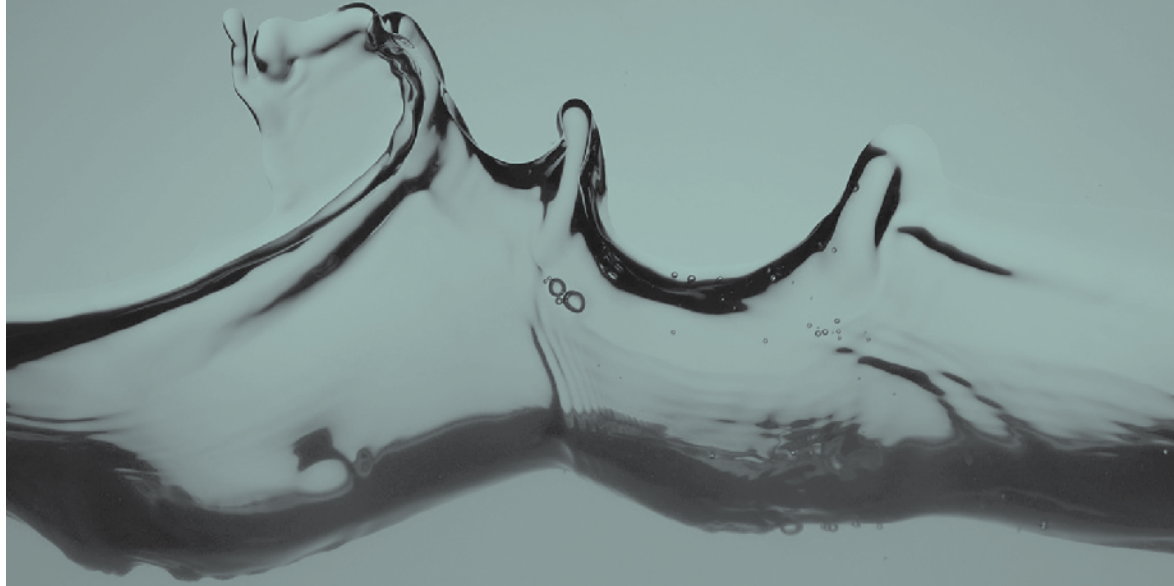


# STRATEGIC HR MANAGEMENT

Student Workbook



**SHRM**

SOCIETY FOR HUMAN  
RESOURCE MANAGEMENT

## Reyes Fitness Centers, Inc.: The Strategic HR Opportunity

*By John Sherlock, Ph.D.*

This case study has been adapted from the original version of the case study found at [www.shrm.org](http://www.shrm.org). The submission instruction is the portion that has been adapted.

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# Reyes Fitness Centers, Inc.: The Strategic HR Opportunity

## Overview

This case describes a growing mid-size U.S. company in the Southeast in the fitness club industry. The recently hired HR director is given the opportunity by the organization's CEO to propose HR initiatives to help the business meet its strategic goals. The case gives students the opportunity to deepen their understanding of strategic HR management.

## Learning Objectives

Students completing this assignment will be able to:

1. Demonstrate basic business acumen in terms of organizational finance, strategy planning and execution.
2. Understand the philosophy behind developing an HR scorecard and its link to strategic human resource management.
3. Understand the process used to develop an HR scorecard.
4. Align HR deliverables with organizational strategy.
5. "Sell" the HR scorecard concept(s) internally.

## Introduction

Lori Patrick's conversation earlier that day with Mike Lowe, the company's CEO, kept running through Lori's head during her 45-minute rush-hour commute home. "What a great opportunity Mike's given me," she thought. "The CEO of this organization believes in the value of HR and asked me to tell him how HR can help the company meet its strategic goals. When I was studying for my master's in HR, we kept reading and talking about how HR needs to position itself as a strategic business partner; but I didn't think I would get the opportunity so soon in my career." Lori had been the director of Human Resources with Reyes Fitness Centers, Inc. (RFC) for only a couple of months. She had been attracted to the position in part because it offered her first opportunity to oversee all of HR, and because of her interview with Mike Lowe. Lowe was fairly new to the company (just less than two years) and was highly regarded by the founder and chairman, John Reyes, and the rest of the board of directors as a strategic thinker and someone with proven ability to inspire and motivate staff. Lori knew from the interview with Lowe that when he said employees were the key to RFC's future, he meant it.

