

Structure, Culture, and HRM in Professional Service Firms

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Abstract

It has been argued that human resource management (HRM) in professional service (PS) firms is becoming more strategic as these firms rely on their human capital as a source of competitive advantage. The current study will examine the relationship between structure, culture and HRM in explaining the performance of professional service firms. This paper will provide the empirical evidence by comparing and contrasting the adoption of a strategic approach to HRM in two Australian PS firms. The case study findings suggest that the adoption of organizational control, in terms of structure, culture and personnel controls, are linked to different levels of firm performance.

Keywords: strategic HRM, firm performance, professional service firms, knowledge workers

There has been extensive research conducted on knowledge-based firms, as they are considered to be a recent organisational phenomenon (Robertson and Swan, 2004), due to the societal shift from industrial to information-based society. Despite the growing literature in the fields of strategic management and an emerging body of strategic human resource management (HRM) research (e.g., Wright, McMahan, Snell, and Gerhart, 2001), little is known regarding strategic HRM (SHRM) in knowledge-based firms. While there is a significant amount of literature supporting the importance of leveraging on knowledge as the basis of creating core capabilities in achieving competitive advantage (e.g., Jackson et al., 2003), few empirical studies exist to show the relationships between structure, culture and HRM in knowledge-based industries. Knowledge-based firms, for example, professional services, employ individuals who are highly skilled, and the firms produce, distribute and use knowledge and information as their source of competitive advantage (OECD, 1996; Soo et al., 2002). Therefore, the aim of this paper is to examine the empirical relationship between organisational control and firm performance in professional service (PS) firms.

Managing Knowledge Workers in Professional Service Firms

The majority of PS firms have a distinctive ownership and governance structure, in the form of professional partnerships, which has been neglected as a form of study in academic research (Greenwood and Empson, 2003). Partnerships are worthy for study because they are associated with successful management of “knowledge workers”, and they seem to have a prestigious aura around their context (Alvesson, 1995). For this reason they have been praised as an exemplar for the new economy (c.f. Greenwood et. al, 2003). Knowledge intensive firms are particularly good examples of contemporary forms of ‘people dependent organisations’ (Robertson, Scarbrough, and Swan, 2003).

They can be defined as “companies where most of the work can be said to be of an intellectual nature and where well-educated, qualified employees form the major part of the workforce” (Alvesson, 2000, p1101) and they have unique characteristics, as described by Lowendahl (1997, p20).

First, they are highly knowledge intensive, delivered by people with higher education, and are frequently closely linked to scientific knowledge development within the relevant area of expertise. Second, they involve a high degree of customization. Third, they involve a high degree of discretionary efforts and personal judgments by the expert(s) delivering the service. Fourth, they require substantial interaction with the client firm representatives involved. Last, they are delivered within the constraints of professional norms, including setting clients needs higher than profits and respecting the limits of professional expertise.

Knowledge-based firms differ from other types of industries, as the nature of their work is of a professional intellectual manner, drawing on mental abilities, rather than physical strength and manual craft (Karreman, Sveningsson and Alvesson, 2002). For instance, in PS firms, knowledge workers are employed to solve complex problems through the development of creative and innovative solutions (Svieby and Risling, 1986). Furthermore, PS firms provide intangible solutions to their customer problems by using the knowledge of their individuals (Ditillo, 2004), thus not only competing for clients, but also for talented professionals (Maister, 2003). In this respect PS firms are appealing to study because they are likely to provide insights on how “knowledge workers’ should be managed in other types of industries, as they are rapidly becoming knowledge-based (Dawson, 2000). For this reason, they should be perceived as “gold collar workers” as they own the means of production (Starbuck, 1992), are relatively scarce and potentially highly mobile individuals within the labour market (Kelly, 1990). Studies have demonstrated that specific HR practices could be used to enhance human capital such as skills, knowledge and abilities (Youndt and Snell, 2004). This explanation is consistent with the human capital theoretical approach, which argues that the skills, knowledge, and abilities possessed by the HR would provide economic value to organizations (Becker, 1993; Schultz, 1961). As firms focus on using the management of knowledge as a source of competitive advantage (Hall, 1993), the human capital approach provides the opportunity for emphasising the intellectual aspects of the firms’ capital (Guthrie, 2001). Research in the PS firms

literature (e.g., Hitt et al., 2001; Teece, 2003) have shown that human capital have a positive impact on firm performance.

