

CHAPTER 2

HRM AND FIRM PERFORMANCE

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Chapter knowledge objectives

- To explore and explain the contribution of SHRM to firm performance
- To investigate the relationships between business strategy and HRM
- To examine the different theoretical perspectives on SHRM
- To examine competing conceptualisations of high-performance work systems
- To examine issues in SHRM research

Chapter skills objectives

- To collect and analyse relevant data and information relating to HR strategy formulation
- To be able to develop and implement an HR strategy and plan
- To understand the nature and challenges of working in a strategic HR role
- To be able to evaluate the contribution of HR policies and practices to organisational performance



This chapter also provides indicative content for the following Intermediate and Advanced Level CIPD modules:

CIPD Intermediate level modules

5BIC Business issues and the context of HR

CIPD Advanced level modules

7HRC Human resource management in context

INTRODUCTION

Over the past two decades, research for the causal links between human resource management (HRM) and business performance has dominated both academic and practitioner debate (Purcell and Kinnie, 2007). Research on HRM was focused on the examination of the theoretical foundations of HRM, aiming to reveal its underlying assumptions, and on issues related to the validity of the techniques used in investigating the HRM–performance relationship. However, ‘the nature of the interaction between HRM and performance, and particularly the search for conclusive evidence of the decisive positive impact of the former on the latter, is for many the whole subject area’s “Holy Grail”’ (Boselie, Dietz and Boon, 2005: 67).

In this chapter we explore the dominant approaches on how HRM influences firm performance. The chapter has four aims. First, it examines the interaction between HRM and business strategies in determining the firm performance, by investigating the relationships between business strategy and HRM. Second, it will explore the theories on which the HRM–performance relationship is based, by examining the different theoretical perspectives in strategic human resource management (SHRM). Third, it will explain the causal link that takes place between the two end points (i.e. HRM and performance) in this relationship, by examining competing conceptualisations of **high-performance work systems**. Fourth, it will summarise the problems encountered when investigating the HRM–performance relationship, by examining multi-level issues in SHRM research. In general, this chapter refers to the so-called modelling of HRM with firm performance, which examines the steps through which HRM influences firm performance. On the basis of these models, we explore the evidence relating HRM practice to firm performance.

In order to understand the HRM–performance relationship, we start by introducing two major concepts that underpin this relationship. The first concept is strategic management, which refers to the managerial decisions and actions that may improve performance in an organisation. The second concept is strategic HRM (SHRM), which refers to the processes that link HRM policies and practices with the strategic objectives of the organisation.

STRATEGIC MANAGEMENT

In a management context, the term strategy is defined as ‘the formulation of organizational missions, goals and objectives, as well as the action plans for achievement, that explicitly recognize the competition and the impact of outside environmental forces’ (Anthony, Perrewé and Kacmar, 1996: 8). The classical approach to strategy refers to the readiness and capacity of managers to take decisions and actions, through long-term planning, in order to accomplish performance goals. Accordingly, **strategic management** is defined as a field that deals with managerial decisions and actions in order to improve the long-run performance of organisations. Strategic management consists of several serially dependent components or steps, which determine the strategic management process in an organisation (also called the strategic management model). These include:

Organisational identification through the development and identification of one’s current purpose and mission, goals and objectives and one’s values and culture.

Environmental analysis. Dependent on how the organisation is identified in step 1, managers assess its internal environment and its external environment. The internal audit and the environmental scan may take the form of a SWOT analysis (strengths, weaknesses, opportunities and threats). The PEST framework, as discussed in Chapter 1, may be a better option for describing the external macro-environment.

Strategy formulation aims to identify the basis for the firm's competitive advantage. Strategy formulation is dynamic, in the sense that it is subject to change as environmental conditions change and must be kept flexible as it deals with the future, which is hard to predict with certainty.

Strategy implementation requires effective exploitation of resources, optimum utilisation of management systems and effective activation of HR practices. However, the intended strategy (i.e. the formulated strategy) may differ from the realised strategy (i.e. the actual strategy that the organisation is following), due to unforeseen forces affecting the process of strategy.

Strategy evaluation refers to the activities that determine how well the formulated and implemented strategy (either intended or realised) has achieved the goals designated by the organisation. In cases where the actual results fall short of the expected results, managers will have to take corrective actions. There is therefore a feedback loop from strategy evaluation to all other steps in the strategy management process.

Strategy formulation can take place at the corporate, business or functional level. The corporate-level strategy refers to the overall strategy of the organisation. The business-level strategy refers to the strategy of a business unit in the organisation that deals with managerial decisions and actions. The functional-level strategy formulation refers to the philosophies, policies and practices that support the operation of the major functions within the business unit. As HRM is a functional area within a business unit, then it may be assumed that it is at this level that the majority of HR strategy decisions will be made. Schuler (1989), for example, identifies three distinct HRM philosophies, that is, fundamental values and guiding principles adopted in managing people: accumulation, utilisation and facilitation. Additionally, Armstrong (2006) identified four areas of HRM policy, that is, how certain things will be done in specific areas of HRM. These policies will be dependent on the underlying HRM philosophy adopted and consistent with the organisation's values:

- 1 Employee resourcing (e.g. planning, recruitment, selection, separation, talent management).
- 2 Employee development (e.g. training, development, careers, performance management).
- 3 Employee rewards (e.g. job evaluation, compensation, incentives, benefits).
- 4 Employee relations (e.g. participation, involvement, communication, health and safety).

STRATEGIC HUMAN RESOURCE MANAGEMENT

Having introduced in the previous section strategic management, we now turn our attention to **strategic human resource management**. Wright and Snell (1989) suggest

DEBATING HRM

HR on the board



Read the article by Brewster, C. (1994) Human resource management in Europe: Reflection of, or challenge to, the American concept?, in P. Kirkbride (ed.) *Human Resource Management in the New Europe: Perspectives on the 1990s*. London: Routledge. pp. 56–92.

