

Second Edition

# Human Resource Strategy

*Formulation, Implementation, and Impact*

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Peter A. Bamberger, Michal Biron,  
and Ilan Meshoulam

ROUTLEDGE



# Human Resource Strategy, Second Edition

What is human resource strategy? How are human resources strategies formulated and how can we explain the variance between what is espoused and what is actually implemented? What impact—if any—does human resource strategy have on the organization’s “bottom line,” and how can this impact be explained? Is there one best HR strategy for all firms, or is the impact of HR strategy on performance contingent on some set of organizational, technological or environmental factors?

*Human Resource Strategy*, 2nd edition, provides an overview of the academic and practitioner responses to these and other questions. Applying an integrative framework, the authors review 30 years’ worth of empirical and theoretical research in an attempt to reconcile often-conflicting conceptual models and competing empirical results. Complex theoretical models and scientific findings are presented in an accessible and relevant way, in the context of the strategic decisions that executives are forced to make on a regular basis.

This new edition features an updated literature review, coverage of the latest challenges to HR strategy, new mini-cases, discussion questions, additional examples, and an emphasis on the strategic implications of the research, making it an ideal resource for students and practitioners alike.

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**Peter A. Bamberger, Michal Biron, and Ilan Meshoulam**

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# I

## **Human Resource Strategy**

### **Emergence and Types**

# 1

## INTRODUCTION

After close to 20 years of hopeful rhetoric about becoming “strategic partners” with a “seat at the table” where the business decisions that matter are made, most human-resources professionals aren’t nearly there.... HR is the corporate function with the greatest potential—the key driver, in theory, of business performance—and also the one that most consistently under-delivers.

—Hammonds (2005, p. 40)

The HR value proposition means that HR practices, departments, and professionals produce positive outcomes for key stakeholders—employees, line managers, customers, and investors.... When others receive value from HR work, HR will be credible, respected and influential.

—Ulrich and Brockbank (2005, pp. 2, 8)

## ORIGINS OF HUMAN RESOURCES STRATEGY RESEARCH

Human resource management (HRM) has changed dramatically since its establishment as the discipline of personnel administration in the first quarter of the 20th century. Emerging from the “welfare officers” of the late 1800s, the new discipline—grounded in the nascent paradigm of industrial psychology and encouraged by the disciples of Frederick Taylor in the 1920s—was viewed as a possible solution to such nagging problems as worker inefficiency and worker unrest (Barley & Kunda, 1992; Schuler & Jackson, 2007). A core tenet of Taylorism was the notion that work becomes more productive and less arduous when individuals are placed in jobs appropriate to their abilities and when they are paid fairly. Taylor viewed the questions of how to match individuals with the job in which they would be most productive and to provide them with fair incentives as fundamental vocational and social issues (Savickas et al., 2009) that could be resolved by applying a scientific management approach. Hence, one of the functions of the new “employment administrators” was developing and applying new testing technologies to rationally select and place employees. To further reduce worker unrest, personnel directors offered a new approach to employee relations, one grounded in the use of entitlements to solidify workers’ allegiance to their employer. The personnel function became the locus of all activities having to do with employee relations, and eventually, contract administration.

The scope of these technical activities widened over the decades, with new functions and technologies added with every shift in managerial thought and discourse (Barley & Kunda, 1992; Francis & Keegan, 2006; Schuler & Jackson, 2007). For example, during the height of the human relations movement (1930s–1950s), personnel directors widened their package of services to include management development (as a means to develop personal potential) and collective bargaining, industrial due process, and labor-management collaboration (as mechanisms to structure and manage labor conflict). With the upsurge of operations research and systems rationalization in the 1960s and 1970s, personnel directors offered new technical services in areas such as work redesign, job evaluation, manpower forecasting and planning, and performance management systems.

However, demands in the 1980s for improvements in both cost efficiency and quality—a product of increased global competition, expansion of the services sector, declining trade union density, and movement toward a “knowledge economy”—placed personnel management at a crossroads (Rucci, 1997; Schuler & Jackson, 2007; Wright, 2008). On the one hand, since its establishment, the personnel function



had based its legitimacy and influence on its ability to buffer an organization's core technology from uncertainties stemming from a heterogeneous workforce, an unstable labor market, and a militant union movement. Yet by the 1980s, managers had become less concerned with these technical sources of uncertainty and were paying greater attention to quality, flexibility and agility, and unique competencies as sources of competitive advantage. Indeed, by the early part of that decade, the strategic management of human resources and the design of "strong" organizational cultures had become the focus of attention for a number of extremely influential management consultants and applied researchers (e.g., Deal & Kennedy, 1982; Ouchi, 1981; Peters & Waterman, 1982). These writers viewed the effective management of human resources (HR) as a critical source of competitive advantage. For example, one of Peters and Waterman's (1982) "Eight Attributes" was "productivity through people," which called for viewing human resources rather than capital investment as the fundamental source of improvements in efficiency—"treating the rank and file as the root source of quality and productivity gain" (p. 14).

Not surprisingly, by the mid-1980s, an increasing number of HR researchers were calling for the personnel function to take on more a strategic or business role. The birth of the strategic approach to HRM—that is, strategic HRM, or SHRM—can be traced to the foundational conceptual models of the Michigan (e.g., Fombrun, Tichy, & Devanna, 1984) and Harvard (e.g., Beer, Spector, Lawrence, Mills, & Walton, 1984) schools. According to the Michigan approach, the main HRM objective was to organize and utilize HRM functions (i.e., selection, appraisal, rewards, and development) so as to maximize their impact on organizational performance. According to the Harvard approach, the key objectives of HRM included aligning the interests of employees and management to boost organizational effectiveness and individual and societal well-being. The main distinction between the two approaches had to do with the point of view being limited to shareholders (Michigan) as opposed to also including other stakeholders (Harvard) (Legge, 1995).

Over the following decades, research has further contributed to the development of the strategic view of HRM. Tyson (1987), for example, called for the replacement of two traditional personnel models, namely the personnel director as the "clerk of works" (an administrative function responsible for the provision of pay, benefits, and employee welfare services) and the "contracts manager" (employee relations expert), with a new, "architect" model. According to this model, personnel would return the responsibility for people management (e.g., appraisal, individual counseling) back to line managers and would instead focus on aligning the firm's human resource system with its business strategy. Similarly, Wright and McMahan (1992) argued that two important dimensions distinguish the strategic approach to human resource management from the more traditional practices of personnel management described above. First, "it entails the linking of human resource management practices with the strategic management process of the organization" (Wright & McMahan, 1992, p. 298). That is, it calls for the consideration of HR issues as part of the formulation of business strategy. Second, the strategic approach places an emphasis on synergy (or, at least, congruence) among the various HR practices (internal fit or horizontal integration), and on ensuring that these practices are aligned with the needs of the business as a whole and the broader environment within which the organization functions (external fit or vertical integration).

Becker and Huselid (2006) pithily summarize the difference between strategic and traditional HRM research in observing that SHRM "focuses on organizational performance rather than individual performance" (p. 899) and that it "emphasizes the role of HR management systems as solutions to business problems ... rather than individual HR management practices in isolation" (p. 899). These more complex HRM systems, sometimes referred to as "best practices," "high performance work systems," or "HR bundles," imply one recipe for successful HR activity that should lead to positive outcomes for all



types of firms. This approach has been challenged by an alternative HRM model that focuses on more tailored configurations of HR practices. Referred to as the “contextually contingent” or “best fit” HRM model, this approach takes account of HR practices suitable for a given type of business under specific circumstances (Becker & Huselid, 2006; Cappelli & Neumark, 2001).

Mirroring the developments in HRM research described above, the HRM discourse over the past 25 years has sought to promote a vision of HR specialists as more closely aligned with the strategic imperatives of the firm, and accorded status as key contributors to business strategy through the effective management of its human capital. More specifically, given that traditional sources of competitive advantage, such as natural resources, access to financial resources, technology, protected or regulated markets, and economies of scale have become increasingly easier to imitate and have thus lost their strategic power, the potential for human capital to provide sustainable competitive advantage has created a new avenue for HR to become a strategic partner. The ultimate goal has become to create value for key stakeholders, including line managers, customers, and investors (Becker & Huselid, 2006; Schuler & Jackson, 2007; Ulrich & Brockbank, 2005). In short, HR professionals want “a seat at the table”—that is, membership in their firms’ top executive decision-making teams.

HR’s continuing search for “a seat at the table” involves a vision whereby HR strategies, systems, and practices are linked to the firm’s financial performance in a distinctive, inimitable way, with the goal of advancing the firm’s long-term success. This requires a systems-wide perspective, with the vertical and horizontal integration described above (based on continuous partnerships between HR professionals and different stakeholders). It also requires replacing subjective estimates of some qualitative impact with matrices for measuring the economic value added by HR activities—that is, their return on investment (e.g., Beatty, Huselid, & Schneier, 2003; Becker & Huselid, 2006; Fitz-Enz, 2002).

## CONCEPTUAL ISSUES

Despite the increased attention paid to strategic human resource management and HR strategy (HRS) in recent years, researchers have failed to clarify the precise meaning of these two important concepts—a shortcoming that has complicated both theory development and testing. Generally speaking, SHRM may be viewed as encompassing a link between HR strategy and business strategy, with the upshot being increased organizational effectiveness and success. Indeed, with the most pressing theoretical and empirical challenge in the SHRM literature being the need for a clearer articulation of the “black box” linking HR and firm performance, researchers have focused on variables associated with strategy implementation capabilities such as the firm’s ability to attract, develop, and retain required human capital (Becker & Huselid, 2006; Collins & Clark, 2003; Jiang, Lepak, Hu, & Baer, 2012). In the sections below, we attempt to clear up some of the confusion with respect to these key constructs in the SHRM literature.

### *Business Strategy*

Business strategy concerns the long-term direction and goals of a firm and the broad formula by which that firm attempts to acquire and deploy resources in order to secure and sustain competitive advantage (Hitt, Ireland, & Hoskisson, 2005; Porter, 1980). Notions of business strategy evolved under the influence of competitive thinking, which, in turn, was stimulated by such diverse areas as animal and social behaviors (e.g., game theory) as well as military science (Ghemawat, 2002). This has led management

scholars (Mintzberg, 1990; Quinn, 1988) to define business strategy in terms of the set of organizational goals business leaders attempt to achieve (i.e., ends) and the policies (i.e., means) by which these leaders attempt to position the firm and its resources in relation to the firm's environment, competitors, and other stakeholders in order to maximize the potential for goal attainment.

Most strategy research to date can be placed into one of two branches. The first, content research, seeks to answer the question of *what* underpins firms' competitive advantage, while the second, process research, concerns *how* firms' strategies emerge over time and lead to desired outcomes (e.g., Barney, 1991; Herrmann, 2005; Mellahi & Sminia, 2009). More specifically, content or policy research focuses on the link between a wide variety of structural (e.g., capacity, technology) and infrastructural (e.g., workforce) parameters and performance, and the ways in which this relationship may be moderated by various environmental contingencies. Much research in this subfield is grounded in the seminal work of Chandler (1962) and his basic proposition that environmental contingencies (e.g., technological change) shape organizational strategies, which in turn determine organizational structure. In contrast, process research examines the formulation and implementation of policies as well as their dynamics over time and their impact on the firm's bottom line. Much process research is grounded in the work of Galbraith and Nathanson (1978), who argued that the key to implementation is the realignment of core organizational systems (e.g., finance, marketing, and operations, as well as HRM).

An important development in the field of business strategy in recent years is the growing emphasis on the concept of strategy dynamics, or the search for theory and practice to help firms balance the conflicting requirements of formulating strategy for the longer term and to deal with immediate short-term pressures (e.g., Segal-Horn, 2004)—what Ghemawat (2002) expressed as “the dynamic question of how businesses might create and sustain competitive advantage in the presence of competitors who could not be counted on to remain inert all the time” (p. 64). Accordingly, current efforts in business strategy involve, for example, research on absorptive capacity (Cohen & Leventhal, 1990; Jansen, van den Bosch, & Volberda, 2005), balancing enterprise competencies in exploration and exploitation (Lavie, Stettner, & Tushman, 2010), and how to strengthen patterns of innovation and knowledge acquisition (Herrmann, 2009).

## *HR Strategy*

As Gardner (2002) notes,

strategy, including HR strategy, involves the acquisition, development, and deployment of resources while anticipating and responding to a large variety of market forces. Strategy also involves anticipating and responding to the tactics of direct competitors in an effort to maintain competitive parity and incrementally build competitive advantage.

(p. 225)

Consistent with this view and the traditional strategy literature (Miles & Snow, 1978; Mintzberg, 1979), we conceptualize HR strategy as the pattern of decisions regarding the policies and practices associated with the HR system, contingent on business strategy and competitive context (Bamberger & Fiegenbaum, 1996; Gardner, 2005). Implicit in this definition are two core assumptions. First, we assume that the focus of attention needs to be on the HR *system*, not the HR *function*. The HR system is one of numerous organizational systems (e.g., the finance system, the marketing system), each of which plays a role in the formulation of organization-wide strategies, and each of which is comprised of function-specific

subsystems (Bamberger & Fiegenbaum, 1996; Becker & Huselid, 2006; Way & Johnson, 2005). In the case of HR, these subsystems are focused on people flow and development, appraisal and rewards, and employee relations. While in many organizations the HR function has primary responsibility for implementing decisions having to do with each of these subsystems, other functional units may play an important role in making the decisions in the first place, as well as in their implementation.

Second, we assume that it is impossible to understand the nature of HR strategy without taking both intra-organizational politics and environmental/institutional contingencies into account (Bamberger & Phillips, 1991; Gardner, 2005; Way & Johnson, 2005). Consequently, we recognize that there is likely to be a difference between a firm's "espoused" or planned HR strategy, and its "emergent" or actual strategy. This assumption is based on a recognition that strategy at any level and in any organizational system is rarely if ever the outcome of a rational, explicit, and top-down process. Thus, the espoused HR strategy is the pattern of HR-related decisions made, but not necessarily implemented. It is often explicated as part of "corporate philosophy" or included as a central component of a managerial mission statement. In contrast, the emergent HR strategy is the pattern of HR-related decisions that, while perhaps never made explicit, have in fact been applied. This "strategy in use" is a negotiated order (Strauss et al., 1963), shaped by the political maneuvering of those interests and institutions likely to be affected by the outcomes of the strategic decision-making process. Extending this notion to the level of HR practices, a number of researchers (e.g., Khilji & Wang, 2006; Wright & Nishii, 2013) have emphasized the need to distinguish between intended HR practices (those designed on a strategic level), actual HR practices (those implemented by line managers), and perceived HR practices (those perceived—and often acted upon—by employees).

### *Strategic Human Resource Management*

We view SHRM as a competency-based approach to the management of human capital, focused on the development of durable, imperfectly imitable, and nontradable people resources. Developing resources with such characteristics is the key to sustainable competitive advantage, particularly since, as Gardner (2002) notes, "the key resource for firms competing in the new economy is no longer land, capital, or hard assets but the human capital necessary to adapt organizations to global competition and maximize the benefits associated with the current technological boom" (p. 225). As an approach to the process of people management in organizations, SHRM is not unrelated to HR strategy. Indeed, the formulation and enactment of an HR strategy designed to "align HR practices to strategic goals" (Lawler, Ulrich, Fitz-Enz, & Madden, 2003, p. 25) is a key element of SHRM. Thus, if *SHRM* is the process by which organizations seek to link the human, social, and intellectual capital of their members to the strategic needs of the firm, *espoused HR strategy* is the roadmap that organizational leaders use to secure that link, and *emergent HR strategy* is the road actually traveled.

## **THE ROLE OF HR STRATEGY IN STRATEGIC MANAGEMENT: THEORETICAL FOUNDATIONS**

That both HR practitioners and researchers have embraced this strategic approach to human resource management is beyond dispute. However, there is far less consensus regarding the forces generating this shift in HRM orientation from managing people (administrative expert) to creating strategic contributions (strategic partner). For example, from a rational choice perspective, it makes sense for any organizational

function to shift its attention to those activities that are likely to provide the organization with the greatest possible return. Accordingly, as noted by Lemmergaard (2009), “HR professionals are subject to vast changes in their need to demonstrate the added value of the HR function to the organization” (p. 182). However, rather than emerging as a rational response to shifting environmental contingencies, several scholars suggest that the shift in HRM orientation may be driven more by institutional, constituency-based interests. Next, we examine in more detail theories associated with both perspectives on the emergence of a more strategic approach to the management of human capital, or in other words, strategic HR management.

### *Rational Choice Theories*

**Behavioral role theory.** Based on the assumption that employee behaviors are key to successful strategy implementation, behavioral role theory (Katz & Kahn, 1978) suggests that by aligning HR policies and practices with firm strategy, employees will be better able to “meet the expectations of role partners within the organization (i.e., supervisors, peers, subordinates), at organizational boundaries (e.g., customers), and beyond (i.e., family and society)” (Jackson & Schuler, 1999, p. 47). Moreover, responses to contingency events may be incorporated into different patterns of role behavior. Accordingly, the role behavior perspective, while primarily focusing on the need for HR practices to elicit employee behaviors consistent with firm strategy, has been extended to incorporate employee role requirements dependent on other situational contingencies, such as characteristics of the industry (Lengnick-Hall, Lengnick-Hall, Andrade, & Drake, 2009).

**Human capital theory.** A second theory grounded in a rational choice perspective, human capital theory (Becker, 1964), suggests that the value of human resources (the knowledge, skills, and abilities that people bring to organizations), as with any other type of capital, lies in their ability to contribute to organizational productivity (Schuler & Jackson, 2005) both directly and indirectly (i.e., by moderating the relationship between business strategy and firm performance; e.g., Hitt, Bierman, Shimizu, & Kochhar, 2001). Thus, organizations make strategic decisions about investing in and managing people just as they make decisions about other economic assets, such as land or machinery (e.g., Wright, Dunford, & Snell, 2001). One of the most important decisions in this regard has to do with whether to internally develop their own human capital or to acquire it from the external labor market—what is often referred to as the “make or buy” decision (Becker, 2009; Wright et al. 2001). Importantly, although firms may have access to valuable human capital, “either through the poor design of work or the mismanagement of people [they] may not adequately deploy it to achieve strategic impact” (Wright et al., 2001, p. 705).

**Transaction cost theory.** This theory (Williamson, 1979; 1981) similarly focuses on the issue of “make or buy,” suggesting that adoption of a strategic approach to HRM can minimize the costs involved in controlling internal organizational exchanges. These costs stem from the need to develop adequate controls to avert situations where employees, “through self-interest or by opportunistic behaviors, fail to fulfill their obligations” (Tremblay, Côté, & Balkin, 2003, p. 1658). The threat of opportunism is affected by the characteristics of the transaction, the partner, and the relationship. Unique strategic approaches to HRM should be adopted to suit firms with highly developed internal labor markets when the nature of the work process is such that employee loyalty and/or firm-specific knowledge, skills, and abilities are highly valued. Such an approach should also facilitate the decision to maximize efficiencies by competing in the external labor market (enhancing flexibility by pursuing shorter relationships with employees) when such firm-specific skills are not required (Lui & Ngo, 2004; Tremblay et al., 2003).

**Resource-based view.** Synthesizing the themes highlighted by the behavioral role, human capital, and

transaction cost theories noted above, the resource-based view (RBV; Barney, 1991; Grant, 2010) suggests that resources that are rare, inimitable, and nonsubstitutable provide sources of sustainable competitive advantage for the organization. As such, the RBV shifts the emphasis in strategy away from external factors (such as industry position) and toward internal firm resources as sources of competitive advantage, providing a strong basis for the development of a more strategic approach to HRM (Wright, Dunford, & Snell, 2001). Indeed, according to some RBV scholars, the greater the rate of change in a firm's external environment, the more likely internal resources are to provide a secure foundation for long-term competitive advantage (Grant, 2010). According to the RBV, people are an important resource in this regard because of the two types of capital—human and social—they can bring to the firm. Human capital (i.e., employees' knowledge, skills, and abilities), particularly when organized in groups and networks, provides the firm with a pool of resources that have the potential (a) to differentiate the firm from its competitors, (b) to be process-dependent and thus hard to copy, and (c) to be difficult to replicate or replace (Colbert, 2004; Wright et al., 2001). In addition, social capital (employees' connections to and relationships with key stakeholders within and external to the organization) may similarly provide the employer with a critical resource that is time-consuming if not impossible to replicate, and often costly to "buy" in the labor market.

**Agency theory.** Finally, building on this notion of people as a source of competitive advantage for the firm, agency theory (Eisenhardt, 1989) adopts a rational approach to postulating how a strategic approach to HRM may better allow this resource to generate the maximum return to the firm. Given the uncertainties inherent in monitoring and rewarding employees' (i.e., agents') compliance with the implicit and explicit contracts typical in employment contexts (the "agent problem"), agency theory proposes that through the strategic alignment of agent and principal (i.e., employer) interests, employment relations and systems can be streamlined (Hayton, 2005). Agency theory has been successfully employed with regard to strategic compensation practices, and—in particular—the widespread adoption of compensation systems that take into account the need to promote principal-agent compatibility by tying pay to investments by individuals (i.e., variable or performance-based pay practices; e.g., Tremblay et al., 2003).

### *Constituency-Based Theories*

However, it is just as likely that HR practitioners and researchers have embraced SHRM out of a constituency-based interest. As Lemmergaard (2009) notes, the HR function has often been "caught up in administrative routines with little impact on organizational effectiveness" (p. 191). This has created a vicious circle in many firms in which only those contributing to performance are accorded high status and invited to participate in strategic decision making, and in which only those participating in strategic decision making are able to maximally contribute to firm performance (e.g., Wei & Lau, 2005). The adoption of a more strategic approach to HRM may be viewed by some HR managers as a means of increasing the legitimacy of HR as a strategic partner within the firm (e.g., Hughes, 2008). Similarly, for SHRM researchers, empirical analysis of the link between HR practices and firm performance may provide an important means to secure greater awareness and respect for the field of HRM as a whole. Underlying such a constituency-based perspective are two established organizational theories and a third, related approach.

**Institutional theory.** The first of the established theories, institutional theory (DiMaggio & Powell, 1983; Meyer & Rowan, 1977), suggests that the adoption of any new organizational form or practice stems from an organizational interest in gaining legitimacy and acceptance from key stakeholders as a means to ensure continued survival. As we will describe in detail in [Chapter 2](#), the adoption of certain

HR practices may stem from coercive pressures exerted by the state (e.g., Equal Employment Opportunity requirements), normative pressures exerted by the HR profession or the investment community, or the mimetic pressures driving organizational leaders to follow managerial fads and adopt the HR practices of other firms as a way of coping with uncertainty.

**Resource dependence theory.** The second established theory, resource dependence theory (Pfeffer & Salancik, 1978), is grounded in the notion that organizations and organizational interests gain power over one another by securing scarce resources and controlling the resources that their constituents are dependent upon. Since dependence is the basis of power (Bacharach & Lawler, 1980), those responsible for the human resource system may increase their level of influence in the organization by (a) enhancing the perceived value of human resources (relative to that of other key production resources) to key organizational interests and (b) making other organizational interests dependent on them for ensuring the efficient and timely acquisition, deployment, and development of human resources. A strategic approach to HRM may offer the potential to do both and may therefore be particularly appealing to those HR practitioners looking to gain greater influence in organizational affairs (e.g., in terms of budget allocations; Wei & Lau, 2005).

**Multiple constituency/multiple stakeholder approach.** Relatedly, the multiple constituency/multiple stakeholder approach recognizes the dynamic and multidimensional as well as multilevel nature of the strategic management process (Freeman & McVea, 2001). This approach is rooted in systems theory (Ackoff, 1970; Buckley, 1967), which emphasizes that organizations are open systems requiring the support of various stakeholders, both external (e.g., regulatory agencies) and internal (e.g., line managers), to address relevant issues and problems (e.g., Arthur & Boyles, 2007; Kepes & Delery, 2006). The goals and objectives of stakeholders, along with power relationships among them, influence organizational goals and objectives, as well as the strategies pursued by the organization—and, thus, the measures of effectiveness that should be used to evaluate the impact of SHRM (Colakoglu, Lepak, & Hong, 2006). Systemic agreement theory, for example, provides a framework in which organizational alignment—the degree to which an organization’s design, strategies, and culture cooperate to achieve desired goals—is proposed to enhance organizational effectiveness and create competitive advantage (Way & Johnson, 2005).

In sum, whereas rational choice theories attribute the emergence of a more strategic approach to people management to the notion that human and social capital, *when managed strategically*, can generate a sustainable source of “rent” for the firm, constituency-based theories suggest that to better understand the emergence of SHRM one must take into account the need for legitimacy on the part of organizations and those managing them, as well as the political interests of the latter.

## **ISSUES OF CONCERN IN THE STUDY OF HR STRATEGY**

Over the past decade, three main issues have dominated the discourse in the SHRM literature. The first issue concerns the *adoption and implementation* of HR strategies. Of interest is not only how an HR strategy may be most effectively formulated, but also what organizational or environmental characteristics predict the adoption of specific strategic HR practices. Additionally, given that “the ability to implement strategies is, by itself, a resource that can be a source of competitive advantage” (Barney, 2001, p. 54), scholars have included the issue of strategy implementation in their examination of this question (Becker & Huselid, 2006). Particular attention has been paid to distinguishing between intended, implemented, and perceived HR practices (e.g., Khilji & Wang, 2006; Nishii, Lepak, & Schneider, 2008). As noted by

Guest (2011), such a distinction allows for “a shift from studying the presence of HR practices to how well they are applied, and by implication, a shift in focus from HR managers to line managers” (p. 9).

The second issue concerns the *content* of HR strategy, and in particular, the policies and practices comprising different HR strategies. What are the main dimensions along which HR strategies vary, and how does this variance manifest itself in terms of specific HR policies and practices? Are there differentiated categories of staff within the firm that need distinct sets of HR policies and practices? A related topic involves the search for a more balanced HR agenda, one that addresses both human and economic concerns. As several authors note, while HR professionals continue on their journey to be business partners, they also need to rediscover their role as guardians of the organization’s people and values (e.g., Francis & Keegan, 2006; Wright & Snell, 2005). How can these potentially conflicting challenges be integrated? Thus, from a strategic perspective, HR also needs to give serious consideration to such ethical matters as the people side of corporate mismanagement and fraud, the exploitation of offshore and/or contingent workers, and the application of genetic screening in employment (e.g., Greenwood, 2012; Lefkowitz, 2006).

Finally, SHRM researchers have perhaps paid the most attention to the consequences of HR strategy, and in particular, the impact on firm performance of various policies, practices, and strategic configurations thereof—that is, “black box” questions such as “Does HR strategy make a difference?” and “What are the most important variables linking HR strategy to unit or firm performance?” This emphasis on the HRM value proposition has, of course, heightened the saliency of measurement (e.g., Gerhart, Wright, McMahan, & Snell, 2006), with such intriguing questions as how to measure program adoption or practice application, and which measures of performance to use. Furthermore, notwithstanding the debate over contribution and measurement, critics have highlighted the marked difference between the rhetoric and the reality of SHRM (Farndale & Brewster, 2005; Kanter, 2003). Kochan’s position that “the two-decade effort to develop a new ‘strategic human resource management’ role in organizations has failed to realize its promised potential of greater status, influence, and achievement” (2007, p. 599) explicitly reflects such concerns.

Our objective in this book is to review the research on all three of these issues, critically evaluating and, where possible, extending management theory. Our intent is not to examine each of HRM’s core technologies (e.g., recruitment or development) from a strategic perspective. Nor is it to provide a review of the latest research on specific HR practices. Rather, our purpose in this book is to examine whether, how, and when human resources may serve to augment the strategic capability of the firm, and how a firm’s HR system can strengthen the link between human resources and firm performance. As such, we take a macro view of HRM and focus our attention on the firm’s overall HR system rather than the activities of its HR function. Our intent is not simply to summarize and evaluate the findings of HR strategy research for students of HR and HR researchers. Rather, it is to provide some new insights into the link between human resources and the competitive activity of organizations; insights that should be meaningful to students and researchers of organizational theory, strategy, and human resource management.

## **PLAN OF THE BOOK**

The book consists of three parts. [Part I](#) begins with a focus on the emergence and formulation of HR strategy ([Chapter 2](#)). Drawing on many of the themes and theoretical perspectives noted above, we will discuss factors explaining variance in HR strategy adoption across firms. We will also contrast a number of normative models offered by HR practitioners with the descriptive models proposed by HR



researchers to explain within-firm variance in HR strategy formulation. Finally, we will examine the link between firm-wide strategy and HR strategy and the degree to which the latter is actually implemented and enacted.

In [Chapter 3](#), we examine the various types and models of HR strategies proposed in the literature. Although researchers have proposed a number of strategic typologies, many of these are, at their core, quite similar. Nearly all differentiate among HR strategies on the basis of the organizational approach either to resource acquisition and retention (i.e., external vs. internal orientation) or to system control (i.e., a focus on process vs. output). Viewing these two characteristics as orthogonal dimensions of HR strategy, we identify and describe four dominant or core HR strategies: (a) a commitment strategy (internal, output oriented); (b) a free-agent strategy (external, output oriented); (c) a paternalistic strategy (internal, process oriented); and (d) a secondary strategy (external, process oriented).

Viewing an organization's HR system as itself comprised of interrelated subsystems that are "designed to attract, develop and maintain a firm's human resources" (Duarte & Martins, 2012, p. 466), in the second part of the book ([Chapters 4 through 7](#)), we will examine subsystem-specific strategies and the "bundles" of HR policies and practices associated with them. Our focus will be on four basic HR subsystems, namely people flow, performance management, rewards (i.e., compensation and benefits), and employee relations. Much of our discussion in these chapters will be based on the four-part typology of HR strategies described in [Chapter 3](#). Adopting a means-ends approach to our analysis, in each chapter we will review the various strategic objectives a firm might adopt for a subsystem given its dominant HR strategy (i.e., commitment, free-agent, paternalistic, or secondary). We will then review the various policies and practices (i.e., means) that, in the context of each dominant strategy, are typically used to achieve subsystem ends.

More specifically, in [Chapter 4](#), we will focus on the people-flow subsystem, its objectives of human resource composition and competence, and such HR practices as planning; recruitment and selection; organizational entry; career development and internal labor market structuring; training, and development; downsizing; and retirement. We will then show how, according to the literature, the ends and means of so-called talent management are likely to vary across the four strategic models.

Using a similar analytical approach, [Chapters 5 and 6](#) will focus on the performance management and rewards subsystems, respectively. Specifically, [Chapter 5](#) will revolve around performance management, examining such issues as job analysis, performance appraisal approaches and dilemmas, and performance feedback. Particular attention will be paid to performance management as a reflective learning process, and we will highlight recent research on more informal mechanisms of peer regulation as an alternative to more traditional, supervisor-driven modes of appraisal and feedback. In [Chapter 6](#), we discuss compensation strategy, with such issues as pay structure and administration (e.g., pay system transparency) and the use of individual and/or group-based pay-for-performance. Again, we will examine differences in evaluation and compensation ends and means across all four dominant strategic types.

In [Chapter 7](#), we will examine what we refer to as the employee relations subsystem. We view the establishment and reinforcement of the psychological contract between employer and employee as the primary objective of this subsystem, and such functions as job design, employee engagement, employee assistance, and dispute resolution as the primary means used to achieve this objective. After reviewing new employment relations strategies and how these may relate to each of the four generic HR strategies, we will review the literature on a number of "best practices" in this realm, including team-based work structures, employee participation and involvement, work/family programs (e.g., flextime, work-family crossover), and alternative dispute resolution systems. We will also discuss recent research on what unions do for workers, employers, and economies in general.

In the third part of the book, we examine whether and how HR strategy affects a variety of outcomes at the firm level, as well as some of the challenges that future HR strategies need to address, particularly those having to do with a more diverse and geographically distributed workforce. More specifically, in [Chapter 8](#), we will review and evaluate the research on HR strategy's impact on firm performance. First we will evaluate the research exploring the impact of HR strategy on a variety of new criteria that go beyond such traditional criteria as turnover and short-term task performance (e.g., learning and competency development), the use of metrics as the basis for managing people as strategic assets, and the importance of risk assessment in HR. Second, the chapter will integrate new research on the mechanisms underlying the impact of HR strategy on performance outcomes (i.e., the "black box"). Third, we will discuss several of the key theoretical and operational challenges (e.g., construct measurement) facing researchers in this area, as well as the implications of this research with regard to the analysis and application of strategic HR logics. In the concluding section of this chapter we will integrate multilevel research on the influence of HR strategy on individuals, groups, firms, and societies (e.g., social classes, subcontracting).

In [Chapter 9](#), after reviewing the literature on diversity and its implications for individual, unit, and firm performance, we will discuss how diversity concerns may shape HR strategies in the acquisition, development, deployment, and retention of human capital. Beyond the usual focus on gender and ethnic diversity, a strong emphasis will be placed on HR strategies aimed at smoothing intergenerational differences and ensuring the retention of aging talent.

[Chapter 10](#) expands our discussion of how a more diverse workforce poses unique challenges to those responsible for developing and implementing HR strategy, this time by focusing on the diversity generated by globalization. Accordingly, in this chapter, we will review research on how multinational companies (MNCs) adapt their HR architecture to meet the demands of globalization while remaining responsive to culture-specific requirements. More specifically, we will examine the impact that globalization may have on each of the four subsystems noted above, namely staffing, performance management, compensation, and employee relations. A strong emphasis will be placed on global work systems and cross-national, virtual teams, global talent management, and the management of expatriates, as well as cross-national pay differentials in the context of global compensation.

The last chapter ([Chapter 11](#)) builds on the theoretical discussion in [Chapter 9](#), reviewing recent research on the emergence and unique nature of HR policies and practices in four emerging economies, namely Brazil, Russia, India, and China (the so-called BRIC countries). For each country, our invited authors examine the historical forces that have shaped contemporary HR strategies adopted by enterprises operating in their respective economies, characterize the nature of these strategies, and discuss the challenges facing HR as their respective economies continue to grow. In reviewing these four mini-chapters, we will discuss (a) the practical, long-term implications of their findings for global HR strategy in general, and (b) what these context-specific trends might suggest for our understanding of the emergence and development of HR strategies more generally.

# 2

## THE ADOPTION, FORMULATION, AND IMPLEMENTATION OF HUMAN RESOURCE STRATEGIES

In [Chapter 1](#), we suggested that a primary area of HR strategy research concerns the adoption, formulation, and implementation of HR strategy. As we noted in that chapter, of interest is not only which organizations are most likely to adopt strategic innovations in HRM, but also how HR strategies tend to be (and might best be) formulated and successfully implemented. In this chapter, we will examine these issues. First, we will review studies that seek to explain both the adoption of specific HR practices as well as the adoption of an overall approach to managing people in the firm (i.e., HR strategy), all on the assumption that HR activities are most effective when tightly aligned with strategic business or organizational objectives. Studies focusing on the adoption of specific HR strategies attempt to answer such questions as the following:

- What explains the adoption of different clusters of HR practices? To what degree is the adoption of such practices a function of managerial ideology, as opposed to organizational structure, institutional pressures, market forces, or some combination of these factors?
- What factors determine the degree to which the adopted policies and practices comprising the HR strategy are internally consistent in addition to/as opposed to externally aligned with business strategy?

We will then turn our attention to normative and descriptive research regarding the formulation of HR strategy. The former attempts to identify “ideal” or theoretical strategy formulation processes, whereas the latter focuses on identifying the actual processes that are in fact used by organizations when formulating HR strategy. As a whole, these studies address such questions as the following: To what degree is the strategy formulation process affected by internal politics as well as conditions in the organizational environment? What is the nature of the relationship between overall firm strategy and HR strategy, and which serves as an input to the other in the strategy formulation process? One of the primary concerns in this section will be to contrast two different perspectives regarding the HR strategy formulation process: rational planning versus incremental emergence. This section will conclude with a discussion of ways to resolve the differences between these two perspectives.

The last part of this chapter will focus on the implementation of HR strategy. Recent research suggests a growing interest in strategy implementation as a focal mediating construct linking HR strategy to firm performance. As Barney (2001) has noted, such an approach is in contrast to the traditional assumption that “implementation follows, almost automatically” (p. 53). Accordingly, we will discuss the difference between a firm’s *espoused* or intended HR strategy, its *emergent* or actual strategy, and the HR practices perceived and enacted upon by target groups. Potential barriers as well as factors contributing to successful strategy implementation will be discussed.

### ADOPTION OF HR STRATEGIES: FACTORS PREDICTING

# DIFFERENCES IN THE ADOPTION OF SPECIFIC HR STRATEGIES AND PRACTICES ACROSS FIRMS

As we saw in [Chapter 1](#), the history of HRM is one of continuous innovation and adaptation. In each phase of its development, the field has successfully developed and introduced new techniques, practices, and roles designed to help it respond to emergent sources of organizational uncertainty (Lengnick-Hall, Lengnick-Hall, Andrade, & Drake, 2009; Schuler & Jackson, 2005). Thus, for example, sophisticated manpower planning methods were put forward in the 1950s, a time when systems optimization was viewed as a key source of competitive advantage and when institutional shifts in the realm of industrial relations placed new constraints on managers' ability to respond to changes in market conditions by simply adjusting human resource deployments (Greer, Jackson, & Fiorito, 1989; Verhoeven, 1982). Similarly, since the mid-1980s, market deregulation, advanced information systems, and process reengineering have intensified competition in the services industries (e.g., banking, airlines, and telecommunications). In response, many service businesses have introduced HR practices such as contingent compensation, job redesign, and 360-degree feedback in an effort to develop a more engaged and service-oriented workforce as a source of competitive advantage. However, questions remain as to the conditions under which such HR innovations are most appropriate, and in what types of organizations (Batt, 2002; Chuang & Liao, 2010).

A number of HR researchers have attempted to identify those factors associated with the adoption of a given HR strategy, or at least the adoption of particular HR practices (e.g., Akingbola, 2013; Florkowski & Olivias-Luja'n, 2006; Johns, 1993; Kossek, 1987; Selden, 2003; Som, 2007; Wei & Lau, 2008). Studies examining this issue have suggested a number of broad factors likely to account for much of the variance in the HR policies and practices adopted across organizations. [Table 2.1](#) shows some of these factors. It is to these that we turn next, using the lens of rational choice and constituency-based theories described in [Chapter 1](#).

**Table 2.1** Factors Potentially Associated with the Adoption and Formulation of an HR Strategy

| Approach  | Sample Factors  |
|---|---|
| Rational choice<br>(External, market-based factors)         | Market orientation (external fit)<br>Sector/industry<br>Globalization<br>National culture<br>Technology<br>Structural organizational characteristics (e.g., size, slack, complexity, ownership) |
| Constituency—Institutional<br>(External, nonmarket factors) | “Best practices”<br>Professional norms<br>Legislative and regulatory requirements (e.g., unionization)<br>Labor market  |
| Constituency—Resource dependence<br>(Internal factors)      | Political interests<br>Fit of HR system (internal fit)  |

## *Rational Choice Approach*

The first set of factors has to do with external, environmental, and market-based forces. Scholars emphasizing these factors adopt what has been called a *rational* or *strategic choice perspective*.

Underlying this perspective is the notion that the adoption of particular HR policies and practices is shaped by the firm's competitive strategy and is thus largely influenced by the organization's product/service market or economic context. We will consider a few of these factors here.

**Market orientation.** A market orientation offers an overarching philosophy in guiding business actions, with organizational leaders using information generated from the marketplace to develop strategic plans. A market orientation often leads firms to seek strategy-compatible HRM practices aimed at promoting customer-oriented employee behaviors (Jaworski & Kohli, 1993; Narver & Slater, 1990). At the same time, less market-oriented firms are less likely to adopt market-driven strategies and thus less likely to tailor HRM practices to facilitate the attainment of strategic goals. For example, in China, due to uneven economic development and enterprise reform, some state-owned firms may be less market driven than others. Those less market oriented tend to have less of an incentive to adopt more innovative, market-focused HR policies and practices than the latter, assuming, like many monopolies, that they can simply pass the cost of less efficient operations on to the consumer (e.g., Ferner, Almond, & Colling, 2005; Liu, Luo, & Shi, 2003; Wei & Lau, 2007, 2008).

The adoption of strategy-compatible HRM practices reflects the notion of external fit, which posits that there should be consistency between the values and aims guiding the firm's system of HRM practices and its overall competitive strategy (Baird & Meshoulam, 1988; Colbert, 2004; Osterman, 1995). For example, to support a strategy aimed at controlling and minimizing expenses, the HR system may place a premium on such practices as standardized work processes, flexible employee deployments, limited employee autonomy and discretion, and close supervision (Huang, 2001; Liao, 2005).

**Sector/industry factors.** Differences among sectors and industries (e.g., public/private; for-profit/nonprofit; production/service; high-tech/low-tech; health care/education/finance) have been cited as possible determinants of HR practices (Som, 2007). Sector or industry characteristics influence HR decisions by providing the context within which "meanings are construed, effectiveness is defined, and behaviours are evaluated" (Jackson & Schuler, 1995, p. 252). For example, relative to private organizations, public organizations have traditionally been characterized by more standardized HRM practices, mainly due to their heavier reliance on bureaucracy and red tape, greater power distance between management and employees, and larger union presence (Freeman & Medoff, 1985; Som, 2007). Yet the traditional demarcation between public and private organizations may be shrinking, as a cost-conscious public sector increasingly borrows tools and practices from their private counterparts. A number of authors have observed a shift in the public sector toward the HRM practices adopted by private firms (e.g., Budhwar & Boyne, 2004; da Costa Carvalho, Camões, Jorge, & Fernandes, 2007), with—to cite one example—some public organizations linking salary and career prospects to employee performance (Boyne, Jenkins, & Poole, 1999). Indeed, public organizations often aspire to be "model employers" that set standards for private organizations to follow, for example, in areas such as employee training and development (Barnett & Krepcio, 2011).

The health care sector offers an additional example of sector-/industry-specific pressures affecting the adoption of HR strategies. This sector heavily relies on laborintensive technologies and a highly skilled professional workforce that is, at least in part, internally motivated—i.e., driven by social and moral obligations (Bartram, Stanton, Leggat, Casimir, & Fraser, 2007). Recent research demonstrates that HR practices in health care that directly support quality- and service-oriented organizational goals are increasingly linked to improved health care delivery (e.g., Leggat & Dwyer, 2005). Thus, for example, practices designed to promote employee empowerment, teamwork, and ongoing professional development may help increase commitment levels and reduce the chronic high rates of turnover currently found among certain types of health professionals (Adinolfi, 2003; Gowen, McFadden, & Tallon, 2006).

**Globalization.** Globalization is another important catalyst for the adoption of innovative new business practices, including HR practices and strategies (Hendry, 1996; Khavul, Benson, & Datta, 2010; Som, 2007). Globalization is the process by which culturally unique practices—including practices relevant to HRM—are diffused across cultures through trade (Zeynep, 2005), joint ventures (Yan, 2003), mergers and acquisitions (Nikandrou & Papalexandris, 2007), and multinational operations (Ferner, Quintanilla, & Varul, 2001). Other ways in which globalization provides learning opportunities include international networks with other firms (Inkpen & Tsang, 2005; Yan, 2003) and the employment of expatriates (Hocking, Brown, & Harzing, 2004; Rowley & Warner, 2007; Vance & Paik, 2005). Thus, globalization has facilitated the convergence of HR policies and practices across different national and cultural settings (Katz & Darbishire, 2000).

**National culture.** A counterweight to globalization is the continuing influence exerted by national cultures. In recent years, a number of research projects—including large-scale studies based on the Cranet network (Brewster, Mayrhofer, & Morley, 2004) and the GLOBE project (House & Javidan, 2004), as well as other, individual comparative studies (e.g., Aycan et al., 2000; Huo, Huang, & Napier, 2002)—have examined cross-cultural differences in approaches to HRM in dozens of countries. Several of these studies have documented differences in approaches to HRM, including the types of HR strategy adopted, which may be attributable to cultural variation in such dimensions as power distance, future orientation, and individualism/collectivism (Aycan et al., 2000; Gooderham & Nordhaug, 2011; Papalexandris & Panayotopoulou, 2004). For example, enterprises nested in cultures characterized by high power distance were found to be less likely to adopt multi-source systems of performance evaluation (Fletcher & Perry, 2001; Papalexandris & Panayotopoulou, 2004).

**Technology.** Aside from sectorial, national, and cultural influences on HR strategies, organizational technology has been and continues to be a powerful predictor of the HR policies and practices adopted by organizations. In organizational theory, technology refers to the way in which labor inputs are transformed into outputs—that is, the way in which tasks are organized and coordinated (and not merely what kinds of machines—if any—are used). In general, theory suggests that the adoption of innovative HR practices is likely to be most prevalent in firms where the technology (a) requires individual skills that are firm specific; (b) makes it difficult to monitor and control the transformation process; (c) demands a high degree of worker interdependence and cooperation; and (d) results in a high degree of role and task ambiguity (Baron & Kreps, 1999; Som, 2007). Such technologies tend to be less prevalent in traditional, mass production organizations (e.g., auto manufacturing), and much more prevalent in high-tech firms (e.g., software development). Relatedly, Lengnick-Hall and Moritz (2003) found that increased access to information (via advanced IT systems) made employees privy to information that was once only a managerial prerogative, with ramifications for power relations and task environments that encouraged the adoption of innovative, high-performance employment practices. These examples suggest that, with the pervasive presence of sophisticated technology, the administrative aspects of HR management are becoming de-emphasized (and even, in some cases, outsourced), while the role of HR as a strategic partner is gaining increasing recognition.

**Organizational characteristics.** Structural characteristics of the organization, such as slack, size, complexity, and ownership, are also posited to be predictive of the adoption of alternative HR strategies. A number of studies suggest that the presence of slack resources may increase the financial support available to back the adoption and maintenance of various HR policies and practices and, consequently, may promote innovative HRM practices (Othman & Poon, 2000; Patel & Cardon, 2010). These may include more training and development opportunities, more extensive selection systems, or the introduction of teams, quality circles, and other forms of empowerment activities (Wright & Haggerty,



2005).

With respect to size of the organization, the bulk of the evidence suggests that larger firms in a particular industry tend to be the first to adopt innovative HR practices, with smaller firms eventually copying them. Storey (2004) and Aycan (2007) found that the larger the company, the higher the level of investment in training and development activities. Several studies found that large firms were more likely to use performance-based rewards such as variable pay, performance bonuses, and stock options (Ryan & Wiggins, 2001; Som, 2007). More generally, there is evidence that HR strategy in small firms tends to be informal. Cardon and Stevens (2004) suggest that compensation practices in small businesses are often ad hoc and uncoordinated, which “may complicate their consistent implementation and impact on worker behavior” (p. 307). Similarly, Gilbert and Jones (2000) and Aycan (2005) found that performance appraisal practices in small firms tend to be informal and continuous and are often used for monitoring and control rather than development purposes.

A number of explanations have been offered for these differences. Kossek (1987) points to the tendency of HR staff in smaller firms to perform diverse job functions and “to have less time to keep abreast of the latest techniques” (p. 81). Johns (1993, p. 581) highlights two characteristics of larger organizations: their complex structures, which require more administrative fine tuning than those of smaller firms; and their greater visibility, which makes them susceptible to legislative and political pressure (including pressure to adopt certain HR practices). Storey (2004) offers a financial explanation, suggesting that the cost of adopting and implementing HR practices may be within reach only of larger firms, which can benefit from economies of scale. Finally, Mayson and Barrett (2006) suggest that what seems to be a less strategic approach to HRM in small firms may actually be “a result of how we are looking for the practices” (p. 451). Along these lines, the open systems approach advocated by Harney and Dundon (2006) may offer a better understanding of why certain practices emerge as they do. They argue that the embeddedness of small firms in their wider environment needs to be taken into account. For example, they point out that in some contexts, informal HRM practices (e.g., informal recruitment practices that rely on the desire for “fit” of new recruits into small work groups) may give small firms an important basis of competitive advantage.

In addition to their research on organizational size and HR practices, Jackson et al. (1989) examined the impact of horizontal differentiation (as one dimension of organizational complexity) on the adoption of HR strategy. Among other things, they found that contingent pay (i.e., bonuses based on productivity) was more prevalent in product-based organizations, while functional organizations placed greater emphasis on employee training and development. More recent studies on HRM systems in multinational corporations (MNCs) suggest that growth in organizational complexity is driving HRM systems in these companies to become more innovative. More specifically, research has focused on how the heightened complexity of MNCs demands new approaches to integration, coordination, and control, often by cross-cultural management teams—with the implication for HR being an increased emphasis on professionalism, skills development, accountability, and flexibility (Harvey & Novecevic, 2002; Som, 2007). This may have implications for both initial employee selection (e.g., an emphasis on cultural adaptability; Tadmor, Tetlock, & Peng, 2009) and the structuring of intra-organizational careers (e.g., greater emphasis on job rotation; Edwards, 2004).

Patterns of corporate ownership and governance may also influence the emergence of alternative HR strategies. As noted by Zhu, Collins, Webber, and Benson (2008), “different ownership forms may lead to diverse organizational structures, policies, and relationships with internal and external stakeholders. In turn, these differences may affect the form of management of an enterprise’s workforce (HR practices)” (p. 158). Studies have examined differences between predominantly state-owned firms, multiple



ownership companies, multinational companies (e.g., foreign-owned/foreign-invested companies), joint ventures, and privately owned firms. For example, in their study of HR practices in Ireland, Geary and Roche (2001) point to the predominance of “country-of-origin effects” over “host country effects,” noting that foreign firms are not required to submit to local practices regarding trade unions and collective bargaining.

**Labor market threats.** Last, threats stemming from the labor market may also influence the adoption of an HR strategy. Labor markets in the West are increasingly shrinking due to unprecedented demographic shifts, whereby a significant decline in birth rates and an increasing number of young workers delaying work with higher education are accompanied by the retirement of the largest cohort of the world’s workforce—the baby boomers (e.g., Burke & Ng, 2006). These trends have forced organizations to develop a long-term orientation toward labor (given that employees are increasingly more difficult to replace) even as they seek the flexibility demanded by shareholders. In order to succeed in the war for talent, companies realize they need to brand themselves as employers of choice by creating a work environment that workers find attractive. This may have implications for the adoption of HR practices and strategies. For example, many organizations need to develop aging-friendly HR policies in order to retain retirement-eligible workers (e.g., Bamberger & Bacharach, 2014; Wang, 2007).

### *Constituency-Based Approach*

The second set of factors draws from the constituency-based approach, and involves nonmarket environmental factors as well as internal factors.

**Nonmarket institutional forces.** Scholars focusing on the role of nonmarket environmental factors typically examine the adoption of alternative HR policies and practices from an institutional perspective. Institutional theory posits that enterprises, like any organizations, are social entities seeking legitimacy and approval for their performance (DiMaggio & Powell, 1983). Accordingly, they may use HR policies and practices as a means to gain the legitimacy and acceptance needed to ensure access to critical resources from potential exchange partners (e.g., employees, trade unions, governments, shareholders, financial institutions) (Farndale, Brewster, & Poutsma, 2008; Jackson & Schuler, 1999; Paauwe & Boselie, 2003). In particular, firms are subject to three sets of forces—namely mimetic, normative, and coercive—which motivate managers to adopt those policies and practices deemed to be legitimate in the eyes of influential stakeholders (DiMaggio & Powell, 1983). Such forces may play an important role in driving convergence in HR policy and practice across firms (Budhwar & Sparrow, 2002).

Mimetic mechanisms refer to the benchmarking and imitation of strategies and practices used by successful firms as a result of uncertainty or management fads. These homogenizing pressures arise when key interests perceive a given set of strategies, decisions, and practices as highly beneficial or even optimal—that is, as “best practices” (Kostova & Roth, 2002). Indeed, imitation may be viewed as a low-risk, efficient means to acquire legitimacy (Guler, Guillen, & Macpherson, 2002). The adoption of many HR practices, from multi-source feedback to graphology, may thus be based more on the tendency to imitate (particularly under conditions of high uncertainty) than on rational or strategic considerations. Still, although imitation is more likely to occur with respect to HR practices that are more easily communicated, divisible, and marketed by consultants, as Boselie, Paauwe, and Richardson (2003) suggest, it may be “difficult to determine whether the implementation of a certain practice or policy is the result of pure blind imitation” (p. 1413).

Normative mechanisms include professional standards and recognized protocols developed and promoted by professional bodies and employers’ associations. Over time, as certain HR practices

become institutionalized and recognized as occupational standards, those responsible for the HR system are likely to develop a personal interest in adopting these practices in order to retain their own level of individual legitimacy with respect to their professional colleagues (Spell & Blum, 2005). The increasing interest of HR managers in securing some form of professional certification attests to the importance of such credentialing as a normative mechanism driving standard practice. The rising use of social networking as a basis for benchmarking may intensify the role of normative forces in driving the adoption of standard practice (Sanchez, Kraus, White, & Williams, 1999; Som, 2007).

Coercive mechanisms arise from trade unions, works councils, employment legislation (such as minimal employment standards and equal employment opportunity laws), and government regulation. HR practices can also reflect the need for foreign-invested enterprises (e.g., MNCs and joint ventures) to meet standards associated with doing business in other countries (Zhu et al., 2008). In addition, given the embeddedness of institutional interests in the governance of state-owned enterprises in emerging and developed countries alike, these firms tend to be characterized by more traditional, paternalistic HR practices relative to private firms, reflecting both institutional inertia and the ability of these firms (in many cases) to pass on the additional expense of operating under such conditions directly to their customer (e.g., Wei & Lau, 2008).

Relatedly, there is reason to believe that labor regulations and unionization may be associated with the adoption of certain HR practices, although the literature examining this link is somewhat inconclusive. On the one hand, several studies suggest that unionized workplaces tend to demonstrate greater use of HR practices such as bonus payments and internal transfers, as well as other practices designed to improve the quality of work life (Frenkel & Kuruvilla, 2002; Ng & Maki, 1994). On the other hand, studies suggest that the presence of an active labor union in companies restricts the ability of HR managers to innovate. For example, Ramaswamy and Schiphorst (2000) and McCourt and Ramguttty-Wong (2003), studying the role of labor institutions in India and Mauritius, respectively, concluded that resistance from unions in those countries acts as a barrier to the adoption and diffusion of new practices (e.g., contingent pay), as any proposed change is subject to approval by union leaders. At the same time, nonunion firms may be quick to adopt HR practices and policies deemed strategic, such as variable pay and job enrichment, as a way of attracting the best talent and maintaining their nonunion status (Gardner, 2005) or avoiding labor unrest (Collings, Gunnigle, & Morley, 2008).

While the decline of organized labor in some countries may make unionization a less robust predictor of HR policies and practices than in the past, in those countries in which unions remain or are emerging as a powerful force, their role in shaping the HR strategies of even nonunion firms may be anything but waning (Som, 2007; Wächter & Müller-Camen, 2002). Then again, regardless of the status of labor regulations in specific countries, a number of researchers suggest that the general decline in union density (the proportion of the workforce covered by collective agreements or members of unions) worldwide is likely to reduce the influence of trade unions on HRM practices (Som, 2007; Venkata Ratnam, 1998; Wächter & Müller-Camen, 2002).

**Resource-dependence-based factors.** As noted above, other constituency-based factors are internal in nature. Scholars studying these factors often use the lens of resource dependence theory. From a resource dependence perspective, intra-organizational political interests likely play a central role in explaining variance in the adoption of particular HR policies and practices across firms. More specifically, according to resource dependence theory (and its associated multiple stakeholder perspective; see [Chapter 1](#) for a description of both perspectives), the possession of resources affects the distribution of power in enterprises. Because human capital is typically valued in firms, HR policies and practices can often reflect the nature of this power distribution (Jackson & Schuler, 1999). As such, the rules and

frameworks governing how human capital is acquired, developed, deployed, and retained are subject to negotiation, and the policies and practices emerging from such negotiation are what Bucher and Strauss (1961) refer to as a “negotiated order.” From this perspective, while different parties may try to legitimize their positions regarding HR policies and practices on the basis of the interests of the firm, those that ultimately emerge and are enacted likely reflect intra-organizational power distributions and the strength of various organizational interests as much as anything else. Johns (1993) gives a nice example of how negotiated orders underlie executive compensation practices in many firms. He argues that although technical merit would suggest the use of longer-term performance measures as the criteria against which to base executive bonuses, most firms in North America tend to base their executive compensation programs on short-term criteria such as earnings per share. Underlying this paradox is the fact that decisions regarding executive pay are typically made by the board of directors in conjunction with other parties involved in dependence relationships with precisely those individuals likely to be affected by their decisions (Conyon & Peck, 1998).

Such negotiations need not be explicit (indeed, in many cases they are quite tacit). Furthermore, rather than focusing on any one particular policy or practice, organizational interests often focus on systems or bundles of practices. Thus, another influence on HR strategy adoption is the degree of fit between particular policies and practices (Becker & Huselid, 2006). Such notions of *systems fit*, *interdependence*, or *bundling* resonate with research on configurational HRM, which suggests that managers often seek to adopt an inherently coherent or aligned set of policies and practices (e.g., Huselid, 1995; MacDuffie, 1995; Subramony, 2009). This line of research focuses on internal fit—that is, the notion that for HRM to deliver added value, a firm’s system of HRM practices must be characterized by an underlying logic, such that the practices adopted cohere and mutually reinforce each other to elicit congruent behaviors from the organization’s human resources (Baird & Meshoulam, 1988; Feldman & Pentland, 2003; Osterman, 1987; Wright & Boswell, 2002). For example, an emphasis on employee involvement should be reflected in spending per worker in training, as well as in annual evaluation criteria. Accordingly, certain policies or practices may be adopted not so much because they contribute to the value of the firm, but rather because any alternative would “fit” less well with those already in place.

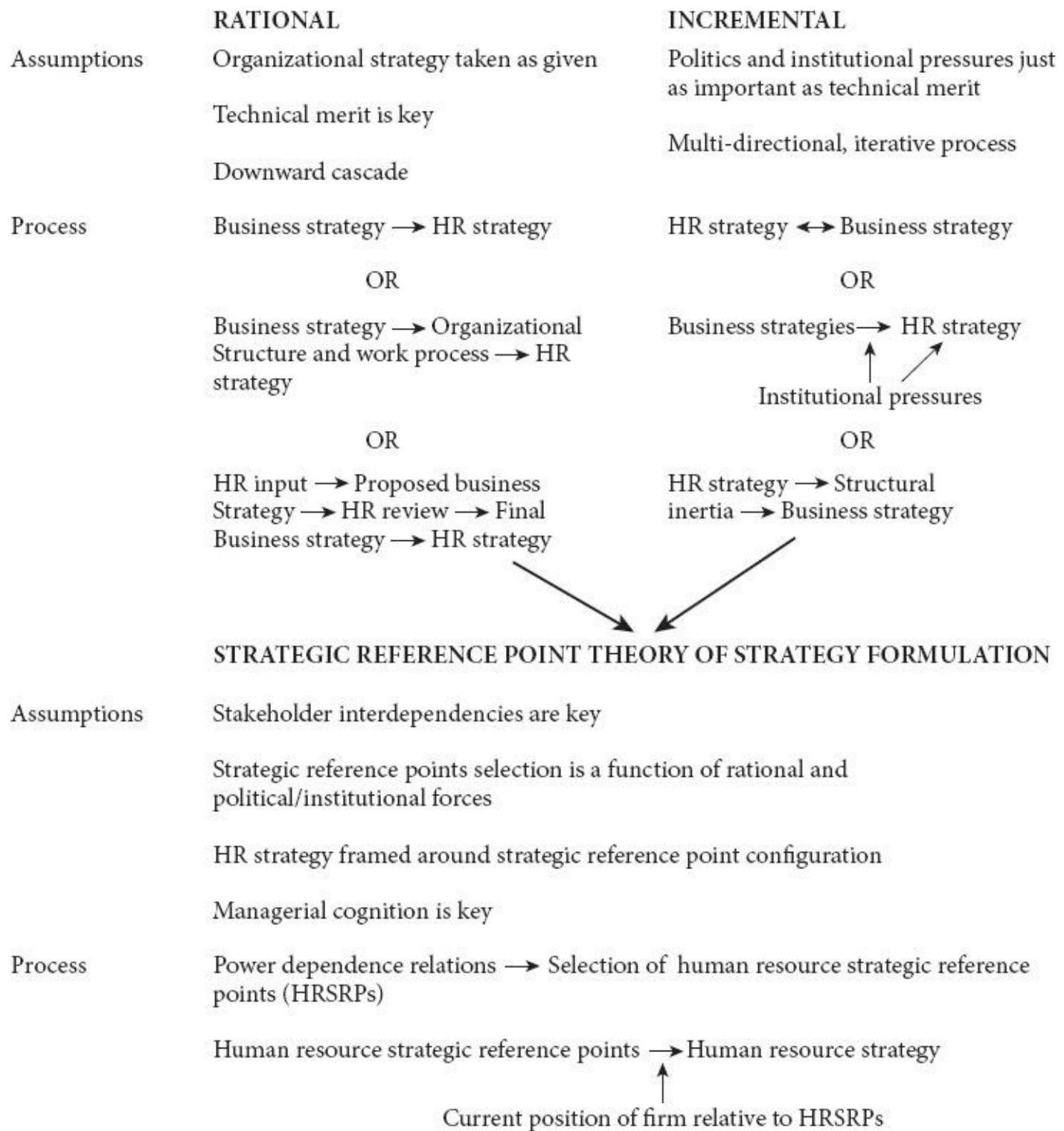
Clearly, numerous factors underlie cross-organizational variance in the adoption of HR strategies, and these factors themselves appear to be highly interrelated. For example, organizational size may predict the adoption of certain HR practices as a function of their effects on organizational structure and institutional relations (i.e., visibility and threats to legitimacy). Thus, while market forces may be highly predictive of certain types of HR strategies and practices under one set of institutional or political conditions, they may have little or no impact under other conditions. We explore this issue in more detail in the next section.

## **HR STRATEGY FORMULATION: RATIONAL PLANNING VERSUS INCREMENTAL APPROACHES**

Two main perspectives dominate discussions on the formulation of business strategy. The *rational planning perspective* holds that strategy is formulated (or at least should be) on the basis of formal and rational decision-making processes. The rival *incremental approach* sees the strategy formulation process as characterized by informality, intra- and inter-organizational politics, fragmentation, and, to a certain extent, even chance.

While at one time many practitioners advocated a formal and rational planning process, most have come to accept that given the bounded rationality of organizational decision makers (March & Simon,

1958), the most that can be done is to follow a more logical yet adaptable process of incrementalism (Quinn, 1978). Following their lead, researchers have also begun to generate theories that attempt to narrow the gap between these two perspectives. In this section, we first review a number of descriptive and prescriptive studies based on one or the other approach. We conclude the section with a discussion of one of the theories developed in order to bridge these two perspectives: strategic reference point theory. Our discussion follows the key points highlighted in [Figure 2.1](#).



**Figure 2.1** Alternative Theories of HR Strategy Formulation

*Models Based on the Rational Planning Perspective*

Early studies of the HR strategy formulation process tended to be highly prescriptive in nature. That is, their intent was to demonstrate, typically on the basis of organizational case accounts, the efficacy of one formulation approach over another. Descriptive models of HR strategy formulation emerged out of this prescriptive research.

Many of the early descriptive models of HR strategy formulation were little more than extensions of basic planning models (e.g., Walker, 1980). Indeed, the key differences between manpower planning and HR strategy formulation as described in these studies revolve around (a) the issues to be addressed in the planning process, and (b) what might be referred to as the planning “horizon” (i.e., short-term versus long-term). Personnel-planning models advocated forecasting HR needs on the basis of one- or two-year business plans, and then reconciling these needs with the results of some sort of internal supply analysis. Of primary concern were issues related to the organization’s required skill mix, intra-organizational personnel flows, and overall staffing levels. In contrast, early prescriptive models of HR strategy formulation advocated taking into consideration the longer-term needs of the organization (i.e., a three- to five-year planning horizon) as well as a wider range of HR-related issues such as operational flexibility, employee competence, morale, and commitment. Nevertheless, these prescriptive models remained firmly grounded in the rational planning approach, and thus assumed that there should exist a one-way link between organizational or business strategy and HR strategy, with the latter being based primarily if not entirely on the former. For example, a number of scholars (e.g., Smith, 1982; Kerr, 1982; Leontiades, 1983) admonished managers to make HR decisions that are consistent with organizational goals. Smith (1982), for instance, suggested that HR policies need to be tailored to reflect the future needs of the organization. Thus, in the same way that other functional units generate system-specific strategies (e.g., for finance, marketing, etc.) on the basis of corporate strategy, so must the HR function. Others (Leontiades, 1982; Gerstein & Reisman, 1983) suggested ways of matching personnel activities with organizational strategic plans. Formulating an effective HRM system thus meant designing a HRM policy to shape employees’ behavior and attitudes, and utilizing HRM practices to align and integrate people of various competencies from different organizational units so as to align with the organization’s overall strategy.

Studies in the 1980s supported the application of such prescriptive models. For example, Dyer (1984, p. 161) proposed that “organizational strategy is the major determinant of organizational human resource strategy,” and cited a number of studies as providing support for this proposition. One such study, LaBelle’s (1983) exploratory analysis of HR strategy formulation in 11 Canadian companies, found that firm strategy was the most frequently mentioned and most strongly emphasized determinant of organizational HR strategy. The study also found “clear differences” in organization HR strategy configurations across businesses that were pursuing different organizational strategies (Dyer, 1984, p. 161). Dyer also cited Wils’ (1984) discussion of the HR strategies pursued by 22 different strategic business units of a single corporation as further evidence that business strategy is the strongest predictor of HR strategy. Similarly, Ackermann (1986), applying Miles and Snow’s (1978, 1984) typology of business strategies (“defenders,” “prospectors,” and “analyzers”; see [Chapter 3](#)), argued that as different HR strategies are appropriate for each business strategy, it is natural for the former to be formulated on the basis of the latter.

During the late 1980s and the early 1990s, several authors (e.g., Schuler & Jackson, 1987; Wright & McMahan, 1992) further proposed conceptual frameworks intended to model how HRM activities are developed to support organizational strategy. Common to these frameworks was the view of strategy as a downward cascade, with the first stage being the identification of high-level business needs. Based on an analysis of these needs—which are shaped by factors both external (e.g., economic, political, or sociocultural conditions) and internal (e.g., organizational culture, cash flow, or technology)—top-level



management defines an overall, corporate-level mission, targets key mission-based objectives, and specifies broad programs and policies designed to help the organization achieve these objectives. These objectives, programs, and policies then become the basis of HR strategy, with the latter strictly contingent on the former. More recent empirical evidence supports these notions. For example, innovation-driven organizational strategies have been found to be predictive of one set of HR subsystem strategies, while organizational strategies focusing on alternative means of achieving competitive advantage (e.g., a quality-enhancement strategy) were predictive of a completely different set of HR subsystem strategies (e.g., Huang, 2001; Liao, 2005).

As suggested above, a firm's strategy may also have indirect effects on HR strategy by determining organizational structure (e.g., functional versus product based) and work processes (e.g., mass production versus flexible manufacturing). Changes in these factors, frequently manifested in terms of changes in information processing, automation, political influence, and the like, affect the strategic direction of the organization and thus create the need to align HRM strategy with these changes (Armstrong & Baron, 2002; Mello, 2001; Ulrich, Younger, & Brochbank, 2010). For example, new product/service innovations, mergers, or joint ventures and partnerships often necessitate shifts in HR policy and practice (e.g., performance management systems, compensation) in order to motivate innovation and/or shift employee orientations.

While most early prescriptive models accepted this premise that HR strategy must be formulated on the basis of organizational strategy, by the mid-1980s, several scholars proposed that organizational strategy should also take into account function-specific constraints. For example, Baird, Meshoulam and DeGive (1983) suggested that while HR strategy must be formulated on the basis of requirements specified in the organizational strategy, corporate strategic planning is most effective when the HR function is involved in the formulation of organizational strategy. They argued that as corporate strategy is based on information stemming from the internal and environmental analyses conducted by functional units, corporate strategy cannot be formulated without some sort of HR input. Moreover, they argued, the HR function has a critical role in helping shape the organization's corporate mission, given that HR is typically the organizational unit responsible for tracking shifts with respect to many of the factors that play into the corporate mission, whether these are environmental (technological, economic, or demographic) or cultural (values or beliefs). Thus, while the HR function may have limited *direct* influence on corporate strategy formulation, it does have the ability to influence the information and hence premises upon which corporate-level strategic decision making is based.

Other researchers (Bamberger & Phillips, 1991; Huang, 2001; Mikkelsen, Nybø, & Grønhaug, 2000) concluded that HR strategy is not necessarily based strictly on the organization's business strategy. Rather, they suggested that factors such as uncertainty, technology, and demographic change often *directly* affect the choices made by those responsible for the formulation of HR strategy. That is, while these environmental factors might or might not have been used as inputs into organizational business strategy, at least in the companies studied, there was substantial evidence that HR strategists directly applied the results of their own environmental scanning and took such issues into consideration regardless of whether or not they were reflected in the organizational business strategy.

Lundy and Cowling (1996) proposed an even more proactive and influential role for the HR function in the strategy formulation process. They argued that HR, like all other organizational functions, should be granted not only an intelligence role in shaping business strategy, but a review role as well. Specifically, they recommend that each functional area, including HR, receive data concerning corporate or unit opportunities and threats, as well as the strategic options being considered. Taking existing internal capabilities (i.e., structures, systems, processes) and external conditions (i.e., labor, economic,

legislative) into account, the functions would review and assess each policy option, and the overall business strategy would be determined on the basis of each of these function-specific assessments. As with earlier prescriptive models, Lundy and Cowling (1996) argue that the overall business strategy should still provide the foundation upon which HR strategy is formulated; but as is apparent from the process described, a business strategy adopted in this manner is more likely to take into account the constraints and concerns of the HR system.

Importantly, scholars taking the proactive approach also raise questions about the basic efficacy of a rational planning perspective when applied to HR strategy formulation. In particular, they argue that other factors such as intra-organizational politics and institutional pressures are likely to moderate the way in which those responsible for the formulation of HR strategy make sense of both business strategy and environmental conditions, and the way these inputs shape the actual pattern of HR decisions made. In this sense, this line of research is in many ways consistent with the incremental perspective of strategy formulation that we describe next.

### *Models Based on the Incremental Perspective*

Although most HR practitioners assume that top management has the ability to formulate and implement appropriate strategies in a rationalistic, top-down mode, many scholars are skeptical of this approach. Such scholars can be divided into two groups. The notion underlying the first, *logical incrementalism*, was established by Quinn (1980). Specifically, he acknowledged that strategic content and processes are subject to a great degree of influence by organizational actors, but claimed that this conscious shaping tends to occur incrementally and *interactively* rather than as a complete whole, with strategies evolving “as internal decisions and external events flow together to create a new, widely shared consensus for action among key members of the top management team” (p. 15). A core element of this approach is that, in many cases, intra-organizational politics influence strategy formulation and implementation (Jackson & Schuler, 1999; Zhu et al., 2008). The second group acknowledges a far smaller degree of conscious shaping by organizational actors, assuming not only bounded rationality on the part of those involved in the strategy formulation process, but also a high degree of environmental *determinism*.

**Interactive approaches to HR strategy formulation.** In one of the earliest descriptive studies of HR strategy formulation, Dyer (1983) identified three modes by which organizations integrate organizational and HR strategy formulation. In all three cases, the HR function contributes to organizational strategy formulation and, in the process, also acquires early insights into its own strategic requirements. All three processes require an assessment of the plan’s feasibility, desirability, and cost from the HR perspective. Under the first mode, known as *parallel planning*, business unit planners report on the implications of their strategic options from an HR perspective, typically after the strategic decisions have already been made. In addition to forcing business-level planners to consider HR-relevant feasibility, desirability, and cost issues, this process also enables those responsible for the HR system to start developing their own strategies for dealing with the HR challenges expected as a result of the plan’s adoption. Under the second mode, *inclusion planning*, HR considerations are taken into account prior to the adoption of any particular plan. Business managers are required to demonstrate that their strategic plans are feasible and desirable from an HR point of view. Finally, under the third, *participative* approach, data are provided proactively to those responsible for the HR system. Firms adopting this approach allow these individuals to review the organizational strategy formulation process and to advise or even challenge planners, if necessary, all the way to top management levels. Such a participative approach gives HR decision makers a voice in the business formulation process itself.



Unlike most prior literature, which explicitly or implicitly assumed a unidirectional relationship from strategy to HR practices, many authors who followed Dyer (1983) over the next two decades emphasized that HR strategy both affects and is affected by organizational strategy in an interactive, two-way fashion (Armstrong & Baron, 2002; Brockbank, 1999; Buller, 1988; Golden & Ramanujam, 1985; Lengnick-Hall & Lengnick-Hall, 1988). For example, Lengnick-Hall and Lengnick-Hall (1988), reviewing the strategy literature, took issue with the perspective under which “human resources are considered means, not part of generating or selecting strategic objectives” (p. 456). They argued that models based on the rational perspective of strategy formulation make three questionable assumptions: (a) that organizational strategy has already been determined; (b) that HR strategy is inherently oriented toward the implementation of organizational strategy, and consequently has little to contribute to formulating organizational strategy or even identifying strategic ends; and (c) that while the HR practices implemented may shift in response to changes in organizational strategy, the issues addressed by these practices remain stable. In offering their own “reciprocal interdependence” model of HR strategy formulation, Lengnick-Hall and Lengnick-Hall (1988) suggested that firms that systematically and reciprocally consider HR in formulating organizational strategy will perform better than firms that either manage the two strategy formulation processes competitively, or formulate HR strategy as a means to solve competitive strategy issues. Armstrong and Baron (2002) concur, remarking that “HR strategy should be aligned to the business strategy ... Better still, HR strategy should be integral part of the business planning process as it happens” (p. 44).

The notion of reciprocal interdependence between business and HR strategy formulation has been gaining increasing support. For example, Taylor, Beechler, and Napier (1996) used resource dependence theory (Pfeffer & Salancik, 1978) to predict the nature of the cross-level interactions in strategy formulation. They argued that the degree of reciprocal interdependence is likely to depend on (a) corporate orientation in the design of system-specific strategies (highly centralist versus decentralized or learning); (b) the nature of inter-system resource transactions and which systems are deemed by corporate elites to be critical to successful implementation of corporate strategy; and (c) the competence of system leaders. The role of HR strategy in contributing to business policy is likely to be greatest in those organizations that are oriented toward decentralizing system-specific strategies; where the HR system is viewed by corporate elites as providing a key basis of competitive advantage; and where those managing the HR system are viewed as highly competent. Such a resource dependence model, as noted above, is grounded in notions of exchange, bargaining, and political interest. As such, predicting the nature and outcomes of the HR strategy formulation process is possible only to the extent that we have a firm understanding of the power and dependence relations among all with an interest in the outcome. Another study, conducted in the context of German industrial relations (Wächter & Müller-Camen, 2002), found support for the notion of co-determinism in HR-firm strategy formulation. The authors noted that in the German context, this is mainly achieved through strong formal employee participation (work councils) rather than professional HR staff, as in the United Kingdom and the United States, where employee representatives and labor union have little influence on firm strategy.

