Praxair is on its second generation of competency models. Despite the considerable external praise attracted by the earlier efforts, Praxair has developed a new model around *values* and *integrity* to reflect the heightened importance of process in its streamlined management structure.

Relying on competencies as a source of competitive advantage raises some interesting questions. What is it about competency models that provide an inimitable source of strategic value to a firm? Is it just the understanding that key competencies are X instead of Y? It might be, if the same competencies were generally applicable across a wide range of organizations rather than entirely contingent on the firm's specific strategy and culture. While this remains an area for further research, the current work suggests that the majority of competencies are generally applicable across firms, though the relevant behaviors would vary (Spencer & Spencer, 1993). If true, it seems unlikely that an individual firm could be prevented from discovering the appropriate competency mix, alone or with the assistance of a consultant.

To the extent that more firms discover the same competencies, the demand for individuals with those attributes will increase, driving up salaries and eroding the initial gains from moving to the competency models in the first place. In short, one can only hope to "beat the market" based on competencies if your firm has information that others lack about the most appropriate competencies and if your competitors have a difficult time replicating the system that supports your competency model. Nevertheless, if most firms are relying on competency models, your firm cannot afford to "opt out". To do so would risk a decline in the quality of your workforce as the incidence of valuable competencies in your normal applicant pool diminishes as other firms hire a disproportionate share of individuals with those attributes. Praxair has explicitly recognized this challenge associated with keeping the best people by giving additional attention to creating a work environment and career opportunities that will encourage their best people to stay, allowing Praxair to avoid being drawn in to a "bidding war" for the best available talent.

*The Strategic Value of Competency Models Is Largely a Function of Their Integration in the Larger HR System*

While discovering the appropriate competencies for an organization is probably not an inimitable source of competitive advantage, the capability to integrate that knowledge effectively throughout the entire HR system may well be. This requires that HR managers think systemically (and strategically) about their area rather than functionally and tactically. It is this infrastructure of an aligned HR system that creates what strategy scholars refer to as "causal ambiguity", making it difficult for other firms to imitate even if they can begin with the same competency model.

*Employee Development*

The threshold question for many firms is the "make or buy" decision. That is, which competencies can we develop and which do we have to acquire in the market? The Partnership firms tend to be divided into two groups. A few, like Quantum, have always hired based on a set of characteristics thought to be fundamental to success in their organizations, and continue to do so. Quantum, for example, relies so heavily on team-based product development and operations teams that if applicants can't work in teams, "they can't work at Quantum." Most of the Partnership firms, however, are in a position where their competitive strategy has changed, the market demands have changed, and they need a work force with a different set of competencies than the ones they currently possess. By necessity, there is a heavy reliance on people development, usually beginning with managers and the more senior leadership throughout the firm. The "leadership gap" is particularly significant in firms that have a recent history of downsizing combined with little new hiring (Lucent) or companies attempting to substantially shift their strategic focus (Praxair).

Finally, several of the Partnership companies have developed more comprehensive efforts such as Sears University. For example, Sears University currently serves 20,000 managers per year and emphasizes the enrollment of intact teams to facilitate knowledge sharing after completion of the program. Not surprisingly, the success of the program is premised on strong support from the senior executive team that has been willing to fully fund the initiative to date.

More targeted development that is aligned with a larger HR strategy is reflected in efforts to support Herman Miller's emphasis on employee participation, which the company considers both an opportunity and an obligation. A considerable amount of effort is spent training employees in the *processes* through which they create value at HMI (the firm is considering the adoption of some form of the Balanced Scorecard approach going forward). This serves the same purpose as the *Learning Maps* (visually engaging posters that depict a series of value chains) developed by Sears. While the firm has long had Employee Stock Option Plans (ESOP) and Scanlon plans, HMI's recent adoption of EVA has heightened the involvement in business literacy training. For example, they have developed a number of courses directly aimed at increasing business literacy: EVA101 is a 2-hour formal course for all employees that introduces the concepts to employees (85% of HMI's employees have been through this course to date). EVA201 is a refresher course that also introduces more advanced concepts. EVA301 is in the works, which will provide even more advanced training on this topic. Finally, HMI has developed a series of "train the trainer" courses to help team leaders (of which there are 350) and others in teaching these courses and concepts to other employees.