For some time now, board membership of a senior personnel/HR person has been identified as one of the major influences on whether the HRM department is involved in various aspects of organisational strategy. Therefore, the board membership of an HR specialist has been taken as being a proxy for HRM strategic involvement, or integration. Authors (e.g. Brewster, 1994; Budhwar and Sparrow, 1997) found that representation of the personnel function at board level is, for some countries, in ascending order, as follows: Italy (18 per cent), India (28.7 per cent), Germany (30 per cent), Turkey (30.0 per cent), Ireland (44 per cent), Denmark (49 per cent), United Kingdom (49 per cent), Switzerland (58 per cent), Finland (61 per cent), France (84 per cent), Sweden (84 per cent).

TASKS: Divide into two groups.

- 1 One group should gather recent research evidence with respect to the benefits of representation of HR at board level and the other group should argue in favour of no representation of HR at board level.
- 2 Each group should then outline the opportunities and challenges that either representation or no representation poses for HR departments and practitioners.

that strategic HRM deals with those HRM activities used to support the firm's competitive strategy. Additionally, Armstrong and Long (1994) support the view that strategic HRM refers to the overall direction the organisation wishes to pursue in achieving its objective through people.

We have to bear in mind that although strategic HRM is sometimes used interchangeably with HRM strategy, they are not the same thing. HRM strategy involves a central philosophy of the way people are managed in an organisation, and the translation of this into HR policies and practices that are integrated with business strategy and within them. The next section will focus on strategic HRM as a theoretical framework rather than HRM strategy as the road map for achieving particular organisational outcomes.

Theories of strategic HRM

In recent years two theoretical frameworks have dominated the field of strategic HRM: the resource-based view and the integration approach (Paawue, 2009).

The **resource-based view** (RBV) argues that HRM influences performance according to the human capital held by the organisation (Barney, 1991). The human capital of an organisation consists of the people who work therein and on whom organisational success depends (Bontis, Dragonetti, Jacobsen and Roos, 1999). Where other organisational resources (technology, information, finance, etc.) are generally available, the only area where competitive advantage can be gained is through the unique contribution of the

people within the organisation. Pfeffer (1994) argues that organisations wishing to succeed in today's global and dynamic environment must acquire and develop employees who possess better skills and capabilities than their competitors. For any resource to be a source of competitive advantage it must be rare, valuable, inimitable and non-substitutable; the HR practices of the organisation can lead to competitive advantage through developing a unique and valuable human capital pool. Within this theory we can distinguish three possible approaches:

High-performance management. This refers to the development of a number of interrelated HRM processes that together improve organisational performance (Stevens, 1998).

High-commitment management. This refers to the development of mutual commitment within the organisation, based on high levels of trust, that eventually influence performance (Wood, 1996).

High-involvement management. This refers to the treating of employees as partners in the organisation through communication and involvement, ensuring that high performance will ultimately be achieved (Pil and MacDuffie, 1996).



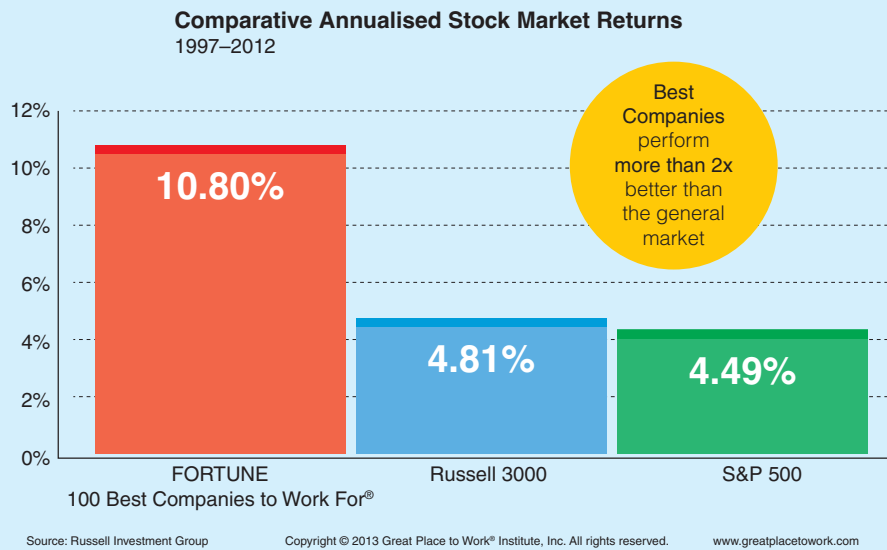
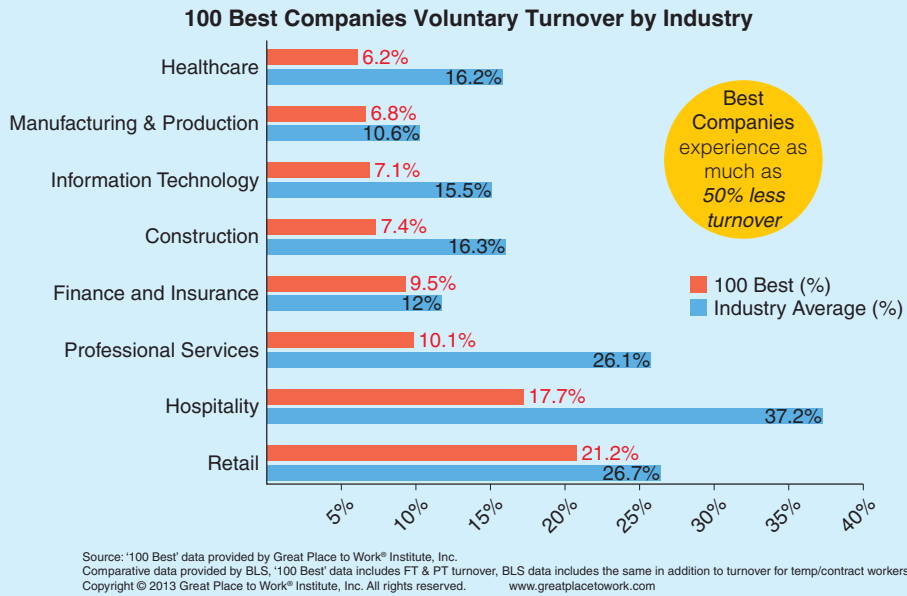
PRACTISING HRM

