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INTRODUCTION TO HUMAN RESOURCE MANAGEMENT

Revised Chapter 1 of
Human Resource Management:
An Economic Approach

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Chapter 1

INTRODUCTION TO HUMAN RESOURCE MANAGEMENT

Often we hear employers state that "people are our most important asset." Often we hear that "investment in people" is fundamental to national competitiveness. At the same time, the payroll costs of a firm can be critical to its success in the marketplace. And in the 1990s, it has become commonplace wisdom that even higher-level white-collar employees are not immune from cost-reducing layoffs or pay cuts. Employers may well invest in people through on-the-job and off-site training programs. But without assurance that the employer-employee attachment is going to be longlasting, such investments are likely to be limited.

It is apparent that our view of human resources and human resource management has contradictory elements. Sometimes employees are thought to be assets; sometimes they are thought to be costs. Sometimes the benefits of investing in employee skills are perceived to outweigh the costs; sometimes employers prefer to hire skills in the labor market and not make the skill-enhancing investments themselves. Can we make sense of these divergent tendencies?

I. Alternative Approaches to Human Resource Management.

Issues such as employer-provided training vs. market acquisition of skills are important decision components of human resource management. However, the language of benefits and costs used in the previous paragraph to introduce that topic suggests an <u>economic</u> approach to the issue. This textbook often takes that perspective in analyzing the human resource area. In contrast, many other textbooks in the field take either a <u>legal</u> approach - because their are many laws and rules which regulate the workplace - or a <u>behavioral</u> approach - because such issues as motivation are often seen as largely matters of psychology. Still other textbooks are largely <u>descriptive</u>; they simply report the customary procedures undertaken in carrying out the human resource function without raising questions about traditions in the field.

All of these approaches to human resources are legitimate and all have something to contribute. Simple economic models often gloss over the complexities of labor-market institutions. Where those institutions need discussion, therefore, we will provide it in the chapters that follow. Nonetheless, there is a growing body of literature which relates human resource practices and strategies to the performance of the firm. Often that literature relies on economic methodology, and we will provide analysis in that vein. That is, the economic approach will be followed where it most helps illuminate the practice of human resource management and the workings of the labor market. But where institutions (such as labor unions) are important to an understanding of the basic processes, they will be introduced.

In all developed countries including the U.S., labor-market practices are heavily regulated. Thus, in the U.S. employers must comply with federal standards regarding minimum wages, the payment of overtime, non-discrimination and affirmative action, relationships with unions, safety and health on the job, the hiring of immigrants, etc. Where such external laws and regulations impinge on management discretion, we will provide discussion - but in far less detail than would a standard labor-law text. Although some readers may begin with the sense that a little knowledge of leadership is all that it takes to be a good human resource manager, that is not the case. Failure to understand the important legal constraints imposed by public policy has proved costly to many employers of uninformed and self-perceived "leaders".

Finally, there many examples where the simple model of economic "rationality" inadequately describes human behavior in the employment context. Concepts of fairness and equity generally stand apart from notions of rational maximizing often found in basic economics. In subsequent discussion, we will not seek to avoid these central considerations of human resource management. Indeed, we will stress them.

II. The Labor Market is "Different".

An almost-universal topic in management-school curricula is the study of financial markets. By contrasting financial and commodity markets with labor markets, we can quickly spot the key differences. Indeed, the institutions and outcomes of the two markets are widely divergent. The differences do not imply that participants in the labor market are behaving incorrectly while those in financial and commodity markets are not. Rather, they reflect the different circumstances of the markets involved.[1]

For example, detailed reports on financial and commodity markets are carried on a regular basis in the newspapers. The prices of particular stocks, bonds, currencies, or metals can be easily located in the financial press on a daily basis. Market traders, who cannot afford to wait for newspaper accounts, can receive almost instantaneous reports of current transactions by electronic means. Those who are concerned about the course of these prices in the future, either to reduce risk or to speculate, have access to secondary forward, futures, and options markets. Other traders stand by, awaiting minor discrepancies in prices between primary and secondary markets, to profit through arbitrage.

In contrast, there are no daily tables of wages (the prices of labor) in the newspapers. Information on wages is much less complete. And even if there were such wage tables, there would be little purpose in publishing them each day; firms often do not change wages more than once a year. Moreover, a table of wages would be rather ambiguous since pay rates often vary across individuals even within an occupation category at a particular firm. Not only do individuals differ in their characteristics but so, too, do the working conditions under which they are employed. In addition, some employers are generally high payers (they pay above the "going" wage) while others are low payers, for reasons we will want to consider later in this textbook.

i. Linking Buyers and Sellers.

Although there are normally no wage tables, the labor market _is_ reflected in the help-wanted advertising section of daily newspapers. Yet wages are often not quoted in such ads or, where quotes are offered, the ads may specify a salary range rather than a single figure. The fact that candidates for employment are not homogeneous (unlike shares of a company's stock or ounces of silver) helps explain this attribute of the labor market.

Even the practice of placing help-wanted ads suggests that the labor market differs from financial and commodity markets. A person wishing to buy shares of a major corporation does not place "stock-wanted" advertisements; instead there is a well-established marketplace ready to fill the need quickly. In contrast, buyers (employers) in the labor market apparently have difficulty in locating sellers (employees) and thus are forced to advertise.[2]

ii. Lack of Market Clearing.

An even more striking difference between the labor and financial/commodity markets is the chronic existence of excess supply. In the stock market, anyone who wishes to sell shares of Exxon at the going price can do so. Sellers may be disappointed at the level of the going price, but not in their ability to sell at it.

The labor-market situation is quite different. Workers may experience difficulty in finding a job, especially during business downturns, even if they are willing and able to accept a wage at or below the level that employers are paying their current employees. In an important sense, the labor market does not seem to "clear" (bring demand and supply into harmony) the way financial and commodity markets routinely do.

Of course, there are examples of non-clearing behavior in other markets, too. It might be said, for example, that advertising of consumer products and similar forms of non-price competition are symptomatic of a shortage of customers in oligopsonistic markets.[3] Even in such cases, however, there is a difference in institutional arrangements relative to the labor market. An automobile manufacturer, for example, may well sell at a price above the marginal cost of production, and thus be anxious to find additional buyers.[4] But it has the option, if it wants, to compete via price reduction, and increase its sales volume.

Generally, this option is not available to a job seeker. He or she cannot generally expect to obtain work just by going to employers and offering to work for less than current employees. If all jobs are filled at the wages the firm has established, unemployed persons are simply told that there are "no vacancies" or that "no help is wanted".[5]

iii. Length of the Relationship and the Fairness Concept.

Buyers and sellers in financial and commodity markets often have no direct relationship with one another at all; they are temporarily joined by an intermediary (a broker or even a computer), but otherwise have no ongoing contact. The markets are impersonal and transitory. Sellers of Treasury bills, for example, have no reason to consider the duration of their future relations with buyers; once the transaction is completed they may never do business again.

The labor market is quite different. It is true that a few very brief employment relationships can be cited. For instance, informal job markets exist in urban areas for day laborers, and in rural areas migrant farm workers quickly move from harvest site to harvest site. But most employees expect to remain with their employers for considerable - although indefinite - time periods, often stretching into years.