The categories of PS firms tend to overlap, as they do not emphasize the features ascribed to a typical profession, such as code of ethics, standardised education, and criteria for clarification (Alvesson, 2001). As a result of the above, PS firms endorse strong professional norms, encouraging homogeneity across organisations. Due to the common knowledge, they have a significant impact on developing identities of professionals and reducing variations between organisations (Alvesson, 2001). One way of achieving this is through control systems such as structures, rules, policies and standard operating procedures in relation to administration and personnel (Abernathy and Stoelwinder, 1995; Abernathy and Brownwell, 1997).

Personnel controls are ex-ante controls, defined by Snell (1992, p297) as ones “that regulate antecedent condition of performance-the knowledge, skills, abilities, values, motives of employees”. Arthur’s (1992) study provided insights into this issue within this stream of literature, by examining the fit between competitive strategy and HRM controls in manufacturing industries. Snell and Youndt’s (1995) research also showed that firms which use a behavioural control approach to HRM tend to associate with a higher level of financial performance than those firms focusing on an input control approach to HRM.

Abernathy and Brownell (1997) analysed personnel controls in a professional service environment which is dominated by professionals who possess the competencies of a knowledge worker. A major finding in this study suggests that when task uncertainty is highest (where task analysability is low and number of exceptions is high), reliance on personnel forms of controls will have a significant effect on performance. In this particular situation, tasks cannot be “programmed”, and behaviour cannot be controlled through pre-determined action. Another recent study by Widener (2004) also demonstrates that the reliance of strategic human capital by PS firms have led to the usage of controls such as personnel control as the means to achieve firm strategy. Personnel controls are needed to regulate behaviour through selection, training and socialisation of professional workers. Ditillo (2004) also argued that personnel and cultural controls can be used to govern the behaviours of

professional workers. These forms of controls allowed the professionals in the particular project teams to engage in effective communication and knowledge sharing amongst one another.

The above studies provided valuable insights on how knowledge-based workers are managed in professional services environments. Personnel controls in this environment assist in developing employees' skills, knowledge, motivation such that employees behave in ways that are instrumental to the implementation of a particular strategy (Bowen and Ostroff, 2004) and allowing firms to achieve superior performance (Delery and Doty, 1998). These controls are considered to be a vital mechanism in assisting the management of people in PS firms, however there is still a lack of knowledge on understanding the effectiveness of personnel controls within a knowledge intensive setting in managing knowledge workers. Therefore, the first research objective is to examine the impact of personnel control on the performance of knowledge-based firms.

Organisational performance is enhanced by the powerful, pervasive role a strong organisational culture plays in shaping organisational life (Saffold, 1988). Organisational culture has a major influence on the success of the business. Kotter and Heskett (1992, p15-16) suggest that strong cultures illustrate to employees "the ways of doing things" within the organisation. It effects practically everything, from who gets promoted and what decisions are made, to how employees dress (Deal and Kennedy, 1992, p4). This is further supported by academics in this field suggesting that strong cultures out perform weak culture (Kotter and Heskett, 1992). Organisational culture enables professionals to engage in effective communication and knowledge sharing. For instance, Robertson, Scarbrough and Swan, (2003) conclude that the institution context (such as culture) has an impact on knowledge creation in a professional service consultancy firms. However, studies are limited in explaining how culture emerges, and how it is managed in PS firms and its impact on firm performance. Therefore, the second research aim is to examine the impact of cultural controls on the performance of knowledge-based firms.

Methods

This study was conducted from the end of August 2004 to the middle of January 2005, in two PS firms. A case study approach (Yin, 2004) was adopted in this study as we collected 40 semi-structured interviews (19 in PSF1 and 21 in PSF2) were conducted with senior partners, professional

staff, 12 HR managers and ex-employees within the two firms. This methodology allows us to analyse thematic issues within and across the case organisations and it is chosen to allow us to interpret the “rich slices of organisational life” (c.f. Ahrens and Dent, 1998, p34). The rationale for choosing these two firms is because they are both located within the same industry, they inherently have very distinctive cultures and different approaches in the way they manage their “knowledge workers”, allowing for an interesting comparison to prevail.

PSF1 and PSF2 are two of the world’s leading PS firms, within their industry group. Both of the firms operate in over 142 countries, with over 125,000 professionals. On average, the interviews lasted over an hour. The interviews were tape recorded and transcribed by one of the researchers. Additional data were collected from secondary sources including annual reports, press releases and media reports relating to the firms and the industry. These data sources were of particular importance as we used them to assist us in categorizing the performance of each case organisation in the research.