Managing human capital at a great place to work

Robert Levering and Milton Moskowitz, the authors of a best-seller book in 1981 called *The 100 Best Companies to Work for in America* and co-founders of The Great Place to Work® institute, argue that 'your company can be a great workplace, and you have the power to make it happen. It begins with an investment in building trust throughout your organization. The return will be a more vibrant enterprise, more innovative products and more satisfying relationships. Employees who trust their managers give their best work freely, and their extra effort goes right to the company's bottom line. Managers who trust their employees allow innovative ideas to bubble up from all levels of the company. Employees who trust each other report a sense of camaraderie and even the feeling of being part of a family. Together they deliver far more than the sum of their individual efforts.' Specifically, Robert Levering says that 'a great place to work is one in which you trust the people you work for, have pride in what you do, and enjoy the people you work with.' [<http://www.greatplacetowork.net>]

Supporting the view that trust is the single most important ingredient in making a workplace great, Levering and Erb (2011) argue that in managing human capital companies should take steps to show an individual how his work directly ties with the company's strategy and purpose, and leaders should share with employees their personal side of information, such as emotional reactions to news and personal takes on values. These steps will build a high-trust workplace culture that makes the company more effective and efficient. Specifically, '30 years of research, in over 40 countries around the world, has shown us time and again that investing in a high-trust workplace culture yields distinct, tangible business benefits. Our studies of the 100 Best Companies show that great workplaces enjoy significantly lower turnover and better financial performance than industry peers' (see Figure 2.1).

FIGURE 2.1 Best companies to work for: statistics



The **integration approach** to SHRM focuses more significantly on the link between HRM strategy formulation and performance. It emphasises the alignment of HR policies and practices within the HRM area and with other strategies across the organisation outside the area of HRM. Within this approach we distinguish three possible foci for integration: horizontal, vertical and combined integration.

Horizontal integration. Here the focus is on the organisation developing a range of interconnected and mutually reinforcing HR practices, the argument being that such alignment will always produce superior results whatever the accompanying circumstances. Underlying this assertion is the premise that there exists a set of HR best practices that fit together and mutually reinforce each other. **Synergy** is a key emphasis of horizontal integration or, alternatively, of internal fit. Synergy will be achieved if the combined performance of a set of HR policies and practices is greater than the sum of their individual performances.

The assumption that best HR practices work in all contexts has been labelled as the **universalistic model** (Delery and Doty, 1996). According to Osterman (1994) and Huselid (1995), who are among the mainstream universalistic theorists, the underlying assumptions of this model are:

- 1 a linear relationship exists between HR practices and business performance;
- 2 best HR practices are universally applicable; and
- 3 internal fit is the key concept.

Although support for a universalistic approach to HRM exists, there are notable differences across studies as to what that approach should look like. Pfeffer (1994) considers employment security, selective recruiting, high wages, incentive pay, employee ownership, information sharing, participation, empowerment, job redesign/teams, training and skill development, cross-training, symbolic egalitarianism, wage compensation and promotion from within to constitute significant best HR practices. There may be many combinations of practices that result in identical organisational outcomes (Doty, Glick and Huber, 1993), the so-called principle of **equifinality**. However, this challenges the concept of a universal 'best practice' model.

Vertical integration. Here, the organisation is seeking to develop a range of HR practices that fit the business's strategies outside the area of HRM. The logic here is that performance will be improved when the right fit, or match, between business strategy and HR practices is achieved. For example, generally, when pursuing an innovation strategy, organisations emphasise HR practices that encourage cooperative, interdependent behaviour and foster exchange of ideas and risk taking. For the quality strategy, the emphasis will be on seeking to enhance quality through ensuring highly reliable behaviour from individuals who identify with the goals of the organisation. For a cost leadership strategy, HR seeks to maximise efficiency through managerial monitoring and close control of employee activities (Schuler and Jackson, 1987). External fit, best fit and strategic fit are considered to be alternative expressions of vertical fit that determine the so-called **contingency model** (Delery and Doty, 1996).

According to Schuler and Jackson (1987) the underlying assumptions of this model are:

- 1 a non-linear relationship exists between HR practices and business performance;
- 2 the impact of the HR practices on business performance is different for the different levels of the critical contingency variable; and
- 3 external fit is the key concept.

Combined integration. When an organisation formulates its strategy by combining internal and external fit it is called combined integration. This approach makes use of bundles of HR practices. The logic here is that different combinations of HR practices will lead to higher business performance, depending on the organisational context (MacDuffie, 1995). Richardson and Thompson (1999) argue that an organisation with bundles of interrelated HR practices that complement and reinforce each other (i.e. horizontal integration) should have a higher level of performance, provided it also achieves high levels of fit with its business strategy (i.e. vertical integration). Delery and Doty (1996) refer to this combined integration approach as the **configurational model**. According to MacDuffie (1995) and Delery and Doty (1996), who are among the mainstream configurational theorists, the underlying assumptions of this model are:

- 1 a non-linear relationship exists between configurations of HR practices and business performance;
- 2 multiple unique configurations of HR practices result in maximal business performance, referring to the concept of equifinality; and
- 3 the configurations are assumed to be ideal types that are theoretical constructs rather than empirically observable phenomena; and
- 4 internal and external fit are both key concepts.

DEVELOPING KEY SKILLS: Developing an HR strategy

On the basis of the three business strategies (cost, quality, innovation), explain the emphasis that managers should assign in adopting HR practices from the areas of resourcing (recruitment, selection), development (training, work design), rewards (compensation, incentives) and relations (involvement, communication).

Task: Read critically the study of Schuler, R.S. and Jackson, S.E. (1987) Organisational strategy and organisational level as determinants of human resource management practices. *Human Resource Planning*, 10(3): 125–141.

MODELLING HRM AND FIRM PERFORMANCE

We saw above three approaches to strategic HRM theory. These approaches suggest different routes through which HR practices contribute to business performance (Delery and Doty, 1996; Katou and Budhwar, 2010):

- 1 Universalistic or best practice models of HRM require that the key set of important strategic HR practices is identified, and that these practices influence business

performance, maximising **horizontal fit**. The model suggests that business strategies and HR practices are mutually independent in determining business performance.

