

Why Small and Medium - Sized Organizations Really Do Need An HR Function

SHRM White Paper

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Introduction

Small (20-100 employees) to medium-sized (101-500 employees) organizations do need an HR function. Statistics related to the effective management and continued growth of an organization support this need. Without professional HR advice from an internal HR professional or an external HR consultant, companies often make costly mistakes that could have been prevented.

The information included in this white paper can help the small business owner ensure she or he is paying attention to the vital aspects of HR or help the mid-sized business owner justify hiring HR services. It can also assist any internal HR professionals in better communicating the value of HR to management. Finally, it can help HR consultants promote their services to small and mid-sized organizations.

Statistics

An October 2000 article highlighted some studies showing that one-third of applications or resumes generally contained distortions, embellishments or falsehoods (CNN.com, 2000).

According to a survey conducted by InfoLink Screening Services over the course of six months, 8.3 percent of all job applicants had criminal records, while 3.3 percent tested positive for illegal drugs, and 26.4 percent had discrepancies in their reported past employment. More than 40 percent of job applicants were found to have unreported DMV information.

According to the U.S. Chamber of Commerce and the American Management Association, about 30% of all business failures are due to employee theft and related forms of dishonesty. The Workplace Violence Research Institute says action against an employer for negligent hiring is becoming increasingly common, with average awards in the millions.

Millions of dollars are paid out in awards for harassment and other legal claims against employers every year.

Hiring an illegal alien can result in fines ranging from \$250 to \$10,000. And these figures may go up with the 2006 focus on immigration.

These statistics may give nightmares to small business owners and entrepreneurs, but most continue business as usual, thinking that it happens to the other guy.

Even when legal issues don't arise, fairly common employment-related mistakes result in costs to the organization in terms of lost productivity, efficiency, effectiveness, sales and revenues, and decreased profitability.

Eight Common HR Mistakes Smaller Organizations Make

1. Failure to Understand Employment-at-Will

Many believe that they can fire at will. After all, it's their business and they have control over who does and who doesn't work there. Unfortunately, case law doesn't necessarily work in their favor, and the Equal Employment Opportunity Commission (EEOC) may call to advise them that an ex-employee has filed a complaint alleging wrongful termination based on case laws that override employment-at-will.

To make matters worse, smaller organizations may not be aware of the documentation needed to support a termination decision, fail to have a documented termination process in place or fail to document performance or behavior feedback showing that an employee was given an opportunity to improve.

2. Designating the Initial Days of Employment as a Probationary Period

Some still use the term probationary period for the initial 30, 90 or more days of employment. This can cause problems when that really good new hire turns out to be not so great and the company terminates him or her. By identifying the first 90 days as a probationary period, the company has indicated that the new hire is officially off probation as of day 91. The business now must show cause in order to terminate.

Since small companies may not be adept at using an *introductory employment period* (a better term than probationary period) to evaluate new hires, they delay taking termination action until day 88, even though they knew the new hire was not working out by day 45. This can create legal liability for them if a complaint of wrongful termination is filed. New hires need to know what is expected and must be kept under observation so that they receive timely feedback on how well they are fulfilling these expectations.

Example: A small manufacturing company had a large production order to complete for a major client, and it delayed using the introductory employment period to terminate five unacceptable new hires. Though the company believed it needed the warm bodies from a staffing perspective, the poor performers were actually *costing it money* in terms of poor customer service and losses in product quality. They were also having a negative impact on the morale of the employees who were carrying the new hires.

3. Lack of Patience in Hiring

Smaller companies may not have sufficient staff to cover an open position, so they rush through the hiring process and make a poor hiring decision. Poor hires take up a supervisor's time, create bad vibes among current employees and create costs for an organization. Poor hires can affect service and product quality and create a bad impression among an organization's customers.

