

CHAPTER 1
How HR Can Add Value

Global competition, information technology, new knowledge, the increase in knowledge workers, and a host of other business environment changes are forcing organizations to constantly evaluate how they operate. In many cases they have embraced new strategic initiatives and significantly changed how they operate. They are utilizing new technologies, changing their structures, and improving their work processes to respond to an increasingly demanding and global customer base. These initiatives involve fundamental changes that have significant implications for their human capital and their human resources functions.

Human capital management should be an important part of the strategy of any corporation. The annual reports of many corporations argue that their human capital and intellectual property are their most important assets. In many organizations, compensation is one of the largest, if not the largest, cost. In service organizations compensation often represents 70 to 80 percent of the total cost of doing business. Adding the costs of training and other human resources management activities to the compensation costs, we can see that the human resources function often has responsibility for a large portion of an organization's total expenditures.

But the compensation cost of human capital is not the only, or even the most important, consideration. Even when compensation accounts for very little of the cost of doing business, human capital has a significant impact on the performance of an organization (Cascio, 2000). In essence, without effective human capital, organizations are likely to have little or no revenue. Even the most automated production facilities require skilled, motivated employees to operate them. Knowledge work organizations depend on employees to develop, use, and manage their most important asset, knowledge. Thus, although the human capital of a company does not appear on the balance sheet of corporations, it represents an increasingly large percentage of many organizations' market valuation (Lev, 2001).

A growing body of evidence affirms that HR practices can be a value-added function in an organization. The initial work on the relationship between a firm's performance and its HR practices was conducted by Becker and Huselid (1998). In their study of 740 corporations, they found that firms with the greatest intensity of HR practices that reinforce performance had the highest market value per employee. They argued that HR practices are critical in determining the market value of

a corporation and that improvements in HR practices can lead to significant increases in the market value of corporations. They concluded that the best firms are able to achieve both operational and strategic excellence in their HR systems.

Role of the Human Resources Organization

The HR function can add value by adopting a control-and-audit role. But two other roles that it can take on allow it to add still greater value. Lawler (1995) has developed this line of thought by describing the three roles it can take on. The first is the familiar human resources management role (Exhibit 1.1).

The second is the role of business partner (Exhibit 1.2). It emphasizes developing systems and practices to ensure that a company's human resources have the needed competencies and motivation to perform effectively. In this approach, HR has a seat at the table when business issues are discussed and brings an HR perspective to these discussions. When it comes to designing HR systems and practices, this approach focuses on creating systems and practices that support the business strategy. HR also measures the effectiveness of the human capital management practices and focuses on process improvements.

The business partner approach positions the HR function as a value-added part of an organization. It is positioned to contribute to business performance by effectively managing what is the most important capital of most organizations, their human capital. But, this approach may not be one that enables the HR function to add the greatest value. By becoming a strategic partner, HR has the potential to add more value (see Exhibit 1.3).

In acting as a strategic partner, HR plays a role that includes helping the organization develop its strategy. Here, not only does HR have a seat at the strategy table, HR helps to set the table. Boudreau and Ramstad (2005a, 2005b) support this idea by suggesting that strategies can be shaped and enhanced by bringing a human capital decision science to HR's role in strategy.

In the knowledge economy, a firm's strategy must be closely linked to its human talent. Thus, the human resources function must be positioned and designed as a strategic partner that participates in both strategy formulation and implementation. Its expertise in attracting, retaining, developing, deploying, motivating, and organizing human capital is critical to both. Ideally, the HR function should be knowledgeable about the business and expert in organizational and work design issues so that it can help develop needed organizational capabilities and facilitate organizational change as new opportunities become available.

Exhibit 1.1. HR Management

AIMS	Business orientation. Services provided expressed as outputs or products.
PROCESS	Build performance management capabilities. Develop managers: link competencies to job requirements and career development. Succession planning. Enhance organizational change capabilities. Build an organization-wide HR network.
PLANNING	HR (and all other functions) inspect business plans; inputs from HR may be inserted in the planning process.

Exhibit 1.2. Business Partner

AIMS	Line management owns human resources as a part of their role. HR is an integral member of management teams. Culture of the firm evolves to fit with strategy and vision.
PROCESS	Organize HR flexibly around the work to be done (programs and projects, outsourcing). Focus on the development of people and organizations (road maps, teams, organizational design). Leverage competencies, manage learning linkages; build organizational work redesign capabilities.
PLANNING	An integral component of strategic and business planning by the management team.

Exhibit 1.3. Strategic Partner

AIMS	HR is a major influence on business strategy. HR systems drive business performance.
PROCESS	Self-service for transactional work. Transactional work outsourced. Knowledge management. Focus on organization development. Change management. Human resource processes tied to business strategies.
PLANNING	HR is a key contributor to strategic planning and change management.