**Deterministic approaches to HR strategy formulation.** Whereas the interactive approaches just discussed leave it to HR system decision makers to identify, interpret, analyze, and then act upon internal constraints when formulating HR strategy, another set of theories suggests that the managerial role in shaping HR strategy may be much more limited. For example, as discussed earlier, organizations seeking legitimacy and acceptance from institutional stakeholders (e.g., government agencies) may adopt a common set of HR policies and practices regardless of overall firm strategy. This institutional perspective (DiMaggio & Powell, 1983; Meyer & Rowan, 1977) suggests that even those elements of HR strategy most aligned with the strategic interests of the firm may be discarded in favor of HR elements

perceived to be critical to ensuring basic organizational stability and survival. As Stephens (2001) notes, such a view of “‘strategy as pattern’ recognizes that strategies are seen as the outcomes of both planned and unplanned activities,” and views strategy as the “interplay of choice, chance and circumstances” (p. 124).

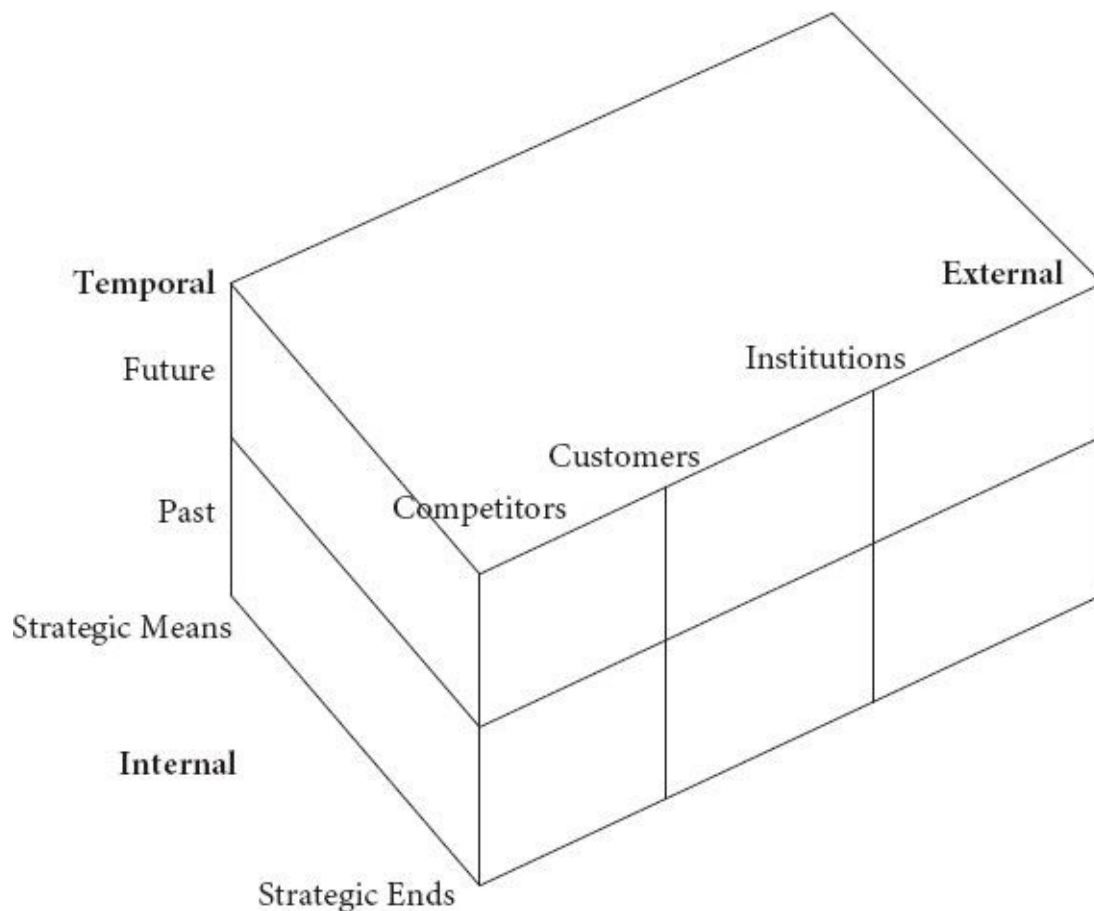
Empirical research supports this notion that conformity to perceived stakeholder expectations may play a key role in shaping HR strategy, and result in a high degree of isomorphism or convergence in HR practices. For example, Huselid, Jackson, and Schuler (1997) found that U.S. firms tend to achieve higher levels of technical HRM effectiveness than strategic HRM effectiveness—a finding that they explain on the grounds that the expectations and regulatory activities of key external stakeholders such as government agencies (e.g., the Equal Employment Opportunity Commission) and professional organizations shape these activities and provide a common basis for both professional HR training and evaluation. Their argument suggests that institutional pressures implicitly constrain the range of strategic options available to an HR system. Similarly, Wright and Snell (1997), in their analysis of the literature on “fit” in HR strategy, question a key assumption of those supporting a contingency perspective, namely that HR practices are adaptable to shifts in firm strategy. They claim that institutional forces limit the ability of organizations to make their HR systems adapt to changing competitive requirements. Finally, several studies have found that institutional forces in the local environments of multinational firm subsidiaries often constrain the ability of the parent to “export” key elements of corporate HR strategy (Spell & Blum, 2005; Wocke, Bendixen, & Rijamampianina, 2007; Zhu et al., 2008).

Population ecologists also discount the role of management in formulating strategy. These researchers argue that organizational performance and survival are largely determined by the environment in which the organization is situated (e.g., Bartram, 2011; Hannan & Freeman, 1989; White, Marin, Brazeal, & Friedman, 1997). More specifically, as noted by White et al. (1997), “the organization’s choice of evolutionary path, perhaps from among several viable in its environment, may be governed by internal evolutionary drivers, which while they do not dominate, do constrain the evolutionary effects of natural selection” (p. 1385). In line with this theory, environmental characteristics such as population density and environmental turbulence have been found to have greater predictive utility in explaining the “selection” of organizations for survival than strategy. Although most scholars criticize population ecology for downplaying the importance of choice of strategic direction for an organization, several contend that there is nothing inherent in population ecology theory that “implies that management actions and decisions are not important” (Welbourne & Andrews, 1996, p. 895). Indeed, Welbourne and Andrews argue that, to the degree that structural cohesion—“an employee generated synergy” providing the firm with a key source of structural inertia—is critical to firm survival, the initial design of a firm’s HR system is an important determinant of firm survival and performance. As they note, “rather than alter human resource systems to match life-cycle or business strategy (as contingency theory suggests), organizations should design HR techniques to strengthen structural inertia early in the life cycle and in this way increase their survival chances” (p. 896). Their findings suggest that firms placing an emphasis on building a strong, cohesive workforce right from the start will increase their survival chances. Nevertheless, in line with the deterministic tendencies of population ecology theory, their findings also suggest that “the die is cast” early on in the lifecycle of an organization, that the range of *effective* HR strategies to implement is greatly limited once the firm has embarked on its course, and that, as Dave Barger, former CEO of JetBlue Airlines put it, “one has to get it right, right from the start.”

*Reconciling the Two Approaches—Reference Point Theory*

In an attempt to reconcile deterministic and political incremental models of HR strategy formulation with those models based on the rational planning perspective, Bamberger and Fiegenbaum (1996) sought to explore cognitive concepts underlying managers' strategic choices regarding the HR strategy formulation process. In this respect, they advanced the concept of human resource strategic reference points (HRSRPs), defined as the targets or benchmarks used by organizational decision makers to evaluate their options, make strategic decisions, and signal system-wide priorities to key stakeholders. The HRSRP configuration may be depicted graphically on a matrix incorporating three key dimensions: internal capabilities, external conditions, and time (see Figure 2.2). The internal dimension captures the degree to which targets emphasize HR processes (i.e., means) versus outcomes (i.e., ends). The external dimension captures the degree to which the interests of various constituents and institutions such as customers, competitors, or regulatory agencies are taken into account. Finally, the temporal dimension focuses on the degree to which targets emphasize historical as opposed to future/desired states. The theory proposes that managers frame HR strategy around this configuration of reference points.

Up to this point, SRP theory draws primarily from the rational planning perspective in that it views managers as having a high degree of control over the strategy formulation process. However, Bamberger and Fiegenbaum depart from the rational planning perspective in two ways. First, they propose that highly deterministic resource and power-based theories explain a system's strategic reference point configuration. Second, they propose that managerial interpretation and sense-making processes moderate the translation of the HR strategic reference point configuration into HR strategy.



**Figure 2.2** The Strategic Reference Point Matrix (Source: Bamberger and Fiegenbaum (1996))

Drawing from organizational theory, the authors argue that resource and power-based theories may be helpful in understanding the emergence of configurations at the system level. These include the population

ecology (Hannan & Freeman, 1989), institutional (DiMaggio & Powell, 1983), and resource dependence (Pfeffer & Salancik, 1978) theories discussed above. A number of authors (Beckert, 2006; Fligstein & Dauter, 2007; Zammuto, 1988) suggest that despite their differences, all these theories lead to common themes with regard to organizational configurations because of the power and resource-based contingencies upon which they are all based. Furthermore, Ketchen, Thomas, and Snow (1993) found that configurations deductively derived from such theories offered greater predictive efficacy than inductively derived configurations (a finding later supported in other studies; e.g., Bantel, 1998; Patel, Thatcher, & Bezrukova, in press). Specifically, extrapolating to the subsystem level, the authors argue that similar power- and resource-based contingencies may drive the clustering of system-level phenomena such as reference points into SRP configurations.

In this context, the ability of any organization or interest to dictate the nature of a given system's SRPs is likely to be contingent on the dependence relations between that organization or interest and the system over which it is attempting to exert influence. Although this assumption may not be consistent with the more conventional notion that system-level strategies are dictated entirely by constraints external to a given system, it is consistent with the reciprocal interdependence theory of strategy formulation discussed earlier. For example, on the basis of the assumption that power-related contingencies underlie the clustering of HR strategic reference points into specific SRP configurations, it is just as likely for a powerful organizational system to influence firm-level strategy as it is for top management to use firm-level strategy to constrain the emergence of a particular system-level strategic reference point configuration.

Bamberger and Fiegenbaum (1996) expand on this underlying proposition (i.e., that the level of HR influence in the firm affects all three reference point dimensions and thus plays the key role in determining the nature of a firm's HR strategic reference point configuration) by demonstrating how power-dependency relations influence the emergence of an HR-SRP configuration. For example, drawing from earlier conceptual and empirical research (Dyer & Holder, 1988; Kossek, 1987), they propose that in firms in which the HR function lacks influence, its ability to consider forward-looking HR programs and policies may be greatly limited. As they note,

When evaluating and selecting among reference points, managers in weaker functions will make greater use of historically oriented strategic reference points. These individuals feel the need to justify strategic choices on the basis of criteria that imply stability and (at most) only incremental change so that their potential for survival and advancement within the organization is not placed at risk. In contrast, managers in more influential functions will make greater use of future-oriented strategic reference points. It is important to these individuals to be able to justify their strategic choices on the basis of criteria that imply more overarching concerns and reflect their interest in securing broader and more synoptic or comprehensive organizational change.

(p. 940)

Similarly, they propose that in organizations in which the HR system is more influential, (a) the internal dimension of the SRP matrix will be dominated by an emphasis on outcome- (i.e., ends-), rather than process- (i.e., means-) oriented targets, and (b) the SRP configuration will be more externally oriented. With regard to the latter, the authors argue that while all HR systems are required by law to take certain institutional interests into account when identifying system targets, the extent to which additional external SRPs are considered is a function of the power wielded by the HR system within the organization. For example, weak HR systems, which are dependent on other organizational systems for resources and

respect, are obligated to pay close attention to the interests and concerns of those external stakeholders in framing HR policies and practices, but tend to lack both the mandate and the resources to consider a broader range of external reference points.

**Table 2.2** HR Strategic Reference Points Configuration Options and Possible Tendencies

| Managers' External Exposure | Loose/Outcome Control |                | Tight/Process (Behavioral) Control |                |
|-----------------------------|-----------------------|----------------|------------------------------------|----------------|
|                             | Low Influence         | High Influence | Low Influence                      | High Influence |
| Low                         | Cell 1                | Cell 3         | Cell 5                             | Cell 7         |
| High                        | Cell 2                | Cell 4         | Cell 6                             | Cell 8         |

| Cell Number | Internal Dimension            |                              | External Dimension          |                          | Temporal Dimension |        |
|-------------|-------------------------------|------------------------------|-----------------------------|--------------------------|--------------------|--------|
|             | Process/<br>Means<br>Oriented | Outcome/<br>Ends<br>Oriented | Low<br>(Narrow)<br>External | High (Broad)<br>External | Past               | Future |
| 1           |                               | X                            | X                           |                          | X                  |        |
| 2           |                               | X                            |                             | X                        | X                  |        |
| 3           |                               | X                            | X                           |                          |                    | X      |
| 4*          |                               | X                            |                             | X                        |                    | X      |
| 5*          | X                             |                              | X                           |                          | X                  |        |
| 6           | X                             |                              |                             | X                        | X                  |        |
| 7           | X                             |                              | X                           |                          |                    | X      |
| 8           | X                             |                              |                             | X                        |                    | X      |

\* = high- and low-power configurations toward which HR systems may tend (assuming that the three determining factors remain stable over time).

Although eight basic SRP configurations are identified (see [Table 2.1](#)), the authors argue that HR systems tend toward one of two primary SRP configurations, namely a “high-power” configuration (indicated by Cell 4) or a “low-power” configuration (indicated by Cell 5). For example, studies describing the role of HR in strategic planning in large MNCs suggest that HR strategy in these companies is driven by a high-power SRP configuration; that is, one that is future oriented (five-year plans), outcome based (i.e., concerned with bottom-line business outcomes), and externally driven (i.e., focused on the demands of a wide range of stakeholders in the firm’s environment) (Farndale et al., 2010; Jarrell, 1993). In contrast, several authors (e.g., Bamberger et al., 1989; Dabic, Ortiz-De-Urbina-Criado, & Romero-Martínez, 2011; Finegold & Frenkel, 2006) show that HR strategy in high-technology startups and highly innovative ventures tends to be driven by a low-power SRP configuration focusing on the relative improvement in the efficiency of internal processes affecting primarily one internal customer (e.g., R&D) over past months or years.

In sum, while managers are posited to have a certain degree of control in framing the SRP configuration that serves as a core input into strategy formulation, Bamberger and Fiegenbaum (1996) posit that managerial control is often greatly bounded. While incorporating and accounting for deterministic organizational theories, their theory places a much stronger emphasis on the micropolitics of organizations (Bacharach, Bamberger, & Sonnenstuhl, 1996) as a constraint on rational planning processes. Yet further *cognitive* constraints on such processes are incorporated into their theory with

respect to the way in which the HRSRP configuration is predicted to shape the pattern of HR policies and practices that we refer to as HR strategy. Findings in this respect are especially interesting for research in the upper-echelon and strategic choice traditions, as they provide some explanation for managerial behavior. In particular, they provide further explanations for managers' varied responses to similar events (Hutzschenreuter & Kleindienst, 2006). The HRSRP approach thus coincides with research suggesting that managerial cognition is not an uncontrollable phenomenon but can, at least to a certain degree, be purposefully influenced (e.g., Wright & Goodwin, 2002).

Drawing from prospect theory (Kahneman & Tversky, 1979), Bamberger and Fiegenbaum (1996) argue that although the HR reference point configuration influences the nature of the HR policies and practices adopted, this effect is moderated by the firm's current position relative to its HR reference points. That is, the way in which the HR strategic reference point configuration affects the nature of the strategic choices made by HR professionals is contingent upon the degree to which these decision makers view the system as being above or below its strategic reference points.

Specifically, the researchers argue that the perceived position of the HR system relative to its SRPs will determine whether the emergent HR strategy is conservative or bold and daring. In particular, they suggest that HR systems that are above their reference points will be more likely to respond to new issues and situations (e.g., the election of a new, more militant union leadership) as threats, and will seek to minimize potential losses by adopting conservative and defensive policies and practices (e.g., retaining a traditional, confrontational approach to labor relations). In contrast, HR systems that are below their reference points will be more likely to view new issues and situations as opportunities and will seek to capitalize on them by adopting more daring policies and practices, radically departing from the norm or tradition. Using the example just cited, for an HR system well below its SRPs, a profound shift in union leadership might provide the impetus needed to encourage HR decision makers to question existing mental models and adopt more innovative, joint labor-management programs (Kochan et al., 1986; Lewin, 2001; Senge, 1994).

Thus, assuming that the skills of HR professionals are randomly distributed across firms, the application of prospect theory to HR strategy suggests that the HR system's position relative to its key reference points will influence the willingness of HR decision makers to challenge their own mental models and consider the adoption of more daring HR strategies. It does *not* suggest that HR decision makers, having identified their system as being above its SRPs, will suddenly discard or fail to build on proven strengths because the nature of some of these practices is still uncertain. Rather, it suggests that having identified the system as being above its SRPs, HR decision makers are likely to build incrementally upon these strengths but be reluctant to adopt programs that depart radically from proven methods. Indeed, when such HR systems confront new situations or issues to which they must respond, HR decision makers are more likely to opt for responses that are consistent with identified strengths and tested routines—that is, more conservative ones.

## **HR STRATEGY IMPLEMENTATION**

Implementation refers to the empirically observable behaviors constituting the enactment of practices intended for adoption (Kostova & Roth, 2002). Researchers have noted that while it is relatively easy to specify an HR strategy, it can be significantly more difficult to execute that strategy. Moreover, those policies and practices actually enacted may be different from those originally intended by management when it laid out its strategy (Barney, 2001; Becker & Huselid, 2006; Khilji & Wang, 2006).

*Intended* HR strategy refers to some configuration of HR practices formulated by policy makers (HR managers and senior management) with the aim of securing a specified set of HR-related objectives. That is, the intended practices represent the operational manifestation of the HR strategy adopted by a firm's decision makers, usually with the expectation that by adopting such practices, the organization will be able to effect some desired change in employee attitudes and behaviors (Khilji & Wang, 2006; Wright & Nishi, 2013). In contrast, *implemented* HR strategy refers to practices that are actually adopted and institutionalized in organizations (Wright & Nishi, 2013). An HR strategy may be viewed as being fully implemented to the extent that the policies and programs upon which it is based are integrated into other organizational processes and are utilized and applied on a routine basis. Emphasizing the distinction between intended and implemented HR Strategy, Gratton and Truss (2003) argue that the quality of an HR strategy is a function not only of its internal and external fit, but also the degree to which its component policies and practices are put into effect in day-to-day practice. They argue that "a key message is that the bridging from business goals to employee performance requires not only policies but also a determination to act, as seen through actual practice" (p. 75).

The discussion above suggests that implementation involves both execution and employee acceptance. That is, while strategy execution may be associated with a range of problems ranging from technical glitches in associated HR information systems to active stakeholder resistance, even those strategies executed may fail to be effectively institutionalized if employees are unaware of or unwilling to utilize and/or comply with the new initiatives embedded in the strategy, or if their perceptions of such initiatives are inaccurate (Arthur & Boyles, 2007; Boselie, Dietz, & Boon, 2005; Kuvaas, 2008; Truss, 2001). Research by Wright and Nishi (2013) suggests that such accurate awareness cannot be taken for granted and that a gap often remains between program/policy implementation and employee compliance or utilization. Indeed, a number of studies suggest that employees' awareness and appraisal (i.e., as to the quality, availability, and fairness) of HR policies and practices serves as an important yardstick for assessing the institutionalization of new HR policies and practices and, ultimately, their overall effectiveness (Boselie et al., 2005; Kehoe & Wright, 2013; Nishii, Lepak, & Schneider, 2008).

The implementation challenge is not easily addressed, because obstacles exist at both the individual and organizational levels (Wright & Nishi, 2013). As Olson, Slater, and Hult (2005) put it, "brilliant execution is more important than brilliant strategy for the simple reason that doing is harder than dreaming, and poorly executed strategy is merely a vision of what could be" (p. 47). So what explains why some intended HR policies and practices are more effectively implemented (i.e., recognized, complied with, and utilized by employees) than others? Wright and Nishi (2013) address this question at multiple levels.

At the individual level, the gap between intended and executed strategy may stem from the fact that practices must usually be implemented by multiple individuals who may employ different schemas in perceiving and interpreting HR-related information. Drawing from such theories as social information processing theory (Salancik & Pfeffer, 1977), research has found significant between-person differences in the information individuals attend to, and how that information is processed (based on past experience, personal tendencies, cultural background, etc.). For example, in the psychological contract literature, Rousseau (2001) argues that people's past experiences with HR practices influence how they perceive and interpret HR and other organizational practices in their current organization.

At the organizational level, the link between intended, implemented, and perceived HR practices may represent a communication challenge, where poor vertical communication and poor coordination across functions may impede implementation (Beer & Eisenstat, 2000). Relatedly, Bowen and Ostroff (2004) argue that HR practices are organizational communication devices that aim to communicate to employees



certain messages (i.e., signaling employees to engage in certain behaviors). This may also be viewed as a political challenge. Political interests may be involved in the formulation of HR strategy (as the notion of negotiated order noted above suggests), but the “order” negotiated by those who “formulate” may not be easily imposed on those responsible for execution. Accordingly, a second wave of negotiating may be required, due to conflicting interests and priorities, and the strategy ultimately negotiated for execution may differ from that originally formulated (e.g., Beer & Eisenstat, 2000).

## SUMMARY

In this chapter, we drew upon the theoretical perspectives introduced in [Chapter 1](#) to understand inter-firm variation in the adoption of alternative HR strategies as bundles of particular HR policies and practices. Specifically, external, market-based factors likely to influence the adoption of specific HR practices and policies were viewed through the lens of rational choice, whereas external, nonmarket factors as well as internal, political factors were viewed through the lens of constituency theories.

In addition, we discussed intra-firm differences in the formulation of HR strategy. Here, too, we employed two distinct theoretical perspectives that have dominated much of the research regarding the way in which HR strategy is (or might best be) formulated. The first, rational planning perspective, consistent with a rational choice perspective on the variance in HR policies and practices across firms, suggests that HR strategies are adopted on the basis of technical merit and strict economic utility. Since technical merit and economic utility may vary from firm to firm (depending, for example, on the nature of its work processes or organizational structure), according to this perspective, such practices are likely to be adopted to the extent that they meet primarily technical and efficiency criteria. With regard to the strategy formulation process, this perspective suggests that HR strategy will, for the most part, be based on firm business strategy and will focus primarily on providing the means necessary for implementing that business strategy.

In contrast, the incremental planning perspective, consistent with the constituency-based perspective on the variance in HR policies and practices across firms, suggests that HR strategies are rarely adopted on the basis of technical merit alone. Instead, a wide range of forces determine which practices will be adopted and when. According to this perspective, the strategy formulation process is both informal and politically charged. Furthermore, for those adopting this perspective, the link between HR strategy and business strategy is in many ways bidirectional.

Finally, this chapter reviewed the literature on HR strategy implementation. In our discussion, we emphasized that the policies and practices often espoused by organizational leaders are not those always enacted, and even if enacted, are not always those perceived by employees as having an impact on their work attitudes and behaviors. Moreover, as noted by Kehoe and Wright (2013), “empirical work has demonstrated that employees’ perceptions of HR practices significantly vary from managerial reports of the HR practices in use” (p. 367). Kehoe and Wright’s findings indicate that, regardless of the espoused HR strategy, it is in fact employees’ “collective subjective experiences with HR practices” that affect the people-related outcomes (such as commitment, absenteeism, and organizational citizenship behavior) intended to be influenced by HR systems.

In spite of the debate over the formulation and implementation of HR strategy, researchers have, for the most part, reached consensus on at least one key issue, namely the existence of strategic configurations. That is, on the basis of consistent research results across industries (Arthur; 1994; Becker & Huselid, 2006; Cappelli & Neumark, 2001; Delery & Doty, 1996; MacDuffie, 1995), most HR strategy researchers

concur that HR practices tend to emerge in bundles or clusters and that these configurations tend to systematically vary across organizations. However, there is far less consensus with regard to such questions as how many configurations exist, how they differ, and which factors predict the emergence of these bundles of HR strategies across organizations. We explore these issues in the next chapter.

# 3

## MODELS OF HR STRATEGY

Having a better understanding of the forces driving the adoption, formulation, and implementation of different HR strategies, the next question we must address concerns the nature of these strategies themselves. In this chapter, we will examine whether it is possible to speak of certain types of HR strategies and the degree to which these types of strategies may systematically vary across organizations. The ability to effectively distinguish among HR strategies is critical for researchers hoping to generate and test theory regarding, for example, the impact of HR strategy on such outcomes as firm performance, and the degree to which such effects may be contingent on a firm's overall business strategy.

Recalling that we defined HR strategy as the pattern of decisions regarding the policies and practices associated with the HR system, on an operational level, it should be possible to distinguish among HR strategies on the basis of the HR policies and practices in place—an approach that would be unwieldy to say the least, given the vast number of possible ways such policies and practices could be combined. Fortunately, as we noted in the previous chapter, HR practices and policies appear to emerge in bundles or clusters, and these clusters of practices tend to systematically vary across organizations as relatively stable configurations.

Analyzing the configuration of HR strategies in terms of typologies is appealing to HR researchers for a number of reasons. First, unlike taxonomies, which categorize phenomena into mutually exclusive and exhaustive sets with a series of discrete decision rules (Doty & Glick, 1994), typologies are grounded in less rigid conceptual schemes. These conceptual schemes, or, as Weber (1949) referred to them, “ideal types,” do not exist in reality, but rather provide a theoretical reference point against which observable phenomenon can be compared and assessed. In this sense, they “are intended to provide an abstract model, so that deviation from the extreme or ideal type can be noted or explained” (Blalock, 1969, p. 32). Without the identification of ideal types of HR strategies, it would be difficult (at best) to describe differences in strategy across organizations and nearly impossible to generate falsifiable hypotheses. Thus, the development of empirically grounded typologies is a critical step in theory development, giving researchers the ability to identify relationships among the different typological dimensions (Etzioni, 1961; Mintzberg, 1979; Porter 1980, 1985). Indeed, Doty and Glick (1994) argue that configurational frameworks and typologies, when constructed properly, meet the same basic criteria as theories—namely, they are structured around specified and falsifiable relationships among a set of well-identified constructs or characteristics.

Second, configurational analysis, or analysis across identified types, is well established in the field of management and organizational theory. Configurations are “conceptually derived interrelated sets of ideal types, each of which represent a unique combination of the organizational attributes that are believed to determine relevant outcomes” (Doty and Glick (1994, p. 232). As Fiss (2007) points out, because many organizational characteristics (e.g., practices, structure, cultural artifacts, and membership composition) tend to appear in relatively stable clusters (as opposed to modular or loosely coupled arrangements), this approach allows for multiple levels of analysis both within and across organizations.

Third, theoretically, individual HR practices should tend over time to support and reinforce one another. Building on the notion of internal fit discussed in the previous chapter, a number of researchers

(e.g., Becker & Huselid, 2006; MacDuffie, 1995; Subramony, 2009) have argued that the appropriate unit of analysis for studying HR strategy is not the individual HR practice, but rather bundles of internally consistent HR practices. MacDuffie's findings in the automobile industry provide strong support for this argument that HR practices tend to be "bundled" together into distinct models or configurations, each having its own underlying logic.

Finally, the field of business strategy is, to a large extent, structured around the identification and application of typologies and strategy configurations. Two of the most well-known typologies of business strategy were developed by Porter (1980, 1985) and Miles and Snow (1978, 1984). Porter (1980) identified two main strategy types used by firms to achieve sustainable competitive advantage. Under Porter's typology, firms that follow a "cost leadership strategy" aim to strengthen the market potential of their products or services by developing a lower cost structure. The alternative is a "differentiation strategy," whereby firms seek to distinguish themselves from their competitors in ways that are valued by customers (e.g., quality, service, or timeliness). By thus positioning themselves relative to their competitors, firms can charge premium prices for their products or services. Typically, the cost leadership strategy is associated with mass production methods, and the differentiation strategy with "flexible" production methods (e.g., Allen & Helms, 2006; Buhalis, 2000). According to Porter, firms with strategies close to one of these ideal types are likely to outperform those that adopt a heterogeneous collection of practices, because the latter tend to be less able to align and focus the utilization of their resources.

Miles and Snow (1978, 1984) identified three ideal types of business strategies, which they called "defenders," "prospectors," and "analyzers." Defenders have a narrow and stable market for their product or service, and they focus on efficiency and the defense of market share as opposed to growth. The "prospecting" strategy tends to be adopted by companies that are searching for new business opportunities via new products, markets, or services. In firms that follow this strategy, resources are focused on generating and implementing innovations as well as acquiring those competencies and synergies that cannot be developed internally. Analyzers operate simultaneously in both stable and dynamic product markets. They are often leaders in the various markets in which they operate, and while not the initiators of change, they follow change more rapidly than do defenders.

Over the years, researchers have proposed other typologies of business strategy, such as the simple-complex framework of Miller and colleagues (Miller & Dess, 1993; Miller, Lant, Millen, & Korn, 1996), or Treac and Wiersema's (1997) typology of product leadership, customer intimacy, and price leadership. However, the typologies of Porter (1980) and Miles and Snow (1978, 1984) have been applied in numerous studies (e.g., Boyne & Walker 2004; Brown & Iverson, 2004; Verreyne & Meyer, 2010) and have been found to be robust (e.g., DeSarbo, Di Benedetto, Song, & Sinha, 2005). Indeed, these typologies have been extended to capture the constraints that firms in different sectors and industries may face in altering markets, services, and revenues.

For example, based on their observations of firms from various industries, Sheppeck and Militello (2000) suggested that "several configurations regularly occur in the organizational landscape" (p. 9). Their model, which combines elements from Porter (1980) and Miles and Snow (1984), view organizations as complex systems influenced by both external forces, such as industry structure (Porter, 1980), and internal forces, such as organizational culture (Miles & Snow, 1984). More specifically, organizations tend to form configurations based on (a) the nature of their operating environment; (b) their strategies for dealing with their constituents and environment; (c) various structural and system features within the organization (including HRM practices); and (d) management values and behaviors. Five high-frequency configurations were identified: "classic operations," "emerging operations," "classic product

leader,” “classic customer,” and “combination.” These configurations represent typical ways in which organizations align their external and internal actions to compete in their industries. As such, when a change occurs in one or more of the system’s components (e.g., the competitive strategy is revised to reposition the firm), decisions must be made regarding leadership actions and HRM practices in support of the repositioned firm. Sheppeck and Militello’s (2000) framework provides a mechanism for understanding the component interactions and determining how tradeoffs among the components should be made, “answering such questions as ‘What does it mean for our pay practices if the industry becomes more chaotic and we need to change operations at a faster and faster pace?’” (p. 13).

A core assumption underlying much HR strategy research is that each of the different overarching business strategy types, such as those described above, is associated with a different approach toward managing human capital; that is, a different HR strategy (Boxall & Purcell, 2008; Delery & Doty 1996, Jackson & Schuler, 1995). Indeed, Delery and Doty (1996) suggest that if this basic premise is correct, “then much of the variation in HR practices across organizations should be explained by organizational strategy” (p. 803). This assertion has been supported by others. For example, Castanheira and Chambel (2010) found that the type of business strategy (cost control versus customization) adopted by service organizations can be used to explain variations in HR practices among call centers. Similarly, Gilbert and Jones (2000) concluded that there are likely to be significant differences in HR practices between small businesses seeking to become medium to large businesses and those intending to remain small. Thus, at the very least, the ideal types of overarching organizational strategy described above provide us with a solid foundation upon which to base our analysis of HR strategies.

## **MODELS OF HR STRATEGY**

Over the past decades, researchers have proposed a number of frameworks by which to differentiate among core or ideal types of HR strategies. Some of these models have been generated intuitively on the basis of theory, while others have been derived empirically. While it may not be possible to reconcile all model differences, we will attempt to identify a number of common, underlying elements across these models. On the basis of these common elements, we will conclude this chapter by proposing a more integrative model of HR strategy.

### *Theory-Driven Models*

Researchers have taken one of two approaches in attempting to develop typologies of HR strategy. The first approach is grounded in a resource-based view of the firm and focuses on the temporal nature of the employer-employee relationship and the labor market parameters underlying that relationship. The second approach is grounded in the means by which employers attempt to monitor and control employee role performance.

**Models of the employer-employee relationship.** HR strategy models grounded in the resource perspective rest on the implicit assumption that the set of employee behaviors, attitudes, and relationships underlying an organization’s HR system can be critical to the implementation of business strategy (Boxall & Purcell, 2008; Wright, Dunford, & Snell, 2001). As a composite whole, this set of behaviors, attitudes, and relationships has the potential to provide capabilities that are valuable, rare, nonsubstitutable, and imperfectly imitable, and can thus serve as a source of competitive advantage for the firm. Underlying such models, however, is recognition that the acquisition and development of such a set of behaviors,

attitudes, and relationships can be costly and that a firm's competitive advantage may be secured more efficiently in some other manner. Consequently, in the simplest terms, models grounded in this perspective distinguish among HR strategies according to the degree to which employers view their human resources as an asset as opposed to a variable cost.

However, resource-based models make a second basic assumption as well, namely that the degree to which a firm views its human resources as an asset (as opposed to cost) influences the nature of the employer-employee exchange or "bargain." For example, to develop a unique set of employee behaviors, attitudes, and relationships and use employee knowledge about products, processes, customers, and suppliers as a source of sustainable competitive advantage (Becker & Huselid, 2006; Schuler & Jackson, 2007; Ulrich & Brockbank, 2005), employers viewing their human resources as an asset may be willing to exchange a guarantee of job security and organizational career development for an employee understanding that compensation will be governed more by internal equity norms than by the external market rate. This type of employment framework is commonly referred to as an internal labor market (ILM; Ito & Brotheridge, 2005). Employers viewing their labor costs as a drain on their income are likely to develop frameworks that allow them to exchange market-based compensation in return for employment-at-will—for example, employing workers in highly unskilled, routine jobs in return for the ability to acquire and dispose of employees as market conditions demand. This type of employment framework is commonly referred to as an external labor market (ELM; Connelly & Gallagher, 2004).

Adopting such a framework, Osterman (1987) identified four different HR strategies that, in his view, derive from the firm's overall business strategy. The *craft strategy* is grounded in the assumption that participants in the labor market are skilled free agents, more loyal to their occupation than to their employer. Mobility is an accepted fact, with staffing based almost entirely on an external labor market, wages determined on the basis of market supply and demand, little guaranteed job security, and an assumption that the employer is "buying" rather than developing a set of employee attitudes and behaviors. Employers adopting such a strategy seek competitive advantage by reducing labor costs and ensuring a high degree of staffing flexibility, thus allowing them to avoid having to assume payroll costs when market demand is low. According to this classic, external labor market framework, employees forfeit job security in return for control over the work process and market-based compensation.

The *secondary* strategy is also guided by an external labor market philosophy. However, it assumes that jobs that require only the most basic skills will be poorly compensated and will offer no job security or internal career potential (e.g., janitorial positions, messengers). Staff turnover is encouraged as a means to keep labor costs down, with new staff recruited from a low-cost, secondary (and often contingent) labor market. Employees exchange flexibility, control over the labor process, and job security for market-based compensation.

As a kind of hybrid strategy, the *industrial strategy*, typically adopted in heavily unionized firms, is characterized by narrowly defined jobs with clearly defined job responsibilities and limited internal mobility based, for the most part, on seniority. Employees are viewed as a limited source of sustainable competitive advantage, and thus a partial internal labor market prevails. For example, wages are based on seniority and the actual job performed and are less influenced by external labor market conditions, but employers offer only limited career development and retain some right to employment-at-will. Employees, in effect, exchange control over the work process and external equity in compensation for a limited degree of job security and a guaranteed wage.

Finally, a *salaried strategy* is adopted in firms in which human resources are viewed as a key source of sustainable, competitive advantage. It is characterized by a classic internal labor market: a strong commitment to job security, job descriptions that are open to revision by management, flexible job

assignments, well-prescribed career paths with an emphasis on internal staffing, and a greater emphasis on meritocracy and salary differentiation. The exchange implicit in such relationships is one in which employers demand loyalty, flexibility in job assignments, and the forfeiture of external equity in compensation on the part of employees, and in return offer job security, extensive development opportunities, and an organizational career.

As suggested by the description above, variation in HR strategy is manifested across one or more of four core dimensions, or what Osterman refers to as the “rules” governing the employment relationship. These are job classification and job definition rules (narrowly or broadly defined jobs; flexible or rigid definitions and classifications); career development rules (whether internal career development is possible and the criteria upon which such development is contingent); job security rules (the degree to which the organization makes an explicit or implicit commitment to continued employment); and finally, wage rules (the degree to which pay is strictly a function of the job classification or is contingent on other criteria such as performance, knowledge, or competencies). Osterman argues that each strategy has its own, exchange-based, internal logic requiring alignment among these employment rules. Thus, for example, firms that guarantee lifetime employment tend not to adopt rigid job descriptions (e.g., Kallinikos, 2003). In this sense, Osterman, and later other researchers (Boxall & Purcell, 2008; Chadwick, Hunter, & Walston, 2004), argue that HR strategy is manifested in terms of configurations of naturally aligned employment rules that are themselves a function of a firm’s business strategy. Firms choose their employment rules on the basis of three overall strategic objectives: cost effectiveness, predictability, and flexibility. Clearly, each objective has its own tradeoffs with respect to the others. Thus, for example, rules adopted with wage minimization objectives in mind may service cost-effectiveness goals, but may be deleterious with respect to predictability. Nevertheless, firms set their HR strategy on the basis of those goals most consistent with their overall business strategy, and then implement those “rules” most likely to serve those objectives (Boxall & Purcell, 2008; Castanheira & Chambel, 2010).

On the basis of Osterman’s typology, we can already identify the three major components of a model of HR strategy that will reappear in one form or another in each of the typologies we will review: ends (in Osterman’s terminology, “goals”); means (Osterman’s “rules”); and logics—the underlying philosophy used to (a) justify the ends and explicate their external fit with the overall business strategy, and (b) assure internal alignment among the selected ends and means (Bacharach, Bamberger & Sonnenstul, 1996; Becker & Huselid, 2006). This demand for internal consistency among the rules, policies, and practices comprising the strategic means, as well as for at least some degree of external fit between both HR means and ends on the one hand and the firm’s business strategy on the other, is a core assumption underlying nearly all models of HR strategy (Baird & Meshulam, 1988; Becker & Huselid, 2006; Lado & Wilson, 1994).

Though Osterman’s (1987) typology has received general acceptance and empirical support in the HR strategy literature (e.g., Boxall, 1995; Huselid, 1995), it has also been criticized for not providing greater insight into which logic is appropriate for which competitive situation. Two more recent models attempt to expand on Osterman’s employment framework specifically by strengthening this critical link between firm strategy and the logic underlying HR strategy. Delery and Doty (1996) propose a typology of HR strategy based on the assumption that firms having a close fit between their HR and business strategies will perform better than those whose strategies are more poorly aligned. The authors suggest three ideal types of HR strategies—“market,” “internal,” and “middle-of-the-road”—again governed by the degree to which human resources are viewed as an asset as opposed to a cost, and the nature of the employee-employer exchange. Instead of differing across four sets of employment rules (as in Osterman’s model),



Delery and Doty's three strategy configurations differ across seven HR practices. For example, the market type of HR strategy is governed by an employer interest in reducing labor costs and is characterized by few internal career opportunities. Employees are hired almost exclusively from outside the organization, and the firm offers little formal training, widespread use of profit sharing, limited employment security, and little opportunity for employee participation in organizational decision making.

In contrast, the internal HR strategy is governed by an employer interest in using employee competencies and social capital as a source of sustained competitive advantage. It is characterized by an internal labor market, with most positions being staffed from within the organization; extensive employee training and a strong emphasis on socialization; performance appraisals focusing on behaviors rather than outcomes and geared toward employee development; limited use of incentive systems such as profit sharing; a great deal of employment security; a higher level of employee participation in decision making; and narrowly defined jobs positioned along a "taller" hierarchy. The middle-of-the-road strategy is defined as a hybrid of the two and is operationalized as the midpoint between the market and internal strategies along all seven HR practices.

Delery and Doty (1996, p. 809) provide strong theoretical grounding for their configurations, noting that on the basis of equifinality assumptions, these three ideal types of HR strategy incorporate practices that are internally consistent ("maximizing horizontal fit") and that—as a group—are logically linked to alternative business strategies ("maximizing vertical fit"). The business strategies to which they are linked are those identified by Miles and Snow (1978). Specifically, the logic and practices of the internal strategy are consistent with the defender business strategy and the HR objectives suggested by it, while the logics and practices of the middle-of-the-road and market strategies are consistent with the analyzer and prospector business strategies, respectively, and the HR objectives specified by them. For example, to maximize efficiency, an HR objective for the defender business strategy is likely to be employee commitment (as a means to reduce dysfunctional turnover and replacement costs). As a group, the practices associated with the internal strategy are geared precisely toward such HR objectives and are thus well aligned with the defender strategy.

Like Delery and Doty (1996), Baron and Kreps (1999) offer a three-part model of HR strategy based on the employee-employer exchange relationship. However, unlike the previous two models, this model assumes that the successful implementation of *any* business strategy requires a unique and sustainable set of human resource competencies. Consequently, rather than distinguishing among HR strategies on the basis of the degree to which employees are viewed as a source of competitive advantage (versus as a cost), Baron and Kreps differentiate among HR strategies according to the logic underlying the way in which firms seek to *efficiently* acquire, develop, and retain such assets. As a result, their model is even more firmly grounded in the notion of labor markets. The first type of HR strategy they identify is an internal labor market (ILM) strategy. Similar to Osterman's "salary" strategy and Delery and Doty's "internal" strategy, the ILM approach is geared toward firms whose business strategies emphasize two HR goals: (a) the retention of firm-specific knowledge, and (b) the minimization of recruitment and training costs. To achieve these objectives, firms implementing ILM strategies adopt sophisticated recruitment and screening mechanisms; emphasize employee socialization; provide numerous opportunities for employee development; use incentives to encourage employee retention; avoid wage compression by emphasizing internal over external equity in compensation; and attempt to staff all but entry-level positions from within.

Similar to Osterman's craft or secondary strategy and Delery and Doty's market strategy, Baron and Kreps' (1999) second type of HR strategy—a "high-commitment" strategy—assumes that employees may be more committed to their line of work than to their employer and may thus have little interest in intra-

organizational career opportunities. The underlying objective of this strategy is therefore to efficiently maximize employee outputs, “using HRM practices targeted at getting more out of employees by giving them more” (p. 2). Such HR practices, often referred to as “high-performance work practices” or “high-commitment, high-involvement” practices, include sophisticated recruitment and selection processes designed to identify superior job candidates; reward practices (individual and team) designed to encourage employee flexibility and willingness to take on extra-role job assignments; and a work culture that emphasizes employee involvement and discretion. Such practices are intended to shape employee behavior and attitudes by developing “psychological links” between organizational and employee goals (Den Hartog & Verburg, 2004; Wright, Gardner, Moynihan, & Allen, 2005). In contrast to the ILM strategy, which is grounded in a tall hierarchy with organizational status based on bureaucratic position, the high-commitment strategy emphasizes egalitarianism. The ILM prefers to internally develop employee competencies and preserve organizational-specific knowledge by offering employment security and extensive career development potential. In contrast, the high-commitment strategy emphasizes the careful acquisition of such competencies. It takes some degree of turnover for granted, but seeks to minimize the deleterious consequences of turnover by underscoring the importance of teamwork, a flat hierarchy, open communication and information, and results-based, deferred compensation.

Baron and Kreps’ third model is in fact a hybrid. They argue that a high-commitment-ILM hybrid strategy is relatively rare in the West, but is the strategy of choice in several Japanese firms (e.g., NEC, Toyota, Matsui). Such a hybrid may be an empirical anomaly in the West because it integrates the job security and internal staffing practices of the ILM strategy with the team-based work structure and results-oriented performance appraisal of the commitment model. An alternative hybrid suggested by the authors appears to be more apparent in an increasing number of American firms. This hybrid involves the application of a high-commitment model with respect to an organization’s core tasks (i.e., those upon which the success of the firm’s competitive strategy is most contingent) and a kind of “secondary” model with respect to all other positions based on the outsourcing of nonmainstream jobs (e.g., clerical or janitorial). Later in this chapter, we describe recent empirical evidence supporting this hybrid model.

Despite their differences, the three typologies described above are similar in that they stem from a resource-based view (RBV) of the firm (Barney, 1986, 1991) and view the employee-employer exchange relationship as providing the defining logic linking strategic means to ends and ensuring that the means are not internally misaligned. Not only do all three of these theory-based models assume that the firm’s competitive business strategy, in effect, “selects” the appropriate exchange relationship between employers and their employees, but they also assume that the nature of this exchange relationship sets the basic framework governing the selection of HR goals and the practices to be used to achieve those goals. Specifically, the three models discussed above all assume that HR practices are selected to service a set of HR objectives that are, at the very least, not inconsistent with the strategic goals of the firm as a whole. In this respect, these typologies overcome a main challenge for RBV theory, namely its inconsistency with Bourgeois’ (1985) “central tenet” of strategy—namely, “that a match between environmental conditions and organizational capabilities and resources is critical to performance, and that a strategist’s job is to find or create this match” (p. 548). By explicitly considering both the internal characteristics of the firm and its external, environmental demands, the models described employ the RBV theory in a manner that is useful for strategic management (Priem & Butler, 2001; Sirmon, Hitt, & Ireland, 2007).

Moreover, the models assume that in addition to assuring external fit, the logic implicit in the nature of the employee-employer exchange also ensures that the practices and policies adopted to achieve these goals are internally consistent (i.e., have a high degree of internal fit). Finally, since these models are based on two ideal types of employee-employer exchange based on internal versus external labor

markets, they tend to specify at least two ideal types of HR strategies along a continuum of logics consistent with a reliance upon internal labor markets at one extreme and external labor markets at the other. Hybrid HR strategies are adopted by those firms whose competitive strategy and/or occupational composition demand a logic taking both internal and external labor market relations into account.

**Employee control models.** A second group of researchers also frame their models of HR strategy around the three parameters of means, ends, and logics. However, the approach adopted by this second group is more concerned with employer control and employee role performance processes than the nature of the employment relationship. As far as these researchers are concerned, a firm's competitive context constrains managers' ability to efficiently monitor and control employee role performance. Thus, this second approach to modeling the types of HR strategy is grounded in the nature of organizational control, and more specifically, the ways in which the organization seeks to direct and monitor employee performance.

Schuler and Jackson (1987), in one of the earliest models of HR strategy proposed, argue that just as organizations differ in their strategies and characteristics (such as structure, size, or age), so do organizational members in their attitudes and behaviors. The function of HR strategy should therefore be to better align member attitudes and behaviors with firm strategy. Recognizing that HR practices can channel and influence employee role behaviors and help make these behaviors more predictable, Schuler and Jackson claim that different clusters of HR practices are required to help the organization achieve its strategic objectives. More specifically, drawing from Porter's (1985) typology of competitive strategies (namely, differentiation or cost leadership), they argue that for each strategy there is a corresponding set of ideal employee role behaviors that are critical for strategy implementation. They identify ten role dimensions (and their respective range of employee role performance goals) that serve as a kind of menu from which strategic HR goals are selected. These role behavior dimensions include, among others, short- versus long-term focus, low versus high concern for quality, and low versus high risk-taking orientation. Thus, for example, role performance objectives supportive of the differentiation strategy are likely to include creativity, a long-term orientation, high concern for quality, high tolerance for ambiguity, and a moderate to high degree of risk taking.

Jackson and Schuler (1987) argue that employers select HR practices designed to channel employee behavior such that individual role performance is consistent with the HR system objectives. That is, HR strategy, as conceptualized by Jackson and Schuler, is based on a set of employee role performance goals consistent with the firm's competitive strategy, as well as a bundle of HR policies and practices designed to channel and control employee attitudes and behaviors such that these goals may be achieved. The bundle of policies and practices varies from strategy to strategy along five dimensions: planning, staffing, appraising, compensation, and training and development. Thus, for example, depending on the competitive strategy and hence, the HR objectives, an HR strategy may be comprised of planning practices that are more or less formal, short- or long-term oriented, and more or less open to employee participation (Bae & Lawler, 2000; Huselid, 1995; Lengenick-Hall, Lengenick-Hall, Andrade, & Drake, 2009; Ngo, Lau, & Foley, 2008).

Although Jackson and Schuler fail to explicate the logic underlying each of their strategy types, two main control-based logics may be inferred on the basis of their discussion. The first is a logic of direct, process-based control in which the focus is on efficiency and cost containment (consistent with Porter's cost leadership strategy), while the second is a logic of indirect output-based control in which the focus is on actual results (consistent with Porter's differentiation strategy). Implicit in Jackson and Schuler's framework is that the logic underlying an HR strategy will tend to be consistent with the firm's overall competitive strategy. Thus, we are unlikely to find firms adopting a differentiation strategy with an HR

strategy grounded in a process-based logic. Simply put, an HR strategy framed around a logic of process-based control is unlikely to attract creative employees or help in the development of employee creativity, nor is it likely to encourage the long-term performance orientation on the part of employees desired by most firms adopting such a strategy.

This focus on employee control as a basis for distinguishing among HR strategies has its roots in the sociology of work. Control is defined by Edwards (1979, p. 17) as “the ability of managers to obtain desired work behavior from workers.” Thus, the control system is the crucial interface between labor and management in an organization. Over the years, changing technologies and increasingly competitive environments have forced administrators to adopt a diverse set of mechanisms by which to control labor (Edwards, 1979; Russell, 2008; Zweig & Webster, 2002). As hinted above, organizational theorists (Ouchi & Maguire, 1975; Thompson, 1967) view these mechanisms as being grounded in one of two alternative approaches, namely behavioral control (also called process control) and outcome control.

Behavioral or process control is often highly cost-effective, but it entails careful planning and direct monitoring of the processes used by workers to achieve a given set of ends. For example, managers may specify how and when tasks are to be completed, frequently monitor a project’s progress, and make ongoing adjustments to employee behaviors (e.g., Bonner, Ruekert, & Walker, 2002; Cardinal, 2001). A number of researchers have emphasized that process controls make people overly dependent on the process, less likely to experiment, and less able to deal with uncertainty or change (Cardinal, 2001; Thompson, 1967). Indeed, because it is inherently means-based, behavioral control is effective only when means-ends relations are completely understood (as in an auto assembly line, for example). When means-ends relations are uncertain (as is typically the case among firms adopting a differentiation strategy), but goals are agreed upon by agents and principals, outcome or output controls—i.e., controls that focus on the ends themselves, or the standards against which employees/units are evaluated, such as margin or market share—may be effective. Yet while output controls may provide the information and motivation needed to direct actions toward desired ends (Bonner, 2005), they are inherently more uncertain than process or behavioral controls. Thus, managers tend to adopt them only when they feel they can reduce this uncertainty by predetermining the premises upon which their subordinates make key decisions. That is, organizations relying on output-based systems of governance tend to rely heavily on practices designed to shape the organizational norms and values underlying many of these decisions (Kunda, 1992; Thompson, 1967; Thompson, Callaghan, & van den Broek, 2004)—practices that are themselves highly uncertain, and both time-consuming and costly to implement.

Dyer and Holder (1988) structure their typology of HR strategies around the notion of differing logics of control as well, again basing their typology on differing clusters of ends, means, and logics. Indeed, Dyer and Holder (1988, p. 1) define HR strategy as “decisions concerning major HR goals and the primary means in pursuit of these goals.” Four key ends or goals are identified, namely contribution, composition, competence, and commitment. Contribution goals have to do with employee performance expectations (e.g., efficiency, creativity, flexibility, and innovativeness). Composition goals have to do with the makeup of the workforce, including its gender mix, skill mix, and staff-line and supervisory ratios. Competence goals concern employees’ knowledge, skills, and abilities—that is, the degree to which the workforce has the competencies necessary to implement the organization’s strategic objectives. Finally, commitment goals have to do with the degree of employees’ attachment to the organization, from casual attachment to total identification. Dyer and Holder argue that to achieve these ends, organizations select means from six different realms of HR activity: training and development, performance management, employee/labor relations, government relations, reward management, and work system design.

Finally, three different types of logics determine how overall HR goals are configured across the four dimensions described above (i.e., contribution, composition, competence, and commitment), and which HR practices from across the seven realms of activity will be clustered to serve these goals. The link between logics, goals, and means is depicted in [Table 3.1](#). According to Dyer and Holder's (1988) typology, an "inducement" logic is most likely to be adopted by firms engaged in a highly competitive business environment in which there is a strong focus on containing costs, maintaining a lean head-count, and insuring that the process by which inputs are transformed into outputs is free from labor-based disruptions. Such organizations emphasize commitment goals (to minimize recruitment, selection, and development costs), narrowly define and routinize jobs (to reduce the level of uncertainty in the production process), and try to build a strong link between work effort and pay. For example, research has demonstrated that contingent pay can be used as a form of inducement to enhance firm performance via employee performance (Beer & Katz, 2003; Subramony, Krause, Norton, & Burns, 2008).

In contrast, an "investment" logic is typically adopted by firms whose business strategy is framed around a tradition of product differentiation (i.e., brand recognition, quality, or functionality) rather than cost leadership. Such organizations rely on a kind of controlled adaptability and flexibility, resulting in an organization with a broad skill mix, but with centralized decision making and a tall hierarchy. Jobs tend to be broadly defined, reward practices incorporate a mix of fixed and variable components to encourage creativity and initiative, and emphasis is placed on employee development and commitment (to retain valuable in-house knowledge). Nevertheless, employee initiative is bounded by a relatively high level of direct, process-based supervision and a highly developed reporting system. As noted by Lepak, Taylor, Teklead, Marrone, and Cohen (2007, p. 225), such systems focus on both skill enhancement via selective staffing and comprehensive training, as well as motivation via performance-based pay and integrative performance management.

The third logic, "involvement," is, according to Dyer and Holder (1988), characteristic of organizations with a hybrid business strategy focusing on both cost leadership and innovativeness. Such organizations typically adopt flat, decentralized structures that maximize cost effectiveness while still allowing them to respond rapidly to competitor actions and shifts in market demands. To meet innovation requirements, the cluster of HR practices associated with this strategy is characterized by an emphasis on staffing, job structuring, supervision, and rewards. Composition, commitment, and competence goals are attained by hiring professionals with a very high level of technological know-how and by structuring jobs so as to provide maximum challenge, involvement, and autonomy. Contribution goals are attained by tightly linking rewards to results (Bae & Lawler, 2000; Yu & Egri, 2005).

In an empirical test of this typology, Swiercz (1995) found support for the inducement and involvement logics, but not for the investment logic. This finding suggests that strategy logics may cluster around the two extremes of organizational control, namely tight, process-based control (dominant in the inducement logic) versus relatively loose, output-based control (characteristic of the involvement logic). Chow and Liu (2009) similarly found support for the inducement-HR and involvement-HR systems. It may be that the hybrid control model is an empirical anomaly, much like the hybrid employer-employee exchange model described by Baron and Kreps (1999), which combined elements of both internal and external labor markets. That is, in the same way that an employer-employee exchange approach to modeling HR strategy suggests two ideal types of strategies at opposite poles of a continuum (i.e., internal versus external), so too does the organizational control approach (i.e., process versus output).

**Table 3.1** Dyer and Holder's (1988, pp. 1–21) Typology of HR Strategies

| LOGICS               |  |   |   |
|----------------------|--|---|---|
| GOALS                | Investment   | Inducement  | Involvement   |
| Contribution         | High initiative and creativity, high performance expectations, some flexibility    | Some initiative and creativity, very high performance standards, modest flexibility | Very high initiative and creativity, very high performance expectations, high flexibility, self-managed |
| Composition          | Comfortable headcount (core and buffer), high skill mix, moderate staffing         | Lean headcount (core and buffer), low skill mix, minimal staffing                   | Comfortable headcount, protected core, high skill mix, minimal staffing                                 |
| Competence           | High   | Adequate  | Very high   |
| Commitment           | High, identification with company  | High, instrumental  | Very high, strong identification with work, team, and company   |
| <b>Practices</b>     |  |   |   |
| Staffing             | Careful selection, extensive career development, some flexibility, minimal layoffs | Careful selection, few career options, use of temps (minimal layoffs)               | Very careful selection, some career development, extreme flex, minimal (or no) layoffs                  |
| Development          | Extensive, continuous learning   | Minimal   | Extensive, continuous learning  |
| Rewards              | Tall structure, competitive-fixed, job based, merit, many benefits                 | Flat structure, high variable, piece-rate, profit sharing, minimal benefits         | Flat structure, high or partially variable, skill and competency based, gain sharing, flex benefit      |
| Work System          | Broad jobs, employee initiative, some groups                                       | Narrow jobs, employee paced, individualized   | Enriched jobs, self-managed work teams  |
| Supervision          | Extensive, supportive  | Minimal, directive  | Minimal, facilitative   |
| Employee Relations   | Much communication, high voice, high due process, high employee assistance         | Some communication, some voice, egalitarian   | Open and extensive communication, high voice, some due process, egalitarian, some employee assistance   |
| Labor Relations      | Nonissue   | Union avoidance or conflict   | Union avoidance and/or cooperative  |
| Government Relations | Overcompliance   | Compliance  | Compliance  |

Snell's (1992) examination of the link between strategic business contingencies and models of HR management control provides support for this notion of a process versus output continuum of HR strategies. Defining control as "any process that helps align the actions of individuals with the interests of their employing firm" (Snell, 1992, p. 293), Snell argues that HR practices, as the "principal methods used to regulate performance," in fact manifest control in organizations. According to his typology, HR practices tend to cluster together around three main types of control: behavioral, output, and input. As with Dyer and Holder's (1988) inducement logic, HR practices grounded in the logic of behavioral control assume a high degree of task programmability (i.e., complete knowledge of cause-effect relations) and are based on carefully articulated operating procedures and the use of direct, in-process behavioral monitoring as a means to identify and correct deviations as they occur. In contrast, HR practices grounded in output-based control are framed around the translation of intentions into targets rather than operating



procedures. This logic (like Dyer and Holder's involvement logic) allows subordinates discretion as to the means to be used to achieve desired ends. It assumes that the standards of desired performance are not only pre-set, but are also highly crystallized.

But what happens when cause-effect knowledge is incomplete and standards of performance are ambiguous? Snell argues that under such conditions, firms tend to adopt HR systems based on input control; that is, they regulate performance by regulating the antecedent conditions of performance, such as training and selection (similar to Dyer and Holder's investment-based model).

Snell (1992) uses data from over 400 single-business-unit firms to show that environmental (e.g., product market variations) and technological factors (e.g., work flow integration) have an impact on both knowledge of cause-effect relations and the clarity of performance standards, and thus in turn determine the extent to which HR systems are grounded in behavior-output or input-based logics of control. The findings suggest that "the constructs of input, behavior and output control provide a viable (and more parsimonious) framework for integrating human resource practices" (p. 318) and that administrative information (i.e., cause and effect relations and the clarity of performance standards) mediates the link between the strategic business context and HR strategy. It also suggests that input-based control may provide the basis of a hybrid HR strategy in that, although support was found for a mediated link between strategic context and both process and output-based control, input-based practices such as training and selection remained fairly constant across strategic contexts.

Given the compelling evidence regarding both the exchange and control approaches, it is difficult to claim that one approach may be more valid than the other. Indeed, perhaps both approaches are correct, and HR strategies vary across two dimensions: one having to do with the strategy's underlying logic of the employer-employee exchange, and the other having to do with the strategy's underlying logic of organizational control. Before trying to reconcile these two approaches, it may be useful to explore some empirical findings with regard to HR strategy.

### *Data-Driven Models*

Data-driven models of HR strategy focus on identifying the most common bundles of practices (i.e., means) as they exist in the field. Researchers may use a variety of statistical methods to identify these bundles, with factor analysis and cluster analysis being most widely used. Just as the HR theorists discussed above link theoretical means to ends, so do these empirical researchers. However, they do so empirically, identifying the statistical tendency of each bundle to cluster in firms with specific business strategies.

Arthur (1992, 1994) conducted one of the first empirical analyses of HR strategies in an attempt to test the proposition that differences in employee relations policies and practices are related to the differences in business strategy. Two sets of questionnaires were sent to a sample of 54 American steel minimills. One of the questionnaires, aimed at HR managers, dealt with the plant's employee relations policies; the other was sent to line managers and dealt with the importance of various competitive strategy characteristics, the number and type of products produced, and the total hourly cost of work. Data from the line managers were used to construct eight business strategy variables, and data from the HR managers were used to construct ten employee relations variables. The cluster analysis, conducted on the basis of these two sets of variables, revealed the existence of two dominant HR strategies: a cost reduction strategy and an employee commitment strategy. These strategies were distinguished from one another on the basis of five realms of HR policy and practice: work organization, employee relations, staffing, training, and compensation.



Arthur (1994) concluded that the goal of the cost reduction strategy is to “improve efficiency by enforcing employee compliance with specified rules and procedures and basing employee rewards on some measurable criteria,” whereas the goal of the commitment strategy is to develop a cadre of committed employees who “can be trusted to use their discretion to carry out job tasks in ways that are consistent with organizational goals” (p. 672). The study found that the commitment strategy’s cluster of practices was characterized by higher levels of employee involvement in decision making, enhanced employee training in problem solving, a stronger emphasis on socialization-oriented development activities, selection methods aimed at maintaining a higher ratio of skilled to unskilled employees, and a higher average wage rate.

In this sense, Arthur’s typology combines elements of both the resource-based and organizational control approaches. The cost reduction strategy is grounded in the assumption that “managers have a relatively complete knowledge of the transformation process (inputs to outputs) and a high ability to effectively set performance standards and measure employee outputs” (1994, p. 672).<sup>1</sup> Under such conditions, employers may directly monitor and reward employees in a highly cost-effective manner, on the basis of their meeting either process- or results-based standards. Labor costs are reduced because of generally lower levels of remuneration and a more limited need for the organization to invest in employee training and development.

However, when such conditions are absent (as is typical for organizations adopting competitive strategies based on differentiation), the uncertainties inherent in the transformation process may be best controlled by adopting a commitment strategy. In addition to providing the organization with enhanced flexibility and agility, such a strategy may offer significant savings by reducing the need to monitor employee compliance with work rules. Nevertheless, the commitment strategy has significant costs associated with it, due to the need to (a) recruit and select the best possible candidates to handle multiple complex, dynamic, and often ambiguous job tasks; (b) develop a sophisticated program of employee socialization (to align the interests of these often externally recruited employees with those of the firm); (c) design work systems that give highly skilled employees the autonomy needed to deal with the uncertainties inherent in the transformation process; and (d) provide above-market, equity-based compensation to attract and retain highly valued human assets. These costs may be justified when “the successful implementation of a business strategy requires a unique set of employee behaviors and attitudes” that cannot reliably be produced on the basis of formalized work rules and task routines (Arthur, 1994, p. 672). In this sense, Arthur’s commitment strategy is labor-market oriented and focuses on the structuring of the employer-employee exchange, whereas the cost reduction strategy is performance oriented and focuses on the structuring of behavioral rules and routines and the monitoring of employee compliance with such rules.

MacDuffie (1995) similarly argues that HR strategies are manifested in bundles of interrelated and internally consistent HR practices, which may be empirically identified. Underlying each of these bundles, according to MacDuffie, is an “organizational logic” that assures that the bundle of HR practices is “integrated with complementary bundles of practices from core business functions” (p. 198). On the basis of these logics, MacDuffie predicted that organizations will use different combinations of HR practices and policies (means) to achieve three primary HR goals (ends): (a) ensuring that employees have the competencies (i.e., skill and knowledge) required to achieve firm business objectives; (b) ensuring that employees have the motivation and commitment needed to exploit these competencies; and (c) ensuring that the discretionary exploitation of these competencies is “appropriately channeled toward performance improvement” (p. 198). Among the practices and policies examined were organizational rewards (i.e., contingency-based compensation), recruitment and selection, and training, as well as the

degree to which the firms relied on work teams, job rotation, and employee involvement in decision making.

MacDuffie proposes that organizations doing business on the basis of a strategy requiring high-volume production (as with Porter's cost leadership strategy) adopt an organizational logic of "buffering." This buffering logic places a premium on stable conditions and an ability to prevent any disruption of production. Specifically, such organizations have an inherent interest in adopting HR practices designed to "buffer" the production process from potential disruptions, such as hiring easily replaceable (i.e., unskilled) workers to perform narrowly defined jobs. Efficiency wages are used to ensure an adequate level of employee motivation, and close, direct supervision can ensure that employee effort is appropriately channeled. In contrast, organizations whose competitive strategy requires rapid market response and high-quality production (i.e., Porter's differentiation strategy) adopt a "flexibility" logic. This logic places a premium on quality control and continuous learning. Rather than seeking a technical "fix" for the problem of uncertainty, these organizations look to their human resource assets to absorb and learn from such contingencies. This focus on employee problem solving requires firms to employ a comprehensive selection process, to make rewards partially contingent on performance, and to focus on employee skill development—all practices designed to build a workforce with the skills and knowledge base required to absorb uncertainty, and one whose "individual interests are aligned with those of the employer."

Using a sample of 62 international assembly car plants, MacDuffie's cluster analysis validated the existence of these two hypothesized HR strategies—which he labeled mass production and flexible production—but also found evidence of a third, intermediate or "transition" strategy. As predicted, relative to the mass production HR strategy, the flexible production strategy was characterized by significantly more extensive training and development activity; more widespread use of work teams, employee involvement, and job rotation; a stronger reliance on contingent pay; and more limited status differentiation (i.e., flat hierarchies). The transition strategy comprised a bundle of practices about halfway between the mass production and flexible strategies.

One limitation of a number of empirical studies designed to distinguish among particular HR strategies is that they are grounded in monolithic assumptions regarding the internally homogeneous nature of such strategies. That is, because they tend to focus on the extent to which particular practices are used across all employees of a firm, many of the studies noted above "ignore the possible existence of different employment practices for different employee groups within a firm" (Lepak & Snell, 1999, p. 2). Guest (2011) similarly argues that it may be simplistic to assume there exists a common bundle of practices and policies for managing all of a firm's employees. Rather, these researchers propose that HR practices may differ across employment groups depending on the uniqueness of their human capital and their centrality to the organization's core work process. Accordingly, while in any given organization there tends to be a dominant HR strategy or HR system architecture, on an operational level, there are likely to be multiple bundles of HR practices unique to particular organizational subgroups. Several studies have demonstrated this to be the case. For example, Siebert and Zubanov (2009), in their study of 325 stores associated with a UK-based retailer, identified two separate workforces, each managed on the basis of a different set of HR policies and practices.

In contrast to the theory-driven models discussed earlier, it should be clear that the empirical models presented above are not grounded in any single control- or resource-based approach. Indeed, the models generated from the field suggest the need to integrate these two approaches since, in practice, the nature of control and the basis of employee-employer exchange tend to covary. The clearest evidence of this is that organizations tend to adopt one of two dominant strategies, with some organizations adopting middle-

ground, “transition” strategies. One of the dominant strategies is a control-based strategy that emphasizes both rule specification and compliance monitoring, as well as a reliance on ELMs and employment-at-will as a means to ensure efficient and undisrupted production. The other is a commitment-based strategy that emphasizes ILMs, aligned employee-employer interests, and the development of unique HR competencies as a means to ensure sustainable market responsiveness and organizational agility. In other words, although the theory-based models of HR strategy suggest two alternative continua for distinguishing among HR strategies (a control-based continuum and a resource-based continuum), the empirical literature suggests the existence of a single continuum integrating the two. How might it be possible to reconcile the differences between the theory-based and empirical models?

## AN INTEGRATIVE APPROACH

We propose that one way to reconcile these differences is by viewing resource acquisition and retention (external vs. internal) and organizational control (process vs. output) not as two alternative continua, but rather as two distinct, orthogonal dimensions of HR strategy. As such, the approaches together provide a framework able to encompass the key variants of HR strategy in a comprehensive yet parsimonious manner—something that neither of the two can do individually.

In the context of such a framework, the “resource acquisition” dimension concerns the “make or buy” aspect of HR strategy; that is, the degree to which the HR strategy is geared toward the internal development of employee competencies as opposed to their market-based acquisition (Cappelli, 2008a, 2008b). The “control” dimension concerns the degree to which the HR strategy is geared toward monitoring employee behaviors and, in particular, employees’ compliance with process-based standards, as opposed to developing an alignment of interests among employers and employees and ensuring that employees are motivated to fully exploit their competencies to serve these common interests.

As can be seen in [Figure 3.1](#), by combining these two dimensions, we generate four ideal types of *dominant* HR strategies. As noted above, some degree of variance in particular HR practices for certain employee subgroups within a given organization is to be expected (Guest, 2011; Lepak & Snell, 1999, 2002). Nevertheless, for the *majority* of organizational members (i.e., core employees), these policies and practices will at the very least remain closely aligned with the key principles underlying the macro or dominant HR strategy. The cells on the diagonal (commitment and secondary) appear to be most similar to the two opposing dominant strategies described by Arthur (1992, 1994) and MacDuffie (1995). That is, according to the findings of Arthur and MacDuffie, the inherent covariance of HR strategies along these two dimensions makes the strategies represented by Cells 1 and 4 likely to be the most prevalent in organizations. Those strategies represented by the off-quadrant cells (i.e., Cells 2 and 3) are less likely to be prevalent due to the fact that they are hybrids with inherent internal contradictions. As MacDuffie suggests, such strategies may be “transition strategies” adopted by firms in the process of moving from one dominant HR strategy to the other.

The commitment HR model (Cell 1) is most likely to be found in organizations in which management either lacks a complete understanding of the process by which inputs are transformed into organizational outputs and/or lacks the ability to closely monitor or evaluate the efficacy of the employee behaviors instrumental to this transformation process. As suggested by Arthur (1992, 1994), under such conditions, employers must rely on employees to deal with the uncertainties inherent in the transformation process and can only evaluate the outputs of that process. Only by forging a commonality of interest can management increase the likelihood that employees will be motivated to (a) use their discretion to

produce outputs consistent with organizational objectives, and (b) stay with their current employer (and thus not transfer valuable knowledge or social capital to competitors) (Boxall & Purcell, 2000; Colvin & Boswell, 2007; Organ, 1988). To develop that commonality of interest, the employee-employer exchange will typically be based on the principles of an ILM, with a heavy emphasis on employee training and development, internal staffing, and internal equity.

|         | Internal      | External   |
|---------|---------------|------------|
| Output  | Commitment    | Free-agent |
| Process | Paternalistic | Secondary  |

**Figure 3.1** A Typology of Dominant HR Strategies

The secondary HR model (Cell 4) is likely to be adopted by firms viewing a highly routinized, low-cost, and stable transformation process as the primary source of competitive advantage. As suggested by MacDuffie (1995), such firms use a technological “fix” to control the uncertainty in the transformation process and demand only that employees enact the specified behaviors required to facilitate uninterrupted production. Implied by this definition is a focus on behavioral or process-based control (Russell, 2008; Zweig & Webster, 2002), in which “close monitoring by supervisors and efficiency wages ensure adequate work effort” (MacDuffie, 1995, p. 201). However, such systems of production are in many cases imitable, thus forcing the organization to look toward labor efficiencies as a complementary source of competitive advantage. Labor efficiencies are provided by ensuring that (a) jobs remain simple enough to ensure a constant and stable supply from the ELM with minimal transaction and training costs, and (b) labor costs remain variable (by maintaining a policy of employment-at-will and relying on a contingent workforce). Increasingly, low-cost, high-volume producers have sought such efficiencies by shifting their production infrastructures to areas in which trade unions and government regulations pose less of a threat to such a strategy, or by targeting their recruitment efforts at individuals unable to seek employment in the mainstream or “primary” labor market, such as immigrants (Ellram, Tate, & Billington, 2008; Hudson, 2007).

The free-agent strategy (Cell 2) parallels Osterman’s (1987) “craft” employment system. As noted above, many employers find it more efficient to purchase the services of experts than to attempt to eliminate uncertainty in the transformation process by routinizing it. For example, rather than attempting to mass-produce buildings, contractors have long relied on independent craftsmen to provide highly specialized construction skills on an as-needed or employment-at-will basis. These individuals are employed for as long as the contractor needs them (typically, until that part of the construction process they are responsible for has been completed) and are then returned to the market to seek alternative temporary employment. However, since employers have relatively limited knowledge of the transformation process, these workers are given extensive autonomy during their employment and are evaluated primarily by the results of their efforts. Although Osterman (1987) refers to this as a craft system of employment, it has become quite prevalent among organizations requiring the services of highly skilled professionals, and it also serves as the HR strategy of choice among so-called virtual organizations. Organizations adopting such a strategy often rely on the ELM to provide them with a stable supply of these highly skilled workers (often employed as independent contractors) simply because of the

costs of relying on an ILM. Particularly when highly specialized skills are required, it is likely to be more efficient to acquire these competencies on an “as-needed” basis than to retain them on an “on-call” basis. Because workers are employed to provide certain outputs or “deliverables” but engage in processes that are often well beyond the capacity of the employer to comprehend, contingent pay (rather than in-house socialization or employee development) is often used to align their interests with those of their employer and to ensure that organizational objectives are met.

Finally, the paternalistic strategy (Cell 3) parallels Osterman’s (1987) “industrial” employment system. As in the case of the secondary strategy, to control the uncertainty in the transformation process firms adopting this strategy monitor employees to ensure their engagement in specific behaviors needed to facilitate uninterrupted production (Russell, 2008; Zweig & Webster, 2002). However, unlike organizations adopting a secondary strategy, organizations adopting a paternalistic strategy use a limited ILM to guarantee that production remains undisturbed and to develop certain HR-based competencies (e.g., multitasking, team-based production) that might provide an additional source of competitive advantage. That is, in return for labor acquiescence to direct managerial process-based control and perhaps some degree of flexibility in staffing and task assignments, management gives labor certain employment guarantees as well as a system of internal staffing, typically based on seniority. Furthermore, the use of an ILM approach to resource acquisition may offer such organizations a limited learning capability that is typically unavailable to organizations adopting an HR strategy grounded in a logic of process control.