- 2 Contingency or strategic fit models of HRM require that a business strategy is identified, and then that we consider how individual HR practices interact with that strategy to result in business performance, thus maximising **vertical fit**. This is a sequential model, the choice of business strategy preceding the choice of HR practices.
- 3 Configurational or bundles models of HRM require that we first derive from theory internally consistent configurations of HR practices to maximise horizontal fit. Then we select a strategic configuration theory. Finally we link the theoretically derived HRM systems to different strategic configurations to maximise vertical fit. This model advocates interrelation, suggesting that business strategies interact with HR practices in determining business performance.

Although there is no clear picture as to which of these models is strongest (Wood, 1999), there is at least some evidence that a contextual approach is preferable (Katou and Budhwar, 2010). Gerhart (2005: 178) writes that 'if studies of the HR–performance relationship continue to find no evidence that context matters, either the contingency theory central to strategic HR is flawed or the methodology'.

In practising HRM we have to distinguish between 'intended' HR policies, which are developed by the decision makers of the organisation, 'actual' HR practices that are implemented with respect to the intended HR policies, and 'perceived' HR practices which indicate how employees experience actual HR practices. Actual HR practices are those which are applied, usually through and by line managers, who undertake on a daily basis a whole series of actions that have an impact on how employees experience HR practices that are applied to them (Purcell and Kinnie, 2007). Although the process of successfully implementing HR practices depends on the skills of the line managers in communicating and dealing with problems, 'there is the risk that line managers simply fail to implement practices or may implement them badly' (Guest, 2011: 9), affecting in turn employees' responses.



PRACTICING HRM

HR best practice at Selfridges

Kinnie, Hutchinson, Purcell, Rayton and Swart (2005) conducted a two-year study into the implementation of HR best practices by line managers at Selfridges. In particular, the research focused on the changing attitudes (or satisfaction) of employees to a number of HR best practices including the performance appraisal, career opportunities, job influence, job challenge and respect shown by one's line manager. Results of the second year survey showed that employee satisfaction with this range of HR best practices had risen substantially across the board. As Kinnie et al. (2005: 45) summarise, this case shows 'how organizations can focus developmental policies on the role of line managers and how these consequently have a beneficial effect on the staff that they manage. What happened in Selfridges was not simply luck in making good appointments but was the outcome of careful planning and forethought by the HR teams in the organization'.

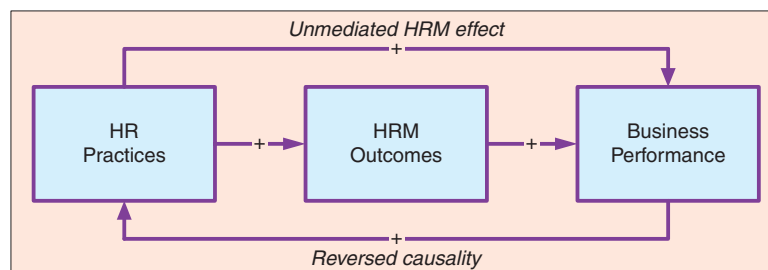
The general causal model of the HRM–performance relationship

One drawback of the models presented above is that they focus on the two end-points of the HRM–performance relationship. At one end is HRM strategy and at the other end is business performance (operational or financial). But what happens between these two end-points? Exactly how do HR practices influence business performance? The mechanism, which remains unknown, is often referred to as the **black box** (Boselie et al., 2005).

In trying to illuminate the black box, researchers initially concentrated on the skills, attitudes and behaviour of employees. This was based on the assumption that improved performance is achieved through people, in terms of better skills, attitudes and behaviour (Guest, 1997). This reflects a general consensus that HR practices do not lead directly to business performance. Rather, they influence human capital, in terms of employee skills, attitudes and behaviour, and it is these HRM outcomes that ultimately lead to performance (Katou and Budhwar, 2006; Wright, McMahan and McWilliams, 1994). This process of A influencing B through C is known as mediation. Here, HRM outcomes (skills, attitudes and behaviours) positively mediate the relationship between HRM and performance. This is known as the mediating model (Paauwe and Richardson, 1997) or **general causal model** (see Figure 2.2).

We can distinguish two types of linkages in this model. There is a direct linkage from HR practices to business performance, which is also called the unmediated HRM effect. This suggests that HR practices have a direct influence on business performance. The indirect linkage through HRM outcomes, which is also called the mediated HRM effect, indicates that HR practices influence HRM outcomes, which in turn influence business performance. It is not necessary for both direct and indirect linkages to be present at the same time. It is possible that a mediated effect may exist in the absence of an unmediated effect. In cases where both direct and indirect linkages are present, the intervening process is called partial mediation. In cases where only the indirect linkage is present, the intervening process is called full mediation. The final link in the diagram is labelled as reverse causality. The argument for this is that high-performing firms can afford HR practices (Huselid, 1995). Thus the performance outcome makes available to the organisation the ability to implement costly HR interventions. Few studies have investigated the strength of forward versus reverse causality. However, Katou (2012a) found that in small firms reverse causality from operational performance to HR practices is stronger than forward causality from HR practices to operational performance through employee attitudes and behaviour.

FIGURE 2.2 The general causal model of the HRM–performance relationship



DEVELOPING KEY SKILLS: Researching the relationship between HRM and performance

Considering relevant data, explain the steps used in investigating the hypothesis that the relationship between HRM systems and organisational performance is mediated through the HRM outcomes of employee attitudes and behaviour.

Task: Go to <http://davidakenny.net/cm/mediate.htm> website and 'learn how you can do a mediation analysis and output a text description of your results'.

While we have explored how the black box works, we yet have to decide on what it actually contains. All agree that HRM outcomes constitute the heart of the general linkage framework presented in Figure 2.2. Some researchers (e.g. Becker, Huselid, Pickus and Spratt, 1997; Guest, 1997) add in further sub-boxes to such linkages. For example, attitudinal outcomes could be a sub-box consisting of employee motivation, commitment and satisfaction. Behavioural outcomes could make an additional sub-box containing employee presence (counterpart of absenteeism), employee retention (counterpart of turnover) and organisational citizenship behaviour (OCB), which refers to the work-related behaviour that goes above and beyond that which is dictated by organisational policy and one's job description (Organ, 1988). However, this process produces two fundamental questions. How many sub-boxes explain the black box, and what is the content of each sub-box? Some authors demonstratively write that 'Until now there has been no consensus in the field of HRM with respect to this problem' (Paauwe, 2004: 58) and 'while we found plenty of acknowledgements of the existence of the "black-box", and some speculation as to its possible contents, few studies tried to look inside' (Boselie et al., 2005: 77).