Smaller organizations may avoid pre-employment testing or assessments since they add time and cost to the hiring process. However, especially in a smaller organization, it is very important that a new hire fit the culture. Better to take the time to hire the best candidate than to terminate a poor fit and start all over again. Some organizations develop their own skill testing without realizing that in order to be effective, testing needs to be valid and reliable to be legally defended or at least only be a piece of the job testing.

Some companies eliminate pre-employment drug testing to speed up the employment process. However, drug testing may lower risk-insurance premiums and assist with providing a healthy workplace for employees.

4. Lack of Skill in Hiring

Many companies do not provide interviewing skills training for supervisors who are responsible for hiring. Without the skills to probe for information, good hiring decisions are a matter of chance.

5. Using Another Organizations Employee Handbook

Writing an employee handbook is a difficult task, and paying to have one written creates additional cost. Therefore, when small business owners identify the need to have written rules and expectations or when supervisors need a tool to back them up when enforcing policies and procedures, they may borrow an employee handbook used by another organization. The borrowed handbook is then revised and distributed.

The small business owner may borrow from an organization that is in a very different business, or is significantly larger, or is subject to unique regulatory controls. Perhaps the borrowed handbook was originally borrowed from another organization and may be out of date or not in compliance with current employment law.

Sometimes policies and procedures may be difficult to administer, so supervisors either ignore or administer them on a haphazard basis. And employees, perceiving inequitable treatment, may take legal action or even undertake union organizing efforts.

Often there are frequent policy revisions or changes, causing confusion among employees. Employees may not be required to sign an acknowledgment and receipt for the handbook. One former employee sued his small financial services organization for wrongful termination citing that he never received a copy of the current employee handbook or the revised policy upon which his termination was based.

6. Poor Documentation Practices

Effective documentation is critical to the employment process. Many employment activities can be the basis for a discrimination charge--from when an employee is interviewed and hired to when the employee is terminated. To be effective, documentation must be accurate, consistent, complete and evaluated.

Lack of documentation, followed by incomplete or inconsistent documentation and poorly worded documentation, can create liability for the organization.

If there is no formal process for documentation, personnel files may contain information on employee behavior or performance issues that have never been shared with the affected employees. Files may contain only commendation memos or recognition for achievements. Supervisors may write notes about poor performance or behavior and, instead of sharing the information with the struggling employee, keep the notes in a private file to use as grounds for termination.

Example: A small printing services company wanted to terminate an employee with two years of service for some abrasive behavior issues. The supervisor had occasionally mentioned some of the issues to the employee, but incidents had not been documented. The employee's personnel file had two memos commending her for her hard work on some specific projects. Although the supervisor wanted to terminate her quickly, the company was advised to place the employee on probation and delay termination until the proper documentation was prepared and the employee was given an opportunity to correct her behavior.

7. Poor Employee Communications

Not all small to medium-sized organizations are challenged when it comes to people management. Many that excel do so because the CEO or owner is able to effectively provide employee coaching and feedback. But over time, this can quickly change as the organization grows and the CEO or owner loses direct contact with employees.

Coaching and giving feedback are two of a supervisors most important and most rewarding responsibilities. Feedback allows supervisors to help employees achieve and sustain good performance. Supervisors are expected to:

Set clear performance standards and expectations.

Clearly explain work standards and rules.

Monitor performance and conduct.

Address performance issues and conduct violations timely, fairly and equitably.

According to a 2005/2006 Watson Wyatt Study, frontline leaders have the most day-to-day contact with their employees and are relied upon to communicate company goals, performance and objectives. Companies with high levels of communication effectiveness treat managers as a distinct and highly valued audience, give managers information in advance and do an effective job of packaging the information so it is easy to deliver. These companies also recognize and reward managers for being effective and attentive communicators over five times more often than do firms with low levels of effectiveness. Effective communication practices drive employee engagement, commitment, retention and productivity. This in turn translates to higher levels of performance and, ultimately, higher returns to shareholders and an increase in a company's market premium (Watson Wyatt, 2006).