The four-type model described above has been empirically validated in a number of studies (e.g., Siebert & Zubanov, 2009; Sun, Aryee, & Law, 2007). Moreover, similar models have been proposed and validated by others. For example, a four-type model proposed by Lepak and his colleagues (Lepak & Snell, 2002; Morris, Snell, & Lepak, 2005) received empirical support in a study of 153 different firms from 97 industries. They identified two overarching dimensions as principle criteria of employment modes and HR configurations, namely value and uniqueness. Human capital *value* is determined by the accumulated knowledge and skills of employees that enable a firm to carry out strategies which improve efficiency and effectiveness, exploit market opportunities, and/or neutralize potential threats (e.g., Porter, 1985; Wright & McMahan, 1992). Theorists such as Barney (1991) and Quinn (1992) have suggested that as the strategic value of human capital increases, firms are more likely not only to employ it internally, but also to rely on it as a basis for controlling the work process. That is, workforces with a higher human capital value are likely to be granted greater autonomy and managed more on the basis of outcome controls than other workers. *Uniqueness* in human capital refers to the extent to which workers’ knowledge and skills are specialized or firm-specific (e.g., Williamson, 1975). Unique human capital involves tacit knowledge or deep experience and understanding that is created *in situ* and cannot be found in an ELM (Perrow, 1961). Firms are therefore more likely to develop and nurture firm-specific human capital that is difficult to transfer to other firms (Becker, 1976).

Lepak and his colleagues (2002, 2005) derived a model reflecting the relationships between human capital characteristics and employment modes by juxtaposing these two dimensions—value and uniqueness. As noted above, the model distinguishes among four modes of employment, which were found to be strongly related to a firm’s business strategy (i.e., the degree to which it was cost focused versus innovation focused): knowledge work, job-based employment, contract work, and alliances/partnerships. The researchers differentiate among the four employment modes by examining the HR configurations used to manage them, acknowledging that the way in which these configurations are applied may vary between and within organizations based on the uniqueness or value of the particular workforces employed. Specifically, they suggest that each employment mode is associated with a particular type of HR configuration.

First, knowledge-based employment is characterized by human capital that is both valuable and unique. Under these conditions, a commitment-based HR configuration (similar to our commitment type) is likely to emerge. This configuration refers to an internal employment arrangement in which employees are thought to possess critical specialized skills, leading firms to maintain a long-term commitment to their development and grant them considerable autonomy to use their competencies.

The second, productivity-based HR configuration (similar to our paternalistic type) will be found in firms operating under a job-based employment mode, where human capital has high strategic value but limited uniqueness. While these workers are valued contributors, their skills are not particularly unique to the firm and thus cannot serve as a differentiating source of competitiveness. Consequently, job-based employees are often expected to be productive without additional firm investment. Firms typically acquire them from the ELM on a full-time basis to contribute immediately, and hold them accountable for meeting relatively clear performance objectives for a well-defined range of tasks.

The third, compliance-based HR configuration (similar to our secondary type) often emerges in firms operating under a contract work employment mode, where human capital is neither of particular strategic value to the firm nor unique. This HR configuration involves relationships in which external individuals are contracted to perform tasks with limited scope, purpose, and/or duration. Finally, in the alliances/partnerships employment mode, human capital is unique but of relatively low strategic value. Under these conditions, firms are likely to adopt a collaborative-based HR configuration (similar to our free-agent type) involving alliances or joint efforts with independent external parties (e.g., R&D labs, accounting and IT firms) to coproduce specific outcomes. Firms using this HR model, compared to the limited scope of the compliance-based HR model, gain the ability to maintain a long-term relationship needed for the application of unique and specialized skills without incurring the costs of internal employment.

While our discussion up to this point has highlighted some of the key differences between the four strategies with respect to each strategy's underlying logic, these strategies may also be distinguished from one another in terms of their respective ends and means.

### *The Integrative Approach: Considering Ends*

Researchers have identified a wide variety of objectives that the HR system is intended to serve—objectives that are embedded in HR strategies. While each of the models reviewed above made reference to various ends or objectives within which different HR strategies might potentially be grounded, it is our opinion that Dyer and Holder's (1988) framework is among the most comprehensive in this regard. As will be recalled, they argued that HR strategic ends vary in terms of four key dimensions, namely (a) the expected employee *contribution* (narrow, well specified, and stable versus broad, ambiguous, and dynamic); (b) *composition* of the workforce (supervisory ratio, skill mix); (c) employee *competence* (employees' knowledge and skill base); and (d) expected employee *commitment* (the degree to which individual interests of employees are aligned with those of management).

As comprehensive as their framework may be, it nonetheless benefits from the addition of two other dimensions suggested by the other frameworks reviewed above, namely agility and alignment. *Agility* refers to the degree to which the HR system is responsive to shifts in the organization's external environment. Not all organizations need agility in the HR system to the same degree. For example, while the flexible production strategy identified by MacDuffie (1995) places a premium on agility, agility is a low-priority objective for the mass production strategy (since the entire strategy is grounded in a logic of stability and "buffering"). Agility as an HR end is typically achieved through an emphasis on employee



skill development (facilitating multitasking and problem solving), the development of an outsourcing capacity for noncritical tasks, and the use of contingency-based compensation.

*Alignment* refers to the fit or synergy among the various components of the HR system. Again, alignment can be more or less important to organizations. HR strategies placing a premium on system synergy are more likely to be found in organizations in which the HR system is itself viewed as a potential source of sustained competitive advantage for the firm (Becker & Huselid, 2006; Feldman & Pentland, 2003; Lado & Wilson, 1994; MacDuffie, 1995; Subramony, 2009). When system attributes are tightly linked, the HR system becomes relatively immobile (i.e., not transferred across firms), causally ambiguous (and so more difficult for competitors to copy), or both. However, developing such synergy can be expensive, and consequently firms relying on other sources of competitive advantage (e.g., economies of scale) are less likely to place an emphasis on this HR goal.

As can be seen in [Table 3.2](#), the four main HR strategies identified according to our integrative model can be distinguished in terms of the six key strategic ends. For example, where the expected employee contribution under the secondary strategy is relatively narrow, well specified, and stable, the contribution ends for the commitment strategy are broad, ambiguous, and dynamic. Where the composition ends for the commitment strategy include acquiring and retaining a skilled workforce able to perform multiple tasks under limited supervision, those for the secondary strategy favor a relatively inexpensive and acquiescent workforce willing to work under relatively tight supervision. Where the commitment strategy aims to enhance the degree to which the individual interests of employees are aligned with those of management, the secondary strategy places little or no emphasis on employee commitment. Where the commitment strategy places a heavy premium on system agility and responsiveness, the secondary strategy places a premium on stability and an ability to buffer the organization's core technology from change. Finally, as suggested by the findings of MacDuffie (1995), internal goal alignment is most critical for the commitment strategy, and least central for his "transitional" strategy (in our case, the free-agent and paternalistic strategies).

**Table 3.2** Typology of Dominant HR Strategies: Ends

| ENDS         | Commitment   | Free Agent  | Paternalistic   | Secondary   |
|--------------|--|---|---|---|
| Contribution | Very high initiative and creativity, high performance expectations, self-managed | High initiative and creativity, high and relatively stable performance expectations, self-managed | Some initiative and creativity, moderate and stable performance expectations, tight control | Very low initiative and creativity, low performance and self-expectation, tight control |
| Composition  | Comfortable headcount (core and buffer), high skill mix, minimal staff           | Lean headcount (core and buffer), very high skill mix, minimal staff                              | Comfortable headcount (primarily core), moderate skill mix, moderate staff                  | Very lean headcount, highly protected core, low skill mix, heavy staff, network based   |
| Competence   | High   | Very high   | Adequate  | Adequate  |
| Commitment   | High, affective attachment to organization                                       | Low, identification with work and occupation only   | Moderate, instrumental and affective attachment   | Limited, entirely instrumental attachment   |
| Agility      | Moderate   | High  | Limited   | Very high   |
| Alignment    | High   | Low   | Low   | High  |



## *The Integrative Approach: Considering Means*

HR strategy researchers have generally adopted one of two approaches with regard to analysis of the means (i.e., HR policies and practices) used to achieve strategic ends. One approach is based on detailed examination of the specific policies and practices developed and implemented by the HR function (e.g., recruitment methods, selection criteria). The other involves examination of the holistic processes embedded within the HR system that may or may not be the responsibility of the HR function. Wright and his colleagues (Wright & Boswell, 2002; Wright & Snell, 1991) advocate the latter approach, arguing that a focus on function-specific practices only (rather than on organizational policies and practices having an impact on the HR system) may provide an incomplete view of the HR strategy as a whole. Although the HR function in many organizations has a key role in shaping the policies and practices underlying the HR system, policies and practices adopted by other functions may also influence the HR system and thus alter the emergent strategy. Consequently, a strategic analysis focusing solely on the HR function is likely to increase the difficulty of identifying conflicts and synergies among individual components of the overall HR strategy.

Beer, Spector, Lawrence, Mills, and Walton (1984) were among the first researchers to propose such a holistic or system-based approach to examining the means by which HR goals may be achieved. They suggested that rather than examining each HR practice as an independent activity, researchers should examine the policies and practices affecting the HR system in terms of four major policy areas. The first, *employee influence*, focuses on the influence or authority allocated to particular employees over particular policy areas. The second, *human resource flow*, deals with the movement of people into and within the organization, including recruitment, internal mobility, termination, staffing, and performance evaluation. The third area is the *reward system*—that is, intrinsic and extrinsic, financial and nonfinancial rewards, and how such rewards tie into the behaviors and attitudes the organization wishes to encourage. Finally, *work system* policy focuses on the design of and interrelationships among tasks and jobs, as well as competency utilization and skill development.

Dyer and Holder (1988) propose a similar framework for the analysis of HR means. Their framework includes six main policy areas: *development* (the enhancement of employee knowledge, skills, and abilities); *rewards* (employee compensation and recognition); *work system* (the design of tasks, jobs, and work processes); *supervision and performance management* (direction and evaluation); *employee/labor relations* (discipline, dispute resolution, and union-management relations); and *government relations* (organizational compliance with government regulations). Although there is a great deal of overlap between this framework and that of Beer et al. (1984), there are some obvious differences. For example, Beer et al.'s framework pays little attention to policies and practices relating to union affairs, while the framework proposed by Dyer and Holder neglects policies and practices influencing the flow of human resources into, within, and out of the organization. Also, in general, Dyer and Holder's framework breaks down HR policies and practices into smaller, somewhat more fine-grained categories.

In an effort to integrate the approaches described above into a more parsimonious framework, we suggest that HR means can most fruitfully be analyzed in terms of HR subsystems. Analysis at the subsystem level focuses on relatively broad realms of activity and is thus able to capture synergies among unique but related policies and practices. Further, as with the HR system as a whole, HR subsystems are likely to be most influenced by the policies and practices implemented by the HR function, but will also be shaped by policies and practices adopted by other organizational functions. An analysis of HR means at the subsystem level therefore offers researchers a mechanism by which to examine broad realms of HR-related activity without neglecting the impact of non-HR functions.

Drawing from the basic frameworks proposed by Beer et al. (1984) and Dyer and Holder (1988), in [Table 3.3](#), we compare the means inherent in the four HR strategies identified earlier along four main HR subsystems:

1. *People flow subsystem.* This subsystem incorporates HR responsibilities such as recruitment, selection, placement, managing employee mobility (internal and external), employee career development, training and development, and HR planning.
2. *Performance management subsystem.* This subsystem includes such HR activities as performance measurement and feedback.
3. *Compensation subsystem.* This subsystem covers rewards (both financial and nonfinancial) and benefits.
4. *Employment relations subsystem.* HR responsibilities in this subsystem include industrial and employee relations; job and task design; and culture management.

This four-part framework of HR subsystems has been applied in a number of studies. For example, Sun et al. (2007) used it in their study of the link between HR strategy and individual and firm performance in Chinese hotels, and Den Hartog, Boon, Verburg, and Croon (2013) used it in their study of a restaurant chain in the Netherlands.

**Table 3.3** Typology of Dominant HR Strategies: Means

| MEANS                            | Commitment   | Free Agent  | Paternalistic   | Secondary  |
|----------------------------------|--|---|---|--|
| People-Flow Subsystem            | Very careful selection, extensive career development and support, heavy reliance on internal staffing and promotion from within, extensive flexibility | Careful selection, extensive flexibility, limited career development and support, external staffing for most positions  | Somewhat careful selection, moderate career development and support, moderate reliance on internal staffing but limited to certain types of jobs and within contractual framework, bounded job security, little flexibility | Very limited selection process, no career development and support, extensive flexibility, heavy reliance on temporary or contract-based employment |
| Performance Management Subsystem | Performance measurement is based on team effort, high-order learning processes, extensive use of 360 degree feedback                                   | Performance measurement and learning take account of both individuals and teams, moderate use of alternative appraisal systems (e.g., 360-degree feedback, peer evaluation) | Objective, absolute criteria for performance measurement that are many based on team effort, limited performance appraisal systems in place   | Performance measurement and learning are based on individuals, low-order learning processes  |

|                              |   |  |   |  |
|------------------------------|---|--|---|--|
| Compensation Subsystem       | Emphasis on internal and employee equity, performance-based pay at individual and group levels, heavy emphasis on benefits, deferred pay and employee assistance  | Emphasis on external equity, performance-based pay at individual level, skill-based pay, limited use of benefits   | Emphasis on internal equity, limited use of profit sharing and group-based contingent pay, heavy emphasis on benefits   | Emphasis on external and employee equity, heavy use of contingent pay based on supervisor-based appraisal, extremely limited use of benefits and employee assistance |
| Employee Relations Subsystem | Broad, enriched, and self-managed jobs; self-managed teams, extensive use of multitasking; emphasis on organization culture as a mechanism of organizational control; extensive internal communications, due process; some union presence | Enriched jobs; self-managed work teams; high degree of autonomy; minimal, facilitative supervision; emphasis on occupational culture as mechanism of control | Narrow jobs, some use of multitasking and team-based work; limited opportunities for employee involvement, process-based supervisory control, heavily unionized, highly developed grievance system with due process | Narrow jobs, limited opportunity for employee involvement, tight process-based supervisory control, no opportunities for employee voicing, union avoidance           |

In the next four chapters of this book, we apply this four-part HR subsystem framework to further analyze some of the key differences between the four HR strategies identified earlier. Specifically, in each of the next four chapters we will explore how, inherent in each of the four main HR strategies identified, a different set of integrated policies and practices is associated with the people flow, performance management, compensation, and employment relations subsystems.

## SUMMARY

We began this chapter by making the argument that HR strategies should be examined in terms of configurations or bundles of practices. We noted that such an approach is widespread in the field of strategy in general and that it offers a number of advantages to the field of HR strategy in particular. Adopting this type of configuration approach, HRM researchers have proposed two main types of strategy frameworks: theory driven and data driven.

Theory-driven frameworks tend to focus either on the temporal nature of the employment relationship or on the way in which labor, regardless of how it is acquired, is controlled. Drawing from the resource-based view, employment relationship typologies differentiate between HR strategies in terms of the degree to which the organization views its people as a key source of competitive advantage, and the logic underlying the organization's efforts to acquire, develop, and retain its human assets. Control-based typologies differentiate between HR strategies in terms of the approach taken by the organization in its effort to manage the uncertainties inherent in the work process (i.e., the process by which production inputs are turned into outputs).

Data-driven frameworks tend not to distinguish between these two perspectives. Instead, their

empirical results suggest that HR strategies vary along a continuum from a commitment model assuming long-term employment relations and autonomous, worker-based control to a mass-production model assuming employment at will and tight control of the work process. In some cases, these studies suggest the existence of a hybrid model of HR strategy that falls somewhere between these two extremes.

Finally, we argued that it may make the most sense to combine the two perspectives discussed in the theory-driven models and view them as orthogonal dimensions of HR strategy. Using this integrative approach, we identified four main types of HR strategy and began to show how they vary in terms of underlying logic, ends, and means. In [Chapters 4, 5, 6, and 7](#), we will expand on this analysis, attempting to show how the four types of HR strategy can be distinguished from one another with respect to four main HR subsystems.

## **NOTE**

1. While Arthur refers to this as a “cost-reduction” strategy in his 1992 article, in his 1994 article, he refers to it as a “control” strategy.

# II

## Subsystem-Specific Human Resource Strategies

# 4

## THE PEOPLE FLOW SUBSYSTEM

Our discussion in the previous chapter suggested that HR practices tend to cluster into discernable configurations or strategies. Furthermore, we noted that most contemporary strategic HR management (SHRM) theories suggest that, in accordance with equifinality assumptions, these clusters tend to encompass practices that are both internally consistent and externally aligned (i.e., with business unit and/or corporate strategy). Reviewing a variety of theoretical and empirically derived frameworks, we argued that typologies of dominant HR strategies tend to be unidimensional, focusing either on the overall labor market orientation of the firm, or on the approach taken to control the work process. Integrating these dimensions, we proposed that, in fact, four ideal types of dominant HR strategies can be identified: commitment, paternalistic, free agent, and secondary.

In this chapter and the three that follow, we explore how key HR subsystems—namely the people flow, performance management, compensation, and employment relations subsystems—tend to vary across each of these four types of strategies. In each chapter, after defining the parameters of the specific subsystem, we will identify some of the key strategic choices needed to be made, as well as the contingencies governing these choices. We will also examine the possible impact of these choices on key organizational outcomes, such as productivity or financial performance, and discuss how these choices tend to be made in more or less predictable patterns, depending on the overall HR strategy.

### **PEOPLE FLOW: A SET OF CHOICES WITH PROFOUND SIGNIFICANCE**

The people flow subsystem encompasses an array of interrelated staffing practices and processes designed to shape the characteristics of the organizational workforce by governing the flow of people into, through, and out of the organization. These include, for example, HR planning, job analysis, recruitment, selection, entry and placement, mobility, career planning and development, and termination (Beer, Spector, Lawrence, Mills, & Walton, 1985; Dreher & Kendall, 1995; Rao, 2009). As such, the people flow subsystem has a direct impact on a firm's human capital and, thus, its ability to meet its objectives in terms of composition (e.g., running fat or lean), competence (e.g., stock of knowledge, skills, and abilities), and cost.

The strategic implications of the practices involved in the people flow subsystem may not be obvious at first glance. Indeed, many of these practices, such as recruitment and development, may appear quite technical in nature. This may explain why the people flow subsystem has traditionally received much less attention than, say, the strategic implications of the compensation subsystem. However, practices like recruitment, development, and termination can only be put into effect once a number of very basic decisions are made—decisions that can have a profound, long-term, and hence strategic impact on any organization. These decisions concern, for example, the degree to which the firm is willing to be dependent on the external labor market (ELM) to supply it with its required human capital, the steps the firm is willing to take to protect its investments in human capital, and the extent to which the organization



is willing to select candidates on the basis of long-term potential as opposed to proven achievements in the past.

Indeed, the potential strategic impact of the people flow subsystem has become increasingly recognized in recent years, as human capital has come to replace other forms of capital as a primary source of sustained competitive advantage (Gardner 2002, 2005; Hitt, Bierman, Shimizu, & Kochhar, 2001; Prahalad & Hamel, 1990; Shaw, Park, & Kim, 2012), and as globalization presents firms with an increasing array of staffing options (e.g., Guthrie, Grimm, & Smith, 1991; Mäkelä, Björkman, & Ehrnrooth, 2009). In fact, Snow and Snell (1993) go so far as to suggest that since the workforce is essentially fixed, “it may be more prudent to assume that competitive strategy is a more adjustable element of the company” (p. 460). As a result, they argue, there is a growing realization that people flow strategy may in fact propel business strategy. That is, staffing practices may not only be derived from organization strategy, but may contribute to its formulation.

Although relatively few studies have examined the precise impact of the people flow subsystem on organizational effectiveness, researchers have proposed a variety of models suggesting the need for this HR subsystem to match the firm’s business strategy. For example, Sonnenfeld and Peiperl (1988) suggested that the degree to which people flow is based on internal or external employment (i.e., whether employees are recruited, promoted, etc. mainly from within versus outside the organization) is likely to moderate the impact of business strategy on performance. Furthermore, research evidence suggests that this impact may be quite robust. For example, Ployhart (2004) and Terpstra and Rozzell (1993) found a strong relationship between a firm’s people flow system profile—the pattern of choices made with respect to a number of core staffing contingencies—and its financial performance. Cascio and Aguinis (2008) and Johns (2006) similarly discussed the effectiveness of the staffing system (its ability to make accurate predictions about future performance) and suggested that the staffing system should be targeted at individual or team in situ performance (a concept that takes into account situational opportunities and constraints that affect performance) rather than individual-level performance.

Although the people flow subsystem encompasses a wide variety of HR practices, most choices that need to be made with regard to these practices are, to a great extent, influenced by a single, fundamental choice, namely the so-called make-or-buy decision (Miles & Snow, 1984). Thus, we begin our analysis of strategic choices by discussing this basic choice between an internal (i.e., make) as opposed to external (i.e., buy) labor market focus. We then discuss four other sets of choices having to do with the main areas of people flow, namely employee entry, development, retention, and separation.

## **THE BASIC STAFFING CHOICE: INTERNAL VERSUS EXTERNAL ORIENTATION**

Miles and Snow (1984) suggested that human capital, like any other form of capital investment, can either be made or bought. That is, as noted by Lepak and Snell (1999) “on the one hand firms may internalize employment and build the employee skill base through training and development initiatives. On the other hand, firms may externalize employment by outsourcing certain functions to market-based agents” (p. 1). From a broader perspective, the make-or-buy decision may be viewed as a continuum, with transactions organized within the firm at one end, and transactions organized on the open market at the other (Klein, 2005; Ramirez, 2004). A tendency toward an internalized staffing system is thus consistent with the internal labor market (ILM) logic discussed in [Chapter 3](#), whereas the reliance on a market-based staffing system is consistent with the ELM logic discussed in the same chapter.



## *Internal Labor Markets and the “Make” Option*

Although there remains a lack of consensus as to the precise nature of ILMs (Camuffo, 2002; Cappelli & Sherer, 1991), the term is used to describe the administrative (as opposed to market-based) labor-allocating systems that characterize employment relationships in many organizations (Baron & Kreps, 1999; Lazear & Oyer, 2004; Rousseau, 1995; Stark, 1986). In general, ILM-based staffing systems exhibit some combination of the following characteristics: limited and designated ports of entry (thus limiting job competition to other current employees); promotion from within along some predetermined career ladder on the basis of either seniority or merit (designed to encourage long-term attachment); skill and pay gradients reflecting firm-specific knowledge and on-the-job training (to encourage employee retention); the extensive specification of procedures governing employment relations (to ensure administrative equity); and job security (Baron & Kreps, 1999; Camuffo, 2002; Pinfield & Berner, 1994).

One example of an ILM firm is Missile Systems International (MSI Ltd.), a mid-sized, state-owned international defense contractor employing approximately 4,000 full-time workers and specializing in the development and production of state-of-the-art missile systems.<sup>1</sup> MSI's primary customers are national defense departments, the largest of which (in MSI's home country) purchases MSI's products on a cost-plus basis. Furthermore, since MSI is a state-owned enterprise, in its local market, it operates largely in the context of regulated competition. Given these conditions, as well as the nature of the defense industry as a whole, MSI has little incentive to move away from traditionally long and slow product development cycles. MSI's internal organizational structure can best be described as a rigid and tall hierarchical bureaucracy. The company places a strong emphasis on loyalty, status symbols, formalized work relations and processes, and centralized decision making. Over 90 percent of MSI's workforce is unionized, with production workers, technicians, and engineers, as well as low- and mid-level managers, all represented by a variety of different unions. Management and the unions have traditionally worked together to ensure job security, and indeed, despite increasing cost pressure in the international market, MSI has managed to avoid significant layoffs. Furthermore, new employees are, with few exceptions, hired at entry level only. MSI prides itself on staffing the majority of its positions from within. The company invests significant resources in organization-specific employee training and development, as well as in employee career planning and management, to ensure that it retains its human capital and thus its edge in competitive, state-of-the-art technologies. To reinforce its “clan culture,” compensation systems are designed to support an ideology of loyalty, and so most pay increases are based strictly on seniority. Finally, the company attempts to strengthen its employees' attachment to the firm by providing “cradle-to-grave” social welfare services and benefits.

Different firms tend to adopt different combinations of these practices for different sectors of their workforce. Indeed, relatively early on in the analysis of such employment frameworks, researchers noted that there may exist more than one kind of ILM. For example, Doeringer and Piore (1971) distinguished between a blue-collar ILM, which places a premium on on-the-job training and seniority as the primary criterion for advancement, and a managerial ILM, which assumes greater skill portability as well as a focus on merit as the primary criterion for mobility. Similarly, Pinfield and Berner (1994), after reviewing some dozen typologies of ILMs, identified what they believe to be three generic types, all of which could conceivably exist within a single firm at the same time. The *wage ILM* tends to dominate in unionized frameworks (not necessarily blue collar) and places a heavy emphasis on seniority as the primary criterion for advancement. The other two types are salaried ILMs. These use merit as the primary advancement criterion and may be distinguished from one another in terms of the competition for advancement. Whereas those in the upper-tiered salaried ILM face job competition from only a relatively

limited number of other managerial employees, those in the lower-tiered ILM have more limited lines of progression and thus face more intense competition for advancement. Of the three types of ILMs, the lower-tiered salaried ILM is the least characteristic of a classic ILM framework.

According to Baron and Kreps (1999), the “make” option may offer some organizations some important advantages. First, the ILM system promotes long-term employment by making it increasingly costly for employees to seek employment elsewhere once they’ve “paid their dues.” That is, since rewards are based on firm-specific knowledge and experience, ILM employees tend to find it difficult to identify employment alternatives offering a similar return on their human capital investment (e.g., Baron & Kreps, 1999; Yoshikawa, Phan, & David, 2005). For example, many employees of the “Big Three” auto manufacturers have taken advantage of employer incentives to pursue advanced degrees. Thus, a surprising number of line workers in the auto industry now have bachelor’s and even master’s degrees. Nevertheless, for the most part, these individuals remain in their old production jobs. Given their seniority, even as newly trained professionals, it would be next to impossible for these workers to match their current compensation package, no less their future earnings (e.g., pension). Of course, the assumption underlying this incentive is that those motivated to continue as employees will also be motivated to contribute to the firm. Fortunately, it appears that many characteristics of ILMs for employees (particularly the potential for career advancement and above-market wages) are also, in general, associated with a motivation to contribute (Baron & Kreps, 1999; Chang & Chen, 2011; Hallock, 2011; Kalleberg & Mastekaasa, 2001).

Second, because the system promotes long-term employee attachment, critical interpersonal networks as well as specific knowledge about the organization and its jobs may be accumulated and maintained over time. Not only might these networks and this job- and organization-specific knowledge be costly to reproduce (in terms of recruitment, selection, and training costs), but they may in fact be *impossible* to reproduce given ambiguous cause-and-effect relations and idiosyncratic learning processes (Argote, McEvily, & Reagans, 2003; Lepak & Snell, 1999).

Third, the “make” option may enable the organization to reduce its labor costs. Lower labor costs may stem from the ability to limit costly external staffing expenditures to entry-level positions only (Dube, Freeman, & Reich, 2010; Mahoney, 1992). Moreover, firms may contain or reduce total labor costs by framing job security as a compensating differential justifying pay concessions by employees (this is particularly true in unionized contexts), or even by persuading employees to exchange monetary payments for hope of “bigger and better things to come.” United Parcel Service (UPS) provides one of the best examples of how, by “paying with hope,” a firm may be able to contain labor costs. At UPS, a long tradition of hiring managers and executives from among employees who started as entry-level package sorters motivates commitment and retention among those in lower-level positions despite rather average starting levels of compensation. As Allen Hill (2013), UPS’s former senior vice president for human resources, put it:

UPS is a company that gives loyalty and expects it in return. There are few remaining companies, I believe, where so many people stay their entire careers with one company. One look at our management committee tells the UPS story. Ten of the 12 management-committee members are lifers, averaging more than 30 years with the company ... If you do your job, work hard and remain loyal to UPS, UPS in turn will give you a great place to work, a job for life, and we will take care of you in your retirement years.

Additionally, given their low rate of turnover, firms with ILM-based staffing subsystems can often

amortize human capital investments (i.e., training and development costs) over a longer period (e.g., Batt & Colvin, 2011). And given the level of employee experience and commitment in such firms, they often have less need for direct monitoring and control, thus lowering supervisory costs (e.g., Arthur, 2011).

Fourth, as Baron and Kreps (1999) noted, ILMs provide staffing efficiencies, particularly with regard to screening and selection. Whereas employers relying on external employment sources depend on data that may be of questionable reliability, ILM staffing systems tend to offer more extensive and reliable screening data. As suggested by Gibbons and Katz (1991), this screening function may also discourage employees from leaving, since external employers tend to be suspicious when employees—particularly those at a higher level—leave an ILM organization to seek alternative employment.

### *External Labor Markets and the “Buy” Option*

However, there is no doubt that firms opting for an ILM employment system can also incur some heavy costs. For example, particularly when merit is used as a basis for internal advancement, ILM-based staffing subsystems can create a highly competitive environment, which can work against organizational interests (e.g., by discouraging teamwork and mutual help; Chen, 2003). Moreover, an internal promotion policy may paradoxically reduce the quality of promotion decisions by opening the door to organizational politics and favoritism (Berger, Herbertz, & Sliwka, 2011; Cao, 2001). Second, given that firms opting for an ILM system rely on administrative as opposed to market systems for allocating labor, over time, they may need to add additional administrative elements (e.g., grievance adjudication mechanisms) to solve problems and ensure internal equity. This implies the tendency of ILM systems to generate an ever-growing bureaucracy, which in turn suggests increased overhead as well as reduced organizational flexibility and agility that may be further exacerbated by the need to structure the organization around jobs and rules (Dobrev, 2012; Piore, 2002). Third, with job security a core element of most ILM systems, labor becomes, in effect, a fixed cost. Although many firms have learned how to limit the downside of this (e.g., UPS’s reliance on “part-time” drivers and even supervisors, or GM’s reassignment of highly skilled model makers to its engineering departments during lean times), the promise of job security can be costly to ILM firms. Fourth, as Baron and Kreps (1999) observed, ILMs can breed cultural inflexibility—an inbred resistance to change in general and to externally derived change in particular. Finally, given the nature of their promotion and compensation policies, firms relying on the “make” option may tend to discourage risk taking and breed mediocrity. As we noted above, firms selecting the “make” option (such as UPS) are often able to pay less and thus secure lower direct labor costs by offering numerous side-benefits such as job security. But the highest quality workers may, on an individual basis, discount the value of such side-benefits (particularly if they feel that their own competencies afford them the most secure form of job security), and either avoid employment in such firms in the first place or, worse, allow the ILM firm to invest in the development of these competencies, only to “jump ship” when a better offer comes along.

Those organizations viewing the disadvantages of the “make” option as outweighing any of the possible advantages are likely to choose the “buy” option and develop an employment relationship governed by the terms of the external market. Firms choosing to “buy” their human resources and staff the bulk of their positions from outside are constrained only by the price of those resources on the market and the quality of the data they have on the potential productivity of external candidates. That is, they will be forced to pay the market price and take into account the risks of making hiring decisions (often for top-level executive positions) on the basis of limited and often imperfect selection information. On the other hand, assuming that candidates with the requisite skills are readily available on the external market at some

reasonable price and that the firm has the ability to identify the best of these candidates, the firm may realize significant savings in terms of training and development and may also be better able to respond to external challenges in real time (having acquired human capital that has already internalized the required competencies; Davis-Blake & Uzzi, 1993; Kalleberg, Reynolds, & Marsden, 2003).

Externally sourced staff may be less committed to the firm than those “made” by the firm, given that the nature of their attachment is likely to be far more calculative than affective or normative in the first place. This may be particularly true with respect to employees secured through labor market intermediaries (LMIs). LMIs have been defined by Bonet, Cappelli, and Hamori (2013) as “entities that stand between the individual worker and the organization that needs work done” (p. 339). They include executive search firms (i.e., headhunters), temp agencies that lease labor to clients, and professional employer organizations that take on the legal obligations of employment for clients. In the context of such “triangular” relations between the employee, contracting firm, and LMI, it is not always clear to whom employees owe their allegiance (Bonet et al., 2013).

However, it may be possible to reduce the risks associated with lower affective or normative commitment (e.g., turnover) by “sweetening” the terms of the employment transaction. And although this suggests that high-quality labor may need to be employed at a market premium (thus inflating labor costs), these additional costs may be compensated for by the fact that ELM firms typically avoid the overhead and administrative costs associated with ILM systems (Dobrev, 2012; Mahoney, 1992; Piore, 2002) and benefit from increased flexibility in both employment and deployment (Bonet et al., 2013; Pfeffer & Baron, 1988).

One example of an ELM firm that we are familiar with is RLA Textiles Inc., a publicly held but family-managed multinational textile firm specializing in the production of both clothing and fabric for the clothing industry. The company employs over 2,000 workers (some 90 percent being low-skilled production workers) in its production plants in three different countries. Production processes in all of its plants are highly automated and computer-controlled, with most employees handling a variety of highly simplified machine-tending and packaging tasks. The company recruits the bulk of its workforce via contractors in the open market, and typically on an extremely short-term basis. For example, in one of the countries in which it operates, it is not unusual for a clan or neighborhood leader to offer the plant manager a certain number of family members to work for a given period of time, typically ranging from one week to several months. No formal contracts are signed with workers employed in the bulk of RLA’s facilities, and employees in these facilities have no union representation. Pay is hourly and turnover is extremely high. According to RLA executives, these conditions meet the strategic needs of the company in that the textile industry is highly cyclical and is increasingly driven by the cost of production. Since labor accounts for a significant portion of overall production costs, RLA, like its competitors, seeks to retain a high degree of employment flexibility, allowing it to rapidly shift its production to those countries in which labor costs are lowest.

### *Contingencies Governing the Make-or-Buy Choice*

So what determines the degree to which either of these two options is likely to yield a greater benefit to the firm? Although a number of researchers have proposed that the make-or-buy option is governed by the nature of the firm’s business strategy (e.g., Miles & Snow, 1984; Olian & Rynes, 1984), at a more rudimentary and theoretical level, several factors are likely to determine the extent to which a firm tends to rely more on making or buying the bulk of its required human resources. A number of researchers have attempted to identify these factors.

Baron and Kreps (1999), as part of their general discussion of ILMs, proposed that firms will tend toward the adoption of an ILM staffing framework and hence be more likely to make (as opposed to buy) required human resources when (a) the organizational work process is highly complex and firm specific, thus demanding firm-specific human capital; (b) the work process is relatively stable and the pace of technological change slow enough to allow for continuous human capital upgrading; (c) the labor market is just tight enough to provide a firm with an internal labor supply a cost advantage over those relying on external recruitment, but not so tight as to encourage high-quality employees in whom the firm has invested to consider alternative employment; (d) the firm's business strategy calls for steady, evolutionary growth based on employee synergies or customer service rather than opportunistic, rapid growth; and (e) the firm culture emphasizes stability and commitment over flexibility and innovation. Empirical research confirms that firms exhibiting these characteristics are more likely to adopt and benefit from an ILM-based staffing subsystem (Geyskens, Steenkamp, & Kumar, 2006; Masters & Miles, 2002).

Osterman (1987) claimed that the choice between "make" and "buy" depends on the extent to which organizations value predictability as opposed to flexibility, where predictability refers to the firm's ability to "plan confidently upon the availability of a qualified labor supply at foreseeable prices" (p. 55). Others concur with Osterman. For example, Masters and Miles (2002) suggested that "when the firm is uncertain about its future demand for workers in a given position, it will be more likely to use an external labor arrangement" (p. 433).

By adopting an ILM-based staffing system, organizations are more able to control the supply and price of labor. In addition, such systems allow the organization to exert greater implicit control over employee decision making due to the strong emphasis placed on socialization and the creation of "appropriate" decision premises (Arthur, 2011; Osterman, 1995; Simon, 1976). Particularly in organizations in which the (catastrophic) risk of a wrong decision far outweighs the potential benefits of a correct decision (e.g., a nuclear power plant), such an advantage may be greatly valued. However, for many firms, the rigidity implied by predictability and such a compliance-based "clan culture" (Ouchi, 1980) can be costly, particularly if the organization depends on employee creativity and risk taking and if the organization is unable to deploy its labor in the most productive manner. Thus, firms that (a) rely on skills which are readily available in the ELM, and (b) need to retain maximum flexibility in their staffing levels and deployments, are likely to opt for "buying" their human capital.

However, Kerr and Jackofsky (1989) questioned many of the assumptions underlying Osterman's argument. They claimed that flexibility may in many ways be enhanced by ILM-based staffing processes. For example, they argued that organizational flexibility may be bolstered when the organization has a pool of readily available, versatile, and well-trained managers "on call" and ready to go. That is, ILM-based staffing systems, at least at the management level, provide the "managerial depth" (p. 160) that is often critical for organizational responsiveness.

Finally, Lepak and Snell (1999) based their predictions regarding ILM versus ELM on three separate theories. According to *transaction cost theory* (Williamson, 1975), there are costs associated with managing human resource allocations on the basis of both market arrangements (i.e., transaction costs) and administrative arrangements (i.e., bureaucratic costs). Administrative arrangements can offer a more efficient means of staffing if the work process is such that the costs of such arrangements are offset by the ability of employers to more effectively monitor employee performance (as is the case when the work process is more complex and long linked). According to *human capital theory* (Becker, 1964), firms will opt for "making" their own human capital when the skills that they require are highly specialized and hard to come by on the external market, and when it is possible to reduce the risk that these skills might be transferred to other firms. Finally, according to *resource-based theory* (Barney, 1991), firms will select

the “make” option and develop an ILM-type staffing system only when labor is viewed as a core competency (i.e., one that is rare, valuable, inimitable, and nontransferable) providing a key source of sustained competitive advantage. Otherwise, they will opt for the more flexible external acquisition option.

On the basis of these three theories, Lepak and Snell (1999, 2002) argued that although many firms adopt a “make” or “buy” policy on an organization-wide basis, some firms adopt a combination of the two, with ILM-type staffing frameworks for more “core” employee groups and ELM-type staffing frameworks for less central groups of employees. Specifically, as described in [Chapter 3](#), their four-type HR strategy architecture is based on two overarching dimensions of human capital, namely value and uniqueness. These dimensions determine the extent to which firms adopt an internal as opposed to external staffing logic. The more valuable the human capital (and, hence, its potential to contribute to the competitive advantage or core competence of the firm), the greater the firm’s interest in avoiding the risks associated with outsourcing its competencies. The more unique or firm-specific the desired competencies, the less likely they are to be available on the external market in real time, thus necessitating the possible internal stockpiling of such skills. That is, as the authors (1999) noted, “as human capital becomes more idiosyncratic to a particular firm, externalization may prove infeasible, and/or incur excessive costs” (p. 36). On the other hand, generic competencies may be more efficiently secured in most cases on the external market (Teece, 1984).

Firms tending to rely on human capital that is both valuable and unique, according to this framework, are most likely to “make” their own human capital and adopt ILM-based staffing frameworks. Employers adopting such a framework need not fear the loss of human capital to competitors as long as the value is generated from firm-specific competencies and skills (such as a knowledge of which forms to use in special situations, or personal relations with a key stakeholder). Although Lepak and Snell (1999, 2002) assume that such employers will automatically adopt staffing policies and practices consistent with Pinfield and Berner’s (1994) “salaried ILM” framework, depending on the nature of organizational control processes, it is just as likely that practices consistent with their “wage ILM” framework will be adopted. That is, in organizations combining output-based systems of control with an internal employment orientation (i.e., a commitment HR strategy), one or both of the salaried ILM staffing frameworks are likely to be adopted. However, in organizations combining process control with an internal employment orientation (i.e., a paternalistic HR strategy), a staffing framework consistent with Pinfield and Berner’s “wage ILM” model is likely to be adopted. Firms relying on human capital that is either low in uniqueness or low in value (or both) will tend to either acquire or contract this labor from the external market using a variety of employment frameworks and staffing mechanisms.

Cappelli (2008a, 2008b) has offered a similar perspective on the choice of make or buy, suggesting—like Lepak and Snell—that in many cases the decision should be to make *and* buy. Specifically, he suggested that particularly in industries characterized by rapid change and fierce competition, the develop-from-within approach may be too slow and risky. As he notes, “a deep bench of talent has become expensive inventory. What’s more, it’s inventory that can walk out the door” (p. 4). And although the hire-from-without models are more expensive and may be more disruptive to the organization, the risks of developing too much talent may be greater than the risks of developing too little. “If we undershoot,” says Cappelli, “we can always hire on the outside market to make up the difference. The cost per hire will be greater, and so will the uncertainty about employees’ abilities, but those costs pale in comparison to retention costs” (p. 4).

As can be inferred from the discussion above, whether a firm tends to make or buy its human capital for the bulk of its employee groups is likely to greatly influence other people flow options. We next explore

some of the other strategic choices relating to the people flow subsystem.

## **RECRUITMENT, SELECTION, AND DEPLOYMENT OPTIONS**

### *Recruitment Choices*

Rynes (1991, p. 429) defines recruitment as encompassing “all organizational activities and decisions that affect either the number or types of individuals who are willing to apply for, or to accept, a vacancy.” These activities are intended to “(a) bring a job opening to the attention of potential job candidates; (b) influence whether these individuals apply for the opening; (c) affect whether recruits maintain interest in the position until the job offer is extended; and (d) influence whether a job offer is accepted and the person joins the organization” (Breugh, Macan, & Grambow, 2008, p. 45). Recruiting practices can have a strategic impact on the firm because they determine the nature of the pool from which new hires are chosen and thus can greatly influence the flow of human capital into the firm, as well as the firm’s ability to retain these individuals (at least in the short run). These practices are relevant regardless of the labor-market logic (internal or external) adopted by the firm, because even firms adopting an ILM-based staffing system rely on recruiting and screening processes for their entry-level positions.

Although recruitment practices vary along a wide range of dimensions (see Rynes, 1990, for a complete review of these dimensions), among the most critical choices that need to be made when considering organizational recruitment are the recruitment philosophy (selling versus realism); the breadth of the recruitment effort; and the methods to be used in executing that effort.

**Recruitment philosophy and message.** The literature on recruitment has been dominated by a debate over which of two alternative recruitment messages yields the greatest long-term benefits: realistic messages versus inflated “sales-oriented” or “flypaper”-type messages. Various hypotheses regarding the consequences of one type of message over the other have been proposed and tested (for a review see Rynes, 1991, and Morse and Popovich, 2009), but several aggregation and meta-analytic studies (e.g., Meglino, Ravlin, & DeNisi, 2000; Premack & Wanous, 1985; Reilly et al., 1981) suggest substantial effect sizes in favor of realism. For example, Reilly et al. (1981) found that on average, the turnover rate for realistically recruited employees was 5.7 percentage points lower than that for employees recruited through more conventional messages. Most interesting was the finding that although realism was found to be universally related to lower turnover, the effect was greatest for more complex jobs. The differences in turnover rates between experimental and control groups was 1.9 percent for jobs rated lowest in complexity, compared with 9.5 percent for jobs rated highest in complexity. Other meta-analyses (e.g., McEvoy & Cascio, 1985; Zottoli & Wanous, 2000; Meglino et al. 2000) reported similar findings. However, little is known about the impact of message realism on the quality of the candidate pool (Rynes, 1990). A realistic recruitment philosophy is only likely to yield positive strategic effects to the extent that it increases the rate of hiree retention without reducing the quality of those candidates available for hire (Roberson, Collins, & Oreg, 2005; Ryan, Horvath, & Kriska, 2005). Thus, although it appears that the benefits of message realism may be universally positive, when jobs are relatively noncomplex, these benefits may be insufficient to balance the potential negative impact of realism on candidate quality. The implication is that message realism may be less likely to generate positive outcomes in organizations adopting process-based systems of control (i.e., heavy reliance on preprogrammed jobs) than in organizations relying upon output-based control.

Also missing in the literature is an analysis of the potential impact of recruitment message in an ILM-versus ELM-based employment system. It is likely that in an ILM, message realism pertaining to the



organization and careers within it is more critical than message realism pertaining to the job itself. Furthermore, the value of such message realism is likely to be greater in ILM-based firms due to their increased reliance on low employee turnover.

**Breadth of the recruitment effort.** When designing a recruitment program, employers need to determine the extent to which they want to target their efforts. Targeted recruitment efforts tend to generate a higher quality, though smaller, pool of applicants, whereas a “wide-net” approach tends to generate larger applicant pools. Some employers purposely set qualification levels high and target their recruitment efforts toward specific subpopulations (e.g., Ivy League graduates only), whereas other employers prefer to cast a wide net to enhance the efficiency of validated selection mechanisms (the efficiency of these mechanisms increases with the size of the applicant pool). Several studies (e.g., Mason & Belt, 1985; Newman & Lyon, 2009) have found that by raising qualification levels and targeting the recruitment message, employers were able to reduce the likelihood that unqualified individuals would apply. Then again, qualified (but perhaps less secure) candidates may also self-select not to apply, or worse, may apply elsewhere. In addition, overly rigorous specification may lead to subsequent underutilization of employees and thus, in turn, to dissatisfaction and turnover (Ryan, Sacco, McFarland, & Kriska, 2000; Truxillo, Bauer, Campion, & Paronto, 2002).

Underlying the question of qualification setting and candidate targeting are issues of efficiency and risk. Clearly, to the extent that costs of candidate selection rise in direct proportion to the number of applicants considered for each position, high qualifications and candidate targeting are likely to enhance overall staffing efficiencies. Furthermore, to the extent that setting high qualifications and targeting candidates are essentially early screening processes, they may reduce the risk of hiring “false positives.” Still, only by casting a wide net can the organization be sure that its recruitment process does not increase the risk of “false negatives”—that is, potentially qualified candidates who are discouraged from applying. Firms with ILM-based staffing systems tend to have more to lose by hiring “false positives” because these individuals, once in the system, are more difficult to remove. Furthermore, as we noted above, if ILM firms (particularly those relying on output-based control systems) are more concerned with avoiding catastrophic errors than with capturing every business opportunity, they have more to gain by avoiding false positives than by missing out on false negatives. Consequently, such firms are likely to have higher hiring standards and will attempt to target their recruiting campaigns (Doherty & Tyson, 2002).

At the same time, firms with ELM-based staffing systems are likely to be more concerned with the risk of overlooking a potential “star,” only to find such individuals subsequently recruited by a competitor. They will therefore tend toward broad-based recruiting, particularly if there is a process-based system of control in place to limit employee discretion and ensure careful and close performance monitoring.

**Recruitment methods.** Firms can use a variety of methods to recruit job candidates, including social media, newspaper advertising, employee referrals, and employment agencies. Some methods are likely to be more effective (in terms of yielding lower posthire rates of turnover and absenteeism and higher levels of job performance) simply because they provide more information upon which to base selection decisions (Breugh, 2008, 2012). Others are likely to be more effective because they perform important prescreening functions and thus influence the quality of the applicant pool (Rafaeli, Hadomi, & Simons, 2005; Rynes, 1991).

These theoretical explanations underlie much of the research in recruitment method effectiveness. Unfortunately, the findings in this line of research are far from consistent. Although most studies concur on the least effective recruitment methods (e.g., newspaper ads tend to be associated with higher rates of turnover and poorer employee performance; Breugh, 2008; Schwab, 1982), there is little agreement as to the effectiveness of other methods, or as to which methods perform best (Breugh, 2012; Rynes, 1991).

For example, some studies have found employee referrals and other informal recruitment sources to generate positive outcomes (Castilla, 2005; Rafaeli et al., 2005), whereas others suggest a potential negative effect (Yakubovich & Lup, 2006). Factors such as employment conditions and employee morale may play a role in mediating these outcomes, with employees who are happy in their jobs and who want to preserve their reputation in the organization tending to avoid referring others who are not likely to perform well (Breugh & Starke, 2000). In addition, as current employees are likely to refer people who are similar to themselves, employee referrals may produce a more homogenous workforce, potentially influencing the firm's diversity makeup (Breugh, 2012). Relying on referrals may thus prevent firms from meeting equal employment opportunity requirements and may even place limits on the organization's ability to learn and innovate (Fernandez & Lourdes, 2005; Kmec, 2008; Schwab, 1982; Senge, 1994).

The efficacy of using external employment agencies is similarly disputed. In general, external agencies may perform an important prescreening function, and may improve the quality of information available about applicants (Houseman, Kalleberg, & Erickcek, 2003). However, some scholars (e.g., Bain & Taylor, 2002) have questioned the ability of employment agencies to transmit to candidates accurate information that would enhance sustainable employee-job fit. Similarly, as noted by Olian and Rynes (1984), prescreening may become dysfunctional in organizations in which staffing needs and criteria are subject to rapid change. If external agencies fail to keep pace with these changes, they may end up screening out desirable candidates who fail to meet the "old" criteria (false negatives), and forward only those candidates meeting the obsolescent requirements (false positives).

Recruitment on college and university campuses seems to increase both the quantity and quality of applicants (Collins, 2007; Collins & Han, 2004). ILM-based firms may particularly benefit from on-campus recruitment. By proactively soliciting the cooperation of local higher education institutes (e.g., through scholarships and internship programs), such firms may create early attachment among prospective employees, have the opportunity to assess students directly, and allow students to get a good sense of what working for the organization would be like (e.g., Breugh, 2012). This may be of special value with respect to those occupations characterized by predictable cyclicity (e.g., accountants or engineers).

Finally, web-based recruitment sources such as social networking sites (e.g., Facebook, LinkedIn), job boards (e.g., [Monster.com](#), [HotJobs.com](#)), chat rooms, Usenet groups, and other cyber communities have featured prominently in recent years, providing firms with access to a virtually unlimited pool of candidates (Cappelli, 2001). Social networks may be used as referral systems, with current employees bringing a job opportunity to the attention of their contacts, who may then bring it to their contacts, and so on. Many firms also engage in their own online recruitment activities, with 90 percent of large firms thought to maintain official recruitment web pages—an unsurprising development, if estimates are correct that online recruitment reduces costs by up to 90 percent compared with traditional recruitment methods, and makes the hiring cycle up to 25 percent shorter (e.g., Cappelli, 2001; Cober, Brown, Keeping, & Levy, 2004; Lievens & Harris, 2003). Moreover, web-based recruitment allows employers to more accurately match information about candidates to the needs of the job, thus reducing the risk of false positives. Some social networking sites have features that allow employers to target-search candidates by qualifications, work experience, geographic location, and other factors (Jattuso & Sinar, 2003; Society for Human Resource Management, 2008), and then customize their pitch to this more targeted candidate pool (Dineen & Noe, 2009). Web-based recruitment also allows for more extensive preselection screening at relatively low cost. Indeed, using such technology, many employment tests once performed on site as part of a more extensive selection process can now be implemented via the web on a wider pool of candidates (e.g., Tippins et al., 2006).

Web-based recruitment is also appealing for job seekers, who can, for example, interact with

organizations' recruitment systems from anywhere at any time, and access a range of online information resources (both formal and informal) about potential employers (e.g., Dineen, Ash, & Noe, 2002; Sylva & Mol, 2009; Thompson, Braddy, & Wuensch, 2008). Thus, as Cappelli (2001, p. 140) noted, "The labor market ... has at last become a true market: wide open, uncontrolled by individual companies, and unconstrained by geography."

At the same time, web-based recruitment may involve certain disadvantages. For example, while web-based recruitment may potentially promote diversity by vastly expanding the pool of possible candidates, in fact, a focus on web-based recruitment may unintentionally reduce the number of applicants from minority or disadvantaged groups that are underrepresented on social media sites (Hansen, 2009). In addition, web-based recruiting may reduce diversity and even expose firms to legal liabilities (such as discrimination lawsuits) if recruiters use non-job-related personal information obtained from social media sites in hiring decisions. Indeed, web-based recruiting may present other legal pitfalls, as recruiters struggle to observe constraints related to transparency, confidentiality, and privacy in the open and still-evolving communication environment of the web (e.g., Naglieri et al., 2004). In addition, because web-based application involves very little effort on the part of job seekers, firms may be "inundated with job applications from individuals who are not good candidates for the advertised positions" (Breaugh, 2012, p. 75). Finally, web-based recruiting opens employers to the risk that information derived from web-based sources may be inaccurate, or that candidates for a position will cheat while taking internet selection tests (Tippins et al., 2006).

What the research suggests is that choices regarding the adoption of recruitment methods are likely to be contingent upon the firm's overall strategic configuration. Indeed, several studies (Miles & Snow, 1978; Olian & Rynes, 1984) suggest that compared to firms with defender strategies, prospectors are more likely to structure their recruitment effort around a greater number of recruitment methods, and, within this mix, rely on more informal methods (e.g., employee referrals) than on external agents. Similarly, Bowen, Galang, and Pillai (2002) found that the type of business strategy more generally (e.g., cost leadership) is associated with the recruitment practices adopted.

The choice of recruitment methods may be associated with the degree to which the firm adopts an ILM-versus ELM-based staffing orientation, and the extent to which the organization relies on process versus output control. As noted earlier, ILM firms tend to place a premium on maintenance of a strong clan culture (Ouchi, 1980). Consequently, they can be expected to sacrifice a heterogeneous candidate pool for one which is more likely to reflect existing organizational norms and values. Thus, ILM firms may place greater emphasis on informal recruitment methods and may in fact rely solely upon them (e.g., Greenidge, Alleyne, Parris, & Grant, 2012). For example, in recent years, several GM business units have recruited strictly on the basis of employee family-based referrals. Firms relying on process-based systems of control tend to have highly routine production technologies and extensive constraints on employee discretion. Such firms tend to perceive less risk in contracting out much of their recruitment function to external agents. Indeed, many traditional manufacturing firms rely on state employment agencies to perform their initial recruitment and screening function.

RLA Textiles Inc. offers a good example of a firm that relies on both clan leaders and state employment agencies to provide casual labor when needed. In both cases, screening is minimal and is typically based on a number of simple criteria, such as good health and basic literacy. In fact, however, the primary screening occurs on the job. Given the low costs of hiring and training, if after a day or two it is apparent that a hiring error has occurred, the company simply dismisses the employee and turns to the contractor for a replacement (typically provided within a number of hours).

## *Selection Choices*

**Selection criteria.** By selection criteria, we refer to those parameters according to which job candidates are screened and evaluated. As Dreher and Kendall (1995) noted, “choices about selection criteria often reflect the overall theme or guiding principles that surround a company’s approach to employment mobility” (p. 449). That is, to a large extent, selection criteria tend to follow the core staffing decision discussed above, namely the degree to which the staffing subsystem is consistent with an internal or ELM logic. However, the choice is also likely to be influenced by the nature of organizational control processes.

Selection criteria are likely to vary along at least three main dimensions. The first of these is the degree to which the criteria emphasize past achievement as opposed to future potential (Olian & Rynes, 1984). Clearly, organizations adopting an ILM-based approach to staffing will be more concerned with the candidate’s development potential (i.e., basic aptitude) and ability to follow predetermined organizational career paths, and less with the individual’s current skills or knowledge base (Charan, Drotter, & Noel, 2001; Dreher & Kendall, 1995). Indeed, because ILM-based firms internalize the transfer of skills and knowledge, and in many cases prefer to transfer these skills as they apply specifically to the particular firm (thus reducing their external transferability), there is little economic reason to focus the selection process on the assessment of preexisting competencies.

Second, selection criteria are likely to vary in the extent to which they focus on individual disposition or attitudes (e.g., assertiveness, agreeableness, openness, positive or negative affectivity; Barrick & Mount, 1991). Some organizations, particularly those relying on team-based task structures and output-based control, place a strong emphasis on what is often referred to as the “cultural fit” of the candidate. From a game theory perspective, such organizations are prime candidates for free riding by employees, at least in the short run. Although various monitoring and reward structures may be put in place to constrain such free riding (which we will discuss in [Chapter 6](#)), a number of authors (Axelrod, 1984; Chen & Bachrach, 2003; Raver, Ehrhart, & Chadwick, 2012) argue that cooperative meta-norms are the most effective weapon against free riding. Consequently, such organizations have an interest in screening out candidates who might pose a threat to these critical preexisting meta-norms. ILM-based organizations are also likely to place a premium on such criteria because one of the principles guiding such organizations (as we have already noted) is maintenance of a clan culture and a culture of compliance. Individuals not likely to “buy into” such cultures can pose a potentially serious threat to their stability (Kunda, 1992).

Finally, as Snow and Snell (1993) noted, criteria are likely to vary in terms of the degree to which they are focused on certain core competencies (applicable to a variety of current and potential jobs) as opposed to the characteristics of a single job. Traditionally, selection criteria have been based on job analysis, a process by which firms identify the core tasks, duties, and responsibilities of a job. This approach, though, assumes that “individuals, jobs and the match between them are stable over time” (Snow & Snell, 1993, p. 452). As long as change is predictable, job analysis can be broadened so as to take into account the job “as it will be” (Scheider & Konz, 1989, p. 51). However, in organizations facing unpredictable change, the tendency is to structure criteria not around specific jobs, but around strategic roles and the competencies required to fulfill these roles (Borman & Motowidlo, 1992; Schippmann et al., 2000; Van der Heijden & Van der Heijden, 2006). As Lawler (1994) put it, “Instead of thinking of people as having a job with a particular set of activities that can be captured in a relatively permanent and fixed job description, it may be more appropriate and more effective to think of them as human resources that work for an organization” (p. 4). In this case, selection criteria may be more likely to focus on synergistic competencies (i.e., an ability to work in teams and to integrate multidisciplinary concepts and

ideas) than on job-specific aptitudes. Snow and Snell's theory (1993) suggests that such role-based criteria may be difficult to incorporate into many ILM-oriented staffing subsystems because ILMs in many firms are job rather than role based. This is particularly likely in ILM firms relying on process-based control and highly preprogrammed work processes. Especially in these cases, role-based selection criteria are likely to be inconsistent with the nature of the jobs needing to be staffed.

It should be noted that larger cultural factors may influence the way firms balance their selection criteria across the three dimensions described here. Von Glinow, Drost, and Teagarden (2002), for instance, found a cross-national "ideological gap" in the adoption of selection criteria. Specifically, they observed that individualistic countries such as the United States, relative to more collectivist countries such as China, deemphasized "proven work experience" in favor of "an ability to get along with others" and to "fit the company's values" as part of their top three selection criteria.

**Selection methods.** Just as selection criteria are, to a large extent, influenced by the make-or-buy decision, the choice of selection methods is largely a function of the chosen selection criteria. Simply put, certain criteria (e.g., future potential as opposed to past achievement) favor certain selection methods or tools over others (e.g., aptitude tests versus interviews). Thus, just as the utility of certain selection criteria may vary by HR strategy, so might the utility of certain selection methods. However, a number of studies suggest that many selection practices (e.g., the validation of a candidate's credentials) are in fact "best practices" and are likely to benefit most organizations (Huo, Huang, & Napier, 2002; Huselid, 1995). So is there any choice to be made here at all?

A possible answer to this question comes from research suggesting that the potential impact of best selection practices on firm financial performance may be contingent upon internal and external contingencies. The causal issue (i.e., profit leading to practice or practice leading to profit) aside, it was found, for example, that the relationship between practice and performance varied by industry, being greatest in the service industries and weakest in manufacturing (Terpstra & Rozell, 1993). The researchers speculated that this is because in service organizations, "human resources are the primary input and there may also be fewer constraints imposed on employee performance (i.e., fewer pre-programmed work processes) in this industry than in others" (p. 43). Thus, their findings suggest that the adoption of fine-grained selection methods may be more likely to offer greater benefits to organizations adopting HR strategies based on output (as opposed to process) control. More generally, however, their findings indicate that although effective selection methods may benefit many organizations, "the relative degree of benefit may vary as a function of critical contingency characteristics" (p. 45).

Still, the validity and reliability of different selection methods should influence a firm's decision to adopt one method over another. Validity refers to the degree to which performance as assessed using a specific selection instrument (e.g., a candidate's performance in an assessment center or interview) predicts work-related criteria such as career potential or job performance. Validity is assessed in terms of a correlation ranging from  $-1.0$  to  $+1.0$ , with zero indicating no validity whatsoever; higher validity coefficients indicate that the method captures more of the domain covered by the criterion, and that it does so in an accurate and reliable manner. Reliability refers to the consistency of assessment scores and is a necessary yet insufficient condition for validity (Oosterveld & Cate, 2004; Paterson, Green, & Cary, 2002). To the degree that a selection instrument is reliable, an applicant would expect to attain the same score regardless of when he or she completed the assessment or who scored the response. Meta-analysis provides an accurate and concise means by which to compare the predictive validity of common selection methods. Applying such an approach, McDaniel, Whetzel, Schmidt, & Mauer (1994) found the validity of interviews to vary depending on whether they were structured ( $r = .24$ ) or unstructured ( $r = .18$ ), and whether they were job focused ( $r = .21$ ) or psychological in nature ( $r = .15$ ). Meta-analyses of other

selection tools indicate that personality tests offer limited validity (e.g., the mean validity of conscientiousness is .15; Hurtz & Donovan, 2000), whereas the validity of integrity tests is generally quite high ( $r = .41$ ; Ones, Viswesvaran, & Schmidt, 1993). Validity and reliability have implications not only for the utility of the staffing subsystem (i.e., the economic benefit associated with using that particular method; Boudreau & Ramstad, 2003) but also for applicant attitudes toward the system (e.g., perceptions of procedural justice; Lievens, De Corte, & Brysse, 2003).

Research suggests that the validity, reliability, and, ultimately, utility of a selection system may be increased by combining several different selection methods (Boudreau & Ramstad, 2003; Ferguson, James, O'Hehir, & Sanders, 2002), as well as by enhancing the knowledge and skills of those involved in the selection process (e.g., Walker & Kwan, 2012; and see the discussion below). For example, using meta analytic techniques, Hunter & Schmidt (1998) found that across jobs and industries, three combinations of selection instruments exhibit the highest validity and utility for job performance: a general mental ability (GMA) test plus a work sample test (mean validity of .63); a GMA test plus an integrity test (mean validity of .65); and a GMA test plus a structured interview (mean validity of .63).

**Breadth of involvement in the selection process.** Who should be involved in making individual selection decisions? In many ILM-based staffing systems, internal selection decisions are made almost automatically on the basis of seniority, as long as basic criteria are met. Individuals in the human resource function do not make the final decision so much as administer a highly preprogrammed selection process.

However, external selection decisions cannot be based on seniority criteria, and therefore some individual, office, or group must take responsibility for these decisions. Certainly, to the extent that a single individual can make decisions, staffing processes may be more streamlined and efficient. Furthermore, to the extent that such decisions are made by a single staff function (such as HR), selection decisions may be more likely to be consistent and equitable. However, as Olian and Rynes (1984) noted, under certain conditions, such narrow, centralized decision-making processes might work against the long-term interests of certain types of firms. Similarly, they found that individual decision makers were less able to assess candidates' potential for highly complex and ambiguous (nonprogrammed) jobs than a team of decision makers already performing similar work (e.g., members of the project team that the hiree will work with). Indeed, a number of studies indicate that, particularly with respect to more complex jobs, panel interviews (in which two or more interviewers together interview one candidate and combine their ratings into an overall score) are not only more valid predictors of job performance (McDaniel et al., 1994), but may also enhance candidate perceptions of selection fairness (Macan, 2004).

These studies suggest that both the level of job ambiguity (i.e., the nature of organizational control) and the centrality of equity and compliance norms (i.e., ILM versus ELM orientation) are likely to shape choices regarding the breadth of involvement in selection decisions. The breadth of involvement is thus likely to be greatest in ELM firms with less-programmable jobs (i.e., firms adopting more of a free-agent HR strategy) and least in ILM firms and firms with highly programmable jobs (i.e., firms with more of a paternalistic HR strategy). ILM firms with nonprogrammable jobs (i.e., firms with commitment HR strategies) are likely to adopt a decentralized selection system involving a relatively large number of organizational interests, but one which is carefully regulated and monitored by a central staff function to ensure consistency and equity.

### *Deployment Choices: Onboarding and Socialization*

Socialization is an ongoing process by which employees learn about and make sense of their new working environment. It consists of at least three stages: an anticipatory stage that occurs prior to organizational



entry; an encounter or accommodation stage in which the newcomer enters the organization; and an adaptation or role management stage in which the newcomer adapts and settles in (Bauer, Morrison, & Callister, 1998; Feldman, 1976; Louis, 1980). The encounter stage is particularly important, as this is the time “when adjustment issues are most intense and problematic and when employees are most susceptible to the organization’s influence” (Klein & Weaver, 2000, p. 47). The introduction to a new organizational life, combined with uncertainty about their precise role and their ability to cope with job demands, can be highly stressful for newcomers (e.g., Fisher, 1985; Saks & Ashforth, 2000). How organizations help newcomers address and adjust to such uncertainties can have a significant impact on both newcomer retention and job performance. Given the stakes involved, it is important to understand the onboarding techniques at management’s disposal and the conditions likely to govern their effectiveness (Bauer, Bodner, Erdogan, Truxillo, & Tucker, 2007; Jones, 1986; Van Maanen & Schein, 1979).

Organizations use a variety of practices to socialize newcomers during the encounter stage. Van Maanen and Schein (1979) classified these practices into six dimensions: collective-individual, formal-informal, sequential-random, fixed-variable, serial-disjunctive, and investiture-divestiture. In collective socialization, a group or cohort of newcomers are exposed to common learning experiences, as opposed to individual socialization, where each newcomer undergoes the process alone. Formal practices involve clearly defined socialization activities (e.g., orientation or training classes), whereas informal practices involve learning on the job. Sequential and fixed practices, respectively, provide information to newcomers about the specific sequence or time within which they will complete certain learning activities, whereas this information is unknown in random and more variable processes. With serial practices, experienced organizational members serve as mentors or coaches, whereas disjunctive practices do not make use of such role models. Finally, investiture practices use positive social feedback to communicate that newcomers’ knowledge, skills, and past experience are appropriate for the new job, whereas divestiture practices seek to communicate the opposite by means of negative social feedback from experienced organizational members.

In their meta-analysis, Bauer et al. (2007) found that socialization tactics were differentially associated with both newcomer adjustment (e.g., role clarity, social acceptance) and work outcomes (e.g., job satisfaction, performance, intentions to remain). For example, they found that information-seeking tactics on the part of newcomers were positively associated with enhanced role clarity and social acceptance and that the solicitation of appraisal information (i.e., feedback) served as a particularly robust predictor of role clarity. In turn, they found that social acceptance was related to all three work outcomes, while role clarity—despite having generally beneficial effects on most work outcomes—was unrelated to turnover. Drawing from these findings, the authors concluded that organizations can improve outcomes by assigning mentors to help new employees adjust, by encouraging newcomers to seek out information about how they are doing, and by ensuring that managers and mentors give feedback in a way that “affirm[s] newcomers’] role as insiders” (p. 717).

As with recruitment and selection, socialization of new hires may also be affected by the firm’s make-or-buy decision. In this respect, firms often consider the expected return on investment of socialization activities (Saks, Uggerslev, & Fassina, 2007). Thus, for example, to the extent that certain socialization practices (e.g., serial practices like mentoring) are associated with such outcomes as lower turnover rates, ILM-based firms are more likely to use them. In this context, a recent longitudinal study by Kammeyer-Mueller, Wanberg, Rubenstein, and Song (2013) focused on interpersonal interactions with coworkers and supervisors during the first 90 days of employment; the authors found that positive and negative patterns of interpersonal relations (i.e., support and criticism, respectively) during the onboarding period were associated, albeit in opposite directions, with later work outcomes such as

proactivity, commitment, and withdrawal behavior. Such socialization activities (i.e., buddy systems, mentoring, and coaching) likely generate their beneficial outcomes, particularly on newcomer retention, by influencing employees' sense of employee-job as well as employee-organization fit (Allen, Eby, & Lentz, 2006). For ILM-based firms that strongly emphasize corporate culture, these returns may be particularly valuable.

## **DEVELOPMENT OPTIONS: CONTENT, MOBILITY, AND LEVERAGING TALENT**

### *Development Content: Norms versus Competencies versus Skills*

From our discussion of the basic make-or-buy choice above, it should be clear that firms opting to “make” a larger proportion of their human capital stock will, by definition, place a stronger emphasis on employee development than those opting to “buy” this stock from the ELM. But how should these ILM-oriented firms invest their development resources? Should they focus more on training employees in basic skills, or should they attempt to develop firm-specific competencies and norms? The question of how best to invest training and development resources is relevant even for ELM-oriented firms, which are likely to engage in at least some degree of employee development.

A number of studies suggest that labor market orientation is likely to be the driving force behind organizations' employee development activity. For example, Lepak and Snell (1999) note that firms tending to “make” their own human capital “invest significantly to develop unique (i.e., firm-specific) skills through extensive training initiatives” (p. 7). They argue that such firms often supplement traditional training programs with mentoring and coaching to ensure that the knowledge, skills, and competencies transferred to new employees are both idiosyncratic and highly inimitable. Indeed, in ILM-type firms, competency development is likely to be far more experiential and to be based more on lateral mobility and long-term career patterns (e.g., succession planning) than on short-term workshops and training programs (Baruch & Peiperl, 2000; Ito & Brotheridge, 2005).

In contrast, firms that acquire most of their human resources from the ELM are likely to select employees on the basis of their past achievements and *current* human capital assets. Several studies (Ito & Brotheridge, 2005; Koch & McGrath, 1996; Snell & Dean, 1992) suggest that such firms tend to rely on more sophisticated selection techniques to recruit and select those individuals already possessing the desired skills, thus allowing those selected to begin performing immediately. Supplementary skill training is often not only unnecessary—that is, involving organizationally specific knowledge that is easily learned—but also inefficient and risky. It may be inefficient because, lacking a staffing subsystem geared toward building long-term commitment, the firm making the investment may not be the firm that sees the return on these human capital investments. It may be risky in that proprietary knowledge may end up being disseminated to direct competitors (Cardon, 2003; Matusik & Hill, 1998). Consequently, these firms are likely to focus on developing employee competencies and firm-specific norms that will ensure the successful integration of new hires. Such investments are likely to be particularly important to ELM-type firms given the heterogeneous background of their staff. With new hires lacking a common set of organizational experiences, critical synergies may not emerge until employees gain a clear understanding of critical, firm-specific competencies and norms. Furthermore, because such competencies and norms tend to be both complex and idiosyncratic to the firm and its culture, dissemination risks are negligible (Matusik & Hill, 1998).

However, classic organizational theory (Edwards, 1977; Simon, 1948; Thompson, 1967) suggests that organizational control structure is also likely to influence the nature of firms' employee development activity. To the extent that the organization relies on output-based systems of control, it places much of the uncertainty in the transformation process into the hands of its workers. Simon (1948) noted that to limit the degree of risk inherent in such a control system, organizations attempt to provide the premises upon which workers will make decisions when confronted by such uncertainty. Such premise framing is not necessary when organizations rely on process control. In these cases, workers are given little discretion to begin with. However, as soon as the nature of the control process gives employees a significant degree of discretion—as when firms structure the work process around nonprogrammed jobs—they have tremendous incentive to channel employee thinking and thus reduce the risk of some catastrophic error. As Kunda (1992) noted, organizations relying on such systems tend to place a heavy emphasis on the development of appropriate employee norms. For example, although knowledge-based firms relying on output control allow workers to come and go as they wish, formal and informal development practices are used to generate a “feeling” that it is inappropriate to be the first to leave in the evening, or to increase the propensity to work long hours (Feldman, 2002; Kossek & Lee, 2008; Perlow, 1998).

The discussion above therefore suggests that both control and labor market factors will influence the pervasiveness as well as the nature of employee development in organizations. Whereas commitment-strategy firms based on ILM and process control are likely to emphasize all three dimensions of development (skills, competencies, and norms), secondary-strategy firms based on ELM and output control are likely to de-emphasize training altogether. Paternalistic firms are likely to place a premium on skill development, whereas firms with free-agent HR strategies are likely to emphasize competency and normative development.

### *Internal Mobility*

How is human capital to be deployed within the organization? As we have already discussed, firms with people flow subsystems grounded in an ILM-based logic are more likely to look to the current workforce as the primary solution for staffing needs. Thus, all else being equal, opportunities for upward mobility are likely to be greater in ILM-based firms. Furthermore, particularly in ILM-based firms, human capital deployments are likely to be made on the basis of predetermined, vertically oriented (as opposed to lateral) career paths.

What criteria should be used to govern such movements? Merit-based criteria—some composite of ability, skill, knowledge, and future potential—tend to give employers the most flexibility in determining how to maximize human resource deployments. As already noted, many ILM-based firms rely on seniority as their primary mobility criterion, in order to (a) maintain employee loyalty and the clan culture, (b) simplify decisions relating to human resource deployments, (c) ensure that employees perceive a high level of procedural justice, and (d) reduce the risk of disputes. Nevertheless, even in these firms, the more complex and nonprogrammed the nature of the work process (as with most managerial jobs), the greater the likelihood that merit will be used as the primary criterion for promotion, and the more likely such promotions will have positive impact on organizational performance (Lin & Li, 2004; Pinfield & Berner, 1993). However, as could be expected, the precise merit criteria used are likely to differ between ILM and ELM firms. A study of mobility patterns in 14 firms conducted by Kerr and Slocum (1987) suggests that in ELM firms, the primary merit criteria are likely to be performance and readiness. In contrast, ILM firms are likely to take a longer-term, developmental perspective, and thus the primary criterion is likely to be potential. In fact, in ILM firms, individuals identified as “high potential” may be

deployed in a variety of positions for which they are not yet ready, with the intent of giving them the exposure needed to develop the broader set of competencies—and connections—required for executive-level placement.

Other choices that need to be made with regard to mobility have to do with (a) the pace of progression (i.e., should promotion occur rapidly or should mobility be characterized by slow, evolutionary steps); (b) the openness of the promotion “contest” (i.e., should the mobility pattern be shaped around a tournament in which only those reaching level “b” are allowed to compete for promotion into level “c”, or should candidates from all levels be considered); and (c) are those not promoted asked to leave the firm (an “up-or-out” policy) (Forbes & Wertheim, 1995; Malhotra, Morris, & Smets, 2010). Little empirical research exists as to patterns within different types of firms with regard to these questions. However, in general, it appears that most American firms (particularly professional service firms) adopting merit-based criteria tend to shape their mobility patterns around a tournament model in which those advancing rapidly early on in their careers have the highest probability of reaching executive positions (Casas-Arce, 2010; Cooper, Graham & Dyke, 1993). This tendency appears to be the greatest among firms with ILM-based HR strategies that nonetheless use merit as the primary mobility criterion, such as law firms (Kerr & Slocum, 1987; Malhotra et al., 2010).

### *Talent Management: Identifying and Leveraging Potential Leadership*

One of the key contingencies affecting the degree to which an organization is able to execute its strategy is whether it has the talent in place to lead that execution. Over the past decades, firms have taken a variety of approaches to ensuring that they have this talent ready to lead when and where needed. For example, in the 1950s, organizations assumed that talented employees would patiently follow the set career paths into management laid out for them and that these paths would provide the organization with the leadership needed in order to respond to future business needs. By the 1980s, with baby boomers seeking less bounded careers, organizations began to experiment with new talent management approaches aimed at broadening employee development opportunities. One such approach, labeled the Dual Career Ladder by Allen and Katz (1986), sought to offer high potentials the ability to develop along a content/technical career path rather than a management path (Boudreau & Ramstad, 2005; Yeh & Lai, 2001).

