# Internal Service and People Equity:

## Driving Business Performance*

Survey says talent management and internal service are **more important than ever**

### In 50 Words or Less

- People equity, a framework to measure and manage human capital, plays an important part in business performance.
- A recent survey explored whether that relationship was strained by the recent economic downturn.
- Results showed that companies that kept the focus on their employees outperformed those that didn't.

by Jerry H. Seibert and William A. Schiemann

* Published as "Power to the People" in *Quality Progress*, April 2010.

**THE RECESSION HAS** affected companies on every level. Many have been changed in fundamental ways, and some have not survived. The economic environment is so profoundly different from the beginning of this millennium, it begs the question of whether organizations' primary relationships have changed, including those with customers and their employees. It even calls into question the relevance of factors such as commitment to quality and internal service.

In past research conducted with QP, Metrus Group, a research and consulting firm specializing in strategic measurement and performance excellence, has documented a strong relationship between internal customer service, people equity (see sidebar, "What is people equity?" p. 26) and business performance, including financial outcomes, quality and customer satisfaction.[1,2]

But does this strong relationship continue to hold during times of economic dislocation, when corporate survival may be on the line?

This is the central question we addressed in a recent survey. We also explored the impact of various anti-recession strategies companies adopt involving the people-equity factors of alignment, capabilities and engagement (ACE). Finally, we examined the effect of those strategies on internal customer service and identified techniques that have been effective at closing internal service gaps.

## About the survey

ASQ members, customers and a sample provided by Metrus Group were surveyed in October 2009. A total of 2,147 people responded. Almost half (48%) of the participants were managers or executives representing companies from a wide range of industries. A summary of the most frequently represented industries and a breakdown by organizational size is provided in Table 1.

We asked participating companies:

- How organizational performance changed during the past two years.
- What tactics the company used in response to the recession.
- The level of workforce alignment, capabilities and engagement, as well as the focus on business results and quality.
- Internal customer service levels for key functions.
- Techniques used to close internal service gaps.

We also asked how the companies were currently performing in the areas of financial results, productivity, customer satisfaction and quality relative to their industry.

## Executive summary / TABLE 1

| Most frequently represented industries | Number of respondents |
|---|---|
| Manufacturing and industrial products | 583 |
| Professional services | 247 |
| Pharmaceutical, biotech and medical devices | 148 |
| Aerospace | 105 |
| High tech | 92 |
| Healthcare services | 90 |
| Government | 60 |
| Transportation and automotive | 54 |
| Defense | 50 |
| Others | 718 |
| **Total** | **2,147** |

| Number of employees | Number of respondents |
|---|---|
| 100 or fewer | 377 |
| 101-500 | 375 |
| 501-5,000 | 437 |
| More than 5,000 | 385 |
| Not reported | 573 |
| **Total** | **2,147** |

Our first goal was to test whether the strong positive relationships previously observed between people equity (as measured by ACE) and business performance, people equity and internal customer service, and internal customer service and business performance held in a downturn.

In our previous research, we found that companies with more engaged employees outperformed those with lower engagement levels.[3] This is in keeping with other studies on the subject. But we also found that engagement alone is not enough.[4] Even if employees feel highly connected and committed to the organization, optimal performance is not achieved unless there is also alignment with company strategy and values, as well as sufficient capabilities to meet customer requirements.

The current survey results demonstrate that even in challenging economic times, high levels of people equity are associated with better performance, as illustrated in Figure 1. Organizations in the top quartile of

## WHAT IS PEOPLE EQUITY?

It is a framework to measure and manage human capital. People equity consists of three core elements:

- **Alignment** is the extent to which employees are connected to the business strategy. It includes employees' alignment with the strategy, customers and the brand, as well as clarity and connection of individual, departmental and organization goals.
- **Capabilities** refer to the extent to which the organization effectively deploys talent, information and resources to meet customer requirements and execute the strategy.
- **Engagement** goes beyond employee satisfaction and includes commitment, advocacy on behalf of the organization and discretionary effort. *—J.H., W.S.*

