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Pursuing shareholder value: implications for human resource management

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Executive Summary

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Introduction

This project has examined the extent of adoption of shareholder value management in large, quoted, UK companies, and specifically, the impact this has had on human resource management.

Shareholder wealth maximisation inherent in capital markets, has resulted in the finance ethos being promulgated within the firm. The need and ability to push shareholder value maximisation techniques and culture deep into the firm is part of most consultancy firms' promises. The Finance function, in this new, more aggressive form, is claiming areas of responsibility once the preserve of the management accountant. Performance metrics, previously based on accounting logic, now have to be subjected to the critical test of consistency with the objective of shareholder wealth creation. Organisational arrangements such as degree of concentration, allocation of responsibilities, control processes, and reward systems, must pass the same test. Potentially the entire organisational architecture needs to be overhauled.

The view that accounting has constrained HR will surprise many management accountants. But to us as researchers, HR stands out as an area likely to be significantly affected by an increased emphasis on shareholder value maximisation. The HR function can be thought of as representing another stakeholder group, the workforce. Also, in the past, HR and accounting logic have proved uneasy bedfellows. HR can then be seen as a potential test bed for two of the main ideas of the shareholder value revolution. First, that shareholder value maximisation is not in conflict with the objectives of other stakeholder groups. Secondly, that shareholder logic can permeate throughout the firm. Where might the impact of shareholder value maximisation be seen and felt? Potentially, the impact might be on the organisation of the HR function, on policies pursued, and on outcomes achieved.

To explore how deeply shareholder value management has been adopted by large UK firms and how human resource management (HRM) has been affected, we undertook two research activities. Interviews were carried out with senior HR and Finance staff from a sample of companies drawn from the top 250 UK companies by market value, and from the largest companies in industries not represented in the top 250. 65 sets of responses form the basis of the analysis in this report.

In addition three case studies were carried out. These differed in detail: two being more extensive studies of companies participating in the interviews, and the third being a larger scale study of a company not represented in the interviews.

In designing our research project to interview both Finance and HR directors we sought to explore the opportunity for a clearer articulation between management accountants and HR professionals. Our main aim is to assess the impact of a shareholder value orientation on HRM. There is some recent evidence that both management accountants and HR managers are becoming aware of the need to overcome the functional divide and identify the HRM initiatives which are justifiable in financial terms and consistent with financial targets.

Overall, we found that reported attitudes towards shareholders and other stakeholders are not good predictors of characteristics of performance measurement systems in organisations as a whole, and in the HR function in particular.

How widespread is managing for shareholder value?

To assess the impact of a shareholder value orientation on HRM we first sought to identify those firms that were managing for shareholder value. A simple shareholder versus stakeholder dichotomy was thought unlikely to elicit adequately the degree of commitment to shareholder value in a particular firm. Interviews therefore sought to identify shareholder value orientation through a range of questions. Usable responses were obtained from 65 firms.

Shareholders or stakeholders?
Comfortingly - for shareholders at least - but unsurprisingly, no quoted form, or unquoted subsidiary of a quoted firm, ignored the shareholder group. A substantial proportion of firms reported that adoption of an explicit shareholder value orientation was a fairly recent development.

Several respondents argued that there was no conflict between shareholders and other stakeholders, because meeting the needs of other stakeholder groups was the route to shareholder value. Others, while acknowledging the difference between meeting needs and acknowledging rights, argued that the importance of the distinction was diminished by remuneration strategies,

'We solved the tension by making all employees into shareholders. All employees hold 1000 options which vest when we double in value.'

Whether as partners with rights, or as means to the end of shareholder value creation, stakeholders other than shareholders were seen as significant by interviewees.

The degree of shareholder orientation
There are a variety of ways in which the information collected can be used to classify firms for the purposes of further analysis. We considered what connection there was between those who seek to maximise shareholder value and those who seek an acceptable level of shareholder value creation. Interviewees were asked if the aim was to maximise, or to achieve an acceptable level of shareholder wealth. This produced a 46% (maximization) to 54% (acceptable level) split. However, additional comments suggested that the distinction was not clear cut. The fuzziness of this classification has been commented on, but interviewees' willingness to adopt one of these two positions seems potentially important. The acceptable value orientation can be thought of as a stakeholder orientation. Thus, classifying firms in this way yields 30 shareholder organisations and 35 stakeholder organisations. This classification forms the basis of many of the analyses in this report.

To provide another dimension to the categorisation of behaviour, respondents were asked about attitudes to other stakeholder groups. Three possible descriptions of treatment of other stakeholder groups were offered, 'not taken into account', 'will automatically benefit when shareholders do well', and 'means to an end'. Interviewees were invited to describe their organisation's position if none of these labels was an appropriate description.