*Targeted Selection*

The common practice among Partnership firms is to use a form of targeted selection process driven by the firm's competency model.[7] Typically they rely on behavioral interviewing methods and include the active participation of line managers and prospective team members. Perhaps the most significant aspect of this wider participation in a process that emphasizes competencies and a distinctive methodology that supports it is that the saliency of competencies tends to be reinforced in other elements of the HR system. As senior line managers get a better understanding of the individual characteristics that contribute to successful leadership in their organization, they will also be more open to introducing these elements into performance management and compensation decisions. Finally, Quantum makes the point that if a firm selects on the behaviors or competencies that really matter on the job, the new hires can be expected to be productive much sooner. Their view is that applicants who can survive the Quantum selection process can start at "merge speed".

***Sears University currently serves 20,000 managers per year and emphasizes the enrollment of intact teams to facilitate knowledge sharing after completion of the program.***

*Performance Management*

There seems to be some increased attention to the performance management process among Partnership firms. Companies that have made an effort to upgrade their performance management systems tend to do so as part of a larger effort to integrate their competency models throughout the HR system. Some of the most significant performance management competencies were found in those firms that were strongly team oriented. For example, at Praxair there are four levels of performance management: company-wide, business unit, broad teams within business units, and specific project teams. Praxair is experimenting with a process that allows teams to decide who outside of their team (i.e., support staff assigned to multiple teams) should benefit from their teams' success and what the nature of that reward should be. Quantum's emphasis on their nine key Value Behaviors in performance management is similar. Quantum's near total reliance on team-based work structures, however, requires a multi-step process including multiple rankings of individuals within teams by other members (25%) and the team leader (25%), and separate ratings of the team by the business unit manager (50%). Similarly, for more than five years Sears has mandated multi-perspective appraisal of all managers. The process emphasizes behaviors consistent with the leadership competencies that support the 3 C's (Sears' strategic imperatives, which include transforming the retailing giant into a *Compelling Place to Work*, a *Compelling Place to Shop*, and a *Compelling Place to Invest*). At the level of Sales Associates, employees get direct feedback from customers who they have served. When setting performance objectives, the key challenge is to improve the "line of sight" between individual or team behavior and firm-level outcomes. At the same time, the performance objectives are structured like a treadmill; if the employee doesn't continue to improve, s/he will move backward.

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*Emphasis on Becoming the Employer of Choice*

While the term may vary, a number of the Partnership firms believe they are in an environment where employees with the type of competencies they are seeking are in short supply. At the same time, it is critical to the success of any people-based strategy to attract and retain the very best. Becoming an "Employer of Choice", however, requires an aligned HR system. It is very easy (and very expensive) to provide compensation and benefit levels that will be attractive. The challenge is to *also* structure an HR system that selects, develops, and produces a level of performance that can justify those investments. If leveraged within a *High Performance Work System* (Becker & Huselid, 1998), however, an Employer of Choice strategy can add considerable value. Sears, for example, is committed to competing based on customer service, which is driven by the quality of their 200,000 Sales Associates (70% of whom are part-time, a group that averages 100% turnover per annum). The intellectual capital represented by their understanding of the Sears strategy—the key to the 3 C's—walks out the door if Sears can't be a "compelling place to work".

For Quantum, building an *extraordinary work environment* is an end in itself, though it is understood to also be related to the firm's business objectives. The Quantum approach, as stated in company documents, is to structure an environment characterized by the following:

1. Achieving long-term business success
2. Ensuring that Quantum's employees feel valued
3. Ensuring a sense of pride of association with the company
4. Instilling a sense of camaraderie and that "all of us are in this together"
5. Ensuring that each employee has the opportunity to reach her highest potential personally and professionally
6. Generating a sense of excitement and fun.