DEBATING HRM

HR and economic crisis

Read the article by Katou, A.A. (2012a) Investigating Reverse Causality between Human Resource Management Policies and Organizational Performance in Small Firms. *Management Research Review*, 35(2): 134–156.

It is argued that an economic crisis hits small businesses more severely than large firms. As a result, small firms are trying to cut costs by reducing the budget of most HRM activities. It is further supported that because small firms cannot compete with large firms in reducing prices, they should concentrate more on the business strategies of innovation and quality enhancement of goods than on cutting costs.

TASK: In small groups of five students, discuss the case for and against cutting the budget of most HRM activities. You may also wish to discuss the view that although HRM policies lead to high organisational performance, it is high-performing firms that can directly afford HRM policies.

The AMO model of the HRM–performance relationship

In trying to unlock the black box a large number of models have been proposed, but one of the most influential is the **AMO model** from Appelbaum, Bailey, Berg and Kalleberg (2000). They proposed an HRM–performance framework, arguing that organisational performance is best served by employees who have the ‘ability’ to do the work possessing the necessary skills and knowledge, who are ‘motivated’ to work and who have the ‘opportunity’ to arrange their skills in doing their work. Their model asserts that performance is a function of Ability + Motivation + Opportunity (i.e. AMO) (see also Boxall and Purcell, 2003; Purcell et al., 2003; Purcell and Kinnie, 2007).

The philosophy of the AMO model is that there is no specific list of HR practices that may influence performance. Instead, the whole process depends on HR architecture that covers policies designed to build and retain human capital and to influence employee behaviour. Thus, according to the HR architecture concept, there is a range of HRM policy domains (ability, motivation, opportunity) that are determined according to organisational context (e.g. industry, culture, country) (Lepak, Liao, Yunhyung and Harden, 2006). The basic HRM policies that are required in order to turn AMO into action are usually considered to be the following: recruitment and selection; training and development; career opportunities that are linked to ability and skill; rewards and benefits that are linked to motivation and incentive and involvement, team working, work–life balance, job challenge and autonomy that are linked to opportunity to participate.

In response to AMO policies, employees will develop organisational commitment, motivation and job satisfaction (attitudinal outcomes). These attitudes will lead to employees demonstrating a range of positive behavioural outcomes. Discretionary behaviour (i.e. making the right choices about how to do a job, such as speed, care, innovation and style) and organisational citizenship behaviour lie at the heart of the employment relationship and should be strongly connected to **performance outcomes**. Highly committed, motivated and satisfied employees are more likely to engage in discretionary behaviour and OCB to help the organisation to be successful. Therefore, it is argued that ‘one of the prime functions of AMO policies is thus the way they help develop attitudes or feelings

DEVELOPING KEY SKILLS: The nature of front-line managers’ strategic HR role

Four different aspects of management of people by front-line managers are usually identified as follows (Purcell et al., 2003): implementing (i.e. putting HR policies into operation), enacting (making HR policies effective), leading (the small actions which front-line managers undertake on a daily basis) and controlling (i.e. controlling the behaviour of employees with respect to their job).

Task: Read critically the chapter by Marchington and Cox (2007) ‘Employee involvement and participation: Structures, processes and outcomes’, in John Storey’s edited textbook *Human Resource Management: A Critical Text*, 3rd Edition. London: Thomson.

Reflect upon the critical role that front-line managers play in the development and continuation of employee involvement techniques.

of satisfaction, commitment and motivation in most employees since these translate into discretionary behaviour, provided the job allows for it' (Purcell et al., 2003: 7).

However, the relationship between HRM policies and attitudinal outcomes is affected by the behaviours of front-line management. Nearly all policies are applied through and by line managers and therefore whether they implement those policies well or badly, consistently or inconsistently, will impact on the outcomes of the policies. This process of external influence is called moderation.

Performance outcomes constitute the ultimate impact of AMO policies, through the serial influence of employee attitudes and behaviour. These outcomes may be operational, such as effectiveness (i.e. if the organisation meets its objectives) and efficiency (i.e. if the organisation uses the fewest possible resources to meet its objectives), or financial, such as ROI (return on investment), ROE (return on equity) and ROCE (return on capital employed). Finally, reverse causality may be encountered from performance to employee attitudes, indicating that the success of the organisation brings positive attitudes to employees, because employees 'feel proud to tell people who they work for and want to stay working for the firm for the foreseeable future' (Purcell et al., 2003: 6).

CASE STUDY

HR and ROI

Meta-analysis studies (i.e. methods focused on combining and contrasting findings from different studies) find that there is growing evidence that HRM positively affects organisational performance (Combs, Liu, Hall and Ketchen, 2006). It is supported that researchers find stronger relationships when examining high-performance work practices (HPWP) systems versus individual HR practices, operational versus financial performance measures and manufacturing versus service organisations (Combs et al., 2006).

Assume that you have recently been appointed as HR advisor for SingularLogic (<http://portal.singularlogic.eu/english-home-page/1229/about-us>), a leading software and integrated IT solutions group in Greece, which provides integrated solutions for the private and public sectors both in Greece and abroad. In addition, SingularLogic operates in various South East European countries through direct subsidiaries in Bulgaria, Romania and Cyprus, having set the foundations for substantial development in the region.

The Board of Directors of SingularLogic is sceptical because the consolidated turnover of the group reached €55.9 million for 2012, which was 5 per cent less than the consolidated turnover of the group in 2011. Whilst you are based at the headquarters of SingularLogic in Athens, part of your role is to visit the group's subsidiaries and to audit their HR processes and practices. You are under pressure to demonstrate the business value of the HR function to the Board of Directors in terms of ROI (i.e. comparing the costs of HR programmes and activities to the benefits derived from them for assessing their worth to the organisation).