## RFC Background

Reyes Fitness Centers, Inc. was launched in May of 2009 by John Reyes with \$150,000 of his own funding and some investment capital from three college friends from the University of North Carolina, Chapel Hill, where they were business majors attending the university in the mid-2000s. The first center was located in Raleigh, NC, and was an immediate success. The center offered a full range of workout equipment, exercise classes, personal trainers, an outdoor pool, on-site daycare, and even a small restaurant. Additional private investment was secured and RFC expanded rapidly from 2009 to 2012, opening approximately three new centers a year throughout the Southeast. By the end of 2012, RFC operated 28 fitness centers, grossing \$51 million in revenues and \$1 million in net income. Figure 1.0 below provides the financial performance of RFC and its comparison to competitors.

Figure 1.0 – 2007 RFC and regional competitor Financial Performance  
(numbers rounded)

	RFC	O'Malley's Fitness center	Constant Fitness	Muscle Mania	Hard body Gyms	Day Spa
Gross revenue	\$51M	\$25M	\$120M	\$45M	\$35M	\$164M
Total expenses (including taxes, interest, depreciation)	\$50M	\$24.75M	\$119M	\$43.5M	\$34M	\$163M
Net income	\$1M	\$250K	\$1M	\$1.5M	\$1M	\$1M
Employees	900	450	1,100	825	750	2,100
Financial performance trends 2004-2007	Flat annual net income.	Flat annual net income.	Decreased annual net income due to expansion.	5% annual growth in net income.	5% annual growth in net income.	Decreased annual net income due to acquisitions.

### Discussion Question:

1) From the table above, what are three observations about RFC's financial performance relative to their competition?

By 2012, John Reyes had general managers overseeing each center and had gradually removed himself from day-to-day oversight of the company. He had become interested in other business ventures and, as a result, his board encouraged hiring a CEO and other senior management team members to oversee the growing enterprise. He hired 48-year-old Mike Lowe as the new CEO of RFC in late 2012, and Reyes assumed the role of chairman. This CEO position was the second in Lowe's career. He had more than 20 years' experience in the fitness equipment industry; before coming to RFC he had been the CEO of a smaller fitness center company in California that had been acquired. Lowe's transition as CEO had gone quite well in Reyes', the board's and in Lowe's view. Lowe had been somewhat concerned about being micromanaged by Reyes, but he was given complete autonomy over the operations of the company and was expected to involve the board only in strategic leadership issues.

## The Fitness Center Industry

While the fitness center industry grew dramatically in the mid to late 1990s (more than 20 percent annually), overall industry growth had slowed considerably, as most towns now had two to three fitness centers within close proximity.

As shown in Figure 1.0, RFC is considered a medium-sized fitness center enterprise. While some competitors (Day Spa and Constant Fitness in particular) continue to focus on large-scale, either through acquisitions of smaller fitness clubs or by opening new fitness centers, many others (including RFC) have reduced the number of new clubs being opened.

There is as much emphasis on health and recreation as ever in the U.S. Industry reports suggest that the outlook for fitness centers in general is quite positive, although some consolidation may occur because certain markets have been saturated with too many clubs to remain profitable. However, the market in the Southeast (where RFC operates) is still growing and market saturation is not anticipated for at least five years.

Fitness centers hire a variety of professional and support staff. Some focus on personal training and employ a large number of certified professional trainers who work with members during club hours (typically 5-6am until 10pm, although the more body-building oriented gyms have recently started offering 24-hour service). In addition to housekeeping and front desk staff, fitness centers employ customer service representatives who can assist existing members with questions and also act as sales representatives, giving tours of the facility to prospective members.

