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STRATEGIC HRM AND ORGANIZATIONAL PERFORMANCE: A REVIEW OF 'BEST FIT' - 'BEST PRACTICE' DEBATE

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Abstract

The assumption that human resources play strategic role in the success of a company has led to extensive research in the field of strategic HRM. This paper reviews the empirical work on HRM and organizational performance link. It focuses on the debate in strategic HRM literature between the contingency theory and universalism, which covers the largest body of the literature in this field.

Key words: strategic HRM, organizational performance, 'best practice', 'best fit'.

Introduction

Human resources have long been seen as a cost to be minimized rather than a potential source of value creation. However, nowadays, people and people management are increasingly seen as key elements of competitive advantage (Allen and Wright, 2006; Pfeffer, 1994, Boxall and Purcell, 2003). The new interest in human resources as a strategic lever, which has emerged in the last two decades, suggests that HRM contributes directly to the implementation of the operating and strategic objectives of firms.

With the advent of the resource-based view of the firm (Barney, 1991), strategic HRM research moved to a more internal focus. According to Barney's (1991) resource-based view, firms should look inward to their resources, both physical and intellectual, for sources of competitive advantage. Firms can develop sustained competitive advantage only by creating value in a way that is rare and difficult for competitors to imitate. Traditional sources of competitive advantage such as natural resources, technology, economies of scale etc. are not only easy to imitate but are also easily accessible, mainly because of the fast development of technology. Thus, human resource systems can become crucial source of sustained competitive advantage.

The resource-based approach is based on the assumption that competitive advantage is obtained if a firm can obtain and develop human resources that enable the firm to learn faster and apply its learning more efficiently than its competitors. (Hamel, Prahalad, 1989). As Barney (1995) underlines "human resources include all the experience, knowledge, judgment, risk-taking propensity and wisdom of individuals associated with the firm". In line with human capital theory, resource-based theory emphasizes that investment in people adds to their value in the firm. Thus, the challenge to organizations is, as Ulrich (1998) stated, "to ensure that they have the capability to find, assimilate, compensate and retain the talented individuals they need". A properly developed HR system creates value when it is incorporated in the operational systems of an organization in a way that it enhances the firm's capabilities. Such a system is difficult to imitate due to lack of understanding of the precise mechanisms by which the interaction of human resource practices generate value.

The assumption that company's human resources can play a strategic role in the success of an organization has led to extensive research in this field, in an attempt to set theoretical frameworks and empirical evidence of the impact of HRM on organizational performance. However, the mechanisms by which human resource management creates and sustains value are complex and are still not well understood. Many studies in this field, covering different HR practices and processes, different variables, and different industries, have led to an intensive debate on strategic HRM and performance link.

Strategic HRM and Organizational Performance

Strategic HRM is concerned with the strategic choices associated with the use of labor in firms and the ways in which HRM influences firm's performance. Wright and McMahan (1992) defined strategic HRM as "the pattern of planned human resource deployments and activities intended to enable the firm to achieve its goals". The assumption underpinning the strategic HRM is that people are the organization's most critical resource and that organizational success largely depends on them. So, if an appropriate set of HR practices and processes is developed and implemented in an organization it will subsequently lead to better organizational performance.

Based on this assumption, throughout the 20th century, there were a number of waves of interest in how to improve workplace performance, and substantial amount of research to establish a clear positive link between HR practices and organizational performance. One of the most important initiatives in recent time is associated with the idea of 'high-performance work systems' (HPWS), the term being introduced by Appelbaum et al (2000) and widely accepted by HRM researchers.

High performance work systems aim to make an impact on the performance of the firm through its people in such areas as productivity, quality, level of customer service, growth, profits. The practices and systems that are identified as supportive of high performance typically refer to more rigorous selection and better training systems to increase ability levels, more comprehensive incentives (such as employee bonuses and internal ladders) to enhance motivation, and participative structures (such as self-managing teams and quality circles) that improve opportunity (Appelbaum et al, 2000).

One of the streams running through the literature on HPWS is that these practices work much better when 'bundled' together (Ichniowski et al, 1996; MacDuffie, 1995). An organization's HR strategies, policies and practices are a unique blend of processes, procedures, personalities, styles, capabilities and organizational culture. Thus, only systemic interactions among these practices can increase organizational performance. Adding only one of the practices is likely to 'have no effect on performance' (Ichniowski et al, 1996; Purcell et al. 2003).