*A Strong Pay-Performance Relationship*

A strong pay-performance relationship is an essential element of a strategy that relies on people as a source of competitive advantage, not only for the effort elicited, but more importantly as a signal that the "right behaviors matter, and will be reflected in an employee's paycheck". The trend toward increasing use of variable pay is apparent among Partnership firms, but it did not appear to be the most important strategic lever in any firm. Several firms mentioned the importance of sensitizing employees to the interests of the company and the importance of profit sharing and stock options in that role. In recent years, Lucent has increased the use of stock options. The program is considered an essential foundation for aligning employee interests with the goal of doubling the firm's market value in the next few years. Lucent provided all employees with 100 options as "founders grants" when the company went public and has expanded their use among managers, though only 5% of the eligible pool received awards last year.

Perhaps a more interesting indication that people-based strategies are being taken seriously is the extent to which managers, particularly senior managers, have a portion of their bonus allocation based on the human capital dimensions of their performance. There is some evidence of such a change. A small change occurred in one of the Lucent units when managerial bonuses were based on financial (20%), customer (20%), and people (20%) dimensions. The people issues were MBO goals around three HR issues (e.g., diversity goals, where supervisors were required to have development plans for all of their subordinates) and were only rewarded if the company also met its earnings per share goal. This is a very common problem in implementing a strategy that involves a people-based dimension. Senior business leaders and particular CFOs are willing to include some payout for human capital related outcomes, but are often faced with paying bonuses when the financials don't seem to warrant it. Unfortunately, this probably indicates that the senior leadership does not fully understand how human capital issues create value in the organization, often as leading indicators, and are largely including people-related dimensions in the bonus pool as an article of faith. In short, there is no consensus around the business case for how these people dimensions affect the implementation of the firm's strategy—and ultimately financial performance.

Quantum and Sears are two exceptions. In Quantum's case, it follows from the belief—from the inception of the firm—in the strategic role of people issues. Bonuses are based equally on results and adherence to Quantum's nine Value Behaviors. This is more than an article of faith. Care is taken to set "nested objectives" so that each employee's goals fit together with a subordinate's goals at each level. Each employee understands how his/her performance affects the next level in the chain, ending with firm performance as a whole; and every employee understands the goals of other employees with whom they work. Sears is equally explicit in articulating the value chain of strategy implementation and the role and impact of people and customer issues on financial performance. Learning Maps reinforce an understanding of these relationships. Sears currently assigns 50% of variable pay based on financial performance and 50% divided evenly between the other two dimensions. For 1998, each of the three dimensions was equally weighted. This is possible because Sears has made the commitment to articulate and empirically verify the performance drivers in its strategy, and as a result, the senior executive leadership realizes that solid performance on people issues should be rewarded because they are a harbinger of financial performance in future periods.

***Element #2*: A *value-added* HR function will be characterized by operational excellence, a focus on client service for individual employees and managers, and delivery of these services at the lowest possible cost.**

*The firms we interviewed uniformly acknowledged their continuing responsibility to "sweat the basics", providing essential HR services to individual employees and managers professionally and efficiently with very short cycle times.*

The firms we interviewed uniformly acknowledged their continuing responsibility to "sweat the basics", providing essential HR services to individual employees and managers professionally and efficiently with very short cycle times. These are typically the same services that HR has provided as part of its traditional role, though improvements in speed support the strategic role, and the service quality provides indirect support for efforts to be the Employer of Choice. As an indication of the breadth of experience in this aspect of HR, the following paragraphs highlight various examples of operational excellence drawn from the interviews:

*The third element of a value-added HR function is the capability to work with line managers as a business partner.*

