They're Not Employees, They're People

From *Managing in the Next Society*

Every working day, the world's biggest nongovernmental employer, the Swiss company Adecco, places 700,000 of its employees as "temporaries" with businesses all over the world perhaps as many as 250,000 in the United States.

Adecco is the industry giant, but it has only a small share of a totally splintered market.

In the United States alone there are some seven thousand temp firms.

Together they place some 2.5 million workers each day.

And worldwide the figure is at least 8 million, if not 10 million.

And 70 percent of all "temps" work full-time.

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When the temp industry first started, some fifty years ago, it supplied low-level clerks to take the place of ledger keepers, receptionists, telephone operators, or stenos in the typing pool who were sick or on vacation.

Today there are temp suppliers for every job, all the way up to temp CEOs.

One temp firm, for instance, supplies manufacturing managers who are in charge of a new plant from its inception on the drawing board until it is in full production.

Another supplies highly skilled health-care professionals such as nurse anesthesiologists.

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In a related but distinct development, the fastest growing business service in the United States during the 1990s was the professional employer organization (PEO).

There are now at least eighteen hundred of them with their own trade association (The National Organization of Professional Employer Organizations) and their own monthly journal (*The PeoEmp Journal*).

These firms manage their clients' employees and their clients' employee relations as well.

Virtually unknown only ten years ago, they had become by the year 2000 the "coemployers" of 2.5 to 3 million American employees, both blue collar and white collar.

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PEOs, like temp agencies, have vastly expanded their scope in recent years.

The first PEOs in the late 1980s offered to do bookkeeping, especially payroll, for their clients.

Now PEOs take care of every task in employment management and employee relations: record keeping and legal compliance; hiring, training, placement, promotion, firing, and layoffs; retirement plans and pension payments.

They originally confined themselves to taking care of the employee relations of small firms.

But Exult (headquartered in Irvine, California)—probably the best known of them—was designed from its start in 1997 to be the coemployers for Fortune 500 companies.

It numbers among its clients BP Amoco—worldwide—Unisys, and Tenneco Automotive.

It has already gone public and is traded on NASDAQ.

In one quarter the second quarter of 2001—its revenues grew from $43.5 million to $64.3 million.

Another PEO, designed originally to do payroll for small businesses with fewer than twenty employees, is about to take over the management of the 120,000 employees of one of the larger states.

And some other large firms are getting into the act—e. g., Accenture (the former Andersen Consulting).

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But who is then the “boss” of these outsourced employees?

If the PEO makes the hiring, firing, placement, and promotion decisions, how can an executive function?

I asked this question of a senior BP Amoco executive whose workforce, including senior scientists, is now being managed by Exult.

His answer: “Exult knows that it has to satisfy my colleagues and me if it wants to keep the contract.

But Exult makes the decisions to fire or to move someone.

It does so however only because I suggested it or after careful consultation with me.

But I also know that Exult has three obligations—to me, to the company, and to the employee—and if it does not satisfy the employee, he or she will leave.

And so, in one or two cases, I have yielded when Exult argued that moving an employee I very much would have liked to keep was in the employee's best interest—and probably, long term, in that of the company as well."

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Both the temp industry and the PEOs are growing fast.

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Adecco is growing 15 percent a year.

The PEO industry is growing even faster, 30 percent a year—in other words, it is doubling every two and a half years.

It expects to be the coemployers of 10 million American workers by the year 2005.

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Clearly, something is happening in employee relations and employee management that does not fit what the management books still write about and what we teach in management school.

And it surely also does not fit with the way human relations departments of most organizations businesses, governments, and nonprofits—were designed and are meant to function.

Strangled in Red Tape

The reason usually offered for the popularity of temps is that they give employers flexibility.

But far too many temps work for the same employer for long periods of time—sometimes year after year—for it to be the whole explanation.

And flexibility surely does not explain the emergence of the PEOs.

A more plausible explanation is that both types of organization legally make "nonemployees" out of people who work for a business.

The driving force behind both the steady growth of temps and the emergence of the PEOs is the growing burden of rules and regulations for employers.

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The cost alone of these rules and regulations threatens to strangle small businesses.