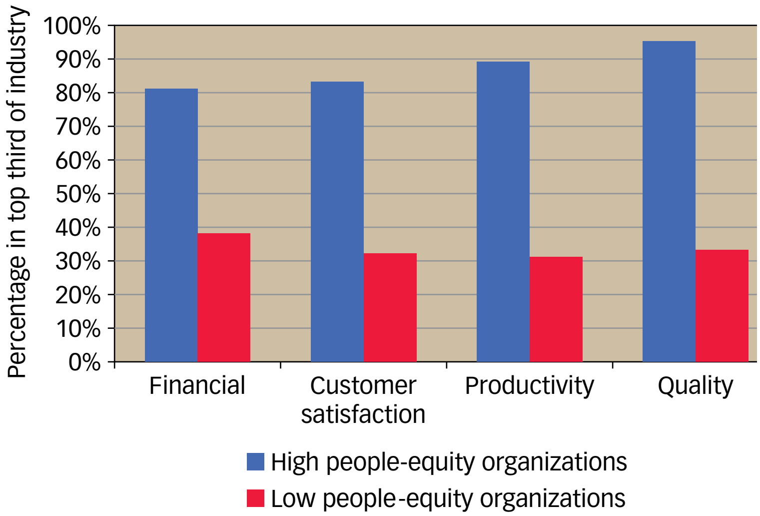
people equity are much more likely to be industry leaders (defined as being in the top third of the industry) on key metrics, such as financial outcomes, customer satisfaction, productivity and quality. While most companies with high people-equity are industry leaders, only about a third of companies with low people equity achieve that status.

In a 2006 study, we reported that internal customer service levels were also strongly influenced by ACE.[5] At that time, we found an average difference of almost 40 percentage points between internal customer service levels in high versus low people-equity companies. As dramatic as that difference was, it appears that during this stressful economic period, the differences are even more extreme. In Figure 2, we compare the internal customer service ratings of various departments for high and low people-equity businesses. The average difference in 2009 is a significant 56 percentage points.

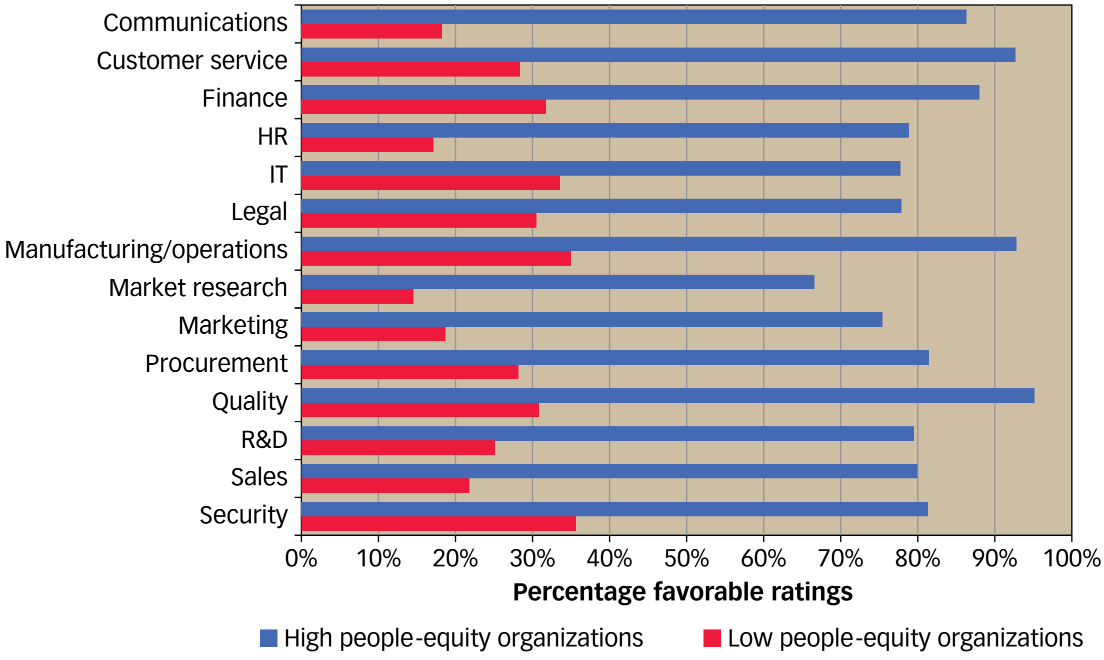
The third relationship we wanted to test was the pattern of better business performance among companies with outstanding levels of internal service. Because people equity showed a strong correlation to business performance and is an extremely strong predictor of internal customer service levels (see Figure 2), it seems a given that internal customer service and business performance are also linked.

Indeed, that was the case: Top quartile internal customer service companies are about twice as likely

## People equity/business performance relationship / FIGURE 1




## Internal service levels—high vs. low people-equity organizations / FIGURE 2



as low internal customer service companies to be industry leaders on the key metrics of financial results, productivity, customer satisfaction and quality.

With strong support for the robustness of the relationship between people equity and business performance, we examined the effect of the recession on people equity. Or, to be more precise, we examined the effect of tactical responses to the recession on people equity.