However, these high performance work systems vary significantly as to the number of practices included, the outcomes, and sometimes even as to whether a practice is positively or negatively related to high performance (Becker and Gerhart, 1996). For example, some models include only four or five key practices, while others include more than dozen (as for example, Pfeffer, 1994). The studies of HPWS also include a

variety of outcome variables, such as profitability (Delery and Doty, 1996), productivity (Arthur, 1994; Huselid, 1995; MacDuffie, 1995), and broader array of benchmarks including quality, employee turnover etc. In addition, studies also differ in whether a practice is positively or negatively related to high performance. As Becker and Gerhart (1996) suggest in some studies high performance employment systems have low emphasis on variable pay (Arthur, 1994), while in others these systems have strong emphasis on variable pay (Huselid, 1995; MacDuffie, 1995). Also, some HR strategies that rely on internal promotions and grievance procedures are described as high performance practices (Huselid, 1995; Pfeffer, 1994), while in other studies these practices are included in more rigid HRM systems.

In addition to the above mentioned, Boxall and Purcell (2003) argue that the definition of the component of HPWS is also confusingly varied due to the absence of presenting the theoretical framework that supports researchers' perception of what practices to include. Most researchers base their perception on the AMO (ability, motivation, opportunity) theory of performance (Appelbaum et al, 2000). This theory translates performance into a function of employee ability, motivation, and opportunity to participate. In other words, employees are to perform better when they are able to do so, they have the motivation to perform better, and when they are provided an opportunity to perform better.

Several models of the relationship between HRM and performance have been developed (Schuler and Jackson, 1987; Guest, et al, 2000; Purcell et al, 2003); however, one of the most heavily cited in recent years is the People and Performance Model developed by Purcell et al (2003). Based on the assumptions of AMO theory 11 human resource practices that give meaning to AMO have been identified, as shown in Figure 1. In their longitudinal study of 12 companies in UK they reported clear evidence between HR policies and practices, levels of satisfaction, motivation, commitment and operational performance. The other key feature of the model is the role of line managers who need to implement the practices properly in order to have best effect on performance.

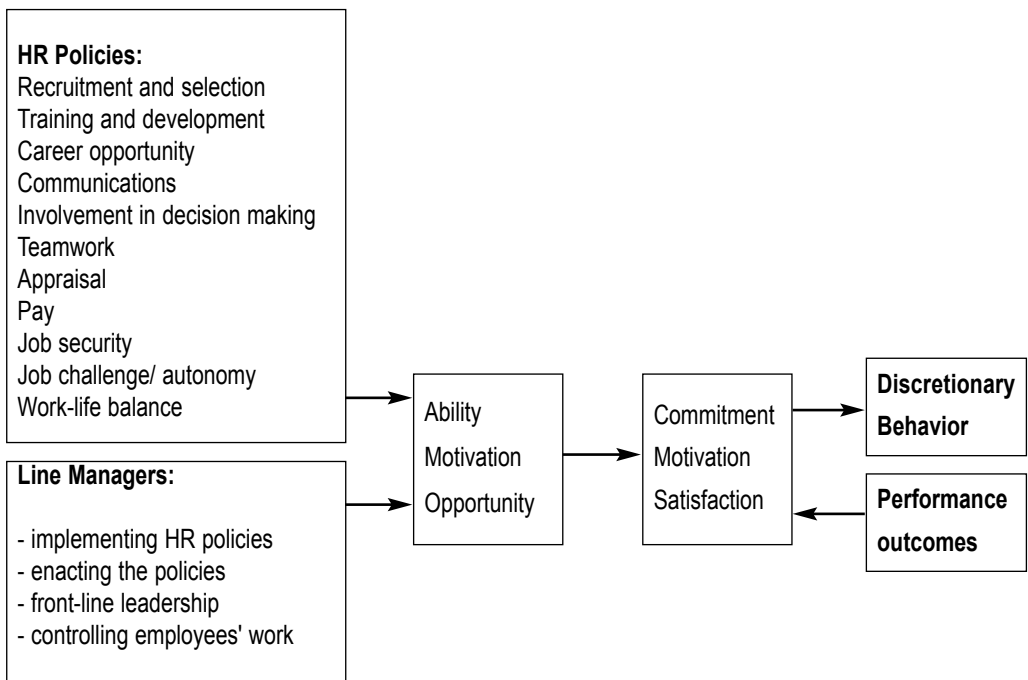


Figure 1. The People and Performance Model (Purcell et al, 2003), CIPD, adapted

In spite of the theoretical frameworks that have been developed and the significant amount of research that presents the link between HRM practices and firm performance, there are still several key questions that remain unanswered. In this regard, Allen and Wright (2006) argue that there is still a general lack of understanding about the concept of fit, and its role in the link between strategy and HRM. Secondly, there are still unanswered questions regarding whether HRM defined as a system of HR practices truly constitutes a resource as outlined by Barney (1991).