According to the government's Small Business Administration, the annual cost of government regulations, government-required paperwork, and tax compliance for U.S. businesses employing fewer than five hundred employees was $5,000 per employee in 1995 (the last year for which figures are available)—a 25 percent surcharge on top of the cost of wages, health care, insurance, and pension, which was around $22,500 in 1995 for the average small-business employee.

Since then the cost of employment—related paperwork is estimated to have gone up by more than 10 percent.

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Many of these costs can be avoided altogether by using temporary workers in place of employees.

That's why so many companies are contracting for workers with temp agencies even though the hourly cost of a temp is often substantially higher than the wage-and-benefit cost of an employee.

Another way to reduce the bureaucratic costs is to outsource employee relations—in other words, to let a specialist do the paperwork.

Aggregating enough small businesses to manage at least five hundred employees as one workforce—which is, of course, what a PEO does—cuts that cost by two-fifths, according to Small Business Administration figures.

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Nor is it only the small enterprises that can cut their labor costs substantially by outsourcing employee relations.

A 1997 McKinsey & Co. study concluded that a global Fortune 500 firm—in other words, a very big company indeed—could cut its labor costs by 25 to 33 percent by having its employee relations managed by an outside firm.

This study apparently led to the foundation of Exult a year later.

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The outsourcing of employees and employee relations is an international trend.

Although employment laws and regulations vary widely from country to country, the costs they impose on businesses are high everywhere in the developed world.

Adecco's biggest market, for instance, is France (the United States is number two); and Adecco is growing 40 percent a year in Japan.

Exult opened a big employee-management center in Scotland in 2000 and has employee-management offices in London and Geneva as well.

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Even more onerous than the costs are the enormous demands that regulations place on management time and attention.

In the twenty years between 1980 and 2000, the number of U.S. laws and regulations regarding employment policies and practices grew by 60 percent, from thirty-eight to sixty.

All of these require reports, and all threaten fines and punishment for noncompliance, even if unintentional.

According, again, to the Small Business Administration, the owner of a small or even a midsize business spends up to a full quarter of his or her time on employment-related paperwork.

And then there is the constant—and constantly growing—threat of employment related lawsuits.

Between 1991 and 2000, the number of sexual-harassment cases filed with the Equal Employment Opportunity Commission more than doubled, from 6,883 a year to 15,889.

And for every case filed, up to ten or more were being settled in-house—each requiring many hours of investigation and hearings, and substantial legal fees as well.

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No wonder that employers (and especially the smaller ones, which constitute the overwhelming majority) complain bitterly that they have no time to work on product and service, on customers and markets, on quality and distribution—they have no time to work, that is, on results.

They instead work on problems, that is, on employee regulations.

They no longer chant the old mantra "People are our greatest asset."

They now say instead, "People are our greatest liability."

What underlies both the success of the temp companies and the emergence of the PEOs is that they enable management to focus on the business.

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This argument, by the way, can also explain the success of the maquiladoras, the manufacturing plants on the Mexican side of the U.S. border (and increasingly in the interior of Mexico as well) that assemble parts made in the United States, the Far East, or Mexico into finished products for the U.S. market.

In fact, I would argue that avoiding onerous paperwork is a stronger incentive for the manufacturing companies than the often questionable labor savings.

The Mexican firm that is the maquiladora's landlord acts as the "coemployers," handling all employee regulations and employee activities (which are as complicated in Mexico as they are in the United States), thus freeing the U.S. or Japanese owner of the plant to focus on the business.

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There is not the slightest reason to believe that the costs or the demands of employment rules and regulations will go down in any developed country.

On the contrary.

No matter how badly needed a patient's bill of rights may be in the United States, it will undoubtedly create another layer of agencies with which an employer has to deal: another set of reports and paperwork; another avalanche of complaints, disputes, and lawsuits.

The Splintered Organization

Beyond the desire to avoid the costs and distractions of regulations, there is another major reason for both the rise of the temps and the emergence of the PEOs: the nature of knowledge work and, most particularly, the extraordinary specialization of knowledge workers.

Most large, knowledge-based organizations have lots of different types of specialized workers; managing them all effectively is a big challenge for the organization.

Temp agencies and PEOs can help solve that problem.