- Lucent monitors service quality at all levels. For example, they report 99% data entry accuracy in the firm's HRIS, with a goal of 100%. Ninety percent of the clients using the employee services center have their problem handled on the first call. Business Services, the operational support for managers, now averages 115 days from job requisition to start date, with a goal of 40 days. Fifty-six percent of clients using business services report being "very satisfied" with HR; the goal is 90% by the end of the fiscal year.
- Sears indicates a considerable proficiency at handling high volume service demands in-house and very efficiently. Sears finds that they can provide these services more cheaply than it would cost to outsource them. As an example, they have reduced the number of Associate Service Centers (handling benefits questions) from 200 to 1 over a seven-year period. At Sears, as with many of the Partnership firms, delivering the basics continues to be important to maintain and build their legitimacy with line managers and other constituencies throughout the firm.
- The HR function at Herman Miller has long operated in a very lean manner (as have the other staff support areas). Consistent with the desire to link HR more closely with the needs of the business, the HR function has recently led the way in the adoption of a worldwide shared services environment. In addition, the HR function reorganized earlier this year and has moved significant resources from corporate HR to line or business unit roles. The business unit leaders, however, will only get the level of support for which they are willing to pay. While the firm is still adjusting to the simultaneous deployment of shared services and a concurrent movement of a significant proportion of HR resources to the line or business unit levels, early indications of the success of this transition have been so strong that other "leverage" areas (finance, accounting, marketing) will soon be adopting a shared services environment as well.

***Element #3*: A *value-added* HR function requires HR managers that understand the human capital implications of business problems and can access or modify the HR system to solve those problems.**

The third element of a value-added HR function is the capability to work with line managers as a business partner. This capability takes several forms, but based on the interviews with Partnership firms would at a minimum include: (1) HR managers with the competencies to serve as a business partner, (2) an HR function structured with the appropriate mix of responsibilities and resources allocated between corporate and business HR units, and (3) sufficient resources to support the "business partner" role. Each of the Partnership firms considered the business partner role important, though some had more experience with that role than did others. Since its inception, Quantum has so fully incorporated this strategic role that it is sometimes difficult to delineate this separate aspect of the company's activities. In recent years, Sears has moved well along that same path. It is useful, however, for those firms in transition to highlight the approach adopted by several of the Partnership firms that are currently going through these changes.

*Lucent*

Lucent's new HR structure is the foundation of a new and higher profile for the HR function. The model emphasizes client services at three levels: individual employees/retirees (300,000), supervisors/coaches (33,000), and senior leaders (381). The linchpin for value creation throughout Lucent is the role of HR Business Partner, in which HR leaders work directly with the senior business leaders to implement strategy. While the Business Partners, and indeed each of the three delivery channels, are measured against strict client satisfaction objectives, their ultimate goal is for the senior executives to say at the end of the year; "We were very successful and couldn't have done it without HR". The vision requires a strong commitment to the senior leadership that HR is working on *their* problems and that all HR initiatives are always focused on solutions for their clients. The details mean going to staff meetings, even when there is no discussion of HR issues, so HR representatives can better understand the business—or creating a team of 58 HR professionals (the *HR Accelerators*) whose job it is to find and eliminate (dismantle) HR policies and practices that no longer add value for Lucent's shareholders. Another example would be bringing in the marketing manager from Network Systems to address a video town meeting of the worldwide Lucent HR community. She explained what is required to significantly grow her business and how HR can partner with her in this effort (better motivational programs for the sales force, new competencies based on future oriented thinking, and so on).

Lucent has also developed a new competency model to support the development of the Business Partner role in HR. The competencies were developed using internal reviews and external benchmarking sources and emphasize five areas that answer the question, "What are the knowledge, skills, and commitments that will enable the Business Partners to deliver upon their customer's (internal client) expectations"? These include the following:

- Understanding the Lucent business, the client's business, and HR business;
- Customer focus;
- Defining, managing, and implementing HR solutions to business problems by identifying, securing, and leveraging resources;
- Managing in a changing, competitive environment; and
- Personal impact.

These competencies are then to be integrated into a HR system of learning and development, staffing and selection, career development, and performance management. The initial integration is through individual assessment tools that form the basis of a customized career development plan. The Business Partner competency model will, over time, serve as a foundation for such models in other HR roles at Lucent.