The 'best fit' - 'best practice' debate

Delery and Doty (1996) categorized the theories of strategic HRM and organizational performance in three modes: the universalistic, the contingency and the configurational.⁶ The largest body of literature in the field of strategic HRM focuses on the extensive debate about the importance of contingency theory ('best fit') and universalism ('best practice').

The 'best practice' model advocates universalism, i.e. it is based on the belief that adopting and implementing a set of 'best practices' will lead to improved organizational performance. This approach received strongest support in many studies (Pfeffer, 1994; Huselid, 1995; Delaney and Huselid, 1996). These studies, across industries or within a specific sector, show that the organizational performance, measured by productivity, labor turnover, growth, market share or financial indicator, is better when more of the high-performance practices are used.

Pfeffer (1994), as one of the strongest supporter of the 'best practice' approach, identifies 16 'best practices' in companies that lead to higher productivity and profit across all types of organizations, some of them being employment security, selectivity in recruitment, incentive pay, information sharing, participation and empowerment, teamwork, training and development, promotion from within, and so forth. Other researchers (Guest, 1999; Patterson et al., 1997) have determined sophisticated systems for recruitment and selection, intensive and ongoing training, job design which ensures flexibility, frequent and comprehensive communication, grievance procedures, promotion, employee share ownership, as best practices.

However, Becker et al (1997) stress that high-performance work systems must be tailored carefully to a firm's individual situation to achieve optimum results.

In addition, Guest (1997) argues that in all studies (Huselid, 1995; Delaney and Huselid, 1996; Arthur, 1994; Ichniowski, Shaw and Prenzushi, 1994; MacDuffie, 1995) where different types of fit were compared, the 'best practice' was invariably the one that received the strongest support. In this regard, Pfeffer (1994) underlines that the empirical support for contingencies is weak and thus the 'best practice' approach should be preferred.

As much as there is support to this approach, there is as well criticism. Firstly, there has been criticism on the variety of 'best practices' both in type and number (Becker and Gerhart, 1996; Dyer and Reeves, 1995). Secondly, the belief in individual 'best practices' is inconsistent with the emphasis on the internal fit in the resource-based view, which suggests the importance of complementary resources (Purcell, 1999; Becker and Gerhart, 1996), i.e. the HR practices can only in combination enable a firm to realize its full potential (Barney, 1995).

Moreover, some cross-national studies do not find any support to the universalistic approach based on national variations both in labor laws and cultural practices (Wever, 1995; Appelbaum and Batt, 1994). However, Boselie, Paauwe and Jansen (2000), in their research of high-performance work systems in companies in Netherlands, found 12 out of Pfeffer's 16 'best practices' that are common in Dutch companies.⁷

6) Guest (1997) redefined the approaches as 'fit as an ideal set of practices', 'fit as strategic integration' and 'fit as bundles' among others, while Richardson and Thompson (1999) as 'best practice', 'best fit', and 'configurational' or 'bundles'.

7) The Dutch economy positively outperforms other EU countries on a number of economic performance indicators like employment, job creation, economic growth (Boselie, Paauwe and Jansen, 2000)

Boxall and Purcell (2003) argue that the 'best practices' have become ends in themselves, apparently disconnected from the company's goals in its specific context. In that context, Becker and Gerhart (1996) point out that the concept of best practices can be accepted for identifying the principles underlying the choice of practices, however human resource practices should be embedded in organizations in a way that they fit organization's needs. Purcell et al. (2003) in their research of people and performance link show that there is no universal 'best practice'. On the contrary, they argue that all successful companies have broad and integrated clusters of practices that are tailored to the needs of the organization.

The 'best fit' advocates that HR strategy will be more effective if appropriately integrated in its organizational and environmental context. This approach covers a range of models focusing either on linking HR strategy to the competitive strategy ('vertical' or 'external fit'), or on 'bundles' or 'clusters' or HR practices that are designed to fit and support each other ('horizontal' or 'internal fit').⁸

The basic assumption underpinning the contingency theory is that companies that have matched the HR strategy with the company's competitive strategy will report superior performance. The most well-known model of external fit was developed by Schuler and Jackson (1987), who offered a theoretical framework of the connections between competitive strategies, desired employee behaviors and particular HR strategies. Namely, they argue that HR practices should be designed to reinforce certain employee behaviors required by Porter's generic strategies.

