Research on Employee Selection in Enterprise Human Resources Management System

Xiaomei Shi
School of Business, Tianjin Polytechnic University, Tianjin, P.R., China, 300387
Email: hj2009hy@sohu.com

Abstract: It is difficult to align incentives by contracting on output; aligning preferences via employee selection may provide a useful alternative. This study investigates this idea empirically using personnel and lending data from a financial services organization that implemented a highly decentralized business model. I exploit variation in this organization in whether or not employees are selected via channels that are likely to sort on the alignment of their preferences with organizational objectives. I find that employees selected through such channels are more likely to use decision-making authority in the granting and structuring of consumer loans than those who are not. Conditional on using decision-making authority, their decisions are also less risky ex post. These findings demonstrate employee selection as an important, but understudied, element of organizational control systems.

Keywords: employee selection, decision-making authority, financial outcomes

1. Introduction

Examine the relationship between employee selection and management control outcomes. Theories from the economics, accounting, and organizational behavior literatures predict that when it is difficult to align incentives by contracting on output, aligning preferences via employee selection may provide a useful alternative. First, contribute to the relatively large and multidisciplinary literature on employee selection as a management control mechanism by providing, to my knowledge, the first direct empirical evidence of a link between employee selection and better management control outcomes. In particular, my results provide evidence in support of longstanding management accounting-based models of management control which posit that control in organizations can be obtained by managing “inputs” (e.g. employee selection) rather than “outputs” (e.g. explicit incentive contracting on financial performance). Similarly, the findings in this paper generally lend empirical support to emerging economic theories on preference alignment as a solution to contracting problems.

2. Feature of Employee Selection System

2.1. Difficulty measuring and contracting on Output

The system has two interrelated characteristics that give rise to challenges in measuring and contracting on output: (1) organizational objectives are stated in relatively intangible terms and (2) financial outcomes are expected to occur over relatively long time horizons. Underscoring both of these characteristics, the new system was implemented with an objective of “building relationships founded on trust” with a belief that focusing on building relationships through member advocacy and service would lead to long-term value creation for both the member and the organization. The change towards the system initially came about because the CEO felt that the organization was performing well from a financial standpoint but was failing to provide strong service to members. He viewed a lack of empowerment among employees as the root cause and was concerned about the implications for the organization’s long-term performance. In his words, “…the best way to improve service was to move the decision as close to the member and the transaction as possible. The most effective way to accomplish that was to empower all employees to make decisions on behalf of the member.

It has many features on employee selection. Namely, output is difficult to measure and contract on, alignment of employee and organizational interests is important, and the selection of employees with particular attributes is increasingly relied on as a mechanism to solve the delegation problem.
The system yields an obvious incentive alignment problem: motivating employees both to use decision-making authority in service provision and to do so in a way that leads to better financial performance in the future. Both aspects of this incentive alignment problem can be seen early in the implementation of the new system.

The organization uses a variety of mechanisms to motivate the effective use of decision-making authority, all of which are consistent with practices that prior literature would predict to find in organizations where incentive alignment is important and outcomes are difficult to measure and contract on. Similarly, and most importantly from the perspective of this paper, this organization has increasingly relied on the selection of employees with preferences aligned with its own objectives.

2.3. Employee Selection

Preference alignment via hiring as a solution to agency problems, the employee selection process at this organization mirrors its basic incentive alignment problem of motivating employees to use decision-making authority in member interactions and to do so effectively.[6] In particular, the organization has actively sought to recruit employees with particular attributes that are indicative of underlying preferences for these objectives. In my own interviews with executives and employees, a primary attribute that surfaced as important could best be described as “empathy”. Variously described in terms such as “a desire to help others”, “cares for others”, and “wants to make an impact on others”, this attribute is clearly seen as an indicator for a potential employee’s desire to use decision-making authority on the behalf of members. Perhaps not surprisingly given the high degree of decentralized decision-making authority in the new system, other attributes that are also viewed as important are confidence in decision-making, willingness to take ownership and accept accountability, willingness to take and accept risk, and a desire to learn.