Table1 Attitudes to Shareholders and Stakeholders

	Means	Other	Automatic	Totals
Shareholder	26	0	4	30
Stakeholder	22	10	3	35
Totals	48	10	7	65

Table 1 indicates that the bulk of interviewees adopted a 'means to an end' approach to stakeholder groups other than shareholders.

Shareholder value and performance measurement
Having invited companies to classify their views towards shareholders and stakeholders, we were also interested in whether shareholder value organisations used significantly different performance measures to stakeholder organisations. We asked interviewees to identify performance measures, used internally, or reported externally, which particularly relate to shareholder value creation.

Sixty-three organisations provided usable responses about performance measures used internally to reflect shareholder wealth creation. Of these 57% made use of measures tied directly to the capital market, but 63% made use of some variant of an accounting profit measure. An attempt was made to link this pattern of response to attitude to shareholder value maximisers and stakeholder companies to analyse the users of capital market based measures generates Table 2 below. The non-italicised numbers show the actual pattern of responses, while the italicised numbers show the pattern that would be expected if attitude to shareholder wealth creation had no effect on usage of capital market based performance measures.

Table 2 Performance measures used inside the organisation – capital market measures

	Use market measures		Don't use market measures		Totals
Shareholder value maximisers	19	17.2	11	12.8	30
Stakeholders	17	18.8	16	14.2	33
Totals	36		27		63

Performance reporting to the outside world

The impact of attitude to shareholder wellbeing on the pattern of responses about external reporting is unclear. Using the basic shareholder value/stakeholder dichotomy described earlier there is no obvious relationship with the broad-brush indicator of shareholder value reporting, or with emphasis on accounting profit figures. However, if the impact of the shareholder value/stakeholder distinction on cost of capital based reporting is examined there is a pattern, as can be seen in Table 3.

Table 3 Performance measures for external reporting - cost of capital

	Use cost of		Don't use cost of		Totals
	Capital	Measures	Capital	Measures	
Shareholder value	9	6.4	11	23.6	30
Stakeholders	4	6.6	27	24.4	31
Totals	13		48		61

We found that there is an indication here that shareholder value maximisers are more likely to report cost of capital based measures, and that stakeholders are more likely to emphasise accounting based measures.

Shareholder value and control mechanisms

The pattern of performance measurement among large UK quoted companies is not dramatically changed by the adoption of a shareholder value approach. It remains to be seen whether the type of control mechanisms in use has been altered. The presence and pattern of use of three specific control mechanisms was investigated. These were budgets, the balanced scorecard, and benchmarking.

Budgets

We found no indication that attitude to shareholder value management affects the chance that a budgeting system is in operation.

The Balanced Scorecard

Interviewees were asked whether the Balanced Scorecard was in use in their organisations. Of the 64 usable answers 33% indicated that the approach was in use at the corporate level. 36% indicated that the tool was in use at the business unit level, although not necessarily in all business units. 25% indicated both corporate and business unit level use. This is not to say that similar systems were not in use.

However, in other organisations the Balanced Scorecard is still an aspiration.

Benchmarking

Interviewees were asked if their organisations used benchmarking at the corporate level. There were 65 usable responses to this question, with 48% of interviewees reporting the presence of a benchmarking activity.

Reported attitudes to shareholder wealth creation seem to have little relationship to patterns of adoption of benchmarking approaches.

Shareholder value and controlling HRM

HR budgets

The major items frequently appearing in central HRM budgets are listed below:
- Executive and senior management recruitment.
- Resourcing and development, including organisational development activity.
- Group-wide HR policies and procedures, for example, 360 degree peer review programmes.
- Group-wide HR services such as compensation and benefits, payroll, global stock programmes, and pensions.
- Corporate initiatives, for example, culture change programmes.
- Surveys of climate and leadership.
- Graduate recruitment.

The major items of divisional spending in divisional HR budgets were usually of an operational nature:
- wages
- training and development
- recruitment
- employee relations
- health and safety.

The impact of a shareholder value orientation appears to be a slight decentralisation of HR.

HR and benchmarking

Formal benchmarking was, surprisingly perhaps, uncommon in the sample with only 16 percent using the approach. The HR issues benchmarked and the frequency with which they were mentioned by organisations undertaking formal benchmarking were:

• Pay and salaries	12
• Saratoga measures*	7
• Training and development spending	6
• HR payroll and numbers in HR	4
• Staff turnover	4
• Recruitment costs	3
• Costs/profit per employee	3
• Graduate recruitment applicants and employment	2
• Return on Investment (ROI) on employees	2
• Absence levels	2
• Labour costs	2
• Procedures	2
• Payroll	1
• Centre for Employment Studies measures	1
• Number of employees	1
• Overtime	1
• Hours	1
• Career development	1
• HR department performance	1
• Baldridge/EFQM measures	1
• Health and safety	1
• Management development	1

* Saratoga Institute, a PriceWaterhouseCoopers Human Resource Service Offering, is a global leader in human capital management.

