
People and the Bottom Line

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Executive Summary

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Executive Summary

Does the way people are treated at work make a difference to the performance of the organisations that employ them? Are there returns to investment in human capital in a similar way to investments in physical capital? These seem straightforward enough questions but they have generated huge amounts of debate. On one side, there is plenty of evidence strongly suggesting that investment in people has important business performance benefits, and yet on the other hand, the research that arrived at this conclusion has been subject to detailed criticism.

And whilst academics gather and dispute the evidence, it would seem that practitioners are not completely convinced either. The take-up of what have been termed High Performance Working Practices (HPWPs) has been slow and many organisations do not adopt them. The doubts of practitioners reflect concerns over what it might mean for individual firms and sectors, and confusion over which people management practices are likely to show the greatest link to performance. Many studies adopt complex measures which are outside the capabilities of most firms to replicate. In terms of a step change in employer behaviour what is needed are some measures that have been linked to performance, that employers can capture for themselves and which do not require considerable academic resource to make useful.

Against this background, this study takes into account concerns from both academics and practitioners, and provides a convincing argument that the investments firms make in their workforce make a difference.

Background to the research

This report presents findings and analysis from *People and the Bottom Line*, the third part of a research project exploring the link between the way employees are managed and organisational performance.

The project began in 2004, when Investors in People UK (IIP UK) – together with the Sector Skills Development Agency (SSDA), the Chartered Institute of Personnel and Development (CIPD) and the Department for Education and Skills (DFES) – began drawing together evidence of the links between skills and organisational performance. This work began with two phases:

- *Phase one* involved an extensive literature review which explored the relationship between skills investment, employee commitment, high performance workplaces, and organisational performance.
- *Phase two* drew on the literature to generate a framework of capability against which organisations could consider all aspects of people management, together with their own investment in people. It drew together a theoretical framework – the 4A Model – alongside a list of 40 measures (related to skills development and wider people management practices) which employers could use in order to monitor performance in each of these areas.

This third phase of activity was developed to assess the link between the measures presented in the 4A model and organisational performance, and to determine which of the candidate 40 measures show the strongest association.

Theoretical framework

The work conducted in phase two of the project¹ identified two key dimensions to the expression of and improvement of human capability in the workplace:

- The first dimension encompasses the development of capability at one end and its deployment at the other.
- The second dimension explores the roles of individuals at one end and organisations at the other and the way in which capability depends on an appropriate partnership.

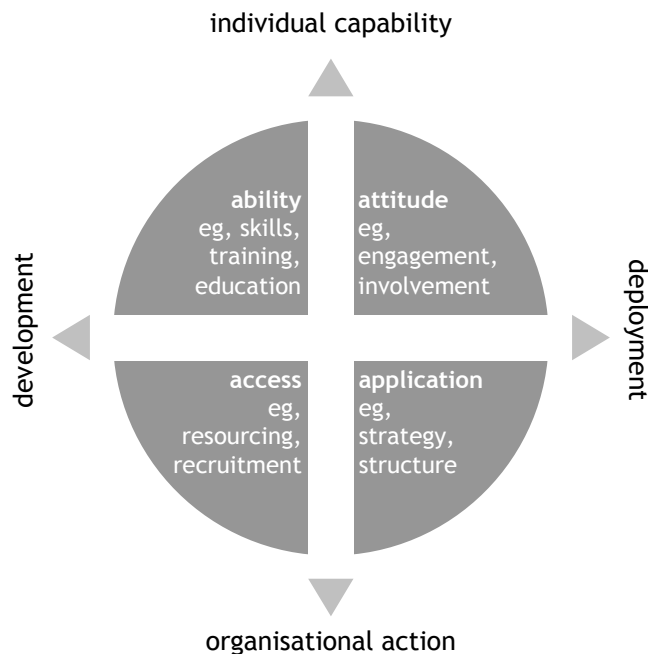
The resulting four quadrants of activity form the 4A model (see Figure 1):

- **Access** – the effective resourcing of roles in the organisation in terms of initial recruitment, ongoing job moves and succession activity. The focus here is on deliberative organisational activity including policy and practice.

¹ Tamkin P (2005), *Measuring the Contribution of Skills to Business Performance: A Summary for Employers*, Institute for Employment Studies

- **Ability** — the skills and abilities of the workforce. In essence, the quality of people that the organisation has at its disposal, and the ongoing development activity of those individuals which maintains and further develops their capability.
- **Attitude** — it is clear that skills are not the totality of what makes people do an excellent job. There is also the engagement, motivation and morale of the workforce and the meaning they find in work, their beliefs about the workplace and their willingness to put in additional effort.
- **Application** — the opportunities made available to individuals to apply themselves. This recognises that people need an appropriate working environment to prosper provided through information, job design, organisational structure and business strategy.