To be a strategic partner, HR executives need an expert understanding of business strategy, organizational design, and change management, and need to know how integrated human resources practices and strategies can support organizational designs and strategies. This role requires extending HR's focus beyond delivery of HR services and practices to a focus on the quality of decisions about talent, organization, and human capital.

As a strategic partner, HR brings to the table a perspective that is often missing in discussions of business strategy and change—a knowledge of the human capital factors and the organizational changes that are critical to determining whether a strategy can be implemented. Many more strategies fail in execution than in their conception.

Despite compelling arguments supporting human resources management as a key strategic issue in most organizations, human resource executives often are not strategic partners (Lawler, 1995; Brockbank, 1999). All too often, the human resources function is largely an administrative function headed by individuals whose roles are focused on cost control and administrative activities (Ulrich, 1997; Lawler and Mohrman, 2003a; Boudreau and Ramstad, 2005a). Missing almost entirely from the list of HR focuses are key organizational challenges such as improving productivity, increasing quality, facilitating mergers and acquisitions, managing knowledge, implementing change, developing business strategies, and improving the ability of the organization to execute strategies. Since organizations do see these areas as important, the HR function is missing a great opportunity to add value.

There is some evidence that this situation is changing, and that the human resources function is beginning to redefine its role in order to increase the value it adds. The first three phases of the present study (in 1995, 1998, and 2001) found evidence of some change, but notably there was more discussion of change than actual change (Lawler and Mohrman, 2003a).

One possible view of the human resources function of the future is presented in a study of business process outsourcing by Lawler, Ulrich, Fitz-enz, and Madden (2004). It shows how four large corporations (British Petroleum, International Paper, Prudential, and Bank of America) transferred many HR administrative activities to the line, to outside vendors, and to highly efficient processing centers. The HR function was left to focus almost exclusively on business consulting and managing the organization's core competencies. This model is consistent with Ulrich's argument that the HR function needs to be redesigned to operate as a business partner (Ulrich, 1997; Ulrich, Losey, and Lake, 1997). Recently, Ulrich and Brockbank (2005) have argued that the HR function

needs to develop a compelling value proposition that focuses on how it can increase the intangible assets that drive the market value of organizations. Boudreau and Ramstad (1997) note that the HR profession could mature in a way similar to finance and marketing.

A number of recent studies have addressed the new competencies required when the human resources function strives to be a strategic business partner (e.g., Smith and Riley, 1994; Csoka, 1995; Eichinger and Ulrich, 1995; Ulrich, 1997; Csoka and Hackett, 1998; Brockbank and Ulrich, 2003). Identifying these competencies needs to be followed by reorganizing the HR function to develop these competencies and to provide services in a manner that adds value as organizations change their overall architecture and strategy.

Creating Change

Describing the new human resources role and the new competencies HR needs is only the first step in transitioning the HR function to a strategic business partner. For decades, the human resources function has been organized and staffed to carry out administrative activities. Changing that role will require a different mix of activities and will necessitate reconfiguring the HR function to support changing business strategies and organizational designs. It also will require the employees in the HR function to have very different competencies than they traditionally have had.

It is becoming increasingly clear that information technology will play a very important role in the future of the HR function (Lawler, Ulrich, Fitz-enz and Madden, 2004). With HR information technology (IT), administrative tasks that have been traditionally performed by the HR function can be done by employees and managers on a self-service basis. Today's HR IT systems simplify and speed up HR activities such as salary administration, job posting and placement, address changes, family changes, and benefits administration; they can handle virtually every administrative HR task. What is more, these systems are available around the clock and can be accessed from virtually anywhere.

Perhaps the greatest value of HR IT systems will result from enabling the integration and analysis of the HR activities. They have the potential to make HR information much more accessible so that it can be used to guide strategy development and implementation. Metrics can be easily tracked and analyses performed that make it possible for organizations to develop and allocate their human capital more effectively (Boudreau and Ramstad, 2006; Lawler, Levenson, and Boudreau, 2004).

A strong case can be made that HR needs to develop much better metrics and analytics capabilities. Our previous three studies identified

metrics as one of four characteristics that lead to HR's being a strategic partner. The constituents of HR want measurement systems that enhance their decisions about human capital. All too often, however, HR focuses on the traditional paradigm of delivering HR services quickly, cheaply, and in ways that satisfy clients (Boudreau and Ramstad, 1997, 2003).

HR has become more sophisticated in its measurement, yet this doesn't seem to be leading to increases in organizational effectiveness. Business leaders can now be held accountable for HR measures such as turnover, employee attitudes, bench strength, and performance appraisal distributions; however, this is not the same as creating an effective organization. The issue is how to use HR measures to make a true strategic difference in the organization.