Although still widely applied, the dual career ladder approach to managing high potentials is limited in two ways. First, many firms find it difficult to equalize the two career paths in terms of compensation, prestige, etc. and to provide sustained development opportunities within the technical ladder. Accordingly, content leaders already more dedicated to their occupation than to their employer may view the ELM as offering them greater development opportunities (Cha, Kim, & Kim, 2009; De Vos & Soens, 2008). Second, while offering an alternative career path, the dual ladder approach still assumes that positions at various points along both paths will remain relevant in the future. Given the velocity with which global markets shift and change, in an increasing number of industries and organizations, this assumption often goes unmet. For employees, this may mean that by the time they have developed the competencies to lead in a particular domain, this domain is no longer relevant to the business. For the organization, it implies a less than efficient investment of human capital development resources.

More recently, Cappelli (2008a; 2008b) proposed a more flexible approach to talent management, drawing on the principles of supply chain management. Cappelli (2008a) argued that firms need to carefully balance make-versus-buy decisions: “Some positions may be easier to fill from outside than others, so firms should be thoughtful about where they put precious resources in development” (p. 76). In this sense, Cappelli is arguing for a mixed approach involving a kind of make and buy, as we discussed

earlier in this chapter.

Additionally, Cappelli noted that firms need to reduce the risks inherent in forecasting demand for talent by, for example, creating an organization-wide talent pool that can be allocated among business units as the need arises, or by breaking up long training programs into discrete parts, such that employees in all functions acquire the same general training (e.g., in general management or interpersonal skills), and then specialize in function-specific material. Finally, internal job boards may allow employees to apply for openings and change jobs within the organization. Some firms do not even require employees to seek permission from their supervisors to move to new positions.

Finally, to improve the return on investment in development, Cappelli suggested that firms ask employees to share the costs of development. This can be done in several ways. For example, employees can be asked to take on learning assignments voluntarily, in addition to their normal work. Alternatively, firms may require employees to sign a “golden handcuffs” agreement, specifying that if they leave the firm before a certain time, they will have to pay back development costs. Organizations may also maintain relationships with former employees in the hope that they may return someday (a strategy often referred to as “alumni recruiting”). As Cappelli (2008a) noted,

Deloitte, for example, informs qualified former employees of important developments in the firm ... Should these individuals want to switch jobs again, they may well look to the place where they still have ties: Deloitte. And because their skills and company knowledge are current, they will be ready to contribute right away.

(p. 76)

Particularly for ILM-based firms, such alumni recruiting may offer a useful, last-ditch means by which to recoup their investment in human capital (Rau & Adams, 2012).

## RETENTION OPTIONS

Prior research is equivocal regarding the relationship between employee turnover and firm performance, and the conditions under which this relationship may vary. Dess and Shaw (2001) compared human capital theory and cost-benefit theories to predict that (a) performance declines as turnover erodes firm-specific human capital, but at the same time, (b) an optimal level of turnover maximizes the difference between its benefits and costs. Viewed through the lens of human capital theory, retaining high potential employees may be key to firms’ success; firms cannot build a sustainable business when they frequently find themselves needing to replace good people lost to other firms (including competitors). However, the cost-effective perspective offers a number of compelling arguments as to why a certain rate of turnover should be tolerated, and even encouraged. For instance, when underperforming employees leave the firm, the costs of replacing them may be more than offset by higher performance from new hires. Replacing poor performers can also benefit the organization indirectly by signaling to other employees that substandard performance is not acceptable (Lawler, 2002; McElroy, Morrow, & Rude 2001). Furthermore, turnover can bring in “new blood,” providing a source of new ideas for innovation and reform (e.g., Dalton & Todor, 1979; Kellough & Osuna, 1995). Moreover, at some level of compensation, the returns from retaining an employee may be less than the costs—even for high performers, people whom organizations (in particular those driven by an ILM logic) would generally like to retain. These tradeoffs suggest that it may be more efficient for organizations to manage turnover than to try to eliminate

it altogether.

The notion of turnover tradeoffs can also be inferred from Abelson and Baysinger's (1984) argument that the relationship between turnover and organizational performance takes the form of an inverted-U curve, where turnover generally benefits organizational performance at low to moderate levels, while above some level, additional turnover imposes more costs than benefits (the other end of the inverted U is where there is no turnover at all). However, empirical evidence supporting the inverted-U hypothesis (Glebbeeck & Bax, 2004; Meier & Hicklin, 2008) suggests that this tradeoff is far from universal and that the benefits of low to moderate turnover may apply only when certain conditions are met. For example, Siebert and Zubanov (2009) suggested that the net effect of turnover (taking into account its costs and benefits) is contingent upon the HR strategy in place. Specifically, drawing from our HR strategy typology (as described in [Chapter 3](#)), these researchers compared the turnover-performance association in commitment and secondary HR systems using a sample of 325 branches of a large UK clothing retailer, and distinguishing between involuntary and voluntary turnover. They argued that the careful selection processes used in commitment work systems results in fewer false positives. High investment in workers (e.g., through training) similarly helps ensure that firms adopting such systems get the most out of their employees. Involuntary turnover (i.e., dismissing underperforming individuals) therefore becomes less necessary. In contrast, in secondary work systems the costs of careful selection may not justify the benefits. Although less careful selection may result in a greater number of hiring errors, the authors argue that it is more efficient for most firms to resolve these errors through involuntary turnover than to prevent them through more careful hiring practices. As for *voluntary* turnover (quits), given the high cost of replacing unique human capital, organizations adopting commitment work systems have an incentive to keep the quit rate as low as possible. In contrast, given that human capital is more easily and cheaply replaceable in secondary work systems, organizations adopting such work systems have less of an incentive to reduce such turnover. In sum, with "a wider range of turnover values over which the effect of turnover on performance is positive" (p. 297), the authors found the inverted-U relationship between turnover and performance suggested by turnover trade-off theory, *but only among those employed in the framework of a secondary work system*. In contrast, based on the notion that the range of turnover that is beneficial for performance is likely to be very small in commitment work systems, the authors found a net negative effect of turnover on performance in such systems.

A recent meta-analysis by Park and Shaw (2012) similarly considered both the traditional, linear negative relationship and the inverted-U relationship between turnover and performance. Moreover, they too studied the potential attenuating role of organization- and context-related factors. Consistent with the findings of Siebert and Zubanov (2009) and others (e.g., Shaw, Gupta, & Delery, 2005), they found that the turnover-performance relationship varied significantly across different types of employment systems. In addition, they found that the size of the negative relationship between involuntary turnover and performance was significantly smaller than the relationship between voluntary turnover and performance. Accordingly, based on the evidence, it is fair to conclude that while low or moderate levels of turnover (particularly involuntary turnover) may be less detrimental (or even beneficial) to firm performance in some work contexts and with certain types of employees, there are many work contexts in which an employment strategy grounded in such a policy of turnover can pose significant risk to the firm.

## SEPARATION OPTIONS

Organizations face numerous options with regard to how to influence employee separations. The primary



choice faced, however, concerns the degree to which the employer is willing to use “reductions in force” as a means to meet cost targets and/or enhance or restore firm profitability. Once this basic decision is made, a second critical choice concerns how such reductions are structured.

As described earlier, organizations adopting an ILM-based logic, and particularly those relying on hard-to-develop employees able to staff nonprogrammable jobs, tend to make employment stability a cornerstone of their HR strategy (Baron & Kreps, 1999). For such organizations, employee loyalty is key to their overall business strategy. To the extent that employees might view the promise of job security as something less than ironclad, they might be tempted to seek alternative and more secure employment when times are good (Armstrong, 2000; Kotorov & Hsu, 2002). Reductions in force thus appear a less-than-perfect choice for such firms.

Furthermore, as a number of studies suggest (e.g., Allen, Freeman, Russell, Reizenstein, & Rentz, 2001; Gerhart & Trevor, 1996; Tourish, Paulsen, Hobman, & Prashant, 2004), although employee separations may enhance or restore short-term profitability, over the long term, they can have a negative impact on profitability. First, employees in whom the organization has invested may end up offering that human capital to a competitor. Second, such hard-to-develop human capital may be less available on the open market when the firm is ready to rehire, and the time necessary to internally *redevelop* these assets may place severe constraints on the organization at a critical time (Greer & Stedham, 1989). Third, a reduction in force may serve as a signal to potential high quality but risk-averse candidates to look elsewhere for employment, and thus limit the firm’s recruitment potential. Finally, the direct financial cost of such separations (particularly when the costs of restaffing are taken into account; Cascio, 2009) may greatly reduce the benefits of such reductions unless the organization undertakes large-scale restructuring to enhance long-term efficiencies (Whetten, Keiser, & Urban, 1995). Although these disadvantages need to be considered by all organizations, for obvious reasons, they are likely to be particularly relevant for ILM-based firms and firms with fewer preprogrammable jobs (i.e., HR systems relying on output-based systems of control).

However, many organizations—including some ILM-based organizations—nevertheless view reductions in force as a useful means to control labor costs and/or ensure labor cost variability and, hence, strategic flexibility. Indeed, over the past two decades, reputable firms have repeatedly laid off large numbers of employees under the imperatives of “downsizing” and “reengineering” (Datta, Guthrie, Basuil, & Pandey, 2010), with a significant number of managers and professionals included as targets for layoffs (Cappelli, 1999). Those organizations choosing to incorporate the potential for employee reductions as a core element of their staffing strategy need to make additional choices regarding the way in which such reductions are to be carried out. That is, choices need to be made as to whether such separations are going to be voluntary (e.g., attrition, early retirement incentives) or involuntary (e.g., layoffs or contractual terminations) (Dreher & Kendall, 1995; McElroy et al., 2001). For the reasons suggested above, many ILM-based firms prefer the former. However, since this effectively gives the choice to the employee, the firm runs the risk that those with the greatest potential will be the most likely to take the offer.

Assuming such separations are involuntary, should they be based on seniority, merit, or some other criterion? Most employers tend to prefer merit-based criteria, thus allowing the firm to reduce its “dead wood” (i.e., those offering the firm a relatively lower rate of return on every compensation dollar spent) and avoid losing those possessing critical competencies. However, this can raise serious questions of equity and ethics, particularly if current performance or future potential cannot be reliably assessed, or if such separations violate employee norms of procedural justice. Assuming that the most senior employees are also those offering the firm the greatest human capital, seniority-based criteria might therefore provide

the greatest long-term efficiencies, particularly in ILM-based firms. However, in ILM-based firms, those employees with the least seniority also tend to be the most poorly compensated, thus demanding that a relatively greater number of employees be dismissed to meet cost-reduction requirements.

Furthermore, there is no guarantee that those with the greatest seniority are also the most productive. Thus, ILM-based firms often seek alternative separation criteria. For example, until recently (when the practice was deemed in violation of basic equal employment opportunity regulations), to ensure that flight attendants never reached higher seniority-based pay grades, female flight attendants were contractually dismissed as soon as they married. In this way, U.S. airlines were able to constrain labor costs and maintain some degree of labor variability, while still basing their staffing subsystem on an ILM logic.

Another choice to be made concerns the timeframe over which downsizing takes place. Downsizing can be a gradual process involving several iterations, in a kind of “salami-slicing” of the workforce. Alternatively, firms may adopt an “all-at-once” approach to downsizing. The former approach is often perceived as more selective and less aggressive. For example, it often involves broad participation (e.g., union representatives or lower level employees) in identifying the need as well as alternatives for downsizing and drawing up the list of layoff candidates (e.g., Freeman, 1999). Such processes were found to be associated with positive postdownsizing effects (e.g., commitment, motivation, performance) among both survivors and targets of downsizing (Allen et al., 2001; Dolan, Belout, & Balkin, 2000).

Finally, an increasing number of organizations maintain relationships with former employees on the basis of alumni networks. Such networks may signal an ethic of care, enhancing an organization’s reputation even in a time of downsizing and economic recession (Pfeil, Setterberg, & O’Rourke, 2003). Moreover, corporate alumni networks may provide value to those inside and outside the organization. For example, as noted above, former employees who were laid off when the firm downsized may be rehired when conditions improve (Cappelli, 2008a). Such practices may further stretch return on investment, particularly for ILM-based firms.

## SUMMARY

The analysis presented above suggests that the profile of organizational staffing practices is likely to vary as a function of a firm’s overall HR strategy. That is, depending on the nature of organizational control systems and the ILM versus ELM orientation of the firm, staffing practices may tend to cluster together into four identifiable patterns, each associated with one of the four ideal types of HR strategies identified in the previous chapter. [Table 4.1](#) presents each of these four patterns, showing how, across each of the choice parameters discussed in this chapter, staffing practices may tend to vary depending on the HR strategy in use.

As can be seen in [Table 4.1](#), the people flow subsystem in firms adopting a commitment HR strategy tends to be based on the kind of salaried ILM framework described by Pinfield and Berner (1994). Recruitment processes are designed to reduce the risk of ultimately selecting “false positives” and to increase the likelihood that those hired actually stay with the organization. Selection processes are future oriented and place a heavy reliance on innovative selection technologies to maximize selection efficiency. Although the selection process provides multiple interests with the opportunity to influence the selection decision, the overall process is subject to centralized regulation to ensure internal consistency and enhance employees’ perceptions of procedural justice. Deployment processes such as mentoring are intended to enhance employee-job as well as employee-organization fit. Finally, staffing systems in such organizations are geared toward employee retention and mobility and therefore place a heavy emphasis

on employee development in the broadest sense, offering plenty of opportunities for talented workers to progress to higher technical or managerial positions.

**Table 4.1** People Flow Subsystem Characteristics by HR Strategy Type

| Choice                 | Commitment   | Paternalistic  | Free Agent   | Secondary   |
|------------------------|--|--|--|---|
| <b>Basic</b>           |  |  |  |   |
| ILM vs. ELM            | Salaried ILM   | Wage ILM   | ELM  | ELM   |
| <b>Recruitment</b>     |  |  |  |   |
| Philosophy & Message   | Realism is critical; Focus on organization and organizational career                               | Realism is moderately important; Focus on organization and organizational career | Realism is important; Focus on job rather than on organization           | Realism is relatively unimportant; Costs may outweigh benefits                        |
| Breadth                | Narrow; Very high standards  | Narrow; Moderately high standards  | Wide-net; Moderately high standards                                      | Wide-net; Minimal standards   |
| Methods                | Limited mix; Informal; Limited if any reliance on external agents                                  | Limited mix; Informal; Some reliance on external agents                          | Extensive mix; Formal and informal; Moderate reliance on external agents | Extensive mix; Mostly formal; Heavy reliance on external agents                       |
| <b>Selection</b>       |  |  |  |   |
| Criteria               | Developmental potential; Mix of job- and competency-based criteria; Heavy emphasis on cultural fit | Developmental potential; Job-oriented criteria; Some emphasis on cultural fit    | Current competencies; Some emphasis on cultural fit                      | Current competencies and job-based KSAs; Little or no emphasis placed on cultural fit |
| Methods                | Greater reliance on sophisticated methods  | Moderate reliance on sophisticated methods                                       | Greater reliance on sophisticated methods                                | Limited reliance on sophisticated methods   |
| Breadth of Involvement | Moderately broad involvement; Centralized regulation of decentralized decision-making process      | Narrow involvement; Centralized decision making                                  | Very broad involvement; Decentralized decision making                    | Moderately broad involvement; Decentralized decision making                           |

For example, Intel relies on multiple, individual and group interviews with potential supervisors, subordinates, and peers to assess not only the candidate's knowledge, skills, and abilities, but just as importantly, the degree to which the candidate will fit into the company's highly emphasized corporate culture. Jobs are designed to encourage employee retention by placing an emphasis on autonomy, challenge, and personal growth. Career structures are developed to facilitate individual development and professional advancement. Although hiring-related decision making is decentralized, these decision makers are required to follow highly specified and centrally controlled hiring processes and policies.

Finally, Intel invests significant resources in employee and management development and attempts to closely link these development programs with individual career management.

Like organizations adopting commitment HR strategies, firms adopting paternalistic HR strategies (such as MSI Ltd., described earlier) are also oriented toward an ILM-based people flow subsystem. However, in this case, the subsystem is likely to be more consistent with the wage- (rather than salary-) based ILM (Pinfield & Berner, 1994). As in the case of the commitment HR strategy, paternalistic recruitment processes also tend to be oriented toward minimizing the risk of hiring a “false positive.” However, in this case, such processes are adopted not so much because of the catastrophic damage such an employee could cause (process-based systems of control greatly reduce that risk), but rather because of the difficulty of removing this individual from his or her job, no less the organization. As will be recalled, at MSI Ltd., every effort is made to ensure employees the highest degree of employment security. Given the more limited risks, organizations adopting the paternalistic HR strategy may outsource some of their recruitment function to external agents. As in the case of the high commitment strategy, the paternalistic strategy places an emphasis on identifying candidates with future potential rather than those with currently needed skills or competencies. However, since work processes in such organizations tend to be subject to greater process-based controls and work roles tend to be framed by the demands of relatively stable jobs, criteria tend to be more job oriented and less demanding of sophisticated assessment methods. Furthermore, the extensive focus on standardized and consistent administrative processes requires a highly centralized decision-making process. Finally, given their ILM orientation, organizations adopting the paternalistic strategy place a heavy emphasis on employee development. However, in this case, formal development activities tend to be skill oriented, with mobility contingent more on seniority than on readiness or merit.

Organizations adopting the free-agent and secondary HR strategies develop their people flow subsystems around an ELM orientation. The preprogrammed nature of jobs in the latter case allow such organizations (e.g., RLA Textiles Inc.) to adopt quantity-rather than quality-oriented recruitment practices that do not necessarily transmit a realistic message and that can easily be contracted out to external agents. In contrast, given the lack of preprogrammed work processes in their organizations and at least a short-term interest in retaining skilled individuals once selected, firms adopting the free-agent HR strategy tend to adopt recruitment processes that are, for the most part, realistic and based on moderately high standards. Although some reliance on external agents may be necessary to secure a broad enough pool from which to make selections, given the dynamic nature of jobs in such organizations, too much reliance on such agents may have detrimental effects on the nature of the candidate pool.

Selection processes across both types of strategies tend to be far more oriented toward identifying past achievements and determining what the candidate can offer on an immediate basis to the firm. Typically, little attention is paid to candidates’ future potential, as in the case of organizations adopting commitment and paternalistic HR strategies. Nevertheless, the fluid nature of “jobs” in many organizations adopting the free-agent strategy demands that such organizations assess current competencies (applicable to a variety of work roles) rather than just current job-based knowledge, skills, and abilities (as in the secondary strategy). This, in turn, justifies the adoption of more sophisticated selection methods and the involvement of a wide variety of organizational interests in individual selection decisions.

Finally, the ELM-basis of the people flow subsystems adopted by both free-agent and secondary firms places relatively limited emphasis on employee development, advancement, and retention. Nevertheless, firms adopting more of a free-agent HR strategy are bound by the less preprogrammed nature of their work processes to ensure that externally recruited employees gain those competencies necessary for teamwork and internal coordination. Furthermore, such work processes tend to increase the dependence

of the firm on their workforce (and hence the relative value of the workforce to the firm), and expose the firm to greater risk when employees can easily move from one employer to the next. Consequently, for firms adopting the free-agent strategy there tends to be a greater interest in retaining current employees, at least as long as their current competencies are required and valued. Merit-based internal mobility may be used as a means to retain those employees offering the greatest value or potential.

This is precisely the approach used by many of the larger law, accounting, and consulting firms around the world. These firms tend to employ recent graduates at the entry level, often in the employment context of a temporary internship or freelance relationship. More permanent employment may be offered to a handful of these workers on the basis of a tournament model. That is, the incentive of eventually being offered a junior partnership is used by these firms as a way to encourage those most highly valued professionals to develop a greater sense of commitment to their employer. Similarly, although nearly all contractors in the construction industry tend to rely on free-agent skilled trades workers (e.g., carpenters, electricians), the larger contractors also tend to offer more permanent employment to a small number of the most highly valued of its freelancers as a means to retain critical human capital, develop some degree of employee attachment, and ensure a tighter alignment of employer-employee interests.

## **NOTE**

1. At the company's request, the corporate name used in this book is fictitious.

## THE PERFORMANCE MANAGEMENT SUBSYSTEM

Performance management is a continuous process of identifying, measuring, and developing the performance of organization members and aligning their performance with the strategic goals of the organization (Aguinis 2009; DeNisi, 2000). The primary goal of performance management is to ensure that the organization and all its components (processes, units, and employees) are working together in an optimal fashion to achieve organizational objectives (e.g., Den Hartog, Boselie, & Paauwe, 2004). To this end, a variety of techniques, both formal and informal, are used to recognize and encourage enhanced performance, provide avenues for competency development, reinforce supportive climates and cultures, and ensure the retention of top performers (Lawler, 2003). As such, the performance management system is central to the function of every other HR system. For example, from a supply chain perspective, the performance management system serves as a key internal intelligence mechanism, allowing organizational leaders to source needed human capital and identify competency gaps at the individual, unit, and organizational levels. It also provides the criterion measures that are essential for validating selection tools and the efficacy of nearly any other HR activity (e.g., training). Accordingly, performance management is critical to the execution of most, if not all, of the people flow processes reviewed in the previous chapter. Similarly, with compensation in many firms partially contingent upon individual, team, and/or unit performance, performance management and employee reward systems are highly interdependent.

These observations notwithstanding, “managers and employees are equally skeptical that performance management adds value; usually, it is seen as a waste of time and resources” (Aguinis, Joo, & Gottfredson, 2011, p. 507). Indeed, though several studies (e.g., Armstrong, 2000; Molleman & Timmerman, 2003) have recognized the potential contribution of performance management systems to organizational effectiveness, others (e.g., Furnham, 2004; Glendinning, 2002) are more critical, suggesting that such systems can become a burden rather than a motivational tool, with the potential for deleterious effects on employee relations.

Consistent with this more critical approach, in this chapter, we adopt a broad perspective on performance management, conceptualizing it as an integrative system that, based on a process of learning, aims to foster stronger links between individual behavior and organizational goals and strategies. Drawing from Cascio’s (2006) definition that “at its most basic level, performance management refers to the evaluation and continuous improvement of individual or team performance” (p. 176), we consider two main performance management processes, namely *performance measurement* (the process of evaluating performance) and *performance feedback* (the process of communicating to employees information about the quality of their work). However, as we view performance management as an inherently learning-based process, we begin by discussing what learning is all about. Then, after reviewing the basic literature on performance measurement and performance feedback, we review some of the choices that managers need to consider when designing performance management systems, highlighting those often affected by these choices. Given our rather critical take on the efficacy of conventional approaches to performance management, we also briefly review the research on several alternative approaches to managing individual and team performance, such as after-event reviews. Finally, we review several subsystem



frameworks and discuss the extent to which different clusters of employee learning and measurement practices might be associated with one or more of the four dominant HR strategies identified in [Chapter 3](#) (commitment, free agent, paternalistic, and secondary).

## **THEORETICAL FRAMEWORKS FOR UNDERSTANDING EMPLOYEE LEARNING**

Fiol and Lyles (1985) defined learning as the process of detecting and correcting errors through better knowledge and understanding. Other definitions (e.g., Argote, 2012; Argyris & Schön, 1978; Knowles, Holton, & Swanson, 1998; Senge, 1994) similarly suggest that learning involves the acquisition and adjustment of competences and skills that, by creating a relative permanent change in behavior or behavioral dispositions, make the learning agent—individuals, teams, or organizations—more successful in pursuing desired goals. Thus, learning is about improving performance (DeNisi, 2011; Edmondson, 2002). But learning is also a *process* involving both action and cognition. Indeed, as a process, learning occurs as a function of iterative cycles of action and reflection, defined by Swift and West (1998, p. 4) as “a turning back on the self,” encompassing both self-awareness and agency. Cumulative action-reflection experiences, by enhancing employees’ (a) knowledge, (b) skills, and (c) implicit understanding of how their behavior affects and is affected by others have the potential to ultimately result in enhanced performance at the individual (Weiss, 1990; Wright, 1936), team (Edmondson, 1999; Stagl, Salas, & Day, 2008), or organizational (Argyris & Schön, 1978; Senge, 1994) levels.

Learning theory suggests that one-time reflection is likely to be far less beneficial than multiple rounds of action and reflection for two main reasons. First, improvement depends on the ability to identify and correct problematic patterns of behavior, with these patterns of stimulus, action, and outcome often recognizable only over multiple rounds of action and reflection. Similarly, correction often depends on a process of “tweaking,” which also typically requires multiple iterations of action and reflection. Recent research in brain science explains why this is so. Kandel’s (2007) work on long-term potentiation in the brain shows that proteins have to be synthesized in order to convert short-term memories into long-term ones and that this is most likely to occur following high-frequency stimulation of chemical synapses. This suggests that employees who engage in continuous and frequent, rather than scattered, reflexive experiences will be better able to recognize varying patterns of stimulus, action, and outcome. Thus, to the extent that their portfolios of guided, role-based reflexivity are characterized by more regular experiences, it is likely that they will be able to build upon a richer set of insights and understandings.

Multiple rounds are also necessary in that learning often requires the questioning of assumptions and recognition that the implicit logics underlying embedded behavioral routines and repertoires may no longer be appropriate or applicable given new contextual conditions or work processes. In their groundbreaking work on organizational learning, Argyris and Schön (1978) noted that although learning can occur within the framework of assumptions that are taken essentially for granted, that learning, which is most associated with striking performance improvement, often requires questioning the validity of such assumptions. They referred to the first, more conventional form of learning (within the framework of taken-for-granted assumptions) as *single-loop learning*. This type of learning occurs when the lessons learned from an action are framed within some existing mental model and are incorporated into existing norms, policies, and objectives. In contrast, *double-loop learning* occurs when error is detected and corrected in ways that require the questioning of these mental models, and perhaps even the modification of an organization’s underlying norms, policies, and objectives (Argyris & Schön, 1978). Multiple rounds

of action and reflection are required to question taken-for-granted assumptions in that the problematic nature of such assumptions is unlikely to be recognized until actors recognize that no matter what conventional steps they take to correct their performance, nothing really works. Furthermore, even when actors recognize that assumptions must be questioned, it may take multiple rounds of failed action-reflection for them to accumulate the political wherewithal to challenge institutionalized structures and regimes.

So how does learning theory inform performance management as it is enacted in contemporary organizations? The answer is that since reflection is facilitated to the degree that it is framed around data and takes others' perspectives into account, performance measurement and feedback have the potential to serve as a foundation for effective reflection. However, as we next discuss, much of the research on performance measurement and feedback suggests that these systems are seriously flawed in many organizations, leading some scholars to conclude that performance management has become little more than a ritual of control (e.g., Senge, 1994; Wilkinson & Shanks, 2004). Accordingly, we next turn to the core technologies underlying conventional performance management, namely performance measurement (or performance assessment) and feedback.

## **CORE CHARACTERISTICS OF EFFECTIVE PERFORMANCE MANAGEMENT SYSTEMS**

Research suggests that the effectiveness of both performance measurement and performance feedback in promoting learning at the individual, group, and firm level is greatly influenced by three factors. These are the degree to which assessment and feedback are (and are deemed to be) (a) fair, (b) to signal critical priorities, and (c) to facilitate perspective taking on the part of organizational members (e.g., Aguinis, Joo, & Gottfredson, 2011; Cascio, 2006; Lawler, 2002). Below, we will discuss these factors in relation to first assessment, and then feedback.

### *Performance Measurement*

Performance measurement involves gathering indicators of the work performed and the results achieved in an activity, process, or organizational unit for the managerial purposes of following up, monitoring, and improving organizational performance (Cascio, 2006; Cohen & Roussel, 2005; Elg & Kollberg, 2009). Performance measurement practices have often been studied through the lens of justice theory, and in particular, procedural justice. Procedural justice theory provides insight into how individuals react to decision processes (Thibaut & Walker, 1975). The theory suggests that “the fairness of the process of decision-making shapes employees’ judgments of decisions makers’ trustworthiness and the long-term prospects for fair treatment” (Korsgaard, Sapienza, & Schweiger, 2002, p. 499). To the extent that performance measurement is conducted in a procedurally just manner (for example, as we discuss below, by including both objective/quantitative and subjective/qualitative indicators and by considering evaluations from multiple sources), employees are likely to view the system as legitimate, even if a particular outcome is unfavorable. Yet when the system is perceived as procedurally unjust, employees are likely to doubt its legitimacy as well as the integrity of management. The system may thus become a source of frustration and dissatisfaction, disrupt relations between managers and employees, and generally generate negative employee attitudes and behaviors (Cropanzano & Ambrose, 2001; Roch & Shanock, 2006; Tyler & Lind, 1992).

Boswell and Boudreau (2000) demonstrated the importance employees place on the fairness of performance measurement practices. They found a significant positive association between employee attitudes and procedurally just performance appraisals. They and others (e.g., Cropanzano & Prehar, 2001) argued that in contrast to distributive justice, which refers to fairness in the outcomes of decisions and can directly maximize an individual's material outcomes, the value of procedural justice is less direct. More specifically, just procedures help protect employees' interests both indirectly (by providing cues concerning the fairness of material outcomes in the long run) and directly (by providing social outcomes, such as a sense of esteem).

Procedural justice is likely to increase to the degree that performance measurement procedures are designed and executed while accounting for validity. This is usually in the form of content validity, or the degree to which a measure includes most of the important behaviors and/or results associated with a job). As we noted in [Chapter 4](#), validity necessitates reliability (usually in the form of between-rater agreement, or the consistency of a measure across different raters; Erdogan, Kraimer, & Liden, 2001; Thurston & McNall, 2010). Folger, Konovsky, and Cropanzano (1992) offered a test metaphor for performance appraisals, which relies on the assumptions that an objective view of reality exists and, in the ideal appraisal situation, that both rater and ratee share this view. However, the problem with this metaphor is that the underlying assumptions are rarely true. Indeed, basic assumptions regarding validity and reliability are often inconsistent with the nature of work as well as the nature of managerial decision making (March, 1994; Thurston & McNall, 2010). To address these gaps, Folger et al. (1992) offered a “due process” model based on perceptions of procedural fairness. According to this model, a fair measurement system “does not require a shared objective reality between rater and ratee, but rather a shared view of acceptable standards and types of information that can be brought to bear as evidence to compare performance to those standards” (Thurston & McNall, 2010, p. 203). Notably, as we discuss in the next chapter, issues of fairness (reliability and validity) in performance appraisal systems are aggravated when performance is linked to pay.

Those involved in measuring performance (i.e., HR personnel and raters, who are often middle and line managers) have a critical role in establishing the reliability and validity of measurement systems (Biron, Farndale, & Paauwe, 2011; Smith, 1986; Woehr & Huffcut, 1994). Raters are subject to social, political, and cognitive variations, and it is therefore “naive to assume that all raters give equally valid ratings by default” (Newman, Kinney, & Farr, 2004, p. 380). And while training cannot entirely eliminate such biases as subjective inflating or deflating of performance reviews (due to either intentional or unconscious errors like leniency or the halo effect), research found that when raters were trained to acknowledge and take account of such biases, measurement accuracy and perceived fairness increased. As Aguinis et al. (2011) put it, “the ongoing training of performance raters—usually managers—is a must” (p. 507).

Firms may use different rater training programs. One prevalent approach is Frame of Reference (FOR) training, designed to “eliminate idiosyncratic standards held by raters and replace them with a common frame of reference for rating” (Schleicher, Day, Mayes, & Riggio, 2002, p. 736). More specifically, to avoid the demanding tasks of observing and recalling behaviors for each ratee and then categorizing these behaviors into relevant dimensions, FOR training focuses raters on important organization-wide dimensions relevant to all jobs, and on behaviors indicative of various effectiveness levels within each dimension (Bernardin & Buckley, 1981; Dierdorff, Surface, & Brown, 2010).

By investing in rater training, firms may signal to both supervisors and employees that the organization is concerned with the way performance evaluations are conducted (Biron et al., 2011). This relates to the second characteristic of effective performance measurement systems, namely, that they serve signaling

purposes. Signaling theory is primarily concerned with reducing information asymmetry between two parties (Spence, 2002). In work contexts, signaling theory suggests that employees need tangible information to help them understand the employer's interests or future prospects. The information gathered is often used to form inferences about what issues are important in the organization and may thus serve to guide or strengthen relevant behaviors (Connelly, Certo, Ireland, & Reutzel, 2011; Srivastava & Lurie, 2001). Similarly, performance measurement may indicate management concern for certain performance-related issues (e.g., emphasizing quantity versus quality indicators, or using relative versus absolute evaluation). These observable practices have an important signaling function as they often help employees better understand the values and norms underlying the organizational culture, and what the organization expects of them. Accordingly, ensuring that performance management practices are transmitting intended (rather than unintended) signals may help promote desired employee attitudes and behaviors (Bowen & Ostroff, 2004; Casper & Harris, 2008; Nishii, Lepak, & Schneider, 2008).

### *Performance Feedback*

Performance feedback serves as an important channel of employee-employer performance-related communication. Defined as "actions taken by (an) external agent(s) to provide information regarding some aspect(s) of one's task performance" (Kluger & DeNisi, 1996, p. 255), feedback is typically provided in order to give employees an indication of how well they are meeting desired goals (DeNisi, 2011; Holton, 2005). Thus, when firms choose to emphasize certain issues in performance appraisal (and to deemphasize others), employees are likely to attribute a high level of importance to these issues, and they will engage in behaviors that fall within a spectrum of actions they believe are desired by the organization. Accordingly, many studies addressing performance feedback have focused on the role of feedback in influencing employee attitudes (motivation) and behavior (performance). Unfortunately, these studies fail to provide clear evidence that feedback is effective in promoting enhanced performance. In fact, in their classic meta-analysis, Kluger and DeNisi (1996) found that only in about a third of the observations included in their analysis did feedback yield beneficial performance effects, with the effects being negative in another third of cases, and null in the remaining observations. Concurring with these findings, Gerstenberg et al. (in press) noted that "despite the ubiquity of feedback experiences, psychological research still has not delivered a conclusive answer regarding how feedback influences performance."

Over the years, scholars have suggested a number of ways to increase the proportion of cases in which feedback has beneficial effects. These studies typically find that feedback will be more likely to yield beneficial performance consequences to the extent that it (a) is perceived as accurate by ratees; (b) focuses ratees' attention on clearly understood learning goals, rather than on their failure to achieve goals; and (c) identifies gaps between the ratees' current performance and their learning goals, while providing clear suggestions on how to close these gaps (e.g., DeNisi, 2011; Shute, 2008; Steelman & Rutkowski, 2004). Although these practices are likely to pose little or no risk, there is little evidence that they actually increase the likelihood of a beneficial feedback effect. This is because, as Van Dijk and Kluger (2004) suggest, the impact of feedback is contingent on two main factors, namely the sign of the feedback (positive versus negative), and the individual's own mode of self-regulation.

Drawing from Higgins's regulation theory (1998), Van Dijk and Kluger (2004) proposed that positive and negative feedback can yield very different performance-related consequences for different people. Higgins's regulation theory suggests that people have two basic self-regulation systems. The first involves the avoidance of punishment and focuses individuals on prevention goals (making them sensitive to

punishments resulting from poor performance). The second system regulates the achievement of rewards and focuses individuals on promotion goals (making them sensitive to rewards obtained from superior performance). Higgins suggested that congruence (or fit) between regulation focus and type of outcome should increase motivation; that is, loss (failure) is congruent with the strategy of avoiding loss in a prevention focus, whereas gain (success) is congruent with the strategy of achieving rewards in a promotion focus. Consistent with this notion of congruence, Kluger and Van Dijk (2004) hypothesized and found that a negative feedback sign under a prevention focus, and a positive feedback sign under a promotion focus, increased postfeedback motivation relative to either a negative feedback sign under a promotion focus or a positive feedback sign under a prevention focus.

### *Perspective-Taking in Measurement and Feedback*

Finally, effective performance management involves numerous stakeholders (supervisors, peers, and even customers) who actively engage in assessing and influencing an employee's performance, whether informally or formally. The effectiveness of these stakeholders in influencing employee learning has a lot to do with the degree to which they are able to recognize the employee's point of view—something psychologists refer to as “perspective taking”—when appraising a target's performance and feeding their impressions back to this target (Galinsky & Moskowitz, 2000; Parker & Axtell, 2001). Weick's (1979) mantra “Complicate yourself!”—suggesting that managers should be able to view situations from multiple perspectives—can be applied to the performance management role as well.

Employees can also benefit from adopting the perspective of those doing the assessing. The trend to offer employees feedback gathered from different sources (as in “360-degree feedback,” described below) offers employees richer, more varied information on their performance than can be generated from any single source. But this information will only be helpful if employees are able to see themselves as others see them and consider frameworks different from their own world views (Mohrman & Cohen, 1995; Smither, London, & Reilly, 2005).

## **CHOICES AND CONTINGENCIES IN THE DESIGN OF PERFORMANCE MANAGEMENT SYSTEMS**

As noted earlier, the efficacy of conventional performance management is influenced by the degree to which performance measurement processes are (and are deemed to be) fair, to signal critical priorities, and to facilitate perspective taking on the part of organizational members. However, in seeking to maximize all three of these parameters, those responsible for designing performance measurement systems are forced to make a large number of choices. In this section, we discuss several of these choices and review the contingencies that may influence them. We begin by introducing a basic choice with respect to performance management systems, namely selecting the unit of analysis upon which performance is to be managed.

### *Whose Performance Is Managed (Individual versus Team)*

Performance management may concern the individual, team, and larger organizational units. With respect to learning, although insight and innovative ideas occur to individuals, not organizations, knowledge generated by the individual does not come to bear on the organization independently. Ideas are shared,

actions taken, and common meaning developed into shared understandings by groups, and eventually institutionalized as organizational know-how (Argyris & Schön, 1978; Bapuji & Crossan 2004; Nonaka & Takeuchi, 1995). Thus, recognizing that a large and increasing proportion of employees conduct their work in a team context, firms are constantly seeking ways to enhance team performance—and team-based learning (defined as a process in which teams acquire and reflect upon the feedback generated by their actions; Edmondson, 1999) has become an important vehicle for influencing team effectiveness and team members' attitudes and behaviors (Edmondson, 2003; Vashdi, Bamberger, Erez, & Weiss-Meilik, 2007). Furthermore, research suggests that an organization's ability to learn often depends on the learning of its work groups and teams (Edmondson, 2002; Senge, 1994). Notably, however, although the application of learning at the organizational level is typically viewed as a function of some collectivity of individual learning, individual learning does not necessarily generate organizational learning. Rather, organizations often need to make a concerted effort to integrate learning at the individual and aggregate levels to affect organizational learning (Ikehara, 1999; Senge, 1994; Wang & Ahmed, 2003).

Crossan, Lane, and White (1999) proposed the “4I” framework for organizational learning, whereby four processes—intuiting, interpreting, integrating, and institutionalizing—link individual, group, and organizational learning. Their model is illustrated in [Figure 5.1](#). Two of these processes, intuiting and interpreting, take place at the individual level, where intuiting refers to “the preconscious recognition of the pattern and/or possibilities inherent in a personal stream of experience” and interpreting to “the explaining, through words and/or actions, of an insight or idea to one's self and to others.” Integrating, defined as “the process of developing shared understanding among individuals and of taking coordinated action through mutual adjustment,” takes place at the team level. Finally, at the organization level, institutionalizing is “the process of embedding learning that has occurred by individuals and groups into the organization,” via “systems, structures, procedures, and strategy” (Crossan et al., 1999, p. 525). The four processes operate dynamically over the three levels, via feed-forward loops (in which new learning is transferred from individuals to groups and eventually becomes institutionalized; Hedberg, 1981; Kluger & Van Dijk, 2010) as well as feedback (in which individuals and groups exploit what has already been learned).



| Level        | Process            | Inputs/Outcomes       |
|--------------|--------------------|-----------------------|
| Individual   | Intuiting          | Experiences           |
|              |                    | Images                |
|              | Interpreting       | Metaphors             |
|              |                    | Language              |
| Group        | Integrating        | Cognitive map         |
|              |                    | Conversation/dialogue |
|              | Institutionalizing | Shared understandings |
|              |                    | Mutual adjustment     |
| Organization | Integrating        | Interactive systems   |
|              |                    | Routines              |
|              | Institutionalizing | Diagnostic systems    |
|              |                    | Rules and procedures  |

**Figure 5.1** Learning in Organizations: Four Processes Through Three Levels

Source: Crossan, Lane, & White (1999, p. 525).

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Given the dynamic and ongoing interrelationship between individual and group learning and behavior, firms must decide when and to what extent to measure performance based on collective versus individual effort (Lam & Schaubroeck, 1999; Soltani, van der Meer, & Williams, 2005). Under individual-level measurement systems, employees are rated based on the degree to which they have met personal objectives. At the same time, firms may consider group or team effort as an integral part of employee performance evaluations. When group effort is considered, success indicators may involve both group processes (e.g., cooperation) and outcomes (e.g., products) (Castka, Sharp, & Bamber, 2003). Group-based appraisal may lessen unproductive or competitive behavior within the team by focusing individuals' attention on group rather than personal objectives, and on how the group can perform more effectively (Carson, Cardy, & Dobbins, 1992; Jones, Buerkle, Hall, Rupp, & Matt, 1993; Scott & Einstein, 2001). Many firms use a blend of individual and joint accountability, with individual and collective criteria weighted differently according to how central group processes are to the firm's success, with simple information sharing at one end and, at the other, collective performance with a common product (i.e., interactive and interdependent effort required to achieve specific objectives).

### *Measurement Choices*

Organizations evaluate employee performance for a wide variety of purposes. Beyond the link to the compensation subsystem (as will be discussed in the next chapter), as noted above, the performance measurement system is often a core means of organizational communication, allowing managers to highlight key organizational objectives, expectations, norms, and values by translating these into measurable performance criteria. Performance appraisal data are also used to guide decisions regarding employee training and development, internal career planning, and individual advancement, as well as to



validate these and other HR decision-making processes (e.g., selection). Indeed, as Baron and Kreps (1999) suggested, because appraisal systems are typically designed to serve so many different functions, they are often far from ideal with respect to any specific purpose.

Key choices with respect to the design of these systems concern the degree to which appraisal frameworks should be (a) objective as opposed to subjective in nature; (b) relative versus absolute; (c) reflective of short versus long time frames; (d) based on a forced or free distribution; (e) based on narrow versus broad input; (f) based on coarse versus fine distinctions; (g) based on observable behaviors versus underlying attitudes; and (h) collected with respect to behaviors, traits, outcomes, or some combination of these (i.e., appraisal format). The main issues with regard to each choice are described next.

**Objective versus subjective measures.** Since performance appraisal data are used as a basis for numerous administrative decisions, as noted above, it is critical for firms to ensure that employees perceive appraisals to be procedurally just (e.g., Colquitt & Greenberg, 2003; Greenberg, 1990). If employees feel that such decisions are based on inaccurate or unreliable data, or on an inconsistent method of data analysis, they may question the legitimacy of the entire decision-making framework. Ultimately, they may demonstrate their dissatisfaction by “voting with their feet” (Folger & Kanovsky, 1989; Howard & Cordes, 2010; Poon, 2012; Zenger, 1992). At the same time, to the degree that employees are able to influence outcome measures without actually advancing the employer’s goals—that is, to create a gap between actual and measured performance (Lazear & Oyer, 2013), something we will discuss further in the next chapter—the interests of the employer may be at risk.

One way to avoid such problems is to base performance appraisals, where possible, on unambiguous, “objective” data. This is more easily accomplished for some types of jobs than others. For example, the performance of a typist might be appraised on the basis of the number of error-free characters typed per minute. But such singledimension, “objective” data might not accurately reflect performance for employees in positions such as sales or customer service. For these workers, a global performance “score” may have to take into account a variety of more or less objective measures that may or may not be equally weighted (e.g., the number of calls taken per hour, the number of “bounce-ups” to a manager, the number of customer complaints, etc.). The balanced scorecard of Kaplan and Norton (1996, 2001) takes account of a range of performance indicators drawn from organizational goals, including such distal indicators as contribution to the efficiency of internal processes and contribution to organizational growth. These include both financial and nonfinancial indicators and are measured both subjectively (e.g., customer satisfaction) and objectively (e.g., cost reductions).

Such a multi-indicator strategy raises the question of how such criteria should be weighted to calculate a global performance score. To the degree that such weights are subjectively determined, procedural justice may suffer. Procedural justice may also suffer if the objective appraisal framework is so formulaic that performance-damaging conditions beyond the control of the employee (i.e., situational constraints; Bacharach & Bamberger, 1995) cannot be taken into account. In general, however, the more programmable the type of tasks performed, the more objective and formulaic the appraisal system is likely to be and the higher its “score” in terms of procedural justice.

More problematic are positions for which objective data are either less available or not subject to clear interpretation (e.g., research scientists, physicians). For these types of positions, organizations typically have to rely on judgmental or “subjective” appraisals. While such appraisal systems are more apt to take into consideration various situational constraints on performance that are unique to the position or individual employee (thus enhancing employee justice perceptions), they are also highly susceptible to evaluator bias (thus damaging justice perceptions).

**Absolute versus relative measures.** In addition to the “objective versus subjective” choice, managers

designing a strategic performance appraisal system need to determine the extent to which appraisal data will be interpreted on an absolute basis—for example, for a call-center employee, the number of calls handled per hour (absolute) versus the degree to which the number of calls handled is above the mean (relative). In general, the greater the potential for job-related situational constraints, the more suitable it may seem to appraise performance on a relative basis. Relative performance evaluations can be used in two ways. First, an individual employee's performance may be benchmarked against the performance of a peer group, so as "to filter out shocks that are common to the whole peer group. This helps the firm to lower the risk (and the associated compensation premium) imposed on individual employees" (Lazear & Oyer, 2013, p. 484). Assuming that everyone in the peer group who performs the same job faces similar job-related uncertainties, such a relative approach controls for these constraints and solves a problem common to most objective, formulaic appraisal systems. On the other hand, it creates a host of additional problems having to do with the selection of the referent group, collusion among those in the referent group (e.g., to keep standards low), and creation of a zero-sum game (i.e., a competitive climate among peers for whom overall performance is contingent upon cooperation). The latter problem (the zero-sum game) may be more significant in firms using the second form of relative performance evaluations, which is based on the rank order of employee performance. This form of appraisal is particularly likely to generate a competitive climate when rank order is used as a basis upon which to allocate scarce rewards, such as promotions (Lazear & Oyer, 2013).

**Short-term versus long-term measurement.** Firms must also consider the time frame of performance measurement (e.g., Aguinis, 2009; Armstrong, 2000). Some firms deliver performance appraisals frequently, on a weekly or even daily basis. As we later describe, real-time performance monitoring systems can provide employers with such immediate performance data. Additional practices, such as weekly one-on-one sessions with supervisors, can help firms troubleshoot problems as they arise (by changing procedures or reallocating resources) and plan follow-up phases and can be viewed as part of an ongoing, iterative learning and development process; one which, by the way, allows employees to monitor the rate of change in their own performance (Kluger & DeNisi 1996, p. 266). Such a continuous process of performance management has long been in place at Intel, where it is used as a mechanism to maintain the company's strong meritocratic culture. At Intel, appraisal is a highly systematized, continuous process, involving up to 30 days a year of supervisor time, multiple appraisals over the course of the year from multiple sources, and at least two formal feedback episodes.

Semiannual or annual performance reviews are designed to give employees a broader perspective of their accomplishments, and are thus more likely to concern long-term performance objectives and developmental targets. Finally, performance appraisals can be timed around the completion of work (e.g., a project). This allows for ad hoc examination of incidents related to specific work tasks, as well as elements contributing to success or failure of the project, at a time when employees' actions are still fresh in everyone's memory (London, 2003; Shields, 2007). Later in this chapter, we describe an example of such an after-event review.

**Forced or free distribution.** Another choice to be made in the context of a more subjective appraisal system is that between a forced versus free distribution of appraisal scores (e.g., Schleicher, Bull, & Green, 2009). Common to many subjective appraisal systems is the tendency of raters to score all rates somewhere around the mean in order to avoid the discomfort of being challenged by a ratee or creating competition among interdependent peers. Forced distribution systems eliminate this problem by requiring that raters distribute their scores along some predetermined distribution (e.g., no more than 10% of rates can receive a rating of "outstanding"). Free distribution systems have no such requirement. Although a forced distribution approach solves the problem of a bias to the mean, it automatically creates a relative

(as opposed to an absolute) appraisal system, with all of the problems described above.

**Narrow versus broad input.** Another way to deal with biases and increase the overall validity of the appraisal system is to broaden the range of actors having input into the appraisal. Traditionally, appraisals were performed by the individual assumed to have the greatest understanding of and access to indicators of actual employee performance, namely the employee's direct supervisor. However, several studies indicate that to the extent that supervisors reflect only one type of employee client, supervisor-based appraisals may not capture the full range of employee performance (Atwater, Brett, & Cherise-Charles, 2007; Murphy & Cleveland, 1995). Furthermore, given their ever-expanding span of control, supervisors may not always be available to observe and note critical performance incidents, be they positive or negative. Finally, by broadening the base of raters, the impact of personal bias on the part of any single rater can be diminished (Atwater, Waldman, & Brett, 2002; Lazear & Oyer, 2013; MacLeod, 2003; Murphy & Cleveland, 1995). Thus, an increasing number of organizations are turning to peers, subordinates, and customers as additional sources of appraisal data. Appraisal systems structured around such multisource frameworks are commonly referred to as 360-degree feedback systems. Such systems, particularly the peer-evaluation component, are most effective in tightly coupled organizations in which (a) the work process makes peers highly interdependent, and (b) the work is so complex and multidimensional that it is difficult for any single evaluator to accurately and comprehensively assess any member's performance.

The peer assessment system in place at MSI provides a good illustration of how such systems operate. At MSI, supervisors are not involved in the appraisal process, although they are responsible for providing feedback based on the peer assessment data (and may thus, informally, put their own "spin" on the results). Instead, peers—using a highly formalized appraisal instrument—are asked to assess (a) the degree to which their colleagues are cooperative and team oriented, and (b) the quality of their colleagues' contribution and performance.

However, the inclusion of multiple raters, as in the case of MSI, has its own problems—such as increasing the risk of coalition behavior (Ferris & Judge, 1991); poor coordination between raters pursuing different goals (Murphy, Cleveland, Skattebo, & Kinney, 2004); or tactical game playing (purposefully lowering a peer's rating so as to make oneself look better; Bamberger, 2007). Indeed, based on two field experiments examining the social consequences of peer-based assessment, Bamberger (2007) found that unless steps are taken to change peer raters' implicit payoff structures when rating one another, a natural tendency of downward biasing may emerge, with potentially devastating effects on team cohesion and cooperation. The findings of Bamberger and colleagues indicate that one way in which to change raters' payoff structures and minimize the risk of such "competitive appraisal" is to require peer raters to sign off on their assessments of their colleagues. By doing so, raters implicitly become more accountable for the ratings that they provide.

**Coarse versus fine distinctions.** Fine versus coarse distinctions in performance evaluation should also be considered. The former refers to a specific, often numerical grade (e.g., 95), whereas the latter involves broader, more roughly defined grading categories (e.g., "A" or "Above Expectations"). Fine grades are more straightforward and may be easier for ratees to understand (e.g., Ray, 2007; Zenger, 1992), but only if sound reasoning underlies different scores. Coarse grades are easier to disperse. Moreover, employees are often more comfortable revealing coarse scores rather than exact numerical scores. However, in that they position individuals in broad categories, coarse grades are less sensitive to different levels of performance within each category. Firms can therefore use fine grades within each category (A+, A, A–, B+, B, B–, and so on) to reflect more nuanced differences in performance level.

**Observable behaviors versus underlying attitudes.** Another decision relates to whether performance

measures should refer to observable behaviors as opposed to underlying assumptions (e.g., norms or mental models). In line with learning theory, as firms seek to improve, failing to question current assumptions and accumulate knowledge critical to later growth may result in outdated and irrelevant competencies, systems, and structures (Autio, Sapienza, & Almeida, 2000; Cohen & Levinthal, 1999; Dess et al., 2003). We allude here to the difference between surface- and deep-level learning, or what we defined earlier as single- and double-loop learning (e.g., Argyris & Schön, 1978; Snell & Man-Kuen Chak, 1998; Visser, 2007). As we described earlier, single-loop learning involves detecting and correcting errors and making simple adaptations within a given system of rules; it is the level of learning needed for incremental improvement. To the degree that a firm assesses performance in terms of observable behaviors only, employees are motivated to engage largely in single-loop learning to meet their performance objectives. In contrast, double-loop learning characterizes firms seeking to “identify patterns suggestive of more deep-seated problems requiring system-level changes” (Vashdi et al., 2007, p. 135). Such firms encourage employees to engage in a continuous process of examining and revisiting assumptions rather than taking them for granted, and the learning that takes place manifests itself as a transformation process targeted at reframing problems and developing new policies, objectives, and mental maps—that is, learning to see things in new ways.

To effectively stimulate double-loop learning, performance evaluation processes must take account of situational constraints—that is, circumstances at work that inhibit employees from using their abilities or expressing their motivation effectively (e.g., Wallace, Paulson, Lord, & Bond, 2005). Failing to identify such barriers to performance may undermine double-loop learning and may result in attention being paid to the symptoms of a problem rather than to its underlying cause. For example, Vashdi et al. (2007) described the response to communication problems encountered by a surgical team: Technicians had difficulty hearing the instructions given by surgeons, who in turn were not certain their instructions had been carried out. The solution reached was that “the surgeons would speak up and the technicians would vocally confirm performing procedures” (p. 135)—an example of single-loop learning. However, when the difficulty was brought up in cross-team meetings, it turned out not to be unique to a specific surgeon, but, rather, common across teams. Closer examination of the problem revealed that the physical layout of the operating rooms obstructed the line of sight between surgeons and technicians, preventing them from using eye contact and body language to augment their verbal communication. After the technicians and surgeons worked together to redesign the layout, the proportion of cases in which surgeons had to repeat their instructions fell dramatically. Thus, double-loop learning led the individuals involved to test long-held assumptions (the suitability of the existing layout), to identify the root of the problem (an obstructed line of sight), and to make changes that addressed the fundamental problem rather than its symptoms (Vashdi et al., 2007).

**Measurement format.** Finally, firms must decide whether to assess employees’ performance in terms of their (a) actions and behaviors, (b) traits and tendencies, or (c) outcomes and objectives, or some combination of the three. Behavior-based appraisal methods include behaviorally anchored rating scales, in which specific behaviors (e.g., “customer service”) are assessed along a rating scale that is linked to classic, level-specific examples (e.g., exceptional = “personally contacts customers after making the sale to make sure that they are completely satisfied”; unsatisfactory = “lets customers wait for service for no good reason”) (Newman et al., 2004). Another behavior-based method is the behavior observation scale, in which the rater judges the frequency with which certain behaviors are exhibited by the ratee (Newman et al., 2004). Alternatively, firms may focus their assessments on employee contributions, based on objectives agreed upon in advance by the employee and managers under a goal-setting rubric such as Management by Objectives (MBO; Drucker, 1954). Finally, firms may employ trait-based scales, in

which individuals are assessed on qualities such as loyalty, cooperation, and initiative (Daley, 2010). Notably, while several studies have suggested that the choice of appraisal format may influence rating accuracy (Priem & Hughes, 1987; Tziner & Kopelman, 2002), others have concluded that various appraisal formats are “virtually indistinguishable in their effect on rater errors” (Newman et al., 2004, p. 379).

## *Feedback Choices*

**Feedback directionality: Unidirectional versus interactive.** Unlike rational theories of communication, which generally see communication in organizations as a top-down process (with, for example, feedback messages transferred from managers to employees), modern theories of communication see communication as a multidirectional, nonlinear process of exchange. In this context, performance feedback may draw from communication theories such as “dialog sense-making” (e.g., Morgan, 1997), which highlight the process of creating shared understandings between all participants—including not only supervisors and employees, but also other stakeholders like peers and customers—who are active players in organization-based social networks.

Traditional feedback interventions were often unidirectional in nature, focusing on top-down communication intended to inform employees about how well they performed their job and to define future objectives. Such an approach to feedback delivery was largely passive from the point of view of the recipients (employees). However, in light of more holistic approaches to performance management, many organizations have adopted interactive and reflective feedback methods, including self-assessment and action planning, which encourage learners to reflect on their actions. Thus, feedback is no longer intended solely for error correction but is used as a multidirectional, dynamic communication tool (Ashford & Cummings, 1983; Rice & Cooper, 2010). Reflective feedback can be viewed as an open dialogue between employees and supervisors, which places strong emphasis on the employee’s own ability to recognize performance deficits and includes a discussion about how the employee plans to improve (Cantillon & Sargeant, 2008; Sargeant, Mann, van der Vleuten, & Metsmakers, 2009). Ultimately, this process should produce not a dictate from manager to employee, but “a shared view of what the agreed improvements will look like” (Cantillon & Sargeant, 2008, p. 1294).

Notably, more interactive feedback may encourage double-loop learning. That is, where feedback takes the form of conversational, reflexive process, employees may be encouraged to look more deeply at what fostered and what impeded their success, and to question the motives and assumptions underlying their behaviors. Vashdi et al. (2007) found that reflexive teams, compared to nonreflexive teams, were “prepared to challenge the appropriateness of team and organizational objectives and the assumptions that underlie them” (p. 118) and were thus more likely to engage in double-loop learning.

**Feedback valence: Positive versus negative.** Performance feedback involves a comparison of one’s performance to a goal or a standard, with the results of this comparison most easily denoted by a positive (overperformance) or negative (underperformance) feedback sign (Kluger & DeNisi, 1996). As discussed earlier, the literature is equivocal with regard to the effect of feedback sign on postfeedback motivation and performance (Belschak & Den Hartog, 2009; Lam, Yik, & Schaubroeck, 2002), with some scholars suggesting that individual and contextual factors are likely to interact with the feedback sign to affect postfeedback outcomes (Van Dijk & Kluger, 2004). Accordingly, in designing performance feedback processes, it is important to understand the advantages and disadvantages of conveying negative versus positive feedback.

Negative feedback may trigger such emotions as shame and guilt. It may also lead to elevated cognitive

anxiety and decrease self-efficacy judgments, which may influence individual tendencies such as risk taking and risk avoidance. As such, negative feedback may discourage employees and keep them from improving, defeating the purpose of the feedback. Finally, negative feedback may lead to confrontations and repercussions (with the upshot being that supervisors clump their ratings at higher scores). On the other hand, negative feedback may initiate constructive discussion around the differences between actual and desired performance, providing instrumental guidance for change. Accordingly, individuals receiving negative feedback—particularly those characterized as prevention oriented in Higgins’s (1998) typology—may exert more effort to change future feedback (Belschak & Den Hartog, 2009; Kernan & Lord, 1991; Kluger & DeNisi, 1996; Pekrun, 2000; Podsakoff & Farh, 1989; Van Dijk & Kluger, 2004).

In contrast, positive feedback communicates managerial satisfaction. Such recognition of good performance may boost the morale of employees and lead to positive emotions such as happiness, security, and pride, as well as a sense of accomplishment. Moreover, positive feedback not only reinforces effective behavior, it also signals confidence in employees’ abilities and fosters high expectations of success, thereby potentially encouraging employees to increase their efforts. Indeed, by acknowledging contributions made, positive feedback may pave the way for productive discussions about future tasks and improvement areas. At the same time, individuals receiving positive feedback—particularly those characterized as promotion oriented (Higgins, 1998)—may “rest on their laurels,” engaging in lower effort and exhibiting less risk-taking behavior (Belschak & Den Hartog, 2009; Kluger & DeNisi, 1996; Phillips, Hollenbeck, & Ilgen, 1996; Van Dijk & Kluger, 2004).

## **ALTERNATIVE APPROACHES TO PERFORMANCE MANAGEMENT**

An organizational performance management system designed to take into account the contingencies noted above will likely have a positive effect on employee performance. However, as suggested by the results of Kluger and DeNisi’s (1996) meta-analysis, even in organizations with valid appraisal mechanisms, the impact of performance feedback on subsequent performance is mixed. Moreover, from a learning perspective, there is good reason to question the efficacy of conventional performance management systems. First, with performance management tightly linked to the distribution of annual bonuses in most organizations, employee performance is typically reviewed only once each year. Accordingly, in most organizations, formal performance management does little to facilitate the identification and correction of problematic behavioral repertoires. Similarly, as managers are rarely appraised on the quality of their own performance management skills, formal performance management processes are often viewed as a “necessary evil,” and one that managers attempt to complete as quickly as possible so as not to interfere with “more important tasks.” Accordingly, in most organizations, formal performance management rarely involves the questioning of assumptions needed for double-loop learning.

Recognizing such limitations, organizations are increasingly looking to complement more standard performance management mechanisms with a number of alternative approaches. *Real Time Performance Monitoring* (RTPM) is one such alternative, providing firms with data to complement and support traditional annual or biannual performance measurement processes. RTPM systems involve ongoing, electronic tracking of employee performance (Adler, 2001). Such systems are often adopted to increase productivity and work quality (e.g., Friedman & Reed, 2007), though other justifications include improved security and ensuring conformance to health and safety regulations (Miller & Wells, 2007). To the degree that performance monitoring provides firms with accurate data regarding the amount and



quality of work an employee is processing, and also makes goals and feedback available to employees so they can adapt their behaviors to manage their performance in real time, performance appraisal and feedback systems are likely to improve (e.g., Ludwig & Goomas, 2009). At the same time, opponents of RTPM claim that it invades employee privacy, increases stress and exhaustion, and decreases job satisfaction and employee trust (Greengard, 1996; Wilk & Moynihan, 2005). To avoid such shortcomings and maximize the beneficial outcomes of RTPM systems, firms need to carefully consider such issues as which behaviors to monitor and in which employee populations. For example, research has found that individuals who were monitored on difficult tasks (in comparison to those monitored on simple tasks) did not work any faster or more accurately than people who were not monitored (Davidson & Henderson, 2000; Kolb & Aiello, 1997).

Another alternative to conventional performance management is the *After-Event Review* (AER; also termed after-action review, post-event review, or incident review), a learning-from-experience procedure that gives individuals, teams, or larger organizational units an opportunity “to systematically analyze their decisions and behaviors and to evaluate their contribution to performance outcomes” (Ellis, Ganzach, Castle, & Sekely, 2010, p. 122). AERs involve three functions (Ellis & Davidi, 2005). The first, *self-explanation*, is a process whereby individuals analyze their own behavior and propose explanations for their resulting success or failure. The second, *data verification*, is a process whereby individuals are confronted with different perceptions of the same data, and are encouraged to consider these perceptions prior to changing or correcting their mental models. Finally, *feedback* is provided both before the AER session begins (by indicating to individuals their relative success or failure in task performance) and during the AER session (by encouraging individuals to gather and analyze data that will ultimately improve their performance). AERs among individual employees have been linked to such outcomes as skill acquisition and improved performance (Ellis et al., 2010; Ron, Lipshitz, & Popper, 2006). Similarly, AERs in teams (i.e., team briefings and debriefings) were found to foster team building, learning, and performance (e.g., Smith-Jentsch, Cannon-Bowers, Tannenbaum, & Salas, 2008; Vashdi, Bamberger, & Erez, 2013).

Finally, *mentoring* may also be viewed as an alternative performance management tool involving highly intensive and continuous assessment and feedback. Most definitions of mentoring suggest that it is a process whereby an experienced person (the mentor—a supervisor, someone else within the organization, or an individual in another organization; Eby, 1997) guides another, usually younger individual (the mentee) in promoting the mentee’s performance as well as professional development (e.g., Allen, Eby, & Lentz, E, 2006; Meinel et al., 2011). Mentoring is a dynamic process, during which the mentor and mentee may define and redefine their roles and objectives in the relationship. Accordingly, mentoring can take different forms. For example, as suggested by Garmel (2004), “it can be structured or loose ... [a] relatively short process or an ongoing one. There can be breaks in the relationship, with its reestablishment at some future time” (p. 1352). Studies have found mentoring to significantly contribute to employee well-being and performance outcomes, including satisfaction, productivity, and skill acquisition, particularly among professional and highly skilled employees (Eby, Allen, Evans, Ng, & DuBois, 2008; Ramanan, Phillips, Davis, Silen, & Reede, 2002; Sambunjak, Straus, & Marusic, 2006). Nevertheless, problems may undermine the success of mentoring programs, such as conflicts between the mentoring and supervisory roles or breaches of confidentiality. With such problems in mind, Taherian and Shekarchian (2008) suggested that “mentors should ideally not be the mentee’s educational supervisor or line manager at work or otherwise be involved in any way in the mentee’s assessment or appraisal to avoid blurring of these distinct roles” (p. e96).

# LINKING PERFORMANCE MANAGEMENT TO HR STRATEGY

In this section, we review the “ideal” performance management strategies suggested by various researchers for each type of generic business strategy and then discuss the types of internally consistent performance management choices offering the highest degree of fit with firms’ dominant HR strategy. It is important to note that in this section, we will again be dealing with “ideal types”—that is, strategic profiles that most likely exist more in theory (or, one might say, in the minds of researchers) than in reality and that are used primarily as points of reference than as examples of how to “best” structure performance management systems. Clearly, most organizations are likely to fall somewhere in the gray area between different strategic profiles. As noted in [Chapter 3](#), one reason this is so is that, although there is likely to be one dominant performance management subsystem architecture or framework covering the majority of the business unit’s nonexecutive employees, different performance management practices may be in effect for particular employee groups at particular points in time and/or employed in different countries (Gimbert, Bisbe, & Mendoza, 2010; Pun & White, 2005; Verweire & van den Berghe, 2004).

## *The Link between Performance Management Strategy and Firm Business Strategy*

A relatively large number of HR scholars (Hoque, 2004; Kennerley & Neely, 2002; Pun & White, 2005) have emphasized the need for companies to customize their performance management systems to support the focus of the firm’s business strategy. For the most part, these studies have adopted Miles and Snow’s (1978, 1984) defender-prospecter typology of business strategy and have attempted to identify the performance management practices most appropriate for each type of strategy. Such research has suggested that prospector firms are likely to conduct less frequent performance appraisals and to emphasize qualitative rather than quantitative measures of performance, which allows management to focus attention on the firm’s critical success factors and competitive bases (e.g., service, innovation, or customization). In contrast, appraisal practices in defender firms seem to be characterized by frequent performance appraisals and more quantitative performance measures, with an emphasis on short-term, cost-reduction goals.

Similarly, prospector firms—which are often characterized by an entrepreneurial orientation and a focus on sustained team effort (Wiklund & Shepherd, 2003)—tend to adopt differentiation strategies involving more radical market/product conceptualization and/or innovation that is more paradigm shifting in nature (Wang, 2003). This suggests that prospector firms, rather than focusing on traditional performance appraisal and feedback, are more likely to encourage team-based learning processes of a higher order, such as those emphasizing double-loop learning. In contrast, defender firms often seek to protect their product market and prosper through stability, reliability, and efficiency. In such firms, one can expect to find more individual-level, simple (i.e., single-loop) learning processes such as those elicited on the basis of more traditional performance appraisal and feedback processes (Wang, 2003).

## *Performance Management Subsystem Strategy and HR Strategy*

Consistent with the literature reviewed above, which proposed that the cluster of performance management practices is likely to vary according to the firm’s overall business strategy, we offer four unique performance management subsystem profiles, one for each of the four ideal types of HR strategy discussed in [Chapter 3](#). This framework, depicted in [Table 5.1](#), applies the choice domains discussed above to these four dominant HR strategies, namely the commitment, free-agent, paternalistic, and

secondary strategies.

As can be seen in [Table 5.1](#), the commitment strategy takes a long-term perspective that focuses on continuous improvement and development and assumes that potential, future-oriented returns are likely to outweigh current investments and errors. Under this strategy, the performance management system will be seen as a means to enhance organizational agility, develop a cooperative and creative culture, and discourage employee attrition. Organizations adopting the commitment strategy, as we noted in [Chapter 3](#), rely on their employees to have the skills and flexibility needed to manage the uncertainties inherent in a complex and ambiguous transformation process, and view such employees, as well as the complex social networks within which they are embedded, as difficult to replace. To this end, such organizations tend to adopt performance appraisal systems that develop a more normative or affective (as opposed to calculative) alignment of interests, and encourage skill/competency development, flexibility, and a team orientation. Furthermore, in order to reinforce a sense of community, cooperation, and lateral accountability, performance appraisals in such firms are likely to take account of team-based rather than individual effort (with both group processes and outcomes evaluated), and are often based on input provided by a variety of internal and external “clients,” often in the form of 360-degree feedback. Learning in such firms tends to be of a higher-order type, involving reflective inquiry and synthesis rather than knowledge reproduction, and is conducted in teams, with AERs a potentially useful mechanism in this regard.

**Table 5.1** Performance Management Practices Associated with the Four Generic HR Strategies

| Choice Category     | Choice   | High Commitment                 | Free Agent                                | Paternalistic       | Secondary                       |
|---------------------|--|---------------------------------|---|---------------------|---------------------------------|
| Basic               | Focus on individual versus team performance                    | Team                            | Individual, team                          | Individual, team    | Individual                      |
| Measurement         | Objective versus judgmental                                    | Judgmental                      | Mixed                                     | Objective           | Mixed                           |
|                     | Absolute versus relative                                       | Mixed, tendency toward absolute | Relative                                  | Absolute            | Mixed, tendency toward relative |
|                     | Forced versus free distribution                                | Free                            | Forced                                    | Not relevant        | Free                            |
|                     | Narrow versus broad input                                      | Broad                           | Mixed                                     | Narrow              | Narrow                          |
|                     | Emphasis on observable behaviors versus underlying assumptions | Underlying assumption           | Both, tendency toward observable behavior | Observable behavior | Observable behavior             |
| Feedback            | Unidirectional versus interactive                              | Interactive                     | Mixed, tendency toward unidirectional     | Unidirectional      | Unidirectional                  |
| Alternative Methods |  | After event reviews             | After event reviews                       |                     |                                 |

At the opposite extreme, as noted in [Chapter 3](#), the secondary HR strategy is adopted by firms using a

“technological fix” to handle the uncertainty inherent in the production process. Given the highly routinized nature of the work process and the temporary nature of the employment relationship in such firms, they may have little need for or interest in employee performance management. The highly routinized nature of the work process implicitly manages employee performance in that employees, by the very nature of their job, have little discretion and few opportunities to deviate from the performance standard. To the degree that performance management is conducted in such organizations, it is likely to be oriented toward short-term error identification and correction (e.g., discouraging risk taking). Unlike learning in commitment employment systems, which is an explicit requirement and often becomes a way of life for many employees, simple, mostly technical or functional learning predominates in secondary employment systems (e.g., Rowold & Schilling, 2006). While such jobs leave little room for meaningful collaborative work and team-based performance evaluation, depending on the nature of the work, both objective and subjective evaluation criteria may be considered.

Performance management practices in firms adopting a free-agent HR strategy are also governed by an emphasis on the external labor market and a decentralized administrative framework (in order to take advantage of local or sector-specific opportunities presented by that labor market). Thus, while they are similar to firms adopting a commitment HR strategy in that they tend to place a heavy emphasis on flexibility and agility, free-agent firms seek to acquire (rather than develop in-house) candidates possessing a profile of skills and competencies applicable to a variety of relatively loosely defined “jobs.” Accordingly, this strategy balances short- and long-term performance objectives. Performance measurement systems for the largest proportion of employees in such organizations are grounded in both cost and quality measures and emphasize both individual and team-based effort. Furthermore, given the highly nonprogrammed and variable nature of jobs in organizations adopting such strategies, their appraisal practices—as in firms with commitment HR strategies—tend to be based on subjective input from a variety of sources. However, since the situational constraints relevant to such temporary positions may be less well understood, assessments may need to be based more on relative (as opposed to absolute) performance. Finally, given the assumption of employment-at-will and temporary employment relationships, feedback in free-agent firms—as in the case of firms adopting a secondary strategy—is oriented mainly toward error correction, with little emphasis placed on providing insights that might facilitate skill development. AERs may be particularly useful for those employed under such conditions, as they allow for more immediate feedback and may be useful in helping members of short-term action teams learn how to more effectively work with each other (Vashdi et al., 2013).

Finally, as noted in [Chapter 3](#), organizations adopting a paternalistic HR strategy seek to achieve organizational predictability and stability by means of preprogrammed work processes and the development of a status-driven “clan” culture. The preprogrammed nature of the work process in these firms means that much of the variance in employee contribution is a function of the job. Accordingly, as with the secondary strategy, there is little variance in employee performance to manage. However, performance management plays an important role in reinforcing norms of loyalty and compliance. Both because of the nature of the work process and the heavy focus on building a sense of clan membership, performance assessment in such organizations is typically based on absolute (as opposed to relative) and objective (as opposed to subjective) criteria. Multisource appraisals may be used to reinforce social norms and to build a stronger sense of the individual’s attachment to and dependence on the collective. Finally, as a paternalistic HR strategy is grounded in the acquiescence of control by labor to management, feedback processes tend to involve single-loop learning, with employees rarely encouraged to question assumptions.

It is important to reiterate that while the typology described above assumes that the configuration of

performance management practices is likely to be more heterogeneous across organizations than within them, hybrid profiles of performance management practices are not only possible; they are quite likely. Specifically, different performance management practices (each consistent with an alternative HR strategy) may be adopted for different employee groups within a single firm. For example, some firms may adopt measurement and learning practices consistent with the commitment or free-agent strategy for their professional workforce, but adopt practices more consistent with the secondary HR strategy for their unskilled production workforce. Firms adopting such an approach to performance management essentially create and maintain a dual employment system, with employees in the first tier rewarded and appraised one way, and those in the second tier rewarded in another way. Thus, while the framework presented above still describes only ideal types of performance management subsystems and is still somewhat based on a holistic assumption that a single set of practices is dominant across the bulk of employees in a firm, it does recognize the potential for significant intrafirm variation.

## **SUMMARY**

In this chapter, we examined how the profile of various performance management practices may be used to identify, measure, and develop employee performance and align it with the strategic goals of the firm. After discussing how learning theory can inform performance management in organizations, we examined the key characteristics of effective performance measurement processes. We then explored the strategic choices faced by executives responsible for designing and administering an organization's performance management subsystem. We also reviewed several alternative performance management practices. In line with prior research, we concluded the chapter with a discussion on how the link between performance management practices and firm performance may be contingent on the degree to which the practices are consistent with the firm's broader HR strategy, as well as the alignment between the configuration of performance management practices in use and the firm's strategic business model.

# 6

## THE COMPENSATION SUBSYSTEM

Although compensation costs comprise, on average, 65% to 70% of total costs in the US economy ... and are likewise substantial elsewhere ..., most managers are not sure of the likely consequences of spending either more, or less, on employees, or of paying employees in different ways.

