

# HR's New Role

Harvard Business Review | Peter Cappelli and Ranya Nehmeh | May–June 2024

In this tight labor market, cost cutting is out. Championing employee concerns is in.



Kirsten Ulve

From World War II through 1980 the focus of the human resources function was advocating for workers—first as a way to keep unions out of companies and later to manage employees' development in the era when all talent was grown from within. Then things changed. Driven by the stagflation of the 1970s, the recession of the early 1980s, and more recently the Great Recession, HR's focus increasingly shifted to relentless cost cutting. Decades of slack labor markets made slashing HR expenses easy because it was hard for people to quit. Pay and every kind of benefit, including training and development, got squeezed. Work demands went up, and job security fell.

Now the pendulum has swung sharply the other way. The U.S. unemployment rate has been below 4% for five years, with the exception of the Covid shutdown period. Productivity growth has lagged, with the 2010s being the worst decade for it in modern times. That, along with slow growth in the labor force, will probably keep the job market tight for some time. Meanwhile, overwork, fear of layoffs, lack of advancement opportunities, and worries of being replaced by technologies like artificial intelligence have created an epidemic of workplace stress in the United States. Evidence that companies have hit the limits of lean staffing includes the

remarkable Kaiser Permanente strike of 2023, which was the largest health-care labor dispute in U.S. history, and pharmacists' walkouts and sick-outs at CVS and Walgreens. In all those disputes one of the main worker demands was that the companies staff open positions.

HR's focus on minimizing personnel costs was not a problem when job markets were cool. But now keeping positions filled and preventing employees from burning out or becoming dissatisfied are the priorities. To meet the fundamental challenge of hiring and retaining good people, HR needs to return to its traditional role of taking care of employees. It must play a lead role in persuading top management to treat employees better and to change company policies on pay, training, layoffs, vacancies, outsourcing, and restructuring.

### **More Talk Than Action**

In a slew of C-suite surveys, including those conducted by the Conference Board, CEOs ranking the importance of stakeholders place employees even higher than shareholders. They also say that talent, especially acquiring it, is the most critical factor affecting their business. Yet so far little has changed in the way that companies manage their workforces. Real wages are still barely keeping up with inflation; weekly earnings actually declined slightly in 2022 and did not grow at all in the first three quarters of 2023. Promotions are rare, with only 4.5% of employees receiving one within two years of being hired, according to an ADP Research Institute analysis of the careers of 51 million U.S. workers. A 2022 McKinsey survey found that a lack of career development and advancement was the most common reason people gave for quitting a job. A dearth of training and feedback from supervisors and two other cost-cutting practices, "hoteling" (not giving workers a permanent office or cubicle and making them reserve one when they need it) and open office layouts, have also contributed to employee discontent.

Then there are the repeated restructurings that have become a way of life at large companies. The constant changes raise employees' stress levels and take a big toll on their mental health. That not only pushes up health-care costs but also increases turnover and undermines employee engagement, performance, and productivity, as well as firms' ability to recruit.

It's understandable why breaking old habits is hard. Telling leaders that the approach they've been following for 40 years—and the one thing investors seem to understand about human capital ("cut it!")—is all wrong does not seem like a career-building move. Nonetheless, HR executives can—and must—make the case to their CEOs and operating executives that the old way is no longer working and that their companies need to change direction.

### **Make True Costs Clear**

One critical step HR can take to get the C-suite to alter course is to show leaders what the costs of current practices really are and illustrate the value of human capital. To that end, HR should provide a dashboard that includes metrics on turnover and what it costs the company, information on why employees are quitting, and figures on vacancies filled from within. It should also include data on employees' well-being, such as absenteeism rates, incidents of new illnesses and disabilities, use of employee assistance programs, and levels of commitment and

engagement. Those things all can have a significant impact on firms' success, but since they don't show up in any single financial accounting category, they have to be pulled out and highlighted for the C-suite. Corporate leaders often are unaware of the reality in their workplaces. A long-running MetLife survey, for example, has found that while 83% of top managers say that their employees are "financially healthy," only 55% of employees feel that way. And in their research Joseph Fuller and Manjari Raman of Harvard Business School have found that C-suite executives believe they routinely implement career advancement practices that their employees say never happen.