Task: Go to http://www.competentiebeleid.be/assets/waarom/Measuring_ROI.pdf for information referring to the measurement of ROI in human resources by Phillips, J.J. (2007) *Measuring ROI in Human Resources*. ROI Institute.

- Demonstrate the HR programme and activities value chain.
- Offer to the executives the types of ROI data.
- Indicate to the company how ROI for human resources will be implemented.

The psychological contract model of the HRM–performance relationship

An alternative approach to illuminating the black box is to focus more directly on the relationship between employer and employee. While employees will typically have an employment contract, in recent years researchers have also begun to focus on the less codified elements of the relationship between employer and employee. This relationship is known as the **psychological contract** (see also Chapter 12). It is defined as ‘an individual’s system of belief, shaped by the organization, regarding terms of an exchange agreement between him/herself and the organization’ (Rousseau and Greller, 1994: 385). Psychological contracts are informal and unwritten in nature, depending on the dynamic interaction between individuals and the organisation. They construct the expectation by both parties to the nature of the exchange between the employer and the employee. There are two somewhat different types of psychological contract that can be considered (Rousseau, 1990). Transactional contracts tend to involve short-term, specific and monetary-related beliefs such as competitive wage rates and performance-based pay. Relational contracts are more concerned with a long-term relationship, characterised by both monetary and non-monetary reward including issues such as job security, loyalty, development opportunity, commitment and trust.

Given the turbulence in employment and employment types in recent years, a number of theorists and practitioners have argued that the traditional psychological contract is progressively replaced by the new psychological contract. The latter is described as an offer by the employer of fair pay and treatment in return for employee commitment to the work performed, considering that employees are responsible for their own career development as well as for their training and development (Robinson and Rousseau, 1994).

A major function of HRM is to cultivate a positive psychological contract that will lead to greater employee motivation, commitment and satisfaction, the attitudinal outcomes we earlier identified as a key stage in the AMO model of the HRM–performance relationship. In other words, psychological contracts can be treated as beliefs stemming from HRM policies and practices. Psychological contract fulfilment is focused on employers’ promise fulfilment as perceived by employees, hence they are likely to reciprocate by fulfilling their own promises and perceived obligations (Conway and Briner, 2005). This is based on the notions of reciprocity and social exchange. If employers uphold their side of the bargain, employees will feel satisfied, committed and motivated, and so they will reciprocate by upholding their side of the bargain (Rousseau, 1995). Therefore, in this model, HR policies influence organisational performance as a result of psychological contract fulfilment.

The nature of the psychological contract itself, however, is shaped by the HR policies in operation. An initial interaction between the organisation and potential employees not only transmits the formal employment terms and conditions of the organisation to the potential job applicants but also communicates the organisation’s beliefs about future employment. Thus an organisation that emphasises training and development may develop an expectation amongst prospective employees that they are part of its permanent employment (Gomez-Mejia, Balkin and Cardy, 2004). The components of employee reward may also serve to construct psychological contract terms by establishing the belief in the perceived value of employees; in other words, that they are worth their rewards in whatever form they are given (Gomez-Mejia et al., 2004).



GRADUATE INSIGHTS

Psychological contract during placement

A placement year in an organisation, or a year abroad, is integrated into many university degrees. Many students usually spend the third year of their course on a work or study abroad or on placement, or a mixture of both. The placement year gives the student an opportunity to take on graduate-level responsibility and 'try out' a career path. The student will be able to put what he/she has learnt on his/her course into practice, whilst gaining valuable professional, and often paid, experience. A placement year enhances the student's graduate employment prospects and can help him/her make more informed career decisions. Over one-third of the placement students are offered graduate jobs by their placement employer (see e.g. at <http://www1.aston.ac.uk/study/undergraduate/placements/>).

A placement programme usually involves a series of business and management training periods under the close guidance of a supervisor. At the beginning of the placement, a typical contract that constitutes the content of the placement experience, the intended learning outcomes and the structure of the relationship between the supervisor and the trainee is developed and signed between the organisation and the trainee. The typical contract helps to prevent later difficulties in cases where the supervisor and the trainee feel that obligations are not being met. In addition to the typical contract that sets out obligations about work and everyday practicalities of the supervision, supervisors and trainees shape up a psychological contract. This contract involves expectations of both parties and helps to develop a trusting and positive supervisor–trainee relationship. The usual insights of the graduate placement psychological contract refer to the hopes about the roles the two parties value most and to the expectations each of the two parties has of the other. Hawkins and Shoet (2004) propose that in cases where the expectations of the psychological contract can be made explicit and agreed upon, the process of learning will be improved.

Discussing with students about their psychological contract during their placement experience, Tom Brothwell (spending one year placement at the University Laval, Quebec, Canada) said that 'The whole experience was second to none; not only academically but culturally as well as being great fun! It has certainly reinforced the international element of my degree and has set me apart from other graduates in the global job market'. Chris Rothwell (placement at Microsoft) said that 'My year's experience here means that I'm able to take on responsibility much faster, allowing me to gain more experience and get a really fantastic start to my career'. Mark Boosey (placement at Reuters) believes that 'I've learnt and experienced loads of important things that just aren't possible in university', whilst Chloe Piper (placement at CSV) said that 'I have learnt how to manage my time, work effectively within a team of volunteers, and how to manage responsibility, especially with cash. My communication skills have been immensely improved because I talk to a range of clients – some speak very little English and others have mental health issues and drug and alcohol problems. I have learnt secretarial and admin skills, as well as passing a food hygiene course'.

The appropriate use of HR policies can therefore create a positive organisational environment that will influence the degree of fulfilment of employer and employee promises (Purcell et al., 2003). Thus, HR policies determine the status of psychological contracts by shaping the day-to-day behaviours of the members in an organisation (Rousseau, 1995). Consequently, a major function of HR policies is to cultivate a positive psychological contract that will lead to improved organisational performance. Effective HR policies produce positive psychological contracts, generating positive attitudinal reactions, which consequently will improve organisational performance.