## Recession-fighting actions' affect on people equity / FIGURE 3

| Action | Alignment | Capabilities | Engagement |
|---|---|---|---|
| Laid off staff | ↓ | ↓ | ↓ |
| Mandatory budget cuts | ↓ | ↓ | ↓ |
| Hiring freeze | ↓ | ↓ | ↓ |
| Reduced pay | × | × | ↓ |
| Frozen pay (no increases) | × | × | ↓ |
| Reduced benefits | × | × | ↓ |
| Mandatory furlough | × | × | × |
| Identified process changes to reduce costs | **↑** | ↑ | **↑** |
| Reduced services to customers | **↓** | ↓ | **↓** |
| Reduced services internally, between departments | **↓** | **↓** | **↓** |

× No impact ↑↓ Moderate impact **↑↓** Strong impact

### Smaller vs. smarter

Belt tightening is the recession tactic of choice for most companies. Smaller is better, the current mantra goes, which leads to reductions in staff, budgets and services. An alternative to cutting back is to invest more in improving and streamlining processes. We wondered if choosing this approach—getting smarter, not just smaller—made a difference in ACE levels within companies. To put it another way, is there a people equity benefit from using the tools of process improvement and cost reduction as part of a recession survival strategy?

Common wisdom says the steps companies typically take to manage an economic downturn have an across-the-board negative impact on ACE levels. But we found there is a difference between the various recession tactics companies use and the impact of those actions on people equity factors. Figure 3 summarizes the results of regression models examining the impact of 10 different tactics on each people equity factor, including the following:

**1. Reducing resources:** Tactics such as layoffs, budget cuts and hiring freezes uniformly had a negative impact on ACE levels. These actions, which include the most severe responses to the recession, can leave employees feeling like they need to carry a heavier load with no additional recognition. With fewer resources, capabilities decline. The perceived inequity of these tactics weakens engagement.

Cutting back also can lead to a value disconnect between employees and their company, thereby undermining alignment. Employees find it difficult to be in sync with the strategic direction of the company when those around them are losing their jobs.

**2. Compensation cuts:** In an interesting contrast, the effects of compensation-oriented tactics were very different. Pay cuts, pay freezes and benefit reductions had a negative impact on employee engagement, which should come as no surprise. But compensation cuts did not have a significant impact on alignment or capabilities. It is possible these actions, while not welcomed, are more likely to be viewed as rational and acceptable—sharing the pain through lower profits for the company and lower rewards for staff. Thus, alignment may be maintained, and with resources preserved in the organization, capabilities remain largely intact.

We examined one other tactic for reducing labor costs: mandatory furloughs, which are typically used to cut pay by reducing total work hours. Like the other techniques, use of furloughs had no impact on alignment and capabilities. But they also had no impact on engagement. Perhaps that is because, unlike the other actions, a furlough may be viewed as somewhat more equitable—you don't get paid, but you're also not required to work during the furlough.

**3. Service suffers:** The greatest negative impact did not come from eliminating resources or reducing compensation. Surprisingly, the most powerful negative effects occurred when companies chose to reduce service levels to customers and when they made changes that reduced services internally between departments.

Reducing services to customers had a strong negative impact on alignment and engagement. It would seem employees see a disconnect between oft-repeated strategies and mission statements that emphasize customer service, and actions that may damage customer relationships, if not harm the customers themselves.

It's no shock that aspects of engagement, such as advocacy and discretionary effort, might also decline in that situation. A lesser effect was observed for capabilities, which may mean employees realize the capabilities for good service remain in place; they are just being underused.

When companies reduced services between departments, there was a strong impact on all three people-equity factors. Logically, changes that imperil a department's ability to service other internal groups would lead to lower perceptions of capabilities. After all, points of failure within the organization can reasonably be expected to ultimately lead to failures with customers. Employees may feel less certain they are on the same strategic page as senior leadership, thus lessening alignment.

The strong impact on engagement is a little more puzzling. Perhaps it is a reaction to being placed in a situation where you're prevented from doing the best work possible, resulting in a certain degree of cognitive dissonance. Or perhaps it flows from frustration with a lack of support from other parts of the organization.

Each of the previously mentioned tactics for managing through an economic downturn can be considered reductive, if not destructive, in their fundamental nature. Leaders may choose to think of them as pruning now for future growth, but that does not change the fact that pruning has serious repercussions for employees and the customers they serve.

One tactic had a positive impact on people equity: identifying process changes to reduce costs. Companies that used this tactic reported a strong positive impact on alignment and engagement, and a moderate positive impact on capabilities. This tactic likely maintains consistency with prerecession goals. Therefore, looking within the organization to collaboratively make improvements and reduce costs actually increases alignment.

For employees, it represents the company choosing surgery over amputation. Not surprisingly, this path can actually lead to higher levels of engagement. Employees are highly attuned to organizational behavior that values people and recognizes their ability to help a company prevail in challenging times. There is a lesson here for every organization facing a difficult future.

## The recession-service connection

In a study of internal customer service conducted in 2007, we reported that average service levels improved compared to a similar study in 1993.[6] In a recession, however, we expected lower levels of internal customer service. Surely, the effects of cutting back on people equity outlined in Figure 3 hold equally true for internal customer service.