In smaller organizations, employees are often promoted to supervisor without any previous experience or training. Even trained supervisors are not always comfortable with delivering bad news. Untrained supervisors struggle with delivering corrective feedback and may sugar-coat the information. Conversely, the untrained supervisor may avoid any discussion about performance or behavior improvement as long as possible, perhaps because he or she doesn't want to make the employee feel bad.

Employees often view the supervisors who lack effective coaching and communication skills as poor supervisors. In post-exit surveys conducted with over 19,700 employees, 88% of the respondents identified little or no feedback or coaching as one of the top seven reasons why they left (Branham, 2005).³ Poor supervision can be one of the reasons employees, particularly good employees, leave organizations. Supervisory training costs money. But, effective supervision contributes to increased productivity, efficiency, effectiveness, sales, revenues and decreased costs--all leading to increased profitability. Workers believe the number one factor that negatively impacts employee productivity is poor management, according to the *2005 Workplace Productivity Poll Findings* published by the Society for Human Resource Management (Burke and Esen, 2005).

An untrained accounting manager at a small manufacturing company had to terminate an employee for performance-related issues. She was extremely uncomfortable during the meeting with the employee and never said that the employee was being terminated. Finally, the employee asked if he was being fired since he was not clear exactly what the conversation was about.

8. Lack of Knowledge of Employment Laws

Companies with as few as 14 employees are subject to 15 federal labor laws, not to mention state and local laws. An organization that grows to 50 employees can be covered by 20 federal labor laws! Small employers may believe that most laws only pertain to larger organizations, or they may simply

be unaware of current employment law requirements since no one in the organization is actually responsible for assuring legal compliance. For example, many owners of small organizations are not aware of the requirement that I-9 forms be completed by all new hires.

Employment laws are often difficult to understand or interpret; they are subject to frequent change. They can vary from state to state, and new laws appear on a regular basis. Even the best-trained HR professionals are challenged to keep up with changes in employment law.

The Benefit From Having a Trained HR Expert on Staff or On Call

According to data reported in Watson Wyatts *WorkUSA 2002: Weathering the Storm*, companies with HR functions that employees perceive as effective are more likely to have high trust levels, good communication, high employee commitment and clear lines of sight, and to effectively manage business change.

A trained HR professional can bring expertise in recruiting, hiring, employee relations, benefits negotiations and administration, compensation administration, employment law, training, and people strategy. In most cases, an organizations employees are its most important resource, and payroll represents between 20 and 30 percent of operating expenses. It makes sense to use a knowledgeable professional or to invest in training for such an important role.

It Makes Good Business Sense

In 2000 and 2001, Watson Wyatt conducted research into the links between HR practices and market value creation. This research showed that improvements in 53 key HR practices were associated with an overall increase of 47 percent in market value. The research was divided into HR categories and practices each having a positive effect on market value. The results included the following:

Low voluntary turnover of employees in general had a 1.5 percent impact on market value.

Recruiting efforts aligned with the business plan had a 0.5 percent impact on market value.

Pay linked to a companys business strategy had a 1 percent impact on market value.

High employee satisfaction had a 1.3 percent impact on market value.

Managers who demonstrated company values had a 1.1 percent impact on market value.

Company Size and the Need for an HR Function

There are no magic numbers, but clearly when an organization reaches 50 employees, it is important to have someone who is trained in human resource management on the management team. With 20 federal labor laws and a myriad of state and local labor laws to be aware of, understand and comply with, small employers are walking in a minefield if they dont pay attention. The expense of adding HR as a focus and function in a formal way can be offset as a risk management strategy.

When the top managers cant interact with every employee at least once a week due to growth or when leaders can no longer have a direct relationship with every employee, it is probably time to add an HR professional and written policies and procedures that go beyond those basic ones required by law.

As the organization grows to 50 employees, the responsibility for hiring, coaching, discipline, reward, recognition and termination often moves to supervisors. There is less direct control of how employees

are managed. And if supervisors have had little or no training and have no one to go to for guidance, chances are that the organization is more exposed to liability for poor or illegal employment practices.