When employment histories of older workers are examined, spells of employment (job tenures) with a single employer have often turned out to last twenty or more years. Moreover, most workers are concerned with (or even fearful of) the possibility of losing their jobs through layoff or discharge.[6] Such a job loss could lead to an extended period of unemployment with no guarantee that an eventual future employer will pay them a wage as high as they received from their former employer.

Media accounts of plant closings have poignantly recorded the complaints of long-service employees who have been laid off after giving "the best years of their lives" to the enterprise. Their employers are depicted as heartless and cruel by both the displaced workers and the reporters covering the story. In contrast, firms which protect their senior workers - say, by retraining them for other jobs within the firm or helping them move to a new location - are pictured as enlightened. These firms are seen as honoring an "debt" to their loyal workers, even if the debt is not strictly a legal one.

In fact, the idea that employers should be "fair" to their employees, especially those of long service, sometimes finds its way into law, or - at least - sparks demands that laws be enacted to enforce the concept. Thus, publicized plant closings in the 1980s sparked demands for legislation to restrict employer ability to lay off or shut down operations. One result was enactment of a federal law in 1988 requiring employers to give 60 days advance notice to employees of impending plant closings or mass layoffs. And, as will be discussed later in this textbook, even where laws are silent, courts have increasingly found implicit employer obligations to their workers in the context of "wrongful discharge" suits.

Absent external law, notions of fairness may be codified in the workplace. In cases where collective bargaining with unions is practiced, labor-management contracts often express social norms in the form of formal rules regarding layoffs, discipline, promotions, and other workplace phenomena. "Progressive" nonunion employers may specify norms of their own behavior in documents such as employee handbooks and personnel manuals.

II. The Concept of Organization.

It would be easy enough to go on citing contrasts between the labor market and financial/commodity markets. Yet, as was noted at the outset, economic analysis in the past often began with the latter type of market as the basic model for the former. For that very reason, traditional textbooks dealing with human resource management frequently discarded the economic approach entirely (or relegated it to a few isolated chapters). Textbook writers have commonly approached the subject from the legal, historical, behavioral, or simply descriptive viewpoints we have already cited, because those perspectives seemed more realistic.

Unfortunately, neglect of economics in human resource management often carries the unfortunate implication that good practice simply results from learning the "folk wisdom" of the trade, and that rigor or quantification are unlikely to improve on existing folkways of management. Human resource management, if such a view were accepted, takes on the aura of a traditional craft - such as blacksmithing - which can only be learned on the job and which is passed with little innovation from generation to generation. But that is not the view embodied within this text in the chapters to come. The economic approach - when combined with the others - emphasizes that human resource management is no different from other functional fields of management. Its effectiveness can be judged in terms of contribution to employer performance. And it can be (should be) subject to analysis and criticism.

i. Beginning at the Beginning.

The simple economic model of the firm found in microeconomic textbooks is really misnamed. It really is a theory of a plant which has a capital stock fixed in the short run. Given the fixed capital stock, average and marginal cost curves can be drawn and profit-maximizing behavior can be predicted. Students will recognize such conclusions as "marginal revenue = marginal cost" from the plant model.

A firm, however, can be more than a single plant. Multiplant firms, for example, are not at all uncommon. More importantly, the word "firm" in ordinary usage implies an organization, not just a production decision.[7] But in the simple theory of the firm (plant), there is no explicit organization, just a clever mixing of factors of production.

It is impossible to say, for example, whether capital hires labor or labor hires capital in the simple model. All that is known is that labor and capital somehow join together. Yet examples of groups of workers combining to hire factories are rare. The norm is for the owners of capital (or their management agents) to hire workers.

Moreover, the workers involved do not turn over on a daily basis. Definite authority patterns exist - employees take orders from supervisors - and the same employees, supervisors, and authority structures tend to remain in place at the firm for extended periods of time. During these periods, a quality of relationship (good or bad) develops between employees and supervisors and influences the effectiveness and profitability of the firm.

The study of such human relationships has traditionally been the province of specialists in organizational design and development. But if the analysis is really to begin from the beginning, fundamental questions must be asked as to why organizations form in the first place. Why don't the owners of capital and the owners of labor (workers) meet on a daily basis in some flexible marketplace and decide - given that day's product prices - on mutually agreeable terms specifying what to produce, what should be the rental price of capital, and what should be the day's wage for labor?

Were such a flexible market actually to exist, there would be no organizations called firms. Indeed, it is unlikely that there would be any supervisors, since mutually-agreeable tasks would have been determined in the market at the beginning of the day. Questions of motivation would not exist. No one would worry about promotion ladders, since every day a new deal would be cut in the marketplace. And unemployment would not be a concern, since anyone willing to supply labor at the going market wage would be hired.

Of course, such a flexible marketplace does not exist. Yet, some limited labor markets approximate certain of its features.

Consider, for example, the construction industry. Workers in construction often move from site to site as jobs are completed. Employees and the contractors or subcontractors who hire them do not have long-term relationships and do not form organizations in the usual sense of that word. In fact the line between employer and employee is sometimes blurred; skilled workers may sometimes act as contractors and may at other times work for someone else. Workers often own their own tools (capital).

Similarly, in some cities, taxi drivers may rent the cabs they drive. In those situations labor is hiring capital rather than the (more common) other way around. Independent truck drivers may also have such arrangements. Readers can certainly find other such examples of labor combining with capital without the formation of formal organizations. The key point is that these types of arrangements are the <u>exceptions</u> in the labor market, not the usual practice. And it is primarily with those standard practices, rather than the occasional exceptions, that this textbook will deal.

ii. Why Capital Usually Hires Labor.

Economics often explains phenomena and choices in terms of relative costs. If it is rare for labor to hire capital, but common for capital to hire labor, the economic explanation requires examination of the comparative costs of the two systems.

Comparative costs, in turn, depend partly on consumer demand and partly on the technical characteristics of production.

Up to this point, the word "capital" has been used loosely. If capital is taken to mean plant and equipment, then it has only limited uses in production. For example, automobile factories are designed to produce automobiles, not other products. At some expense - as during World War II - they can be converted to produce aircraft or military vehicles. Converting them to produce shoes or soap, however, would entail scrapping most of the existing equipment and installing completely different machinery, all at heavy cost.

Thus, the notion of capital meeting labor in some phantom marketplace and deciding what to produce is unrealistic. Capital in the sense of financial capital is fungible between uses. But once "formed" into plant and equipment, physical capital often has quite specific uses. It has what economists call "putty-clay" characteristics, i.e., capital formation decisions are usually not reversible. Often, the decisions involve not only what to produce, but also the scale of production. The underlying production functions may well contain economies of scale so that - within a range - larger producers experience lower costs and have competitive advantages over smaller producers.

Such considerations mean that plants - often of considerable size - will be found in the marketplace at fixed locations producing similar or identical output from day to day. In principle, even with large, fixed plants, workers could hire capital. Yet if there are any costs at all in dealmaking, it will be much cheaper for the operator of a plant to hire 50, 100, or 1,000 workers rather than for groups of workers to coalesce and agree among themselves to hire a plant. Indeed, the notion of workers hiring capital facilities is generally not economically feasible.

iii. Why Organizations Form.