## RFC Strategy

During Lowe's tenure, RFC opened just one new fitness center (just outside of Atlanta, GA). This modest club expansion is consistent with the three-year financial strategy the RFC board has agreed on, where the focus is on growing the profitability of existing clubs by increasing member enrollment and retention. The company is privately held by a small group of investors and the board wants it to stay that way. The board has discussed positioning itself for acquisition by one of the larger fitness club chains at some point in the future. It is agreed that improving the bottom-line (i.e., net income) performance of RFC will only help in this regard.

Within Michael Porter's classic framework of various business strategies, (see Michael Porter of Harvard University Five Forces research) RFC's strategy most closely aligns with Porter's "focus" strategy, where a company focuses on serving the needs of a particular market segment to achieve a competitive advantage. RFC has positioned itself as a place where the whole family can enjoy fitness and social activities. RFC has deliberately chosen not to compete

with gyms that cater to body builders with large free weight workout areas, 24-hour access, onsite training supplement sales, and “no-frills” amenities. RFC’s strategy is to attract families by offering a wide variety of fitness offerings including cardio equipment; free weights and circuit training weight machines; personal training; and exercise classes (such as Pilates, yoga, stationary cycling, etc.). Most RFC fitness centers have a snack bar where nutritional smoothies and other healthy snacks can be purchased. All RFC centers offer extensive locker room facilities and on-site daycare. Newer RFC fitness centers have small indoor basketball courts and TV lounges to appeal to the 10- to 16-year-old age group.

From his first day on the job, Lowe has stressed to the staff that he wants them to be strategic in how they approach their daily, weekly, and annual activities and projects. By that he means that they should consider how their jobs contribute to RFC being able to provide a fitness club experience to couples and families that is superior to any of the competition. He has worked diligently with his senior management team and the board to understand how RFC creates value for its customers, employees and investors. The business model for how fitness centers make money is fairly straightforward: profitable firms grow by recurring monthly member revenue (via new member recruitment and existing member renewal) while maintaining relatively stable fixed costs and low variable costs. Lowe has worked to identify both financial and nonfinancial variables that drive RFC performance. By locating RFC fitness centers in upper-middle-class locations and focusing marketing efforts on couples and families, RFC has been successful recruiting new members. Research data shows that members typically do not have issues with the RFC monthly dues. Member feedback indicates that having a friendly place for the whole family to stay fit is a driver of member value.

### RFC Strategic Challenges

As with most start-ups, the early strategy for RFC focused on growing revenue. They did this by opening several clubs each year and offering new club promotions to attract members. RFC experienced rapid revenue growth (more than 20 percent annually) through 2012. However, several of the RFC centers are not reaching their profit goals. Mike Lowe tried to address this by implementing operational efficiencies when he first came on board at RFC, but he soon realized that the profit challenges were driven in large part by a customer retention problem. While a certain amount of turnover is expected in the industry (due to competing clubs, families moving out of the area, etc.), the best industry data RFC can find relating to member retention shows that their member retention is approximately 20 percent lower than industry average.

An analysis of member records shows that members often join during a special promotion (where the initiation fee is waived) but then rarely use the center

and fail to renew. A telephone survey of members (lapsed and current) reveals that “non-use” was one of the reasons for members not renewing or stating they were unlikely to renew. An analysis of member-visit frequency shows that more than 50 percent of members in 2013 hadn’t even visited their RFC fitness center two times per week. The hypothesis is that members who aren’t going to their RFC fitness center frequently are far less likely to see sufficient value to renew. Another concern is member feedback that RFC staff members do not provide very good or excellent customer service. Lowe, senior management, and the board have had extensive discussions about the member retention problem. While part of Lowe’s strategy to increase profits is to enroll more members in existing fitness centers, those profits will be short-lived if members stay only one year. Data also shows that membership cost, quality of offerings, amenities, etc., are all rated highly.

Lori thinks about these strategic issues and how HR might affect them. “There’s no question that problems with customer service and member retention come down to people issues. It is affected by the type of people we bring on board, how they’re trained and how their performance is managed and rewarded.”

## RFC Organizational Structure

The organizational chart for RFC is shown below in Figure 2.0.