METHOD PROBLEMS IN INVESTIGATING THE HRM AND FIRM PERFORMANCE RELATIONSHIP

We have presented in the previous section three general models that describe the relationship between HRM and business performance. These models have dominated both theoretical and empirical research and academic and practitioner debate over the last twenty years or so (Gerhart, 2007). However, core questions about the relationship between HRM and performance are still unanswered (Camps and Luna-Arocas, 2012). This is because various problems have bedevilled research in this area, making our knowledge still unsure (Guest, 2011). These fall into five broad areas (Purcell and Kinnie, 2007):

- 1 The methodology framework followed.
- 2 The performance measures used.
- 3 The configuration of the HRM system.
- 4 The theory that explains the causal link between HR practices and performance produced.
- 5 The level of analysis used.

Methodology problems

There are three main methodological problems within this kind of research. First, most studies exploring the HR–performance link used surveys addressed to single responders, such as a senior HR manager. This single individual is asked to describe both HR practices and organisational performance. The problem here is one of bias, specifically what is termed as **common method bias**. To overcome this problem, multiple respondents are used, or different sources are employed for collecting (dependent) performance measures and explanatory HR practices measures.

The second methodological problem is that survey studies tend to collect cross-sectional data, that is, all the data are collected at the same point in time. This does not allow us to make any inference about whether HR practice causes performance outcomes, whether performance outcomes cause HR practices or whether something entirely separately causes both. Cross-sectional research can only reveal associations and not the direction of causality in the relationship between HR practices and performance.

Third, most studies do not consider the lag effect, which refers to the time that takes an HR practice to impact on performance. The most logical design to address the time taken

for HR practice to influence performance would seem to be measuring HR practice at one time and then, at a later time, measuring organisational performance.

Performance measure problems

Our second research problem in relation to the HR–performance debate is to decide what measures of performance to take. With respect to performance, the most important problem refers to the use of objective (explicitly measured) or subjective (based on perception) performance measures. Referring to the objective data, although profitability is assumed to be a profound end goal of HRM, the problem is that there is no convincing methodology for measuring the influence of HR practices on profitability (Purcell and Kinnie, 2007). There are so many other factors which will intervene to influence profitability; consider for example the PEST framework discussed in Chapter 1. This has led many researchers to explore measures that are closer to the HR practices, for example employee turnover or absence (Harter, Schmidt and Hayes, 2002). While both profitability and absence are objective measures, however, both objective and subjective measures are highly variable between sectors, economic philosophies and geographic areas. This brings the necessity of controlling for context (Gerhart, 2005). The controls used in the analysis are frequently categorised into organisational level control variables (such as age and size of organisation) and individual level control variables (Budhwar and Sparrow, 2002).

HR configuration problems

Another potential problem that makes drawing unequivocal conclusions difficult is the choice and definition of the HR practices used in the analysis. There are countless combinations of HR practices that result in identical organisational outcomes. Marchington and Grugulis (2000: 1114) stress that ‘lists of HR practices are developed on the basis of looking at what other researchers have used or by constructing groupings of practices on the basis of factor analysis, and then attempting to impose some theoretical justification for this ex post facto’.

Theory problems

With respect to the theory problems, Boselie et al. (2005) report large disparities in the treatment of the components, emphasising the precise mechanisms that outline what is taking place between HRM and performance. As we discussed above, this is known as the black-box problem. However, most theories assume that employee attitudes and behaviour constitute the heart of the HRM–performance relationship.

Further various models discussed above treat the HRM system as being composed of three parts: content, process and strength (Bowen and Ostroff, 2004; Katou, 2012b). **HRM content** refers to the individual HR policies and practices that make up an HRM system. **HRM process** refers to the method by which HR policies and practices are communicated to employees. **HRM strength** refers to how HR policies and practices are experienced by employees (Kinnie, Hutchinson, Purcell, Rayton and Swart, 2005). HRM strength, which reflects organisational HRM climate in terms of a collective understanding of expected

behaviours and incentives to adhere to them, is influenced by both HRM content and process. However, it is argued that HRM process mediates the relationship between HRM content and HRM strength (Bowen and Ostroff, 2004).

Level of analysis problems

One difficult challenge in HRM research refers to the level of analysis (i.e. plant, business unit and corporation): 'Plant-level studies provide the advantage of measuring HR practices quite specifically and probably most accurately'; 'Business level studies are the optimal setting for assessing the links between HR practices and business strategy'; and 'Studying these phenomena at the corporate level provides a tremendous advantage in the assessment of financial performance' (Wright and Gardner, 2003). HRM can be related to outcomes in different ways at different levels of analysis (individual level of analysis with HRM outcomes at higher levels of analysis). However, this 'multilevel' approach to studying perceptions of and reactions to HRM systems will inevitably need to deal with the concept of variance at different levels of analysis.

DEVELOPING KEY SKILLS: Evaluating the contribution of HR policies and practices to organisational performance

Considering the major models for investigating the relationship between HRM and firm performance, and the related primary problems that are usually present when investigating this relationship, explain how you will evaluate the contribution of HR policies and practices to organisational performance.

Task: Go to <http://hrlink.in/topics/list-of-top-useful-hr-websites> website and pick up online HR-related websites. This will help you in evaluating the HRM–performance relationship.

CASE STUDY

AmBev Brazil [www.ambev.com.br]

AmBev (America's Beverage Company) is a brewing company headquartered in Sao Paulo, Brazil. AmBev was established in 1999 with the merger of two breweries, Brahma and Antarctica. It is the biggest brewery company in Latin America and the fifth in the world. AmBev took a major step towards globalisation in 2004 when it merged with Interbrew, a leading brewery company based in Belgium, creating InBev. Starting an expansion plan, InBev acquired beverage companies throughout many countries, and finally bought Anheuser-Busch, which is America's leading brewer, creating the largest brewery in the world in terms of volumes produced, named AB-InBev.

AmBev produces and/or bottles beers (such as Antarctica, Brahma, Skol and Stella Artois) and soft drinks (such as Pepsi, Lipton Ice Tea and Gatorade). It employs 46,500 people, its revenue is US\$ 15.7 billion, and its net income is US\$ 5.1 billion (2012 figures). Based on the fact that AmBev was the dominant producer in Brazil, with a market share of 60 per cent, its internationalisation process was guided by the necessity to expand to countries with higher growth potential. However, AmBev firmly believes that the success of its internationalisation depends on the quality of its human resources; and it further believes that when a company has good quality of human resources, when there is internal harmony and common vision, then the company is sure to succeed in implementing its goals.