3. Decision-Making Authority in Employee Selection

The net effect of this widespread use of decision-making authority is that the organization is approving many loans that would otherwise be denied by system-rules based on credit scores and debt ratios, as shown in Figure 1. Employees appear to view credit score exceptions as riskier decisions than debt-ratio exceptions as evidenced by the relatively lower 50%-70% loan approval rate for borrowers that do not meet credit score criteria. First, all types of employees appear to utilize decision-making authority relatively extensively. Even old system employees referred by old system employees – the category that is expected to be the most reluctant to use decision-making authority – approve 71% of loans from system-denied applicants and make rate exceptions on 23% of approved loans. Not surprisingly since these employees self selected to remain in the organization, they appear to have “adapted” to the new system. Despite this, employees hired into the system are significantly more likely to use all types of decision-making authority. This is true across all categories of new system employees. These predictable patterns also remain when comparisons are restricted to within new system employees – with those referred by other new system employees showing significantly higher loan exception rates across all exception types. Some of these general patterns remain for corporate and back office employees, particularly the comparisons between old and new system employees, but the results are not as strong in this sample of employees. In particular, there is little distinction in the use of decision making authority across loan exception types for new system employees who are not referred when compared to those who are referred by other new system employees. As noted earlier, it is reasonable to expect employee selection to have stronger effects in this setting among customer-contact employees, but these weaker patterns may also be due to smaller sample sizes of employees or loans within the corporate and back-office employee group.

![Figure 1. Loan Approval and Application Rates by System Rule Status](image)

Loans with credit-score exceptions are more likely to be observed if the employee making the lending decision has had prior lending experience with the borrower on the loan, and they are less likely for larger loans. More importantly, the coefficient estimates show that the predicted patterns in the use of decision-making authority across employee categories remain: new system employees show higher conditional rates of credit-score exceptions than old system employees generally, with the highest rates demonstrated for new system employees referred by other new system employees.

The latter type of employee demonstrates significantly lower charge-off rates than all other employee categories. All other categories of employees demonstrate mean charge-off rates in excess of 2% which are statistically indistinguishable from each other. These patterns generally hold up under multivariate analysis.
Conditional charge-off rates show the same pattern across employee categories. The coefficient estimates demonstrate the lowest conditional charge-off rates for systems referred by new system employees when compared to all other categories followed next by new system non-referred employees. The coefficients for the remaining employee categories are statistically indistinguishable from each other. Employees selected via channels that are likely to sort on the alignment of their preferences with organizational objectives show more effective use of decision-making authority.

4. Conclusions

The link between employee selection and better management control outcomes is a topic that has been the subject of considerable theoretical research across literatures as varied as accounting, economics, and organizational behavior. Yet, it is one for which little if any direct empirical evidence exists. By studying a setting in which there is a basic incentive alignment problem – motivating employees to use decision-making authority and to do so effectively – that is difficult to solve via measuring and contracting on output, I am able to provide direct evidence of this link.

The quantitative and qualitative evidence presented in this paper demonstrate a setting in which employees appear to balance organizational interests in their decisions despite being highly motivated and directed to focus on service provision to customers and in the absence of strong explicit or implicit incentives linked to organizational performance. Employee comments as well as my own interviews and observation suggest that this arises, at least partially, because employees rather explicitly recognize the link between the organization’s performance and their ability to continue to provide service in the future. Thus, while employees may be intrinsically motivated to focus on one task (service provision) at the expense of others (cost control), their beliefs about the impact of ignoring the task for which they are not motivated on their ability to carry out the task for which they are motivated may lead them to at least partially internalize an organization’s performance objectives. Building such beliefs into models of preference alignment as a solution to agency problems may yield novel predictions about the costs and benefits of relying on employee selection as a control system.

The empirical results and qualitative data presented in this paper also suggest a potentially fruitful avenue of future research in the accounting literature. One the one hand, the empirical results show employee selection as a solution to a fundamental accounting problem – the difficulty of defining and measuring output in a particular context. On the other hand, there are ongoing attempts at this field site to measure performance against many of its more intangible objectives. If the performance measure “design problem” can be solved, would we see organizations move away from preference alignment and back towards traditional performance-based incentive alignment. What are the potential consequences if any. Moreover, while not discussed in detail throughout the paper, this organization has increasingly turned towards formal measurement and monitoring of its employee selection model – tracking, for example, employee referral rates and a variety of measures of the motivation of its workforce. Future research may be able to yield insights into the nature of performance measurement in settings where employee selection is important and output is difficult to contract on.

On a final note, a limitation of this study is that while I demonstrate better control outcomes linked to employee selection, I do not investigate the mechanism through which this occurs. In delegated decision environments like the one studied in this paper, employees selected through more aligned channels may simply have better judgment or invest more effort in acquiring local knowledge. Alternatively, such employees may invest more in learning about the organization and the resources available to them in carrying out their work. In this way, some employees may be better than others at allocating an organization’s resources to achieve desired outcomes. The employee focus on the importance of “following up” on decisions, suggest that this is a potentially reasonable interpretation for the results in my research setting. Future research can make progress by investigating the potential mechanisms through which employee selection leads to better management control outcomes.

References