Results

Cultural control. PSF1 and PSF2 have different level of investment in promoting their organisational culture. As part of its cultural change process, PSF1 invested considerable time in educating Partners and Potential Partners in understanding the organisation’s culture, so they are able to translate their culture in their day-to-day activities. It is interesting to note that each Partner was required to undertake a lifestyle inventory personality profile test. This allowed Partners to understand their behaviours and how it impacts others, for this reason Partners have commented on their new cultural initiatives as a process of “self discovery”.

At PSF2, we did not find strong reliance on cultural controls. The firm’s culture incorporates a range of signals, however as a result of changes in the organisation’s senior management leadership the reliance on these signals has slowly faded away. The firm originally adopted a set of shared meanings. However, due to the high turnover of CEOs, each CEO had a different agenda and thus, the shared meanings became meaningless. It was interesting to note, that when employees were questioned about the firm’s culture, there were uncertainties of the organisation’s culture. This suggests that culture control is not used to unite the firm.

Enacting cultural change cannot just be achieved by training. The approach in PSF1 is to attain a “high performance culture” which began two years ago. An advisory partner commented that in order to achieve this type of culture “it can not be done the old fashion way of controlling everything employees do, treating it like a hierarchy. We need to give employees their space to grow, take chances and risk in a supportive way”. However, this approach is top down, allowing partners to understand their behaviours and how they impact others. Partners are required to engage in a lifestyle inventory personality profile test. This test determines partners working style across a colour matrix red, blue and green. The following colours determine partners working styles: Red is aggressive, perfectionist, competitive, or defensive. Green is analytical. Blue is the approach taken with people. Several PSF1 employees have commented on how partners have changed their behaviour.

Performance management. Partners in both firms are rotated from their current positions every 5 years. Both firms adhere to similar partnership hierarchical structure. PSF1 Partnership has a distinct hierarchy, including: The Firm Leadership Team, National Business Unit Partner, Industry Unit Partner, and Business unit Partners. The manner, in which PSF1 Partners are promoted within the hierarchy, depends on their level of experience in the business unit or industry and overall performance. At PSF2, the Partnership hierarchy has two distinct levels: Equity (Unit holders) and Non-Equity (Salary) Partners. Within Equity Partners, depending on the number of units these Partners hold they are further split into Executives, Service Line Partners and Business unit Partners.

The process of admitting potential Partners into the Partnership level in PSF1 is highly formalised. It includes a nomination process, intensive training sessions, and a 3-day assessment on a range of skills. At PSF2, the assessment process is more informal. Senior partners “counsel out” applicants who do not possess the competencies required at the Partner level. Partners at PSF1 are remunerated across a number of skills sets (that is, people, client and firm). At PSF2, Partners are remunerated in their area of expertise across practise, business (i.e. customers) and people management. In firm/practise management, Partner’s remuneration is determined by how they continuously grow the firm in order to generate more revenue. In client/business management, Partners are remunerated on customer satisfaction. In people management, Partners are remunerated on how they effectively manage their professionals in order to retain them.

Personnel control. PSF1 and PSF2 adhere to similar personnel controls, in terms of recruitment and selection, operational HRM, and performance management system. However, the key difference within the personnel control is in training and development. In PSF1, its Human Capital Division provides ongoing training to professionals at all levels. It is apparent that the division works closely with Partners and Directors. They have tailored their training programs by incorporating a strategic perspective to meet the needs of the business. Furthermore, they have instigated numerous soft skills training programs for all levels.

On the other hand, the primary role of the Human Capital Division in PSF2 is in recruitment. Typically, organising training is not part of their duties. The division also provides assistance to their professionals when promoted to the next level, by sending them to career centres, which are conducted by external consultants. However, the on going in-house training in regards to their day-to-day activities is limited. The personnel controls at PSF2 are exercised through its HR processes (such as recruitment and selection, training and development and operational HR). Respondents commented that the HR processes are disorganised. The HR role as described by an advisory partner is an “operational role, a support role, but could they engage in being strategic, absolutely they could”. A Tax director commented “without any disrespect, they (HR) are admin people, they advise us on what we have to do, these are the forms we have to fill in”. They engage in the day-to-day transactional activities, such as payroll, organising employee annual and study leave, retention issues, reward entitlements etc.

Firm Performance. External documents (such as annual reports, industry reports, etc.) were used to collect data relating to firm performance. PSF1 performs significantly better than PSF2. In 2003-4, PSF1 increased its profit by 2.3 percent while PSF2 experienced a reduction of its revenue by 9.5 percent. PSF1 had a staff turnover of 0.6 percent in comparison to PSF2 annual turnover of 17.6 percent. PSF1’s growth was 7.7 percent whereas PSF2 was 3 percent within the industry.