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Not so long ago, even in the 1950s, as many as 90 percent of the workforce were "nonexempt"—subordinates who did as they were told.

The "exempt" were supervisors who did the telling.

Most nonexempt employees were blue collar workers who had few skills and little education.

They typically did repetitive tasks on the plant floor or in the office.

Today less than a fifth of the workforce is blue collar.

Knowledge workers (two-fifths of the workforce) may have a supervisor, but they are not "subordinates."

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They are “associates.”

Within their area of knowledge they are supposed to do the telling.

But, above all, knowledge workers are not homogeneous.

Knowledge is effective only if specialized.

This is particularly true of the fastest growing group of knowledge workers—the fastest growing group in the workforce altogether—knowledge technologists such as computer repair people, paralegals, programmers, and many others.

And because knowledge work is specialized, it is deeply splintered even in large organizations.

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The best example is the hospital—altogether the most complex human organization ever devised, but also, in the last thirty or forty years, the fastest-growing one in all developed countries.

A fair-size community hospital of 275 or 300 beds will have around three thousand people working for it.

Close to half of them will be knowledge workers of one kind or another.

Two of these groups—nurses and specialists in the business departments—are fairly large, numbering several hundred people each.

But there are around thirty “paramedic specialties”: the physical therapists and the people in the clinical lab; the psychiatric caseworkers; the oncological technicians; the two dozen people who prepare patients for surgery; the people in the sleep clinic; the ultrasound technicians; the cardiac clinic specialists, and many, many more.

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Each of these specialties has its own rules and regulations, its own education, its own requirements, its own accreditation.

Yet each, in any given hospital, consists of only a handful of people—there may be no more than seven or eight dietitians, for instance, in the 275 bed hospital.

Each group, however, expects and requires special treatment.

Each expects—and needs—someone higher up who understands what it is doing, what equipment it needs, what its relationship should be to doctors, nurses, the business office.

Also, within the individual hospital there are no career advancement opportunities for any of them; not one of them wants to be the hospital's administrator or has any chance of getting the job.

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Few businesses currently have as many specialists as the hospital does.

But they're getting there.

A department store chain I know of now counts fifteen or sixteen distinct knowledge specialties, most of them employing only a handful each in any one store.

In, too, there is increasing specialization and increasing need, apparently, for concentration on one speciality.

The person who selects the mutual funds the firm should offer its clients does not sell those mutual funds nor does she service them.

And increasingly there are fewer and fewer career opportunities for the individual knowledge specialist within the organization.

The experts who select the mutual funds to be offered to retail customers are not going to become mutual-fund salespeople.

But they are also not particularly interested in becoming a manager beyond running a small group—a handful of fellow specialists at most.

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The American hospital has largely tackled this problem of specialization by piecemeal outsourcing.

In many hospitals (perhaps a majority by now) each of the several knowledge specialties is managed by a different outsourcer.

Blood transfusion, for instance, is run by a firm that specializes in blood transfusions and manages the transfusion departments of a fairly large number of separate hospitals.

Like a PEO, it is the coemployers of the transfusion people.

Within the chain the individual transfusion specialists also have career opportunities.

If they perform well, they can become managers of the transfusion department at a bigger and better-paying hospital or supervisors of several transfusion units in the chain.

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Both the large temp company and the PEO do across the board what in the hospital is done piecemeal.

Each of their clients, even the biggest, lacks the critical mass effectively to manage, place, and satisfy the highly specialized knowledge person.

And this is what the PEO and the temp agency can provide.

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Thus both the temp agency and the PEOs are performing a vital function for the employee as well as for the employer.

This explains why the PEOs can claim, and apparently document, that the people whose coemployers it has become report higher satisfaction—in contradiction to everything human-relations theory would have predicted.

The metallurgist in the medium-size chemical firm may be well paid and have an interesting job.

But the firm needs and employs only a handful of metallurgists.

No one in upper management understands what the metallurgist is doing, should be doing, could be doing.

There is no opportunity, except a remote one, of becoming an executive, and in any event that would mean giving up what the metallurgist has spent years learning how to do and loves.

The well-run temp firm can and does place the metallurgist where he can make the maximum contribution.

And it can—and does—place the successful metallurgist in increasingly better and better-paid jobs.