Figure 2.0: RFC Organizational Chart - Management

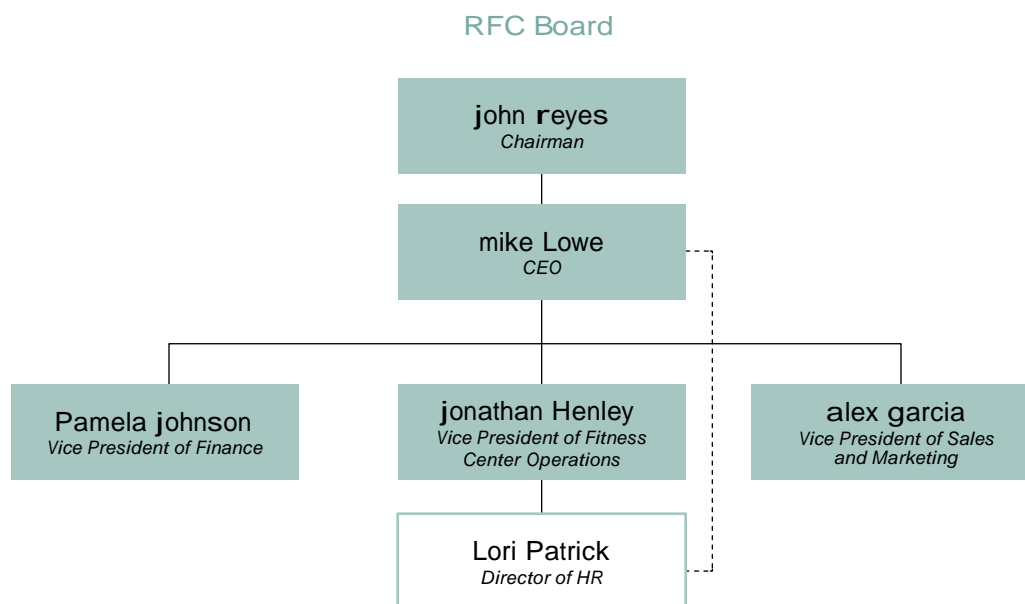
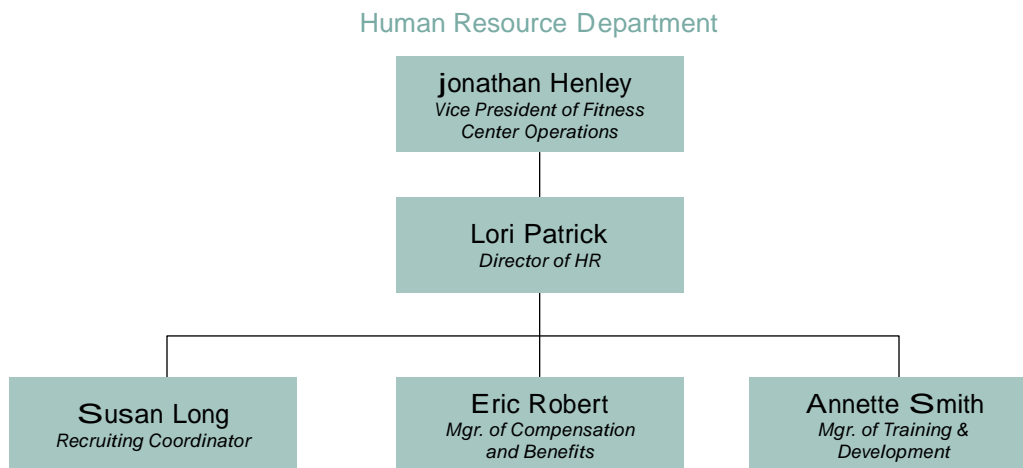




Figure 3.0: Organizational Chart – Human Resources Management



### How Lori and the HR team are Regarded by Others at RFC

Jonathan Henley, Vice President of Fitness Center Operations:

“I feel that Lori is trying to do a good job here and appreciate that she’s seeking to add strategic value. Each member of her team has been with RFC for more than five years, which will help. Although Lori reports to me for performance management purposes, her position is designed for her to work directly with the CEO on people strategy issues. She does a great job keeping me informed of the things she’s working on.”