These differences can be explained by the differences in the internal structure of PSF1 and PSF2. Firstly, in PSF1, partnership structure has been used to engage in constant monitoring of the performance of partners, therefore ensuring partners refrain from engaging in any opportunistic behaviour, which may be detrimental to the firm. Partners were trained in all aspects of the skills

required for effective performance. Secondly, HRM function has to understand the operation of the business. In this type of setting, HRM's should not just provide the traditional HR functional activities (such as PSF2), but also provide the necessary softer skills to professionals in people management roles. Lastly, in order for KIF's to enact a strong culture, they need to ensure that the professionals in the leadership (partnership) roles understand the firm culture and that they constantly endorse the culture in their everyday operations.

Role of HRM function. The role of the HRM function in both firm vary significantly. PSF1's HRM function has partially adopted the strategic business partnership role. The HRM function works closely with partners and directors to provide them with a supportive function in their everyday transactional activities and the necessary training to assist them in people management. However, there is lack of training provided to senior managers and below on training issues. In contrast, HRM in PSF2 tends to incorporate the traditional aspects of HRM, including operational activities (i.e. the day to day transactional functions, preparing performance appraisals templates etc). There is a lack of guidance given to partners in the people management role, however, more importantly, PS2 has realised this issue and is trying to rectify this problem by restructuring its HRM division to engage in this strategic partnership role.

Discussion and Implications

The current study provides insights in how PS firms manage their professional workers where their tasks are inherently knowledge-based. It also demonstrates that the relationship between structure, culture and HRM is important in explaining the performance of PS firms. Firstly, a robust performance management system requires employees to set goals which are aligned closely with the organisation's objectives. This means that professionals will engage in strong work ethics to achieve their personal goals as well as organizational goals. Furthermore, they will be recognised and rewarded for this alignment. Continuous feedback should be given to professionals as part of this system. Secondly, cultural controls should be strong, promoting strong norms. Professionals will therefore not be resistant in achieving the firm goals, as they will strive to achieve the values and beliefs of the organization because they adhere to them. This will further enhance the level of motivation and allow professionals to freely share knowledge with one another.

The findings in our study are provided support for the notion of SHRM, especially in the linkage between HRM and firm performance (e.g., Snell and Youndt, 1995; Wright et al., 2001). Findings from this study indicate that personnel controls in both PS firms were utilized differently. To be competitive, PS firms will have to restructure its HRM function to allow the department to participate in strategic decision-making and through the adoption of cultural and personnel controls to achieve higher level of firm performance. The current study has demonstrated that personnel and cultural controls have an impact on the management of knowledge workers, such that employees behave in ways that are instrumental to strategy implementation in the professional service industry (Widener, 2004). The findings also provided support for the impact of organisational control system on the management of knowledge workers in PS firms (Robertson et al., 2003).

In order for the HRM function to add value, the function has to engage in a business partnership role by providing strategic advice to line managers (Galang, 1999). The current study also highlights the importance of adopting a HRM investment orientation (as shown in PS1) to allow firms to compete effectively in the market. This essentially meant that knowledge-based workers must be treated as a resource, consistent with the notion of the resource-based view of the firm concept of SHRM (e.g. Barney and Wright, 1998) in knowledge-based industries, as firms focus on using the management of knowledge as a source of competitive advantage (Hall, 1993).

Limitations. A possible limitation from this study is the research method undertaken. It has been noted that case study research lacks generalizability, and the findings provide a limited body of accumulated knowledge (Langfield-Smith, 1997). In future, a longitudinal research design should be used to test the relationships between HRM systems, control systems, and firm performance. There are a number of future research implications. From this study there was lack of evidence in explaining the effectiveness of personnel controls in PS firms. Researchers could observe the operation of control systems in knowledge-based organizations to determine what elements within the management control systems are effective in managing knowledge workers. Future research could also expand the relationship between firm performance and strategy to test for the moderation effect of the strength of HRM systems within this relationship (Bowan and Ostroff, 2004).

Conclusion

In summary, the current paper has demonstrated that differences in the performance of knowledge-based firms can be explained by organisational control systems, in this case, cultural control and personnel control. The qualitative case studies of two PS firms has provided additional evidence which supports the notion of SHRM as a key factor in explaining firm performance. However, the findings cannot be generalized across all professional service firms. The current findings could be used to develop into a research model for future research into the strategic management of knowledge-based workers in PS firms.

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