## The Elements of High Performance HRM Systems

While the experience of the five Partnership firms is certainly compelling, an issue that frequently arises for us is the extent to which the policies and practices adopted by these firms can in fact be considered "best practices", or whether the HR management systems in these firms are so highly customized and tailored to each situation that generalizations across firms mean very little. In his recent review of the literature, Pfeffer (1998) argues that there are in fact seven "best practices" that can lead to superior economic performance if adopted by any firm. These practices are:

***The Business Partner competency model will, over time, serve as a foundation for such models in other HR roles at Lucent.***

- employment security
- selective hiring
- teams and decentralized decision-making
- high pay
- extensive training
- reduced status distinctions
- extensive information sharing

Pfeffer's concept of *employment security* does not reflect the provision of lifetime employment security to all employees, but rather reasonable assurances from the organization that they will not be able to "work themselves out of a job". In addition, the expectation that average- to high-performing employees will remain with the firm for reasonable time periods is required if the firm is expected to make significant investments in employee training and development. *Selective hiring,* widely found in the prior research to be value-added at the level of the firm, is necessary to make sure that the firm attracts and retains the very best employees, who are then able to derive maximum benefit from the rest of the system. *Teams and decentralized decision-making* have considerable conceptual and practical appeal in a delayered environment where employees have the requisite knowledge to make their own decisions and also where market pressures require them to do so quickly. *High pay*, not considered here to be a form of corporate largess, serves multiple functions. First, when matched with a selective hiring system, it can help the firm to generate a substantial pool of candidates from which to choose. In addition, paying higher wages than those of competitors serves as a form of "efficiency wage", in that employees are less likely to leave when their next-best opportunity, by definition, pays less than their current job. The economic returns from *extensive training* are more likely to be captured by the firm if employees are motivated to stay with the firm and contribute to its success (fostered, in part, through selective hiring, high levels of pay, and teams). Similarly, *reduced status distinctions* between employees help to build an *esprit de corps* among employees and encourage the belief that all employees are "in this together". Finally, *extensive information sharing* is part of the "glue" that makes the parts of such a system work together, in that in an environment where decision-making is decentralized and largely in the hands of capable and enabled teams, sharing of information is ever more crucial to the overall organization's success.

***The ability to appropriately transform a high performance HRM philosophy into practice requires that HR managers balance several competing roles.***

While each of these elements represents a choice to emphasize the performance enhancing dimensions of the HRM system, it is equally important to remember that each is part of an integrated high performance HRM *system*. Employment security in the absence of selective hiring and continual development brings to mind a civil service environment more than a method for eliciting high performance from a firm's workforce. Similarly, teams and decentralized decision-making without information sharing, focused selection, and training are unlikely to generate optimal solutions over the long run. Indeed, one reason that the five firms in this study have such successful HR strategies is their recognition of these interdependencies. As we observe the implementation of these strategies, however, we are reminded of Schuler's (1990) distinction between *HR Philosophies* and *HR Practices*. These firms philosophically embrace each of these elements in their HR strategy, yet as each moves from philosophy to *practice*, the five firms we studied show considerable diversity.

The ability to appropriately transform a high performance HRM philosophy into practice requires that HR managers balance several competing roles. Ulrich (1997), for example, defines these roles as *Administrative Expert*, *Employee Champion*, *Change Agent*, and *Strategic Partner*. In these five firms, we have seen evidence of considerable effort to enrich the HR role by expanding their "above the line" activities (change agent and strategic partner) while not sacrificing the quality of their more traditional "below the line" (administrative expert and employee champion) contributions. Each of the firms in our study explicitly recognizes the importance of each of these roles and is committed to professional excellence in each.

**TABLE I** **Ulrich's Model of HR as a Business Partner.**


Source: Ulrich, 1997.

### Remaining Challenges

While the Partnership firms as a group have made significant progress in raising the strategic profile of HR in their respective organizations, they acknowledge the considerable challenges that remain. In some cases these challenges focus on more fully developing HR as a strategic player and business partner, in others they have established a strategic foundation and are concentrating on the next business problems facing the firm. Table II summarizes the nature of these challenges and their distribution across firms. For the most part, Partnership firms have achieved a solid record of operational excellence in HR. While they continue to look for improvements and drive out costs where they can, the emphasis is clearly on the issues surrounding the development and consolidation of a more strategic role. Indeed, in our experience, one of the distinguishing characteristics of leading edge HR management functions is that they have a clear idea of what they are up against and what they must accomplish to move to the next level, even if they are not as yet satisfied with their own performance.