Although the nature of capital equipment explains why capital hires labor, it does not explain why organizations form. The term "organization" implies continuity. Why are the <u>same</u> workers employed day after day? In theory, hiring could be done on a daily basis. Workers would then be employed by firms two days in a row only by sheer coincidence.

The unusual nature of such a daily selection suggests that there are costs to rapid workforce turnover. Firms find it advantageous (cheaper) to retain workers over long periods than constantly to find new ones. Workers find it to their advantage to remain with a firm rather than to seek new employment on a daily basis.

From the viewpoint of the firm, various costs of turnover can be suggested. All workers, even in a particular occupation, are not identical. Some workers are more capable than others. Some can work cooperatively in teams; others have trouble getting along with fellow employees. Some can work without policing by (costly) supervisors; others need constant monitoring and direction. Some are trustworthy; others may be prone to steal company property. Screening workers to determine their talents and propensities can be a costly activity, involving interviewing, testing, etc.

But before screening can even occur, a pool of potential workers must be found. In the absence of perfect knowledge and zero costs of mobility in the labor market, firms may have trouble obtaining a pool of workers to be screened in the first place. Advertising may be needed to attract such a pool. Recruiting offices may need to be established or recruitment officers sent to distant locations. Employment agencies or "headhunters" may have to be hired.

Sometimes the market may not supply workers who have the special skills needed by a firm. In such cases, expenditures on training will be required. Training may be needed over an extended period and experienced workers may have to be diverted from regular production to provide the training to novices. When added together, recruitment, screening, and training costs can be expensive propositions for the firm and provide an incentive to hold down employee turnover.

From the worker perspective, there may also be turnover costs. Workplaces differ in conditions offered. Some employers offer pleasant surroundings and amiable fellow employees; others do not. Some provide training that might be useful in future employment at other workplaces; others simply use workers' existing skills. Some offer steady employment while others may be subject to seasonal or cyclical swings in demand. Finding a suitable job may involve the worker in a prolonged search which can be costly, particularly if the search involves a spell of unemployment during which no wage income is received.[8]

The incentives for firms and workers to stick together and avoid turnover give rise to the formation of organizations. Firm investment in workers in the sense of recruiting, screening, and training costs means that the successful firm will have a value beyond the price its capital equipment could fetch in the marketplace. The firm has a pool of "human capital" on which it may draw. If the firm is to be viable, the flow of value from this human form of capital must reflect the firm's investment in its workforce.

On the other hand, absent perfect information, the firm may from time to time hire poor quality workers who can only be sorted out through monitoring by supervisors. In addition, the mere hiring of someone - even if he or she is highly skilled and potentially productive - does not guarantee actual performance of job duties. Supervisors will be needed to ensure that the firm receives an appropriate return from its human capital pool. Authority relationships, combined with rewards and penalties, must be created. These relationships, rewards, and penalties are important aspects of the culture of most organizations.

Workers will typically feel they have an investment or "stake" in their jobs. Taking a new position is an either/or decision; a worker accepts a job offer or rejects it. A decision to accept may involve sacrificing other employment opportunities. Workers will have expectations concerning the treatment they will receive from their employers once hired. These expectations may or may not be met. When they are not met, employee relations problems are likely to occur, perhaps adversely affecting productivity.

Since expectations may be disappointed, workers may want to have agents to represent them. They may seek unionization or be receptive to appeals from union organizers. In such cases, the internal union political process establishes union demands which in turn influence the firm's human resource policies. Or workers may find other ways to pressure the firm to provide what is perceived to be fair treatment. That is, rather than "exit" (quit) their jobs, employees may find ways - possibly costly to the firm - to "voice" their discontent.

The kinds of firm and worker considerations outlined above give rise to both the existence of organizations and to the inherent organizational problems which ensue. Thus, the study of human resource management is closely tied to the study of organizational forms and to the analysis of solutions to organizational problems in the context of the employer-employee relationship. Since such forms and problems have economic roots, studying human resource management without reference to its economic underpinnings at best produces an incomplete picture. At worst it leads to an ad hoc approach ill equipped to cope with a changing environment.

iv. The Contingent Worker Example

One way in which firms sought to reduce commitment to employees and obtain more managerial flexibility since the early 1980s was the increased use of "contingent" workers (part timers, temporaries, etc.). In such cases, employers - whether consciously or not - made a trade off. Because of their temporary nature and limited attachment to the firm, it does not pay for employers to make substantial investment in contingent workers. Thus, there can be a loss of skills and loyalty to the firm.

The point is not that it is "wrong" for firms to rely on contingent employees. Indeed, for some firms that may be the optimal approach. Rather, the key issue is to recognize and weigh the costs and benefits before embarking on such a human resource strategy. We want to consider the trade offs, not just follow the herd or rely on past practice.

v. Stockholders and Stakeholders.

In the simple economic model, employees are paid the going wage for their worktime. The transaction is viewed as "arms length," giving the worker no particular claim on the employer other than the agreed-upon wage for each hour worked. Indeed, the only persons with any equity in the firm are the official owners. For most firms of significant size, these owners are likely to be outside shareholders.

It is the shareholders, or - more likely - their designated agents, who are viewed as the appropriate parties to make such decisions as the product mix, the technology of production to be employed, marketing strategy (including pricing), and plant location. Yet claims are often put forward by business critics that there are other "stakeholders" in the firm who should have rights akin to shareholders. Such claims are made on behalf of communities in which production facilities are located, on behalf of consumers of the firm's output, or on behalf of other businesses which may be affected by the firm's purchasing or supply decisions. Most important for our purposes, such claims are often made on behalf of the firm's workforce.

Economists have traditionally recognized certain grounds for government intervention on behalf of parties affected by firm decisions who are not themselves stockholders in the firm. The most obvious examples are instances of air or water pollution, i.e., situations in which the firm inflicts costs on area residents by treating the local atmosphere or river as if it were a free good. Certain kinds of zoning rules might also fall under the justification supplied by the theory of property rights and externalities. What I build on my land may affect the value of your property.

In general, however, economists have traditionally not been receptive to wider notions of the "social responsibility of business." They have tended to remain loyal to Adam Smith's dictum that the "invisible hand" of the marketplace would be sufficient to guide businesses devoted to maximizing the wealth of their shareholders.[9] Such wealth maximization, in the standard economic model, is seen as ultimately benefiting society at large. Given this approach, employees, like other suppliers and consumers, have no particular claim on the firm; they are free to take their business elsewhere (quit) if they become disenchanted with the pay or working conditions offered.

Despite these traditional economic views, the labor market is heavily regulated suggesting a societal rejection through the political mechanism of the simple free-market approach. Certain kinds of transactions are prohibited, e.g., slavery, employment of prostitutes, paying less than the minimum wage, or hiring child or teenage workers below specified ages in many occupations. Elaborate legal frameworks regulate the relations between unions, employers, and workers. Special rules apply to the operation of certain employee benefits such as pension plans and health insurance. In some cases, employers are required to provide certain benefits such as workers' compensation for employees who are injured on the job or suffer job-related illnesses.

A virtual grab-bag of justifications for such regulations is offered. Some, like the bans on prostitution or slavery, are ultimately grounded in concepts of morality. There is, however, a common theme that runs through many of the arguments. Lawmakers, and their political constituencies, believe that employers have some obligation to their workers apart from paying the agreed-upon wage. They also believe that employers will tend to "chisel" on this obligation if not regulated.