—Gerhart and Rynes (2003, p. 1)

Compensation (also called pay or remuneration) can be defined to include “all forms of financial returns and tangible services and benefits employees receive as part of an employment relationship” (Milkovich & Newman, 2008, p. 9). Accordingly, the compensation subsystem focuses on how such returns may be used to enhance the human capital available to the firm and to encourage desired employee attitudes and behaviors. Interestingly, both managers and employees often downplay the importance of pay in motivating employees. Indeed, Rynes, Gerhart, and Minette (2004) reported that when people are asked directly about the importance of pay, “they tend to give answers that place it somewhere around fifth ... in lists of potential motivators.” Yet in meta-analytic studies of actual behaviors in response to motivational initiatives, pay nearly always emerges as “the most effective motivator” (Rynes et al., 2004, p. 382).

Numerous researchers have applied different theories to explain the link between organizational compensation practices and performance and the way in which a wide variety of contingency factors can moderate such a relationship. In this chapter, we first review several of these theories. We then examine the strategic considerations that managers should consider when designing a compensation subsystem. In this discussion, we will highlight the results of empirical research focusing on the link between specific compensation practices and firm performance and the possible contingencies governing such potential links. Taking these contingencies into consideration, several researchers have proposed that distinct compensation practices tend to cluster together into internally consistent compensation strategies. In the final part of the chapter, we review several of these proposed compensation strategies and discuss the extent to which such compensation strategies might emerge in one or more of the dominant HR strategies identified in [Chapter 3](#).

## FRAMEWORKS FOR UNDERSTANDING THE COMPENSATION-PERFORMANCE LINK

Underlying the compensation subsystem in many organizations is likely to be a set of assumptions about how rewards may be used to motivate employee participation, contributions, development, and retention. These assumptions regarding the ways in which pay and recognition may be used to shape employee attitudes and behaviors are themselves grounded in a handful of seminal psychological and economic theories. Two such theories, expectancy theory (Vroom, 1964) and equity theory (Adams, 1963), provide the foundation for contemporary compensation strategy. In addition, reward strategies draw from the assumptions embedded in two other theories, namely human capital theory (Becker, 1975) and agency theory (Eisenhardt, 1989; Fama & Jensen, 1983).



## *Expectancy and Equity Theories*

Building on reinforcement theory, or the notion that a response is more likely to occur when it is followed by a reward, Vroom (1964) argued that it is not so much prior reward experiences per se that shape motivation, but rather the degree to which the individual perceives the existence of an instrumental link between behaviors and rewards. That is, the more an individual perceives his or her personal effort to account for only a small proportion of the variability in output, the less effective an output-contingent reward is likely to be in motivating such effort. Furthermore, such expectancies are only likely to motivate if the expected value of the outcome or reward is personally meaningful (the valence factor in Vroom's theory). As we will discuss in more detail below, the contingencies implicit in expectancy theory provide the basis for determining when and how to adopt what is widely referred to as a "variable pay strategy," or one based on the notion of pay for performance.

However, expectancy perceptions are unlikely to be the only factor determining the degree to which rewards may be able to channel and encourage desired employee attitudes and behaviors. According to equity theory (Adams, 1963), norms of fairness governing the exchange relationships between individuals and their employing organization are also likely to shape employee behavior. For example, if employees feel that their input/output (reward/contribution) ratio is less than that of a similar set of employees in the same or another firm, they might adopt any one of a variety of actions (e.g., reduce effort, quit, strike) aimed at restoring equity or a sense of balance in these comparative ratios. The matter becomes more complex when we take into account that employees may select from among three different types of reference groups when making such comparisons: (a) other employees in different positions in the same organization (what is referred to as "internal equity"); (b) other employees in similar positions in other organizations competing in the same labor market (what is referred to as "external equity"); and (c) other employees in similar positions in the same organization (what is referred to as "employee equity"). From the employer perspective, it may be next to impossible to ensure equity at all three levels. For example, to ensure external equity (and thus avoid turnover among highly valued employees who might perceive enhanced reward/contribution ratios outside the firm), it may be necessary to "break" existing pay structures and thus violate internal equity norms. But when should one form of equity take precedence over another? Indeed, as we will see below, many of the choices and contingencies that need to be addressed in designing compensation strategies can be framed within these three different forms of equity.

## *Human Capital Theory*

The two theories reviewed to this point focus primarily on the impact of pay on motivation or effort. However, performance is not simply a function of effort. It is also a function of the knowledge, skills, and abilities (KSAs) that individuals can bring to bear when motivated to do so. Indeed, this is a core assumption of the resource-based perspective (Barney, 1991). In line with these arguments, human capital theory (Becker, 1975; Gerhart, 1990) assumes that higher earnings go to those who, by investing in themselves through education and experience, improve their KSAs and thus enhance their productive capacity. Since there are costs for doing so (i.e., time, tuition, opportunity costs), the more an organization is willing to reward individuals for overcoming such barriers, the more likely is that organization to be successful in attracting and retaining individuals with these desired attributes. The theory therefore suggests two ways to enhance an organization's human capital base: (a) by widening the differentials between entry-level positions and KSA-rich executive positions in the firm's pay structure, and (b) by increasing the degree to which pay increases are contingent on human capital enhancement (i.e.,

knowledge- or skill-based pay). Firm competitiveness and performance is likely to be enhanced to the extent that the organization expands and creates synergies on the basis of its in-house human capital base (Schuler & Jackson, 2005; Wright, Dunford, & Snell, 2001), and to the extent that it can leverage these KSAs to increase operational flexibility (e.g., Gardner, 2002; Murray & Gerhart, 1998).

## *Agency Theory*

Perhaps one of the most influential theories affecting organizational compensation subsystem strategies in recent years is agency theory (Eisenhardt, 1989; Fama & Jensen, 1983). Underlying this theory is the assumption that organizational reward systems can be used as an efficient means to promote convergence in the interests of employers (principles) and employees (agents), which otherwise diverge. According to agency theory, employees are averse to effort and (all else equal) will exert only sufficient effort to ensure continued employment. When the employer compensates the employee at the same rate regardless of the latter's effort level, all the risk of employment is transferred to the employer, who (like the employee) is risk averse. To reduce that risk (known as the agency problem) and ensure that employees exert the desired amount of effort to justify the agreed-upon amount of pay, the employer must be able to monitor employee effort. However, monitoring is not always cost-effective, no less possible, particularly when work processes are complex and the means-ends links upon which they are based are poorly understood and difficult to preprogram (as in such fields as teaching and medicine). In these situations, it may be to the principal's advantage to share some of the risk with agents by making a portion of the latter's reward contingent on the achievement of some outcome desired by the principal (e.g., profit or market share). Indeed, risk sharing may serve as an important signaling and screening mechanism, helping firms seeking to attract and retain "highly charged risk takers" (e.g., Baron & Kreps, 1999; Cadsby, Song, & Tapon, 2007).

However, such a risk-sharing solution is also not necessarily cost free, since risk-averse agents may demand higher pay to make up for the risk that due to contingencies beyond their control, increased effort may not necessarily yield the outcome upon which their reward (or some portion of it) depends (e.g., Cadsby et al., 2007). One way around this problem is to make rewards contingent upon *relative* (as opposed to absolute) performance, since the performance of one's peers is also likely to be affected by such contingencies. However, doing so introduces a kind of competitive or tournament dynamic, which may be deleterious to an organization whose overall success is contingent upon teamwork and interdepartmental cooperation (e.g., Gerhart, Rynes, & Fulmer, 2009). The adoption of a group-based agency framework (i.e., team- or departmental-based pay systems) may solve some of the problems associated with a tournament dynamic (Bamberger & Levi, 2009), but are likely to create a host of new concerns related to the problem of free riding (Guthrie, 2000; Hackman, & Wageman, 2005). Specifically, under such a framework, since all team members benefit when a team-level outcome is achieved, individual team members have a natural incentive to let their peers do all the work. Although game theory suggests a number of factors that may ameliorate the free-rider problem inherent in group-based agency frameworks (e.g., small group size, group permanence; Axelrod, 1984; Dawes, 1980), it may not always be possible to artificially impose these conditions on work groups for purposes of enhancing the effectiveness of the reward system. Not surprisingly, as Hollenbeck, DeRue, and Guzzo (2004) put it, "The degree to which teams should operate and be rewarded for behaving as cooperative or competitive systems is at the heart of the debate on reward structures for teams" (p. 362).

Agency-based contracts may be further complicated when employees are asked to delicately balance a number of less than complementary objectives. Principals may find that making rewards contingent upon

the achievement of outcome “x” (say, output) leads to the sacrifice of organizational outcome “y” (say, quality). Thus, many organizations seek to balance incentives across a number of critical outcomes by building into their incentive scheme a number of reward contingencies (e.g., meeting both short-term and long-term objectives). However, the more complex the agency contract becomes, the more blurred the instrumentalities and the weaker the incentive effect (e.g., Gerhart et al., 2009).

Thus, despite the fact that many organizations use variable reward strategies grounded in the principles of agency theory, such systems of performance-based pay may not necessarily be the panacea they are often believed to be (Larkin, Pierce, & Gino, 2012). In the next section, we will address some of the contingencies identified by strategy researchers that are likely to moderate the link between agency-type pay strategies and firm performance.

## **CONTINGENCIES AND CHOICES IN THE DESIGN OF COMPENSATION STRATEGIES**

Several research teams (Flannery, Hofrichter, & Platten, 1996; Gerhart & Rynes, 2003; Gómez-Mejía & Balkin, 1992; Milkovich & Newman, 2008) have sought to identify the parameters by which compensation systems vary, as well as the factors likely to explain why different reward alternatives may be beneficial for some objectives, but detrimental to others. In this section, we group these parameters into four different categories of tradeoffs and conundrums that managers typically need to consider when designing a strategic compensation subsystem: basic choices, internal equity choices, external equity choices, and employee equity choices.

### *Basic Choices*

Milkovich and Newman (2008) identified a number of basic policy decisions that underlie all compensation subsystems and that shape subsequent system-related decisions. Among the most critical of these basic choices is whether to emphasize internal or external equity. As suggested above, it may be difficult (at best) for an employer to develop a pay strategy that places equal emphasis on the three forms of pay equity (internal, external, and employee equity) and still meets efficiency objectives (i.e., does not raise labor costs to the point that the firm can no longer compete effectively). Indeed, the choice often comes down to whether the firm should place an emphasis on ensuring consistency in its own pay structure (internal equity or internal alignment) versus meeting market prices for labor (external equity or competitiveness).

Firms focusing on the latter have market-driven pay systems, which are strongly based on what competitors pay. Such systems can create a situation referred to as “pay compression,” in which the differential between low- and high-level positions is narrowed as a result of the need to meet inflated market-level prices for highly in-demand entry-level staff. Such a situation is not uncommon among high-technology firms constantly in search of fresh talent offering skills attuned to constantly changing business demands (Cascio, 1990; Colvin, Batt, & Katz, 2001). In firms focusing on internal equity, in contrast, a job’s worth to the firm is based mainly on its content and less on market supply and demand curves (Wang & Holton, 2005). An emphasis on internal equity creates a wedge between the wage within the firm and the wage outside the firm, thus allowing the firm to extract economic value (rents) from workers inside (Dulebohn & Werling, 2007). This is most often found among firms that are highly dependent upon retaining firm-specific knowledge and experience and that have less need for labor flexibility.

Put in other terms, firms relying on internal labor markets (ILMs) are more likely to carefully guard internal consistency in their pay structure. For example, at the defense contractor, MSI, a strong emphasis is placed on formal job evaluations to establish consistent organizational pay differentials and a job structure where jobs are ranked according to their worth given the company's business model. MSI's tall and rigid hierarchy allows it to ensure that jobs are more precisely placed in their appropriate grade along the pay structure. To provide room for continuous pay growth over time, MSI's pay structure incorporates far more grades or levels than might be found in other, less paternalistic high-technology companies.

Firms relying on external labor markets (ELMs) are more likely to emphasize the need to stay in line with ELM rates. For example, at RLA Textiles, the vice president for human resources dedicates a substantial portion of his time to collecting data on labor supply and comparative hourly wage rates for different types of workers in different geographic locations. The objective here is to ensure that RLA never pays more than its competitors, but also never offers too little to attract needed labor in real time.

In addition to such a labor market contingency, organizational structure is also likely to play a role in determining the relative emphasis placed on internal as opposed to external equity. For example, studies have found the degree of unit inter-dependency to affect the relative emphasis placed on these two alternative forms of equity. Specifically, firms with more autonomous units were more likely to emphasize external equity, whereas firms characterized by high unit interdependency were more likely to focus on internal equity (Gómez-Mejía & Welbourne, 1990; Howard, Turban, & Hurley, 2002; Nickerson & Zenger, 2008).

A number of additional basic choices need to be made in designing reward subsystems. First, the organizational reward subsystem in most cases implicitly either encourages or discourages risk taking by employees (e.g., Balkin, Markman, & Gómez-Mejía, 2000; Hayton, 2005). Certain organizations have a need for stability and predictability. Perceiving the cost of multiple missed opportunities to be far less than that of one "disaster," such organizations are likely to use their compensation system both to signal to current employees a preference for risk aversion, and to screen out risk takers from among job candidates. "Earnings-at-risk" incentive plans in place in some customer service centers are but one example of such an approach (Renn, van Scotter, & Barksdale, 2001).

Second, and related to the risk aversion issue, is the question of "pay mix"—that is, the proportion of monetary compensation that is paid on a variable (as opposed to a fixed) basis. While pay may vary based on different criteria (e.g., seniority, job grade), the level of employee contribution or performance is the criterion drawing most attention. As we discussed in our review of agency theory, employers have a natural interest in sharing some of the risk inherent in compensation with their employees. The more they manage to do so, the more variable the compensation system, and the more contingent employee pay is likely to be on some outcome or set of outcomes. Research has tied this issue to firm life cycle and cash flow, arguing that younger, more cash-hungry firms are likely to place greater reliance on variable pay as a means to enhance resource flexibility (e.g., Balkin & Gómez-Mejía, 1984; 1987; Cardon & Stevens, 2004). However, it is likely that the degree to which firms increase pay variability is even more contingent upon their ability to address those problems that we associated with agency-based contracts (e.g., blurred instrumentalities, tournament dynamics). Thus, as a number of authors suggest (e.g., Baron & Kreps, 1999; Guthrie, 2000; Kuvaas, 2006), greater reliance upon fixed pay is more likely in those situations in which:

- the production technology is complex (with unclear means-ends links) and tasks are ambiguous;
- the culture emphasizes cooperation;

- the firm's competitive advantage rides on hard-to-measure quality or innovation; and
- large and highly fluid work groups increase the risk of free riding.

A third basic choice has to do with the degree of emphasis placed on monetary rewards, such as tangible cash or benefit payments, as opposed to nonmonetary rewards such as recognition, career development, and job security. Research suggests that economic returns alone are not sufficient to extract the unique value-adding assets controlled by employees (Herzberg, 2003; Simon, 1991; 1993), or to retain them (Bloom & Milkovich, 1997; Hay, 2002; Mengel, 2001). Simply put, economic returns structure a transactional relationship that must be easily expressed in pecuniary terms, and which therefore can always be copied or purchased away by a competitor. However, it may be much simpler for growing and dynamic firms to provide nonmonetary rewards such as challenge, career development, and participation than it is for mature firms using routine technologies and operating in stable contexts. The latter often need to make a concerted effort to provide such rewards by, for example, redesigning production processes and making greater use of ILMs. Such efforts can be costly, and a return on the investment can rarely be expected in the short term (Balkin & Swift, 2006; Baron & Kreps, 1999; Hambrick & Snow, 1989).

Finally, in designing their compensation subsystem, firms must make a number of decisions regarding how the system is to be administered and managed (Gerhart & Rynes, 2003; Gómez-Mejía & Balkin, 1992; Milkovich & Newman, 2008). For example, to what degree are pay decisions to be tightly controlled by some central authority as opposed to diffused to organizational subunits? Second, how flexible and responsive will the pay system be to the emergence of unpredictable and unique situations (e.g., the need to “break” a pay structure to recruit an engineer with “one-of-a-kind” skills and experience)? A firm's overall HR strategy is likely to determine both of these issues. For example, firms placing greater emphasis on the ELM are likely to decentralize specific compensation decisions to allow a closer tie to external market demands and are also more likely to adopt a flexible approach to the type of unique, market-driven situation described above.

In managing compensation, firms also need to determine their level of system transparency. In more transparent or open pay systems, employees have greater access to pay-related information, including—in the most open systems—information on how much other employees are paid (Colella, Paetzold, Zardkoohi, & Wesson, 2007). In contrast, pay secrecy is characterized by restrictions on the information employees have access to about others' pay levels (Colella et al., 2007). The importance of information in enabling fairness judgments and assessments of effort-reward instrumentalities makes the issue of communication central to pay system administration (Bamberger & Belogolovsky, 2010; Collela et al., 2007; Hartmann & Slapničar, 2012).

There is much controversy on whether pay transparency is preferable to pay secrecy (Bamberger & Belogolovsky, 2010; Colella et al., 2007). On the one hand, pay transparency may be associated with negative employee attitudes and behaviors. For example, under open pay systems with variable pay mechanisms, a logic that gives extra money to high performers without increasing the size of the pot—thereby reducing payouts to everybody else—may give rise to jealousy and injustice perceptions (e.g., Burroughs, 1982). Furthermore, research suggests that under open pay conditions, managers tend to centralize their performance ratings, that is, shift their ratings toward equality (Leventhal, Karuza, & Fry, 1980; Major & Adams, 1983), and thus to inefficiently reward performance.

On the other hand, research has shown that pay transparency may benefit employees and their employers in a variety of ways. One of these may be a positive sorting effect, manifested by a tendency of top performers to stay and poor performers to leave. For example, a recent study by Shaw and Gupta

(2007) found that under high pay system communication (i.e., an open pay system), pay dispersion was negatively related to good performer quits, particularly when performance-based pay increases were emphasized. No such relationship was observed under low-pay system communication (a secret pay system). Similarly, Card, Mas, Moretti, and Saez (2012) found that among lower- (but not higher-) paid employees, job search behaviors were more prevalent under conditions of open (as opposed to secret) pay.

A second positive consequence of transparency is that it may reduce the risk of pay discrimination (Gely & Bierman, 2003). In fact, it is with the potentially discriminatory effects of pay secrecy in mind that the UK has passed legislation making it illegal for companies to forbid their employees to talk to one another about their pay, and permitting employees who suspect pay discrimination to request detailed pay information from their supervisors.

Third, according to Balkin and Gómez-Mejía (1990), transparent pay systems may bolster the norms and values at the core of organizational cultures emphasizing involvement, commitment, trust, cooperation, and fairness. For example, the New York data-analytics company SumAll makes pay scales and individual salaries open to all of its employees (Weber & Silverman, 2013). In a *Wall Street Journal* story about this company's approach, one of its employees noted, "It's not like you come in and [pay] is posted on your forehead, but having the figures in the open alleviates co-workers' curiosity and anxiety.... When it's a secret you want to know it more" (Silverman, 2013). Then again, there are plenty of firms characterized by precisely such cultural traits that nevertheless attempt to ensure pay secrecy. Moreover, in organizations lacking such cultural traits, scholars acknowledge that open pay can generate jealousies and exacerbate interpersonal conflicts, potentially "adding fuel to an already volatile situation" (Gómez-Mejía & Balkin, 1992, p. 55).

Finally, research suggests that in boosting individual task performance, pay transparency may be preferable to pay secrecy. Bamberger and Belogolovsky (2010) ran an experiment in which students were compensated on the basis of their performance in a game-type task. Some of the students (those in the transparency condition) were provided with general pay information and were allowed to discuss pay-related issues with the other students in the experiment, while others (in the control condition) were not. All participants were expected to demonstrate improved performance over multiple rounds as they gained experience playing the game. However, the researchers found that the improvement in task performance was significantly greater for those in the transparency condition. Moreover, they were able to demonstrate that—at least among individuals with a low tolerance for inequity (i.e., those more sensitive to disparities in contribution/reward ratios; Huseman, Hatfield, & Miles, 1987)—part of this beneficial effect of transparency over secrecy could be explained by diminished perceptions of the degree to which performance actually influences pay. In a subsequent study, Belogolovsky and Bamberger (in press) found these same effects to be generalizable across all participants (regardless of their personal inequity tolerance and any other individual differences) when the incentive was based on subjective assessments of performance and allocated on the basis of relative (rather than absolute) performance—precisely the conditions governing incentive reward arrangements in most organizations!

Once these basic choices are made, those designing the pay system confront a wide range of more nuanced, yet highly challenging issues. The pay-related policies and practices chosen with respect to these issues are likely to have no less an effect on the organization's ability to achieve four basic compensation aims, namely (a) attraction of human capital; (b) motivating those with human capital to apply it in the interests of the firm and (c) to develop it further in a manner consistent with firm objectives; and (d) retention (e.g., Boudreau & Ramstad, 2006; Lawler, Ulrich, Fitz-Enz, & Madden, 2004; Milkovich & Newman, 2008).

# INTERNAL EQUITY CHOICES

As noted earlier, internal equity has to do with the degree to which organizational pay structures—“the array of pay rates for different work or skills within a single organization” (Milkovich & Newman, 2008, p. 59)—are internally consistent. It involves comparisons among jobs or skill levels in a single organization, in terms of their relative contribution to meeting the organization’s business objectives, and addresses such questions as “Do programmers contribute more to customers than software engineers or technical support staff?” Internal equity is greatest when the contribution/rewards ratio remains relatively stable across jobs within the organization, that is, when work of equal value is equally rewarded and when pay differentials accurately reflect work of unequal worth (Milkovich & Newman, 2008; Shore, Tashchian, & Jourdan, 2006). Internal equity choices therefore concern the dimension(s) along which contributions are to be evaluated (i.e., job versus skills/knowledge/competencies), and the egalitarian nature of pay systems in terms of the size of pay differentials, eligibility for supplementary forms of pay, and the number of pay levels encompassed (broad versus narrow bands).

Traditionally, to assess contributions, organizations assessed the value of the job performed by an employee (Dulebohn & Werling, 2007). Assuming that work processes were stable and highly routinized, and that employees were expected to perform one and only one job, the characteristics of the task rather than of the employee were likely to account for most of the variance in relative contributions. In such steady-state environments, “employees and management could come to a reasonable consensus as to what various jobs were worth” (Lawler & Worley, 2006, p. 4). Consequently, fairness could best be assured by evaluating the relative value of specific jobs on the basis of some comprehensive and valid evaluation framework (e.g., the Hay point system). Jaques (1990) argued that job-based systems reinforce notions of personal accountability and responsibility, something that skill or competency-based systems (discussed below) cannot do. Becker and Huselid (1992) argued that the ranking framework and tournament dynamics inherent in most job-based systems may offer significant motivational potential, particularly where there is greater spread in pay between lower and higher positions. As they noted, tournament theory suggests that “the appeal of successively higher salaries motivates employees to devote greater attention to organizational interests at all levels and discourages shirking” (p. 337). Indeed, their findings indicate substantial support for such a notion. Lawler (1990) noted that job-based internal equity facilitates staff movements, allows for centralized control of the pay system, is likely to yield a high “fairness” score on the part of employees, and may help managers avoid political conflicts stemming from particularism in pay. However, with regard to the latter two points, Ferris and Judge (1991) disagree. They argued that political considerations enter into assessments of the relative contribution of jobs (“point-grabbing”), since job value can often be translated into managerial power. Consequently, employees may often have reason to doubt the validity and fairness of job evaluations.

Moreover, with an increasing number of firms looking to enhance their operational flexibility by increasing the ability of employees to “multitask,” or perform a variety of tasks (often in the context of work teams), the assumptions underlying the job-based approach may no longer hold. Job descriptions can no longer be considered stable, and given that “there are often no traditional jobs, only clusters of tasks and activities” (Lawler & Worley, 2006, p. 4), employees can no longer be viewed as being assigned to any one particular job. Several authors (Cardy & Selvarajan, 2006; Guthrie, 2002; Nybø, 2004) have claimed that for firms structuring their work around projects and/or seeking operational agility, responsiveness, and flexibility, such a job-based approach may be highly dysfunctional. As noted by Lawler and Worley (2006, p. 4),



A reward system that focuses on jobs does little to produce an understanding of the new skills and knowledge individuals need or, for that matter, an understanding of what new individuals the organization needs in order to develop new competencies and capabilities. It also typically offers little or no incentive to develop the new skills and knowledge that will help the organization change.

Accordingly, particularly in rapidly changing environments, traditional systems of valuing jobs may be less effective than a system based on placing a value on the multiple skills and/or competencies required for employees to be more versatile, take on multiple tasks, or work as “team players.”

The appropriateness of these two approaches to internal equity is likely to be contingent on a number of factors. For example, several scholars have argued that the relative efficacy of a competence/skill-based (as compared to a job-based) pay structure depends on the nature of the organizational culture within which it is embedded, with competence-based structures likely to be more efficacious only in more commitment-oriented organizational cultures (Ledford, 1991; Wallace, 1991). However, recent evidence (e.g., Dulebohn & Werling, 2007; Heneman, Fisher, & Dixon, 2001; Murray & Gerhart, 1998) suggests that basing internal equity on employee skills may have less to do with organizational culture than the existence of work processes that allow firms to take advantage of the enhanced skill-base that they are now paying for. That is, a skill-based approach to internal equity may yield the greatest returns to firms basing their competitive advantage on highly flexible and agile operations, and whose HR strategies are grounded in the use of output as opposed to process controls (i.e., the commitment and free-agent HR strategies).

A second internal equity choice concerns the degree to which rewards in general and the pay structure in particular should be hierarchical as opposed to egalitarian. Although, in principle, the norm of internal equity suggests that the rewards/contribution ratio should remain constant, in practice, this norm is not always followed. As noted by Baron and Kreps (1999), “If X contributes more than Y, X should be paid more than Y. But if X contributes twice as much as Y, it isn’t necessarily required that X be paid twice what Y gets” (p. 293). That is, in designing reward systems, organizations have the ability to build in as much dispersion or compression (i.e., the extent of differences in pay across jobs within a group or an organization) as the external labor market will permit. Recent meta-analytic evidence by Park and Sung (2013) indicates that vertical (i.e., between-job) dispersion is positively related to both workforce performance and firm performance. So why don’t we see a universal trend toward increasing pay dispersion? The answer is that certain factors may limit a firm’s interest or ability to increase vertical dispersion. National culture may be one such factor. For example, in certain Asian countries, only a relatively limited degree of dispersion is culturally legitimate. Labor market pressures may also act as a constraint on dispersion or compression. For example, Ben and Jerry’s Ice Cream (prior to its sale to Unilever) maintained a highly egalitarian pay structure in which the highest-paid employee could earn no more than seven times the lowest-paid employee. Ben and Jerry’s was forced to drop this pay policy when it was unable to recruit an external CEO willing to accept a compensation package consistent with such a norm. Industry-related characteristics may also affect pay dispersion. For example, Sorensen and Sorenson (2007) found that pay dispersion varied as a function of the number of organizations operating within an industry in a region, the diversity of industries offering employment within a region, and the variance in firm sizes in an industry region.

Egalitarian reward systems are characterized not only by flatter pay structures, but also by the existence of fewer (but typically broader) pay grades or “bands,” and the tendency to make a larger proportion of the workforce (and not just higher level executives) eligible for special incentives such as bonuses and options. Hierarchical pay systems typically incorporate a greater number of more “narrow” pay grades

and grant eligibility for special incentives only to higher levels. Research has suggested that egalitarian pay structures are more prevalent in organizations adopting a commitment HR strategy since it is highly supportive of the cooperative, status-free culture such organizations seek to build, and since such organizations (with their reliance on ILMs and intrinsic forms of motivation) are more insulated from external market pressures (e.g., Baron & Kreps, 1999; Bose, Pal, & Sappington, 2010; Gómez-Mejía, Berrone, & Franco-Santos, 2010). The broad bands inherent in egalitarian structures may also allow for greater recognition of individual (as opposed to job-based) differences in performance. On the other hand, firms relying on an ELM may find that such egalitarian systems limit their ability to attract and retain talent that may be more highly valued on the outside unless they are willing to somehow expand the existing bands or create informal “sub-bands,” a potentially costly proposition and one that, for the most part, is inconsistent with the very nature of an egalitarian reward system. Similarly, firms placing a high emphasis on work force stability and process-based control (i.e., those with a paternalistic HR strategy) may find that such an egalitarian framework limits their ability to take advantage of a “tall” hierarchy as a means to minimize turnover and engender the desired “clan” culture (Gupta, Conroy, & Delery, 2012; Hambrick & Snow, 1989; Lazear & Shaw, 2009).

### *External Equity Choices*

A key decision in the design of any organizational reward system concerns the degree to which the firm’s overall reward package matches or exceeds that of its competitors in the ELM. The application of market-driven pay systems entails different considerations. For example, should an employer pay levels exceeding those of its competition in order to attract and retain the best workers? What is the relevant (local, international) market against which comparison should be made (Milkovich & Newman, 2008)? There are at least three main reasons why external competitiveness is likely to be a critical strategic issue for most organizations (Dulebohn & Werling, 2007; Gómez-Mejía & Balkin, 1992; Till & Karren, 2011). First, it is a major influence on organizational recruitment success. Second, compensation level is the major determinant of pay satisfaction, and thus of employee retention. Finally, particularly in labor-intensive firms, decisions regarding external equity can have a direct impact on the overall costs of production, and thus on firm competitiveness. That is, firms in labor-intensive industries that pay above-market rates of compensation are also likely to have above-market production costs, and hence need to find an alternative to a cost-leader business strategy. This suggests that a firm’s business strategy is likely to be a key contingency influencing external equity decisions, with firms competing on the basis of cost leadership rarely paying above-market levels of compensation for all employee groups. Organizational life-cycle characteristics may also influence external equity decisions, as growing firms may seek to offset immediate fixed costs by offering greater incentives along with a relatively lower base salary. Finally, firms less concerned with internal equity (such as those with a free-agent or secondary HR strategy) are more likely to adopt a “lead-the market” reward strategy with respect to highly valued employee groups, or groups of employees upon whom the organization’s success is more dependent. In contrast, firms with a commitment or paternalistic HR strategy may attempt to leverage nontangible rewards (such as employment security or career growth) as a compensating differential to allow them to compete for and retain highly valued employees, while still paying at or even below the market rate.

At MSI, for example, entry-level engineers tend to be compensated at below-market levels and to advance at rates significantly slower than in other technology-based firms. One might therefore ask why young engineers continue to seek employment at MSI. The answer is twofold. First, MSI offers a high degree of job security as well as a benefits package unmatched by its competitors in the labor market.

Second, MSI is known to compensate its loyal and long-term employees at levels far above those prevailing in the ELM for similar medium and high-level positions. Thus, in economic terms, for those remaining committed to the company and willing to “move up” over time, current pay may be viewed as actually incorporating a substantial supplement in the form of deferred compensation.

### *Employee Equity Choices*

As noted earlier, employee equity concerns the way in which employees performing the same job in the same organization are differentially rewarded. Typically, organizations choose from one of four basic employee equity options or reward criteria: membership, tenure, skill, or performance. Organizations basing employee equity on membership simply reward all employees on an equivalent basis, assuming that at least a satisfactory level of performance is achieved. A limited degree of employee equity is achieved in that unsatisfactory employees are terminated, whereas satisfactory employees are retained, continue to receive compensation, and can hope to earn more through advancement from one pay grade to the next over time. Such systems, however, provide little or no material incentive for employees to perform above the minimal satisfactory level, and pay dissatisfaction can develop if employees perceive a lack of procedural justice in the manner in which they and their coworkers are moved from one pay grade to the next.

Not surprisingly, therefore, many organizations seek to rationalize the manner in which they differentially reward employees performing identical tasks by basing these rewards on objective criteria that, at least in principle, may have a positive impact on group, unit, or firm performance. These criteria typically entail either tenure or skill/knowledge.

Underlying a tenure-based system of employee equity is the assumption that on-the-job experience increases employees’ potential contribution and that this increased contribution deserves an enhanced reward. Organizations adopting this framework either provide a direct and automatic pay increase for each year of service, or base advancement (and hence earnings potential) on seniority criteria. A seniority-based system of employee equity may lower labor costs by promoting stability and may reduce transaction costs associated with recruitment, selection, and training. It may also enable the firm to retain proprietary knowledge and the synergies inherent in complex social networks. Of course, the risk associated with such an approach is that low-seniority “stars” and junior staff with obvious high potential may become frustrated and thus serve as easy targets for raiding by competitors basing employee equity on performance rather than seniority.

Underlying a skill/knowledge-based system of employee equity is the assumption that although individual contribution is still basically contingent on the type of job performed, marginal enhancements in contribution can be generated on the basis of an expanded skill base. Organizations adopting this framework thus offer marginal, within-range pay enhancements to employees meeting certain skill requirements or successfully completing specified training programs.

Finally, the vast majority of firms use pay for performance (PFP) as the primary means to ensure employee equity, providing marginal reward enhancements to those employees or groups of employees demonstrating above-average performance. In the following sections, we will highlight the key issues raised by PFP and its implementation. Our discussion will be divided into two parts. First we will discuss whether, when, and how PFP can be an effective means to compensate employees. Following this, we will discuss several of the critical choices faced by enterprises considering the adoption of pay for performance to enhance employee equity.

# PAY FOR PERFORMANCE

## *Does PFP work?*

Over the years, the issue of pay for performance has generated quite a bit of interest, most of it directed at establishing its impact on employee and firm performance, and on elucidating the factors potentially conditioning such effects. Research regarding the impact of PFP on employee and firm performance suggests a generally positive impact. For example, in a longitudinal study of over 300 business units, Gerhart and Milkovich (1990) found a strong positive relationship between firm performance and the proportion of performance-based incentives and bonuses to total pay. Specifically, they found that an increase in the “bonus-to-base” ratio of 10 percentage points (the mean was .20) was associated with a 0.48 percent increase in return on assets. Gerhart and Milkovich’s findings have been extensively replicated and extended. For example, a number of more recent studies, including both lab experiments and field studies, suggest that the proportion of total compensation accounted for by variable performance-based pay is positively related to firm performance, as indicated by such measures as return on assets, Tobin’s *q*, and market share (Cadsby et al., 2007; Carpenter & Sanders, 2002; Dohmen & Falk, 2011; Lin & Cheng, 2013).

Underlying much of this research is the assumption that the beneficial, productivity-related consequences of PFP are the result of enhanced employee motivation. However, several studies suggest that much of this effect occurs on the basis of what we referred to earlier as “sorting”—better performing employees opting to join and remain with firms offering greater PFP, and weaker performers self-selecting alternative employment. For example, Lazear (2000) found that over 30 percent of the productivity improvement occurring at Safelite—the auto glass replacement company—subsequent to the adoption of incentive pay could be directly attributed to such a sorting effect.

Whether the mechanism involves sorting or improved motivation, findings such as those described above give the impression that PFP is a universally effective means to enhance employee productivity and firm performance. Yet, as Baron and Kreps (1999) wrote, making pay partially or entirely contingent upon performance is “a fairly delicate and potentially dangerous set of motivational tools, which should be used with circumspection” (p. 245). One indicator that PFP may be less than a panacea is its relatively limited application for nonmanagerial positions (Larkin et al., 2012). An international survey of some 130,000 workers found only 40 percent received rewards tied to performance (Kelly Services, 2010), and over half of Fortune 1000 companies reported using individual performance-based pay for only “some,” “almost none,” or “none” of their workforce (Lawler, 2003a). As these numbers suggest, it may make little sense to offer performance-based rewards to employees, such as assembly line workers, who have little or no discretion over their work output.

Moreover, research has identified a number of factors that may condition or even reverse the otherwise beneficial productivity effects of pay for performance. One of these factors has to do with the degree to which performance can be easily or accurately measured. For example, in certain jobs, it may be years before it becomes clear whether an employee’s efforts have yielded desired outcomes. In such jobs, performance must be measured subjectively. However, such assessments can be “noisy,” often leading employees to assume that their “true” performance—which they assume to be greater than their measured performance—will not be captured and, hence, rewarded. Similarly, the impact of effort on measured performance can be uncertain (or “noisy”) when extenuating factors over which the employee has little or no control influence performance outcomes. Accordingly, Kang and Liu (2010) suggested that incentive pay “may not work perfectly to the interests of principals (i.e., owners of the enterprise) if firms operate

in a highly uncertain environment” (p. 683), and Langbein (2010) proposed that “when tasks are complex performance pay may be worse than alternative forms of pay and contracts” (p. 11).

Another conditioning factor has to do with the degree to which extenuating circumstances (e.g., a downturn in the market) may affect the firm’s ability to pay, or when the size of the reward depends on performance relative to a set of others (rather than relative to some absolute criterion). Lazear and Oyer (2009) noted that in both of these situations, employees will often view “luck” as playing a key role in determining performance-pay contingencies, thus limiting PFP’s influence on their motivation to exert effort. Thus, as we suggested in our discussion of agency theory, the efficacy of PFP may be more limited in those contexts in which (a) the focus is on hard-to-measure quality, innovation, or service for which clear indicators may not be available, and/or (b) the work process is complex, involving ambiguous tasks and unclear cause-and-effect relations subject to the influence of factors beyond the ability of the employee to control.

But even when conditions may be more appropriate for the use of PFP, questions remain as to how much pay should be contingent on performance and how varied pay should be for those performing the same job (i.e., horizontal pay dispersion). Regarding the first issue, Bloom and Milkovich (1998) argued that for many nonprogrammable tasks, the risks shifted onto the agent in the framework of a contingent pay system may be so high that the agent will either (a) demand a compensating differential in the form of an increased base pay (as a kind of insurance policy); (b) leave; or (c) engage in practices designed to reduce pay variability (e.g., entrenchment and non-action) that may coincidentally be detrimental to the firm. Their findings show that in such cases, increased use of contingent pay may in fact have an adverse impact on firm performance. Specifically, they found that high-risk firms that relied more heavily on incentive pay tended to exhibit poorer performance than comparable high-risk firms that deemphasized incentive pay. With regard to the second issue (i.e., how varied pay should be for those performing the same job), Park and Sung (2013) found in their meta-analysis that horizontal pay dispersion was negatively correlated with both firm-level financial performance and individual-level job performance.

## *PFP Choices*

The research on whether, how, and when PFP affects workforce and firm performance suggests that there is no one best way to implement a PFP system. Indeed, when considering the adoption of PFP, firms have a number of choices to make. These include (a) whether rewards are based on individual versus group performance; (b) whether rewards are based on achievement of a priori objectives (i.e., incentive pay) or on appraised behaviors (i.e., merit pay increases or bonuses); (c) the frequency with which performance is assessed and rewarded (semiannually, annually, every two or three years); (d) the timing of reward distribution (immediately postperformance or deferred to some later point); and (e) which employee groups should be eligible for incentive pay.

**Individual versus aggregate PFP.** Regarding the first issue—individual versus aggregate performance—individual-based systems such as merit pay and individual bonuses appear to be most effective only when there are minimal interdependencies among employees, when competition among employees is desired, or when delayed performance dysfunctions (i.e., those only appearing over time, such as poor product quality) can be traced back to an individual employee. This is because individual PFP is unlikely to motivate enhanced effort to the extent that employees are unable to individually control the work outputs upon which rewards are contingent. Furthermore, in work organizations demanding a high degree of cooperation, PFP may weaken meta-norms of cooperation by making employees feel they are in competition with one another for a set pool of rewards (i.e., a zero-sum game). Managers thus face a

dilemma, in that they may want to use rewards both to foster team cooperation and cohesiveness, and also to recognize individual differences in the contribution members make toward team accomplishments (Hollenbeck et al., 2004; Weinberger, 1998). Unfortunately, the extant research provides little advice to managers on how to deal with this conflict. The scant research that exists (Baron & Kreps, 1999; Gerhart et al., 2009) suggests that aggregate pay may only be effective when the organization is able to control incentives for free riding, when the overall HR strategy is structured around cooperation and teamwork, and when the firm can control the problems associated with “time and hurdle” and “ratchet” effects. Time and hurdle problems relate to the tendency of workers to “bank” expended effort from one assessment period to the next, or to take dysfunctional action so as to just meet the period’s specified quota or criterion. Ratchet effects involve the tendency of group incentives to lose their motivational effect as standards are shifted up over time, and of group members to use peer pressure to avoid such upward shifts by punishing “rate-busters.”

Furthermore, the level of aggregation—work-group, unit-wide, or corporate—may have profound implications with respect to free riding because, as we already discussed, there is an inverse relationship between group size and the ability of group members to monitor and sanction free riding. Typically, therefore, organizations attempt to aggregate to the lowest possible level, depending on the type of work performed or position in the organizational hierarchy. For production workers, the most appropriate level may be the work group or department, unless tight interdependencies with other work groups or departments reduce perceived instrumentalities to the point that group members sense that they lack the ability to control the variance in measured and compensable outputs. For executives, however, this is likely to be the division or corporation as a whole, again depending somewhat on whether corporate units are tightly (i.e., vertically integrated) or loosely coupled (horizontally integrated), and the degree to which overall firm performance depends on maintaining interdivisional synergy (Gerhart et al., 2009; Gómez-Mejía & Welbourne, 1990). Some organizations, such as General Electric, use a combination of aggregation levels—individual, team, business unit, and corporate—for different employee populations (Milkovich & Newman, 2008).

Two of the most popular forms of aggregate-level pay for performance programs are gain sharing (typically unit-wide) and profit sharing (typically corporate-wide). A number of studies suggest that despite the aggregation problem noted above, both programs may be associated with enhanced firm performance (e.g., Arthur & Aimen-Smith, 2001; Kraft & Ugarkovic, 2006). However, because most studies addressing this issue are cross-sectional in nature, it is impossible to determine the cause-and-effect relationship between profit sharing and firm performance (i.e., highly profitable firms may simply be more likely to adopt profit-sharing programs; e.g., Milkovich & Newman, 2008).

**Results versus behavior-based PFP.** A second issue to consider is how much emphasis should be placed on results-oriented or objective performance measures, such as profitability or the number of units produced, relative to behavior-based measures, such as evaluations of effort (Gupta et al., 2009). Behavior-oriented measures can be used for any type of job, providing that there is sufficient opportunity to observe behaviors and ability to assess them. Such measures can also account for variables that are beyond the employee’s control, but that nevertheless influence performance. In addition, behavior-based measures reduce the risk that employees will focus only on explicitly measured results at the expense of broader, prosocial behaviors (e.g., organizational citizenship behaviors, contextual performance; Arvey & Murphy, 1998; Gerhart et al., 2009). At the same time, the subjectivity of behavior-oriented measures can undermine their value in differentiating between employees (Milkovich & Wigdor, 1991; Viswesvaran, Ones, & Schmidt, 1996) and can introduce “noise” into the PFP system, thus diminishing employee perceptions of the impact of increased effort on assessed performance.

**Timing of PFP.** The timing of performance-based rewards—relating to both the length of time used to assess performance and the frequency of reward distributions—is no less important. Reinforcement theory suggests that the motivational impact of a performance-based reward is greatest when the reward is granted upon immediate completion of the desired behavior. Indeed, many piece-rate and commission systems operate precisely in this manner, with the employee seeing his or her earnings rise in direct proportion to the number of units produced. Many nonincentive variable pay systems work in a similar fashion, with a spot bonus (i.e., a single, lump-sum payment that does not become part of the base salary) granted upon successful achievement of some specified objective or on the basis of a positive performance review.

However, certain long-linked work processes (such as those inherent in research and development) produce outcomes that are impossible to evaluate in the short run, and other tasks may require short-term performance plateaus or even declines (for example in revenues) to yield more significant long-term performance enhancements (e.g., enhanced market share). Furthermore, a focus on short-term performance could actually provide an incentive for employees to take actions yielding short-term benefits, and then to leave the organization before the long-term implications of these actions become clear. This may be particularly salient in executive compensation. For example, studies (Bergstresser & Philippon, 2006; Guidry, Leone, & Rock, 1999) have shown that incentive-based pay may lead managers to “maximize their short-term bonuses by emphasizing short-term value creation at the expense of long-term value” (Devers, Cannella, Reilly, & Yoder, 2007, p. 1027). Consequently, some organizations prefer to provide smaller merit increases in base pay over time, or, alternatively, award bonuses in part through some deferred payment (e.g., stock options).

**PFP for whom?** Flannery et al. (1996) viewed the question of eligibility for PFP—that is, who is eligible to be compensated on the basis of performance, and what percentage of those eligible actually receive some reward—as contingent upon the HR strategy. According to Flannery et al., firms having more of a secondary HR strategy tend to offer performance-based incentives only to those 20 to 40 percent of employees considered to be “key” (i.e., those upon whom the firm’s future is highly contingent and whose skills are not easily replaceable), and only some 20 to 40 percent of these will actually qualify for any performance-based reward. In contrast, firms adopting a commitment strategy tend to offer such schemes to between 80 and 100 percent of their employees, and a similar proportion of these actually receive some reward. Flannery et al. (1996) also found that for those meeting performance criteria, payout levels in secondary-strategy firms were generally quite high, equivalent to 60 percent or more of base pay, whereas commitment-strategy firms tended to limit the size of the incentive to between 10 and 25 percent of base pay. More recent data similarly suggest that “when performance-based pay is used, the proportion contingent on performance is typically low” (Larkin et al., 2012, p. 1196). For example, the median bonus for MBA graduates represents only 20 percent of base salary (VanderMey, 2009).

## **LINKING COMPENSATION STRATEGIES TO HR STRATEGY**

A common assumption implicit in much of the literature on compensation strategies is that to yield its desired effects, compensation strategy must offer a high degree of both internal and external fit (Milkovich & Newman, 2008). With regard to internal fit, this means that the firm’s choices with respect to the compensation system need to be carefully aligned and not work in opposing directions (Gómez-Mejía et al., 2010). Regarding external fit, most scholars tend to focus on the degree to which reward practices as a whole are consistent with the firm’s overall business strategy (e.g., Cooke & Huang, 2011; Rodríguez,



Espejo, & Cabrera, 2007; Scott, Reilly, & Andrzejewski, 2003). In this section, we identify internally consistent compensation strategies that offer the highest external fit with each of the four dominant HR strategies identified in [Chapter 3](#).

### *The Link between Compensation Strategy and Firm Business Strategy*

Beginning in the late 1980s, HR theorists (e.g., Balsam, Fernando, & Tripathy, 2011; Broderick, 1986; Carroll, 1987; Fay, 1987; Wei & Atuahene-Gima, 2009; Yanadori & Marler, 2006) began to propose configurations of pay practices appropriate for particular types of organizational business strategies. For the most part, these frameworks adopted Miles and Snow’s defender-prospector typology of business strategy and attempted to identify the pay practices most appropriate for each. For example, Carroll (1987) proposed that reward practices in “defender” firms were characterized by extensive use of individual-level variable pay, and only moderate use of group-based incentives (primarily gain sharing). In addition, according to Carroll, such firms place no more emphasis on external equity than on internal equity, offer only moderate-sized bonuses, and make only moderate use of deferred compensation. In contrast, reward practices in “prospector” firms are characterized by a focus on sustained team effort and employee retention. Thus, according to Carroll, these firms make almost no use of individual-based, variable pay. Instead, they rely on rewarding large bonuses (with a portion typically in a deferred form of payment) on the basis of team performance, and place a greater emphasis on external over internal equity.

Gómez-Mejía and Balkin (1992) identified two alternative compensation configurations, which they called algorithmic and experiential. The former, for the most part, mirrors the compensation strategy posited by Carroll to be dominant in defender firms, whereas the latter, for the most part, mirrors that posited by Carroll to be dominant in prospector firms (see [Table 6.1](#)). For example, whereas the algorithmic configuration is grounded in a job-based pay system and emphasizes internal equity, the experiential configuration is grounded in a skill-based pay system and emphasizes external equity. Furthermore, to enhance organizational agility, pay decisions are highly decentralized in firms with experiential pay strategies, whereas they are highly centralized in organizations adopting more algorithmic pay strategies to maximize control over labor costs. However, Gómez-Mejía and Balkin’s (1992) model differs from that of Carroll in that they claimed that these two alternative configurations are “two poles on a continuum” (p. 67), with most organizations falling somewhere in between. Thus, they argue, depending on corporate or business unit strategy, one firm’s compensation strategy may be more or less experiential relative to another’s.

In a more recent study, Yanadori and Marler (2006) found that a firm’s innovation strategy influenced compensation systems for strategic employee groups in the high-technology industry. Focusing on compensation packages for R&D employees (key to the successful implementations of any innovation strategy) in 237 companies, they found that firms pursuing innovation had higher differences in pay levels between R&D employees and other employees, a stronger emphasis on long-term pay relative to short-term pay, and a longer vesting period of stock options granted to R&D employees.

**Table 6.1** Key Reward Practices Associated with the Algorithmic and Experiential Configurations

| Choice Domain                            | Algorithmic                      | Experiential                       |
|--|----------------------------------|------------------------------------|
| Job vs. skill basis of internal equity   | Job                              | Skill                              |
| Internal vs. external equity orientation | Internal                         | External                           |
| Egalitarian vs. hierarchical             | Hierarchical                     | Egalitarian                        |
| Base pay vs. incentives                  | Focus on base pay                | Focus on incentives                |
| Material vs. nonmaterial                 | Monetary rewards underemphasized | Stronger focus on monetary rewards |
| Administration                           | Centralized and bureaucratized   | Decentralized and flexible         |

|                     |                |                          |
|---------------------|----------------|--------------------------|
| Risk sharing        | Minimal        | Emphasized               |
| Basis of pay growth | Tenure and job | Demonstrated performance |

Source: Gomez-Mejia and Balkin (1992).

The notion that firm's overall strategy influences its compensation strategy has strong empirical support. For example, algorithmic patterns were found to match the characteristics of a defensive strategy and a mechanistic organization (a hierarchical structure with specialized tasks, low levels of job discretion, and vertical communication channels), whereas experiential patterns matched the characteristics of a prospective strategy and an organic business structure (lateral communication channels and a high degree of job discretion) (Camelo, Martín, Romero, & Valle, 2004; Cox, 2000). Even more significantly, studies have found interactive effects of firm strategy and reward strategy on performance (Gómez-Mejía & Balkin, 1992; Wei & Atuahene-Gima, 2009). For example, Wei and Atuahene-Gima (2009) found in their sample of Chinese firms that the relationship between market orientation and new product performance was contingent on the reward system. More specifically, risk-taking rewards (rewards that are uncertain and vary based on firm performance) had a significant attenuating effect, whereas long-term rewards had a significant amplifying effect on the relationship between market orientation and new product performance.

Still, Flannery et al. (1996) argued that trying to "fit" reward practices to one of two types of business strategies may fail to capture all of the contingencies that organizations hope to address in the design of their compensation subsystems. Thus, they suggested that it makes more sense to structure reward practices around four alternative organizational "cultures," each of which may be more or less appropriate for a number of business strategies, and each of which may be shaped by a number of environmental, strategic, and organizational factors. Flannery et al.'s (1996) "functional" culture is driven by the need to minimize uncertainty and unpredictability. To achieve these objectives, compensation practices must be consistent with uncertainty-reducing practices such as guaranteeing employment security, ILM-based staffing, and encouraging specialization. Thus, for example, firms characterized by a "functional" culture tend to place heavy emphasis on internal equity. In contrast, organizations characterized by a "process" culture focus on quality and customer satisfaction, and heavily emphasize teamwork, learning, and skill development. Compensation practices in such firms tend to be supportive of such an orientation (e.g., team-based incentives) and encourage a high level of organizational commitment. Flannery et al.'s (1996) "time-based" culture is adopted by firms seeking to reduce cycle times and capitalize on strategic opportunities through enhanced flexibility and agility. Since these organizations need to be able to attract the necessary talent quickly and must motivate employees to work together as a team to meet project-specific objectives, their pay practices tend to reflect a focus on the ELM and to reward team-based competencies and outcomes. Finally, the "networked" culture is adopted by firms in which short-term projects are managed on the basis of highly situational roles and by contracting external human resources to maximize flexibility (i.e., free-agent HR strategies). Compensation practices consistent with such organizational cultures, namely a two-tiered pay structure and a heavy emphasis on external equity, are found in the construction and film industries. Notably, given that different cultures may coexist in single organizations, these results also suggest that the focus in strategic compensation research may need to be more on the fit between reward strategies and HR strategy at the business-unit level than on the fit between reward strategies and overall business or unit operational strategy.

## *Compensation Subsystem Strategy and HR Strategy*

In one of the earlier attempts to demonstrate the link between reward practices and HR strategy, Dyer and Holder (1988) proposed that practices related to all four of the subsystem choices identified above (i.e., basis of pay, internal equity, external equity, and employee equity) would vary depending on four key HR strategy dimensions (contribution, composition, competence, and commitment). For example, firms adopting what Dyer and Holder referred to as an “investment” HR strategy (having high expectations for employee initiative, a “comfortable” headcount, very high competency requirements, and high employee commitment demands) could best achieve such strategic HR objectives by placing an emphasis on internal equity, building a tall hierarchical pay structure, using variable pay to only a limited extent, and basing this variable element on individual skill enhancements and aggregate performance.

Although Dyer and Holder’s framework provided the basic elements of a model of subsystem fit, it focused on a wide variety of HR subsystems and therefore was limited in detail with regard to the nature of coherent compensation subsystems. Furthermore, like the strategic frameworks proposed by others (e.g., Arthur, 1992; 1994; Pfeffer, 1994), Dyer and Holder’s framework assumed that, depending on the firm’s strategic contingencies, there exists a single, optimal approach to compensation that is ideal for managing all employees. However, as noted earlier, Lepak and Snell (1999; 2002) and Guest (2011) questioned this assumption, suggesting that different reward practices may be in effect for different groups of employees in a single firm, such that hybrid profiles of reward practices may occur within firms. The result is that most firms will, over time, attempt to identify some combination of pay practices that, although taking into account the value and uniqueness of different employee groups (Lepak & Snell, 2002), still provides some degree of overall internal coherence and consistency (Gómez-Mejía et al., 2010).

Still, scholars continue to argue that a lack of internal fit between the reward subsystem and other HR subsystems may undermine the effectiveness of the overall HR system. For example, O’Donnell and Shields (2002) argue that this may occur when the compensation subsystem is targeted at individuals, while the appraisal subsystem focuses more on group output. Similarly, Colella et al. (2007) suggested that a damaging internal misfit may occur when a policy of pay transparency is combined with an experiential pay strategy. This is because in the context of the wider pay distributions that tend to be generated by experiential pay strategies, pay openness may exacerbate perceptions of injustice. Accordingly, while it may be important to tailor pay systems to internal workforce-specific contingencies, the evidence suggests that practitioners need to be cautious about implementing pay practices that are either themselves misaligned or inconsistent with other aspects of the broader HR strategy.

Taking this into account, and assuming, like Dyer and Holder (1988), that clusters of compensation practices vary according to the firm’s HR strategy, in this final section we discuss four unique compensation subsystem profiles, one for each of the four ideal types of HR strategies discussed in [Chapter 3](#). This framework, depicted in [Table 6.2](#), applies the four choice domains discussed above to these four dominant HR strategies, namely the commitment, free-agent, paternalistic, and secondary strategies.

As can be seen in [Table 6.2](#), the commitment strategy focuses on using the reward system to enhance organizational agility, develop a cooperative and creative culture, and discourage employee attrition. Rather than relying strictly on agency-type contracts, as noted in [Chapter 5](#), organizations adopting this strategy seek to establish a more normative or affective (as opposed to calculative) exchange relationship. Thus, they tend to focus on nonmaterial rewards designed to build organizational commitment and a greater sense of identify with the firm. Reward practices consistent with an ILM are critical in this respect, as are reward practices that encourage KSA development, flexibility, and a team orientation. Thus, for example, nonmaterial rewards (e.g., benefits) may be used to complement market-level

monetary remuneration to attract only the highest-quality candidates for entry-level positions and to set up barriers of entry against competitors (Gómez-Mejía et al., 2010). Although variable pay may be used to further enhance an alignment of interest between employers and employees, it is rarely a significant element of the pay package, and—given the focus on cooperation—is typically based on some aggregate dimension of longer-term performance (e.g., profit sharing).

**Table 6.2** Reward Practices Associated with the Four Generic HR Strategies

| Choice Category | Choice  | High Commitment   | Free Agent   | Paternalistic   | Secondary   |
|-----------------|---|---|--|---|---|
| Basic           | Internal vs. external                             | Mixed, but emphasis on internal   | External   | Internal  | External  |
|                 | Level of risk-sharing and risk-taking orientation | Some risk sharing; risk taking encouraged with moderate use of variable pay | Strong interest in risk sharing; risk taking encouraged; heavy use of variable pay | No risk sharing; risk aversion emphasized (moderate use of pay-at-risk); focus on fixed pay | Some risk sharing; risk aversion emphasized with moderate use of variable pay (i.e., pay-at-risk) |
|                 | Monetary vs. nonmonetary rewards                  | Emphasis on nonmonetary rewards   | Mixed with emphasis on monetary remuneration                                       | Mixed with emphasis on nonmonetary rewards  | Emphasis on monetary remuneration   |
|                 | Administration                                    | Mixed with tendency toward centralization and pay openness                  | Decentralized; pay secrecy   | Highly centralized, tendency toward open pay  | Decentralized, pay secrecy  |
| Internal Equity | Job vs. skill                                     | Skill or competency   | Skill or competency  | Job   | Mixed job and skill   |
|                 | Hierarchical vs. egalitarian                      | Egalitarian   | Mixed with tendency toward hierarchical  | Hierarchical  | Hierarchical  |
| External Equity | Lag vs. market vs. lead                           | Market  | Lead   | Lag/Market  | Market  |
| Employee Equity | Membership vs. tenure vs. skill vs. performance   | Mixed tenure, skill, and performance  | Performance  | Tenure, some skill, very limited performance  | Membership, some performance  |
|                 | Level of aggregation                              | Some individual, mostly group, unit or corporate                            | Individual   | No individual, some unit or corporate   | Individual  |
|                 | Timing  | Long-term   | Short-term   | Long-term   | Mixed   |
|                 | Bonus vs. merit increase                          | Mixed (some merit pay)  | Bonus  | Mixed (some deferred pay)   | Bonus   |
|                 | Eligibility for, probability and level of payout  | High eligibility and very high probability; very low payout                 | Moderate eligibility and probability; moderate payout                              | Low eligibility, high probability; low payout   | Low eligibility (“stars” only), low probability; very high payout                                 |

In contrast, reward systems for the largest proportion of employees in firms adopting a secondary HR strategy are grounded on the assumption that for most jobs in the organization, efficiency can be maximized by focusing on the ELM and maintaining a policy of employment-at-will to keep labor costs highly variable. The nature of the work process and employment relationship in these firms is reflected in

a strong emphasis on monetary remuneration and keeping the pay system as decentralized as possible so as to take advantage of cost-saving opportunities presented by the ELM. Internal equity is of concern only to the extent that a job- or skill-based rationale allows for the creation of a two-tiered system, with a relatively small managerial and professional elite occupying the upper tier. The highly controlled nature of the work process makes risk sharing relatively unnecessary for the largest proportion of employees. However, the existence of such an internal dual labor market allows for a relatively large proportion of the total pay package for a relatively small number of key or “star” employees to be based on variable pay. Employee equity for the bulk of the workforce is based on membership. That is, although those with the highest level of short-term performance may not receive any variable pay supplement, they tend to be the last to be laid off. This can be a relatively powerful motivational force, particularly for a contingent workforce with limited alternative employment opportunities.

Pay structures in firms adopting a free-agent HR strategy are built around the relative contribution of skills and competencies as opposed to jobs. However, internal equity is often sacrificed to ensure the rapid acquisition of required skills and competencies. This, in turn, may necessitate a policy of pay secrecy to reduce the risk of problems associated with perceived internal inequity. Furthermore, the temporary, at-will nature of the employment relationship is reflected in a focus on monetary remuneration and short-term, lump-sum payouts, both of which may often be at above-market rates.

Finally, the reward subsystem in firms adopting a paternalistic HR strategy is driven by a focus on an internal equity as well as norms of loyalty and compliance. As much of the variance in employee contributions in such firms is a function of the job, pay structures tend to be job based. These pay structures tend to be both hierarchical and “tall,” reflecting the need for firms to provide for pay growth through internal advancement. The internalization of employment and the promise of such long-term nonmonetary rewards as employment stability allow such firms to pay less attention to ELMs when setting pay levels and thus, in some cases, even lag behind the market average, at least for some nonentry-level positions. Employee equity at the individual level is typically based on seniority rather than performance. To the extent that pay is contingent on performance, the governing criteria typically involve some objectively measured, aggregate level of performance (e.g., corporate cost savings).

## **SUMMARY**

This chapter began with a review of the main theories underlying much of the existing compensation research (i.e., expectancy, equity, human capital, and agency theories). We then discussed four groups of strategic choices—basic factors, internal equity factors, external equity factors, and employee equity factors—that have many implications for the design and implementation of compensation subsystems. The chapter ended with a discussion on the link between reward practices and firm performance and how this link is contingent on internal and external fit, or the degree to which the individual practice is consistent with other reward practices (internal fit) and the alignment between the configuration of reward practices in use and the firm’s broader strategic profile (external fit). One element of that broader strategic profile—the people-flow subsystem—was explored in [Chapter 4](#). We explore a second element—the employee relations subsystem—in the next chapter.



## THE EMPLOYEE RELATIONS SUBSYSTEM

In the previous three chapters, we focused on highly tangible strategic subsystems having to do with staffing, performance management, and rewards. In this chapter, we are interested in a subsystem that revolves around more amorphous concepts, including psychological contracts, voicing, justice, and social identity. Yet this subsystem, to a large extent, underlies many of the strategic options discussed in the previous three chapters. Specifically, our focus in this chapter is on the employee relations subsystem, a rather broad collection of frameworks, policies, and practices that together play a key role in the definition and maintenance of core organizational values and philosophies.

We begin by describing in more detail what we mean by the employee relations subsystem and why it is important. We then review those subsystem parameters along which key decisions regarding employee relations are made, as well as some of the basic contingencies governing these choices. In the second part of the chapter, we discuss how these choices tend to be made in a more or less predictable pattern depending on the overall nature of the dominant HR strategy.

### THE EMPLOYEE RELATIONS SUBSYSTEM: DOMAINS AND SIGNIFICANCE

Most definitions of employee relations in the literature revolve around a particular set of HR activities (e.g., grievance handling, employee discipline) aimed at eliciting employee compliance with organizational policies and norms (Gómez-Mejía, Balkin, & Cardy, 2010; Milkovich & Boudreau, 1991). However, we view the employee relations subsystem as much broader than simply a collection of HR functions. We define the employee relations subsystem as relating to those strategic managerial activities aimed at establishing, enforcing, and reinforcing the “psychological contract” (Rousseau, 1995) between employer and employees, and thus shaping both the tangible work environment as well as the less tangible normative base (i.e., culture) of the organization. In this sense, the employee relations subsystem encompasses a wide range of managerial choices having to do with (a) the nature of control and coordination in the workplace (Edwards, 1979; Ferner, Edwards, Edwards, Marginson, & Tregaskis, 2007; Friedman & Reed, 2007); (b) the degree to which the firm has an interest in having employees internalize the organization as a core element of their self-identity (Alvesson & Willmott, 2002; Bandura, 1986; Thatcher & Zhu, 2006); and (c) the way in which employee equity expectations are balanced with the organizational need for rule compliance, and wellbeing is balanced with the organizational need for effectiveness (Bamberger & Donahue, 1999; O’Reilly & Puffer, 1989; Taris & Schreurs, 2009). Such choices provide the foundation on which employees come to understand, interpret, and eventually internalize the terms of their employment relationship, or their work-related psychological contract.

#### *Employee Relations Choices and the Psychological Contract*

Rousseau and Wade-Benzoni (1994) defined work-related psychological contracts as “the beliefs people

hold regarding the terms of their employment relationships ... which affect employees' behavior toward ... fellow employees and also affect their commitment to the organization" (p. 466). In this context, they identified three types of contracts, each of which they viewed as shaping and signaling the nature of the organizational culture (p. 472). The first type, the *transactional contract*, focuses on short-term, instrumental exchange. The obligations of the two parties engaging in such a contract are mutually perceived to be narrow in scope, based on a limited and specified degree of interdependence, and requiring only a peripheral and temporary engagement. *Relational contracts*, in contrast, focus on long-term, complex, and affective relationships (not unlike those in a family) that demand extensive emotional investment by both parties. That is, they demand the bilateral exchange of social and emotional resources such as loyalty, security, and trust. Both parties' expectations are for a deep, all-encompassing and, most of all, long-term relationship. The third type of psychological contract is the *balanced contract*. Using the type of employment relationship existing at General Electric as an illustration, Rousseau and Wade-Benzoni described this contract as including both relational components (e.g., shared values and mutual commitment) and transactional components (mutual instrumental expectations).

Although work-based psychological contracts are clearly shaped by choices associated with the people flow, performance management, and reward subsystems, choices regarding the three core issues noted above (i.e., the nature of control and coordination, the internalization of an organization-based self-identity, and the balancing of equity with rule compliance and wellbeing with effectiveness) also play a critical role in shaping the nature of an organization's psychological contract with its employees. For example, organizations investing in work-family programs may be viewed as making a concerted effort to shift the nature of their psychological contract with their employees toward the more relational end of the continuum (Osterman, 1995; Taylor, DelCampo, & Blancero, 2009).

However, in addition to their contract- (and culture-) shaping role, choices regarding each of these three employee relations issues also play an important role in the maintenance of this contract. Specifically, choices regarding the workplace governance system and the relative importance placed on equity as opposed to compliance influence the degree to which such contracts are enforced and, thus, psychologically reinforced. Contracts that are not enforced, or are enforced in an inconsistent or inequitable manner, are likely to result in a highly anomic (Durkheim, 1897/1951) and uncertain work context characterized by the effective breakdown of contracts. Rousseau and Wade-Benzoni (1994) refer to such a situation as one of "no guarantees," reflecting the absence of commitments and the deinstitutionalization of standards and understandings. A number of studies (Bamberger & Donahue, 1999; O'Reilly & Puffer, 1989; Zhao, Wayne, Glibkowski, & Bravo, 2007) have found such situations to be associated with heightened levels of employee rule violation and lower levels of individual and group performance.

### *Significance of the Employee Relations Subsystem*

Besides their impact on shaping and maintaining psychological contracts, choices affecting the core employee relations issues noted above are likely to have a variety of direct and critical organizational implications, many of which can be directly translated into dollars and cents. For example, as noted above, many organizations seek to enhance their employee relations by adopting programs designed to address the core work-life balance problems experienced by many employees. Given that household chores and childcare responsibilities are associated with high levels of absenteeism and increased rates of turnover, the adoption of some sort of work-life program can have a direct impact on a firm's labor costs and, consequently, its bottom line (Li & Bagger, 2011; Wang, Walumbwa, Wang, & Aryee, 2013).



We discuss this issue further below.

Choices regarding employee involvement and organizational rule compliance structures can also have an impact on turnover-related costs. Freeman and Medoff (1984) argued that lacking an opportunity to voice their concerns, the only alternative that dissatisfied employees may have is to exit the organization. Exit behavior, or quitting, increases the costs associated with organizational staffing and training, not to mention those often associated with disruptions to critical intra-organizational networks and the loss of proprietary knowledge. Indeed, empirical findings suggest that when employees are afforded greater voicing opportunities through some form of grievance procedure (e.g., a formal ombudsman) or via upper hierarchies (e.g., communicating work-related concerns and suggestions to their supervisors), quit rates are significantly lower (Batt, Colvin, & Keeffe, 2002; Haines, Jalette, & Larose, 2010; Milliken & Morrison, 2003).

A lack of fairness in organizational governance processes, or what Greenberg (1990) referred to as procedural justice, may also serve as a prime motivator for employee unionization efforts. There is evidence that many nonunion employers attempt to maintain their nonunion status by adopting some form of alternative governance structure—one offering employees some framework through which to voice their concerns (Freeman & Kleiner, 1990; Lavelle, Gunnigle, & McDonnell, 2010; Navrbjerg & Minbaeva, 2009). Such employers tend to view the costs of unionization as far outweighing any of the possible disadvantages associated with some sort of internal system of employee voicing. However, other evidence suggests that nonunion firms often reframe their governance structures not so much to avoid unionization as to avoid costly legal battles (Feuille & Hildebrand, 1995; Olson-Buchanan & Boswell, 2009).

More importantly, however, employee relations choices made with the intent of shifting the psychological contract more toward the relational end (for example, by adopting worker assistance programs such as in-plant childcare) can have important commitment-related implications (Osterman, 1995; Taylor et al., 2009). This is not a new concept. Already in the 1920s, with the adoption of the American Plan or welfare capitalism, firms attempted not only to avoid unionism (Brandes, 1970), but to “tie the employee to the firm and to create the illusion, if not the reality, of community” (Osterman, 1995, p. 697). Several researchers (Costas, 2012; Edwards, 1979; Kunda, 2006; MacDuffie, 1995) have noted the economic advantages of such community-like employee relation systems. These systems are based on attitudinal and normative control mechanisms (e.g., friendship and family cultures) that emphasize employee-management closeness and reciprocity. With the “ostensible personal incorporation of organizational goals” (Kunda, 2006, p. 226), organizations may be able to downplay hierarchy and reduce supervisory costs (since committed workers require less direct control), absenteeism- and turnover-related costs (since committed workers are normatively and not just instrumentally motivated), and eliminate costly buffers previously built into the work process (e.g., inventories, back-up systems) that were once required “as a safeguard against labor troubles” (MacDuffie, 1995, p. 201).

Other ways in which firms can move more toward a relational-oriented psychological contract and enhance employee engagement include, for example, creating an enjoyable and psychologically healthy working environment. Bakker (2005, pp. 27–28) applied the concept of *flow* (Csikszentmihalyi, 1990; Ellis, Voelkl, & Morris, 1994) to describe how employees may feel when employed in such an environment, defining it as a short-term experience that is characterized by absorption, enjoyment, and intrinsic motivation. According to Bakker, “absorption refers to a state of total concentration, whereby employees are totally immersed in their work,” and time seems to fly. Work enjoyment is “the outcome of cognitive and affective evaluations of the flow experience,” associated with positive judgments about the quality of working life. Finally, Bakker conceptualizes intrinsic work motivation as relating to the

performance of work-related activities “with the aim of experiencing the inherent pleasure and satisfaction in the activity.”

To the degree that firms provide employees with autonomy and support, employees are more likely to experience flow at work. In contrast, psychologically poor working conditions such as abusive supervision (i.e., when supervisors engage in sustained display of hostile, nonphysical behaviors such as public ridicule or invasions of privacy) often relate negatively to flow and employee wellbeing (Demerouti & Fullagar, in press; Tepper, 2000, 2007; Wu & Hu, 2009). Importantly, empirical findings (Salanova, Bakker, & Llorens, 2006) have supported an upward spiral model of resources and flow at work, suggesting that flow is influenced by and influences job resources by building people’s enduring personal resources. Taken together, these observations demonstrate how the quality of employees’ working environment contributes to building and maintaining a mutually beneficial relational psychological contract.

### *Key Subsystem Domains and Related HR Functions*

As we noted above, the employee relations subsystem is shaped by the way an organization addresses questions relating to control and coordination, the degree to which employees are expected to internalize organizational goals, and the balancing of equity with rule compliance and wellbeing with effectiveness. Managerial decisions regarding these three issues are manifested across a number of subsystem domains. However, before discussing these subsystem domains and the way they reflect managerial decisions, we must first recognize that objectives of employee relations subsystems vary. Just how these objectives vary is important to understand because subsystem practices with regard to the three core employee relations issues depend, to a large extent, on subsystem objectives.

In some organizations, the overarching objective of the employee relations subsystem is to facilitate bureaucratic control and ensure employee rule compliance. Bennis (1985) illustrated this type of subsystem by referring to the philosophy of management once dominant in General Motors: “Don’t think, dummy—Do what you’re told!” (p. v). In others, the key subsystem goal is to eliminate barriers potentially inhibiting organizational effectiveness. In such organizations, although control and compliance remain important employee relations objectives, an emphasis is placed on harnessing employee knowledge (typically through some form of employee involvement program) to address key organizational problems. For example, employee-based task forces are an important element at the Division of Fire and Aviation of the U.S. National Park Services. This organization uses trained, regional readiness review teams to conduct in-depth, readiness inspection reviews on a regular schedule (U.S. National Park Services, 2008).

Finally, in some organizations, the primary objective is to enhance individual attachment and commitment to the organization and its objectives, and in this sense to achieve the two previous objectives (control and commitment, and elimination of barriers to effectiveness) as well. That is, the objective of the employee relations system is to build upon and complement a more utilitarian (Etzioni, 1961) control structure, thus allowing management to reduce its reliance upon more traditional means of bureaucratic control (Kunda, 2006). As several authors have noted (Edwards, 1979; Kunda, 2006; Pfeffer, 2006), infusing organizational norms and values into workers’ self-identity is perhaps the most sophisticated and effective (though complex and often costly) means by which to secure control, ensure compliance, and eliminate barriers to effectiveness.

These objectives are very much related to the two basic dimensions underlying our typology of dominant HR strategies (i.e., resource acquisition and organizational control). That is, since organizations

with HR strategies emphasizing internal over external acquisition place a premium on employee retention, they are more likely to shape their employee relations subsystem around more complex, commitment-related objectives. Similarly, given the high level of discretion granted to employees in organizations emphasizing output-as opposed to process-based systems of control, these organizations are similarly likely to shape their employee relations system around commitment objectives. As shown in [Table 7.1](#), this logic suggests that a commitment-based HR strategy (output-based control with internal resource acquisition) is likely to be associated with an employee relations subsystem structured around the highest-level objectives noted above (i.e., enhancing individual attachment to the organization). A secondary HR strategy (process-based control with external resource acquisition) is likely to be associated with an employee relations subsystem structured around the lowest-level objectives noted above (i.e., bureaucratic control and rule compliance). Finally, the paternalistic and free-agent HR strategies are likely to be associated with employee relations subsystems structured around a set of mixed objectives. In the case of the former, work systems based on strict control and compliance objectives are likely to be inconsistent with the clan culture and the focus on equity so dominant in such organizations (Arthur, 2011; Baron & Kreps, 1999; Ouchi, 1980). In the case of the latter, work systems based strictly on commitment objectives are likely to be inconsistent with the temporary nature of employment relations dominant in firms adopting a free-agent HR strategy, and with the fact that the primary allegiance of most free agents is to their own craft or occupation rather than to their employer (Gouldner, 1959; Kim & Mueller, 2011; May, Korczynski, & Frenkel, 2002).