Boudreau and Ramstad (2006) have identified four critical components of a measurement system that drive strategic change and organizational effectiveness: logic, analysis, measures, and process. Measures represent only one component of this system. Though measures are essential, without the other three components they are destined to remain isolated from the true purpose of the HR measurement systems.

Boudreau and Ramstad have also proposed that HR can make great strides by learning how more mature and powerful decision sciences have evolved their measurement systems (Boudreau and Ramstad, 1997). They identify three anchor points—efficiency, effectiveness, and impact—that connect decisions about resources such as money and customers to organizational effectiveness and that can similarly be used to understand HR measurement.

1. *Efficiency* asks, "What resources are used to produce our HR practices?" Typical indicators of efficiency are cost-per-hire and time-to-fill-vacancies.
2. *Effectiveness* asks, "How do our HR policies and practices affect the talent pools and organization structures to which they are directed?" Effectiveness refers to the effects of HR policies and practices on human capacity (a combination of capability, opportunity, and motivation), and the resulting "aligned actions" of the target talent pools. Effectiveness includes trainees' increased knowledge, better-selected applicants' enhanced qualifications or performance ratings of those receiving incentives.
3. *Impact* reflects the hardest question of the three. Impact asks, "How do differences in the quality or availability of different talent pools affect strategic success?" This question is a component of talent segmentation, just as for marketers a component of market segmentation

concerns, “How do differences in the buying behavior of different customer groups affect strategic success?”

Today’s HR measurement systems largely reflect the question of efficiency (Gates, 2004), though there is some attention to effectiveness as well, through focusing on such things as turnover, attitudes, and bench strength. Rarely do organizations consider impact (such as the relative effect of different talent pools on organizational effectiveness). More important, it is rare that HR measurement is specifically directed toward where it is most likely to have the greatest effect on key talent. Attention to non-financial outcomes and “sustainability” also needs to be increased, because strategic HR can affect these as well (Boudreau and Ramstad, 2005a).

The Emerging HR Decision Science

The majority of today’s HR practices, benchmarks, and measures still reflect the traditional paradigm of excellence defined as delivering high-quality HR services in response to client needs. Even as the field advocates more “strategic” HR, it is often defined as delivering the HR services that are important to executive clients (leadership development, competency systems, board governance, etc.). This traditional service-delivery paradigm is fundamentally limited, because it assumes that clients know what they need. Market-based HR and accountability for business results are now recognized as important (Gubman, 2004). However, it often amounts merely to using marketing techniques or business results to assess the popularity of traditional HR services, or their association with financial outcomes.

Fields such as finance have taken a different approach. They have augmented their service delivery paradigm with a “decision science” paradigm, which teaches clients the frameworks to make good choices. Significant improvements in HR decisions will be attained not by applying finance and accounting formulas to HR programs and processes, but rather by learning how these fields evolved into the powerful, decision-supporting functions they are today. Their evolution provides a blueprint for what should be next for HR. The answer lies not just in benchmarking HR in other organizations, but in evolving to be similar to more strategic functions such as finance and marketing.

The marketing decision science enhances decisions about customers. The finance decision science enhances decisions about money. For human capital, a decision science should enhance decisions about organization talent, and those decisions are made both within and outside the HR function. Boudreau and Ramstad have labeled this emerging decision science “talentship,” because it focuses on decisions

that improve the stewardship of the hidden and apparent talents of current and potential employees (Boudreau and Ramstad, 2005a).

Organization Design

Contributing to effective organizational design is a major domain in which the HR function has the opportunity to add strategic value. Increasingly, the only sustainable competitive advantage is the ability to organize effectively, respond to change, and manage well (Mohrman, Galbraith, and Lawler, 1998; Lawler and Worley, 2006). Confirmation of this statement is provided by Lawler, Mohrman, and Benson's (2001) study of the Fortune 1000, which shows a significant relationship between firm financial performance and the adoption of new management practices designed to increase the capabilities of the firm.

Staff functions, in general, and HR functions, in particular, are under fire in many organizations because they are perceived as controlling rather than adding value, and as not responding to the demands for change that come from operating units. HR functions are being asked to provide expert support to the strategic initiatives of the company and to take advantage of technology, outsourcing, and other approaches to deliver more efficient and responsive services.

Organizational design is increasingly being recognized as a key factor that enables organizations to develop capabilities and, therefore, to perform in ways that produce a competitive advantage. Organizations are adopting design features with an eye to the value they contribute, that is, how they help the organization accomplish its mission (Galbraith, 2002).

All parts of the organization, operating units and staff functions alike, are being redesigned to deliver higher value. For support groups, doing so requires the development of a business model—a value proposition defining what kind of value they will deliver that the company is willing to pay for because it enhances company performance. It also requires them to determine how services can best be delivered.