Put another way, there is a general social view that employees <u>are</u> stakeholders in their firms, but that firms are reluctant to acknowledge their stakeholder rights. This view is not unique to the American labor market. Most industrialized countries devote considerable regulatory effort to defining employer obligations in the employer-employee relationship.

Subsequent chapters will explore the notion of the employee as a stakeholder more fully, including observations on differing international perspectives concerning this notion. However, it is evident that most employees think they have some stake in their jobs, a stake which typically increases with their length of service. The nature of that stake is most often not spelled out in contractual form, and indeed, it might be difficult to write such a contract. To do so would require specifying how the employer and employee would behave towards each other in any foreseeable circumstance (and even in unforeseeable situations!). Thus, instead of an explicit agreement, there is an <u>implicit contract</u> - sometimes ill defined - surrounding the employment relationship.

The fact that employees are stakeholders does not mean that every legislative proposal that is made to protect an alleged stakeholder interest is optimal and appropriate. But the stakeholder relationship does explain why such proposals are so often made. And, from the viewpoint of human resource management, acknowledging the stakeholder concept helps explain the complexity of the employer-employee attachment. It is key to understanding why there is such a attachment in the first place.

vi. Motivation.

The fact that employees are stakeholders in the firm means that the economic fortunes (or misfortunes) of the firm will have an important influence on the economic condition of its employees. In the worst case, if the firm fails and ceases operation, whatever stake the employees had is wiped out. But the fact that there is a connection between the economic condition of the firm and its employees does not necessarily mean that the employees will thereby be motivated automatically to act in the firm's interest, i.e., to act so as to maximize profits.

Employees (and professional managers) are the firm's agents. They are hired to achieve the firm's objectives. But it costs something to monitor their performance and monitoring is imperfect. Given the limits of monitoring, employees may undertake actions which are not in the best interests of the firm. Such actions may range from inconsequential occasional "goofing off" to theft and embezzlement.

A longstanding goal of human resource policy has been to design systems which "motivate" employees, that is, which induce them to identify the firm's interest with their own and to work accordingly. If such motivation can be achieved, the firm can cut back on costly detailed monitoring, confident that appropriate employee performance will be forthcoming.

One possibility is to create automatic or discretionary compensation systems, which provide tangible rewards for improved performance. As will be seen in a subsequent chapter, designing such systems without inadvertently creating perverse incentives is more difficult than it may first appear. Motivation can also be achieved (sometimes) through such devices as supervisory training or developing appropriate group norms through employee involvement teams and similar techniques. The objective is always the same, whatever tool is employed: making the goals of the agent (employee) coincident with those of the principal (firm or shareholders).[10]

III. The Complexity of the Employment Contract.

As already noted, one of the difficulties in defining the employer-employee relationship is the lack of employee homogeneity. Unlike bushels of wheat or tons of steel, workers are not easily standardized. Their productivities, skills, and attitudes vary. Some employees may be self-motivated problem solvers; others may shirk responsibility if not carefully monitored.

i. The Evaluation of Employees

The employee evaluation problem produces costs of turnover, since every employee who must be replaced "inflicts" on the firm the need to evaluate his/her successor. And even on the job, the question of employee output measurement is complicated. Firms may have difficulty sorting out good from bad performers.

In professional and managerial occupations, for example, employees do not turn out a simple standardized output that can be readily totaled. Is a scientist or engineer who is unable to solve an assigned problem necessarily a poor performer? Before such a question can be assessed, it is necessary to know something of the complexity of the problem and the facilities made available to seek its solution. Is a manager of a money-losing facility necessarily at fault? Surely, general economic conditions must be considered, or else one would erroneously penalize managers during general business recessions for circumstances beyond their control. Under some economic environments, a good manager may simply lose <u>less</u> money than a poor one.

Even production workers who turn out standardized (countable) products pose evaluation problems. Workers often are employed in <u>teams</u>. Although today the word "team" brings to mind fashionable ideas such as employee involvement groups, the idea of team production is much more ordinary. In a work team one employee's output is dependent on that of the others. Thus, a poor worker within a team can reduce the output of his/her teammates. But team problems may also stem from equipment unreliability, incompetent supervision, or perverse incentive systems. Again, interpreting worker output turns out to be a complex matter, even when that output can be easily measured.

The measurement and interpretation problem is a reflection of the absence of perfect information in real world firms. The problem requires the firm to devote resources to its solution. Someone has to undertake the design and operation of systems of employee screening and evaluation. Often the measurement and interpretation problem leads to a preference for filling vacancies and promotional opportunities from within the firm (a career ladder). It may be easier to evaluate employee potential among existing firm employees than among outsiders, since the firm has already had experience with the former group.

ii. Adjudication and Voice

Once firms adopt the policy of internal advancement and long-term relationships with their employees, the stakeholder attribute of employees is established. Employees at the time of hiring are accepting more than just a current job and wage; they are also tying their futures to the firm. They assume that satisfactory performance will be defined and recognized, and that superior performance will be appropriately rewarded. They assume that minor and isolated mistakes will not result in disproportionate penalties.

But since employee evaluation is complex, uncertain, and subjective, employees will not always agree with the opinions of their evaluators. They may believe that their employer has unfairly abused the implicit understanding established at the time of hiring. Thus, some form of adjudication between these conflicting perceptions may be necessary for the overall employment system to operate successfully. That is, a means may be needed whereby employees can "voice" complaints about their evaluation or other workplace concerns.

iii. Dealing with Uncertainty

Apart from the question of individual evaluation, a complex exchange of future, as well as current, value is involved in the employment relationship. And the difficulty with a future exchange of value is that no one can foresee the future with certainty. External circumstances may result in internal changes within the firm that frustrate even recognized superior performers.

It is likely, for example, that if the firm in the future finds itself in a precarious financial situation - because of a general economic downturn, a shift in consumer tastes, a modification in government regulation, a more efficient competitor, a change in exchange rates, or a rise in material costs - worker expectations will be disappointed. Promotional opportunities may dry up. Layoffs may be threatened.

Exactly what is the employer obligation in these circumstances? As already noted, it is just not possible to specify all such contingencies and build them into the usually unwritten implicit employer-employee understanding. The future is uncertain and there is an inevitable element of risk which is likely to be shared between employer and employee. Exactly how that risk ends up being distributed - a decision which, as a formal matter, is typically in the hands of the employer - can affect the general quality of the employer-employee relationship. Even in the case of firms with written union contracts, there are often disputes about contractual interpretations and obligations.

The complexity of the employer-employee relationship is inevitable given the complexity and unpredictability of the real world economic environment. Within the firm, someone must undertake to deal with the inherent problems of the human resource management function: recruitment, screening, training, evaluation, discipline, compensation, and rewards, as well as routine record keeping. Someone must pass judgment on the claims of the employee/stakeholders.

iv. Conflicts Within Management

Of course, the "someone" does not necessarily have to be the elaborate human resource bureaucracy that often comes to mind when we hear the phrase "Personnel Department". According to one survey, expenditures on the formal human resource department run about 1% of total operating costs in a typical firm.[11] In very small firms, there may not be enough employees to justify creation of a separate human resource management department. But there will be a human resource management <u>function</u> to be performed, whether or not there is a formal department to carry it out. The existence of the function is independent of its place on the organization chart. What the place on the organization chart influences is the effectiveness of the function's performance.