There have been several studies that offered some support to the contingency approach (Miles and Snow, 1984; Schuler and Jackson, 1987; Delery and Doty, 1996; Youndt et al, 1996). Huselid (1995) found that companies that link HRM practices to strategy report higher financial performance, while Youndt et al. (1996) in their research of 97 manufacturing plants found that the fit between HR practices and strategy, in particular the quality strategy, provides the best results.

This approach does not lack criticism as well. Some scholars (Becker & Gerhart, 1996; Boxall & Purcell, 2003) argue that 'best fit' model raises questions about which are the most critical contingencies or elements in the organizational and environmental context. In addition, Boxall and Purcell (2003) underline that this model overlooks employee needs and prevailing social norms and legal requirements which are also part of the strategic goals of HRM. Therefore, a more sophisticated approach to the contingency theory would require considering the interaction between certain critical contingencies in the organizational context and the environment in which it operates, such as culture, operational processes and external environment.

In this regard, Boxall and Purcell (2003) propose a framework of major factors (contingencies), both inside and outside a company, that affect management choices in developing HR strategies. In particular, these factors are organized in two broad categories: economic and technological factors and social and political factors. See Figure 2.

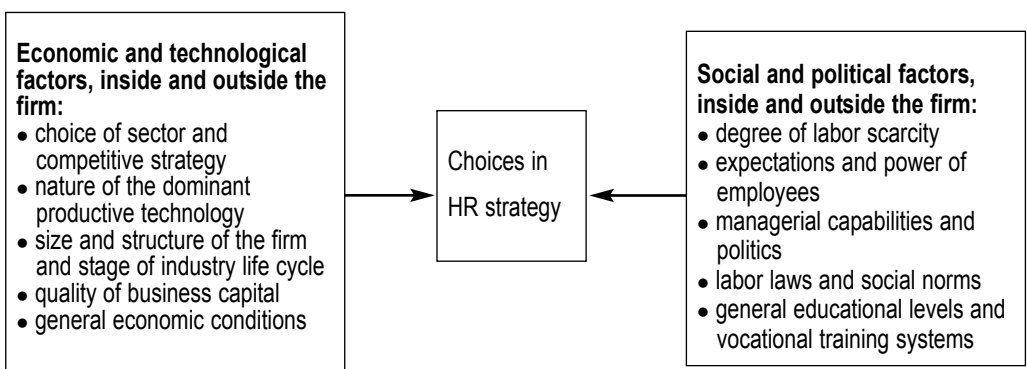


Figure 2. Major factors affecting HR strategies, Boxall and Purcell (2003)

8) According to Delery and Doty's categorization (1996), these are the contingent and the configurational modes.

The configurational approach or bundling conveys the assumption that companies with bundles of HR practices have higher level of performance. The idea is that practices within bundles are interrelated and therefore reinforce each other having greater impact on performance (Ichniowski et al., 1996; MacDuffie, 1995; Dyer and Reeves, 1995; Delery, 1998). The aim of bundling is to develop mutually reinforcing set of HR practices which jointly contribute to the attainment of organization's strategies.

Research has provided some evidence in favor of the configurational approach. Dyer and Reeves (1995) stress that employee performance is a function of both ability and motivation and that the logic of bundling is to enhance both. Thus, best results should be obtained when there are several ways to enhance employee abilities and skills and incentives to enhance their motivation. MacDuffie (1995) in his research of manufacturing plants that have flexible production found that bundles of internally consistent HRM practices are associated with higher productivity and quality.

Some researchers (Wright and Snell, 1998; Boxall and Purcell, 2003) agree that the concept of 'internal fit' is too simplistic, taking into consideration the paradoxical elements involved in managing people, and that strategic tensions among competing interests should be considered as well. Nevertheless, the combination of both vertical and horizontal alignment was a significant step in explaining how HRM could contribute to the accomplishment of strategic goals of companies.

Conclusion

The review of the research on strategic HRM and organizational performance clearly presents the complexity of the field. Guest (1997) argues that although there is empirical support for each of the three main approaches to HRM and performance, there is consistently stronger support for the internal fit or 'best practice' model. However, there is still lack of theory about the nature of HRM practices, and little consensus on what these are or the way they are linked.

To sum up, most researchers agree that the theory and the empirical research on the nature of HRM, the nature of the outcomes and the nature of the linkages need to be improved. As some scholars (Becker and Gerhart, 1996; Purcell, 1999) suggest, in order to reconcile the tension in this debate, it is necessary to make ... "an analytical distinction between the surface level of HR policies and practices in a firm (which are influenced by the societal, sectoral and organizational context) and an underpinning level of processes and principles (the generic HR processes)", because, "... both general principles and specific contexts play an important role in the theory and practice of strategic HRM" (Boxall and Purcell, 2003).

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