

# WHY SMALL AND MEDIUM-SIZED ORGANIZATIONS *REALLY DO NEED AN HR FUNCTION*

By Patricia A. Mathews and Phyllis G. Hartman, SPHR

## **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 “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 Organization’s 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 supervisor’s 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).<sup>3</sup> 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 Wyatt’s *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 organization’s 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 company's 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 don't 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 can't 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.

### **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.

## References

- Applications for jobs, schools won't let ex-convicts forget crimes. (2000, October 2). *CNN.com*.
- Branham, L. (2005). *The 7 hidden reasons employees leave: How to recognize the subtle signs and act before it's too late*. Washington, DC: AMACOM.
- Burke, M.E., & Esen, E. (2005). *Workplace productivity poll findings*. Alexandria, VA: Society for Human resource Management.
- Watson Wyatt. (2002). *WorkUSA® 2002—Weathering the storm: A study of employee attitudes and opinions*. Washington, DC: Author.
- Watson Wyatt. (2006). *Effective communication: A leading indicator of financial performance—2005/2006 communication ROI study*. Washington, DC: Author.

*Patricia Mathews, president of Workplace Solutions in St. Louis, Mo., has over 25 years of generalist experience in human resources, including union and non-union environments, regulated environments, total quality management initiatives, internal and external consulting, and customer service initiatives. Ms. Mathews has worked with manufacturing, finance, construction, entertainment, agriculture, insurance, health care, high-tech, retail, telecommunications and other industries as well as the nonprofit sector. She is a recognized speaker and presenter and is a published writer. Ms. Mathews is an active volunteer in her community and has served in various roles in her local SHRM chapter. She is a member of the SHRM Employee Relations Special Expertise Panel.*

*Phyllis G. Hartman, SPHR, founder & principal of PGHR Consulting in Pittsburgh, Pa., is an experienced human resource professional with more than 18 years in the field. She has worked as a management professional in HR in manufacturing and service sectors. Her company provides general HR consulting services and training for manufacturing, service, health care, professional association and not-for-profit social service and arts organizations. Ms. Hartman teaches business and HR courses for colleges in Pittsburgh. She has published many articles, white papers and two book chapters on HR and business topics. She has been an active volunteer in SHRM at the local, state, regional and national levels and currently serves as the director of Workforce Readiness for the Pennsylvania State Council in addition to being a member of the SHRM Employee Relations Special Expertise Panel. Phyllis holds an M.S. in HR management from La Roche College and a B.S. in education.*