Larger firms typically find that there are sufficient economies of scale in specialization to justify a separate human resource management department. But the creation of a separate department poses its own problems. A tension necessarily arises between line managers, who actually use most of the firm's human resources, and staff human resource managers who may control and design the systems through which those resources are obtained, evaluated, compensated and rewarded, and sometimes removed.[12] Human resource managers are more prone to emphasize the claims of employees/stakeholders than are line managers facing immediate production deadlines. A critical decision for top management, therefore, is the relative authority to be exercised by the two groups.

IV. The External Constraint.

In considering the appropriate balance between the human resource manager and the line manager, top management is likely to be influenced in part by factors external to the firm. If the human resource area is perceived to be a potential problem, top management is more likely to place the function in the hands of professionals, than if the area is quiescent. An important factor historically in persuading top management that the human resource area was a source of potential trouble was the perceived external threat of unionization. During periods when unions were growing rapidly, such as the 1930s and 1940s, human resource professionals tended to gain authority relative to line managers.

A second source of potential external difficulty in the human resource area has been government regulation. Such regulation has come in two main spurts. During the Great Depression of the 1930s, part of President Roosevelt's "New Deal" legislative program involved the expansion of social insurance programs such as unemployment compensation. Laws dealing with union rights were enacted. And various forms of protective regulation, such as a federal minimum wage, were adopted. Federal action, in turn, was imitated at the state level. This expansion of government regulation required expertise at the firm level to interpret the new rules and evaluate their implications for the firm's human resource policies.

There was also a spurt of regulatory expansion beginning in the mid 1960s and extending until the late 1970s. The nation's racial problems triggered the enactment of a number of civil rights statutes including laws and regulations covering equal employment opportunity (EEO) at the workplace. At the same time, rising female participation in the workforce drew EEO regulation into sex-related issues. New regulations during this period also covered such areas as occupational safety and health standards and the provision by employers of fringe benefits for employees, such as pensions and health insurance. Concern about inflation in the 1970s led to episodes of federal wage controls and guidelines.

The 1980s - years of political conservatism - are generally also viewed as a period of quiescence in the regulation of the labor market, although this view is exaggerated. For example, immigration controls aimed at employers, legal requirements for advance notice of plant closings, and complicated tax laws regulating employee benefits were adopted in this period. In any event, with the 1990s have come new demands for government regulation.

During the 1992 presidential election campaign, President Clinton or his advisors suggested such employer mandates as required training expenditures, required provision of health insurance, and mandated family leave entitlements. Although at this writing, the outcomes of these suggestions cannot be known, collectively they suggest an increase level of government intervention in the workplace.

i. The Human Resource Manager as a Police Officer.

While external challenges to the firm (such as unionization or expanding government regulation) historically created a demand for the services of human resource professionals, these challenges also made the position of the human resource manager more difficult. Human resource managers could easily be seen as naysayers and police officers rather than as positive contributors to the firm's performance. But when internal human resource challenges lead top management to strengthen its human resource function, managers of that function are more likely to be viewed as integral parts of the firm's overall strategy.

There is no simple solution to this external/internal dilemma. However, it is often the case that internal human resource policies designed to recognize the employee as a stakeholder will also help cope with the regulatory environment. For example, an employee discharged for improper conduct will frequently be disqualified for receiving unemployment compensation. The employer, which funds the unemployment compensation account from which such benefits are claimed, may wish to challenge any claims the discharged employee might make for unemployment insurance in order to hold down firm labor costs. An employer which has a system of due process, i.e., a system which carefully reviews the evidence and metes out appropriate penalties, is more likely to prevail in blocking payments than one which fires employees at a whim.

Despite such examples, it is a mistake for human resource managers to see their main roles as police officers. The external forces which have in the past led to an upgrading of the human resource management function - union growth and regulatory expansion - have experienced periods of ebbs and flows. Clearly, human resource managers cannot always assume that the tide will bring them increased status.

What kind of human resource departments are best positioned to play an important role regardless of the tide? Those human resource departments which become part of their firm's strategic planning mechanism and integrate human resource policy into the firm's overall objectives are likely to retain their status and authority. They can adapt to the external environment. But those human resource departments which primarily function as police will lose ground whenever the regulatory tide ebbs.

ii. Stakeholders and the Political Process.

Even in conservative periods such as the 1980s, the labor market is still left with a heavy overlay of government intervention from the past. Of course, other markets are also subject to regulation. Even the highly flexible financial and commodity markets are constrained by complex rules and procedures involving disclosure requirements, insider trading, and the like. Nevertheless, it is legitimate to ask why there is so much focus on the labor market.

The stakeholder approach has already been mentioned as a key element in fostering regulation. Employees do have a stake in their jobs, but the mutual obligations of employers and employees are not clearly specified and inevitably give rise to frictions. Since there are more employees than employers, politicians in democratic countries will devote more effort to specifying employee rights than employer rights. This is not a very complicated explanation, but it has the virtue of being true.

iii. Macro Considerations: Social and Economic.

Although simple democracy explains the focus on employees, there are other factors as well. National welfare suffers when social harmony breaks down. Social conflict inevitably is focused on the workplace; it is in the labor market, after all, where most people derive the bulk of their incomes. Thus, for most people the labor market is the most crucial market in which they participate. Quite rationally, they pay close attention to labor-market developments which could affect them adversely.

Employer actions in the labor market will tend to spark debate, controversy, and demand for remedial regulation. Individual employers who pursue their own firm-level objectives may produce the kind of negative externalities toward social harmony that air pollution produces in the atmosphere. Labor laws of the 1930s and EEO laws of the 1960s were designed to calm social tensions which were produced, in part, by the then-existing employer policies and practices.

Just as macro-social considerations have played a part in the regulatory scheme, so, too, have macro-economic considerations. In general, macro-economic policy since the end of World War II has been aimed at reducing the twin evils of inflation and unemployment. Inevitably, the actions of individual firms can have negative externalities on the objectives of low inflation and low unemployment. Wage increases at the firm level may add to inflation, but no automatic mechanism internalizes this cost to society into the firm's profit and loss calculations. Similarly, the multiplier effects of firm hiring and layoff policies on the overall unemployment rate are not normally considered by the firm in its decision making.

Although these issues of macro-economic policy are outside of the scope of this text - since they deal with questions beyond the control or concern of firm-level managers - it is important for managers to understand that such issues exist. As long as human resource decisions have an impact on the general health of the economy and on the social balance, regulatory policies will be proposed and aimed at such decisions. Examples include the wage controls and guidelines of the 1970s (aimed at inflation) and the proposals for plant closing restrictions in the 1980s (aimed at unemployment). Some of these policies may be effective; others may be ineffective or perverse. But they will continue to exist or be debated.

iv. Regulatory Constituencies.

Regulatory programs create constituencies which seek to protect existing government rules and to foster new ones. Provisions in the tax code, for example, which favor employer-provided benefits such as health insurance are supported by consultants and insurance companies who design and provide such benefits. Employers who have already incorporated such benefits into their compensation practices also become part of the constituency.