In fact, the 10 recession-fighting tactics had similar effects on internal service. Service reductions between departments had the greatest negative impact, as you may expect. Cost-oriented process improvement had a moderate positive effect, while other tactics had modest negative effects. Yet, on average, internal customer service levels have continued to improve, even through the recession. The typical department had a seven percentage point increase in favorable ratings compared to the 2007 results.

But this unexpected finding is somewhat misleading. Companies that are doing well despite the recession—their performance on key metrics has improved during the last two years—account for all of the increase in internal customer service ratings. In companies where financial performance, productivity, customer satisfaction or quality have deteriorated over the last two years, internal customer service scores are down by approximately 15 percentage points. There is a gap of as much as 25% between the firms that are struggling and those that are successfully navigating the recession.

## Closing the gaps

The finding that, for many companies, internal customer service (as well as business performance) is trending downward means there will be an increasing number of internal service gaps. The needs and requirements of internal customers are diverging from the capabilities of internal service providers, but there are a range of techniques that can be used for addressing such gaps. The final part of this study asked respondents which techniques they have used and how effective each has been.

Table 2 reveals that among 12 well-known techniques, most are used for closing internal service gaps by about one-third of companies. Two techniques stand out as more widely applied: plan-do-check-act and process management were used by at least half of the companies. They were also more likely to be effective compared to other techniques.

Customer value mapping, while one of the less frequently used techniques, was also among the most effective. Some—such as balanced scorecard, work out and theory of constraints—were rated as effective by less than half of those who applied them.

This data may help guide companies that are beginning to experience problems related to internal service gaps. An awareness of which techniques have been effective in other companies could accelerate service improvement efforts and help companies avoid wasting effort on approaches that are less likely to succeed.

## The criticality of people

Our survey results demonstrate the importance of workforce alignment, capabilities and engagement on organizational performance and business results, independent of the vagaries of economic fluctuation. The relationship between people-equity factors and business outcomes remains strong, as does the connection to internal service levels.

These relationships take on more importance when you consider the impact of various tactics used in response to an economic downturn. Staff, budget and salary reductions all have detrimental effects, although not always in the same way. The riskiest strategies involve reducing service levels to customers or making changes that reduce internal service levels. Those tactics had the greatest negative impact on ACE levels.

Companies that take this route risk double jeopardy: Lower ACE scores lead to lower internal and external customer service, both of which are drivers of business results. Companies will be better served by focusing on process improvement and closing internal service gaps. The only recession tactic that had a positive impact on ACE was a strategy of process improvement, with a focus on reducing costs.

Internal service includes many processes amenable to this approach, and our data highlight several techniques that have been reported as effective at a wide range of companies. To maintain the highest levels of performance, leaders must manage more than the bottom line; there must be a focus on the organization's people equity and a commitment to internal customer service. QP

## Techniques for closing internal service gaps / TABLE 2

| Technique | Percentage using | Percentage rating effective or very effective |
|---|---|---|
| Plan-do-check-act | 50% | 67% |
| Process management | 57% | 66% |
| Customer value mapping | 32% | 62% |
| Lean/lean office | 36% | 60% |
| Lean Six Sigma | 34% | 58% |
| Benchmarking | 40% | 58% |
| Six Sigma | 33% | 57% |
| Process value analysis | 27% | 56% |
| Business process reengineering | 30% | 54% |
| Balanced scorecard | 28% | 49% |
| Work out | 29% | 48% |
| Theory of constraints | 22% | 44% |



### REFERENCES

1. J.T. Kostman and William A. Schiemann, "People Equity: The Hidden Driver of Quality," *Quality Progress*, May 2005, pp. 37-42.
2. Jerry H. Seibert and J. Lingle, "Internal Service: Has It Improved?" *Quality Progress*, March 2007, pp. 35-40.
3. Kostman and Schiemann, "People Equity: The Hidden Driver of Quality," see reference 1.
4. William A. Schiemann, *Reinventing Talent Management*, John Wiley & Sons and Society for Human Resource Management, 2009.
5. Seibert and Lingle, "Internal Service: Has It Improved?" see reference 2.
6. Ibid.

*JERRY H. SEIBERT is global director of diagnostic services for Metrus Group, a research and consulting firm based in Somerville, NJ. He earned a master's degree in industrial/organizational psychology from Western Kentucky University in Bowling Green.*

*WILLIAM A. SCHIEMANN is the CEO and founder of Metrus Group. He earned a doctorate in organizational psychology from the University of Illinois at Urbana-Champaign. He is the co-author of* Bullseye! Hitting Your Strategic Targets Through High Impact Measurement *and author of* Reinventing Talent Management.