**Table 7.1** Dominant HR Strategies and Employee Relations Subsystem Objectives

| Nature of Resource Acquisition and Retention | Nature of Organizational Control Processes  |  |
|--|---|--|
|  | Process   | Output   |
| External                                     | <p><b>Secondary HRS</b></p> <p>ER objective: Control and compliance; cost minimization and flexibility maximization ER focus: Fixed, compliance-based work systems; very limited (if any) governance system focus</p>   | <p><b>Free-Agent HRS</b></p> <p>ER objective: Bounded commitment ER focus: Work systems emphasizing employee involvement and intensive collaboration within the context of a detailed employment contract; moderate to extensive governance system focus</p>   |
| Internal                                     | <p><b>Paternalistic HRS</b></p> <p>ER objective: Benevolent control and compliance; amelioration of potential barriers to productivity ER focus: Work systems incorporating limited employee involvement; employee assistance; moderate to extensive governance systems focus</p> | <p><b>Commitment HRS</b></p> <p>ER objective: Creation of a “caring culture” and a sense of community to signal the expectation of volunteerism on the part of the employee ER focus: Work systems emphasizing employee involvement; extensive governance systems focus; heavy focus on employee assistance and work/family benefits</p> |

Choices with regard to three key employee relations parameters tend to follow the subsystem objectives selected (Dyer & Holder, 1988). These employee relations parameters concern (a) the nature of the work system (i.e., having to do with control, coordination and employee involvement objectives); (b) the degree to which the organization attempts to address employee concerns not directly related to the workplace (i.e., having to do with social identity and the internalization of the organization and its goals); and (c) the nature of the workplace system of governance (i.e., having to do with balancing equity with compliance objectives and wellbeing with effectiveness objectives). Thus, if the primary objective is control and compliance, HR employee relations functions are likely to be limited to a focus on compliance-oriented (i.e., highly authoritarian) systems of governance and highly standardized and fixed work systems. If the goal is the elimination of barriers to enhanced organizational effectiveness, functions are likely to be expanded to include the development and administration of work systems based on some degree of employee involvement, as well as the liberalization of workplace governance systems (i.e., movement toward more integrative systems of governance; Bamberger & Donahue, 1999). If commitment is the primary objective, then employee relations functions are likely to include a focus on alternative

governance and work systems (particularly those emphasizing employee involvement), as well as the development and administration of assistance programs and culture-strengthening activities (such as the socialization-oriented development activities described in [Chapter 4](#)).

In the section below, we describe each of these subsystem domains in more detail and discuss how the nature of each domain is likely to vary across our four ideal types of HR strategies.

## **STRATEGIC CHOICES IN THE WORK SYSTEMS DOMAIN**

Work systems have to do with the manner in which organizational inputs such as material, people, and data are transformed into some type of output (Bacharach & Bamberger, 1995; Perrow, 1979). In more operational terms, we view work systems as having to do with the way in which jobs are designed and structured, discretion allocated, and supervision exercised. As Blau (1968) noted, just how to control and coordinate such systems is “a fundamental issue” confronting executives of organizations (p. 465). Blau suggested that management may be through direct or indirect controls. Direct management requires executives to maintain close contact with operations and to issue corrective orders where necessary, while indirect management involves “impersonal controls that constrain operations to follow automatically the policies and programs specified by top executives.” However, sociologists such as Braverman (1974) and Edwards (1979) argued that in addition to these two modes of structuring the work system, a third, even more indirect approach must be considered, one based on organizational norms and values.

### *Types of Work Systems*

Direct administrative control through supervision involves the personal direction, evaluation, and disciplining of workers by management and the organization and control of work tasks through continuous and direct supervisory instruction (Edwards, 1979). In many skill- or craft-based occupations (such as the construction trades), it is difficult if not impossible to routinize or standardize the transformation process, and the organization is dependent on its members’ ability to handle the uncertainty embedded in its core tasks. In such organizations, direct and continuous supervisory involvement may offer those accountable for the organization’s outputs the simplest means to ensure that these outputs meet basic quality and uniformity objectives. Thus, this rather traditional approach to work process design (grounded in the master-servant type of employment relationship predating the Industrial Revolution) calls for incumbents of broad and complex jobs to be afforded a high degree of discretion when performing their tasks. In this sense, this type of work system is based on output rather than process control. However, because there is no guarantee that the interests of agents and principles are aligned, it also calls for a highly structured and status-oriented hierarchy that gives supervisors the authority needed to monitor and intervene, such that organizational objectives (as opposed to the personal objectives of job incumbents) are attained.

The disadvantages of this traditional approach to structuring the work system stem from its reliance on output control in contexts in which there is no guaranteed alignment of interests on the part of agents and principals. Because there is no guarantee of goal consensus, such work systems demand close and relatively intensive monitoring and the creation of an extensive bureaucratic hierarchy designed to provide such monitoring in a highly “rational” and legitimate manner. For example, in most RLA Textiles plants, employees are subject to direct and continuous monitoring by a relatively large group of supervisors. Supervisors literally “look down the necks” of each of their subordinates (in some cases via

ceiling-mounted video cameras), and attempt to control their workforce by threatening swift and severe punishment (i.e., dismissal) when employees deviate from basic work rules and production norms. The ability of supervisors to fire their subordinates at will (and with minimal cost and hassle to the company and its management) provides supervisors with an effective fear-based mechanism by which to better align the interests of workers with those of management, at least for the short term.

However, over the long run, this can be costly to an organization, not only in terms of an expanded supervisory overhead (such direct and intense supervisory control may require the employment of a great many “heads” to monitor the work of relatively few “hands”), but in other ways as well. For example, particularly when these “hands” are skilled or professional workers, such systems of control may breed conflict, with administrators being viewed by workers as “organizational despots, encumbered by few restrictions on their power over workers” (Edwards, 1979, p. 33). And perhaps even more significantly, tight hierarchical structures and the strictly vertical and top-down flow of information may limit organizational agility and slow down response time. This is precisely the case at MSI. A substantial portion of MSI’s employees are highly trained and hard-to-replace scientists, engineers, and technicians. These professionals tend to resent any attempt to restrict their autonomy. Indeed, the firm experiences frequent labor-management disputes over the boundaries of managerial versus professional control. Lacking the ability to align employee interests with those of management through staffing and reward practices, management has been forced to develop tight hierarchical structures and highly formalized control systems to ensure that objectives are met. The existence of these structures and rigid systems largely accounts for the longer product development cycles and slower market response time described earlier.

Taylorism, or indirect control through standardization and routinization, offers a solution to at least some of the disadvantages of such traditional work systems.<sup>1</sup> It eliminates the paradox inherent in the approach described above by shifting the basis of managerial control from outputs to processes. That is, by separating the execution of work from its conceptualization, and by deconstructing complex work processes into simple, routine steps requiring little, if any, pre-job training—in other words, by controlling the actual task behaviors of workers—management can essentially guarantee the attainment of organizational goals in a far more streamlined fashion. Because workers have far less discretion and because most task-related decisions are programmed into the work itself, there is a far more limited supervisory imperative. Furthermore, on the basis of such an approach, the nature of the dependence relationship between workers and their employers can also be dramatically shifted in favor of the latter, because it is easier to replace an unskilled worker than one with proprietary skills. Indeed, as we noted in [Chapter 3](#), such an approach to work process design offers significant efficiency advantages to employers. Not surprisingly, therefore, by the 1920s, indirect control through routinization and standardization had for the most part replaced direct supervisory control as the basis of work systems design (Perrow, 1979).

However, as has been well documented, Taylorism also has its disadvantages, most of them having to do with the alienating effects of such work systems (Blauner, 1964). That is, indirect control through routinization may engender a sense of meaninglessness, isolation, and self-estrangement on the part of workers. As Chinoy (1992) suggested in his classic analysis of automobile assembly-line workers, individuals experiencing such feelings of alienation are likely to demand ever-increasing rates of pay to compensate for dissatisfaction on the job. Furthermore, the high levels of alienation inherent in these work systems tend to be accompanied by negative outcomes such as relatively high rates of absenteeism and turnover and low worker motivation (Loukidou, Loan-Clarke, & Daniels, 2009; O’Driscoll, Pierce, & Coghlan, 2006). Consequently, organizations adopting such work processes have no choice but to develop buffers (e.g., inventories, substitute workforces, repair spaces) to protect against any type of disruption

that might “prevent the realization of economies of scale” (MacDuffie, 1995, p. 200). That is, rather than addressing the root cause of alienation, organizations adopting these types of work systems tend to invest in programs and structures designed to mitigate the consequences of alienation. As MacDuffie (1995) wrote, such buffers may be seen as costly for several reasons. “First, the buffers represent a commitment of resources not directly devoted to production. Inventory buffers in particular are costly to store and handle and can hinder the move from one product design to another. Most important, buffers can hide production problems” (p. 200).

A third type of work system incorporates output control with efforts aimed at ensuring that the interests of workers are aligned with those of their employers. Edwards (1979, p. 150) maintained that “the most sophisticated level of control grows out of incentives to workers to identify themselves with the enterprise, to be loyal, committed and thus self-directed or self-controlled.” These types of work systems are characterized by broad and flexible jobs, offering even those workers with limited skills greater responsibility and discretion. Employees are given extensive autonomy and opportunities to participate in organizational decision making, and are encouraged to widen their skill base so as to optimize efficiencies in human resource mobilization. However, to ensure that such autonomy and discretion is exploited in a manner consistent with the organizational objectives determined by management, these work systems are also characterized by a high degree of normative control—“the desire to bind employees’ hearts and minds to the corporate interest” (Kunda, 2006, p. 218).

According to Kunda (2006), norm-based control requires that management pay a great deal of attention to the development, articulation, and dissemination of an organizational ideology. As he noted, “ideological principles are embodied in specific managerial policies governing the member’s work life. These policies are designed to minimize the use and deemphasize the significance of traditional bureaucratic control structures ..., and to elicit instead behavior consistent with cultural prescriptions” (p. 218). Thus, although an ideology of openness, flexibility, and tolerance is typically promoted, subtle forms of group pressure are used to “continually enforce in each other and in themselves an overt adherence to the (specified) member role” and to “silence any expression of deviance” (p. 219). Kunda (2006) acknowledged that such work systems may produce a highly motivated workforce and that the decreased reliance on inefficient bureaucratic systems of control may foster personal initiative and innovation. However, he and others (e.g., Covaleski, Dirsmith, Heian, & Samuel, 1998; Garrety, 2008; Perlow, 1998; Westwood & Johnston, 2012) also noted that such systems contain within them the roots of organizational tyranny, as the boundaries between work and nonwork lives become blurred, and as organizations begin to question and redefine the boundaries of employee identity and privacy (Barley & Kunda, 2004).

### *Work Systems, Employee Relations Objectives, and HR Strategies*

A number of studies have attempted to identify the link between HR strategy and organizational work systems. The bulk of these studies are grounded in the assumption that work systems, like other elements of the employee relations (ER) subsystem, tend to be structured around the ER objectives embedded in the organization’s dominant HR strategy. Furthermore, these studies suggest that organizations whose work systems are incongruent with their ER objectives tend to perform less effectively than organizations whose work systems and ER objectives are more closely aligned.

For the most part, stemming from the early work of Walton (1985), these studies have focused on two alternative sets of ER objectives, namely control and compliance as opposed to commitment. Referring to the former, Walton noted that “at the heart of this traditional model is the wish to establish order, exercise



control and achieve efficiency in the application of the work force” (p. 78). According to Walton, organizations with HR strategies placing an emphasis on such ER objectives tend to adopt a combination of traditional work systems integrating elements of Taylorism (i.e., systems based on indirect control through routinization and standardization) with direct supervisory control. At their extreme, these systems rest on the notion that labor is a “variable cost,” thus requiring that jobs be structured around the “lowest common denominator assumptions about workers’ skill and motivation” (p. 78). This is necessary to ensure that workforce flexibility (the ability to staff jobs as needed) does not come at the cost of reduced performance standards.

In contrast, HR strategies calling for commitment-oriented ER objectives demand the adoption of work systems that promote the development of mutual trust, common interests, shared goals, and employee empowerment. As Walton (1985) noted, “in this new, commitment-based approach to the work force, jobs are designed to be broader than before, to combine planning and implementation, and to include efforts to upgrade operations, not just maintain them” (p. 79). With a focus on team-based work processes, the intent is to allocate much of the responsibility for performance monitoring to a set of peers, thus saving on the costs of supervision and, more importantly, eliminating the adversarial nature of labor-management relations dominant in control-based work systems (Jong, Ruyter, & Lemmink, 2005; Jønsson & Jeppesen, 2013; Kirsch, Ko, & Haney, 2010).

In this sense, Walton described the ER objectives and associated work systems that one would expect to find in organizations adopting either secondary or commitment HR strategies. Although Walton did not directly address the ER objectives sought by organizations adopting paternalistic HR strategies or the kinds of work systems implemented by such organizations, he did suggest that many organizations have modified their control-oriented work systems to take into account many of the dysfunctional effects of direct supervisory control and Tayloristic work systems. Specifically, he suggested that during the late 1970s and early 1980s, particularly in unionized firms such as GM, Ford, and AT&T, there was a move to modify work systems away from the classic Taylorist model and toward a “transitional” model. Katz (1985) documented some of these modifications in the auto industry, noting a movement toward broader job classifications and the adoption of a variety of employee involvement and quality-of-work-life programs. Like Walton (1985), Katz noted that although he observed some broadening in the scope of individual responsibility on the job and thus some degree of employee empowerment, for the most part the traditional control- and compliance-oriented work system remained. What was different was the construction of a parallel administrative structure alongside it, one designed to correct and mitigate (or in MacDuffie’s term, “buffer”) some of the problems associated with traditional control-based work systems.

For the most part, empirical studies have demonstrated support for the types of work systems described by Walton (1985) and their tendency to cluster around organizations with different types of HR strategies (see [Table 7.2](#)). For example, Arthur (1992) used cluster analytical techniques to empirically identify distinct patterns of employer choices with regard to a variety of ER parameters, including work systems design. Drawing from Galbraith (1977), Arthur argued that in organizations adopting HR strategies grounded in process or behavioral control, the key to ensuring efficiency and firm performance is to avoid any deviation from standard, highly routinized work processes, such as the introduction of employee involvement programs. Such deviations can cause “production bottlenecks” and increase the costs of production. Thus, Arthur’s theory suggested that in organizations adopting secondary or paternalistic HR strategies, jobs will be more narrowly defined and work systems will be more constrained by formal and predetermined rules and standard operating procedures. In contrast, he suggested that ER objectives in organizations with free-agent or commitment HR strategies (i.e., strategies grounded in output-based



control) will revolve around the alignment of employee-employer interests and the maximization of employee discretion. In this context, Arthur suggested that managers in such organizations will have an interest in broadly defining jobs so as to give employees the autonomy and discretion needed to deal with the uncertainty inherent in organizational transformation processes.

Using a sample of American steel minimills, Arthur (1992) identified two main types of ER systems: a cost-reduction system paralleling Walton's (1985) control framework, and a "commitment" maximization system paralleling Walton's framework of the same name. Consistent with his predictions, Arthur found that, as compared to work systems in firms adopting a commitment model, cost-reduction work systems were characterized by the presence of more simple and low-skilled jobs as well as by more limited opportunities for employee influence in decision making. Arthur's (1992) findings were further confirmed by Lepak and Snell (2002). Specifically, they examined whether the nature of a firm's employment mode varied as a function of its HR configuration (based on their four-type HR configuration model described in [Chapter 3](#)). They found that the commitment-based HR configuration was more prevalent among knowledge-based employees than for workers in the three other employment modes (job-based employment, contract work, and alliance/partnership), while the compliance-based HR configuration was used most extensively for employees in the contract mode.

It should be obvious that none of the studies reviewed up to this point have described the nature of work systems in organizations in which the free-agent HR strategy is dominant. As we noted above, in such organizations, work systems based on compliance objectives are likely to be inconsistent with the output-based approach to control of the work process. External experts are hired in such situations specifically because they have internalized the control of uncertain work processes that, although important to the organization, remain too peripheral to justify any attempt at preprogramming (Lepak & Snell, 1999). It is critical for the organization to rapidly harness the knowledge and skills brought by these partners to the organization, and to ensure maximum trust among as well as cooperation between these temporary "outsiders" and more permanent or core employees (Lepak & Snell, 1999). Work systems employing process-based control operate against these objectives because they fail to provide these external experts with the autonomy needed to perform what is expected of them. Furthermore, such systems are likely to operate in a manner contrary to the occupational ethos and thus raise suspicion, rather than build trust (e.g., Bacharach, Bamberger & Conley, 1991; Dietz, 2004). Thus, the question remains: How do organizations shape work systems so as to rapidly generate social cohesion in the context of an essentially transactional-based psychological contract?

**Table 7.2** Dominant HR Strategies and Employee Relations Choices by Subsystem Domain

| ER Domain            | Secondary  | Paternalistic  | Free Agent  | Commitment   |
|----------------------|--|--|---|--|
| Work System          | Control oriented: Direct control through supervision; indirect control through routinization and standardization; no employee involvement in decision making | Transitional: Benevolent Taylorism (job enrichment; limited employee involvement via establishment of a parallel hierarchy)                                | Bounded commitment: Broadly defined jobs demanding cross-functional collaboration, team-based work; employee influence in decision making is extensive but limited to operational or project-related issues                     | Commitment oriented: Flexible definition of job tasks, team-based work, peer pressure replaces supervisory control; extensive employee involvement in both operational and strategic decision making                 |
| Assistance           | Not relevant   | Limited primarily to EAP services  | Not relevant. EAP services tend to be provided by union or professional organization.   | Extensive adoption of both EAPs and work/family programs   |
| Workplace Governance | Nonunion framework dominant; few if any institutionalized mechanisms for dispute resolution  | Union frameworks widespread; in nonunion contexts, alternative dispute resolution may be adopted for union avoidance and/or to reduce costs of litigation. | Union and nonunion frameworks in effect; Professional constraints on rule making and enforcement may also be in effect; alternative dispute resolution mechanisms used in nonunion contexts as specified in employment contract | Mostly nonunion governance frameworks with heavy emphasis on alternative dispute resolution; focus is on informal, peer-based dispute resolution, but formal, multistep grievance systems are relatively widespread. |

The research of Lawler and colleagues (Lawler, Thye, & Yoon, 2009; Lawler & Yoon, 1995) may shed some light this question. Their research suggests that organizations have two alternative strategies for stimulating such cohesion. On the one hand, transactional relations can foster trust and cohesion if exchanges are repetitive and continue over a sufficiently long period of time. The positive emotions generated by frequent and continuous exchanges over time tend to promote a sense of cohesion and trust, building bonds of emotional rather than strictly instrumental attachment. Alternatively, the construction of a common social identity can shorten the path to the development of such trust and cohesion. In the case of organizations with free-agent strategies, given the temporary nature of the employment relationship, work systems tend to be designed with the second process in mind.

Langfield-Smith and Smith (2003) offer similar insights. They sought to examine how control mechanisms and trust were used to achieve control in inter-firm relationships between an electricity company and its outsourced IT operations. The results showed that the control strategy adopted was based on trust, rather than market-based or bureaucratic. As they wrote, “control was achieved through outcome controls and social controls developing over time, and through the development of trust, particularly goodwill trust” (p. 281).

What these studies suggest is that, to stimulate the rapid development of group cohesion and trust-based relations, free-agent organizations tend to adopt commitment-oriented work systems, closely paralleling

those described by Arthur (1992, 1994) and MacDuffie (1995). Such systems involve broadly defined jobs demanding intensive collaboration and cross-functional interdependence, a reliance upon team-based work processes, and extensive employee involvement in decision making on operational, project-related issues (Baird, 2002; Luna-Arocas & Camps, 2007; Nonaka & Takeuchi, 1995). However, because external partners are likely to direct their primary loyalty and attachment toward their craft or profession and its traditions and ethos, and because the employment relationship is short-term, such work systems are likely to be oriented toward more limited commitment objectives.

Consequently, free-agent work systems are likely to differ from the commitment model described above in at least three important ways. First, given the short-term, transactional nature of the relationship, both employers and free agents have an interest in specifying expected outcomes (deliverables) and deadlines in the form of a detailed contract. Thus, unlike the model described above, norm-based managerial control in the case of free agents is bounded by contractual agreements. Second, although (as noted above) free agents' jobs tend to be broadly defined, their occupational traditions and ethos tend to limit the employer's flexibility with regard to staffing and job design. That is, free-agent work systems tend to limit employers' ability to add responsibilities or assign employees tasks not broadly covered by the contract (Bacharach et al., 1991; Fisher, Wasserman, Wolf, & Wears, 2008; Sonnenstuhl & Trice, 1991). Finally, although free-agent work systems tend to encourage employee involvement in decision making, such involvement tends to be limited to matters related to the particular project to which the individual is assigned, and even then, to issues that are more operational (as opposed to strategic) in nature (Bacharach et al., 1991; Fisher et al., 2008). Despite these limitations, to minimize agency problems, work systems in organizations in which the free-agent HR strategy is dominant are likely to be structured so as to maximize employees' commitment and contribution to the project or team to which they are assigned.

## **STRATEGIC CHOICES IN THE ASSISTANCE DOMAIN**

A second ER subsystem domain has to do with the noneconomic benefits provided by organizations. Depending on the nature of the organization's ER objectives, such benefits may be used primarily to ameliorate personal problems that could pose a barrier to effective performance, and/or to elicit desired employee attitudes and behaviors.

Although there are numerous forms of noneconomic benefits that an organization can provide, two dominant forms are work/life programs and employee assistance programs. As others have noted (Kossek, 2006; Osterman, 1995; Roman & Blum, 1998), early forms of these programs became popular in the early part of the 20th century, primarily out of a desire to increase employees' commitment to the firm and/or reduce their interest in unions.

**Work/life programs** include direct provision of daycare on- or off-site, referrals for child- or eldercare, flexible working arrangements, and health and wellness programs (e.g., discount memberships in fitness facilities). Such benefits have become increasingly widespread since the 1980s. For example, using a national probability sample of establishments with over 50 employees, Osterman (1995) found that over 40 percent of such firms offered flexible hours at the time of the survey. Similarly, a study by the Society of Human Resource Management (SHRM, 2010) among HR professionals found that 49 percent offered flextime programs to their employees. However, these figures represent a drop from those reported in 2006 (57 percent). The 2010 SHRM report also showed a drop in other work/life benefits, including a 13 percent drop in retirement planning services (from 52 percent in 2006 to 39 percent in 2010), an 8 percent drop in company-owned cars for employee use (from 31 percent to 23 percent), and a

15 percent drop in eldercare referral services (from 26 percent to 11 percent).

There is little doubt that underlying much of the growth of work/life programs in the 1980s was the increased participation of women in the labor force, and—in particular—of women with children under the age of three (mothers of under-threes comprised 49 percent of all working women in 1993, up from 28.3 percent in 1975; Goodman, 1995, p. 6). As Giancola (2011) noted, these programs were offered “as an effective method for dealing with the child care needs of working mothers” (p. 291). Specifically, as a larger proportion of an organization’s employees faced child- or eldercare problems, the risks of lateness, absenteeism, and distraction grew, as did the costs associated with them (Kossek, 2006). The adoption of such programs was not only associated with more positive employee attitudes (e.g., Kossek & Michel, 2010), but also served an important recruitment and retention function, signaling to potential recruits the existence of a “caring” or “family-oriented” organizational culture (e.g., Kelly et al., 2008; Lambert, 2000). Furthermore, the prevalence of work/life programs grew in the 1990s as flexible work arrangements became “a popular option that enabled employees to better manage their time and reduce the tension between work and their personal lives” (Giancola, 2011, p. 291).

At the same time, the main explanation for the limited growth in work/life benefits since the start of the new millennium (as evident from the SHRM report noted above) likely has to do with economy-wide instability. Simply put, many insufficiently profitable firms or firms whose profits were uncertain were unable to afford such benefits (William, 2000). For example, in one of their case companies, Abbott and De Cieri (2008) found that “worsening economic circumstances led to a focus on cost reductions across the business ... This was reported to have resulted in removal or reduction of work life benefits” (p. 314).

**Employee Assistance Programs (EAPs)** are “job-based programs operating within a work organization for the purpose of identifying ‘troubled employees’, motivating them to resolve their troubles, and providing access to counseling or treatment for those employees who need these services” (Sonnenstuhl & Trice, 1990). Early forms of employee assistance (such as R. H. Macy’s workplace psychiatry program or Western Electric’s Counseling Department) were grounded in the principles of welfare capitalism and the findings of early organizational researchers such as Elton Mayo (1945) and Dickson and Roethlisberger (1939) (of Hawthorne studies fame). On the basis of the human relations paradigm developed by these scholars (Perrow, 1979), organizations originally adopting such programs implicitly assumed that potential maladjustment to their work could have an impact on employees’ performance. Consequently, they argued that it was in the employer’s interest to help the worker address such problems. However, organizations adopting employee welfare, social work, or counseling departments typically structured such activities around the assumption that employees’ troubles stemmed primarily from off-job sources, such as alcoholism (Bacharach, Bamberger & Sonnenstuhl, 2001; Bamberger & Biron, 2006). Moreover, by the 1950s, only a relatively small proportion of primarily larger firms were continuing to offer such services, and most of these programs focused strictly on employee drinking problems (Bacharach et al., 2001).

However, beginning in the 1970s, a combination of largely institutional and legal forces led to the rapid and widespread adoption of more broad-based programs aimed at preventing and treating a wide variety of employee behavioral and medical problems, including not only substance abuse, but also family disruptions, stress and other psychiatric problems, and work-based trauma (critical incident stress) as well (Bergh, 2000; Cooper, Dewe, & O’Driscoll, 2003; Spell & Blum, 2005). In their contemporary form, EAPs are designed to provide organizations with a mechanism to help them avoid costly disruptions, productivity losses, and increased turnover stemming from any of these primarily external sources. Supervisors refer employees to the EAP strictly on the basis of documented job performance

problems prior to initiating disciplinary action. The EAP provides an assessment and then refers the employee to the appropriate treatment provider while maintaining employee confidentiality. Follow-up occurs both during and after treatment in the hope that subsequent disciplinary action and eventual dismissal can be avoided altogether.

Like work/life programs, EAPs became increasingly prevalent during the last two decades of the 20th century and dropped in numbers during the first decade of the 21st century. Roman (1982) reports that by 1979, 57 percent of Fortune 1000 companies had some form of EAP, as compared to 25 percent just seven years earlier. Similarly, Hartwell et al. (1996) found that about 50 percent of the American workforce employed in establishments with over 50 employees had access to EAP services via their workplace at the time of the study, and Spell and Blum (2005) found in their sample of 244 organizations that 45 percent had EAPs. Underlying the growth in EAPs, as noted above, were a variety of institutional and legal/regulatory forces, including the Drug-Free Workplace Act and the Americans with Disabilities Act (ADA) (Spell & Blum, 2005). However, some of this growth is undoubtedly a function of the documented benefits provided by such programs to employers (Cooper et al., 2003; Roman & Blum, 1998). These include (a) increased ability of the organization to retain the services of employees in whom it has a substantial human capital investment; (b) reduced managerial involvement in counseling employees with behavioral disorders; (c) greater control over employee health care costs; (d) reduced rates of absenteeism, lateness, and safety violations; and (e) improved compliance with the ADA's requirement for "reasonable accommodation."

However, despite these advantages, a substantial proportion of firms still fail to offer EAPs. This suggests that although such programs may offer a means to achieve important ER objectives for some firms, for others they do not. Indeed, there is evidence that the adoption of such programs is very much linked to the nature of a firm's overall HR strategy, and thus its ER objectives. Furthermore, in periods of economic downturn, EAPs are often among the first programs to be cut back (SHRM, 2010).

### *Assistance Programs, ER Objectives, and HR Strategy*

It may be argued that employment benefits are likely to be more prevalent in internal labor market (ILM) firms (i.e., firms in which the paternalistic or commitment strategy is dominant) than in firms relying on external sources of labor (i.e., firms in which the secondary or free-agent HR strategy is dominant). As we have discussed many times in this volume, firms relying on ILMs are likely to make greater human capital investments in their workers than are other employers (see Baron, Davis-Blake & Bielby, 1986; Doeringer & Piore, 1971; Lazear & Oyer, 2004; Piore, 2002). Consequently, they have a greater interest in retaining employees, and as noted above, benefits such as work/life programs and EAPs may be efficient in this regard.

Indeed, studies suggest that ILM-based firms, and firms adopting commitment HR strategies in particular, are more likely to gear their ER subsystems around work/family programs (Budd & Mumford, 2006; Deitch & Huffman, 2001; Goodstein, 1994; Osterman, 1995; Sonnenstuhl, 1996). Consistent with these studies, and as shown in [Table 7.2](#), work/life programs may promote employee engagement and effort in that providing such benefits signals caring on the part of the organization, and—most importantly—the implicit expectation that such caring be reciprocated by the employee. Similarly, although EAPs may have an underlying humanitarian purpose, ILM-based firms (relying on either commitment or paternalistic HR strategies) may also view EAPs as a cost-effective and institutionally legitimate mechanism for dealing with those employees who deviate from the organizational norm. In contrast, firms relying on an external labor market (ELM) (i.e., secondary and free-agent HR strategies) may find it far



less costly to simply replace such employees. As Spell and Blum (2005) noted, “work sites with high turnover may find that the costs of EAPs ... are not worth the benefits since employees don’t remain in the organizations for very long” (p. 1127). From the point of view of the individual free agent as well, it is the occupation or profession that provides a sense of community and long-term connection rather than any given employer. It is therefore a natural consequence of the free-agent system that many of the occupations and professions from which free agents are drawn (e.g., law, accounting, the construction trades) provide their own peer-based assistance programs (Bacharach et al., 1996; Budd & Mumford, 2006; Hartwell et al., 1996; Roman & Blum, 1998).

## **STRATEGIC CHOICES IN THE GOVERNANCE DOMAIN**

A third critical ER domain has to do with workplace governance or, in other words, organizational rule making and dispute resolution processes. Although such processes have, in the past, been most closely examined in the context of unionized firms and collective bargaining, contemporary researchers have begun to pay close attention to the increasing number of nonunion companies that offer their employees alternative mechanisms for dispute resolution and even a more extensive role in organizational rule making. Thus, to understand workforce governance systems, we need to examine ER choices having to do with (a) the nature of the employee role in organizational rule making, and (b) the nature of workplace dispute resolution.

The core strategic choice regarding workforce governance has to do with whether or not the system of governance will be based on the principle of independent and democratic employee representation. In most Organisation for Economic Co-operation and Development (OECD) countries, this choice is left to the workers, who are given the right to opt for union representation. Nevertheless, managers in many OECD countries have used both legal and illegal means to try to influence the outcomes of such worker decisions. For employers, the stakes associated with the decision can be high, because both organizational rule making and dispute resolution are profoundly influenced by the presence of a union. Indeed, in many countries, employer HR strategy is often driven by an interest in avoiding situations in which employees ask for a vote on unionization in the first place. For example, the increased use of contract labor may be at least partially explained by managers’ interest in so-called union avoidance. Certainly, such arrangements may in many cases make workforces more flexible and enhance the competitiveness of the enterprise (an interest of both labor and management). However from the unions’ point of view, because contract workers are so difficult to organize, they fracture the collectivism that characterizes unions and thus undermine their power. Not surprisingly, therefore, unions try to place limits on the use of contract labor in already organized establishments (Olsen, 2005).

### *Union versus Nonunion Governance Systems*

The primary differences between union and nonunion governance systems have to do with (a) the degree to which employees are given an opportunity to independently select individuals from among their ranks to represent their interests and concerns before management, and (b) the degree to which the resolution of disputes is based on a system of due process. Under a union-based governance system, management must negotiate work-related rules and systems of rule administration with the employees’ representatives. These employment terms are specified in a contract that is subject to interpretation by both sides. The need for a system of dispute resolution arises because the two sides often interpret contractual provisions

on the basis of opposing logics or perspectives. As Feuille and Hildebrand (1995) noted, unions tend to interpret contract provisions on the basis of a “logic of employee rights,” whereas management tends to base their interpretations on the basis of a “logic of efficiency” (p. 342).

Typically, most collective bargaining agreements specify an exchange between management and labor in which the former agrees to have their personnel decisions subject to challenge and possible reversal via some bilateral arbitration process, and the latter agrees to forfeit the right to strike during the life of the contract. In general, disputes are not subject to immediate arbitration. Rather, disputes (or “grievances” as they are typically referred to) tend to follow a multistep prearbitration resolution process in which those unresolved at lower hierarchical levels are appealed to higher levels in both the company and the union (e.g., Feuille & Hildebrand, 1995; Lunenburg, 2000; Trudeau, 2002).

With the decline in trade union recognition and density worldwide, efforts to close the “representation gap” revolve around either (a) revitalizing unions or (b) encouraging alternative frameworks for giving employees a voice (Tailby, Richardson, Upchurch, Danford, & Stewart, 2007; Waddington, 2005). Revitalization efforts seek to tackle and reverse such problems as reduced membership or the erosion of representation structures such as work councils (Frege & Kelly, 2003; McIlroy, 2008). Recent studies offer a number of revitalization strategies and frameworks for unions weakened by two decades of industry restructuring, restrictive labor laws, and employer hostility, including organizing, coalition building, international solidarity, labor-management partnerships, and improving relations with the government (Ackers, Marchington, Wilkinson, & Dundon, 2005; Ackers & Payne, 1998; Haynes & Allen, 2001; Heery, Kelly, & Waddington, 2003; Tailby et al., 2007).

The goal of a union organizing strategy extends beyond simple member recruitment (Heery & Adler, 2004). Its aim is to organize the unorganized by encouraging workers themselves (rather than paid officers) to play a direct role in building and maintaining an institution providing mutual aid and enabling them to collectively resolve their own problems at work (Bacharach et al., 2001; Heery & Adler, 2004; Heery et al., 2003; McIlroy, 2008). The organizing agenda differs from the traditional servicing agenda, which focuses on day-to-day assistance to and representation of members in return for membership dues (e.g., Bacharach et al., 2001; Heery & Adler, 2004; Milkman & Voss, 2004). However, shifting from a more traditional recruitment model to such an organizing strategy is by no means simple in that, aside from threatening the status quo and those within the union benefiting from it, it typically forces the union to devote more resources to organizing, with the result being fewer resources available for serving current members (Voss & Sherman, 2000).

Another union revival strategy, the labor-management partnership, aims to create a relationship of mutual gain between employers and unions. For employers, many find it both economically effective and ethically responsible to involve the union more closely in strategic matters. For unions, partnership is viewed as a means to restore unions’ historical ability to secure employee rights. Several authors (e.g., Ackers et al., 2005; Ackers & Payne, 1998; Haynes & Allen, 2001; Tailby et al., 2007) have argued that partnership-based governance may be the only viable revitalization strategy for unions. The underlying argument is that the reconstruction of representative employee participation is needed to achieve organizational efficiency objectives and accommodate new labor laws. Partnership may thus provide unions with important opportunities for increasing their social and economic influence and deepen their institutional role at various organizational levels (Ackers & Payne 1998; Martinez Lucio & Stuart, 2002, 2004; Tailby et al., 2007).

As a result of declining union density, nonunion systems of employee governance are becoming increasingly prevalent. Such systems enable management to determine and administer work rules on a unilateral basis and—also on a unilateral basis—to determine whether and how it wants to resolve



employee complaints. Nevertheless, as noted above, an increasing number of firms have attempted to provide employees with greater opportunities to both influence the shaping of work rules and to voice their opinions about current rules, practices, or decisions (e.g., Heery, Healy, & Taylor, 2004; Tailby et al., 2007). For example, during the past three decades, employers have experimented with quality circles, team briefings and after-event reviews, and alternative empowerment schemes to promote greater commitment among employees and to give them a greater sense of influence over their work and general work processes (Biron & Bamberger, 2010; Heery, 2002; Spreitzer, 2007). In addition, a wide range of alternative dispute resolution mechanisms have been introduced, including multistep grievance systems, open door policies, “ombudsman” positions, and even peer review boards. However, in nearly all such cases, management reserves for itself the right to make the final decision. Intel, for example, uses a multistep disciplinary process in which employees are first given a warning and then put under a status of “corrective action,” under which the employee and his or her supervisor jointly establish performance/behavioral goals for a defined period of a time. At the end of this period, the employee’s performance is evaluated against these pre-set objectives. Dismissal or other punitive action can only be considered after this assessment is made.

Indeed, many companies have adopted advanced nonunion governance frameworks precisely with the intent of eliminating any employee interest in seeking union representation. Such “union avoidance” ER strategies are grounded in the assumption that employees do not require “independent” representation to influence organizational rule making and receive due process in the handling of grievances. However, this assumption may be questioned for several reasons. First, lacking independent and collective representation, many employees may feel too much of a personal risk to individually voice concerns to their employer. Second, lacking “legally provided tools of bargaining power” (Kim & Kim, 2004, p. 1078) and being “enterprise confined,” nonunion employee representation “cannot make credible threats of sanctions in support of employee demands, or even to hold management to its commitments to consult” (Tailby et al., 2007, p. 2). Third, most nonunion dispute resolution systems end with (at most) top-level managerial review (as opposed to external arbitration) as the final step (Chachere & Feuille, 1993). Fourth, as noted by Mahoney and Klaas (2008, p. 258), “in contrast to labor arbitration, employees in non-union dispute resolution systems are often required to secure their own representation,” which may involve high costs. And finally, union representatives acquire knowledge and expertise in grievance handling from prior cases (the “repeat player effect”; Bingham, 1997). In nonunion systems, “this knowledge is often scattered across numerous unaffiliated employment attorneys; thus, individual employees are at a disadvantage relative to the employer” (Mahoney & Klaas, 2008, p. 258).

## *HR Objectives and Workplace Governance*

Why do some firms make union-avoidance the cornerstone of their ER policy, whereas other firms (such as UPS and Southwest Airlines) have a tradition of almost encouraging their workers to join a union? To answer this question, a better understanding of the link between ER objectives and alternative workplace governance frameworks is required.

At the core of the union governance issue is the degree to which unionization is consistent or inconsistent with overall ER objectives. Although the “gut” response of most managers is that unionization is in no way in the employer’s interest, the research of Freeman and Medoff (1984), Mishel and Voos (1992), and most recently, Carol Gill (Gill, 2009; Gill & Meyer, 2013) suggests otherwise. According to these researchers, employee turnover in union settings is lower than in nonunion settings, not only because of the existence of a union wage differential, but also because unionized workers have the

opportunity to express and enforce their opinions. That is, a union-based governance system provides individual workers with a formalized employee voice that, in the long run, can help eliminate inefficiencies in production. However, perhaps most importantly to managers, labor productivity tends to be higher in unionized firms than in nonunion firms. Much has been written on the union-productivity association (e.g., Bennett, & Kaufman, 2007; Freeman & Medoff, 1984; Gill, 2009; Metcalf, 2003; Verma, 2005). Higher productivity derives, among other things, from more-efficient utilization of available human capital, better firm competitiveness, higher worker satisfaction, and lower turnover, which leads to lower recruitment costs, less interruption of work, higher return on investment (e.g., training), and a more skilled workforce.

Nevertheless, at the macro level, as Pencavel (2005) noted, empirical evidence on unionization and market productivity is mixed. For example, at times, Scandinavian countries operated with high levels of unionism and had superior economic performance. At other times, countries like Ireland and the Netherlands operated at mid-levels of unionism and did well. And in some periods countries with low levels of unionization, such as the United States, outperformed other economies. Doucouliagos and Laroche (2003) reached a similar conclusion. Moreover, the optimal level of unionism and its presumed effect on productivity may depend on different factors, such as the presence (and effectiveness) of other mechanisms for giving workers a voice (Kaufman, 2005).

Reviewing the state of research since his 1984 book with Medoff was published, Freeman (2005) concluded that the original book's claims about what unions do remain valid. As he noted, "the empirical assertions about what unions do to wages, dispersion, and inequality of pay; fringe benefits; quits and turnover; profitability; job satisfaction; human resource management policy; and political activity and outcomes appear robust over the past two decades" (p. 650). Still, research on unions' effects on productivity has generated a wide range of estimates, with Freeman (2004) himself as well as others suggesting that the original book may have been "overly optimistic" (Hirsch, 2004, p. 431).

Consequently, for some firms, employee representation and the union-based governance system may in fact facilitate the achievement of key ER objectives. For example, unionization may give such employers an element of workforce stability and predictability. Giving employees a sense that their voices are heard and providing a framework for ensuring due process may help ameliorate feelings of alienation, inequity, and dissatisfaction among employees, and may thus, as discussed above, help in reducing productivity and efficiency barriers. Moreover, such a system may increase the efficiency with which employee relations are handled and even reduce the number of disputes and individual employee cases that managers have to deal with, in that unions tend to think about the broader, long-term implications of a given dispute on employee relations—something individual employees rarely consider (Baron & Kreps, 1999).

On the other hand, employee representation may have important disadvantages for certain firms. For example, the imposition of a formal system of governance may greatly limit employers' freedom of action with regard to resource deployment and work organization. Furthermore, to the extent that the union negotiates for work rules limiting the efficiency of various work processes, a union-based governance system may increase overall labor costs and slow the firm's reaction time to shifts in the market or technology. Finally, rather than developing a sense of commitment to their employer, employees' attachment may be oriented more toward their union (Bamberger, Kluger, & Suchard, 1999).

Workforce governance in organizations more heavily weighting these union disadvantages is likely to be driven by two main objectives, namely (a) ensuring regulatory compliance and (b) union avoidance. While a nonunion environment may facilitate employment-at-will, such organizations must still ensure that employment-at-will policies comply with local employment laws (regarding, for example, equal employment opportunities and the protection of those with recognized disabilities). Accordingly, in such

contexts governance systems are likely to be designed so as to minimize the risk of costly litigation while still giving managers maximal flexibility.

As for governance strategies aimed at union avoidance, as ironic as it may appear, union avoidance efforts are often structured around building workforce governance systems that closely mirror those found in unionized firms. That is, to maximize employee commitment and attachment, and to help internalize organizational norms, union avoidance governance strategies often empower employees to contribute to setting work-related rules and policies. Similarly, they may include alternative dispute resolution mechanisms based on the principal of due process. Typically, such organizations attempt to empower employees by establishing formal plant-level groups, teams, or task forces mandated to address such issues as safety, quality, and employee development.

The adoption of due process-based dispute resolution frameworks is likely to enhance employees' sense of procedural and distributive justice, further strengthening employees' perception of a caring culture and deepening bonds of attachment. Although nonunion employers are hesitant to offer outside arbitration as the final step in such a process, many do offer an adjudication panel comprised (at least in part) of employees as the final step (Feuille & Hildebrand, 1995). In the United States, however, nonunion employers adopting such rule-making and dispute resolution frameworks need to be careful to avoid violating the Wagner Act's provision banning the establishment of employer-dominated labor organizations (Hogler, 1993).

### *HR Strategy and Workplace Governance Frameworks*

Although there appears to be a link between ER objectives and workforce governance systems in theory, few empirical studies have focused on such relations. Nevertheless, the variance in governance frameworks across firms emphasizing alternative HR strategies has been examined in at least one study. Arthur (1992), in his study of American steel minimills, examined the link between HR strategy and due process—specifically, “the degree to which mills relied on formal procedures to resolve employment-related disputes” (p. 493). As expected, Arthur found formal grievance systems to exist in all 14 unionized plants. Among the nonunion minimills examined, seven reported having no formal grievance system whatsoever, and the remaining nine plants reported having some sort of formal process for dealing with employee grievances. Most importantly, Arthur found a significant link between the dominant HR strategy and the nature of workplace governance. Specifically, he found that among the 12 firms in which a “pure-type cost reducing” or “inducement” (i.e., secondary) HR strategy was dominant, the level of due process in workplace governance was significantly lower than the mean level for all the minimills studied. In contrast, the level of due process was significantly higher than the mean in those firms in which a paternalistic HR strategy was dominant. The level of due process for those 14 firms (8 unionized and 6 nonunion) in which the commitment strategy was dominant was not found to differ significantly from the mean. Finally, the level of due process among specifically nonunion commitment-oriented firms was statistically identical to the mean for all union and nonunion minimills. Together, these findings suggest that, as proposed above, firms in which a commitment-oriented HR strategy is dominant attempt to closely mirror union-based governance practices even in those cases in which no union is present. More recent studies further support this conclusion. For example, Collins and Smith (2006) and Ngo, Lau, and Foley (2008) found significant relationships between high-commitment HR practices and employee relations climates characterized by a high degree of employee empowerment and involvement in determining policy.

Based on these findings and the theory presented above, it is reasonable to assume that workplace

governance practices will vary according to the dominant HR strategy in a firm. Such a pattern of variance is highlighted toward the bottom of [Table 7.2](#). Specifically, as can be seen in the table, governance systems in firms in which the secondary HR strategy is dominant are likely to be characterized by a lack of formally constituted employee organizations. The temporary nature of employment relationships in such firms, and the fact that many employees in such organizations may be employed by one firm and contracted to another, make it difficult for employees to organize. These same conditions make it difficult for employers to justify organizing nonunion frameworks (e.g., employee task forces) designed to give employees input into organizational rules and policies. Providing employees with such influence may slow down managerial decision making and may be viewed as constraining managerial flexibility. Although the formation of such alternative employee representation frameworks may be an effective union avoidance tactic, as noted above, for such firms, the threat of unionization is limited to begin with, due to the temporary and often contractual nature of the employment relationship (Kalleberg, 2000; Mitlacher, 2007).

Similarly, firms in which the secondary HR strategy is dominant are characterized by few if any institutionalized mechanisms for dispute resolution. As noted above, such firms tend to adopt the Tayloristic principle of separating the execution of work from its conceptualization, and deconstructing complex work processes into simple, routine steps requiring little on-the-job training and even less pre-job training. As a result, the firm's dependence on any particular worker or group of workers is limited. Consequently, such organizations tend to lack any incentive to give employees formal opportunities to voice concerns, preferring to rely on informal voicing mechanisms based on the supervisor-employee relationship, or if necessary, to let employees "vote with their feet." To the extent that formal voicing or grievance mechanisms are provided, they tend to be limited to issues subject to strict government regulation (e.g., claims of age or gender discrimination). U.S. courts have made it clear to employers that by adopting alternative dispute resolution frameworks for the resolution of employee claims of discrimination, they can avoid the costs and risks of litigation (Feuille & Hildebrand, 1995; Wheeler, Klaas, & Mahony, 2004).

In contrast, union-based workplace governance frameworks are common in firms in which the paternalistic HR strategy is dominant (Arthur, 1992; Dyer & Holder, 1988; Ngo et al., 2008). In such firms, the collective bargaining process is likely to give employees at least a limited degree of control over work rules, and a formal grievance procedure ending in arbitration tends to provide employees with extensive due process rights. For employers operating in highly stable and less competitive product or service markets, such governance frameworks may offer a high degree of stability and predictability, and thus enhanced organizational performance (Bacharach & Shedd, 1999; Harcourt & Lam, 2009; Thirkell & Vickerstaff, 2002).

However, many firms in which the paternalistic HR strategy dominates operate under nonunion conditions. Governance systems in nonunionized paternalistic firms tend to differ from systems in unionized paternalistic firms in two respects. First, there is generally an absence of employee input into the setting of workplace rules. As in the case of the secondary HR strategy, the adoption of mechanisms designed to provide employees with input into the organization of work and the design of the work process would directly contradict many of the core Tayloristic assumptions on which this HR strategy is based. Furthermore, given the ILM grounding this strategy, such frameworks are typically not required to boost employee commitment to the firm. Stability, predictability, and employee commitment are typically provided by the presence of an ILM and a clan culture, which create a strong incentive for loyalty by, in part, making it costly to leave.

Second, although formalized, multistep dispute resolution frameworks are prevalent in such systems,

they tend to be characterized by strict limitations with regard to the employee's right to representation (i.e., the employee is typically forced to represent him or herself). Furthermore, the final step tends to be an appeal to a senior line or staff manager or, at most, some sort of internal managerial panel (Chachere & Feuille, 1993; Colvin, 2003). Firms in which the paternalistic HR strategy dominates may be driven to adopt such dispute resolution frameworks by two factors. Given the stability of the workforce and the nature of work processes, such firms tend to be highly susceptible to union organization drives. Thus, the adoption of some form of remedial voicing system may play a key role in such firms' attempts to retain their nonunion status (Freeman & Kleiner, 1990; Klaas, Olson-Buchanan, & Ward, 2012; Sheppard, Lewicki, & Minton, 1992). Second, like firms dominated by the secondary HR strategy, such dispute resolution frameworks may be adopted out of an interest in reducing the risks of employee litigation (e.g., Wheeler et al., 2004).

In firms dominated by the free-agent system, both nonunion and union-based governance frameworks are likely to be in effect. In the case of firms hiring non-unionized free agents, although there may be no contractual requirement to provide employee input into the setting of work rules, institutionalized work practices and professional ethos may nevertheless demand a certain degree of employee input. Indeed, the output-based system of control at the core of the free-agent strategy demands that employees be empowered to influence or even determine how to best structure the work process. Nevertheless, in such firms, formalized dispute resolution frameworks are unlikely to be prevalent unless they are specified in the particular free agent's employment contract. For example, to reduce the risks and costs of litigation, it may be to the advantage of both the employer and the free agent to specify that any unresolvable dispute be subject to third-party arbitration.

Collective bargaining provides many unionized free agents in the building trades and the arts with a more formal means to influence the establishment of basic workplace rules and employment conditions. However, for many professional free agents, professional associations may offer an alternative means to influence workplace rules. For example, professional associations in such fields as law and accounting have succeeded in institutionalizing certain rules and work practices designed to protect the professional stature and labor market position of their nonunionized constituents (Abbott, 1993; Adler, Kwon, & Heckscher, 2008). In addition, both unions and professional associations (e.g., the American Medical Association, state bar associations) have generally succeeded in institutionalizing formal dispute resolution systems, limiting the ability of the employer to unilaterally determine how to handle employee complaints or to implement sanctions against the employee. In the case of unionized free agents (i.e., members of craft unions), such dispute resolution mechanisms tend to be based on a multistep grievance process ending in arbitration. However, even in the case of nonunionized professional free agents, employers may be required to submit disputes to a professional (i.e., peer-based) review board.

Finally, as Arthur (1992) noted, although firms dominated by the commitment HR strategy are likely to be characterized by nonunion governance systems, this strategy in no way precludes the existence of union-based governance systems as well. Indeed, several authors (Katz, 1985; Kochan et al., 1986) have noted that unionized firms in such industries as steel and automobile manufacturing have moved toward more of a commitment-based HR strategy, in part by enhancing their union-based governance system. That is, while retaining a multistep grievance system ending in arbitration, they have attempted to expand the opportunities for employee involvement in the setting of work rules and the transformation of work processes. For example, in conjunction with the United Autoworkers, a number of automobile manufacturers have set up multiple frameworks for employee involvement (e.g., reorganizing of work around semiautonomous teams) and have given employee representatives extensive influence over such areas as safety, ergonomics, employee development, benefits, and employee assistance. Underlying such

efforts is a desire not so much to reduce turnover (the existence of ILMs ensures a relatively low rate of turnover), but to more strongly align employee interests with those of the firm and enhance operational efficiencies.

Nevertheless, the bulk of those firms adopting the commitment strategy tend to be nonunionized. In these firms, as noted above, employers have attempted to use alternative employee representation and participation schemes to strengthen workers' sense of attachment to the organization. In some countries, such as Germany, this has been accomplished by the adoption of works councils or employee participation committees—representative bodies lacking the ability to strike or negotiate over economic issues. However, in the United States, such frameworks are currently precluded under the terms of the Wagner Act. Thus, in the United States, nonunion firms have had to “walk a tightrope” in finding alternative mechanisms to allow employee input into the setting of work rules and procedures. Semiautonomous work teams, quality circles, and labor-management task forces are among some of the most widely adopted mechanisms.

Similarly, governance systems in these firms are characterized by a focus on due process, albeit typically with management still retaining the right to make a final, unilateral decision. Feuille and Hildebrand (1995) noted that the most widely mentioned type of due process mechanism in such firms is the “open door” appeal to higher management, allowing the aggrieved employee to appeal an adverse decision up the organizational chain of command. As noted earlier, alternative mechanisms include mediation on the part of some organizational ombudsman's office, and/or settlement by a management or joint employee-management review panel. There is little robust evidence that such alternative dispute mechanisms have any positive impact on productivity in nonunion workplaces (Feuille & Hildebrand, 1995). Nevertheless, by signaling recognition of the importance of equity and procedural justice, the mere existence of such mechanisms may help organizational leaders achieve their key ER objective, namely the creation and strengthening of an organizational culture based on a sense of community, caring, and employee volunteerism.

## **SUMMARY**

We began this chapter by suggesting a need for a broader definition of the employee relations subsystem. Within this context, we defined this subsystem as relating to those strategic managerial activities aimed at establishing, enforcing, and reinforcing the psychological contract between employer and employees. Based on this definition, we suggested that the ER subsystem encompasses a wide range of managerial choices having to do with (a) the nature of control and coordination in the workplace; (b) the degree to which firms want employees to internalize the organization as a core element of their self-identity; and (c) the way in which employee equity expectations are balanced with the organizational need for rule compliance, and wellbeing is balanced with the organizational need for effectiveness. Thus, it should be clear that the ER subsystem is a core element of the HR system and that despite its industrial relations orientation, it often serves as the foundation on which other elements of the HR strategy are built (Ferris, Arthur, Berkson, Kaplan, Harrell-Cook, & Fink, 1998; Fulmer, Gerhart, & Scott, 2003).

After explaining the significance of the ER subsystem and its potential impact on key organizational outcomes, we proposed that subsystem strategies tend to be based on ER objectives and that these ER objectives are themselves a function of the firm's dominant HR strategy. Specifically, we argued that the more ER objectives focus on simple employee rule compliance, the less sophisticated the ER subsystem. In contrast, we argued that in firms placing an emphasis on individual attachment and commitment to the

firm, the ER subsystem tends to be more sophisticated and complex. Finally in the second part of this chapter, we reviewed some of the literature describing how, across three critical subsystem domains—work systems, noneconomic benefits such as employee assistance, and the workplace system of governance—ER subsystems tend to vary in a fairly predictable manner depending upon firms’ dominant HR strategies.

Taken in combination with the previous three chapters, the material presented in this chapter suggests that HR subsystem practices tend to cluster together into internally consistent packages or configurations. For example, as we noted in the current chapter, the adoption of formalized alternative dispute resolution systems is highly consistent with the staffing, performance management, and compensation practices typical of firms in which the commitment HR strategy is dominant. However, one question that remains to be examined is whether such consistency is really necessary to enhance firm performance. In the next chapter, we directly address this question in an attempt to gain a further understanding of the link between HR strategy in all its respects and overall firm performance.

## NOTE

1. In this chapter, we focus strictly on the work design elements of Taylorism. Taylor’s (1911) scientific management approach also called for the adoption of more rational systems of selection and advancement—systems developed on the basis of scientific research. Taylor also proposed more rational systems of compensation, placing an emphasis on performance-based incentives (i.e., piece-rate compensation). As Perrow (1979) wrote, the idea was to “take the eyes of labor and management off the division of the surplus (higher wages or higher profits) and instead turn them toward the problem of increasing the *size* of the surplus” (p. 64).



# III

## Human Resource Strategy

### Impact, Challenges, and Developing Approaches

## THE IMPACT OF HUMAN RESOURCE STRATEGY

The bottom-line imperative of high organizational performance dominates many discussions about how HRM contributes to firms. The literature abounds with models purporting to explain how HRM practices have an impact on employee behavior and hence affect bottom-line firm performance.

—Hailey, Farndale, and Truss (2005, p. 49)

Does HR strategy make a difference? That is, to what degree can managers expect to influence their “bottom line” by adopting one HR strategy over another? Given the centrality of such questions, it should come as no surprise that the bulk of strategic HRM research in recent years has focused precisely on such issues. Indeed, if HR strategy is unassociated with key organizational outcomes, then—aside from intellectual curiosity—researchers have little incentive for further inquiry. Over the past 25 years or so, dozens of studies have explored the association between HR strategy and a wide variety of organizational outcomes, including turnover, efficiency, productivity, innovativeness, financial performance, and firm survival. In this chapter, we review these studies, not only to assess the degree to which HR strategy may predict organizational outcomes but, perhaps more importantly, to gain a better understanding of the nature of such effects.

In the first section of this chapter, we review several early studies suggestive of a relationship between HR strategy and firm performance, as well as more recent evidence of this relationship. Next we review empirical research exploring alternative explanations for the HR strategy-performance link and seeking to identify key moderators of this relationship. Finally, we discuss several of the key methodological, practical, and theoretical challenges facing researchers in this area.

### **DEMONSTRATING THE LINK BETWEEN HR STRATEGY AND FIRM PERFORMANCE**

HR researchers have long had an interest in elucidating the impact of specific HR practices on individual-level outcomes such as turnover and job satisfaction. Key early studies include those of McEvoy and Cascio (1989), who demonstrated that job enrichment and realistic job previews can be effective in reducing turnover, and Hackman and Oldham (1980), who showed that redesigned work systems can enhance job satisfaction and employee motivation. Over the past quarter century, scholars have also investigated the impact of HR practices on organizational-level outcomes such as productivity and financial performance (Boselie, Dietz, & Boon, 2005; Dyer & Holder, 1988; Guest, Michie, Conway, & Sheehan, 2003; Ichniowski, Shaw, & Prenzushi, 1997; West, Guthrie, Dawson, Borrill, & Carter, 2006; Wright, Gardner, Moynihan, & Allen, 2005). Initial studies in this genre aimed at establishing the nature and magnitude of the HR impact on such outcomes. For example, a number of studies suggested that productivity (i.e., lower labor costs and scrap rates) may be enhanced through the adoption of specific HR practices such as “transformational” labor relations (Cutcher-Gershenfeld, 1991), more intensive training and enriched work systems (Guzzo, Jette & Katzell, 1985), and contingent pay systems (Weitzman & Kruse, 1990). Work in the field of human resource accounting (Cascio, 1991; Flamholtz, 1985) suggested that substantial financial returns may be gleaned through HR practices designed to enhance a

firm's human capital base. Similarly, utility analysis researchers (Boudreau, 1991; Schmidt, Hunter, MacKenzie, & Muldrow, 1979) suggested that HR practices yielding a one-standard-deviation increase in employee performance can produce a financial return equivalent to up to 40 percent of salary per employee.

Although these studies have consistently pointed to the positive impact of HR policies and practices on a variety of organizational outcomes, because they have tended to focus on individual HR policies or practices, the results need to be treated with some caution. As Huselid (1995) noted, it is likely that firms adopting such practices in one area are likely to use them in other areas as well. Based on this assumption, he reasoned that

to the extent that any single example reflects a firm's wider propensity to invest in such practices, any estimates of the firm-level impact of the particular practice will be upwardly biased ... (and) the sum of these individual estimates may dramatically overstate their contribution to firm performance. (p. 641)

Consequently, several more recent studies have examined the impact of such practices as manifested in strategies or coherent bundles.

In two of the earliest studies examining the impact of human resource strategy on organizational outcomes, Schuster (1986) and Kravetz (1988) looked at the relationship between "progressiveness" in HR management and firm profits. In both cases, a positive association was found between strategy and performance. However, in both studies, the analyses were limited to simple bivariate correlations, making it impossible to control for the potential confounding effects of industry and firm size.

More statistically compelling studies have been conducted since the 1990s. For example, using a sample of 30 U.S. steel minimills, and controlling for the age, size, union status, and business strategy of the mills, Arthur (1994, p. 679) found plants adopting commitment HR strategies to have a significantly lower number of labor hours per ton of output (an indicator of efficiency) and lower scrap rates (an indicator of production quality). Thus, on the basis of the strategic taxonomy developed in his earlier study (1992), Arthur concluded that HR strategy is associated with variation in manufacturing performance. Moreover, Arthur's findings suggested that the commitment HR strategy may be comprised of a set of "best practices," and may thus offer a universal source of competitive advantage. Nevertheless, in many ways, Arthur's study raised more questions than it answered. First, Arthur himself wondered how generalizable these findings would be with respect to manufacturers in other industries, not to mention organizations in entirely different fields (e.g., education or health). Second, Arthur acknowledged that the strategy-performance link may be contingent on other factors such as the firm's business strategy or the degree to which system practices are internally aligned. Given his small, single-industry sample, Arthur was unable to address either of these concerns. Finally, although demonstrating that HR strategy may indeed explain some of the variance in performance-related variables, Arthur was unable to place a precise figure on the magnitude of this effect.

Using a larger, multinational sample of automotive assembly plants, MacDuffie (1995) provided further support for a strategy-performance link, thus suggesting that Arthur's findings may indeed be generalizable (at least to firms in other heavy industries). More importantly, however, his study offered tentative answers to the two other questions raised by Arthur's study. First, MacDuffie's results suggested that although individual HR practices may be associated with enhanced firm performance, the greatest effects are manifested when these practices are grouped together into internally consistent bundles. This finding suggests that the full positive impact of specific practices on performance may be contingent on

the implementation of other, complementary practices. Second, MacDuffie's findings supported the universalistic approach suggested by Arthur's findings. Specifically, whereas findings supportive of a contingency or "fit" perspective would have shown that both mass (i.e., control-based) and flexible (i.e., commitment-oriented in Arthur's framework) production plants with a good fit between their HR and production strategies outperform those with poor fit, MacDuffie's findings suggested that plants adopting the "innovative HR practices" typically associated with flexible production consistently outperformed plants adopting alternative HR strategies, *regardless* of their production strategy.

Despite these important findings, MacDuffie's study was also somewhat limited by a small, single-industry sample. Furthermore, although suggesting that individual and system-wide HR practices may have a substantial impact on a firm's bottom line, MacDuffie's study (like Arthur's) focused on manufacturing outcomes such as productivity and quality. Consequently, like Arthur, MacDuffie was unable to quantify the magnitude of the impact of HR strategy on overall firm performance. Finally, like Arthur, MacDuffie was unable to control for two potential methodology-based biases. The first concerns the potential simultaneity between HR strategy and firm performance. In simple terms, using cross-sectional data, neither Arthur (1994) nor MacDuffie (1995) were able to take into account the possibility that more successful firms may systematically be more likely to adopt more commitment-oriented HR strategies. The second bias concerns the potential for selectivity or response bias—that is, the possibility that response rates may be greater for better performing firms and firms adopting "commitment" or "flexible" strategies.

Responding to these limitations, Huselid (1995) attempted to provide the first estimates of the magnitude of the HR strategy effect on a firm's bottom line, while controlling for such potential biases (e.g., using outcome measures from the year subsequent to that in which data on HR practices were collected). Drawing data from a national sample of nearly one thousand firms, Huselid examined the impact of high-performance work practices on both intermediate employee outcomes (namely turnover and productivity) and short- and long-term measures of corporate financial performance. Like Arthur's (1994) "commitment" HR strategy, Huselid's highperformance work practices included extensive employee involvement and training, contingent pay, comprehensive and careful employee selection, and extensive use of internal labor markets.

Rather than asking respondents to indicate the presence or absence of each of the high-performance HR practices, Huselid (1995) had respondents indicate the proportion of employees affected by each practice, thus providing a more sensitive estimate of the breadth and depth of practice implementation and providing an indication of the degree to which such practices could be deemed to be "dominant" in the firm. Furthermore, to avoid the biases inherent in the conceptual and empirical overlap among individual items, Huselid used factor analysis to identify the subsystems underlying these individual practices. Using such an approach, Huselid explored the degree to which subsystem practices associated with a commitment (or "highperformance") HR strategy had an impact on firm performance.

Huselid's findings suggested that application of a commitment strategy can yield substantial returns. For example, in practical terms, each one-standard-deviation increase in each subsystem practice scale reduced turnover by 7.05 percent, or by 1.30 percentage points (from a mean of 21.48 percent), even after controlling for firm size, the impact of unions, and employee compensation. Similarly, under the same control conditions, a one-standard-deviation increase in each subsystem practice scale was found to raise net sales per employee (an indicator of productivity) in a single period by an average of \$27,044, or nearly 16 percent of the mean sales per employee. Finally, with respect to firm financial performance, a one-standard-deviation increase in each subsystem practice scale was found to be associated with a per-employee gain in firm market value of \$18,641, and a per-employee gain in annual accounting profits of

\$3,814. This decade-long line of research involving four national surveys and observations on more than 2,000 firms led Huselid and Becker (2000, p. 851) to conclude that a one-standard-deviation change in the degree to which HR best practices are in place in a firm has an average economic impact equivalent to 10 to 20 percent of a firm's market value.

More recent studies further support the HR-performance association and generalize it to other countries. For example, Fabling and Grimes (2010) confirmed this association using Statistics New Zealand's 2001 Business Practices Survey (BPS). The BPS collects data from a representative sample of approximately 3,000 New Zealand firms employing six or more full-time employees (an 82 percent response rate). After controlling for the impact of general (non-HR) management practices and firm characteristics (e.g., general strategy and planning skills), Fabling and Grimes (2010) found that the adoption of high-performance work practices (and, in particular, training and performance-based pay) was associated with an improvement (relative to parallel measures three years prior) on three different firm performance measures: profitability relative to major competitors; productivity relative to major competitors; and market share.

Wright et al. (2005) sought to more closely examine the causal aspects of the HR practice-organizational performance relationship. Recognizing the need to better understand the causal chain through which HR impacts profitability, they examined how measures of HR practices correlated with past, concurrent, and future operational performance measures (e.g., quality, profitability, productivity). The results, based on data from 45 business units, indicated high and invariant correlations with performance measures at all three times. However, when controlling for past or concurrent performance, the correlation of HR practices with future performance was virtually eliminated. Although these results by no means suggest that HR practices do not have a positive impact on performance, they provide no more support for concluding that HR practices affect performance than they do for concluding that performance affects HR practices. As the authors noted, "these results spark cautious interpretation among even predictive studies" (p. 28).

The studies described above, alongside others, also provide some insights into the processes through which HR practices may influence performance. For example, Huselid's (1995) findings suggest that a significant proportion (approximately 75 percent) of the impact of practices associated with the commitment strategy "is attributable to either lower turnover or higher employee productivity or both" (p. 663). Similarly, focusing on publicly traded firms included in *Fortune Magazine's* "100 Best Companies to Work for in America," whose relative performance was examined via comparisons to both companies in the broad market and a group of matched firms, Fulmer, Gerhart, and Scott (2003) found that superior performance of companies in the 100 Best list (over the broad market, and in some cases, over the matched group) was partly explained by stable and highly positive workforce attitudes (e.g., fairness, respect, and pride).

Other studies have sought to identify conditioning factors for the HR-performance link. For example, Huselid's (1995) findings suggested that whereas internal fit (the degree to which complementary practices are not implemented in isolation) had a significant and positive impact on financial performance, external fit (the degree to which the HR strategy is aligned with firm business strategy) had no similar effect. In contrast, as we will discuss in more detail below, Delery and Doty (1996) found external fit to play a critical role in determining the impact of HR strategy on performance. Others considered firm characteristics as potential moderators. For example, Fabling and Grimes (2010) found that the strength of the HR-performance relationship differed by firm size and age (i.e., stronger among younger firms and those in high-tech sectors). In the next section, we further explore factors likely to mediate and moderate the HR-performance association.

# EXPLAINING THE LINK BETWEEN HR STRATEGY AND FIRM PERFORMANCE

How can the effect of HR strategy on firm performance be explained? As we suggested above and in earlier chapters, it is commonly assumed that the impact of HR strategy on firm performance is a function of three interrelated processes (Boxall & Purcell, 2008; Guest, 2007; Jiang, Lepak, Hu, & Baer, 2012; Kehoe & Wright, 2013; Lepak, Liao, Chung, & Harden, 2006). First, HR strategy is likely to shape the human capital base of the firm through policies and practices having to do with recruitment and selection, as well as training and development. Second, HR strategy is likely to influence employees' motivation, commitment, and performance through policies and practices relating to career development and advancement, compensation, and commitment-building benefits (e.g., employee assistance). Third, HR strategy can have an impact on firm performance by influencing the degree to which talented and motivated employees are provided with the job-related opportunities and discretion to contribute. We will discuss these three processes in the next section.

## *Human Capital, Motivation and Development, and Opportunity-Based Explanations*

**Human capital.** Strategic HRM theorists have argued that underlying these assumed processes are a number of well-grounded organizational theories, several of which we discussed in [Chapter 1](#). First, the resource-based theory of the firm (Barney, 1991) explains the impact of HR strategy on performance on the basis of human capital. More specifically, theorists adopting this perspective suggest that HR policies and practices influence the organization's ability to acquire, develop, effectively deploy, and retain talent, with human capital inventories and deployments influencing organizational outcomes. For example, based on a meta-analysis of 92 studies covering data from over 19,000 organizations, Liu, Combs, Ketchen, and Ireland (2007) identified selectivity, compensation level, and training as the main KSA-enhancing practices (KSA standing for knowledge, skill, and ability) through which firm performance is positively influenced. More recently, Park and Shaw (2013) interpreted their own meta-analysis to suggest that the beneficial effect of HR practices may operate through reduced turnover. They argue that lower turnover not only facilitates the retention of talent, but also better preserves the organization's social fabric. However, they and others (e.g., Siebert & Zubanov, 2009) also found that the inverse relationship between turnover and performance varies across types of employment systems and job types, such that HR strategy, by influencing employee turnover, may have different performance-related implications depending on the overall nature of the employment system.

Building on the critical mediating role of turnover and human capital, Nyberg and Ployhart (2013) proposed the Context-Emergent Turnover (CET) theory, suggesting that HR policies and practices interact with surrounding organizational conditions to influence the timing and nature (i.e., quantity and quality) of knowledge/skill/ability depletion at the unit or organizational levels. In turn, they argue, the dynamic nature of this human capital depletion explains a substantial portion of the impact of HR on unit or firm performance. That is, consistent with the resource-based view, they propose that a unit's human capital stock mediates between HR strategy and unit performance. Moreover, they argue that the impact of a unit's human capital stock on firm performance is moderated by the timing and nature of collective turnover. Although CET theory has yet to be empirically validated, it incorporates many of the ideas developed over the past two decades with respect to the role of human capital accumulation, development, and retention as a critical link between HR policy and practice (on the one hand) and firm performance (on

the other).

**Motivation and development.** Behavioral theory (Jackson et al., 1989; Jackson & Schuler, 1987; Wright & McMahan, 1992) suggests that certain HR activities can elicit and reinforce the kinds of behaviors and attitudes required by the firm. Building on this theory, Mossholder, Richardson, and Settoon (2011) proposed that helping behavior is likely to occur more frequently in commitment HR systems than in other forms of HR systems (e.g., compliance HR systems). Others have also applied concepts associated with organizational citizenship (Organ, 1988) to suggest that HR policies and practices create conditions conducive to behaviors such as helping, collaborative effort, and cooperation, which in turn have a cumulative impact on firm performance. The logic is that employee attitudes (e.g., satisfaction, commitment, engagement) are linked with organizational outcomes through positive employee behaviors, such as organizational citizenship behaviors (Organ, Podsakoff, & MacKenzie, 2005; Ostroff & Bowen, 2000; Purcell & Kinnie, 2007; Sun, Aryee, & Law, 2007; Whitman, Van Rooy, & Viswesvaran, 2010). For example, adopting such a logic, and using data from hotels in the People's Republic of China, Sun et al. (2007) found that organizational citizenship behavior partially mediated the relationships between high-performance HR practices and two indicators of firm performance, namely productivity and turnover.

Agency theory (Eisenhardt, 1989) also explains the impact of HR strategy on performance in terms of its motivational effects. That is, from an agency theory perspective, HR policies and practices may be more effective in enhancing firm performance to the extent that they better align the interests of workers with those of management. Indeed, as we already discussed in our review of compensation strategy, researchers have extensively applied agency theory in examining the conditions under which pay for performance is likely to enhance individual and unit/firm performance.

**Opportunity.** Finally, control theory (Ouchi, 1977; Thompson, 1967) has also been used to explain the impact of HR strategy on firm performance (Snell, 1992). Here the logic is that certain HR policies and practices, particularly those dealing with supervision and performance management and the design of work systems, affect opportunities for employee contributions. Simply put, studies suggest that even when a workforce is highly motivated, organizational control structures may limit their ability to enhance their value-added contribution to the firm. For example, Biron and Bamberger (2010) posited that structurally empowering individuals to decide not only how to work, but what to work on is associated with improved individual task performance. To test this idea, they simulated a call center and gave better performing participants in an experimental condition the opportunity to choose the kinds of calls they wanted to answer. Their findings not only supported their basic proposition, but also indicated that granting such control to the participants was associated with enhanced wellness-related outcomes (i.e., lower burnout) and had no adverse impact on overall operational efficiency. Similarly, Grant (2008) found that by designing jobs so as to give employees a greater sense of the prosocial benefits of their work, individual motivation and unit performance was enhanced significantly.

### *The Search for Alternative Explanations*

While human capital, motivation and development, and opportunity-related processes offer plausible explanations for the association between HR strategy and performance, alternative explanations cannot be ruled out. For example, Welbourne and Andrews (1996) drew from population ecology theory (Hannan & Freeman, 1989) to argue that the positive impact of HR strategy on firm performance is explained by its impact on what they refer to as “structural cohesion,” or in other words, the “employee-generated synergy that propels a company forward, allowing it to respond to its environment while still moving forward” (p.



896). These authors argue that certain HR strategies may be more strongly associated with firm performance because they provide the stable infrastructure necessary for the organization to rapidly and effectively respond to change. Using a sample of start-up organizations, they found that start-ups placing more value on employees at the time of their initial public offering (e.g., those which adopted high-performance HR practices and cited employees as a source of competitive advantage in their mission statement) had higher sales growth and innovation as well as better survival chances. Other researchers (e.g., Mayson & Barrett, 2006; Messersmith & Guthrie, 2010) have subsequently made similar, inertia-based arguments. For example, several researchers suggest that a stable infrastructure allows firms to retain a highly cohesive workforce, which helps support effective unit-level processes (such as cooperative networks of teams) and ensures consensus about key organizational goals (Collins & Clark, 2003; Francis & Keegan, 2006; Lawler & Mohrman, 2003; Ployhart & Moliterno, 2011; Ulrich & Brockbank, 2005). On the other hand, these findings and the logic underlying them may not be applicable to larger, more established firms, where greater inertia may only make it more difficult to respond to environmental shifts. Indeed, in larger firms, such inertia may provide greater long-term agility, but may also limit short-term responsiveness.

However, most strategy researchers have in recent years focused their attention on the role of strategic complementarities and contingencies not as *mediators* of the strategy-performance link, but rather as potential *moderating* constructs (Becker & Gerhart, 1996; Becker & Huselid, 2006; Boselie et al., 2005; Ferris, Hochwater, Buckley, Harrell-Cook, & Frink, 1999; Park & Shaw, 2013; Shaw, Park, & Kim, 2012; Wright & Boswell, 2002; Wright & Gardner, 2003). That is, rather than identifying the particular processes underlying the link between HR strategy and firm performance, researchers' attention has turned to gaining an understanding of the mechanisms by which this relationship is weakened or intensified. At the core of this research are three alternative theoretical perspectives, commonly referred to as the universalistic, contingency, and configurational approaches.