The growth of unions in the 1930s and 1940s was certainly fostered by the government regulation and policy of that period. Although the rules have not been so favorable to unions since, the establishment of a large labor movement naturally focuses public policy on issues of the labor market. Despite membership losses in the 1980s, unions remain a significant political influence when such workplace issues as pension regulation are debated in Congress.

v. Regulation Fosters Regulation.

Finally, regulation has a tendency to create problems which then call for regulatory solutions. Thus, for example, employer-provided health insurance is heavily subsidized through the tax code, since employer payments for such coverage are not subject to individual income tax. Many employees have employer coverage and, therefore, pay only a fraction of the cost of medical procedures (or nothing at all in some cases). The low marginal cost to the patient, in turn, combined with other aspects of the health care industry, has led to a substantial increase in the quantity and price of medical services. As costs of health care rose, new regulations expanded to encourage "health care cost containment." And proposals arose to provide job-related coverage for workers who did not have health insurance already to protect them from rising medical costs.

It is important that human resource managers develop an appreciation of the political economy of regulation and social policy. Larger employers and employer associations have an interest in the course of regulation in the labor market. An understanding of the costs and benefits of regulation is essential to the development of an employer position with regard to proposed regulatory changes.

The external effects on the social and political atmosphere of human resource decisions taken at the firm level pose a problem for the employer community. Actions of particular firms, taken in their own best interest, e.g., a mass layoff at an unprofitable facility, may run contrary to social norms and create political reactions in the form of regulatory constraints. Individual firms do not internalize these downstream costs to other employers of their human resource policies. Firms may support organizations such as Chambers of Commerce or trade associations to look after their wider interests. But these organizations primarily deal with proposed regulations in the legislative arena; they cannot control the actions of individual firms which may spark the proposals in the first place.

VI. Excessive Legalism.

There are many human resource professionals with legal backgrounds, because of the regulatory framework surrounding the labor market. However, too much concentration on legal aspects of human resource leads to overemphasis on the policing function. Simply staying out of legal trouble is not by itself a human resource strategy.

In terms of training, students with MBA backgrounds or other business degrees in human resource management have a potential advantage over individuals with exclusively legal backgrounds. The law does not provide a firm with an human resource strategy. Such a plan must be a reflection of the firm's general objectives. An overall firm plan involves all the major functional areas within the firm such as marketing, production, and finance. Students from educational programs providing an overview of the various functional areas have an edge in making the human resource function a key element in the firm's strategic plan.

Thus, there are two conclusions to be stressed. Readers of this textbook who are considering or planning human resource careers are well advised to obtain broad training in the various management functions, regardless of the particular degree program they are following. Generalist training is of value for implementing the specifics. On the other hand, generalists should not expect to be able to handle human resource issues purely on the basis of instinct and gut-feel. The labor market for MBAs shifted in the late 1980s as employers became concerned about the value they could expect to receive for the salaries they paid. The old appellation "jack of all trades, master of none" is not a label to wear in the new managerial labor market. Those planning careers in general management or other functional fields still need basic knowledge of the human resource function. That is what this textbook aims to provide. But excessive concentration on legalism is not the answer.

Consider the following circumstances and questions:

*A firm is planning to enter a product market known for its uncertainties and rapid changes. What form of compensation system for employees would be best suited to this new venture?

*A firm finds it has a shortage of labor in a given technical occupation. Should it intensify its recruiting efforts, raise pay levels, or train and promote existing employees into the occupation?

*A firm faces a bargaining demand from a union for an enhancement of its pension plan. Management has determined that the cost of the enhancement, along with the other demands being made, does not exceed the firm's planned labor cost increase. But does the firm have an interest in the composition of the compensation offered to employees, apart from meeting overall cost targets?

While there may be legal aspects involved in these circumstances and questions, the answers cannot be found in law books. In this regard human resource is no different from other functional areas within the firm which are subject to regulation. Marketing, for example, is constrained by regulations regarding truth in advertising. Yet a marketing strategy for the firm cannot be obtained by studying the regulations of the Federal Trade Commission. Nor can a financial plan be based exclusively on the rules of the Securities and Exchange Commission. The law is more likely to provide the "don'ts" rather than the "do's."

V. Are Human Resource Management Policies Efficient?

Human resource management offers guidance to employers concerning the appropriate use of its human resources. Even apart from the regulatory restrictions just discussed, the word "guidance" sometimes implies constraint. There are practices that line managers might follow with regard to their employees which may not be considered good policy by human resource managers.

i. Constraints on Management.

In the simple economic view, constraints of any kind are often associated with inefficiency. Individuals and firms are assumed in economic theory to be rational maximizers; if they are hindered from following their inclinations, suboptimal results are predicted to follow. Thus, for example, international trade theorists condemn quotas on imports as inefficient because quotas prevent profit-maximizing importers from purchasing as much from abroad as their self-interest would otherwise dictate.

Applied within the firm, however, the view that constraints are always inefficient is misleading. Indeed, taken to an extreme, such a belief is contradicted by the existence of firms as productive organizations. Management decision making of any sort is, after all, the imposition of constraints. Someone must establish company policies, goals, and plans, and such policies, goals, and plans are themselves constraints. Firms are systems of authority, budgetary limits and controls, and decisions. Thus, to say that constraints are inherently inefficient is to say that firms are inherently inefficient, clearly an untenable position.

ii. Domestic and Foreign Examples.

Various reasons can be cited to support the proposition that good human resource policies raise efficiency. Perhaps the most significant evidence is empirical; during the 1970s and 1980s various case studies documented that many of the most successful enterprises devote substantial attention and resources to their human resource policies.[12] Indeed, Americans became fascinated with the human resource policies - such as "lifetime" employment and consensus decision making - of large Japanese firms which had so successfully invaded the product markets of the U.S. and other countries. Yet by the 1990s, it became evident that merely emulating someone else's human resource policy was insufficient; many firms which were successes in the 1970s and 1980s fell from grace by the early 1990s. Thus, human resource policy can contribute to corporate success. But it cannot overcome poor marketing, onerous debt loads, or other strategic mistakes.

iii. Management Education and the Search for Efficiency.

Historically, dealing with the "labor problem" -- as it was called in the 19th century -- led to the development of professional management education and to schools of business. Creation of the "scientific management" approach in the early part of the 20ieth century by Frederick W. Taylor and other was in large part focused on human resource problems.[14] Organizations such as the American Management Association had their roots in the search for remedies to the labor problem. Thus, underlying management education is the belief that better ways of managing - through appropriate policies and constraints - can be uncovered or invented, particularly in the human resource area. The founders of management education believed that solving human resource problems was an integral part of the search for efficiency.

VI. Plan of the Text.

In the chapters that follow, many of the themes that have been mentioned above will be explored in more detail. Chapter 2 discusses the connection between the general strategy of the organization and its human resource policy. What does it mean to link strategy with human resource policy? What consequences might be expected? We will then turn to an analysis of the labor force including projected trends in chapter 3. The phrase "workforce diversity" has been much in vogue. But what is it and what trends in diversity can be expected? A more detailed exploration of labor-force concepts appears in chapter 4 along with discussion of job search, labor-force participation, and potential sources of labor supply.