And in a PEO full-service contract (and many PEOs won't accept any other), it is expressly provided that the PEO has the duty and the right to place the people whose coemployers it is in the job and in the company where they best fit and belong.

How to balance these responsibilities to employing client and employee is probably the PEO's most important job.

Companies Don't Get It

HR policies still assume that most if not all the people who work for a company are employees of that company.

But as we have seen, that is not true.

Some are temps and others are employees of the outsourcers who manage (say) the company's computer systems or call centers.

Still others are older part-time workers who have taken early retirement but still work on specific assignments.

With all this splintering, no one is left to view the organization in its entirety.

HR organizations and PEOs concern themselves only with the people who are legal employees.

Temp agencies claim to be selling productivity—in other words, to be doing the organization's oversight job for them—but it's hard to see how they can deliver.

The productivity of the people they supply to a customer depends on placing them, managing them, motivating them.

The temp agency has no control over any of these areas.

Nor does the PEO.

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This lack of oversight is a real problem.

Every organization in existence needs employee management that views all the people on whose productivity and performance the organization depends as its responsibility—whether they're temps or part-timers, whether they're employees of the organization itself or of its outsourcers, suppliers, and distributors.

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There are signs that we are moving in that direction.

A European multinational consumer goods maker is about to split off its large and highly regarded employee management function into a separate corporation that will act as the PEO for the parent company throughout the world.

But it would also manage the relationships with, and the utilization of, the people who work for the multinational and are not legally its employees.

Eventually this in-house PEO will offer itself as the coemployer for the employees of the multinational's suppliers and distributors and for its more than two hundred joint ventures and alliances.

And Sony, the Japanese consumer-electronics giant, is experimenting with a plan under which an applicant for a permanent job in one of its major plants must first work for ten months as an Adecco temp.

During this time, however, Sony would be the trial employee's personnel manager even though Adecco would be the legal employer.

The Key to Competitive Advantage

Actually it is more important today for organizations to pay close attention to the health and well-being of all their workers than it was fifty years ago.

A knowledge-based workforce is qualitatively different from a less skilled workforce.

True, knowledge workers are a minority of the total workforce—and are unlikely ever to be more than that.

But they are fast becoming the largest single group.

And they have already become the major creator of wealth.

Increasingly the success, indeed the survival, of every business will depend on the performance of its knowledge workforce.

And since it is impossible, according to the laws of statistics, for any but the smallest organization to have "better people," the only way an organization in a knowledge-based economy and society can excel is through getting more out of the same kind of people; that is, through managing its knowledge workers for greater productivity.

It is, to repeat an old saying, "to make ordinary people do extraordinary things."

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What made the traditional workforce productive was the system—whether it was Frederick Winslow Taylor's "one best way," Henry Ford's assembly line, or Ed Deming's Total Quality Management.

The system embodies the knowledge.

The system is productive because it enables individual workers to perform without much knowledge or skill.

In fact, on the assembly line (but also in Deming's Total Quality Management), greater skill on the part of an individual worker is a threat to coworkers and to the entire system.

In a knowledge-based organization, however, it is the individual worker's productivity that makes the system productive.

In a traditional workforce the worker serves the system; in a knowledge workforce the system must serve the worker.

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There are enough knowledge-based organizations around to show what that means.

What makes a university a great university is that it attracts and (above all) develops outstanding teachers and scholars and makes it possible for them to do outstanding teaching and research.

The same is true of an opera house.

The knowledge-based institution that most nearly resembles a knowledge-based business is the symphony orchestra, in which some thirty different instruments play the same score together as a team.

A great orchestra is not composed of great instrumentalists but of adequate ones who produce at their peak.

When a new conductor is hired to turn around an orchestra that has suffered years of drifting and neglect, he cannot, as a rule, fire any but a few of the sloppiest or most superannuated players.

He also cannot as a rule hire many new orchestra members.

He has to make productive what he has inherited.

The successful ones do this by working closely with individual members and individual sections.

Their "employee relations" are a given and they're nearly unchangeable.

Their "people relations" make the difference.

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It would be difficult to overstate the importance of focusing on knowledge workers' productivity.

For the critical feature of a knowledge workforce is that knowledge workers are not "labor," they are capital.