### *Universalistic, Contingency, and Configurational Explanations*

Although all three of these perspectives are grounded in the assumptions and theories discussed above with regard to the link between strategy and performance, they differ in terms of the degree to which the assumed HR strategy effect is likely to be moderated by internal and external fit, and the way such a moderation effect is likely to operate. Researchers adopting a universalistic perspective (e.g., Osterman, 1995a; Pfeffer, 1994; Terpestra & Rozell, 1993) argue (a) that many of the HR practices which we associated with the commitment strategy and which Huselid referred to as "high performance work practices" (e.g., participation, incentive pay) are, on an individual basis, always better than comparative practices which we associated with the other HR strategies discussed, and (b) that their effects on firm performance are additive. Consequently, these authors claim that all organizations, regardless of size, industry, or business strategy, should adopt these so-called best practices.

In contrast to the linearity argued by the universalists, researchers adopting a contingency perspective (e.g., Cappelli & Neumark, 2001; Colbert, 2004; Lengnick-Hall & Lengnick-Hall, 1988; Schuler & Jackson, 1987a) posit that the assumptions underlying the HR strategy-performance link are applicable only (or mainly) under conditions of high external fit (Baird & Meshulam, 1988; Becker & Huselid, 2006; Liu et al., 2007). That is, "human resource management strategy is considered in an interactive way, not in a unidirectional or reactive manner" (Martin-Alcazar, Romero-Fernandez, & Sanchez-Gardey, 2005, p. 636). Contingency researchers claim that to have a significant, positive impact on firm performance, HR practices must be aligned with the organization's overall business strategy. Two other categories of

moderating factors that have been included in contingency models include organizational factors, such as size, technology, or structure (e.g., Datta, Guthrie, & Wright, 2003), and environmental factors, external to the organization, such as the competitive, macro-economic, and labor contexts (e.g., Boxall & Purcell, 2008).

Finally, underlying the configurational approach is the assumption of “equifinality” and a focus on the system or pattern of interrelated HR practices (Feldman & Pentland, 2003; Gratton & Truss, 2003; Jiang et al., 2012; Meyer, Tsui & Hinings, 1993; Subramony, 2009). Theorists adopting the configurational approach posit that internal coherence among individual HR practices is key, and that—assuming that these practices are internally consistent—combinations of HRM practices are likely to have larger effects on organizational outcomes than the sum of the component effects due to individual practices. That is, the contribution of HR to performance is explained through “the synergic integration of the elements that build it” (Martin-Alcazar et al., 2005, p. 637). Resource-based theory (Barney, 1991) provides an explanation for such equifinality effects. When a complex pattern or system of interrelated HR practices is in place in an organization, these strategic capabilities become even more difficult to imitate. Lacking an understanding of just how these practices and policies interact, competitors are less likely to be able to reproduce such synergies. Furthermore, many of these policies and practices may be path dependent, requiring that competitors first replicate “socially complex elements such as culture and interpersonal relationships” before being able to implement particular elements of the complex web of interrelated HR practices (Becker & Gerhart, 1996, p. 782). MacDuffie’s (1995) and Verburg, Den Hartog, and Koopman’s (2007) finding that “bundles” of internally aligned HR practices have a more powerful positive impact on firm performance is supportive of this perspective.

Several studies have attempted to comparatively test the alternative hypotheses implicit in each of these three perspectives. In one of the most comprehensive of these analyses, Delery and Doty (1996) examined seven key HR practices consistent with what we referred to as the commitment strategy (e.g., use of internal labor markets, training, profit sharing), and tested hypotheses consistent with all three perspectives. Following the universalistic perspective, they proposed a direct positive link between these seven practices and financial performance. In line with the contingency perspective, they posited that the positive link between these practices and financial performance would be moderated by the degree to which the behaviors elicited or encouraged by these practices were consistent with the organization’s strategy. The greater the alignment between business strategy and individual HR practices, the better the financial performance. Finally, following the configurational perspective, they hypothesized that the synergistic effect of configurations of internally consistent HR practices would explain the link between HR strategy and firm performance. Thus, at the most basic level, they proposed that firm performance would improve as a function of the degree to which its HR practices, as a group, were internally consistent and most similar to an ideal type strategy (e.g., commitment, secondary). However, since external fit was also viewed as a moderator of the strategy-performance link, they posited that a given system of aligned HR practices would enhance firm performance only when that strategy was appropriate for or consistent with the firm’s business strategy. By this reasoning, then, the strategy-performance link would be moderated not only by the degree of internal consistency among HR practices, but also by the degree to which this configuration of practices was aligned with the organization’s strategy.

Their analyses, based on a stratified random sample of over 1000 banks, provided strong support for the universalistic perspective, and some support for both the contingency and configurational perspectives. In line with the human capital, motivational, and work structure assumptions presented at the beginning of this section, three individual HR practices (employment security, profit sharing, and results-oriented appraisals) were all found to have a strong positive association with financial

performance regardless of the other practices in place, and regardless of organizational strategy. Financial performance was found to be some 30 percent higher for banks one standard deviation above the mean on each of these three practice scales than for those banks at the mean (p. 825). In line with the contingency perspective, three HR practices—performance appraisal, participation, and internal career opportunities—were found to be associated with higher levels of financial performance only when these practices were aligned with organizational strategy. Specifically, as Delery and Doty (1996) wrote:

Banks that implemented a prospector strategy involving high innovation reaped greater returns from more results oriented appraisals and lower levels of employee participation than did banks that relied on a defender strategy. Banks implementing a defender strategy performed better if they relied less on results-oriented appraisals and gave their officers higher levels of participation in decision making. (p. 826)

Finally, Delery and Doty (1996) found that the more closely a bank's HR strategy resembled what they referred to as a "market-type" system, the higher its performance, whereas the more closely it resembled their "internal system" (similar to what we described as a paternalistic strategy), the worse its financial performance. Specifically, a decrease in distance from the market type system of one standard deviation from the mean was estimated to result in a 13 percent increase in financial performance (p. 827). Taken as a whole, Delery and Doty's findings suggest that although the behavioral-, agency-, and control-based assumptions underlying the link between HR strategy and firm performance may explain part of the strategy effect, a more complete understanding is not possible without taking contingency and configurational factors into account. As Delery and Doty (1996) concluded, "some HR practices are more appropriate under certain strategic conditions and less appropriate under others" (p. 829).

Consistent with Delery and Doty's conclusions, Youndt, Snell, Dean, and Lepak (1996) argued that the universalistic and contingency perspectives may not be mutually exclusive and may in fact be more complementary than competitive. Their study focused on the continuing debate over the value of "deskilling" as opposed to "upskilling" as a core element of a firm's HR strategy. Although the universalistic perspective suggests that HR strategies focused on upskilling will, regardless of an organization's strategic posture, produce significant returns for the firm, such a notion may only be applicable if we assume that all firms have an inherent interest in providing their employees with greater opportunities to contribute. Youndt et al. (1996) argued that this may only be the case for firms adopting a quality or flexibility-based manufacturing strategy. However, for organizations adopting a cost-based manufacturing strategy, such an assumption may not hold. Instead, such organizations may seek to reduce their labor force and lower wage levels by adopting mechanized production systems requiring lower skill levels and decision-making capabilities on the part of their remaining employees. Thus, they posited that the value of these two alternative strategies—an administrative strategy (similar to our secondary HR strategy) and a human-capital-enhancing strategy (similar to our commitment strategy)—"ultimately rides on the particular manufacturing strategy a firm adopts" (p. 837). Therefore, they posited a main effect between HR strategy and firm performance in line with the universalistic perspective, *as well as* a conditional effect on the part of manufacturing strategy as it relates to the link between HR strategy and firm performance.

Using a sample of 97 industrial plants surveyed at two points in time, the researchers found support for both perspectives. Specifically, in line with the predictions of the universalistic perspective, a measure tapping the extent to which a plant's HR practices were consistent with a human-capital-enhancement (i.e., commitment) strategy was significantly associated with firm performance (e.g., productivity) and

uniquely accounted for up to 14 percent of the variance in various performance measures. However, the conditional effects of manufacturing strategy on the HR strategy-performance link explained an additional 14 percent of the variance in these performance measures. Specifically, in the context of a cost-based manufacturing strategy, an administrative (i.e., secondary) HR strategy had a significant positive association with firm performance, whereas a human-capital-enhancing (i.e., commitment) HR strategy had a significant positive association with performance in the context of a quality-based manufacturing strategy. As the authors concluded, “maximizing performance appears to depend on properly aligning HR systems with manufacturing strategy” (p. 853).

Other studies support either the contingency or configurational perspective over the universalistic perspective. For example, in their study of HR practices in petrochemical refineries, Wright, McMahan, McCormick, and Sherman (1998) suggested that internal fit among these practices is crucial, and that “HR practices derive their effectiveness from existing as a coherent and internally consistent system of practices” (p. 4). Specifically, they found that commitment-oriented selection, compensation, and appraisal practices were positively related to firm financial performance only in those refineries where a highly participative work system was in place. These practices were inversely related to performance when no such system was in place and employee participation was low.

Similarly, Chang and Huang (2005) found in their study among 380 Taiwanese companies that a significant impact of strategic human resource management (SHRM) on firm performance occurred under conditions of external fit between HR and firm strategy. Specifically, firms that implemented strategic HRM (in contrast to traditional HRM) outperformed under an innovation-oriented firm strategy. No similar effect occurred under cost-reduction and quality-enhancement strategies, “because SHRM promotes team-based job designs, flexible workforces, employee empowerment and incentive compensation, and so on, which are essential for facilitating innovation in organizations” (p. 444).

### *Resolving Inconsistent Findings*

Several studies have attempted to reconcile these inconsistent findings regarding the explanatory potential of these three main perspectives. Becker and Gerhart (1996) attempted to resolve the debate by arguing that findings will differ based on the level of analysis. They posited that to the extent that the universalistic notion of best practice is valid, it is likely to be so only at the highest level of the HR system. That is, as a set of guiding principles, there may be a set of universal or best HR practices—for example, valuing employee performance. However, how this universal principle is implemented is likely to be contingent on “appropriate firm-specific alignments” (p. 786). That is, practices designed to affect such a universal guiding principle are likely to vary at the operational or business level from firm to firm and will yield high performance at this level only to the extent to which they are aligned with one another and are consistent with the business unit’s overall strategic profile. Thus, one explanation for the inconsistent findings noted above may have to do with the different levels of analysis (i.e., corporate versus business level) at which such studies have been conducted. This being the case, strategic configurations may provide explanatory value only in terms of potentially complex, nonlinear, and often idiosyncratic interactions. Researchers using factor analysis to empirically identify strategic configurations may fail to capture the situational specificity of such configurations and end up mis-specifying key configurational components.

Paralleling this explanation, Gerhart, Trevor, and Graham (1995) noted that although *individual* best practices may add basic value to the firm, because such practices are less difficult to imitate, they provide only a limited source of sustained competitive advantage. Greater value may be created to the extent that

firms are able to generate a complex *system* of integrated best practices that meet the unique business needs of the firm; that is, a system that offers a high degree of internal and external fit. A number of more recent studies (e.g., Boon, 2009; Huselid & Becker, 1995; Pena & Villasalero, 2010) suggest initial support for this notion.

A third explanation for the mixed findings regarding the contingency and configurational approaches may be that the benefits of external and internal strategic fit may be offset by reduced organizational flexibility. A number of authors (e.g., Bartram, Stanton, Leggat, Casimir, & Fraser, 2007; Wright and Snell, 1997) argued that given managers' cognitive limitations as processors of information and decision makers, it cannot be assumed that managers will be able to match their HR strategies to actual (as opposed to perceived) organizational conditions, even if that is what they desire to do. As Lengnick-Hall, Lengnick-Hall, Andrade, and Drake (2009) noted, "implementation of SHRM may be affected by top management not all 'singing from the same page'" (p. 76). Even if managers are able to correctly interpret weak signals regarding critical contextual conditions, and even if they *do* have perfect knowledge regarding the cause-effect linkages between HR practices and the firm's ability to respond to such conditions, there is no guarantee that they will be able to design and implement the necessary changes in HR, no less do so in a timely manner. Consequently, when HR strategies are so internally consistent that it is impossible to change one practice without threatening the entire web of interrelated practices, the organization's ability to respond to environmental shifts may be further constrained. If, as a result, the HR practices in use become increasingly misaligned with organizational demands, any positive impact of internal consistency on the HR strategy-performance relationship may be effectively negated (e.g., Huo, Huang, & Napier, 2002; Wright & Snell, 1997).

Of course, methodological inconsistencies may also play a role in generating inconsistent findings regarding the universal, contingent, or configurational impact of HR practices on performance. For example, Wall and Wood (2005) argued that "future progress depends on using stronger research methods and design that, in turn, will require large-scale long-term research at a level of magnitude that probably can only be achieved through partnerships between research, practitioner and government communities" (p. 429).

## **THE CHALLENGES AHEAD**

The review above suggests that strategic HRM research in the past decades has paid increasing attention to understanding the relationship between HR strategy and firm performance. Specifically, researchers have documented the causal relationship between HR strategy and firm performance. Moreover, scholarly efforts have enhanced our understanding of the strategy-performance link, the theoretical principles underlying it, and the factors mediating and moderating such a relationship. In addition, scholars have provided important insights into the ongoing debate regarding the universal, contingency-based, and/or configurational impact of HR practices on firm performance. However, a number of theoretical, methodological, and practical issues remain to be resolved in the HR strategy-firm performance research.

### *Theoretical Challenges*

While, as suggested above, we now have a relatively clear understanding of the mechanisms linking HR strategy to firm performance and the conditions governing this relationship, several theoretical challenges remain. One of these has to do with strategy sustainability, and the longer-term implications of HR

policies and practices on the health and wellbeing of a broad range of organizational stakeholders. To date, scholars have taken a snapshot approach to understanding how HR strategy is related to firm performance. However, it is possible that what is beneficial to the firm today may not be beneficial in the future. Moreover, certain “best practices” may have adverse effects on employees’ families and the community in which the enterprise is situated. Theories have yet to be developed (no less tested) that capture these broader and longer-term implications of HR policies and practices and are, according to some, vitally needed (Brewster, 2007; Hesketh & Fleetwood, 2006).

A second challenge has to do with understanding how the timing of strategic shifts in HR policies and practices may influence firm performance. While, as noted above, there is some evidence that HR strategy causally precedes firm performance, and that shifts in HR policies and practices can have a significant impact on firm performance, we still know little about how the temporal nature of strategic shifts and the sequencing of new HR policies or programs affect organizational outcomes. Theory needs to be developed to answer such questions as whether there is a “first-mover advantage” in adopting new HR policies and practices and whether it pays to adopt new HR policies and practices in anticipation of environmental shifts (as opposed to reacting to them). The context-emergent turnover theory (Nyberg & Ployhart, 2013) discussed earlier presents one of the first attempts to capture the interplay of context and timing in strategy-performance relations, but there is far more for us to learn in this regard.

### *Methodological Challenges*

Challenges also remain with regard to how we test theories regarding the consequences of HR strategy. First, researchers need to better tailor their measures of effectiveness and HR to the particular context (Rogers & Wright, 1998). As Becker and Gerhart (1996) noted, metrics appropriate at the corporate level (e.g., market value) may not provide an adequate standard for studies at the business unit level. Furthermore, the standard metrics of capital market value and profit fail to reflect organizational performance among firms striving to meet alternative objectives such as increased market share, revenue growth, or technological innovation. HR strategies designed to meet profit goals, for example, may have an adverse impact on growth or market share objectives. The measurement of organizational effectiveness has long been debated in organizational theory, and to assume that a given set of financial indicators reflects a consensus among all organizational constituencies regarding organizational goals is, to put it bluntly, somewhat naive. Finally, as Wall and Wood (2005) noted, “measures of the dependent variable (performance) minimally should come from a different source from that used to measure HRM practices, and ideally would be ‘objective’—to reduce the likelihood of common method variance” (pp. 441–442).

Second, measurement problems do not only affect the dependent (or outcome) variables in the HR strategy-performance equation. They also affect the independent (or predictor) variables. Different researchers not only focus on different practices, they also measure the implementation of these practices in different ways. For example, different researchers may use a dichotomous (yes/no) scale indicating whether a practice is actually in effect (presence of practice), the proportion of employees affected by a given practice (breadth or coverage of practice), or the degree to which certain practices are adopted (depth or intensity of practice) (Boselie et al., 2005). Similarly, in measuring HRM, it is important to distinguish between intended, perceived, and actual HR practices, consistent with Legge’s (2005) famous juxtaposition of HRM “rhetoric” with organizational “reality” (for more details, see [Chapter 1](#); Khilji & Wang, 2006; Wright & Nishii, 2013).

The fact that different researchers measure strategic HR practices in different ways makes it difficult to cumulate findings. This is all the more so in those studies in which researchers identify some bundle,

system, or strategic configuration of HR practices. Although, as noted in [Chapter 3](#), these systems or strategies are comparable, they are far from identical. Even those strategic profiles or configurations identified empirically appear to vary from industry to industry, and may in fact exist more in the minds or interpretations of researchers than in reality. Until researchers come to some consensus as to the ideal types of strategic configurations, it will be impossible to generate the standard metrics needed to empirically capture the relationship between such systems of practices and performance.

Another methodological concern in the measurement of HR practices has to do with the relatively high potential for unreliability. Particularly where subjectivity or judgmental assessments are required, researchers should use multiple raters from each organization (e.g., Becker & Gerhart, 1996; Boselie, Brewster, & Paauwe, 2009; Boselie et al., 2005) and apply interrater reliability estimates as opposed to internal consistency-based estimates of reliability (i.e., Cronbach's alpha). In addition, effect estimates would most probably become more stable across studies were researchers to replace standard regression-based analytical approaches with SEM models, which take random measurement error into account (Gerhart, 1997).

Third, researchers must take into account that measures taken at different levels of analysis (work group, division, plant, corporation) are likely to yield different results (Lepak & Snell, 1999; 2002). As Delery (1998) noted, "the key issue is that the constructs of interest must be measured at the appropriate level" (p. 295). As he pointed out, implicit in the research decision to average the use of practices across the organization is the possibly false assumption that all employee groups are equally important. Our argument, that there tends to exist a dominant HR strategy in most organizations, assumes that core strategic practices are applied across most of an organization's employees. Yet, in any individual firm, such an approach should be viewed as based on a working assumption requiring empirical validation. Indeed, Lepak and Snell (1999; 2002) and Guest (2011) argued that the dominant HR strategy might vary across employment groups based on their human capital (e.g., core versus peripheral employees; Siebert & Zubanov, 2009).

Finally, future research would further benefit from the incorporation of temporal effects. Relatively few studies of the strategy-performance relationship are based on longitudinal data. Those that are still tend to include data on HR practices from only one point in time. This makes it impossible to ascertain the degree to which any shift in HR strategy or the adoption of new strategic practices over time may have a subsequent impact on firm performance. Indeed, until such longitudinal data are collected, it will be nearly impossible to determine which effect is stronger: HR strategy on performance or performance on HR strategy. Similarly, by collecting longitudinal data on strategic HR practices, researchers will be able to uncover the potential feedback effects of one practice or system of practices on another. Knowledge of such feedback effects will provide important insights into the potentially path-dependent nature of HR strategy, not to mention providing important insights into how HR strategies emerge over time. In addition, longitudinal research designs will allow us to gain a better understanding of how the HRS-performance relationship may vary over the course of the organizational life cycle. Finally, by collecting such longitudinal data, researchers will be able to more accurately estimate the potential implementation-to-benefit lag in the return stemming from shifts in HR strategy. The degree to which this lag may be contingent on contextual factors and the magnitude of the impact over short/long periods of time also warrant attention.

### *Practical Challenges*

Finally, HR researchers and practitioners alike must confront what Becker and Gerhart (1996, p. 796)



called a “major ‘disconnect’” between what the research literature suggests and what firms should and actually do. More recent research echoes the difficulties in translating and implementing HR research findings, similarly emphasizing the disconnect between what research suggests are key ingredients in strategic HRM, what organizations offer and allow for, and what options employees perceive they can genuinely access (e.g., Kossek, Baltes, & Matthews, 2011; Pfeffer, 2005). That is, a major challenge facing SHRM researchers is to make their research results meaningful to practitioners in the field. Although the results of the studies discussed above suggest that firms should have a significant incentive to adopt, at the very least, key strategic HR practices, such program adoption may be more complex than commonly assumed. First, the incentive to adopt such practices may be greatest among those having the most to gain and the least to lose, namely those firms exhibiting poor performance relative to their competitors (e.g., Bamberger & Fiegenbaum, 1996; Weinstein & Obloj, 2002). However, such firms are also likely to lack the necessary resources and complementarities (i.e., flexible production systems, highly developed management) required to implement such practices in an effective manner. Second, even among firms having the necessary resources and complementarities, organizational inertia (e.g., Wei & Lau, 2008), institutional (e.g., Farndale, Brewster, & Poutsma, 2008) and political (e.g., Wächter & Müller-Camen, 2002) pressures, and entrenched managerial mental models or logics (e.g., Pfeffer, 2005) may make it impossible for many firms to effectively manipulate individual HR practices, no less entire HR systems.

Another, related issue has to do with the implementation of HR strategy. As Boselie et al. (2005) noted, “the HR department might be responsible for the design and evaluation of employee management policy and practices, but in many cases ... implementation is left to direct supervisors and front-line managers” (p. 12). This may undermine what Boselie and Paauwe (2005) called “HR delivery”: aligning HR strategy with business strategy, convincing line managers of the value of HR practices, and coordinating the implementation effectively (including proper training, coaching, and support for line managers). Indeed, a number of authors (e.g., Becker & Huselid, 2006; Boselie & Paauwe, 2005) emphasize that the quality of HRM implementation is a vital condition for its effect on firm performance.

## **SUMMARY**

This chapter began with a review of more than 25 years of research on the link between HR strategy and firm performance. We then discussed the various mechanisms potentially explaining the link between HR policy and practice on the one hand and firm performance on the other, as well as factors potentially moderating such relations. In particular, we reviewed the three main approaches that scholars have taken in seeking to understand whether, how, and when various factors may condition the impact of HR strategy on performance, namely the universalistic, contingency, configurational, and contextual perspectives. The chapter ended with a review of the key theoretical, methodological, and practical challenges facing scholars examining the HR strategy-performance relationship.

## DIVERSITY AND INTERGENERATIONAL STRATEGIES

Employee diversity concerns the distribution of personal attributes among members of an organization or work unit (Jackson, Joshi, & Erhardt, 2003). These attributes include those that can be readily detected upon coming into contact with another (e.g., age, sex, race/ethnicity, disability, or national origin—what are typically referred to as “surface-level attributes”), as well as those that become evident only as employees get to know one another over time (e.g., personality, values, or functional/educational background, or orientations—referred to as “deep-level attributes”). Some of these deep-level attributes, such as beliefs, norms, values, and orientations, are assumed to have a direct impact on interpersonal relations, while others, including educational and functional background, are assumed to have more of an impact on task performance, in that they shape the knowledge, skills, and abilities brought by individuals to the workplace.

Contemporary workplace diversity and inclusion policies and practices began to emerge in the United States in 1964 when Congress passed Public Law 88–352 (78 Stat. 241). Section 703 of this law made it unlawful for an employer to “fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions or privileges of employment, because of such individual’s race, color, religion, sex, or national origin.” Title VII of the act created the Equal Employment Opportunity Commission (EEOC) to implement the law. Similar legislation exists in many other countries, with enforcement usually being the responsibility of the country’s labor courts or some similar form of EEO commission. By the 1970s, the EEOC in the United States began publishing employment guidelines specifying the criteria to be used as a basis for enforcing this law (as well as other subsequent laws regarding discrimination on the basis of age and disabilities), and highlighting the role of a firm’s ethnic/racial and gender composition in the adjudication of discrimination suites. With the onus of proof on the employer, it is not surprising that by the end of the 1970s, organizations began paying significantly greater attention to issues of diversity. Scholarly interest in diversity also began to emerge in the 1970s, with researchers focusing primarily on the possible benefits and costs to the firm associated with diversity, as well as on those factors that affect whether diversity ultimately generates a net benefit (i.e., diversity’s “dividend”) or cost to the firm or its work unit.

We begin this chapter by examining the evidence regarding the consequences of diversity for the firm, and the contingencies that influence whether these consequences, when all is said and done, are likely to be more positive or more negative. Based on this body of research, we review several mainstream diversity strategies adopted by contemporary organizations. We conclude the chapter with a discussion of age diversity in organizations, and how organizations are attempting to cope with the challenges generated by age diversity via alternative multigenerational HR strategies.

### **DIVERSITY’S DIVIDENDS: DIVERSITY’S IMPACT ON ATTITUDES, BEHAVIORS, AND PERFORMANCE**

Workforce diversity is a relatively new phenomenon. Four main factors account for the growth in workforce diversity around the world. First, heightened awareness of human rights and the adoption of legislation requiring employers to not only desist from discriminating against social minorities, but also to take affirmative action to correct for their disadvantaged position in the economy, resulted in an influx of women and minorities into local labor markets and, in the case of the former, into occupations and positions previously reserved for men. Second, labor market reform in many parts of the world (e.g., Europe) facilitated migration, allowing citizens of one country to seek employment in other countries. Third, the globalization of product and service markets created a demand for a more global workforce, one able to provide the organization with the social and cultural capital necessary to compete in increasingly dynamic global markets. Finally, technological change allowed organizations to seek human capital far from their local headquarters. As a result, organizations now staff virtual development teams with employees positioned in development centers around the world.

But how does workforce diversity affect employee attitudes and behaviors? What is the impact on firm performance? For several reasons, the scholarly community still has few answers. First, diversity appears to have very different consequences depending upon whether it is examined at the level of the individual, work unit (i.e., group/team), or enterprise. Second, diversity's impact varies by the particular attribute and outcome of interest, with surface-level diversity having different consequences than deep-level diversity, and both having a differential pattern of effects depending on the outcome considered. Third, diversity dimensions likely do not exert influence in isolation of one another, making it likely that the consequences of diversity along one particular dimension are contingent on diversity along some other dimension, or some overall attribute profile (Lau & Murnighan, 1998; van Knippenburg, Dawson, West, & Homan, 2011). More specifically, research on demographic fault lines suggests that the way in which individuals' multiple diversity characteristics align with those of other work group members explains more of the variance in satisfaction, expected performance, and team learning than the way in which individuals are similar or different from others in their group along some single attribute (Lau & Murnighan, 2005). Finally, the consequences of diversity are likely to be contingent on various factors, such as the time span over which the consequences are assessed and the nature of work-based interdependencies.

A good way to get a handle on how diversity and inclusion may affect performance is by considering the theoretical underpinnings of such a relationship. Underlying the bulk of the research on diversity are the theories of *social identity* (Tajfel & Turner, 1986) and *social categorization* (Turner, Hogg, Oakes, Reicher, & Wetherell, 1987). According to these related theories, similarity or differences in visible and typically inherent traits (e.g., gender, ethnicity/race) affects feelings of identification, with how people identify themselves being associated with intergroup biases and relations. Consistent with *similarity-attraction theory* (which suggests that people prefer others like themselves and that differences make people uncomfortable; Byrne, 1971), these intergroup biases can affect employees' ability to communicate, and willingness to cooperate, with those different from them (Nonaka & Takeuchi, 1995; van Knippenberg, De Dreu, & Homann, 2004; Zenger & Lawrence, 1989). Two other theories guiding diversity research are the *value in diversity* and *upper echelons* theories, as well as related theories of *cognitive diversity* and *information elaboration*. These theories suggest that diversity along both surface and deep attributes increases the information available to organizational actors and allows for constructive conflict and debate, thereby facilitating enhanced problem solving, creativity, and decision making, and providing the organization or subunit with a potential competitive edge. Finally, *inclusion theory* (Shore et al., 2011) suggests that to the degree that organizations satisfy employees' need to belong while still retaining their uniqueness, employee job satisfaction and creativity may be enhanced, and

occupational stress and intentions to leave, reduced.

Findings regarding the impact of diversity along surface attributes on attitudes (e.g. job satisfaction, group cohesion) and behaviors (e.g., turnover) have been mixed. Consistent with social identity theory, early research found that diversity along a variety of dimensions is often associated with negative attitudes and dysfunctional behaviors. For example, Williams and O'Reilly (1998) concluded that "increased diversity, especially in terms of age and ethnicity, typically has negative effects on social integration, communication and conflict" (p. 115). But these consequences do not affect all groups evenly. Indeed, Riordan (2000) found that in majority-white contexts, white employees have more negative work attitudes when employed in groups with a large number of minority group members, while being different from others in a work group seems to have little impact on the attitudes of minority group members. Similarly, gender diversity has more negative implications on work outcomes such as organizational commitment for men than for women (Tsui, Egan, & O'Reilly, 1992). On the other hand, several studies suggest that positive affective outcomes are no less prevalent than negative consequences, or that diversity is simply unrelated to such outcomes (Harrison, Price, & Bell, 1998; Jehn & Mannix, 2001). For example, although some studies of gender diversity have found positive performance effects (Jackson, Joshi, & Erhardt, 2003; Rentsch & Klimoski, 2001), others have generated negative (Jehn & Bezrukova, 2003) and nonsignificant (Richard, 2000; Watson, Johnson, & Merritt, 1998) findings. Indeed, in a recent review, Joshi and Roh (2007) found not only approximately the same number of studies reporting positive or negative effects for racial/ethnic diversity across three outcome types (performance, process, and affect/attitude), they also found that there were more null findings than positive and negative effects combined. Nevertheless, in two recent meta-analysis of the effects of team demographic diversity on team outcomes, both Joshi and Roh (2009) and Bell, Villado, Lukasik, Belau, & Briggs (2011) found race and gender diversity to have weak but still significant negative relationships with team performance.

The same seems to be true with regard to age and tenure diversity. Kilduff, Angelmar, and Mehra (2000) found age diversity to be positively associated with top management team (TMT) performance, while others (Bunderson & Sutcliffe, 2002; Simons et al., 1999) found no significant effect on TMT performance. Timmerman (2000) found age (as well as ethnic) diversity to be inversely associated with sports team performance in those sports requiring a high degree of player interdependence, such as basketball, but not in low interdependence sports such as baseball. As for tenure diversity, studying TMTs, Hambrick, Cho, and Chen (1996) found that while heterogeneity in company tenure is positively related to growth in market share and profits, it is inversely related to the quality of TMT response to competitors' actions. The prevalence of such inconsistent finding has been documented in several reviews (e.g. Certo, Lester, Dalton, & Dalton, 2006; Williams & O'Reilly, 1998).

Research evidence regarding the performance implications of deep-level diversity is more consistent, at least with respect to particular deep-level attributes. More specifically, several studies have found functional/occupational diversity to be associated with enhanced team performance (Barsade, Ward, Turner, & Sonnenfeld, 2000; Carpenter, 2002; Jehn & Bezrukova, 2003; Pitcher & Smith, 2000). Moreover, in a recent meta-analysis of team-level diversity, Bell et al. (2011) found functional background diversity to have a small positive relationship with general team performance as well as with team creativity and innovation. Such findings are consistent with top echelon and information elaboration theories in that they suggest that diverse backgrounds among team members afford the team a wider range of perspective and enhanced social capital—both of which can have powerful positive implications for team/organizational performance. However, other dimensions of deep-level diversity can make it more difficult for team members to develop the kind of synergies needed for effective team operations. For example, differences among members' core values have been found to have a negative impact on team

performance (Jehn, Northcraft, & Neale, 1999). Similarly, Barsade et al. (2000) found deep-level diversity with respect to positive affect (a core personality trait reflecting a tendency to “see the cup as half full”) in TMTs to be inversely associated with organizational performance, and Boone and Hendricks (2009) found deep-level diversity with respect to TMT members’ locus of control (i.e., the degree to which individuals feel matters are controlled by them versus by fate) to be negatively related to return on sales.

### *Contingency Factors*

Inconsistent findings such as those noted above can be generated by a number of factors, including error-prone measurement or inconsistent conceptualization of key terms (such as diversity or performance) across studies, as well as the presence of “boundary conditions”—contextual factors that may alternatively strengthen or weaken relationships. Understanding the impact that these contextual factors may have on diversity’s consequences is important in that they highlight the conditions under which particular diversity strategies might be most successfully adopted and when particular strategies might best be avoided.

While there are many factors at the dyad, unit (i.e., group/team), and organizational levels that may moderate the impact of diversity on key organizational outcomes such as cohesion, cooperation, turnover, and performance, most research suggests that a wide variety of factors are likely to influence the impact of diversity on these outcomes by facilitating or impeding either social integration (Harrison et al., 2002) or information elaboration (van Knippenberg et al., 2004). Contextual factors that facilitate social integration are likely to weaken any adverse effects of the dissimilarities among employees driven by diversity, while factors that increase the salience of information/knowledge exchange and the sharing of different perspectives are likely to boost the beneficial effects of such dissimilarities. Accordingly, several of the most widely studied contingency factors include the nature of the occupation or industry, the nature of the task, organizational/unit climate or culture, the lifespan of the unit, and the proportion of minority (e.g., women, Hispanics) to majority group members.

At the most macro level, Joshi and Roh (2009) suggested that although in *general* gender and ethnic diversity have only weak negative implications on team performance, these effects appear to be contingent upon both the nature of the occupation and the nature of the industry. More specifically, their meta-analytic results indicate that in occupations dominated by male or by white employees, gender and ethnic diversity had more robust negative effects on team performance outcomes. As they explain it, “the dominance of a particular demographic group within a particular occupational setting can signal greater access to resources and privilege for this group” (p. 618), with such unequal, status-based access to resources resulting in suboptimal team performance. Similarly, they found that the impact of gender and ethnic diversity depends on the industry within which the work team is nested. More specifically, they found slightly positive effects for both forms of diversity in service industries (possibly, they speculated, because diversity enhances the team’s ability to interact with diverse clients), whereas in manufacturing and high tech, the effects were negative.

In terms of task characteristics, research findings suggest that task interdependence may reduce the risks of diversity-related conflict and increase the likelihood that organizations will be able to capitalize on the potential benefits of diversity. When tasks are structured so as to require cooperative interdependence, the rewarding aspects of achieving success may become associated with members of other groups, thereby increasing intergroup attraction and providing a basis for the emergence of supportive intergroup relationships (Dovidio, Gaertner, & Kawakami, 2003). Additionally, consistent with social identity

theory (Tajfel, 1969), task structures creating job-based interdependencies may reduce the salience of demography-based collective identities and increase the salience of other superordinate organizational or occupational identities (Chatman, Polzer, Barsade, & Neale, 1998). With such interdependent activity providing opportunities to develop “meaningful interpersonal relationships that cross group boundaries” (Brickson, 2000, p. 96) and to “disconfirm negative stereotypes of disliked out-groups, thereby breaking down the monolithic perception of the out-group as a homogeneous unit” (Miller, 2002, p. 397), the potential for intergroup conflict is diminished while the potential for individuals self-identifying with different groups to exchange information and perspectives is enhanced. The net result, according to Hopkins and Hopkins (2002, p. 544), is a positive impact on organizational performance and, ultimately, the creation of value-in-diversity.

In terms of culture and climate, Ely and Thomas (2001) argued that diversity is more likely to lead to positive outcomes when the organizational culture emphasizes “integration and learning.” Empirical studies that examined the effects of dissimilarity (relational demography) in organizations with differing cultures generally support this line of reasoning (Chatman et al., 1998; Dass & Parker, 1999; Gilbert & Ivancevich, 2000).

Similarly, organizational and unit climates may also moderate the effect of team diversity. At the organizational level, Gonzalez and DeNisi (2009) found diversity climate—“aggregate member perceptions about the organization’s diversity-related formal structure characteristics and informal values” (p. 24)—to moderate the impact of gender and racial/ethnic heterogeneity on firm productivity and return on profit. More specifically, studying a chain of restaurants, they found racial/ethnic heterogeneity to be positively related to both outcomes in restaurants characterized by a more pro-diversity climate, but inversely related to both outcomes in restaurants characterized by a less pro-diversity climate. The findings regarding gender heterogeneity were similar, although in more pro-diversity climate restaurants, the positive effects of gender heterogeneity on both outcomes flattened out at moderate to high levels.

At the unit/team level, West (2002) identified several facet-specific team climates that provide the right context for diversity in teams to most effectively share perspectives and information and generate the synergies associated with heightened levels of innovation. These include a climate of psychological safety as well as a climate characterized by a sense of shared objectives. Similarly, Bacharach, Bamberger, and Vashdi (2005) found that in teams characterized by a stronger support climate, team members’ demographic dissimilarity from one another had less of an adverse impact on the development of close relations with members of some other demographic group—relations that they argued served as the basis for effective team processes.

Several studies indicate that the effects of diversity are also moderated by temporal factors. In one of the first studies to differentiate between surface- and deep-level diversity, Harrison et al. (1998, 2002), found that while gender diversity had negative consequences on team cohesion early on in the teams’ existence, these adverse effects declined over the life of the team. In contrast, deep diversity in the form of attitudinal differences among members had weak adverse effects initially, but these adverse effects increased in strength over the life of the team. Carpenter (2002) found similar effects of demographic diversity among TMTs.

Finally, the impact of diversity on key organizational outcomes may be contingent upon the proportion of minority to majority group members. Kanter (1977) proposed that as long as diversity involves the placement of “tokens,” there are likely to be few adverse consequences. This is because, at very low levels of representation in a unit, dissimilar employees have little choice but to integrate, and majority group members can still see them as “individuals,” distinct from the demographic group to which they

may be associated. However, problems (and solutions) may emerge beyond one or two “tipping points.” As minority representation increases beyond some initial tipping point, cross-group interaction may slow and cease, with both minorities and majority group members preferring to “stick together” rather than integrate, often resulting in the emergence of what has been referred to as “ethnic (or gender) enclaves” in organizations. Such enclaves serve as obstacles to inter-group information exchange and may be perceived as an impending threat by members of the majority group (Bacharach et al., 2005). However, drawing from Kanter (1977), Allmendinger and Hackman (1995, p. 426) suggested that moderate levels of minority representation ameliorated many of the “difficulties experienced by the original pioneers,” such that homophilic tendencies (i.e., the tendency to “stick” with those with whom one feels similar) on the part of the minority weakened as their number approached parity. Blalock (1967) suggested a similar curvilinear association between minority representation and majority homophily. His Minority Group Size-Inequality hypothesis posited that “a given increase in the minority percentage should produce a smaller increment in intergroup competition in situations where the minority percentage is already high” (p. 148). Given Blalock’s assumption that homophilic tendencies on the part of the majority stem largely from the perceived threat of minority competition, this theory suggests that, beyond some tipping point, the positive relationship between minority representation and homophily may also have a diminishing effect.

Empirical support for such a curvilinear relationship is limited, with most of the evidence stemming from gender-based studies of employment discrimination (e.g., Pfeffer & Davis-Blake, 1987). However, in one study of the impact of minority representation on organizational outcomes, Allmendinger and Hackman (1995) found that while satisfaction with work relationships and members’ perceived relationship quality declined as the proportion of female members increased from 0 to the 30 percent to 40 percent range, beyond that point, further increases in the proportion of female unit members were associated with *increased* levels of perceived relationship quality and satisfaction.

Interestingly, in spite of the arguments noted above regarding equivalent homophily effects for minority and majority group members, these researchers identified a significant gender-by-proportion interaction effect. Specifically, while the association between female representation and relationship quality was curvilinear for women (i.e., U-shaped with a tipping point at approximately 40 percent), for men the association was essentially negative and monotonic (i.e., linear), with only a slight weakening of the negative effect of female representation on relationship quality at the highest levels of female representation. Similar findings of a significant race-by-proportion interaction were reported by Ruef, Aldrich, & Carter (2003).

### *Securing a “Diversity Dividend”: Implications for HR Strategy*

The research findings described above suggest that because so many factors moderate the impact of diversity on unit or organizational performance, the probability of gaining an economic return on resources invested in diversity management is likely to be quite low. But if that is the case, how is it that companies continue to make huge investments in diversity? One explanation, consistent with institutional theory, is that the failure to make such investments puts organizations’ legitimacy at risk. More specifically, as many governments assess company compliance with EEO laws largely on the basis of “good faith effort,” diversity management makes real economic sense. As noted by Yang and Konrad (2011), “legitimacy is a valuable commodity that indicates an organization’s propriety in its actions and integrity in its dealings, factors that help the organization to garner material resources from a wide variety of actors” (p. 13). Another explanation, this one consistent with the resource-based perspective (Barney, 1991), is that diversity programs and policies, by giving firms access to human and social capital they



might not otherwise have been able to harness, opens the door to resources and markets that may have previously been unreachable, as well as the potential for greater information exchange and elaboration.

Given these potential benefits, the research literature suggests that organizations have a wide range of diversity policies and practices to choose from in order to try to secure a “diversity dividend.” These policies and practices roughly break down into two types. The first type aims to ensure the attraction and retention of a diverse set of individuals and focuses largely on systems of recruitment, selection, and talent development. The second type aims to ensure that once recruited, employees are able to move beyond intergroup differences, bring their entire set of identities to work, and exploit the entire sum of their demographic and cultural knowledge in order to address key organizational problems (Cox, 1993; Ely & Thomas, 2001).

## **STRATEGIES FOR ACQUIRING AND RETAINING A DIVERSE TALENT POOL**

Organizations seeking to enhance and maintain diversity and inclusion in their workforce can implement a wide range of strategies aimed at attracting, developing, and retaining women, minorities, and members of other disadvantaged populations. With regard to attracting such individuals, several strategies may be considered.

### *Targeted Recruitment*

The first of these is targeted recruitment. This involves (a) identifying those particular populations that, relative to the relevant labor market, are underrepresented in the organization’s labor force, and then (b) implementing recruitment practices aimed specifically at attracting candidates from these populations. For example, research has shown that minority candidates and other targeted group members may be more attracted to firms with minority recruiters (Highhouse, Stierwalt, Bachiochi, Elder, & Fisher, 1999; Kim & Gelfand, 2003; Rau & Adams, 2005). Accordingly, organizations seeking to increase their pool of, say, Hispanic candidates might assign Hispanic recruiters to meet with and interview prospective candidates from that community.

### *Affirmative Action*

A second means by which organizations may enhance their ability to attract a more diverse talent pool is to take *affirmative action* to hire and promote a workforce that better reflects the demographic mix in its relevant labor markets. In the U.S., affirmative action efforts began to be adopted several years after the passage of Title VII, when Executive Order 11246 required government contractors to “take action to reduce historical discrimination barriers, identify job groups where members of protected classes are underutilized or underrepresented in comparison to labor market prevalence, and to formulate timetables and goals for remedying barriers and under-utilization” (Kossek & Pichler, 2006, p. 251). Examples of such practices include designating positions to be targeted to members of specific demographic groups, and relaxing certain job requirements for disadvantaged/minority candidates.

Affirmative action programs have been widely criticized, not only because they are often seen as putting deserving majority-group candidates at an unfair disadvantage, but also because, by limiting the firm’s ability to access the best human capital, they also weaken the firm. Additionally, because those

hired under such programs are often perceived to have been selected based more on their identity group membership than on their qualifications, they may be viewed as less competent by their superiors and peers (Heilman, Block, & Stathatos, 1997)—with all that entails for both the individual’s wellbeing and the cohesiveness of the workforce. However, recent research suggests that the general consequences of affirmative action are generally positive. For instance, Holzer and Neumark (2000) found that affirmative action increased the number of recruitment and screening practices used by employers, raised employers’ willingness to hire stigmatized applicants, increased the number of minority and female applicants, and increased the degree to which employers provide training and formally evaluate employees. They also found that when affirmative action was used in recruiting, it generally did not lead to lower credentials or performance among women and minorities hired. When used in hiring, while the minority employees hired did often have somewhat weaker credentials, ultimately their performance was not lower than that of other, mainstream workers. Overall, the authors found that the more intensive the search, evaluation, and training that accompanied affirmative action, the greater the offset of any policy-based tendency to hire less-qualified or less-productive women—and minorities.

### *Ensuring the Validity of Selection Tools and Testing for Disparate Impact*

The effectiveness of diversity-friendly recruitment strategies in meeting diversity objectives is likely to be limited if those recruited are ultimately rejected on the basis of poor-quality selection mechanisms. By poor quality we refer to low or weak predictive validity (i.e., the selection mechanism yields scores that are only weakly correlated with subsequent job performance) and substantial disparate impact (i.e., scores on these selection mechanisms are significantly lower for minorities than for mainstream candidates) (Kossek & Pichler, 2006). Although many large employers periodically assess the validity of their selection tools and check for possible disparate impact, for many small organizations, resource limitations and small sample sizes may make such investigations both impractical and relatively meaningless. As an alternative, employers often look to the empirical research literature, and in particular, to meta-analyses of studies on particular selection methods.

Meta-analyses indicate that tests of general mental ability (GMA) offer some of the highest and most generalizable validities among selection tools (explaining approximately 25 percent of the variance in subsequent on-the-job performance; Schmidt, 2002). However, Huffcutt and Roth (1998) reported that such tests may be characterized by substantial disparate impact (with whites scoring about one standard deviation higher than blacks and about two thirds of a standard deviation higher than Hispanics). Other selection tools, albeit with lower validities, may have lower disparate impact. For example, Huffcutt and Roth (1998) reported that, on average, whites scored only half a standard deviation higher than minorities on structured interviews. To the degree that studies find a particular test’s validities to be generalizable across a wide range of occupations and organizational contexts with little or no disparate impact, such tests are likely to be more effective in ensuring that women, minorities, and other disadvantaged groups are not unfairly excluded from employment opportunities.

### *Mentoring and Network Groups as a Strategy for Retention*

A variety of programs have been proposed as helping enhance the retention of minority employees. These include mainstream management efforts such as mentoring (Ragins, 2010; Thompson, DiTomaso & Blake, 1988). As noted by Kossek and Pilcher (2006), “same-race and gender mentoring programs have the advantage of enabling individuals of similar background to share common workplace experiences and

learn about what works well in the particular organizational culture” (p. 266). Additionally, consistent with more contemporary perspectives on retention such as embeddedness theory (Mitchell, Holtom, Lee, Sablinski, & Erez, 2001), Friedman and Holtom (2002) reported that minority network groups within organizations may be highly effective in maximizing the longer-term employment of such individuals. As described by these researchers, “these groups—usually initiated by the employees themselves, but supported by the company—are designed to help minority employees be better connected to each other, and thus gain greater access to information, social support, and mentoring” (p. 405) Based on data obtained from a large company with extensive network groups, the researchers found significantly lower turnover intentions among minority managers who joined one of these groups compared with those who did not. They also found that network group involvement explained a large proportion of the variance in turnover intentions above and beyond that explained by the usual turnover factors (e.g., age, education, satisfaction). Accordingly, they concluded that employee network groups can be useful in helping companies retain managerial-level minority employees.

## **STRATEGIES FOR MAXIMIZING THE POTENTIAL BENEFITS OF DIVERSITY**

As suggested earlier, the presence of a demographically diverse workforce does not necessarily mean that the organization will secure so-called diversity dividends. Indeed, as noted above, even in firms in which numerical diversity objectives are met, women and minorities may remain isolated in “ethnic enclaves,” and there may be little exchange of information, knowledge, and perspectives across identity groups (Bacharach et al., 2005). Accordingly, employers may also implement inclusion strategies aimed at reducing isolation among women and minorities and maximizing cross-group information exchange by confronting the propensity toward homophily (i.e., people’s tendency to limit their primary exchanges to those who are similar to themselves). Three of the most widespread strategies adopted by organizations to maximize the potential return from diversity are (a) diversity-based performance appraisals, (b) diversity training, and (c) cross-race/gender mentoring.

### *Diversity-Based Performance Appraisals*

Diversity-based performance appraisals were among the earliest diversity programs to be adopted on a large scale (Fretz & Hayman, 1973). Such appraisals incorporate effectiveness in reducing bias and promoting diversity objectives into managers’ regular performance evaluations. These programs may improve managers’ diversity-related performance in two main ways. First, the feedback accompanying diversity-based appraisal may direct managers’ attention to diversity-related behavior, and thus motivate behaviors more consistent with diversity objectives (Reskin, 2003). Second, appraisal on such issues may enhance managers’ sense of accountability for diversity. Indeed, in experimental studies, subjects who knew that their decisions were to be reviewed by experimenters showed lower levels of bias in assigning jobs (Salancik & Pfeffer 1978; Tetlock, 1985).

### *Diversity Training*

By the late 1980s, quite a few corporate trainers and psychologists had developed training modules designed to familiarize employees with antidiscrimination law, to suggest behavioral changes that could

address bias, and to increase cultural awareness and cross-cultural communication (Bendick, Egan, & Lofhjelm 1998). Such efforts were (and are) grounded in extensive social psychological research suggesting that giving people information about out-group members and about stereotyping may reduce bias (Fiske 1998; Nelson, Acker, & Melvin, 1996). However, evidence on the real-world efficacy of such training is mixed. Kulik and Roberson (2008) concluded that diversity training programs resulted in positive learning effects in both educational and organizational settings and enhanced positive attitudes toward diverse organizations. On the other hand, attitudes toward particular groups did not seem to be significantly affected by diversity training (Kulik & Roberson, 2008). Additionally, several studies of diversity training have suggested that it may *activate* rather than reduce bias (Kidder, Lankau, Chrobot-Mason, Mollica, & Friedman, 2004; Rynes & Rosen 1995; Sidanius, Devereux, & Pratto 2001). For example, Nelson et al. (1996) noted that because of the elusive nature of cognitive bias, “conscious attempts at thought regulation may backfire, leading to exaggerated stereotyping under conditions of diminished capacity, or when self-regulation efforts are relaxed” (p. 31).

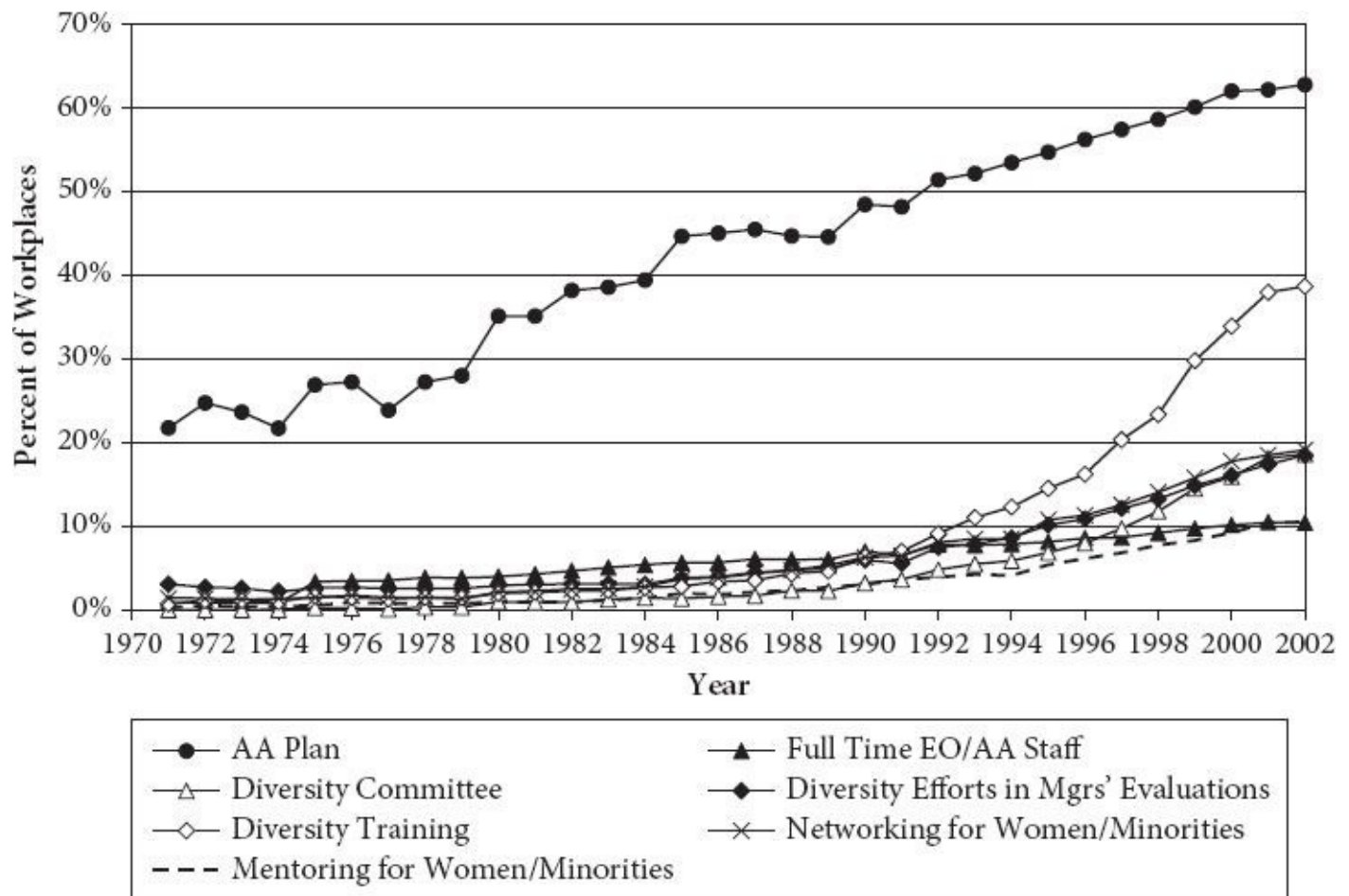
### *Cross-Gender/Race Networking and Mentoring*

Finally, in contrast to the within-group networks and mentoring strategies noted earlier, cross-gender/race networking and mentoring may be an effective means to reduce the isolation of women and minorities in many organizations. As noted by Kalev, Dobbin, & Kelly (2006), “students of inequality have speculated that differential network contacts and differential resources accruing from these contacts may explain part of the continuing inequality between whites and blacks, and between men and women” (p. 594). Cross-gender/race networking involves bringing network participants together to share information and career advice, for instance via periodic brown-bag lunches. Cross-gender/race mentoring links female/minority newcomers with male/white mentors in order to give the former entry to networks and knowledge sources that they might otherwise be unable to access.

### *Comparative Efficacy of Corporate Diversity Strategies*

Although, as noted throughout the discussion above, scholars have attempted to examine the efficacy of *particular* diversity programs and policies *within* one or several organizations, few studies have examined the *comparative* efficacy of alternative strategies *across* organizations. Recently, however, Kalev et al. (2006) combined federal data describing the workforces of 708 private-sector establishments from 1971 to 2002 with their own survey data on employment practices in these companies in order to examine the effectiveness of several mainstream diversity programs in enhancing diversity in managerial positions. As shown in [Figure 9.1](#) below, the proportion of firms adopting diversity-related programs grew significantly between 1971 and 2002, with the most impressive growth being in affirmative action (adopted in over 60 percent of firms by 2002) and diversity training (nearly 40 percent of firms by 2002).

Kalev et al.’s (2006) findings showed that diversity training and diversity evaluations were least effective at increasing the share of white women, black women, and black men in management. Efforts to attack social isolation through mentoring and networking showed modest effects in general, although networking appeared to have a *negative* effect on the promotion of black men into management. Most effective were affirmative action plans. Following the establishment of an affirmative action plan, the odds of finding white women and black men in management rose by 9 percent and 4 percent respectively.



**Figure 9.1** Percent of Private-Sector Workplaces with Affirmative Action Plans and Diversity Programs, 1971–2002.

Note: Based on Princeton University Human Resources Survey, 2002. Varying N. Maximum N = 708.

Adapted from Kalev, A., Dobbin, F. & Kelly, E. (2006). Best practices or best guesses? Assessing the efficacy of corporate affirmative action and diversity policies. *American Sociological Review*, 71, 599.

## AGE AND MULTIGENERATIONAL HR STRATEGIES

### *Why Suddenly a Concern with Age Diversity?*

Until recently, age diversity was not a major concern of organizational scholars or HR practitioners. The workforce, after all, was relatively age-homogeneous, with most employees entering the workforce between the ages of 18 and 22, and retiring 30 to 40 years later. Although many young adults still enter the workforce at age 18, the age-related demographics of the workforce in many countries are changing, reflecting greater and greater age diversity. For example, whereas the number of workers in the U.S. workforce aged 25 to 54 is forecast to rise only slightly (2.4 per cent) between 2010 and 2016, during that same time period, the number of workers aged 55 to 64 is expected to increase by 36.5 percent (U.S. Bureau of Labor Statistics, 2008). Meanwhile, the labor force participation (LFP) rates for older adults aged 60 to 72 have been rising steadily since 1985 and are expected to increase into at least 2030 (U.S. Bureau of Labor Statistics, 2013).<sup>1</sup>

A number of factors have come together to increase the age heterogeneity of the workforce in most organizations around the world. First, increased life expectancies combined with declining birthrates have put significant pressure on governmental insurance programs such as Social Security. In the United States, older adults (aged 55+) represent an increasingly larger segment of the total population, and are

expected to account for 39 percent of the population by 2050, versus 29 percent in 2005 (Toosi, 2006). In Europe, Japan, and China, the working-age population under 60 is actually expected to decline between 2000 and 2050 (see Table 9.1). With fewer workers forced to support an aging population that is living longer, many governments have been forced to cut and/or delay retirement insurance benefits. Accordingly, rather than disengaging from the workforce at age 62 to 65, an increasing number of workers are being motivated to postpone their retirement until they reach age 67 or beyond, generating what might be seen as a supply-side “push” toward greater age diversity.

Second, in the past 20 years, many companies that had in the past offered their employees a “defined benefit” pension plan (under which the company promised to pay a set pension to the retiree for as long as they lived) switched to a “defined contribution” plan (in which the pension fund ultimately available upon retirement is contingent upon the performance of market-invested employer and employee contributions). With the recent recession dramatically reducing the value of these funds precisely as the first baby boomers began to reach retirement age, this shift in pension financing not only further intensified the pressure on older adults to defer their retirement, but forced many of those who had already retired to return to work. Accordingly, the shift in pension structures has only added to this supply-side push toward increased age diversity.

**Table 9.1** Trends in Working Population Age 15–59 Years (in Millions)

| Nation | 2000 | 2025 | 2050 |
|--------|------|------|------|
| U.S.   | 76   | 196  | 217  |
| Europe | 113  | 100  | 86   |
| Japan  | 79   | 65   | 49   |
| China  | 829  | 913  | 787  |
| India  | 594  | 869  | 939  |
| World  | 3636 | 4818 | 5404 |

Source: United Nations (2002) World Population on Aging 1950–2050

Further reinforcing this supply-side push has been a shift in norms and attitudes regarding retirement, with an increasing proportion of older adults opting to continue working even after they become eligible for some sort of retirement benefit—either scaling down their hours in their current workplace, or retiring and then taking a new position (often part time) to supplement their retirement income or “just to keep busy.” Kim and Feldman (2000) described this form of workforce disengagement as “bridge retirement” (also called “bridge employment”)—“employment that takes place after a person’s retirement from a full-time position but before the Source: United Nations (2002) World Population on Aging 1950–2050 person’s permanent withdrawal from the workforce” (p. 1195). Studying a sample of retiring university faculty, they found it to be associated with both retirement satisfaction and overall life satisfaction.

Finally, in addition to the supply-side “push” toward age diversity, there also appears to be a growing demand-side “pull.” Even in the context of high unemployment, an aging workforce has already exacerbated shortages of engineers in the United States and skilled tradespeople in Europe (Stone & Tetrick, 2013). With a rising portion of those currently employed eligible or soon to be eligible to receive some sort of retirement benefit, employers are also increasingly keen to retain their older, retirement-eligible workers. Given that much of a firm’s human and social capital often resides precisely within this workforce (McKinsey Global Institute, 2008; Toosi, 2006), many employers are beginning to adopt policies and practices aimed at retaining these older employees so as to avoid the loss of needed skills and proprietary knowledge, or to overcome shortfalls in matching HR requirements with availabilities (Alley, Suthers, & Crimmins, 2007; Wang, Zhan, Liu, & Shultz, 2008).



## *Is Age Diversity “Good” or “Bad”?*

**Consequences of age diversity at the individual level.** At the individual level, much of the research on age diversity has focused on age stereotyping (DeArmond et al., 2006; Maurer & Rafuse, 2001) and discrimination (Perry, Simpson, NicDomhnaill, & Siegel, 2003)—or, in other words, the degree to which older workers pay a price by being employed in a multigenerational workplace. Stereotypes about older workers have been primarily negative, framing older workers as less comfortable with technology, and as rigid, less open to new ideas, less productive, and more difficult to train (Cuddy, Norton, & Fiske, 2005; Kulik, Perry, & Bourhis, 2000; Ringenbach & Jacobs, 1994). Meta-analytic findings indicate that such views are fairly widespread among younger workers. For example, in their meta-analysis, Finkelstein, Burke, and Raju (1995) found that younger workers judged their younger peers as more qualified than older workers and believed that the younger workers had greater potential for development. Similarly, the meta-analytic findings of Gordon, Arvey, Hodges, Sowanda, and King (2000) also revealed a slight negative bias against older adults with respect to job qualifications and interpersonal skills, and a more robust negative bias with regard to their potential for development. On the other hand, it is important to note that in both meta-analyses, younger workers were found to rate their older colleagues as more dependable, careful, and stable in their job. Moreover, more recent research suggests that some of the more negative age-related stereotypes may no longer be as strong or impactful (Bertolino, Truxillo, & Fraccaroli, 2013; Weiss & Maurer, 2004).

Despite these recent signs of change, the perception remains that many older (and even middle-aged) workers are treated unfairly in decisions about hiring, deployment, and compensation, with younger workers preferred over older ones. Indeed, between 1997 and 2012, the total number of age discrimination cases filed with the EEOC rose by 50 percent (from 15,785 to 22,857), while (noninflation adjusted) monetary rewards to plaintiffs more than doubled (from \$44 million to \$92 million). However, these monetary rewards reflect only a small part of the price (manifested, for example, in terms of the duration of unemployment and wage loss upon reemployment) that older workers pay for age discrimination.

**Impact of age diversity at the team and firm levels.** At the level of the team, the impact of age diversity has been examined from two perspectives. The first perspective has to do with the impact of aging on the individual’s performance and contribution to the firm. After all, if age diversity means retaining a set of workers with a downward performance trajectory and limited training and development potential, the implications for the work unit and firm as a whole are likely to be negative. Gratefully, although people’s physical strength, psychomotor abilities, and sensory capabilities tend to decline with age, “it does not automatically follow that these declines result in lower work performance” (Hedge, Boreman, & Lammlein, 2006, p. 51). Indeed, meta-analytic results show little or no evidence of a link between age and either task (McEvoy & Cascio, 1989; Waldman & Avolio, 1986) or contextual (i.e., citizenship) performance (Williams & Shaw, 1999). Several factors explain why aging or an aging workforce does not necessarily predict poorer performance at the individual or aggregate level. First, the variation in aging within and across people means that it is rare for an individual to suffer a decline in all or even multiple competencies simultaneously. Accordingly, older adults suffering a decline in one particular competency may compensate on the basis of some other, superior competency. Second, many of these declines occur over extended periods of time, allowing people the time needed to retrain or develop new, alternative competencies. Finally, some of these declines can be minimized or reversed on the basis of prevention and wellness programs.

The second perspective has to do with the impact of intergenerational differences in work groups,



units, or the organization as a whole. Much of the research on the impact of age diversity on group/unit/firm performance stems from the same perspectives discussed earlier with respect to gender and race/ethnic diversity, namely social identity and relational demography (Avery, McKay, & Wilson, 2007; Ostroff, Atwater, & Feinberg, 2004), organizational demography (Zenger & Lawrence, 1989), and information elaboration (van Knippenburg et al., 2004). Accordingly, this body of research focuses on how age diversity or intergenerational differences affect communication and information elaboration in the firm.

The tendency of older workers to defer retirement or engage in bridge retirement means that it is not unusual to find four generations in contemporary workplaces, namely “veterans” (those born before 1946), baby boomers (born between 1946 and 1964), Generation Xers (born between 1965 and 1980), and Millennials or Generation Yers (those born after 1980). Complicating communication and information elaboration in a team or organization employing multiple generations is that the work values held by members of a given generation tend to differ from those held by members of another. W. Stanton Smith (2008) of Deloitte, LLP summed it up as follows:

- Baby boomers: “Work, work, work—it’s what we’re about!”
- Gen Xers: “Work, work more with flexibility. Work even more? Let’s talk!”
- Millennials: Work flexibly anywhere, but I need complete access to information; work anytime.... On my terms!”

In light of our discussion on the effects of diversity on team, unit, and firm performance more generally, one might suspect that such deep-level, values-based differences between generational cohorts act as a “double-edged sword,” generating both positive and negative consequences. And indeed, that is what the research on age diversity demonstrates. Some scholars suggest that age diversity can have positive effects on team, unit, or firm performance due to intergroup synergies, particularly when, as a result of greater exposure to older workers, age stereotypes held by younger workers begin to break down (Chiu, Chan, Snape, & Redman, 2001; Kilduff et al., 2000). Studies have accordingly reported positive effects of age diversity on performance (e.g., Li, Chu, Lam, & Liao, 2011). In contrast, other studies, based on one or more of the theories discussed earlier in this chapter, have posited and found negative effects (e.g., Ely, 2004; Leonard, Levine, & Joshi, 2004; Timmerman, 2000; West, Patterson, Dawson, & Nickell, 1999; Zenger & Lawrence, 1989). However, in a recent meta-analysis, Bell et al. (2011) found age diversity in work teams to be completely unrelated to team performance.

A number of scholars have attempted to explain when and/or how age diversity may be more strongly related to performance at the team or firm level. In a study of 83 teams from eight organizations, Kearny, Gebert, and Voelpel (2009) focused on team need for cognition—the tendency to engage in and enjoy effortful cognitive endeavors—as a possible moderator of the relationship between both age diversity and team performance. Age diversity was positively related to these outcomes when team need for cognition was high, but not when it was low.

Rather than focusing on the contingency factors explaining when age diversity might be more or less strongly related to performance, Kunze, Boehm, and Bruch (2011) attempted to explain the mechanisms by which age diversity may adversely affect firm performance. Their findings indicated that it did so by creating an age discrimination climate, or a collective sense among a firm’s employees that the organization treated certain age groups unfairly relative to others. This in turn had a negative impact on employees’ affective commitment to the organization, which in turn explained diminished performance.

If in fact the negative consequences of age diversity on team and firm performance operate by

generating an age discrimination climate and reduced organizational commitment, then it may be that such negative consequences may be ameliorated by more aggressively enforcing anti-age discrimination policies (Chiu et al., 2001), and by implementing activities aimed at sensitizing organizational members to the opportunities and challenges presented by an aging and multigenerational workforce (Kunze et al., 2011). It is to these strategies to which we turn next.

### *HR Strategies for Retaining Aging Workers and Reducing Age Diversity Risks*

Given the demographic shifts noted at the beginning of this section, any discussion of strategies for managing age diversity must deal with two distinct but related issues. The first issue concerns the management of aging workers so as to generate and retain a more age-diverse workforce (and in the process, avoid the loss of hard-to-replace knowledge, skills, abilities, and social capital). The second issue is how to manage a more multigenerational workforce to minimize the risk of any adverse consequences.

In terms of HR strategies to maximize older worker productivity by retaining their competencies and relationships, several scholars suggest the priority must be placed on holding onto and transmitting their “accumulated wisdom” and “institutional knowledge” (Beehr & Bowling, 2002). For example, Schetagne (2001) claimed that the most important older worker strategy was the transfer of their knowledge and skills to younger generations of workers.

Others focus on what employers might do to simply retain older workers beyond the point at which they are eligible to retire. For example, Hedge et al. (2006) argued that as skill obsolescence may be particularly problematic for older workers and motivate them to retire earlier rather than later, skill training should play an important role in any strategy aimed at motivating older worker retention. Additionally, they called for manipulating job responsibilities and assignments to meet the physical and cognitive abilities of older workers, as well as for developing more creative compensation and benefits plans directly meeting the needs of older workers. For example, they suggested that for many older workers an extended health benefits package may offer substantial value.

Most recently, drawing on embeddedness theory (Mitchell et al., 2001), Bamberger and Bacharach (2014) proposed that three mechanisms operate to motivate retirement-eligible older workers to defer retirement and stay on the job: (a) HR policies and practices aimed at enhancing older workers’ job fit; (b) older workers’ sense of the sacrifices they would make by retiring upon eligibility; and (c) older workers’ links to fellow workers. Testing their model on a national probability sample of some 500 workers surveyed twice (once just prior to becoming eligible to retire, and a second time one year later), they found that a combination of all three factors—e.g., job challenge (fit), perceived organizational support (sacrifice), and stability of close workplace peer relations (links)—had a substantial influence on the decision to retire or not retire upon eligibility, even when taking the effects of person-based antecedents (e.g., age, health, assets, expected retirement income) into account.

However, by motivating older workers to defer retirement, organizations may ultimately increase the age heterogeneity of their workforce. And as noted above, such increased age diversity can create challenges for the firm by, for example, increasing the risk of age discrimination, or generating barriers to effective communication flow. To address such challenges, a number of scholars have called for training at executive and lower levels to promote a positive awareness of age diversity, to aggressively enforce antidiscrimination policies, and to emphasize findings suggesting that an age-discriminatory corporate culture lowers performance (Armstrong-Stassen & Templer, 2005; Elliott, 1995; Hedge et al., 2006; Rynes & Rosen, 1995). It remains to be seen whether age-related diversity training will have the

questionable impact observed in established diversity programs noted earlier.

## **SUMMARY**

The research on employee diversity is vast and, in many ways, conflicting. This is not surprising, given that diversity manifests itself across multiple dimensions, with each type of diversity often have different effects depending on the outcome in question (e.g., performance, communication, relational quality), the level of analysis (individual, team, unit, organization), time frame (short versus long), and context. In this chapter, we tried to clarify some of the more general effects of employee diversity on individuals, teams, and organizations, and identify what factors may allow firms to reap a “dividend” from higher levels of employee diversity. Taking the results of the theoretical and empirical research into account, we also reviewed a number of HR strategies that may be adopted to enhance diversity, as well as to ensure that heightened levels of diversity do not inversely affect the firm or its members.

## **NOTE**

1. According to the U.S. Bureau of Labor Statistics (2013), the LFP rate for men aged 60 to 72 increased 38 percent from 1985 to 2010, rising from 26.5 percent to 36.7 percent. The LFP rate for women aged 60 to 72 increased by 80 percent during that period, from 15.4 percent to 27.7 percent.

There is little doubt that to be viable during the twenty-first century in the global environment, organizations, whether global or domestic, will need to be more global in their outlook, if not in their operations. The complexity involved in operating in different countries and employing different nationalities of employees is a key variable that differentiates domestic and global HRM.

—Kiessling and Harvey (2005, p. 25)

With the globalization of product and service markets has come the increasing globalization of labor markets. Accordingly, for many firms, the management of global workforce has become no less critical than the global management of marketing, sourcing or innovation (Boxall & Purcell, 2008; Collings, Scullion, & Curran, 2009; Harvey & Novicevic, 2003). Even small start-up firms are often forced to “go global” in order to source that last bit of know-how needed in order to meet product or service specs, establish a market presence, secure the production synergies necessary to ensure competitiveness, or find the unique competencies or talent required to manage the critical uncertainties faced by the enterprise. In previous chapters, we identified the complex choices and challenges associated with the strategic management of human capital. However, up until now, our analyses have largely assumed a common set of cultural values and institutional frameworks, not to mention a uniform managerial infrastructure facilitating control and coordination. An understanding of global HR strategy demands the consideration of how the same systems examined earlier in this book may be differentially structured and managed so as to meet the contingencies posed by diverse sets of norms and values, legal/institutional and regulatory frameworks, and market contexts.

In this chapter we explore the strategic implications of managing a workforce that is spread across two or more countries. In particular, we will address five issues central to the field of global HRM, having to do with how global firms: (1) design their work processes, (2) staff positions across borders, (3) balance local and global considerations in managing employee performance, (4) optimize equity and competitiveness considerations in compensating employees worldwide, and (5) manage employee relations across diverse regulatory contexts. After reviewing the literature on how globalization affects each of these five main HR domains, we identify and discuss several factors that may underlie the variance in enterprise policy and practice with respect to the management of a global workforce.

## **JOB DESIGN ON A GLOBAL BASIS**

At its core, globalization involves the geographic dispersion of enterprise operations across national boundaries. Accordingly, if nothing else, globalization demands the consideration not only of which positions to locate “at home” versus “off-shore,” but also how to modify the nature of these positions in order to satisfy local considerations and ensure cross-national coordination. That is, globalization forces management to decide which work activities to keep local (i.e., co-locate), which activities to distribute to which foreign locations (i.e., offshore), and how to ensure coordination among those operating at substantial distance from one another (e.g. Couto, Mani, Lewin, & Peeters, 2006). The main issue here concerns interdependence or the degree to which (and how) discrete elements in the work process are linked to one another. Generally speaking, the greater the interdependence between work elements or

tasks, the greater the amount of coordination and control required, and the greater the risk associated with control or coordination breakdowns (Cramton, 2001; Kumar, van Fenema, & Von Glinow, 2005; Nemiro, 2000).

In co-located work, physical proximity facilitates monitoring and coordination. However, when work is globally distributed, physical distance, cultural gaps, and language and time zone differences often necessitate more intensive, continuous and formalized synchronization in order to ensure that messages are understood as intended (e.g., Herbsleb & Mockus, 2003; Rottman & Lacity, 2006). Kumar, van Fenema, and Von Glinow (2009) suggest that alternative forms of coordination and control are often necessary because the global distribution of work introduces a new form of task interdependence, different from the more classic forms (i.e., pooled, sequential and reciprocal) noted in the organizational literature, which they refer to as *integration interdependence*. This new type of interdependence, structured around complex, global supply chains, is characterized by four main elements. First, global dispersion requires the breakdown of the overall enterprise work process into sub-tasks with each subtask revolving around a particular component of the product or service, and with work on each component encompassing unique processes and demanding unique competencies. Second, the components, produced independently but in parallel with one another, have little or no value on their own, but rather take on value when incorporated into an integrative product or service. Third, value is created from these parallel production processes by a separate, “fitting” or integration process. Finally, all parties need to be aware of the other elements in the supply chain and the units responsible for delivering them in that changes in the nature or delivery of these other elements can have a dramatic impact on the nature and efficiency of integration.

The integrative interdependence inherent in most forms of globally distributed work places greater coordination demands on the organization units involved in that vast amounts of information may need to be transmitted on a continuing and realtime basis to allow for the smooth and efficient integration of multiple components sourced from disparate units. The coordination and control demands may be heightened to the extent that the component-specific information facilitating integration is tacit or “difficult to express or codify.” The fact that one unit’s output cannot simply be “thrown over the wall” for the next unit to work on, and that “actors must continuously be aware of their counterparts’ activities to proceed on their own work” (Kumar et al., 2009, p. 655), places immense pressure on globally distributed work units. Accordingly, in such contexts, organizations are likely to have to (a) develop systems facilitating the continuous and open flow of information, and (b) adopt policies and protocols ensuring implicit coordination among dispersed actors and that, regardless of distance, coworkers are able to anticipate each others’ needs and facilitate each others’ actions.