Productivity is often connected with competitiveness and in chapter 5 we will look at this concept at the macro (national), industry, and firm level. We will see that there is a connection between cost and productivity but also that productivity is not the only influence on competitiveness. Nonetheless, living standards and real wages depend importantly on productivity and various suggestions have been made, explored in chapter 5, for improving American productivity performance.

Just as there can be productivity variations between firms, so, too, can there be variations between individuals. Chapters 6 and 7 are based on this simple observation. One possibility - discussed in chapter 6 - is to hire selectively, in order to pick desirable individual productivity characteristics. Firms can improve their attractiveness to employees, and, hence, screen more effectively, by offering favorable working conditions and accommodating employee needs. However, once employees are hired, assessment of their individual productivity and linkage of that assessment to rewards is often accomplished through performance appraisal techniques. Chapter 7 explores the appraisal/reward issue and notes that - for very understandable reasons - firms often have difficulty in individual productivity measurement, an example of what will be more generally termed a "principal/agent" problem.

Chapter 8 introduces the idea of using automatic pay systems (such as piece rates and profit sharing) to stimulate individual and/or group productivity. Principal/agent problems can arise here, too, but even if they do, some pay systems turn out to have desirable characteristics other than just providing work incentives. Certain pay systems can share risk with employees, help stabilize employment, and provide more job security.

If pay is considered in the context of a labor market, then demand and supply influences ought to be pivotal in pay determination. Chapter 9 examines the demand/supply framework. That framework does indeed help in the understanding of pay outcomes. But the labor market exhibits peculiarities of "non-clearing" behavior, i.e., persistent labor shortages and surpluses, an important proviso in the application of simple demand/supply analysis. An approach to determining firm-level pay policy (how much to pay relative to the market average) is also introduced in chapter 9.

Chapter 10 looks at evidence on how firms make pay decisions and on how they divide pay between cash and benefit programs. Benefits, we will see, have become important components of total compensation. Regardless of the mix of cash versus benefits, firms must from time to time update their general pay levels. How they do that is discussed in chapter 11. And the pressures on firms to alter their cash/benefit mixes, due to changes in public policy, are also considered.

Collective bargaining is often viewed as a system of setting pay. It is that, of course, but there is much more to union-management relationships. Chapters 12 and 13 are devoted to understanding those relationships. Especially during the 1980s, union membership in the private sector declined. What were the reasons? And are there general lessons to be learned from that decline? Lessons for management?

Traditionally, collective bargaining has been seen as an adversarial relationship. And even in the absence of unions, there are conflicts and potential conflicts between employers and employees. But there are also examples of cooperation which we explore in chapter 14. Where employees have job-related complaints, channels to "voice" them are often created, some more effective than others. The exercise of individual employee voice, either through internal firm channels, or through external forums such as the court system, is also explored in that chapter.

The concept of investment in employees, mentioned at the outset of this introductory chapter, is the topic of chapter 15. Firms may invest in employees, or employees may invest in themselves. Whoever does it, there should be some economic return - and there is. But the recovery of that return can depend on the length of the employment attachment. Hence, the connection between employment stability and investment in "human capital" is also discussed.

Government intervention in the labor market has already been referenced as an important constraint on human resource management. Chapters 16 and 17 explore some of the key areas of regulation including minimum standards (such as payment of minimum wages and overtime premiums), social insurance (such as Social Security), limiting labor supply by controlling hiring of immigrants, and - a program that has had a profound impact on the human resource management function - equal employment opportunity. Proposals for mandating the provision of certain benefits are also discussed.

By the 1990s, references to "globalization" of markets had become commonplace in business. Human resource management has expanded to have an international dimension. Contrasts between American and foreign human resource practices are one aspect of the international element. But it is also the case that world labor markets are becoming linked, partly via immigration flows, but - more importantly - through product-market competition. Chapter 18 points to both the comparative and integrative side of human resources.

Finally, in chapter 19, we look ahead. What changes in human resource management can be expected in the future? How can we go about answering that question in the short and long runs? What resources for forecasting are available?

VII. Lessons from Chapter One.

The themes set forward in this introductory chapter will reappear throughout the subsequent text. Seven points, however, are important to stress from the outset:

1. An economic approach to human resource management can provide an insight into, and an understanding of, the human

resource field which is often lacking in traditional human resource management textbooks. Nevertheless, it is important to recognize that the labor market differs dramatically from the abstract perfect markets of elementary economics courses and even from real-world flexible financial and commodity markets. Wages are set infrequently, employees are not homogeneous commodities, measurement and information are imperfect, and the costs of employee turnover can be high. Thus, where appropriate, the economic approach will be combined with descriptive, legal, behavioral, and institutional analysis in the chapters that follow.

2. Deviations of the real world labor market from the abstract perfect market explain the formation of organizations (including firms) and give rise to the organizational problems so often studied in business and management schools. Among these are creating incentives to that employees and hired professional managers "do the right thing."

3. Employee turnover costs contribute to indefinite and often long-term employer-employee relationships. The employment contract is not a simply exchange of today's labor for today's wage. Rather, it is a complex -- and often imprecise - implicit agreement whose terms can easily be misinterpreted by either side. In some cases, employees may seek unions to act as their

agents in defending perceived rights under these agreements. In other cases, employers create their own internal voice systems.

4. Employees are stakeholders in their firms. This concept has crucial implications for human resource policy formulation. The fact that employees are stakeholders in the firm does not mean, however, that employees will see their interests as identical to those of the firm. Thus, supervision, compensation systems, or other behavior regulating or motivating devices are often necessary to bring the interests of the firm and employee closer together.

5. The view that employees are stakeholders, and the importance of that stake to the income security of much of the population, has given rise to substantial governmental regulation of the labor market. Also important in explaining the growth of labor market regulation throughout the industrialized world is the potential that individual employers can inflict negative externalities on social harmony. Once in place, labor-market regulation tends to foster further regulation as regulatory problems require regulatory solutions.

6. Historically, human resource management has been elevated in importance within firms by external threats, such as the growth of unions in the 1930s and 1940s or the expansion of government regulation of the labor market in the 1960s and 1970s.

It is unwise, however, for human resource managers to view their role primarily as a police agent, just enforcing government rules which keep the firm out of trouble. Human resource management should be an integral part of firm policy and planning.

7. There is an inevitable tension between human resource professionals and line managers. Although line managers are agents of the firm's shareholders, their self interests and the interests of the shareholders do not always coincide. Human resource policies and constraints can be viewed as devices to prevent this discrepancy of interests from reducing firm efficiency.

EXERCISE FOR THE STUDENT

Below are two edited and modified articles which appeared on the business pages of a major daily newspaper. Consider the actions of the two firms (whose names have been changed) described in the articles. Evaluate the human resource decisions made by Cargo-Aire and Defense-Electronix. Are their actions appropriate, given the reported circumstances? What impact might the actions have on employee productivity, retention, and recruitment?

CARGO-AIRE CUTS PAY, TRIMS WORKFORCE

Cargo-Aire said Tuesday that 2,600 of its non-union employees will take pay cuts of up to 15% to save money for the financially troubled air cargo carrier.

The company also said about 80 middle managers, 8% of the managerial work force, were laid off Tuesday as the company moved to eliminate a total of 124 positions.