Figure 1: The 4A model of capability



Source: Tamkin P, Giles L, Campbell M, Hillage J (2004), *Skills Pay: The Contribution of Skills to Business Success*, SSDA Research Report 5

Each quadrant of the model was then populated with measures that had either been tested within the literature reviewed, were already used elsewhere (and were therefore accepted by organisations), or were new measures that had been developed to provide a reasonable test of investment by an organisation in that quadrant of activity. The criteria used to identify potential measures included resonance with employers (ie they should be meaningful to employers and align as far as possible with measures already in use); rigour and lack of ambiguity; and the capacity for longitudinal study (ie the measures should be able to track organisational inputs, outputs and performance over time).

This analysis led to a set of 40 measures across the quadrants of the 4A model: a list of core and desirable measures of HR practice.

Objectives and methodology

The main aim of this new research was to examine the link between the measures presented in the 4A model and organisational performance, and to determine which measures show the strongest association. In addition, it was to provide a method that will enable examination of a causal link in the future.

In doing so, the initial 40 measures underpinning the 4A framework were to be tested and reduced to a smaller set which show the greatest correlation with organisational performance.

More specifically, the objectives were:

- *Using the framework of human capital, Human Resource Management (HRM) and organisational performance measures/indicators, identify a core set of indicators which show the most robust relationship with business performance and which organisations can feasibly collect.*
- *Test if this core set can be collected in a consistent way so that aggregate data can be generated.*
- *Explore how easily employers can identify the information required, and the feasibility of future data collection.*
- *Use the generated core set of indicators to test the association with business performance across a broad and representative cross sector of employers.*

At a more detailed level it was hoped that the project would answer some key questions:

- Can the measures be collected in a consistent way so that aggregated data could be generated for analysis at organisational size, sectoral, regional and national levels?
- Can meaningful correlations be drawn?
- What methodology should be adopted to assess a causal link in the future?

To achieve these objectives, the researchers conducted a telephone survey across a wide range of employers. The survey was first piloted, in order to test the effectiveness of the questionnaire, and then rolled out to cover 2,905 organisations with 25 or more employees, of which 2,500 were private sector and 405 were public sector.

The questionnaire was designed to explore each element of the 4A model, collecting employers' views on how they invest in people and the processes they use to manage the capability and contribution of their staff. Questions were based on elements identified from the earlier phases of research plus additional questions requested by the IIP Human Capital working group. Responses allowed each of the four quadrants of the model to be populated, whilst additional information on organizational performance was also gathered which could be compared to performance information from an independent business database. This enabled the researchers to explore the link between the quadrants of the 4As model both separately and as an integrated model, and to assess which measures had the strongest relationship with on organisational performance.

Analysis: factors influencing index scores

Initial analysis of responses, involving frequencies and cross-tabulations, revealed that a number of characteristics affected an organisation's performance on measures that make up the 4A model. These included variations of size and sector, plus three elements of an organisation's strategy: its approach to innovation, its efforts to create a great working environment, and the emphasis placed on meeting the needs of external stakeholders. The impact of being IIP-recognised was also investigated and found to have a positive and significant effect across all 4A indices, and in each case the scale of this effect was substantial. The data demonstrate that IIP recognised organisations have greater investment in their workforces and more sophisticated processes and practices than non-IIP organisations.

Analysis: relationship with business performance

Next the data were analysed in greater depth to explore the relationship between scores on the index and company performance, in order to understand whether the way in which employees are managed affects performance regardless of organisational characteristics.

To do this, regression techniques were used to help understand the correlations between the variables (ie questionnaire responses) in more depth. Regression enables us to hold constant all the factors we have identified as influencing index scores, including previous company performance. Initially the focus was on whether specific clusters of HR practices are linked to organisational performance:

- Is it access policies (ie careful recruitment and resourcing) that has an effect?
- Is it the ways in which the firm looks to increase ability (ie through high levels of workforce training and development)?
- Is it attitudes that are important – the ways in which the workforce is motivated, engaged and aligned to the needs of the business?
- Is it the application of people in the workplace – the ways in which the organisation ensures that employees are given appropriate opportunities to apply their skills and motivation through job design, etc?

Statistical tests found only a weak relationship between these individual quadrants of the 4As model and performance, suggesting that no single sub-system of HR practices impacts on performance in isolation. However, if we combine our measures across all parts of access, ability, attitude and application, we find much more powerful statistical relationships between the degree to which firms invest in their people and a wide array of organisational performance measures.

These are clearly very significant findings. The size of the effects are also of note and provide, in tangible terms, a sense of the relationship between the index and the

organisation's performance. The results imply that if a business increases its investment by the equivalent of increasing its combined index score by one (around 10 per cent), this would equate to²:

- an increase in gross profits per employee of between £1,083 and £1,568.
- an increase in operating profit per employee of between £1,139 and £1,284.
- an increase in profit margins per employee of between 1.19 per cent and 3.66 per cent (ie the ratio of profit over sales).
- a 0.09 per cent increase in sales growth per employee.
- a 3.1 per cent increase in the probability of achieving sales from new technology.