Alex Garcia, Vice President of Sales and Marketing:

“HR is a tough job because employees are never satisfied. You can never pay them enough and employee loyalty doesn’t exist anymore. Lori and her folks do the best they can in administering the HR policies in a fair manner.”

Pamela Johnson, Vice President of Finance:

“I think Lori will do a very good job leading HR at RFC. She has a master’s in the field and has been a quick study learning what RFC is all about. I think the challenge as we pursue improving profitability at RFC is to look at all of our costs—and HR’s budget may be affected.”

## The Strategic HR Opportunity

As Lori pulls into her driveway that night, she remembers how her conversation with Mike Lowe ended. Lowe asked her about the HR department's initiatives for the coming two years. He specifically said that he expects the department's plan to be clearly linked to the organization's strategic goals and to demonstrate how accomplishment of those goals will be measured. Lowe was willing to consider additional money for HR initiatives as long as a probable return on investment could be shown. He requested that the goals be presented to him and his senior management team in 45 days. "What an opportunity," Lori thinks as she walks into her house. She decides that creating an HR scorecard (as described in the book, *The HR Scorecard*) is the best way to present HR's goals, because the scorecard development process will require her team to identify how HR's goals contribute to the organization's goals.

### Discussion Questions:

- 1) Identify and prioritize a set of tasks for Lori. Provide a rationale for your prioritization. Link your responses to the key concepts in *The HR Scorecard*.
- 2) Based on your understanding of RFC and its business strategy, how can HR add strategic value to RFC?
- 3) What challenges do you anticipate Lori will encounter as she develops the HR scorecard for RFC?

## Background

This part of the case is a continuation of the strategic HR opportunity at RFC. The case resumes with Lori Patrick, the HR director, back at the office the day after being directed by Mike Lowe to develop a set of strategic HR initiatives to help RFC achieve its strategic objectives.

## Lori Convenes a Staff Meeting

"I appreciate you all taking time away from your other work to meet with me today. Mike Lowe has presented our team with a very exciting opportunity. He has asked us to develop over the next 45 days a set of strategic HR initiatives that will help RFC achieve its strategic objectives." Lori asks for general reactions, and staff members express excitement about the opportunity. They realize that a key to making RFC successful involves people issues, but express anxiety about developing specific strategic objectives. "Won't this make our jobs more vulnerable if we don't meet our objectives?" one member asked. Lori responded, "CEOs everywhere are asking their departments to demonstrate how they add value to the bottom line. We should develop objectives we think are challenging but have a good likelihood of being met. If we do that and work hard to achieve them, I think we can count on Mike giving us his full support even if we don't meet every single one." Another team member said that she was a member of SHRM and that there were member resources available to help develop strategic HR objectives. Lori enthused, "Great. We'll definitely want to tap all the resources like this that we can. At lunch today, I'm picking up a copy of The HR Scorecard for each of you. It shows how HR can add strategic value to an organization and offers a process that we can use to develop a scorecard to identify, manage and measure strategic HR initiatives that will drive or enable successful implementation of an organization's strategy."

Lori continued, “We have measured HR activities in our department for a long time, such as cost per hire, time to fill a position, number of employees trained, etc. But to add strategic value, we must shift our focus to measure outcomes, not activities. Further, those outcomes must add essential value to RFC’s ability to execute its strategy and meet its objectives. Our first planning meeting will be this Thursday at 9 a.m. I’m well aware that 45 days is not much time. I want to meet with each one of you over the next couple of days and talk about how you can contribute and how we will manage things so that other responsibilities don’t suffer.”

### Discussion Questions:

- 1) If you were one of the employees in Lori’s meeting, what questions and concerns would you have?
- 2) What other messages do you think are important for Lori to relay to her staff?

### HR’s Strategic Role and Scorecard Development

*The HR Scorecard* outlines a seven-step process to implement HR’s strategic role in an organization.

#### The HR Scorecard: Seven-Step Process

1. Clearly define the business strategy.
2. Build a business case for HR as a strategic asset.
3. Create a strategy map.
4. Identify HR deliverables within the strategy map.
5. Align the HR architecture with HR deliverables.
6. Design the strategic measurement system (HR scorecard).
7. Implement management by measurement.