A spokesman for Cargo-Aire declined to say how much the airline would save as a result of the salary and staff cuts in the administrative, clerical and executive ranks, which follow agreement by Cargo-Aire's unionized workers to accept sizable wage and benefit reductions.

Its 650 pilots have agreed to 25% wage cuts and its 2,000 machinists, a group that includes those who repair and load the cargo planes are taking 15% wage reductions. The cuts announced Tuesday will range from 5% for lower-paid workers to 15% for the highest paid, including Robert M. Lion, chairman and chief executive of Cargo-Aire.

Bid to Trim Losses

Lion called the wage reductions a "crucial first step" in returning the company to profitability. He said Cargo-Aire will now concentrate on restructuring about $300 million of its $525 million long-term debt and on improving its service.

Lion said previously that Cargo-Aire would be forced to close unless the massive wage and benefit concessions were obtained by the end of the year.

The cost-saving measures are part of an effort to trim losses at Cargo-Aire, which has lost an average of $74,600 per day over the last five years. Last year it lost $44.2 million on revenue of $1.1 billion.

Besides the salary cuts, Cargo-Aire said it will no longer supply company cars for most management employees. Also, the length of non-union workers' vacations is being reduced 20%.

DEFENSE-ELECTRONIX CORP. IMPOSES 60-HOUR WORKWEEK ON ITS SALARIED STAFF

Defense-Electronix recently told its professional and other fixed-salary employees that they will be working 60-hour, six-day weeks during December. Yet company employees say that it is large-scale layoffs that have left the firm short-handed.

The company is more than a month behind schedule on some of its Pentagon contracts and is attempting to catch up during the holidays, according to an official at the Defense Contract Administration Service, a branch of the Defense Department.

But not all of the Defense-Electronix employees think that working 20 extra hours a week without pay is how they want to demonstrate the holiday spirit.

"The 20-hour overtime policy makes me feel really badly," one Defense-Electronix engineer said. "It's supposed to be the holidays, and people want to spend some time with their family and shopping for Christmas gifts."

Another worker added that "I usually work overtime, but that's voluntary. With all these extra hours without pay, some of the hourly-paid people are making more money per hour than I do."

Executives at the company could not be reached for comment Thursday. A secretary to company Vice President John Ellis said the entire executive staff had left for a meeting. "They may be here tomorrow, but I'm not sure. There are conflicting rumors," she said.

An internal Defense-Electronix memo tells workers: "For the month of December, regular work schedules for manufacturing personnel will be 6:30 a.m. to 5 p.m. [10 hours] Monday through Saturday. This will be necessary to finish the year with a strong shipment month and to make a strong start for January-February-March shipments."

The Defense-Electronix Corp. does overhaul and service work for all three military services and holds contracts worth $2.9 million, according to the Defense Contract Administration Service. The firm also makes frequency synthesizers, which are used to test military electronics gear.

Earlier this year, Ace Aircraft announced to its employees that they were expected to work five hours of unpaid overtime a week. That policy provoked such an outpouring of indignation that the company quickly canceled it.

"Nobody is fighting it here," the Defense-Electronix engineer said. "We are just afraid to lose our jobs. People get fired here at the drop of a hat. And with the ongoing downsizing of our industry, what choice do we have? It's overtime or the unemployment line."

FOOTNOTES

1. Ross notes that "if labor markets behaved like financial markets, the theories of finance would be used to study them." The fact that different approaches are taken in the modern study of these markets represents recognition of the differences in institutional structure between them. The quote is from Stephen A. Ross, "The Interrelations of Finance and Economics: Theoretical Perspectives," American Economic Review, vol. 77 (May 1987), p. 29.

2. Sellers of certain consumer oriented financial assets, e.g., mutual funds, insurance policies, do advertise. In the case of such assets, there may well be considerable information costs and, hence, an incentive to advertise. Economies of scale help determine which side -- buyer or seller -- pays for the advertisement. An insurance company hopes to reach many potential clients just as an employer with a vacancy hopes to reach many potential applicants. The cost per client (applicant) is low. Someone in the market to buy an insurance policy is not looking for a large number of offers so that cost considerations explain why such buyers do not place "insurance-wanted" ads. In the labor market, job seekers occasionally do place "situations-wanted" ads. But typically, it is cheaper for job seekers to scan the ads of employers with vacancies, determine which might suit their needs, and then make themselves known to the prospective employers.

3. An oligopsonistic market is one in which relatively few sellers compete.

4. Evidence that price generally exceed marginal cost can be found in Robert E. Hall, "Market Structure and Macroeconomic Fluctuations," Brookings Papers on Economic Activity (2:1986), pp. 285-338.

5. The phenomenon of "no-help wanted" is analyzed in Arthur M. Okun, Prices & Quantities: A Macroeconomic Analysis (Washington: Brookings Institution, 1981), pp. 59-61.

6. The term "layoff" is generally applied to a circumstance in which a worker or workers are terminated for "economic reasons" such as a decline in demand for the firm's products. An employee is laid off, not because of incompetence, poor performance, or misconduct, but because his/her services are not needed. Layoffs may be temporary, i.e., the worker may expect to be recalled to the firm when demand picks up. In contrast, a "discharge" (or "firing") usually refers to a termination based on individual incompetence, poor performance, or misconduct.

7. Many analysts have contributed to the analysis of the formation of the firm as an economic entity. Prominent names in the field include Ronald E. Coase, Oliver E. Williamson, and Alfred Chandler.

For a brief review, see Alfred E. Chandler, "Organizational Capabilities and the Economic History of the Industrial Enterprise," Journal of Economic Perspectives, vol. 6 (Summer 1992), pp. 79-100.

8. Unemployed workers may be eligible for unemployment insurance benefits, depending on their prior work history. Benefits received by those who are eligible are generally substantially below their foregone earnings. Unemployment insurance is discussed in later chapters.

9. Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations (New York: Modern Library, 1937 {1776}), p. 423.

10. John W. Pratt and Richard J. Zeckhauser, eds., Principals and Agents: The Structure of Business (Boston: Harvard Business School Press, 1991).

11. "Human Resources Activities Cost Firms Nearly $700 Per Worker," Daily Labor Report, September 30, 1991, pp. A9-A10.

12. Such conflict is itself a reflection of the deviation of the firm as an organization from the simple economic model of the firm. In theory, all agents of the firm, whether line managers or not, ought to be engaged in the mutual pursuit of the firm's profit-maximizing objective. The difficulty of creating incentives so that all managers work toward this end without conflict is at the root of staff/line tensions.

13. William G. Ouchi, Theory Z: How American Business Can Meet the Japanese Challenge (Reading, Mass.: Addison-Wesley, 1981); Thomas J. Peters and Robert H. Waterman, Jr., In Search of Excellence: Lessons from America's Best Run Companies (New York: Harper & Row, 1982); Fred K. Foulkes, Personnel Policies in Large Nonunion Companies (Englewood Cliffs, N.J.: Prentice-Hall, 1980).

14. Taylor's solution to the labor problem involved "scientific" time-and-motion studies as a special piece-rate system. He is often identified with a movement to "de-skill" factory work (that is, break skilled jobs down into simple operations which could be performed by unskilled workers) so that supervision could be more rigorously enforced.