Leveraging Profits through People:
Some Powerful and (Mostly) Cheap Ways to Boost Your Bottom Line

Human resources related costs often exceed 50% of a business's total budget. As a consequence many managers and company owners regard them as something to control as tightly as possible. Their theory — and one that is hard to disagree with — is that the less you spend on human resources, the more that is left over for profit.

However there is another perspective, one that I encourage you to consider: human resource dollars are an investment. The logic for this perspective comes from the fact that the only active parts of your business are the people. Facilities, tools, machinery, computers, and business processes are, by their nature, inert. Without people, these things just sit there. People are required to put them into play, to create value for your company; and therefore your human resources are the key leverage point for profit.

Which perspective is right? As with most things, the answer isn't one or the other. If you don't pay attention to human resources costs, you'll pay too much; and you'll soon be out of business. The same holds true for the investment side. If you don't pay attention to the quality of people you hire, their morale and their motivation, you won't get the return you should for your human resources dollars; and you'll soon be out of business.

Here is an example. Al and his son, Alan Jr. owned Al's Best Uniforms (not the real name), a forty-five-employee uniform rental company located in the Mid West. Al was a wizard in the washroom and his production was the envy of his competitors. However, he never cared much for the sales and customer service side of the business, and he did everything he could to avoid handling customer calls. He left it all to an old friend who managed the sales and customer service side of his business.

When Al's old friend retired, Alan Jr. got the job. Al's instructions were: "I don't care what you do, just keep costs under control." Alan Jr. was a nice enough young man; but, like his father, he had never worked as a service sales driver. In fact, his only experience was in working in the laundry. Alan Jr. diligently began tightening up on expenses. Inventory was trimmed; cosmetic truck maintenance was put off. Custom orders from old customers were refused as being unprofitable.

Service sales driver morale deteriorated. The two most experienced drivers quit and accepted jobs with the competition. Alan Jr. saw this as an opportunity to replace high wage employees with cheaper help. He hired a couple recent high school graduates for one third less pay. This did reduce salary costs, but the new hires were disasters. Customers complained about wrong sizes and late deliveries. Repairs were not being made. One by one, as contracts expired, customers left, giving their business to Al's competitors.

Seeing the handwriting on the wall, Al sold out to a national chain. Because his business had eroded, he received significantly less than he would have received a year earlier. The national chain promptly fired Alan Jr. and brought in an experienced sales and customer service manager.

Al blamed it on the economy and cut throat competition from national chains. However the real causes stemmed from his missteps in managing human resources. He put an inexperienced person in a key management job, and then compounded the error by not providing training. He lost two key employees and replaced them with cheaper, less competent people. And perhaps most critical, he didn't staff his sales and customer service operation with employees who had a natural inclination for giving good customer service.

How are you doing in managing your human resources? Are you just controlling costs or are you leveraging your human resources dollars? If you think you may have focused too much on the cost side, you can get back in balance with the four-step human resources tune-up described below.

<u>Step 1. Take inventory.</u> This is an objective review of your human resources. Who is contributing and who is not? Are there employees who lack training or direction? Are there people who should be promoted? Terminated?

How do you take a human resources inventory? One way that doesn't require a lot of time or paperwork is to rank your employees by performance and potential. Get a blank sheet of paper and draw a line from top to bottom, making two columns. Write "performance" at the top of the left hand column and "potential" at the top of the right hand column. Then rank your employees separately on performance and on potential, putting the best at the top and the worst at the bottom. If you have subordinate managers, have them rank their reports.

<u>Step 2. Take action.</u> One of the benefits of taking an inventory is that it creates the opportunity to take action. For example:

- If someone is top in performance and potential, maybe they could move up to a bigger job.
- If someone is low on performance and high on potential, schedule training or coaching.
- For someone high on performance and low on potential, make sure they know that you appreciate their hard work. You don't want to loose them.
- For someone who is at the bottom on performance and potential, it may be time to replace them with a higher quality employee. The quickest way to improve a company is to replace poor people with good people.

These are just examples, not hard and fast rules; so you'll need to use your judgment. For subordinate managers, after they rank their employees, meet with them and discuss what actions to take.

<u>Step 3. Be selective.</u> Terminating poor employees is a quick way to improve a company, but it can be painful and sometimes results in legal problems. A cheaper, less troublesome option is to do a good job in hiring.

Success in hiring starts when you give yourself a chance to be selective. If you have one vacancy and one applicant, there is no chance to be selective. You're stuck with whoever walks through the door. On the other hand, if you're able to pick from several qualified applicants, your chances of hiring a top quality employee improve dramatically.

Once you have several applicants, evaluate them against job requirements and on how they stack up against each other. Many times managers with a vacant position are in a big hurry to fill that position, and this leads to taking short cuts in the evaluation process. Remember, you're getting ready to invest big money. If the employee will be paid $30,000 per year in wages and benefits; and he or she stays with you for ten years, you're making $300,000 decision!

One reasonably accurate, relatively cheap way to evaluate applicants is with written tests. Research over the past ninety years has shown that starting to use valid pre-employment selection tests will improve productivity by 9%. That is a noticeable gain; but even better, since you're probably paying the same for high producing and low producing employees, the gain goes straight to the bottom line. For a medium sized firm, over the course of a year, this can mean $100,000 extra profit, and that's a pretty good return.

<u>Step 4. Take care of your investment.</u> You may have hired talented people, but your job isn't done. Don't throw them out in the middle of the lake and expect them to become champion swimmers. Good performance comes from a combination of ability and motivation, and that means training and good motivation management.

First, make sure your employees have the know how to do the job you're asking them to do. This includes facts, processes, procedures <u>and</u> the ability to apply the knowledge to the job. This doesn't necessarily require classroom training, but it does mean that every new employee and every new supervisor gets enough instruction and coaching so they have a chance to succeed.

Second, make sure your company has a positive motivational climate. This is more complicated than training. First you have to remove "demotivators." These are things that make people unhappy, like unpleasant working conditions. Sometimes demotivators will come from inept supervisors and managers. Whatever the cause, demotivators have a powerful influence; and you have to remove them before anything else can be done.

Once you've taken care of the demotivators, it is time to address the positive side of motivation. Motivation is directed energy. Managers don't have much control over the energy part of the definition. It is a product of the person's metabolism and personality, both of which are pretty well set by the time they come to work. Instead, focus on the direction component. Make sure that everyone — from owner to laborer — has clear goals for what they are to accomplish. These goals should be challenging, but achievable <u>in the eyes of the employee</u>. If they are seen as too hard, the employee will simply give up. If they are too easy, you won't get any extra effort.

Once goals are in place, you'll need to manage the consequences. If goals are met, something positive should happen to the employee. If they are not met, something negative should happen. One effective technique is to make a part of the employee's compensation depend on goal achievement. Be careful to link the goals to things that also bring the company success. You don't want to put yourself in a position of paying extra while you are loosing money. Also the amount of incentive pay should be proportionate to the level of compensation. Senior managers could have as much as half of their pay at risk, depending on results, while hourly employees might not have anything at risk, but instead have the potential to earn a bonus for high production.

Human resources are a huge cost, and this means you'll always look at them with an eye to cost control. But human resources also may be your single largest capital investment, so you should be looking for ways to leverage the return from that investment. As a start, I recommend taking the four steps in the HR tune-up: Take inventory, take action, be selective and take care of your investment. The potential for gain is high, and the costs are low.

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