Lori uses this process because she knows that what she is trying to achieve goes beyond presenting an HR scorecard but is, in fact, the beginning of repositioning HR into a strategic role at RFC.

She starts by meeting with her formal supervisor, Jonathan Henley, vice president of fitness center operations. Lowe had briefed Henley on what he has requested of Lori; Henley offers to help Lori in any way he can, but notes that HR is far more her expertise than his. Henley spends considerable time traveling to fitness centers and working with club managers to ensure the facilities stay clean and safe, and that the equipment is in working order. Henley suggests that Lori discuss her strategic HR initiatives with Pam Johnson, vice president of finance, because her department’s support is critical to Lori’s success. Lori takes that advice and meets with Johnson and her staff several times over the 45 days. Her meeting with Alex Garcia, the vice president of sales and marketing, goes really well. Garcia’s focus is to have his team bring in new members through advertising and special promotions. The incentive compensation program for his sales representatives has been an excellent motivation tool. There have been only a few months in the last 36 when monthly sales goals were not reached.

Lori learns from senior management that there is general agreement that

RFC's strategy has shifted from revenue growth through club expansion to profit building through member retention and cost management. While cost management is important, RFC is not opposed to spending money if the dollars are an investment in something that will have a positive return (more than break-even) and is clearly linked to RFC strategy. In regard to member retention, it seems to Lori that while everyone knows member retention is important, no one is clear about their specific role in retaining members.

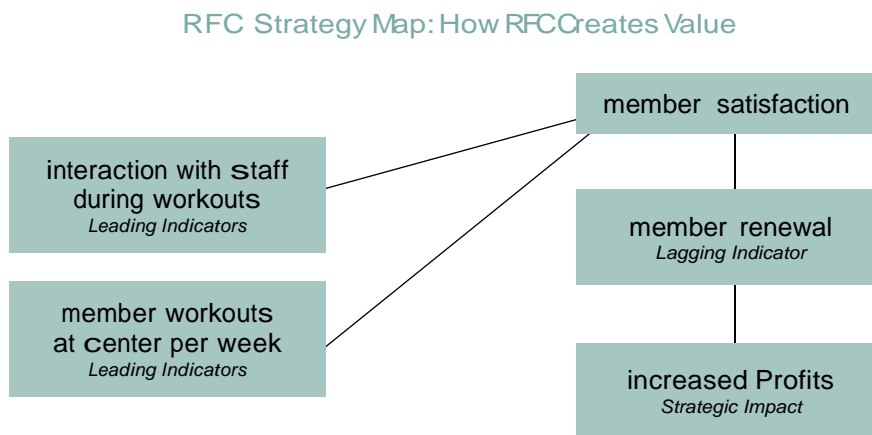
Lori and her HR team members hold a series of focus groups to collect qualitative data on what the staff knows about RFC's strategy and their role in it. The comments gathered indicate that staff members are generally unaware of what the strategy is, other than to make money; and further, that employees are unclear how they specifically contribute to the organization's strategy. Lori knows from her experience that this is not uncommon. *The HR Scorecard* stresses that the business strategy must be very descriptive so that employees understand their role in the plan and so that they can measure the success of the strategy. She raises this point in her weekly update meetings with Mike Lowe, and he agrees that communication about the organization's strategy must improve.

For the second step in the process, Lori finds that building the business case for HR as a strategic asset is easier than she expected. In her meetings with the vice presidents, she shared various articles from SHRM and material from *The HR Scorecard* and found that they understood that RFC had nothing different

in terms of weight training equipment, etc., from any other gym in town—it is the employees serving the members that make the difference. Finance had already worked up a financial scenario about how profits would improve with various increases in member retention. Lori plans to use these numbers to demonstrate how HR can support RFC’s retention strategy by helping to build a team trained and motivated to provide great service to members—and deliver member renewals.

For the third step, Lori works with Mike Lowe on the following graphic (see Figure 4.0) to show how RFC creates value—and ultimately, profit. While this value map will likely be expanded, it provides a good pictorial for managers and employees to better understand RFC strategy.