HR Process Checklist to Determine the Need for an HR Function

One way to determine the need for an HR function is to do an HR audit. An audit form or help for doing an audit may be available through a paid HR consultant, a local small business council or a college or university business department along with the help of a low-cost intern. It is also possible to do a simple self-audit using a checklist (an example is provided at the end of this paper).

Conclusion

If they only consider the cost of hiring an HR professional or an HR consultant, small and mid-sized business owners and entrepreneurs do not realize the full value of effective HR practices and processes. Basing employee-related decisions and actions on misinformation, half-truths and assumptions can lead to financial losses, unrealized gains in profitability and productivity and, ultimately, business failures.

Employees are the only truly unique component of any organization and can help it grow and prosper as well as fail and die. The investment in effective HR practices and functions and professional advice is as critical to the success of an organization as having the right equipment, materials, products and processes.

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HR Processes: Self-Audit Checklist

Make notes or check off items that your organization has; consider establishing those that don't exist.

Employee Communications and Documents

Employee files: How are employee files organized? Who is responsible for employee files? Who has access? Are confidential files, such as those containing health information or I-9 forms, kept separate?

Employee handbook or employment policies: Is there an employee handbook/manual? Is it current and legally compliant? Is it appropriate and relative for the size and scope of your business operations? Is an employment-at-will statement included? Is a no-harassment policy included? Is a no-discrimination policy included? Do employees sign a receipt/statement saying they understand they are covered under the contents? Are supervisors trained in administering the policies?

Employee communications: Is there an employee newsletter/e-mail? Are there bulletin boards and a policy on who can use them? Is there a complaint/grievance process in place? Is there an employee suggestion process? Are employee surveys ever conducted? How often? Are results communicated back to employees? Are exit interviews done? Is the information acted upon?

Legally required posters/notices: Has a review of the federal laws the company needs to follow been done? (If not, check <http://www.dol.gov/elaws/>. This site also lists poster requirements.) Are the appropriate posters available for employees to see?

Documents: Are confidentiality statements or conflict of interest forms being used? Are they needed based on your business structure?

Recruitment, Employment and Selection

Recruitment processes and sources: How does the company find applicants? Who conducts the interviews? Have interviewers been trained? Are the methods/sources effective in getting qualified candidates?

Selection processes: Are hiring processes and decisions documented? Is valid and reliable, nondiscriminatory testing being used? Are background investigations and reference checks being done?

Necessary forms, applications, etc.: Is the employment application legally compliant focusing only on job-related data collection? Do offer letters list compensation based on pay dates (weekly, monthly, NOT annually)?

Job descriptions: Are there written descriptions of job duties and responsibilities for all positions? Are they current and accurate? Are all items related to job content and essential functions? Do they list the physical requirements of the job? Do employees participate in the development and review of

their job descriptions? Is there a process in place to review and update them periodically?

New-Hire Orientation

Is there a company new-hire orientation? Do departments do orientations? Does management follow up with new hires to check on how they are doing in their new jobs?

Compensation and Wage Administration

Pay processes: How are pay rates determined? How are jobs classified as exempt versus nonexempt? Is the process legally compliant? (Check http://www.dol.gov/esa/whd/flsa_.) Is there an annual increase process? How are increases determined: tenure, performance, skill-based?

Consistent pay standards: Is equal pay provided for equal work? Are pay rates both externally and internally equitable? Are pay rates competitive? Does the company comply with pay laws when paying current and terminated employees? Are there procedures for recommending and approving salary adjustments?

Compensation system: Is there a system of formal salary structures that sets pay rates for each job? Is there a stated position to market? Is outstanding or exceptional performance recognized and rewarded? Is there a formal salary budget process?

Incentive plans: Are there bonuses or incentive payouts? Are there plan documents describing how the plans operate? Is incentive information communicated to employees? Is there a formal program to measure actual performance for short-term incentive purposes?