If leaders realized that the true cost of turnover is often a multiple of an employee's annual salary, they would immediately demand changes.

To supply leaders with good information, HR must get control of data from company vendors. Many firms can't see how well their hiring practices work, because their applicant-tracking-system vendors have all the data about job candidates and their performance-appraisal vendors have the data on how hires are doing. Businesses should require that their data be delivered to them in usable, compatible formats and, if not, that the vendors themselves do analyses for companies on demand.

Perhaps the single most important piece of information that most leaders lack is what turnover actually costs. When we've tested groups of CEOs about this, we've found that they have no idea. Unfortunately, HR leaders often don't know either, or the figure they use is completely off: Most cite the cost as \$4,000 an employee, which is simply an estimate of the marginal administrative costs of hiring a new person. It ignores things like training expenses, new hires' lower initial performance, and the time coworkers have to spend interviewing candidates. If leaders realized that the true cost of turnover is often a multiple of an employee's annual salary, knew what the value of the firm's best employees was relative to that of average employees, and understood that 29% of people who have just been promoted quit (perhaps because 39% of employers routinely fail to give promoted employees more pay), they would immediately demand changes. It's one thing to tell leaders that treating employees well is the right thing to do and that it supports the company's environmental, social, and governance goals. It's another to be able to add that the failure to do it costs the business in question an extra \$10 million each quarter.

Ten years ago, driven by better information on the true costs of turnover and how the retention and performance of frontline workers affect operational and financial results, Walmart embarked on an ambitious change program. (See "The Right Thing to Do," HBR.org, December 7, 2017, and "You've Got to Set Your People Up to Succeed," May–June 2023.) Among other moves, it increased pay, improved benefits, invested more in training, and redesigned jobs and schedules.

At Neiman Marcus, Eric Severson, the chief people officer, spearheaded a similar transition by persuading the rest of the C-suite that the retail chain was investing too little in human capital. He presented top management with data on the costs of turnover and the benefits of retention

and leveraged “voice of the customer” tools from marketing to find out what drove turnover and successful hiring. On the basis of that information, the company introduced generous paid parental and family leave for all its associates, which was rare in retail but would be especially valuable to its mainly female workforce, and allowed many jobs to continue to be remote after the pandemic. Severson also got the company to stop outsourcing recruiting by showing that it could be done better and more cheaply in-house.

Such companies are the exception, however. At thousands of firms, a lack of information continues to drive job cuts and decisions to put off filling open positions. Executives announce restructurings and layoffs because they think investors like them. But even when these sweeping plans aren’t carried out, they panic employees, causing them to freeze up and start looking for jobs elsewhere. Recent evidence has shown that cutting head count deep and early, the typical advice when earnings fall, leads to worse financial performance because of the difficulty of staffing up again. (Meta and other tech companies that had layoffs in early 2023 in response to investor pressure announced hiring plans a few months later.) And research by Ciao-Wei Chen and Laura Yue Li of the University of Illinois at Urbana-Champaign shows that leaving positions open also can have significant costs. They found that a one-standard-deviation increase in the length of job vacancies was associated with 5% to 6% lower quarterly returns on assets.

Better information on the true costs of such actions might change senior management’s decisions. HR can easily close the gap by sharing the right data with leaders.

### **Address Employee Stress**

HR should establish standard, credible metrics for employee stress and discuss them alongside financial and production numbers. But the priority should be on reducing the causes of stress, not monitoring it or alleviating its symptoms. Implementing wellness programs to help employees manage stress is like building trauma centers to deal with car accidents.

One huge cause of stress is uncertainty. That’s why HR should encourage leaders to communicate their plans more proactively with employees. If employees don’t know what’s in the works, they’ll make up their own stories, which are practically guaranteed to be worse than the reality.