And what is decisive in the performance of capital is not what capital costs.

It is not how much capital is being invested—or else the Soviet Union would easily have been the world's foremost economy.

What's critical is the productivity of capital.

What brought about the Soviet Union's economic collapse was that the capital productivity of its investments was so incredibly low—in many cases less than a third that of capital investment in a market economy and sometimes actually negative (as in the case of the huge investments in farming during the Brezhnev years).

The reason was simple—no one paid any attention to the productivity of capital, no one had that as their job, no one got rewarded for it.

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Private industry in the market economies teaches the same lesson.

In new industries, leadership can be obtained—and maintained—by innovation.

In an established industry, however, what differentiates the leading company is almost always outstanding productivity of capital.

In the early part of the twentieth century, General Electric, for instance, competed through innovations in technology and products with its long-term rival Westinghouse, or with the Europeans such as Siemens.

But in the early 1920s, after the era of rapid technology innovation in electro-mechanics had come to an end, GE concentrated on the productivity of capital to give it decisive leadership, and it has maintained this lead ever since.

Similarly, Sears Roebuck's glory days—from the late 1920s through the 1960s—were not based on merchandise or pricing.

Its rivals, such as Montgomery Ward, did just as well in both areas.

Sears's leadership was based on getting about twice the work out of a dollar that other American retailers did.

Knowledge-based businesses need to be similarly focused on the productivity of their capital, that is, of the knowledge worker.

Free Managers—to Manage People

Temps and especially PEOs free up managers to focus on the business rather than on employment-related rules, regulations, and paperwork.

To spend up to one-quarter of one's time on employment-related paperwork is indeed a waste of precious, expensive, scarce resources.

It is boring.

It demeans and corrupts, and the only thing it can possibly teach is greater skill in cheating.

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Companies thus have ample reason to try to do away with the routine chores of employee relations—whether by systematizing employee management in-house, or by outsourcing it to temps or to a PEO.

But they need to be careful that they don't damage or destroy people relations in the process.

Indeed, the main benefit of decreasing paperwork may be to gain a little more time for people relations.

Executives will have to learn what the effective department head in the university or the successful conductor of the symphony orchestra has long known: the key to greatness is to look for the potential of people and to spend time developing it.

To build an outstanding university department requires spending time with the promising young post-docs and assistant professors until they excel in their work.

To build a world-class orchestra requires rehearsing the same passage in a symphony again and again until the first clarinet plays it the way the conductor hears it.

And this is also what makes a research director successful in an industry lab.

The one way to achieve leadership in the knowledge-based business is similarly to spend time with the promising knowledge professionals: to get to know them and to be known by them; to mentor them and to listen to them; to challenge them and to encourage them.

These people may no longer legally be the organization's employees.

But they will still be the organization's resource and capital and the key to its performance.

Employee relations can—and indeed should—be systematized; and that means that they can perhaps should—become impersonal.

But that should make people relations all the more important.

If employee relations are being outsourced, executives need to work closely with their counterparts in the outsourcer on the professional development, the motivation, the satisfaction, and the productivity of the knowledge people on whose performance their own performance and results depend—maybe the main (though unspoken) lesson of the BP Amoco story related earlier.

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Two hundred and fifty years ago, in what we now call the Industrial Revolution, the permanent large organization emerged.

The cotton mill and the railroad were the first ones.

But while unprecedented, they were still based on manual labor, as was all earlier work.

Manual labor whether it was farming, manufacturing, clearing checks by hand, or entering life insurance claims into a ledger was still the work of the great majority as late as fifty or sixty years ago, even in the most highly developed economies.

The emergence of knowledge work and of the knowledge worker—let alone their emergence as the "capital" of a knowledge-based society and knowledge-based economy—is thus as profound a change as was the Industrial Revolution 250 years ago, perhaps an even greater one.

It will require more than a few new programs and a few new practices, however helpful they are.

It will require new measurements, new values, new goals, and new policies.

It will predictably take a good many years before we have worked these out.

However, there are enough successful knowledge-based organizations around to tell us what the basic assumption has to be for managing employees in a knowledge-based organization.

It has to be that employees may indeed be our greatest liabilities, but people are our greatest opportunity.

(2002)