These results are congruent with the literature reviewed within Tamkin et al³, which suggests that bundles of HR practice are more impactful than single HR practices. This makes intuitive sense as firms need to create a strategically consistent HR environment. It suggests for example, that there will be limited benefits to firms creating great recruitment or succession practices if they do not attend to staff development or motivation. The results also show that as IIP recognition is strongly associated with higher index scores and higher index scores with better performance, achieving the Standard could provide the framework to improve policy and increase investment, which in turn is associated with better performance.

Analysis: comparing upper and lower quartile scores

Further analysis of the data was conducted to compare those organisations that were in the top 25% of index scores (the upper quartile) with those in the lowest 25% of scores (the lowest quartile). The results of this comparison showed that:

- Younger firms are significantly less likely to be located in the lowest quartile. This might suggest a degree of inertia in HR strategy development in older firms. It was also noted that large firms are more likely to be in the upper quartile and medium-sized firms in the third quartile.
- The most consistent differences between the lowest quartile firms and the highest quartile firms are in terms of their innovation strategy and positioning, and their overarching strategic objectives. Upper quartile firms are significantly more likely to develop their own new technologies or buy in up-to-date technologies. This contrasts with the lowest quartile firms who are more likely to use tried and tested technologies.

² All figures are based on annual company accounts data

³ Tamkin P, Giles L, Campbell M, Hillage J (2004), *Skills Pay: The Contribution of Skills to Business Success*, SSDA Research Report 5

- Upper quartile firms are also much more strongly orientated towards creating a great working environment for their employees, meeting the needs of other external stakeholders and being innovation led.
- Finally, it was observed that multiple establishment firms are more likely to be located in the upper quartile of the index.

Taken together, such results show that – if factors such as size, sector, previous performance and the strategic objectives of the firm are held constant – then better scores on the index (and therefore greater investment in people) are associated with better financial performance. This suggests that there may be potential benefits to all firms of adopting a coherent range of HR practices and investments in their people, irrespective of their circumstance.

Even where firms are already investing in their workforce, there would seem to be benefits of doing more; there was no evidence that higher scores on the index show diminishing returns.

Analysis: identifying key measures

In addition to exploring the link between people management and organisational performance, the project sought to distil the measures (76 in total including the 40 original measures and those added from the human capital group) which were tested to identify a core set which show a robust relationship to performance, and which organisations can feasibly collect.

This total was initially reduced, removing measures which:

- had achieved relatively low response rates in the survey (perhaps because employers found it difficult to provide data)
- had relatively little variation in responses (and therefore gave us little with which to differentiate organisations)
- did not help raise the reliability of the individual 4A indices.

This still left a relatively long list of measures (37), which form the basis of our regression analysis of the link to performance. For most organisations this would prove to be too many, and so to distil these further, the items which accounted for the greatest impact in terms of variability between responses from organisations were identified and studied. Each item within each quadrant of the 4A model was looked at, which then led to the identification of the items that had the greatest impact in each case.

This analysis gave a scaled down set of 12 measures, as captured in the table below.

Table 1: The key 12 measures

Area	Measures
Access	1. Proportion of new appointees tested on recruitment
	2. Proportion of new appointments for which there was a person specification
	3. Proportion of employees covered by a succession plan
Ability	4. Proportion of workforce that have a current personal development plan
	5. Proportion of the workforce that have a career development plan
	6. Proportion of employees qualified to degree level
Attitudes	7. Proportion of managers that left voluntarily over the last twelve months
	8. Proportion of staff that receive profit related pay
	9. Proportion of staff that have a regular appraisal
	10. The frequency with which staff have one-to-ones
Application	11. Who decides on the pace of work (1 = exclusively managers; 5 = exclusively workers)
	12. Who decides on task allocation (1 = exclusively managers; 5 = exclusively workers)

Source: IES, 2008

These 12 measures provide a core set for organisations to use to measure their own investment in people within the organisation and which could be used to provide further evidence or the base for tracking research.

In addition, there are three items from the survey which have not been suggested as a measure as they do not test *degree* of adoption, rather they capture whether a process exists or not. As the presence or absence of the process is indicated as important in the regression analysis they are included and it is suggested that organisations ensure that these three processes are in place:

Table 2: Key processes

Area	Items
Ability	1. The organisation evaluates development in a systematic way
	2. The organisation focuses on the long term development of its managers
Application	3. The organisation encourages and captures the suggestions of the workforce

Source: IES 2008

Conclusion

Overall, the findings from this project demonstrate that organisations that adopt an integrated range of HR practices, captured by the 4A model, are likely to perform better on key indicators like profit and sales growth. The research has also demonstrated that employers of all types and sizes could benefit from this strategic investment in people.

Whilst this research was not intended to demonstrate causality, it has laid the ground for future work that could do so by providing a tested set of measures that were both acceptable to employers and shown to relate to performance.