Salary was by far the most frequently benchmarked HR issue.

The financial evaluation of HR spend

Evaluating HR initiatives

The most common form of financial evaluation involves cost savings, which allow a simple cost-benefit analysis.
- Savings on headcount, compared to consulting fees.
- Early retirement schemes with clear cost savings.
- Changing reward structures.

The business case
Identifying and demonstrating the link between HR and financial returns is very difficult.

In many instances the business case is seen as self-evident where projects are part of a strategic mandate from the business and do not emanate from the HR department. In some cases, major 'top down' HR initiatives are driven by the board without subsequent evaluation other than comparison of costs.

Technical or operational efficiency is measurable in non-financial terms and most HR managers are trained and proficient in the selection of appropriate policies in areas such as recruitment methods and pay strategy.

Is the financial assessment of HR possible?
An alternative explanation for the lack of financial evaluation of HR expenditure could be that HR managers do not feel it is possible. Have companies given up asking their HR colleagues to present a convincing financial case for HR expenditure because HR has denied the possibility of such a case ever being available? We found little such evidence among our sample of companies.

The financial competence of HR professionals
A reasonable expectation might be that financial competence would be a greater requirement for HR directors and senior managers in shareholder value maximising companies. However, the level of financial competence is generally rated higher in stakeholder companies (median response=4) than in shareholder value maximising companies (median response=3). Despite this the proportion of companies employing individuals who rank their financial skills highly or very highly doesn't vary significantly between shareholder value maximising and stakeholder companies. Where financial competence is low, two main reasons are put forward. First, career HR managers display less confidence compared to those who have spent a significant amount of time working in other business functions. Secondly, many HR staff feel they possess what one manager describes as 'the skills but not the tools'. Although the basic concepts are there, they cannot assess the value of HR alternatives in practice.

The role and standing of HR
A key indication of the standing of HRM in an organisation is the presence of a HR director on the main board of directors. Overall, 15% of companies in the FTSE 100 have a HR director on the main board of directors. This figure is significantly lower than commonly supposed.

Table 4 Influence of HR in shareholder value and stakeholder companies

Director on main board	21%	11%
HR function involved in planning	90%	80%
Self rated effectiveness of HR(a)	3.3	2.96
HR outsourcing (b)	55%	63%

(a) Self-rated effectiveness of HR measured on a five point scale from 'a lot better than average'. (=5) to 'a lot below average' (=1).
(b) HR outsourcing if the company outsourced more than two main HR activities.

These findings further reinforce our view that a shareholder value emphasis was not driving HR from a position of strategic influence. In short, prioritising the financial markets over other stakeholders was not associated with a reduced role for the HR function in corporate strategy.

The role of finance departments in HR activities
The role of the finance function in HR issues had changed little over the previous five years in 45 per cent of cases. It had increased in 31 per cent and decreased in 24 per cent of companies. Organisations reported a decline in the role of the finance function in HR for several reasons. In some companies the HR function desired greater self-reliance and in others new HR directors possessed good finance training from previous jobs in the business. In other cases HR had become more competent at handling the financial aspects of HR issues.

HR record keeping and target setting
Many organisations collected records on important HR outcomes but rather fewer set targets.

A comparison of HR records and targets between shareholder value and stakeholder companies suggests both were more common in stake-holding organisations than shareholder value maximisers. This further reinforces our view that shareholder value companies were not excessively focusing on reducing HR expenditure.

The reporting of HR costs and performance
It was rare for companies to report through the organisation measures on the performance of the HR function. This was reported by 17 per cent of companies.

HR policies in shareholder value and stakeholder companies
So far we have discussed the role and style of operation of HRM in shareholder value and stakeholder companies. The specifics of HR policy areas covering payment systems, communication, industrial relations, equal opportunities and training and employment security are explored in the full research report.

Communication
HR departments can contribute to shareholder value by making employees fully aware of the shareholder interest. Overall, the percentage of companies communicating financial information (including the share price) to employees was almost identical in shareholder value (90%) and stakeholder companies (92%).

Industrial relations
Trade union recognition was more widespread among shareholder value maximising companies although trade unions appeared to be less involved. Joint consultation committees with trade unions were more common in stakeholder organisations.