Time management: How is time recorded and monitored? Is there an attendance policy and procedure? Is there a no-call/no-show policy? How is payroll notified of excessive absenteeism? Is there a reward for good attendance?

Benefits

Paid time off: Is there a policy regarding paid time off, vacations, holidays, sick days, personal days? Is there an accrual policy or system for paid time off?

Leaves of absence: Is there a stated leave of absence policy? What does it cover? How do employees apply for a leave? Who must approve leaves? How are leaves tracked? Is there compliance with laws pertaining to military leave, family and medical leave, pregnancy leave, disability leave, workers compensation leave?

Optional insurance benefits: What benefits are provided: health, life, dental, vision, employee assistance program, disability? Which are company provided and which are voluntary? When do benefits become effective? What premium contributions are required of employees? Who is eligible for coverage? Are there summary plan descriptions? Are flexible benefits offered? Is the company in compliance with COBRA requirements? (See http://www.dol.gov/dol/topic/health-plans/cobra.htm_.)

Retirement benefits: Is there a pension plan? Is there a 401(k) plan? What are the entry dates? Are there participation requirements? Is the 401(k) self-directed? Is there a profit-sharing plan and/or a stock purchase plan? Have all the compliance testing and reporting requirements been met?

Required benefits: Is information available to employees regarding workers compensation policy and procedures?

Reward and recognition: Is there an employee recognition and/or reward program? Are there regular rewards for attendance, quality, customer service, sales, savings or efficiency recommendations, hiring anniversaries, community activities, etc.? Are these applied fairly and consistently?

Safety and Wellness

Processes: Are there a safety policy and procedures that provide standards appropriate to the company/business? Is regular safety training done? Is an OSHA log maintained? Is there a process in place to respond to emergencies or violence? Are the required and appropriate first-aid supplies available to employees?

Wellness: Are CPR/first aid training or procedures provided? Does the company provide blood sugar screenings, blood pressure screenings, cholesterol screenings? Is medical information kept private and confidential? Is information on diet and exercise provided? Are there facilities for exercise or working out? Are safeguards in place to ensure the safe use of exercise facilities?

Employee Training and Development

Workforce metrics: Are costs of hiring and turnover rates tracked? Are flexible work arrangements available/offered: job sharing, flextime, cross-training, telecommuting?

Employee training: What kinds of training are provided? How are employees selected for training? Is pay for technical training courses, licenses, certification and/or tuition reimbursement provided?

Supervisory/management training: Are your supervisors new or experienced? Are regular supervisory training courses available?

Employee development: Do employees receive career counseling or feedback? Are there dual career tracks? Is there a succession plan?

Performance and Behavior Feedback Processes

Coaching and discipline: Is there a progressive discipline process/policy in place? Are there general work rules covering items such as attendance, absence, tardiness, theft, alcohol and drug use, insubordination, confidentiality, harassment, hours of work, meals and other breaks, smoking, dress code and personal appearance, hiring of relatives, ethics, conflicts of interest, outside employment, use of phone, Internet, e-mail and voice mail, safety, violence, etc.? Are supervisors trained on how to coach and administer discipline?

Performance appraisal: Is there a performance appraisal process? Is there a periodic appraisal of performance for all employees with the results documented on a performance appraisal form? How often do employees receive formal, written performance feedback? Do employees participate in the process? Are supervisors trained on how to conduct effective performance appraisals? Is the appraisal used to determine salary increases, pay grades, etc.?

Termination

Termination forms and processes: Are terminable offenses documented? Are there written termination procedures? Who is responsible for conducting terminations? Are there pay and benefits policies regarding terminated employees? Is there a system for responding to unemployment claims? Is there a rehire policy?

Human Resource Responsibilities

Administration: Is someone designated to be responsible for human resource management? Is there a HR manager and/or an HR department? Are HR responsibilities carried out by employees in other departments? Are any HR responsibilities outsourced? To whom? Is there an HR strategic plan? Are individuals responsible for HR administration regularly trained in HR-specific competencies?