Figure 4.0 – RFC Strategy Map



### Discussion Questions:

- 1) Explain the difference between a leading and lagging indicator.
- 2) What other potential leading indicators exist in this case?

For the fourth step, Lori and her team spend considerable time discussing the RFC strategy and the organizational goals Mike Lowe had established:

Have a minimum of 50 percent of adult members visit an RFC center two times per week (currently only 35%).

Have 90 percent member satisfaction with RFC staff interactions (no formal data collected, but anecdotal data suggests it’s well below that now).

Improve profitability by a minimum of 10 percent annually.

Continue to achieve new member goals at current rate.

Improve the annual member retention rate to 75 percent (currently 62%).

Some of the key questions posed in *The HR Scorecard* related to this step include, “How would employees need to behave to ensure that the company achieves these goals?” and “Is the HR function providing the company with the employee competencies and behaviors necessary to achieve these objectives? If not, what needs to change?”

In terms of HR deliverables, it becomes clear to Lori that there needs to be better alignment of the performance management system with RFC’s strategic plan. Currently, performance goals are focused on job description activities instead of on results that contribute to RFC’s goals.

As for member retention, Lori thought that HR needed to ensure that staff assigned primary responsibility for retention knew it, and that they had adequate customer service skills and training. While there was a need for an individual in management to have primary responsibility for leading retention efforts, Lori felt that HR should make sure that all RFC employees saw member retention as part of their jobs as well. All managers should incorporate retention activities and goals into employees’ annual performance plans. Lori recognized that her team and senior management must work to build a culture where excellent customer service is seen as an absolute priority and a core value. Lori decided to present this culture change to senior management as a multi-year initiative.

Finally, Lori knew that the compensation system should be analyzed to see if an incentive program would be effective to focus performance not only on member retention efforts but on profitability as well. Lori was aware of other organizations which had successfully implemented profit-sharing programs linked to achievement of strategic objectives, and she thought it might work well at RFC. Lori would need to work closely with Pam Johnson and her finance team to conduct a cost-benefit analysis of any proposed incentive program.

### Discussion Question:

- 1) What other HR practices/systems might Lori consider in developing a comprehensive HR scorecard?

For the fifth step, Lori evaluated how best to align the HR architecture with the HR deliverables her team was considering. Lori and her team thought about how the components within the HR system fit together (internal alignment) as well as how the HR system aligned with (i.e., supported) the RFC’s external strategy components. While Lori felt her HR department’s organizational

structure was aligned well with the RFC strategy, she felt certain job functions should change to focus behaviors toward the HR deliverables identified in the fourth step.

For the sixth step, Lori and her team reviewed the deliverables that had been developed within the strategy map and identified the following preliminary HR scorecard measures (Figure 5.0).

Figure 5.0: rFc Hr scorecard

strategic objective		specific, measureable goal (Hr deliverable)	Hr scorecard progress
Have a minimum of 50 percent of adult members visit an RFC center two times per week .		Align the performance management system to clarify skills and behaviors required to increase member visit frequency by _____.	
Have 90 percent member satisfaction with RFC staff interactions.		Create and execute a customer service training program with 95 percent of staff completing training with satisfactory competency rating by _____.	
Improve profitability by a minimum of 10 percent annually.		Initiate a culture-building program by _____. Once implemented, achieve 90 percent agreement (through an employee survey) that culture promotes and recognizes excellence in customer satisfaction and organizational performance.	
Continue to achieve new member goals at current rate.		Align the incentive program for new member sales with retention program by _____.	
Improve member retention to 75 percent.		<p>Have incentive program in operation by _____.</p> <p>Align the performance management system with expected member retention behaviors for all positions by _____.</p> <p>Have 95 percent of employees receive satisfactory or better performance rating on customer service factors.</p>	

### Discussion Question:

- 1) Discuss the strengths and weaknesses of the RFC's scorecard above. Should anything be added?