Equal opportunities and training
'Investors in People' was no more likely in stakeholder companies (55%) than shareholder value maximisers (76%). Central policies on gender and racial discrimination were reported in 90% of shareholder value companies and 88% of stakeholder companies.

Employment security
Our evidence suggests that shareholder value companies do restrain labour costs more than shareholder value companies and create fewer jobs.

- HR directors in SVM companies did share certain priorities. The reward strategy for managers was seen as vital to align business decision- making with shareholder value.
- None of the companies examined in the cases placed any great emphasis up on the need to extend share ownership to all employees.

Conclusions

The basic question underpinning this research project is, how does the shareholder value management approach affect the human resource management function? Our research has generated the following conclusions:

Performance measurement
We found that the use of multiple performance measures, both internally and externally, is a characteristic of both shareholder and stakeholder organisations

There is a statistically significant tendency for shareholder companies to be more likely to report cost of capital based measures externally than stakeholder companies.

Familiarity with performance measures directly relating to stakeholder groups other than shareholders, is less than for those measures directly related to shareholders.

Control mechanisms
Budgeting is a key control mechanism. The majority of organisations operate a budgeting process with a strong top down element. There tends to be multiple HR budgets in an organisation. The most common arrangement is for there to be a central HR budget and separate budgets for strategic business units. There is some suggestion that a shareholder value orientation is associated with decentralisation of the HR budget, but the difference in proportions is too small to be statistically significant.

We had expected to find widespread adoption of the balanced scorecard. However, the approach was present in only one third of the companies examined.

Similarly there was less use of benchmarking than we had anticipated. Less than 50% of the sample used benchmarking, and most schemes were informal rather than formal. There is a suggestion in the data that benchmarking is more common among firms with a shareholder rather than stakeholder orientation.

Financial evaluation
The tenor of the HR literature suggests the presence of significant financial hurdles in the way of investing in employees. We found few such barriers.

We also found that financial appraisal of HR is rare and no more likely in companies emphasising shareholder value than stakeholder companies.

HR structures, policies, and procedures
The involvement of HR in strategic decisions, as evidenced by the presence of a main board HR director, is marginally more likely in shareholder organisations.

In the specific HR policy areas examined there are few differences between shareholder and stakeholder organisations. There is some slight indication that performance linked reward is more widespread within stakeholder organisations, perhaps indicating a greater willingness to share gains.

Involvement with share options is pervasive. However, in terms of reward for performance, their use tends to be at more senior management levels.

In general there is a high level of communication of aggregate financial information throughout organisations.

The proportion of employees holding shares, or a claim on shares, in their employing organisation is significantly larger than can be explained by performance related pay. However, it appears that the potential consequences of involving employees in the organisation's goals, through encouraging ownership of shares and options on shares, were not well appreciated.

As far as employment security goes, there is evidence that shareholder companies control costs better, and create fewer jobs than stakeholder companies. As far as adoption of equal opportunities policies goes, there is no difference between stakeholder and shareholder organisations.

The implications of shareholder value management for HRM policies are not clear-cut. In shareholder value maximising companies we found little evidence managers regarded linking pay to performance as a guaranteed way to unite the interests of shareholders and employees. Whereas these managers communicated the share price to employees some communicated relatively little further financial information. The vast majority of shareholder value maximising companies did recognise trade unions but appeared to consult less through joint consultation committees.

Overall, we found little evidence that a shareholder value focus in companies has triggered a 'race to the bottom' preventing sophisticated approaches to HRM. The outcomes are not surprising given that we found no extra financial pressures exerted on the HR function in shareholder value compared to stakeholder organisations.

Absence of pattern

The overall conclusion is clear. Reported attitudes towards shareholders and other stakeholders are not good predictors of characteristics of performance measurement systems in organisations as a whole, and in the HR function in particular. We found few statistically significant results, though the sample seemed to suggest several plausible tendencies.

There are several possible reasons for this absence of clear patterns. One possibility is that the research was premature. A second possibility is that adoption of shareholder value is merely the adoption of language and rhetoric, rather than adoption of ethos and associated practices. A third possibility is that there are many alternative mechanisms through which the pursuit, if not the maximisation, of shareholder value can be achieved.

A final possibility is that while organisations pursuing shareholder value are aware that they are not adopting textbook solutions, costs of information collection and costs of disrupting existing processes suggest that further changes are not worthwhile.

The 'multiple routes' argument seems to us the most convincing answer. Existing systems can be adapted or enhanced rather than uprooted or replaced. The final 'costs of further change' hypothesis also seems to us to have merits. We see companies making the easy changes quickly, but holding back from the root and branch overhaul that theory would advocate. After all, the relevant decision criterion is net present value, not simply present value.

The key question is whether the benefits of further change outweigh the costs.

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