Two important trends have been noted in organizational design (Mohrman, Galbraith, and Lawler, 1998). The first is recognizing that design is something more than structure, since it includes elements such as management processes, rewards, people systems, information systems, and work processes. These elements must fit with the strategy and with each other for an organization to perform effectively (Waterman, 1982; Nadler, Gerstein, and Shaw, 1992).

The HR organization must think about whether the elements of the design of the HR function indeed do create a high-performance

organization—that is, one capable of delivering maximum value while consuming the fewest possible resources. Doing so means concentrating on the way HR organizes to deliver routine transaction services, traditional HR systems development and administration, and strategic business support. HR must think about its own structure, competencies, customer linkages, competency development, management processes, rewards, and information technology to ensure that scarce resources are optimally deployed to deliver value. In addition to making sure the HR function is optimally designed, HR must ensure that it adds value by helping design the company and its various business units.

The second trend is acknowledging that organizational designs involve complex tradeoffs and contingencies. Clearly, one design approach does not fit all organizations. As new business models emerge, new approaches and organizational forms spring up to deal with the complex requirements that organizations must address (Mohrman, Galbraith, and Lawler, 1998). These new models include complex partnerships, globally integrated firms, customer-focused designs, and network organizations. Furthermore, multi-business corporations are recognizing that different businesses exist in different markets and face varying requirements. Consequently, variation in organizational design is increasing, both within multi-business corporations and between businesses (Galbraith, 2002). Thus, for the company and the HR function, one size does not fit all situations. Different organizational forms require different kinds of HR contribution, and thus different HR functional designs and systems.

Design of the HR Function

Organizational design decisions, for HR as well as for companies as a whole, are made in four key areas:

1. Which functions should be centralized and leveraged, and which should be decentralized in order to focus on the unique needs of different parts of the organization? Organizations are combining centralization and decentralization, trying to be big (coordinated) in functions such as purchasing, when there is an advantage to being big; and small (decentralized and flexible) in functions such as new product development, when there are advantages to being small and agile.
2. Which functions should be performed in-house, and which should be outsourced? Companies are outsourcing when they can purchase high-quality services and products more inexpensively or reliably than they can generate them internally.
3. Which functions should be hierarchically controlled, and which should be integrated and controlled laterally? In some areas, orga-

nizations function in a lateral manner, integrating and creating synergies across various parts of the organization, creating cross-functional units to carry out entire processes, and collaborating with suppliers and customers (Mohrman, Cohen, and Mohrman, 1995). Organizations are searching for ways to leverage across business units while setting up organizational and management approaches that give the optimal levels of flexibility and control to various business units.

4. Which processes should be information technology-based? Today, most organizations are wired and have ERP systems that can do a great deal of the administrative work of HR, but is it advantageous to have them do it?

Traditionally HR (and many other staff groups such as information technology) has been organized in a hierarchical manner and HR has seen its mission as designing, administering, and enforcing adherence to HR policies and systems. As a result, HR has been seen as expensive, a necessary evil consuming resources disproportionate to the value that they add to the company. Among the changes in structure and process that are being advocated for staff functions such as HR are the following:

1. Decentralizing business support to operating units in order to increase responsiveness.
2. Contracting with business units for services that are to be delivered, and perhaps even requiring services to be self-funding as a way of ensuring that businesses get only the services that they are willing to pay for and that they see as contributing to business performance.
3. Finding the most efficient way to deliver processing and transactional services, such as creating efficient central services and/or outsourcing.
4. Using information technology to make processes more efficient and to deliver increased value.
5. Participating in cross-unit teams in order to deliver integrated services and/or to partner with customers to increase line ownership over HR systems or to bring the HR perspective to various organizational cross-functional team activities.
6. Creating centers of excellence that provide expert services often in a consulting capacity to the business.
7. Increasing the rotation of people within various staff functions and between staff and line, and having fewer lifelong careers within a narrow staff function, in order to broaden the perspectives of HR staff professionals and increase their awareness of business issues, as well as to increase the depth of understanding of HR issues among line management.

Conclusion

The future of the HR function in organizations is uncertain. On the one hand, if current trends continue it could end up being largely an administrative function that manages an information technology-based HR system and vendors who do most of the HR administrative work. On the other, it could become a driver of organizational effectiveness and business strategy. Many of the key determinants of competitive advantage depend on effective human capital management. More than ever before, the effectiveness of an organization depends on its ability to address issues such as knowledge management, change management, and capability building, which could fall into the domain of the HR function. The unanswered question at this point is whether HR organizations will rise to the occasion.

In order to increase HR's contribution to organizational effectiveness in the future, HR must rethink its basic value proposition, structure, services, and programs in order to address how it can add value in today's economy with its new organizational forms and business strategies. HR faces a formidable challenge just in helping organizations deal with the human issues that are raised by large-scale, strategic change. To face these challenges effectively, human resources has to focus on how it can add value and how it is organized; it must also improve its competencies and in some areas develop new ones.