To satisfy the need for quality of its human resources, AmBev helps its employees to discover and to develop their talents and skills, to face professional challenges, to manage their careers and to enhance their personal development. It tries to inspire them, to encourage them, to reward them and to take care of them. Emphasis is put on health, education, experience and skills of employees. Specifically, AmBev has established 12 agricultural production centres where the company is delivering teaching programmes for young farmers on how to use efficient techniques for growing ingredients necessary for the popular soft drinks that AmBev is producing. The shareholders of AmBev believe that its success depends on the following ten dimensions (see http://www.ab-inbev.com/pdf/AB-InBev_Ten_principles.pdf):

- 1 Our shared dream energises everyone to work in the same direction: to be the best beer company in a better world.
- 2 Great people, allowed to grow at the pace of their talent and compensated accordingly, are the most valuable assets of our company.
- 3 We must select people who, with the right development, challenges and encouragement, can be better than ourselves. We will be judged by the quality of our teams.
- 4 We are never completely satisfied with our results, which are the fuel of our company. Focus and zero-complacency guarantee lasting competitive advantage.
- 5 The consumer is the Boss. We connect with our consumers through meaningful brand experiences, balancing heritage and innovation and always in a responsible way.
- 6 We are a company of owners. Owners take results personally.
- 7 We believe common sense and simplicity are usually better guidelines than unnecessary sophistication and complexity.

- 8 We manage our costs tightly, to free up resources that will support top-line growth.
- 9 Leadership by personal example is the best guide to our culture. We do what we say.
- 10 We don't take shortcuts. Integrity, hard work, quality and consistency are keys to building our company.

Case Study Tasks: Assume that you are the newly appointed head of the HR department of AmBev. You have the following tasks:

- 1 To present to the Board specific programmes that must be initiated in order for successfully delivering the ten dimensions.
- 2 To explain to the Board how you would measure the value added of these programmes.

Source: AB InBev (2010) *Dream, People, Culture: 10 Principles*, http://www.ab-inbev.com/pdf/AB-InBev_Ten_principles.pdf. Retrieved 8 July 2013

CHAPTER SUMMARY

The key points that we have identified in this chapter are the following:

- This chapter explained the potential contribution of HRM to sustainable firm performance. In doing so, the various theoretical perspectives that have been put forward to explain this relationship were evaluated.
- Concepts such as strategic management and strategic HRM that are related to the HRM–performance relationship are introduced. Strategic management refers to the managerial decisions and actions that may improve performance in organisations, and strategic HRM refers to the processes that link HRM policies and practices with the strategic objectives of the organisation.
- The theoretical frameworks of the resource-based view, whereby HRM influences performance according to the human capital held by the organisation, and the integration approach, whereby HRM strategy formulation focuses on the alignment of HR policies and practices within the HRM area and with other strategies outside the area of HRM, have dominated the field of strategic HRM.
- Three major models that explain the relationship between HRM and organisational performance have been critically presented. These are the universalistic or best practice models of HRM, arguing that the organisation is developing a range of interconnected and mutually reinforcing HR practices that will always produce superior results whatever the accompanying circumstances; the contingency or strategic fit models of HRM, arguing that the organisation is developing a range of HR practices that fit the business's strategies outside the area of HRM; and the configurational or bundles models of HRM, implying that the existence of specific combinations of HR practices that depend on organisational context lead to higher business performance.
- The general causal model of the HRM–performance relationship is presented whereby the precise mediating mechanisms through which HR practices influence business

performance are explored. These mediating mechanisms, which are popularly referred to as the black box, assume that HRM outcomes such as employee skills, attitudes and behaviour positively mediate the relationship between HRM and performance.

- In trying to illuminate the black box, the AMO HRM–performance framework is explored, arguing that organisational performance is best served by employees who have the ability to do the work, possessing the necessary skills and knowledge, who are motivated to work appropriately and who have the opportunity to arrange their skills in doing their work. Additionally, the psychological contract HRM–performance framework is presented, whereby the state of the psychological contract, based on the notions of reciprocity and social exchange, mediates the relationship between HR policies and organisational performance.
- Important problems in empirical research demonstrating the causal links between human resource management and business performance, such as the methodology framework followed, the performance measures used, the configuration of the HRM system, the theory that explains the causal link between HR practices and performance produced and the level of analysis used, are presented. Although there is growing evidence that high-performance work practices affect organisational performance, these problems make the size of the overall effect difficult to estimate and produce mixed results.

REVIEW QUESTIONS AND EXERCISES

- 1 What is meant by strategic management? Explain the steps of the strategic management process.
- 2 What are the levels of strategy formulation? Discuss what is the focus of each strategy.
- 3 What is meant by strategic human resource management? Present the theoretical frameworks that have dominated the field of strategic HRM.
- 4 What is meant by black box? Explain the linkages between HRM and firm performance.
- 5 Which are the basic properties of the universalistic, contingency and configurational models?
- 6 What are the core concepts in the AMO and the psychological contract HRM–performance frameworks?
- 7 Why is it difficult to evaluate the contribution of HR policies and practices to organisational performance?

EXPLORE FURTHER

Muller-Camen, M., Croucher, R. and Leigh, S. (2008) *Human Resource Management: A Case Study Approach*. London: Chartered Institute of Personnel and Development. *This is a very good book exploring HRM through the case study approach. The chapter, 'The psychological contract, absence and turnover' in particular provides a very useful summary of the key issues linking HRM practices, the psychological contract and important employee attitudes towards and behaviours at work.*

Schuler, R.S. (1989) Strategic human resource management. *Human Relations*, 42(2): 157–184. *Although this article was now written some time ago, this still provides an excellent review of the key theoretical developments in strategic HRM.*

The Chartered Institute of Personnel and Development website at <http://www.cipd.co.uk/>. *This website is worth exploring as it will provide you with lots of very useful information regarding the profession.*