Two of the things they’re most anxious about these days are technological change and restructuring.

### **Fear of AI.**

Perhaps the biggest worry across workplaces is whether new forms of AI will eliminate jobs. That was one of the main concerns prompting the 2023 Hollywood strikes by screenwriters’ and actors’ unions, which succeeded in getting studios to place boundaries around the use of AI to replace human talent. HR needs to calm the furor by communicating to the organization, “We’re just figuring out how these tools can be used. In the past it has taken decades for new technologies to be fully embraced, and virtually none has lived up to the hype.” In fact, the

evidence so far suggests that generative AI, which has produced widespread worker fear, will be more likely to enhance jobs in the near term than eliminate them. (See “How to Capitalize on Generative AI,” HBR, November–December 2023.) It’s particularly important to be clear that the company has no secret plan to replace people with AI. In addition, it’s smart to engage employees in evaluating AI’s potential uses, because doing so helps reduce their stress and increases learning in the process.

### **The restructuring threat.**

Company efforts to reorganize to adapt to the changing business environment are another major source of workplace stress. The shift to “green” products, for instance, was one of the main issues in the 2023 United Auto Workers strike, which ended with the union’s securing protections for employees from restructuring resulting from the transition to electric vehicles.

Throughout the business world, companies see the ability to restructure quickly as the key to long-term success. Yet without employee support, change efforts fail. Lately that support has been harder for companies to come by. Gartner’s Cian O Morain and Peter Aykens note that a survey conducted by their company found that employee willingness to get behind new initiatives plunged from 2016 to 2022. (See “Employees Are Losing Patience with Change Initiatives,” HBR.org, May 9, 2023.)

We believe that if leaders fully understood the effects of reorganizations on mental health, turnover, and job performance, they would limit them or go about them in different ways. While many new organizational structures are unlikely to last, all too often they involve changes that cannot be easily reversed, such as laying off employees and hiring new ones.

### **Find Better Ways to Be Dexterous**

When companies do restructure, they should avoid simply moving from one rigid architecture to another, redrawing boxes on the org chart and reassigning employees to new managers. A smarter approach is to compartmentalize change by creating smaller P&L units that grow or shrink based on needs in a company’s target markets. AIG was famous for entering markets by creating new companies to go after them and then shutting those ventures down if the markets became unprofitable. That was no doubt painful—but not as painful as restructuring the entire corporation first to chase a new market and then again to exit it. Two other companies that have taken a similar approach are the French infrastructure company Vinci and Haier, the Chinese multinational maker of home appliances and consumer electronics.

The downside to decentralizing around autonomous P&Ls is a loss of synergies, but there are remedies for that. ING, for instance, inspired by tech companies’ agile models, loosely groups small multidisciplinary teams into larger collectives for the purpose of coordinating bigger tasks. When a project finishes, the team assigned to it disbands. Functional experts in legal, finance, and operational risk are not assigned to teams but can be called on to help out and give objective advice. The system can flex to meet new demands, but job titles and reporting arrangements do not change.

Business leaders should also rethink how contract employees and vendors are used. Almost 50 years ago, Charles Handy and John Atkinson argued that contractors should do the peripheral work that shifts when business needs and strategies change, allowing the core of the business and its employees to remain stable. In recent decades companies have done just the opposite and have resorted to using contract workers and to outsourcing entire core functions, such as IT, to drive down operating costs. In many cases that was a mistake because the vendor couldn't deliver or, worse, went out of business.

### **Rebuild the Internal Labor Market**

One effective way for companies to increase flexibility and reduce employee anxiety is to retrain workers and give them opportunities to transfer into promising areas of the organization. HR can play a central role in making the case for those practices.

Despite the fact that training is necessary to grow talent from within, companies invest remarkably little in it. A survey conducted in 2020 by MIT's Paul Osterman suggests that the average U.S. employee gets only a half day of training per year—and that includes training of any kind, from compliance with new administrative practices to safety training.