Perhaps the first challenge during this transition is to develop an appropriate structure within which the HR function allocates the appropriate mix of responsibilities and resources between HR at the corporate and business unit level. The tradition in many business units has been operational, and the new demands of a business partner role are not always matched by the required resources (time and competencies). This challenge is even more difficult when this new HR role must be integrated within a larger business environment characterized by the rapid, global growth many firms are experiencing. Beyond these role-related issues, those interviewed identified a range of firm-specific challenges related to specific business problems or HR processes. In broadest terms, several of these could be categorized as the human capital problems surrounding strategic change. Perhaps the most significant was HR's efforts to support change and specifically to support efforts at leadership development and organizational renewal.

### Introduction to Special Issue Case Studies

The following case studies are based on one- to two-day interviews at each company, typically supplemented by additional documentation and telephone interviews. These studies were not designed to provide a comprehensive record of each firm's HR strategy and every HR practice. Instead, we asked participants to focus on "what matters most" in their own respective organizations. Specifically, what were they doing in HR that really added value to their firm and where were their most significant challenges? The resulting case studies, therefore, are organized around the following themes:

- ***The Role of HRM Throughout the Firm***: This section is designed to provide background for the case study and, in very broad terms, to describe the relative emphasis on strategic and operational HR roles throughout each business.
- ***High Impact HRM Practices***: This section focuses on those HR strategies, philosophies, practices, or processes that are making the most important contribution to the firm's success. In short, it's what is being done well *and* having a significant impact.
- ***The Challenges***: This section focuses on the most important challenges confronting HR in each firm over the next few years.

As we noted in the introduction, Wayne Brockbank of the University of Michigan concludes with an excellent essay that gives a "look over the horizon" for the HR profession as it prepares to enter the twenty-

**TABLE II** HR Challenges by Firm.

| Firm | Support High Growth | Employee Development & Renewal | Acquiring & Retaining Talent | Performance Management | Change Management | Corporate & Business. Unit HR Structure | Competencies for Strategic HR Role | Global Growth | New Labor Relations Model | Succession Planning and Leadership Development | Clarify HR Strategic Role |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Herman Miller[1] | | | | | x | | | | | | x |
| Lucent | x | x | | | | | x | x | x | | |
| Praxair | | | | | x | x | | x | | x | |
| Quantum[2] | x | x | x | | x | | | x | | | |
| Sears | | | x | | x | x | | | | | |

[1] Herman Miller also mentioned development of competencies models and diversity management.
[2] Quantum also mentioned managing joint ventures and acquisitions.

first century. Mike Losey, Tony Rucci, and Dave Ulrich then comment on this special issue in an interview conducted by us as guest editors. The interview is followed by Joe Ryan's review of William Joyce's new book on *Megachange*.

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## ENDNOTES

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2. Much of the next two sections was adapted from Brian Becker, Mark Huselid, Peter Pickus, and Michael Spratt (1997). "HR as Source of Shareholder Value: Research and Recommendations", *Human Resource Management*, Vol. 36, 1, pp. 39–48.
3. Not only are investments in human capital *not* reflected in a firm's balance sheet, they are expensed in their entirety on an annual basis. Thus, in contrast to capital investments (e.g., the purchase of a building) that are depreciated over their useful lifetimes, investments in people lower accounting earnings (net income and cash flow) by their full amount in the year in which they are incurred. This provides managers whose compensation is tied to accounting rates of return a significant disincentive to invest in human capital.
4. These human capital based competencies are in part the source of the "intangible capital" represented by the difference between the book value of a firm's assets (i.e., shareholder's initial investment) and the current market value of those assets. The best known variant of this measure is known as Tobin's *q*, which is a ratio of firm market value to the replacement cost of its assets.
5. This relationship statistically controls for other differences across firms that might influence this relationship (R&D investment, industry, plant and equipment, prior sales growth, etc.).
6. For ease of interpretation, these dollar values are based on the average market values of firms in the sample. The actual effects are in percentages so they would be proportionately larger or smaller based on an individual firm's market value per employee.
7. Given the mix of participant responsibilities, it was not always possible to discuss every aspect of the firm's HR function on each visit. Other firms may also have implemented processes like targeted selection, but they were not mentioned in the interviews.