The last step, implement management by measurement, required a significant mind-set change within Lori's HR department. *The HR Scorecard* states that the seven-step model Lori followed produces a powerful management tool that is much more than something to "keep score" of HR's effect. Rather, it provides a framework for every team member to learn what it takes to actually manage HR as a strategic asset. Lori's department had a history of measuring things. The dramatic difference now is that the things being measured are directly related to RFC strategy. Lori talked with her staff about the change, but she realizes it will require further discussion and experience with this new type of department management approach for the significance of this difference to really sink in.

### Formal Presentation of HR's Strategic Objectives and Scorecard

It seemed as though the 45 days had flown by. Lori held a final meeting with her staff before the presentation to senior management. "I want to thank each of you for embracing this strategic approach to HR. I realize it is new to many of you. You are all quick learners! Please understand that as we go forward with the HR scorecard initiatives, I am going to ask Mike to support our team's continued learning of how to implement strategic HR, HR measurement, etc. I am sure that the senior management team will have suggestions."

Lori had greatly appreciated the support received from Jonathan, her formal supervisor. While she had kept Jonathan informed of her progress and asked for his input periodically, she felt empowered throughout the process. She felt confident that she had his support going into the presentation.

Lori took her PowerPoint presentation and notes and walked toward the boardroom to present her scorecard. She was pleased that all of the people in the room were familiar with the work that had been done, and had contributed to its development with their comments and reactions. In particular, Lori was satisfied with her efforts to gain support from Pam Johnson. Pam and her team were of incredible assistance in working through the metrics and deliverables. Their focus, she thought to herself, is appropriately on the dollars and cents; as long as the HR strategic objectives were clearly tied to delivering that financial performance, the HR team's proposal should be well-received. The next two hours were spent presenting the HR scorecard and discussing strategy.

Lori was exhausted driving home that day after the presentation to Mike and senior management. The last 45 days had been quite a challenge—the day-to-day HR activities didn't stop simply because HR had become strategically focused. Time had to be managed so both could be done. In reflecting on the presentation, many of the senior management team's comments to Lori were particularly gratifying:

“You’ve done a good job linking your HR deliverables to what RFC is trying to do as an organization. I feel like we’re all on the same page now,” remarked Pamela Johnson. She also appreciated Mike Lowe’s comments that the HR scorecard project had some unintended benefits: “Through the work your HR team carried out, Lori, we’ve become aware how our corporate strategy and objectives could be clearer—not only to the senior management and the board, but to the entire staff. Thank you for that.” She also appreciated the comments that the exercise would be helpful for other VPs to go through with their departments as well, in some modified form, because it provided a useful process to identify and link what a department/division is striving to deliver directly into the RFC strategy.

Lori realized that the real work, in a sense, had just begun. The HR scorecard initiatives still needed refinement and communication throughout the organization. Mike’s comments about clarifying some of RFC’s strategic objectives would likely affect Lori’s HR scorecard. Lori had quickly learned from this experience that HR flexibility is important, because any modifications to RFC strategy could affect the HR strategy and the HR scorecard. One clear action item coming out of the presentation involved the need to decide who should have specific responsibility for member retention activities and results. Mike had already pulled Lori aside and said he would like to get her input on that decision. Everyone liked the idea of building a culture where everyone felt a part of creating a great experience for members visiting an RFC center. The work on the performance management system, training program and incentive program would take considerable time and effort to develop because Lori planned on having very open dialogue with the staff about what was being developed, why, and getting their input on the design of the initiatives. She knew from some of her discussions with staff that they were still a bit fuzzy on what the RFC strategy was all about and their role in it. Hopefully, the development of the HR scorecard would help all staff to better understand what RFC was trying to achieve. While she had concerns about what might happen if she didn’t deliver on her team’s HR deliverables, this concern was more than offset with the satisfaction that, for the first time in her HR career, she was engaging in strategic HR and seeing a clear link between what HR was doing and the organization’s bottom-line performance. It felt good.

### Discussion Questions:

- 1) Consider the process Lori used to develop this first draft of the HR scorecard. What do you think was done particularly well? Why? What might you have done differently?
- 2) As Lori observed, the real work begins once the scorecard is developed and put in place. What critical things will Lori and her team need to do over the coming months to be successful? What problems do you anticipate?

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