The dearth of training translates into fewer opportunities to move up. Indeed, one of the most astonishing characteristics of the contemporary workplace is how little career advancement there is. Research suggests that only 10% to 20% of job vacancies are filled by current employees. And like the McKinsey study we mentioned earlier, a Pew Foundation survey found lack of advancement to be a substantial cause of turnover: Sixty-three percent of people who'd left their jobs in 2021 cited it as a reason for quitting. Lateral moves are even rarer than upward ones: Only 1% of U.S. employees move laterally to different businesses and operations in a given year, according to data from the Society for Human Resource Management.

Internal job markets not only cost very little but also save enormous amounts of money by reducing turnover and the need to hire from the outside.

The benefits of retraining are enormous because it prevents companies from replacing good employees with people with different skill sets, who often have to be paid more. Some companies have realized this. Several years ago, IBM offered some employees who were about to be restructured out of jobs the option of taking severance or moving into roles requiring new skills that they would receive training in for one day a week on their own time—a way of sharing the costs with them. This approach had a huge payoff—including better productivity, better employee fit, and lower turnover—and saved twice as much money as the retraining cost. In 2019 PwC committed \$3 billion to retraining and promised its workforce of 275,000 that all employees who agreed to undergo it, even those whose roles were eliminated by automation, would have a job with the company, though it might not be the same job.

Internal job markets help current employees move to new positions in their organizations where the growth is and where they can learn new skills. They not only cost very little but also save enormous amounts of money by reducing turnover and the need to hire from the outside.

Though internal job markets date back to the dot-com days of 1995 to 2000, they were scaled down after the Great Recession under pressure from line managers who didn't want to let their good employees leave them, even if it was for better jobs in the same organization. Now these programs are being revived, often under the name "talent marketplace." (See "How to Design an Internal Talent Marketplace," HBR, May–June, 2023.)

HSBC says its talent marketplace was critical to its transformation into a digital-first bank. Unilever's former CEO Alan Jope praised its revamped internal job market, Flex Experiences, for helping the company rearrange talent in a way that allowed it to weather the pandemic and become more agile. A few years ago Flex expanded into matching employees with learning opportunities on projects, particularly those with ESG objectives. Since 2018 Unilever has reallocated 500,000 employee hours toward more than 4,000 business-critical projects, improving overall productivity by 41% in the process. Seventy percent of the assignments in those projects were cross-functional, helping employees build skills that will make the organization even more agile.

### **Strengthen DEI Efforts**

A final area where HR can take the lead is diversity, equity, and inclusion. The "equity and inclusion" components, which get less attention, are where HR advocacy for employee interests is especially needed. Improving equity involves making the treatment of employees and the distribution of opportunities fairer, offering opportunities on a clear and meritocratic basis, reducing favoritism, and tying rewards to actual performance in a straightforward way—all changes that reduce perceived injustices, which can create enormous stress for employees. Increasing inclusion comes down to creating an atmosphere of tolerance and helping employees with their individual challenges.

A work environment in which employees feel safe being who they are encourages people to speak up and inspires a sense of pride and belonging. Those positive feelings translate into hard work and increased employee loyalty. Employers who get DEI right are far more able to attract talent because it widens the pool they can access, particularly among younger people.

...

Responding to a long-term change like the shift from slack to tight labor markets usually takes a great deal of time. But no one wants to be at the end of the line of companies reacting to an important inflection point. The question is, Who will be at the front of the line? Over the past 40 years companies have built HR practices and operating cultures based on the notion that squeezing employment costs and HR resources had little downside. Some of the cost cutting was indirect—by not filling vacancies and letting the remaining employees figure out how to get additional work done—and some was direct, like shrinking training and development budgets. That model is no longer working, yet companies continue with it out of inertia and because costs like turnover, unstaffed positions, and disengaged employees have no line item in the financial accounting systems of enterprises in the United States and many other countries. (See

“How Financial Accounting Screws Up HR,” HBR, January–February 2023.) To change harmful, outdated practices, HR will have to provide business leaders with that vital information.