Such demands are more related to organizational design and operations than HR. However, all four of the elements of integrative interdependence noted above also have important people-related implications. For example in optimizing the dispersion of these parallel work processes across national boundaries, due consideration must be given to local human capital requirements and availabilities, as well as to the long-term implications of such dispersion on the enterprise’s core, people-based capabilities. Is it in the firm’s long-term strategic interest to outsource certain production processes if manufacturing prowess serves as a key enterprise capability? Similarly, in ensuring implicit coordination among dispersed units, consideration must be given to developing leaders with a keen understanding of how all of the dispersed pieces fit together. This may require staffing systems structured around the expatriation of local stars as well as talent development and compensation systems that facilitate such expatriation. Finally, and perhaps most importantly, integrative interdependence may require the re-design of jobs in order to ensure that job incumbents have a clear understanding of (and an implicit “line of sight” to) those engaged in the

parallel production of other components in the supply chain. For example, jobs may be designed to ensure that employees get real-time feedback from those integrating their components with those of others on problems encountered in the integration process. Alternatively, work may be structured around globally distributed, virtual teams to facilitate real-time information transfer, and the development of implicit coordination competencies grounded on a global, enterprise-based identity and mindset.

### *Designing Work around Globally Distributed (Virtual) Teams*

Cross-cultural teams, or teams consisting of people from two or more nationalities, are important mechanisms for transferring and deploying tacit knowledge across national borders (e.g., Dubé & Paré, 2004; Henderson, 2005). Cross-cultural team members can work together face to face or virtually. Virtual teams involve groups of geographically and/or organizationally dispersed coworkers that rarely, if ever, meet in a face-to-face setting. Instead, they use a variety of information technologies to accomplish their tasks (Bell & Kozlowski, 2002; Martins, Gilson, & Maynard, 2004).

Freedman (2008) suggested that to effectively design the work of their global teams, firms must tackle “the triple challenge presented by distance, language, and culture ...” (p. 375). In terms of distance, global virtual teams who carry interdependent tasks across countries add task coordination hurdles associated with differences in members’ time zones and working hours (e.g., Martins et al., 2004). For example, members’ communication in global virtual teams depends on the availability and quality of synchronous and asynchronous information and telecommunication media (e.g., Cramton, 2001; Maznevski, & Chudoba, 2000). Second, “language may be an even bigger potential problem than functional differences and culture per se” (Schweiger, Atamer, & Calori, 2003, p. 134). This is because, in addition to “language” competence (proficiency), sociolinguistic competence (“the capacity of individuals to interpret the social meaning of language and to respond appropriately in the context of interactions”; Henderson, 2010; p. 364) is required when operating across language boundaries (Hymes, 1971). And finally, national culture, or “the collective programming of the mind which distinguishes the members of one human group from another” (Hofstede, 1980, p. 25), is a source of various coordination problems in global teams, having to do with team members’ differences in the level of power distance, individualism (as opposed to collectivism), masculinity (as opposed to femininity), uncertainty avoidance, and long-term orientation (as opposed to short-term orientation) (Hofstede, 1991). Related challenges include differences in time perceptions that “are based on different ethnic and national orientations about time that affect team-member perceptions of deadlines” (Saunders, Van Slyke, & Vogel, 2004, p. 19). Such differences can result in inconsistent models for the pacing of the work process, with such inconsistencies complicating “hand-offs” from one team element to the next, and making it more difficult to secure team synergies (Lee & Liebenau, 2002; Orlikowski & Yates, 2002).

Recognizing the aforementioned distance-, language- and- culture-related challenges faced by global teams, Kumar et al. (2005) proposed two alternative work-design strategies intended to handle the intensity of collaboration in globally distributed team work. The first set of strategies aims at *reducing* the intensity of collaboration among globally distributed team members. Organizations seeking to reduce the intensity of collaboration in globally distributed teams may sequentialize the teamwork such that “a string of solo acts substitutes for concurrent teamwork” with work being passed back and forth by means of asynchronous media” (p. 134). Alternatively, collaboration intensity may be reduced by modularizing the team’s work such that teamwork is split up “into independent chunks that can be performed in parallel” (p. 136). These strategies may involve drawbacks such as slow response times, reduced flexibility and agility, and difficulties in providing the kind of integrated “systems” of products and services increasingly

demanded by customers.

The second set of strategies aims at *enabling* intense collaboration. These strategies are particularly suitable when the team's work process demands intense reciprocal or integration interdependence and the creation of unique synergies. In such situations, simultaneous virtual collaboration using real-time communication technologies such as tele/videoconferencing, real-time distributed groupware sessions, and chatting may provide many aspects of real-life co-located interaction. Still, despite rapid new advances in virtual collaborative technologies, intense collaboration among globally distributed team members remains a challenge with the result being the slower development of collaborative/trusting relations among distributed team members, slower team learning curves, and greater difficulty in developing team synergies. Accordingly, organizations structuring work processes around intensively collaborative, global virtual teams often have little choice but to craft into team-based positions the need for short-term stints of on-site collaboration and/or job rotations, or look to longer-term staffing strategies (such as expatriation) as a means by which to facilitate the development of synergies, collective mindsets and collaborative processes essential for the effective functioning of global, virtual teams.

## **GLOBAL STAFFING**

Global staffing is the process of acquiring, deploying, and retaining a global workforce in organizations with operations in multiple countries (Scullion & Collings, 2006). There are two dominant themes in the literature on global staffing. The first is the management of expatriates (expats) and the second is the real-time recruitment, selection and development of talent on a global basis.

### *Staffing of Expats*

Research on global staffing has focused largely on expatriation-based staffing strategy; an ethnocentric approach to global staffing grounded on the assumption that effective coordination and control is most easily achieved when foreign units are managed and/or staffed by parent-country nationals (i.e., PCNs or expatriates) (e.g., Bolino, 2007; Harvey, Speier, & Novecevic, 2001; Taylor, Beechler, & Napier, 1996). However, Tadmor, Galinsky, & Maddux (2012) reported that, many expats "fail to achieve prosperity in their new cultures," and return home early either voluntarily or involuntarily. In their research, Tadmor et al. hypothesized and found that PCNs demonstrated greater creativity and innovation as well as better overall professional success in their international assignment (i.e., faster promotion and positive reputation) to the extent that they identified with *both* their home and host country cultures rather than one or the other. Their findings suggested that underlying the beneficial effects of such biculturalism is a heightened level of integrative complexity, an information processing capacity on the part of individuals involving the ability to consider and combine multiple perspectives.

Perhaps because of its uncertain outcomes, PCN expatriation is no longer the single or dominant global staffing strategy utilized by multinationals (Collings, Scullion, & Morley, 2007). The increasing importance of markets in developing countries, high expatriation failure/refusal rates (especially in those cases where there are significant economic, legal, and cultural gaps between the parent and host countries), the high costs of expatriate assignments (relocation costs alone can total in the tens of thousands of dollars), and the strategic need for a more multicultural corporate climate, management team, and workforce, have led to the development of three alternative global staffing strategies (e.g., Collings et al., 2009; Harvey et al., 2001).



The first is the polycentric strategy, which relies on recruiting primarily host-country nationals (HCNs; i.e. individuals from within the country) to manage the subsidiary's operations. The second is the geocentric strategy, in which headquarter and subsidiary positions are filled by the most qualified candidate, regardless of nationality. Firms adopting geocentric strategy thus rely on PNCs, HCNs and third-country nationals (TCNs). The latter are often experienced managers from neither the parent nor the host country, who take on regional management responsibilities (e.g., Perlmutter, 1969; Taylor et al., 1996; Schuler, Dowling, & De Cieri, 1993). And the third strategy, inpatriation, involves the relocating and/or hiring of HCNs or TCNs (often managers) into the parent organization on a semipermanent to permanent basis (e.g., Harvey, 1993; Harvey & Buckley, 1997). Furthermore, recent research points to the growing use of short-term, nonpermanent forms of international assignments as an alternative to traditional expatriation (e.g., Collings, et al., 2007; Dowling & Welch, 2005; Fenwick, 2004; Mayerhofer, Hartmann, Michelitsch-Riedl, & Kollinger, 2004; Tahvanainen, Welch, & Worm, 2005). For example, short-term international assignments (transfer to a foreign subsidiary for a period ranging between one and twelve months) do not necessitate the relocation of the assignee's family, and allows for remuneration issues (salary, social security benefits, etc.) to be handled in the home country.

### *Global Talent Acquisition and Management*

Beginning in the late 1990s when demand for talented employees far exceeded the supply, global firms were confronted with growing challenges of talent acquisition, retention and management (e.g., Beechler & Woodward, 2009; Guthridge, Komm, & Lawson, 2008; Michaels, Handfield-Jones, & Axelrod, 2001). As Cheese, Thomas, and Craig (2008) put it "talent has become a precious resource fought over by competitors in a global war for talent" (p. 9). Three factors underlie the importance of global talent management for multinational firms. First, research has found that internationally competent managers are a key to global business success (e.g., Black & Gregersen, 1999; Shen & Darby, 2006). Second, with the growing number of firms internationalizing and the growth of emerging markets (e.g., Central and Eastern Europe, India, and China), the demand for global management competencies is constantly increasing (Collings et al., 2007; Scullion, Collings, & Gunnigle, 2007). And third, because global firms typically fill jobs with more demanding skill-sets than do domestic firms (Guthridge & Komm, 2008; McDonnell, Lamare, Gunnigle, & Lavelle, 2010), they often have little choice but to source these skills from a broader, global labor market.

Mellahi and Collings (2010) sought to identify barriers to effective global talent management (i.e., factors that may impair talent utilization in global firms). From the perspective of agency theory, when the goals and interests of the global firms as a whole and those of the subsidiary are not aligned, the subsidiary may undermine the effective management of talent for self-serving reasons. More specifically, given that subsidiaries are generally evaluated and rewarded for their own performance, it may be in the subsidiary interest to retain their best talent (even though they are underutilized) rather than allowing them to come to the attention of the headquarters or other subsidiaries (e.g., O'Donnell, 2000). In addition to these subsidiary level barriers, Mellahi and Collings (2010) also discussed headquarter level barriers from the perspective of bounded rationality. Specifically, they argue that decision makers at a firm's headquarters do not always have access to accurate information about all possible candidates from all subsidiaries, and have limited capabilities to reach a judgment using all pertinent information. Instead, to simplify their judgment, they often select people that are close to them, that are good enough (suffice) for the position. At the same time, social and geographical distance isolates subsidiary level talents from the headquarters and limits their opportunities to serve at the upper echelon management team of the global

firm (e.g., Bouquet & Birkinshaw, 2007).

Considering these barriers, a number of studies suggest that the globalization of talent management necessitates the adoption of new staffing tools, methods, and processes (Farndale, Scullion, & Sparrow, 2010; Kim, Park, & Prescott, 2003). Some of these tools involve market mapping (i.e., the graphical analysis of supply and demand in alternative labor markets and how various factors may affect these market relations) and employer branding (i.e., the management of the employer- and employment-related perceptions of current and potential employees in particular labor markets) (Cheese et al., 2008; Sparrow, 2007).

If these tools sound like they are applications of marketing to HR, that's because they are! Essentially, global talent management requires the adoption of many of the same approaches to behavior analysis and change used by companies to control consumer behavior. The only difference is that these same approaches are used to better understand differential patterns of workforce behavior across alternative labor markets and then to leverage such understandings to enhance global human capital acquisition and retention.

## **GLOBAL PERFORMANCE MANAGEMENT**

A survey of performance management systems and practices in 278 organizations, two-thirds of which were multinational enterprises, indicated that 91 percent used a performance management system. Of these, 75 percent used the same system for the majority of their employees worldwide (Bernthal, Rogers & Smith, 2003). On the one hand, such statistics point toward convergence and consistency in performance management among global firms. On the other hand, such convergence may be problematic for several reasons (e.g., Claus & Briscoe, 2009; Hellqvist, 2011).

First, Western concepts of performance management may not always suit other cultures due to cross cultural differences in power distance (i.e., the managersubordinate relationship may be differentially interpreted), individualism/collectivism (i.e., preferences for team- or unit-based appraisal versus individual assessment may vary), and face-saving (i.e., different levels of comfort with the provision or receipt of critical feedback may lead to problems with accepting and acting upon developmental feedback) (Hellqvist, 2011). Second, it may be problematic to apply a consistent set of performance criteria across contexts given unique situational constraints (i.e., characteristics of the work context that may interfere with employees' performance; Peters & O'Conner, 1980; Bacharach & Bamberger, 1995). For example, differences in local accounting rules or labor laws from one country to the next may make it difficult to compare the relative performance of subsidiary managers in different countries. Similarly, it may be unfair to assess sales and marketing staff along a common set of criteria or objectives given that markets in some countries may be more developed than in others (Dowling & Welch, 2005). Finally, the application of a common performance management system across countries may be problematic because country-specific managers may differentially interpret performance objectives or criteria, the time frames within which these objectives are to be met, or the consequences of under-par performance (Evans, Pucik, & Barsoux, 2002). All of these issues raise important questions about the validity of performance measures when applied across very different contexts.

Not surprisingly, therefore, several scholars have concluded that global firms may find it difficult for firms to apply a common set of performance criteria across all of the countries in which they operate (e.g., Cascio, 2006; Dowling & Welch, 2005; Murphy & DeNisi, 2008). This has led some scholars, such as Briscoe and Schuler (2004) to suggest that "multinational enterprises need to construct criteria for

evaluation according to each subsidiary's unique situation" (p. 356), taking account of such situational constraints as severe inflation, currency devaluations, and local leave and holiday requirements.

## **GLOBAL COMPENSATION AND BENEFITS**

Until fairly recently, the primary reason for establishing or moving certain operations to other countries was to take advantage of lower labor costs (Edwards, Sánchez-Mangas, Tregaskis, Levesque, McDonnell, & Quintanilla, 2013). In this context, multinational firms would either contract for labor at local rates or directly compensate their global workforce in accordance with the rates prevalent in the local labor market. However, as noted above, the drivers for internationalization have expanded to include the acquisition of talent unavailable at home, the need to position talent closer to strategic partners or markets, and an interest in maximizing strategic flexibility, all of which demand a more nuanced approach to managing compensation than simply paying at the prevalent local wage.

Cultural differences and divergent legal frameworks may also make it difficult for multinational firms to apply a common compensation policy and structure across all of the countries in which they operate. For example, should engineers in France be compensated at the same rates as engineers in the United States when those in the French subsidiary, following common practice in that country are granted four or more weeks of vacation while those in the United States are typically granted only two weeks? Similarly, the absence of a national health insurance policy in the United States put the onus of health insurance on employers with the upshot being that benefits in the United States accounted for over 30 percent of total pay for the average American worker in 2012 (Hallock, 2013). Should benefits similarly account for over 30 percent of total pay for those employed by an American firm operating in a country with national health insurance?

Researchers investigating the role of cultural self-identify in shaping global compensation systems suggest that corporate compensation frameworks be customized to take into account diverse cultural contingencies (Earley & Erez, 1997; Festing, Eidems, & Royer, 2007; Rousseau & Tinsley, 1997). More specifically, the cross-cultural organizational literature suggests that compensation and reward policies be developed to align with, and reinforce national cultural attributes. Thus, for example, individual-based pay-for-performance schemes may be more suited to those employees from nations identified as more individualistic (e.g., United Kingdom, Canada), whereas those from more collectivist countries (e.g., Singapore, Japan) are likely to prefer performance-based pay determined on the basis of team or group outcomes (Gerhart, 2008; Luthans, Marsnik, & Luthans, 1997; Lowe, Milliman, De Cieri, & Dowling, 2002). Of course, this raises significant complications in those global firms expatriating employees from one country to work in another. When a facility or unit employs individuals from a diverse set of cultural backgrounds, it may be impossible to structure pay to align with each employee's own set of cultural values. In such cases, firms have may no choice but to apply a more uniform set of pay policies and practices that place greater weight on meeting the more general demands and contingencies presented by the broader, corporate HR strategy.

Differences in employment law, collective bargaining regimes, corporate governance regulations, financial and labor markets (e.g., cost of living, employment rates), and general institutional development may also demand that firms adjust their compensation policies and practices to meet local needs (Bloom & Milkovich, 1999; Bloom, Milkovich, & Mitra, 2003; Budhwar & Sparrow 2002; Festing et al., 2007). For example, differences in the laws governing the granting, valuation, and taxing of certain benefits (e.g., company car) and forms of pay (e.g., stock options) may result in significant differences in the way in

which employees are compensated even if the value of total compensation is consistent across countries (Gerhart, 2008; Sano, 1993; Shibata, 2000).

Solving such cultural or regulatory/institutional dilemmas can be complicated and costly, necessitating multinational firms to both acquire local compensation data, and adjust pay structures and systems accordingly (Harvey, 1993; Thompson & Yurkutat, 1999). Poor judgment in determining country-specific differences in pay can generate perceptions of distributive injustice and pay inequities that can elicit pay dissatisfaction and a variety of problematic outcomes including turnover and even employee theft. Moreover, among members of virtual teams, country-based pay differentials can generate jealousies that, in turn, can damage trust and cooperation, and thus limit team effectiveness. Gratefully, governments are becoming increasingly cognizant of the barriers such differences can impose on the free flow of labor across markets and the efficient operation of such cross-border labor markets. Accordingly, particularly in Europe, significant progress has been made in adopting a common set of laws and institutions that facilitate the development of more convergent pay architectures. Such common architectures and pay systems aim to promote the standardization of pay structures and policies among the global firm's subsidiaries (Almond et al., 2005; Reynolds, 2000), and thus enhance employee equity perceptions (Fryer, 2003). Moreover, such convergent pay systems facilitate global talent sourcing, increasing the ease with which a firm's local talent may be optimally and most efficiently deployed (Cheese et al., 2008).

## **GLOBAL LABOR RELATIONS**

Collings (2008) defined international labor relations as the labor relations “issues and problems, for both capital and labor, arising from the internationalization of business, and the labor relation strategies, policies and practices which firms, employees and their representatives pursue in response to the internationalization of business” (p. 175). A labor relations perspective is important for understanding the management challenge in global firms, because, as Lane (2003) notes, “while host institutions are not viewed as totally constraining actors ... they pose certain limits within which action occurs” (p. 84). In this regard, each location within which a global firm operates may offer specific labor relations advantages and disadvantages (Collings, 2008; Cooke, 2006; Edwards & Kuruvilla, 2005). For example, a country with relatively few institutional/regulatory constraints may offer global firms the opportunity to set up operations on a nonunion basis that, for many firms, may be viewed as a major source of competitive advantage (Collings et al., 2009; Gunnigle, Collings, & Morley, 2005).

Many international labor scholars agree that unregulated global competition, value chains, production, and trade have caused shifts in patterns of labor regulation in most industries and countries, slowly eroding national labor regulation regimes and institutions such as trade unions (Burawoy 2010; Webster 2010). The weakening of national labor laws and country-specific unions has generated a search for alternative mechanisms for regulating labor-management relations. The result has been the emergence of non- or cross-state forms of labor regulation (such as the Core Labor Standards set up by the International Labor Organization), corporate-based standards (such as those being applied by large retailers in the countries from which they source their merchandise), global trade unions and union federations, and grassroots' worker campaigns.

These emergent global labor regulation mechanisms can be divided into three main strands (Fransen & Burgoon, in press). The first strand aims to strengthen the capacity of workers to organize and bargain with businesses and governments. The second strand focuses on international institutions promoting and

enforcing policies protecting workers and affecting jobs and wages. And the third strand focuses on voluntary business activities aimed at advancing worker rights. Many of these mechanisms are voluntary, self-regulatory regimes established by nonstate actors stepping into what was previously the prerogative of sovereign states, both with and without government cooperation (e.g., Haugler, 2001; Williams, Davies, & Chinguno, in press). For example, the first international framework agreement was signed in 1988 by the French food multinational corporation Danone and the global union federation for the sector, the International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers Associations. About 80 such agreements have been signed to date (Williams et al., in press). However, a question still remains as to the regulatory effectiveness of such emergent governance regimes. Whereas financial support and the ability to operate in other countries may serve as incentives for compliance with such regulation mechanisms, skeptics claim that compliance with these mechanisms mainly serve the need of global firms to strengthen their legitimacy (Dai, 2007; Pries & Seeliger, 2013). Nevertheless, research (Porter & Ronit, 2006; Vogel, 2008; Webb, 2004) increasingly points to the growth of such regimes as a viable alternative to the traditional state-based approach to managing labor-management relations.

## **STRATEGIC CONCERNS IN THE DESIGN OF GLOBAL HR SYSTEMS**

When deciding how to structure and administer staffing, performance management, compensation and labor relations on a global basis, managers in global firms need to balance three main forces, namely: (a) the interests of the firm as a whole, (b) the institutional/normative and regulatory constraints operating on the local level, and (c) broader notions of best practice. Achieving such balance is rarely simple. For example, if an enterprise characterized by employment-at-will and external labor market employment relations acquires a subsidiary with a deep-seated internal labor market culture rooted in a national culture of life-time employment, which approach should govern employment relations in the subsidiary following its acquisition?

Based on a study of over 1000 MNC subsidiaries in Canada, Ireland, Spain, and the United Kingdom, Edwards et al. (2013) suggest that global firms' HR practices reflect the consideration of all three forces. More specifically, they find little evidence of convergence and isomorphism, with firms adopting a single set of best practices and applying these practices across all of their international subsidiaries. On the other hand, they do find evidence that some best practices are widely adopted both across and within firms. Accordingly, their findings suggest that a given firm may adopt an internationally standard HR policy or practice (such as the implementation of basic occupational safety protocols) on a global basis because the failure to apply such a basic employment practice may result in the questioning of the firm's basic legitimacy. This same firm may also globally adopt a best practice specific to a particular country (such as the design of jobs on the basis of Japanese lean production models) in order to better align its HR strategy with the competitive interests of the firm. Finally, country-specific operating units of this same firm may adopt different HR policies and practices (such as codetermination, collective bargaining, or strict union avoidance) depending on the local institutional environment within which those units operate.

A variety of firm-level and institutional factors likely play a role in determining how global organizations manage such potentially conflicting forces when deciding upon the policies and practices that will be used to govern employment relations in each of the countries in which they operate (Aguilera & Dencker, 2004; Lawler, Shyh-jer, Pei-Chuan, Johnngseok, Bing, 2011). However, two factors likely to

play a key role are (a) the manner in which the firm initially engaged the particular overseas workforce (i.e., acquired versus organically developed) and (b) the degree to which the company's competitive strategy is contingent upon intense interdependencies among the operating units and the development and maintenance of a unitary and strong corporate identity (Aguilera & Dencker, 2004; Bjorkman, Fey, & Park, 2007).

The first criterion above has to do with the make or buy notion discussed earlier in this book, and thus the degree to which corporate views the operating unit's human capital as its own. Firms establishing their own off-shore presence and "growing" their own human capital may be more likely to apply the same broad architecture of HR policies and practices in place in their home country. In contrast, firms acquiring an overseas operating unit through a merger or buy-out may have difficulty replacing indigenous employment regimes with those applied in their home country. Accordingly, the policies and practices used to manage human capital acquired through a merger or acquisition are often slowly adjusted over time to be more consistent with those of the parent firm (Aguilera & Dencker, 2004; Froese, Pak, & Chong, 2008). However, even acquired units may be under intense pressure to quickly adopt the HR policies and practices of the parent to the extent that the unit was acquired specifically for its human capital. That is, the degree to which convergence is pushed across a company's acquired foreign units largely depends on the logic underlying the acquisition. If the acquisition was done in order to achieve operational efficiencies or gain local market access, there may be little pressure on the acquired unit to adopt the HR policies and practices of the parent. If on the other hand, the unit was acquired in an effort to secure a source of human capital, then the ability to efficiently deploy this human capital may be contingent upon the rapid application of the parent firm's overarching HR policies and practices (Aycan, 2005). Indeed, even in units acquired for operational efficiency but whose local management and/or professional staff may serve as a talent pool for units operating in other countries, the parent enterprise may deem it worthwhile to align HR policies and practices for exempt (i.e., managerial, professional, and technical) staff, while retaining the "local" HR policies and practices for the nonexempt staff. Consistent with such an approach, Yanadori (2011) using compensation data from 10 subsidiaries of a U.S.-based multinational corporation in the Asia Pacific region, found that compensation practices for managers differed across foreign subsidiaries to a lesser extent than they did for nonmanagerial employees.

The second criterion concerns the degree to which the company's globalization strategy is grounded upon the leveraging of geographically dispersed capabilities on the basis of intense, integration interdependence. As suggested above, such an approach often requires the development of a common collective mindset so as to facilitate the ability of dispersed units to anticipate one another's' actions and operate synergistically. In order to ensure the development of shared understandings, the basis for such a collective mindset, global firms may seek to export a common set of HR policies and practices to all foreign locations. Indeed, using a sample of 97 multinational companies, Claus and Hand (2009) demonstrated that a global integration strategy incorporating a dominant set of standardized HR policies and practices, was more effective than a local responsiveness strategy (characterized by decentralized management structure and the dominance of localized HR policies and practices) in ensuring the adoption of a standardized approach to performance management, key to institutionalizing a common set of organizational norms and values. That is, a centralized HR infrastructure, combined with the global application of a dominant set of HR policies and practices may be necessary in order to generate identification with the enterprise as a whole and the internalization of norms and values that are instrumental to the development of shared understandings.

Still, as noted above, research suggests that managers consider a wide range of factors when determining how to balance pressures toward cross-facility convergence and isomorphism (on the one

hand), and divergence and local distinctiveness on the other. Thus, for example, although we noted above that there may be significant deployment-related advantages for pushing convergence when enterprises acquire foreign units largely for their knowhow and local talent, there may also be advantages for allowing these units to continue to manage their human capital independently on the basis of established, local practices. Underlying such an approach is the notion that managers may be best off “not fixing what ain’t broken.” Moreover, when applying the dominant HR strategy to the newly integrated foreign unit, there is always the risk that key talent (i.e., those offering the greatest value to the firm and/or those at the hub of key knowledge networks) may be motivated to leave. Accordingly, even companies known for their interest in ensuring HR and cultural convergence may make exceptions when acquiring foreign units possessing key knowhow and/or knowledge-generating human capital and social networks. For example, when Google, a company known for its deeply embedded corporate culture and unique HR policies and practices, acquired Waze, Ltd., an Israeli developer of networked mapping technology, a key element of the acquisition agreement was that the latter would be allowed to continue to operate independently and manage its staff on the basis of its own set of HR policies and practices.

## **SUMMARY**

In this chapter, we have reviewed the strategic implications of managing a global workforce and what globalization means when developing and executing strategies specific to each of the HR domains examined in earlier chapters. Accordingly, we examined how globalization affects: (1) the design of organizational work processes (at the macro level) and job design (at the micro level), (2) human capital acquisition and deployment, and the systems developed by the organization to leverage access to key human resources on a global basis, (3) the management of employee performance, (4) equity and competitiveness considerations when compensating employees worldwide, and (5) industrial and labor relations policies and practice, and the systems that organizations must adopt and integrate in order to balance the interests of enterprise-wide fairness with the demands of local regulatory compliance. Noting the complexities of attending to each of these considerations, we highlighted the central dilemma underlying global HR, namely how to balance conflicting pressures toward convergence and isomorphism (on the one hand) versus divergence and local distinctiveness in HR practice (on the other). We concluded our discussion of two factors often influencing the way in which organizations balance these pressures, namely (a) the historical nature of the parent-subsidiary relationship (i.e., make or buy), and (b) the need degree to which relations among dispersed operating units is grounded on intense, integration interdependence.



## Evidence from the BRIC Countries

As noted in the previous chapter, there is substantial empirical evidence suggesting that employment relations systems are manifesting a tendency toward convergence (Katz & Darbshire, 2000). Accordingly, both within and across enterprises, HR policies and practices are in many ways becoming more similar (Edwards et al., 2013). Indeed, consistent with the “system” and “dominance” elements of the “system, society, and dominance effects” (SSD) approach (Smith & Meiksins, 1995), Edwards et al. (2013) found that HR practices associated with several dominant economies (such as the United States) have become widely diffused around the world. Reinforcing this trend toward HRS convergence has been the globalization of markets and supply chains, which has exerted system-level pressures on firms to adopt a common set of people-related policies and practices that are consistent with integrated frameworks of production and consumption. Still, in line with the earlier findings of Katz and Darbshire (2000), Edwards and colleagues also found that accompanying these pressures toward convergence in some aspects of people management are society-specific, countervailing forces pressing in favor of divergence.

In this chapter, we expand on this paradox by offering four case studies illustrating how HR strategies can simultaneously manifest both converging and diverging characteristics. We focus on the HR strategies adopted by organizations in the four BRIC countries (Brazil, Russia, India, and China). These countries not only represent some of the world’s largest economies, they also are among those dominating industrial production and economic growth. As four of the most vibrant emerging economies, Brazil, Russia, India and China are the obvious cases to examine in order to better elucidate how and why certain HR practices and policies have become more widely diffused and institutionalized than others.

## REFLECTIONS ON THE EVOLUTION OF HR POLICY AND PRACTICE IN RUSSIA

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Since 1991, Russia has experienced an unprecedented transformation: a large-scale transition from a planned economy to an economy based on the principles of the market. This transformation, which has had a profound impact on social and economic structures, labor relations, institutions, and national culture and identity, has attracted the attention of business and management scholars, as well as economists, sociologists, psychologists, and anthropologists who have closely followed and studied the developments. The purpose of this mini-chapter is to examine this transformation with respect to management theory and practice, and review the key developments in Russian HR strategy as described in

the literature published over the last 20 years. This mini-chapter also presents a critical examination of the interactions between research and actual HR practice in Russia.

To accomplish these goals, we searched for relevant English- and Russian-language publications in the most reputable refereed international and Russian academic journals. The search identified a number of predominantly English-language papers published in business and management, economics, and sociology journals, with additional Russian-language publications that are largely descriptive and theoretical. While they bring attention to topical HR issues, they typically neither provide estimates of the scope of a phenomena or practice, nor test hypotheses valid regarding the antecedents or consequences of alternative management approaches. Therefore, they were not relevant for the purposes of this chapter. One notable exception is research in the area of labor sociology and labor economics, which is represented, in particular, by Gimpelson and Kapeliushnikov (Kapeliushnikov, 2001; Kapeliushnikov & Demina, 2005, Gimpelson & Kapeliushnikov, 2011), whose work builds upon extensive empirical studies and contributes to a better understanding of the dynamics of Russian employment relations.

### *Economic and Business Developments in Russia*

Since 1991, the Russian economy and Russian business practices have gone through three distinct periods, which have included two financial crises that strongly affected the Russian economy: the Asian financial crisis of 1998 and the global financial crisis that started in 2008. A key macroeconomic trend during the first stage (1991–1998) that had a significant impact on managerial practice was the rapid and massive privatization and accumulation of assets (Brown, Earle, & Telegdy, 2005; May, Puffer, & McCarthy, 2005; McCarthy & Puffer, 2008; Puffer & McCarthy, 2011). The disputed practices of massive privatization were dubbed the “piratization” of Russia, and the emerging variant of capitalism was widely perceived as brutal and unfair (Goldman, 2003; Kuznetsov & Kuznetsova, 2008). On the basis of data from the Russian Longitudinal Monitoring Survey, Denisova, Eller, & Zhuravskaya (2010) find that about 50 percent of Russians were disappointed with the transition at this stage, and that the majority of the population favored stronger state regulation, as well as the state provision of goods and services. As reported by Croucher and Rizov (2011), workers’ disillusionment with the economic transition and reforms has been recorded in numerous studies. It was aggravated by the perceived worsening of job security and career prospects (Gimpelson & Oshchepkov, 2012; Guriev & Zhuravskaya, 2009; Linz and Semykina, 2008). Privatization lowered the performance of Russian firms, as measured by a multifactor productivity index, by 3 percent, while its positive effects were not evident in the firms with the domestic ownership for up to five years (Brown et al., 2005).

The second stage spanned from 1998 to 2008. The 1998 default on the national debt and devaluation of the national currency that Russia experienced as a result of the Asian financial crisis had a tremendous impact on the Russian economy and was a catalyst for a major shift in managerial attitudes and priorities (May et al., 2005). The devaluation of the Russian currency enabled national producers to capitalize on new development opportunities in terms of making their products more competitive in the domestic and international markets. After 2000, growth in commodity markets benefited the metallurgy and oil and gas industries, which were key contributors to national GDP and significantly lifted domestic consumption and employee compensation. Many Russian companies started to expand internationally and began to reach out toward foreign capital markets. Businesses also experienced the first wave of changes in ownership. The new owners, who targeted going public in Russia or abroad and higher capitalization, were more interested in long-term business development and relied on enhanced political and economic stability, supported by the once again improving welfare. As a result, the business environment began to

change from within, supported by Western financial institutions' increasing demand for greater transparency in terms of business operations and management.

The third stage, which began in 2008, was initiated by another crisis in the Russian economy. As I discuss below, anecdotal evidence suggests that during this transition, managerial attention moved toward efficiency, HR development and training, staff retention, and cost-cutting strategies as a basis for all restructuring activities. These practices, which were widely used throughout the country, represented the most radical departure from Soviet-style HRM practices.

At this point, it is difficult to predict the path that economic development will take in Russia. However, the key symptoms of institutional failure prevail, namely capital flight (USD 80.5 billion in 2011 and estimated USD 60–65 billion in 2012) (*RIA Novosti*, 2012), an increasingly influential shadow economy, the slow growth of small businesses, significant income inequality, and pervasive corruption (Kuznetsov & Kuznetsova, 2008; *The Economist*, 2012).

### *Labor Market and Compensation*

The reaction of the Russian labor market to the dramatic structural changes of the 1990s was far from what was expected based on the experiences of the other Central and Eastern European countries, which had gone through the privatization process earlier. In particular, the Russian employment market remained relatively stable, while wages decreased significantly. According to Gimpelson and Kapeliushnikov (2011), the combination of flexible wages and highly inertial employment (“adjustment without adaptation”) has survived two major economic crises and has been a stable feature of the Russian labor market for the last 20 years. Employment increased during the booming early years of the new century, while losses during the financial crisis that began in 2008 were minor. Furthermore, wages reacted quickly to the economic growth and the ensuing decline (Gimpelson & Kapeliushnikov, 2011; Schwartz, 2003). The way in which the labor market adjusted to the structural economic changes has also benefited political interests, which tend to praise societal stability above all else.

The mechanism behind the adjusting effect of wages is found in the two-tier wage structure that is common in Russian enterprises. Companies in both the private and public sectors rely on this structure, which encompasses a fixed basic wage and a variable wage. The latter includes a variety of bonuses and wage premiums, depends on the economic performance of the company, and works as a risk-sharing instrument by allowing companies to efficiently adjust to the market environment despite the very stringent formal labor regulations (Gimpelson & Kapeliushnikov, 2011).

Stability and inertia in the labor market meant that Soviet-style HRM practices could persist in the long run despite privatization and other structural reforms. One specific example, provided by Buck, Filatochev, Demina, and Wright (2003), is the traditional social welfare bundle, which consists of a system of direct subsidies and various forms of supplements (financial and in-kind) that support employees' artificially low base wages. These direct and indirect “social subsidies” were traditionally accompanied by a high level of job security and were intended to promote the employee's identification with the firm and to ensure the achievement of pre-set production targets (Friebel & Guriev, 2000). In fact, these practices survived throughout the 1990s and the first decade of the new century, and remain in force in many industries today. As shown by Gimpelson & Kapeliushnikov (2011), low wages may be a function of a lower productivity, labor redundancy in monocities, and general managerial inefficiency.

The apparent neglect of even basic HRM functions during the period under review led some authors to believe that the Western HRM paradigm could not be applied to the Russian context and should be substituted with Akerlof's more fundamental implicit gift-exchange model of labor contracts (Croucher &

Rizov, 2011). This understanding of the nature of human relations, based on the perceived fairness of remuneration in exchange for noncontractual gifts to the firm, fits Russia's paternalistic model of employment relations and the pattern of law-avoiding behavior evident in the country (Kovaleva, 2007). It also fits Kapeliushnikov's (2001) concept of "adaptation without restructuring," which describes how nonorthodox forms of labor-market organization, such as part-time and secondary employment, nonformal contracts, hidden compensation, and delayed salaries, absorbed the shock effects of the transition in the 1990s.

Stable employment at the macroeconomic level over the last 20 years coincided with high employee turnover. Personnel turnover in Russia was the highest among all of the transition economies during the 1990s and the first decade of the 21st century, reaching 70 percent in some industries (electronics retail) and creating a number of HR challenges (Efendiev, Balabanova, & Yarygina, 2012; Gryaznova, 2012). According to Gimpelson & Kapeliushnikov (2011), gross worker turnover (measured as the sum of all hiring and firing) made up to 43–62 percent at the economy level over the period of 1992–2008. Schwartz (2003) attributed this high rate of employee turnover throughout the 1990s to such factors as low wages, unpredictability, disordered control over hiring, and the lack of systematic approaches to employee retention and key performance indicators.

The post-2000 boom coincided with the first managerial staff shortages and the beginning of true competition for talent. While 40 percent of companies reported labor surpluses prior to the 1998 crisis, firms started reporting labor shortages soon after the turn of the century (Krasilnikova & Bondarenko, 2012). According to the latest edition of the *Russian Monitor of Economy of Education*, enterprises continue to experience labor shortages, especially at the level of line professionals (17 percent) and skilled workers (42 percent), and in the manufacturing, transport, and construction industries (with 50–60 percent of enterprises reportedly understaffed) (Krasilnikova & Bondarenko, 2012). The shortage of skilled and qualified labor was largely covered in the media as a scourge of the Russian economy and was believed to be one of the major constraints on economic development (Gorelik & Malakhova, 2006). The shortage is very likely to worsen in the foreseeable future, given the negative birthrate throughout 1990s and a rapidly ageing population.

The retention of staff became expensive, as real wages grew by 12–15 percent annually in 1998–2008 (Gimpelson & Oshchepkov, 2012). To keep up with rapidly growing consumer markets, fast-moving consumer goods (FMCG) companies and other consumer goods companies had to constantly hire new people and were forced to offer above-average annual compensation increases of 15–28 percent and sometimes up to 40 percent. Larger Russian and, later, international companies started hiring the best Russian staff at 25 percent to 100 percent above market rates (Neumann International AG, 2010). Notably, however, although salaries grew significantly, they were often starting from the low base inherited from the 1990s.

Although the global financial crisis eased the competition for labor at the entry and middle-management levels to some extent, top management remuneration was only partially affected. While the compensation of many top managers in telecommunications, construction, and real-estate development suffered a substantial decrease (of up to 37 percent), the annual compensation for top managers in the oil and gas, and retail industries continued to rise, even at the height of the crisis in 2009 (*Forbes*, 2010).

## *Recruitment*

Given the rapid rate of employee turnover, the focus on career mobility, high costs for training, and the need to grow in rapidly developing markets, over the past decade, recruitment became a key focus area

among both HR practitioners and academic scholars in Russia. In an interesting study of internal and external labor markets in Russia, Yakubovich and Kozina (2007) uncovered many specific features of the Russian labor market, the composition of managerial teams, and the positioning of HR professionals. They link these features to the country's cultural heritage and institutional background. In particular, Yakubovich and Kozina (2007) explain that Russian companies' preference for internal and extended internal (i.e., hiring from among one's personal acquaintances within and outside of the firm) labor markets reflects two major cultural and institutional features: the high centralization of power and the high concentration of business. Indeed, Russian companies tend to be highly centralized at the level of CEOs, who control financial flows and human resources. Puffer and McCarthy (2011), who study the evolving systems of corporate governance in Russia, also comment that classic agent theory of delegation of managerial functions and decision-making power does not apply to emerging relationships between owners and managers in Russia. New owners tend to be personally in charge of their businesses, are not ready to delegate responsibilities, and rely heavily on personal connections in all business operations, including HR management. According to Avraamova et al. (2006), who describe the results of a survey of 1,500 Russian top managers, HR managers participate in the implementation of personnel policies in 60 percent of the companies surveyed. In the remainder of the companies, the personnel policy lies in the hands of top management. The same study shows that 71 percent of top managers rely on internal labor markets for recruitment, with personal connections considered to be the most valid and reliable tool among all types of companies (state, private, and public), while 60–75 percent of all vacancies in the 1990s were filled through personal networks (Gerber & Mayorova, 2003; Kozina, 1999; Yakubovich, 2005). Less popular but often-cited recruitment mechanisms include hiring through cooperation with higher-education institutions and through relations with professional associations, and state-run employment centers are reported to be the least popular recruitment tool (Avraamova, et al., 2006).

The 2006 Monitor of Economy of Education recorded surprisingly different patterns in the recruitment practices of high-efficiency and low-efficiency enterprises (as self-reported by the respondents and independently assessed by interviewers). Only 31 percent of high-efficiency companies were dependent on recruitment through internal markets (colleagues or acquaintances), while the corresponding figure for low-efficiency companies was 54 percent. Low-efficiency companies also relied on state employment services to a greater extent than high-efficiency companies, with the figures at 74 percent and 38 percent, respectively. High-efficiency companies relied more on recruiting agencies (33 percent versus 12 percent in low-efficiency companies) (Bondarenko, Krasilnikova, & Kharlamov, 2006).

### *Training and Development*

Russian employees tend to see the provision of training and development opportunities as part of the long-term psychological contract with the company (Gryaznova, 2005, 2012). Russian top managers believe that educational programs have a positive impact on companies' performance on several levels: they are believed to decrease turnover among the most capable specialists; dramatically increase the company's dynamic activities, especially in the areas of new production technologies and management; expand the company's network, including its foreign partnerships, and provide better access to capital markets through contacts with potential investors (Avraamova et al., 2006).

Historically, enterprises in Russia cooperated with the educational system through a number of channels, varying from partially sponsored educational programs to internships and career forums. However, since the beginning of this century, all forms of cooperation—financial grants and support, internships, and career forums—have declined first as a result of large-scale restructuring, described

above, and second as a result of cost-cutting measures. As reported by Krasilnikova and Bondarenko (2012), in 2011, only 25 percent of surveyed companies reported implementing some form of cooperation with educational institutions. Companies active in industries that have traditionally had close relations with the professional education system, such as the manufacturing, transport, and construction industries are also less actively seeking cooperation with educational institutions. Nevertheless, they simultaneously proclaim a need to expand such activities. Companies working in innovative industries (communications and business services) have introduced the most efficient ways of engaging students, using such activities as career forums, open doors days, and internships (Krasilnikova & Bondarenko, 2012).

The number of companies providing personnel with training and qualification-upgrade programs has declined as well. The figure fell from 68 percent in 2007 to 55 percent in 2010 (Krasilnikova & Bondarenko, 2012). Traditional sectors (manufacturing, transport, and construction) have typically led in this regard, with 30–40 percent of enterprises in these industries providing qualification-upgrade programs for managers, and 40–50 percent providing such programs for professionals and qualified workers. Historically, large and medium firms have led in providing various forms of training and development programs for employees (Krasilnikova & Bondarenko, 2012). High-efficiency companies are more likely to provide in-house development programs, including mentorships (68 percent versus 39 percent in low-efficiency organizations) and professional education (41 percent versus 13 percent) (Bondarenko et al., 2006).

In addition, the demand for educational services, whether delivered in-house or outsourced, has evolved. Initially, demand from Russian companies was focused on knowledge-based learning of rules and procedures, which corresponded to the risk and responsibility avoidance attitudes and behavioral patterns, inherited from the Soviet period. However, after 2000, this focus shifted to learning based on creativity, innovation, and initiative, which better reflected the changing environment and the business strategies of Russian companies (May et al., 2005). The differentiation in firms' training needs and demands is highlighted by Gimpelson, Kapeliushnikov, and Lukiyanova (2012), who find that low-efficiency firms tend to hire workers supplied by the traditional professional educational system, while high-performance firms look for workers with specific, sophisticated skills.

The Soviet educational system was known for supplying the economy with qualified and highly professional personnel. However, soon after the turn of the century, employers became dissatisfied with the quality of recent graduates, which had declined as a result of widespread failures in the educational system resulting from a long and profound crisis (Neumann International AG, 2010). As acknowledged by education providers and foreign investors, Russians were always able to very efficiently cope with crisis situations and Russian owners and managerial teams demonstrated very good dynamic capabilities in a rapidly changing and uncertain business environment (Kovaleva, 2007, Shekshnia, McCarthy, & Puffer, 2007). According to another study, the critical abilities of success for Russian managers used to be networking, socializing, politicking, and motivating and rewarding subordinates (Luthans, Welsh, & Rosenkrantz, 1993). However, Russian managers fell short in the areas of long-term development, operational effectiveness, routine management, and succession planning and development (Kovaleva, 2007; Shekshnia et al., 2007). According to a survey of business needs in management education, the top five skills needed but not necessarily prevalent among Russian MBA graduates today are strategic thinking, leadership, teambuilding and teamwork, implementation skills, and initiative and risk taking (Vikhanskiy, Gryaznova, & Petrovskaya, 2009). Nevertheless, companies are satisfied with MBA graduates' competences in presentation, negotiation, and interpersonal skills (Vikhanskiy et al., 2009). In another study of training needs in Russia, Filinov (2004) identifies several areas in need of attention: setting and maintaining performance standards (for oneself and one's subordinates, vendors, suppliers,

and business partners), identifying opportunities for innovation, transforming ideas into words and actions, recognizing problem areas and implementing solutions, time management, project management, working in teams, cooperation, and commitment.

The development of managerial skills and senior-level managers has been covered in a number of publications (May et al., 2005; Michailova, 2000; Shekshnia et al., 2007). The latest trend is the attempt to develop first-line and shop-floor leaders from within the companies themselves. Indeed, it has been long warned that economic growth in Russia cannot be sustained based on beneficial commodities markets and that the economy needs restructuring and diversification. One of the most often cited obstacles for the development of manufacturing sectors has been low labor productivity. One way of addressing this problem is to increase operational efficiency through the education and training of first-line/shop-floor managers.

### *Workplace Norms and Values*

Almost all of the HR-related research that appeared during the period under review touches upon the Russian culture and the Russian leadership style, and how these factors affect workplace practices, group work, information sharing, participation, and perceptions of responsibility. Despite the high number of comparative cultural studies, their results often contradict each other. This might be explained by the transitional nature of Russian cultural and business values, which often reflect the uneasy coexistence of conflicting values (Kuznetsov & Kuznetsova, 2008; May et al., 2005). However, most scholars agree on a number of specific features of the Russian business culture: high power distance and an ensuing respect for authorities and limited trust.

Of the many possible cultural dimensions that might influence HRM practices, power distance stands out as the one with the greatest potential impact on organizational dynamics and as one of the most distinctive features of the Russian business culture, especially when compared to the Anglo-Saxon culture (Elenkov, 1998; Fey & Shekshnia, 2008; Hofstede & Hofstede, 2005; Michailova, 2000, 2002; Naumov & Petrovskaya, 2010; Puffer, McCarthy, & Naumov, 1997; Schuler & Rogovsky, 1998). In countries with high power distance, managers and employees view each other as fundamentally unequal, which leads to such organizational phenomena as hierarchies, the centralization of power and decision making, large income inequalities, and top-down paternalistic communications. These perceptions also result in the suppression of creativity, bottom-level initiatives, and individual responsibility. Other important implications of high power distance are status and special privileges for people with power, seniority-based organizational practices, and psychological dependency of less powerful people (Hofstede & Hofstede, 2005).

High power distance is reinforced by a law-avoidance orientation typical among Russians, and based on four assumptions: (1) the law is meant to defend important people; (2) the law is applied differently and depends on one's hierarchical position; (3) people should develop defenses to survive in the social hierarchy (the most common defenses are relationships, belonging to a group, and mistrust of outsiders); and (4) there are alternative ways to reach goals than abiding with the law (Kovaleva, 2007).

A high level of distrust exists at the societal level; at the macro business level, as evident in the flight of capital during 2000s and especially after 2008 and at the micro level between owners and managers and between managers and employees (Croucher & Rizov, 2011; Puffer & McCarthy, 2011). There are various explanations for why Russia is a low-trust country, such as geographical vastness, multiethnicity, and the "double standards" and holistic system of informal relations that first appeared as a form of a societal response to the rigidities of the Soviet political and economic systems. These standards are



culturally embedded and, as such, persist despite the economic transition (Kuznetsov & Kuznetsova, 2008). The business response to the shortage of trust and the weakness of formal institutions, which used to be one of the defining characteristics of Russian business environment, was to substitute the inefficient and unreliable market instruments with networking and informal institutions, such as culture and ethics (Kuznetsov & Kuznetsova, 2008; Puffer & McCarthy, 2011).

### *HR Strategy in Russian MNCs*

The first multinational companies (MNCs) came to Russia as early as the 1990s, bringing expatriate managers and, presumably, advanced Western managerial practices that dramatically differed from existing practices in Russian companies. Privatization in which foreign investors took control had a significant positive impact, lifting firm performance by 18–35 percent while privatization in which domestic investors took control resulted, on average, in a 3 percent decline in performance (Brown et al., 2005). It would not be an overexaggeration to say that a new Russian business culture developed under the strong influence of foreign management (Kovaleva, 2007).

Given that managerial knowledge and practices are contextually embedded (Michailova, 2000), even those managerial practices that have proven to be superior in a number of countries cannot be taken for granted in any given cultural context, especially in such a complex culture as the former Soviet Union, and how the transfer of managerial techniques and best practices actually occurred through multinationals, working in the Russian market, deserves a special consideration. Fey and Shekshnia (2011) find that Russians were attracted by the organizational culture of foreign firms, which they assumed was based on fairness, transparency, and meritocracy, and which they viewed as offering employees an opportunity to have an impact and feel part of something important. Russian managers, who gained experience in foreign companies, in the beginning of the new century started moving to Russian companies, bringing not only the former's best practices but also a culture of continuous development (Shekshnia et al., 2007). A new breed of Russian owners and managers had also emerged by that time, driven by the pursuit of efficiency and international development.

After the turn of the century, many Russian and foreign companies had to hire expatriates to compensate for the shortage of managerial skills, to support the international expansion of the Russian companies and to secure access to Western financial markets. Foreign companies brought expatriate managers to guarantee efficient control over their local operations and to support the flow of best practices from headquarters to those operations (Solntsev, 2012). As noted by Shekshnia et al. (2007), multinationals were therefore a major source of innovation in the area of management and business development. As a result, knowledge transfer from Western multinationals to the Russian market has become a focal issue for both researchers and practitioners (May, Young, & Ledgerwood, 1998; May et al. 2005; Michailova, 2000; Michailova & Hutchings 2006; Puffer et al., 2011; Vikhanski & Puffer, 1993).

### *Summary and Conclusion*

Politicking, networking, and access to “administrative resources” remain the driving forces of business development in Russia, while “HR initiatives have regressed and achieving organizational performance has become a mosaic of inverted and subverted efforts” as a result of a recent national policy (May & Ledgerwood, 2007, p. 25), with the lack of accountability being one of the greatest barriers to progress in Russian management reform. As noted by Kuznetsov and Kuznetsova (2003) and Puffer et al. (2011), institutionalized but unorthodox forms of behavior and business patterns in Russia persist because they

fulfill certain pragmatic purposes—for example, they offer a rational reaction to the uncertainty and challenges resulting from institutional distortions. In an article about HRM in emerging-market economies, Cooke et al. (2011) conclude that research to date fails to offer predictions as to how HRM practices will evolve in Russia.

Many scholars agree that the key challenge for the most successful Russian businesses is to find sustainable ways of accumulating organizational knowledge (Kovaleva, 2007). In this regard, Russian companies and managers remain reluctant to share internal information, to contribute to case studies, or to participate in research. Today, corporate universities have emerged in both Russian and multinational companies in response to the continued inefficiencies of the higher-education system in preparing qualified professionals. They also respond to the need to quickly adjust to growing markets, and to hire and retain necessary personnel. Corporate universities do not only serve needs in training and development (including the immediate need to update the skills of new hires and fresh graduates), but also serve as vehicles for rebuilding corporate culture, and embedding a more effective set of workplace norms and values.

In recent years, Russian companies have been successful in domestic and international markets. The sustainability of this success will depend on firms' abilities to build strong organizational cultures and efficiently transmit and embed those cultures among new organizational members. Given their initial disappointment with Western HRM practices that were often blindly and formally adopted, the research evidence suggests that Russian executives are looking for superior HR policies and practices coming from other emerging markets, especially China. Therefore, comparative studies of Russia, China, India, and other dynamically developing economies might be of interest. Finally, researchers should note that given the changing nature of the Russian economy and labor markets, there is a growing need for research on how a variety of conventional HR issues are playing out in Russia. Among these issues are: generational gaps, labor migration, the evolution of the system of the social benefits, and the growing labor-market segmentation between traditional and new innovation-based sectors, efficient and less-efficient enterprises, and central and provincial labor markets.

## **HUMAN RESOURCE MANAGEMENT STRATEGY IN CHINA**

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Over the past three decades, China has experienced significant economic reform, with the adoption of open market strategies and economic legislation. It has achieved an annual GDP growth rate of 7 to 13 percent, representing the largest increase of any economy over the same period, and has become the second largest economy in the world. Accompanying and driving this rapid economic development has been the increasing competitiveness of China's enterprises, marked by rising product quality alongside growth in both domestic and international market share. In some areas, active technological innovation and the development of unique products have driven Chinese companies into the top five hundred global enterprises.

While government legislation, technological development, and active integration into the world economy are central to China's economic development, HRM also plays a pivotal role in this process, a factor increasingly recognized by China's managerial elite. Corporations are selecting key managerial personnel such as company vice presidents to be in charge of HRM, and/or raising HR positions to

executive level—in both respects, giving HRM “a seat at the table.” Moreover, recognizing the importance of HR management and development to national strategy, China’s national leadership now includes the field in its national development plans. In short, HRM is becoming widely recognized as a key component of China’s core competitiveness.

Nevertheless, the extent to which high-performance HR practices have been diffused to and adopted by Chinese organizations remains unclear. Similarly, few scholars have addressed the degree to which HRM’s newfound respect in China is actually manifested in the field. Accordingly, our primary objective in this mini-chapter is to shed light on the state of HR policy and practice in Chinese organizations, drawing on both the literature and data from a recent national survey of over 200 Chinese enterprises.

## *A Review of the Literature*

Drawing from research cited in both the SSCI (Social Science Citation Index) and CSSCI (Chinese Social Science Citation Index), we focused our review on three main aspects of Chinese HR strategy: (a) the strategic position of HRM within Chinese organizations, as well as the implementation of strategic HRM; (b) the development of a Chinese model of SHRM and how it is both similar to and different from Western models of SHRM; and (c) the impact of SHRM on the performance of Chinese enterprises.

**The strategic role of HRM in China.** In general, the strategic role of HRM has become gradually recognized by an increasing number of Chinese corporations. Surveys conducted by Mitsuhashi, Park, Wright, and Chua (2000) and Braun and Warner (2002) both found that HR and line executives within Chinese corporations are increasingly recognizing the strategic importance of HR.

Empirical research also suggests that, regardless of ownership type (state or privately owned), HRM goes beyond the technical aspects of managing employment affairs. Instead, effective management practices that have gained support in Western research are being widely implemented (e.g., Ahlstrom, Foley, Young, & Chan, 2005; Cooke, 2000; Ding, Ge, & Warner, 2001; Gong, Law, & Xin, 2006; Xie, 2005; for reviews, see Cooke, 2009; Zhu, Thomson, & De Cieri, 2008). For example, two studies comparing HRM within Chinese enterprises between 1994/1995 and 2001/2002 (Zhu, Cooper, De Cieri, & Dowling, 2005), and 1999 and 2006 (Sumelius, Smale, & Björkman, 2009), found that the implementation of strategic HRM (SHRM) has become more widespread in China. The authors argue that this is due to China’s economic reform, which has increasingly led Chinese corporations to face open-market environments. Under these environments, pressures from market competition are forcing Chinese corporations to place greater emphasis on human capital, with HRM’s stature in the firm rising as a result. The infusion of Western notions of SHRM has also been supported by foreign investments and joint ventures.

Wei and Lau (2005) similarly suggest that stronger market orientations have raised awareness of the importance of HRM; the authors note that the higher a corporation’s human capital stock, the more likely it is to adopt Western SHRM practices. Other research suggests that rather than company size and ownership type, the driving force behind changes in HR policy and practice is the broader institutional environment. For example, Sumelius, Björkman, and Smale (2008) found that communication with peer companies and corporate headquarters has a significant positive correlation with the adoption of high-performance HR practices in multinational corporations. Similarly, Wei, Liu, Zhang, & Chiu (2008) found that group culture and developmental culture had significantly positive effects on the adoption of highperformance policies and practices.

It is worth noting that the aforementioned research has focused little on examining Chinese corporate HRM and corporate strategy from a strategy-HR fit perspective. Still, the research on strategy-HR fit that

has been conducted suggests that, as elsewhere, corporate strategy is linked with the type of HR strategy adopted by the firm. For example, in a study focusing on Japanese companies in China, Takeuchi, Chen, and Lam (2009) found that companies adopted three different types of business strategies (cost reduction, differentiation, and quality enhancement), with the nature of HRM in these companies varying according to the type of strategy adopted. Likewise, Cunningham and Rowley (2010) found that in small and intermediate-scale corporations in China, the nature of HR tends to follow the otherwise informal processes in place in such firms. As such, the Western form of “strategic HRM,” which tends to stress formality, is rare in such firms in China. Cunningham and Rowley argue that the reason for such informal HRM in small and intermediate-scale companies in China is that they need to be highly flexible and agile—something which might be limited by the adoption of more formal HR policies and practices.

**Comparative conceptualizations and models of HRM.** Given China’s unique economic and cultural characteristics, it is possible that HR and its component policies and practices take on a different form and have a different meaning in China relative to the West. Taking this possibility into account, researchers have developed models of HRM specifically in line with the characteristics of the Chinese market and Chinese culture. For example, Su and Wright (2012) found that better performing HR systems in China to be characterized by a combination of commitment HR practices on one hand (e.g., rigorous selection and extensive training) and control HR practices on the other (e.g., competitive mobility and promotion, and employee discipline management). These researchers argue that this is due to the fact that, compared to Western companies, the success of Chinese corporations is still very much reliant on cost reduction, thus requiring an emphasis on control in HR management. A focus on control is also consistent with the emphasis placed on power distance in many organizations.

Researchers have also explored the applicability of Western HRM models in characterizing HR in Chinese organizations. In one such study, Xiao and Björkman (2006) found that the employment security and behavior-oriented appraisal elements of the commitment model of HR found in Western organizations are, at best, only weakly associated with the Chinese version of high commitment work systems. The researchers explained this anomaly on the basis of differences in the institutional context. As they noted, enterprises in the growing private sector in China have attempted to differentiate themselves from those in the once dominant state-owned sector by demonstrating their commitment to their employees in other ways. Furthermore, given that Chinese labor law restricts employment-at-will at the national level, basic parameters of employment security are guaranteed by law, thus making employment security policies at the enterprise level in many ways irrelevant and invariant.<sup>1</sup>

Other researchers have proposed models of HRM under the backdrop of China’s unique economic and cultural environment. For example, the Dynamic Adaptive Model of Strategic HRM (Zhang, Dolan, Lingham, & Altman, 2008) proposes that, given the dramatic fluctuations within the Chinese market, emphasis needs to be placed on the flexibility of HR-related practices and the speed with which HR-related decisions are made and executed. In contrast, the Management by Values Framework (Zhang & Albrecht, 2010; Zhang, Dolan, & Zhou, 2009) posits that HRM must focus on developing individualized and mutually trusting environments for employees from a range of backgrounds, from relatively conservative Chinese employees to those from relatively open Western cultures. Although these models lack cross-cultural validation, they are nevertheless a step toward the development of culturally specific SHRM frameworks.

**The link between best practices in HR and firm performance in China.** A relatively large number of studies have examined the extent to which the Western notion of HR “best practice”—built around high commitment/involvement work systems—is effective in Chinese corporations. For the most part these studies indicate that such “best practice” systems are positively associated with the performance of

Chinese firms (see Kim, Wright, & Su, 2010; Liang, Marler, & Cui, 2012 for reviews). It should be noted, however, that a number of studies published in Chinese journals have also failed to find evidence of such a positive relationship between such best practice and firm performance (e.g., Zhang, 2006; Jiang & Zhao, 2004; Liu, Zhou, & Chao, 2005). One explanation for the lack of consensus is that scholars have differentially defined “best practice.” Indeed, at least one study demonstrates that while practices associated with the commitment model of HRM may have limited effects on firm performance in China, a more hybrid set of practices capturing both commitment and control, may offer the greatest explanatory power with regard to the performance of Chinese corporations (Su & Wright, 2012).

Another explanation for these divergent results is that, consistent with the contingent HR strategy approach noted earlier in this book, the link between best practices and firm performance is likely to be moderated by a variety of intervening factors. Research on the HR strategy-firm performance link in Chinese firms has focused on three such moderators, namely, corporate strategy, ownership type, and corporate autonomy.

Several studies demonstrate that HR strategy and corporate strategy interact to significantly affect corporate performance. Björkman and Xiucheng (2002) found that the beneficial effect of high-performance work systems on firm performance is contingent upon the systems’ compatibility with the firm’s corporate strategy. Similarly, in a study that focused on small and intermediate-scale pharmaceutical companies, Zhang and Li (2009) found that when high-performance work systems were combined with innovation strategy, company performance was poorer than when high-performance work systems were combined with low-cost strategy. And, in a study incorporating companies from various ownership types and corporate size, Chow, Huang, and Liu (2008) found that the positive relationship between a commitment-based configuration of HRM and performance was more robust in the context of a corporate strategies focusing on a cost-, as opposed to a quality- or innovation-based advantage. Although these studies emphasize the importance of low-cost strategy to Chinese corporations, a study that focused on Chinese hotels found a positive relationship between high commitment work systems and performance only among those hotels emphasizing differentiation (i.e., possessing a 4–5 star rating; Sun, Aryee, & Law, 2007).

In terms of ownership, researchers found that compared to state-owned corporations, the positive relationship between commitment-oriented HR practices and firm performance is greater for foreign and privately-owned enterprises than for state-owned enterprises (Law, Tse, & Zhou, 2003; Ng & Siu, 2004). Moreover, the beneficial impact of HR-corporate strategy compatibility has been found to be stronger in foreign-owned (as opposed to state-owned) enterprises (Wei & Lau, 2008). This may be due to institutional reasons, with state-owned enterprises often being better protected from fluctuations in the market. However, other research suggests that the relationship between HRM and performance is unaffected by ownership type (Ngo, Lau, & Foley, 2008), suggesting that more research is needed to uncover those factors determining just when ownership conditions the strength of the HR-performance relationship.

Finally, research has found that the relationship between SHRM practices and performance is stronger for companies with greater autonomy (Kim, Wright, & Su, 2010; Wei & Lau, 2008). These findings are important in China because certain markets and economic sectors in China are under tighter government control, with organizations in such markets and sectors being less autonomous in the determination of their HR policies and practices.

### *Results of the National Survey of HR in Chinese Enterprises*

To gain a more comprehensive understanding of HRM in China, the authors conducted a national survey of HR policies and practices in Chinese organizations in 2012. Managers from 286 organizations participated. These organizations included various types of privately owned corporations (92.7 percent), non-for-profit organizations (5.1 percent), and government agencies (2.2 percent). The sample was highly representative, with industries spanning manufacturing, chemical plants, communications, construction, trade, retail, biomedicine, consulting, finance, and media communication, etc. In terms of company size, 26.6 percent of organizations had less than 300 employees, 44.6 percent had 300 to 3000 employees, and 28.8 percent of organizations had over 3000 employees. The annual turnover rate of these organizations ranged from 0–300 percent, with an average turnover rate of 13.78 percent.

**Recruitment and selection.** External recruitment remains the most important way for companies to hire employees (82.9 percent indicating that the external market serves as a key recruitment source), with newly graduated bachelor and master degree students being most favored by corporations (72.1 percent). Still, over 37 percent of firms reported that their existing workforce serves as an important recruitment source, suggesting that internal labor market orientations remain strong in Chinese firms. Those sourced from the external labor market were recruited using both web-based (88 percent) as well as more conventional, face-to-face (e.g., job fairs—62 percent) and employee referrals (39.0 percent) means.

In terms of selection, 79.4 percent of organizations relied on more objective and empirically supported methods of hiring such as cognitive and skills testing, when selecting candidates. Moreover, 34.5 percent of organizations reported referring candidates to specialized testing agencies for detailed assessment. At the same time, nearly 35 percent of firms indicated that selection was based primarily on more subjective methods of candidate assessment such as interviewing.

**Training and development.** Survey results show that 76 percent of corporations focused their training efforts on professional and technical positions, but over 50 percent of organizations reported engaging in management development as well. Much of the training in the participating organizations appears to be administered or conducted by in-house personnel, with 85 percent of organizations reporting that they maintain their own, internal training and development staff. However, even in those firms with in-house training staff, much of the training activity is conducted by external agents, with 57 percent of organizations reporting that they use the services of external trainers.

**Compensation and Benefits.** The survey results indicate that the organizations adopted a variety of approaches in compensating employees, with the majority (52.4 percent) basing employee pay on job contribution (i.e., job-based pay model) and only a small proportion applying a skill or competency-based pay model (15.4 percent) or structuring pay solely on the basis of external/market competitiveness (20 percent). Employee contribution was considered in a number of ways including seniority-based rewards (40 percent of organizations), and pay-for-performance (39 percent). The results also show that 72 percent of organizations reward employees, at least partially, on the basis of team performance. Indeed, the vast majority of firms (67.4 percent) reported pay systems integrating two or more of the elements listed above. Finally, the data indicate a clear relationship between pay form and structure on the one hand, and organization type and management philosophy, on the other.

**Performance management.** As expected, participating organizations reported placing a stronger emphasis on assessing and managing the performance of more managerial, technical and professional staff (as opposed to those employed in what are typically referred to as “exempt” positions). In nearly all cases, primary emphasis was placed on supervisory assessment, with some organizations reporting the collection of data from peers. In contrast, our data suggest that few Chinese firms rely on customer-based appraisals of their employees. Our data also suggest little variance across firms regarding the performance criteria assessed and their relative weights. Nearly all firms surveyed indicated that their

systems focus on employees' work attitude, performance, skills, and attendance.

Performance feedback sessions (i.e., performance reviews) were reported as common practice in 68 percent of participating companies, with the longest of these meetings being two hours, and an average feedback meeting time of 21 minutes (SD = 26.59). Of these companies, 61 percent require evaluation results to be normally distributed (i.e., forced distribution). Interestingly, the vast majority of participating firms indicated that assessment results have little influence on the determination of organizational training priorities.

**Perceived centrality of HR to competitiveness.** An additional means by which to understand the priority Chinese organizations place on different aspects of managing people is to assess how managers in these firms associate various HR functions or activities to the competitiveness of their firms, and no less importantly, how they allocate their time to each of these functions. Table 11.1 displays how participants responded to both questions (with 1 indicating least important or least amount of time, and 5 indicating most important or most amount of time).

Most apparent from this table is the absence of a clear correlation between perceived importance and time invested, which suggests that time allocation is not necessarily based on the importance or centrality of an activity. For example, participants viewed HR strategy and planning as the most important function (M = 4.49). However, relative to the other HR functions, this activity was rated as receiving the least time input (M = 2.22). In comparison, employee relations was regarded as the least important function (M = 3.45). Consistent with this rating, managers reported allocating a very limited amount of their time to this activity (M = 2.65). This is interesting in that, in the past, employee relations were regarded as one of the most important HR functions in China. Participants consistently reported recruitment as one of their major areas of concern, second only to HR strategy and planning. However, in contrast to the latter, HR managers reported allocating a significant amount of their time to recruitment-related activities. Several factors may explain this. One explanation may lie in the changing nature of the Chinese economy and its increasing reliance on human capital as a basis for competitive advantage. A second explanation may be that an increasing number of firms are facing exceptionally high turnover rates (particularly in nonstate-owned manufacturing enterprises and also those in the technology industry), with the result being that HR staff have no choice but to spend a lot of time continuously recruiting new employees.

**Table 11.1** Importance Ratings and Time Involvement In HR functions In China

| HR Function                | Degree of Importance (SD) | Time Involvement (SD) |
|----------------------------|---------------------------|-----------------------|
| 1. HR strategy & planning  | 4.49 (.86)                | 2.22 (1.18)           |
| 2. Recruitment & selection | 4.01 (.88)                | 3.82 (1.20)           |
| 3. Training & development  | 3.65 (.89)                | 2.91 (1.12)           |
| 4. Performance management  | 3.88 (.88)                | 3.12 (1.13)           |
| 5. Compensation & benefits | 3.97 (.75)                | 3.16 (1.15)           |
| 6. Employee relations      | 3.45 (.88)                | 2.65 (1.06)           |
| 7. Culture building        | 3.80 (1.08)               | 2.36 (1.10)           |
| 8. Career development      | 3.98 (0.89)               | 2.62 (1.08)           |

**Factors related to turnover.** Finally, consistent with our expectations, we found that employee turnover rates in the companies participating in the study were inversely associated with the emphasis placed by the company on training and development as well as with employee satisfaction and mean compensation levels. Turnover was also inversely related to the level of HR investment in activities aimed at reinforcing employees' company-based identity and internalization of company norms and values.

Comparative analysis also indicates that turnover was lowest in state-owned, government, and



nonprofit organizations, while highest in foreign-owned, joint ventures, and private-owned corporations. Privately owned companies manifested the highest rates of voluntary turnover. The obvious explanation for these findings is that institutional constraints continue to exert enormous influence on various aspects of HR management in China, with institutionally tied organizations most cognizant of their responsibilities to their workforce.

### *Summary and Conclusion*

Based on our review of the literature and an analysis of recent, national survey data, it appears that the Western concept of HR “best practice” has been implemented in a wide range of Chinese organizations varying in terms of both ownership and size. Still, the nature of best practice in China may be somewhat different from best practice in the West. While the focus remains on commitment and longer-term employment relations, there is also evidence that best practices in China entail a stronger focus on direct managerial control.

As in the West, empirical findings suggest that, on the whole, such best practices are positively correlated with performance of Chinese enterprises. At the same time, our review pointed to a number of contextual factors that may condition the impact of HR strategy on firm performance among Chinese enterprises, with the most salient moderator appearing to be the business model or strategy. In particular the link between high-performance work systems and firm performance in China appears to be limited to those enterprises established on the basis of a low-cost (as opposed to product differentiation/innovation) business model.

Finally, despite the enhanced status of HR in Chinese Management, there remains a significant gap between those HR functions deemed most tightly linked to firm performance (and likely to further enhance the reputation of HR in Chinese management), and those functions actually receiving a significant portion of managers’ time and effort.

## **HR STRATEGY IN INDIA**

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More than 20 years have elapsed since the Indian government enacted economic reforms, effectively bringing one-sixth of the world’s population into the global economy. After decades of protectionism, India experienced a revolutionary change when it shifted from a regulated to a “free market” economy. The liberalization of the foreign investment climate in India facilitated the integration of Indian economy with the global economy. This liberalization resulted in sudden and increased levels of competition for Indian organizations. Moreover, as noted by Som (2008), liberalization was also associated with heightened turbulence in the product market environment, new opportunities with regard to technology and resource mobilization, and more intensive restructuring and alliance activities. The dynamics set in motion by liberalization forced Indian organizations in to shift away from indigenous, costly, suboptimal technology and toward performance-based, competitive, and higher technology manufacturing.

In the process, liberalization also brought about a shift in the way that Indian organizations managed their human resources (Som, 2006) For example, phased liberalization created intensive competition through easier entry and greater foreign participation (MNCs like Hyundai Motors, Ford, Toyota,

Cummins, Wal-Mart, Eli Lilly, General Electric, and Monsanto) in the Indian market. Indian firms such as Hero Honda, Tata Motors, Ranbaxy, Infosys, Wipro, and Satyam, undertook significant organizational changes in response to such foreign entry, particularly with regard to their HR policies and practices.

### *Evolution of Strategic HRM Practices in India*

Formalized personnel functions have been common in Indian organizations for decades. Between the years 2000–2006, liberalization placed pressures on HR specialists and departments to bring about large-scale professionalized changes in organizations in order to cope with the challenges brought about by the new economic environment. Indian organizations needed to cope with the need to develop a highly diverse workforce into well-trained, motivated, and efficient employees with the subsequent de-skilling, re-retraining, and multiskilling problems, workforce reduction policies, and retention and career development issues. A study of 54 organizations by Som (2008) found a large number of Indian organisations creating a separate HR management/development department and adopting innovative HR practices during these years. HR departments became more open to change, focusing on strengthening the employee-employer relationship while playing a more definitive role in the overall management of the organization. HR managers became more professionalized and began to apply recognized, international practices and standards. As a result, the image of HR began to shift, with other managers no longer viewing it strictly as a cost center and a technical unit responsible for salary processing, training, and staffing. Increasingly, many of the more technical HR functions were allocated to line managers, allowing HR departments to focus more on leveraging human capital to meet current and future business needs. The study also found that during these years, Indian organizations increasingly adopted more transparent and equitable staffing strategies and processes. Promotion policies became more attuned with recruitment policies, favoring candidates possessing needed competencies and driven less by seniority. Organizations began to engage in a wider range of employee development activities, including job rotation, in order to ensure the availability of those competencies required to meet future contingencies. Additionally, Indian firms began to more widely adopt performance-based pay schemes linking compensation to performance.

For the past five years, Indian firms have intensified their adoption of dominant innovations in HR practice, widely applying these HR practices in their organizations. Indeed, a survey by Hay Consulting conducted in 2012, found that the cost cutting and efficiency priorities of Indian HR managers—introduced to weather the economic storm generated by liberalization—have increasingly been replaced with a focus on driving performance and growth. Central to this focus is a concern with human capital development; ensuring that the most competent people are deployed in well-designed and well-fitting jobs with the resources needed for optimal performance.

### *Cultural Values and Institutional Environment*

But how does this shifting HR environment and adoption of dominant HR policies and practices fit with India's unique culture and institutional environment? Hofstede (1991) found that India ranks low to moderate on uncertainty avoidance, high on power distance, low on masculinity, and low on individualism. Though it is only indicative, this cultural profile suggests that Indians are generally risk averse, reluctant to make important decisions in work-related matters, not inclined to accept responsibility for job-related tasks and generally indifferent to job feedback. It also reflects that the hierarchical nature of Hinduism, the early socialization process that highlights the importance of the family structure, respect for age and seniority that might have a direct bearing on decisions about

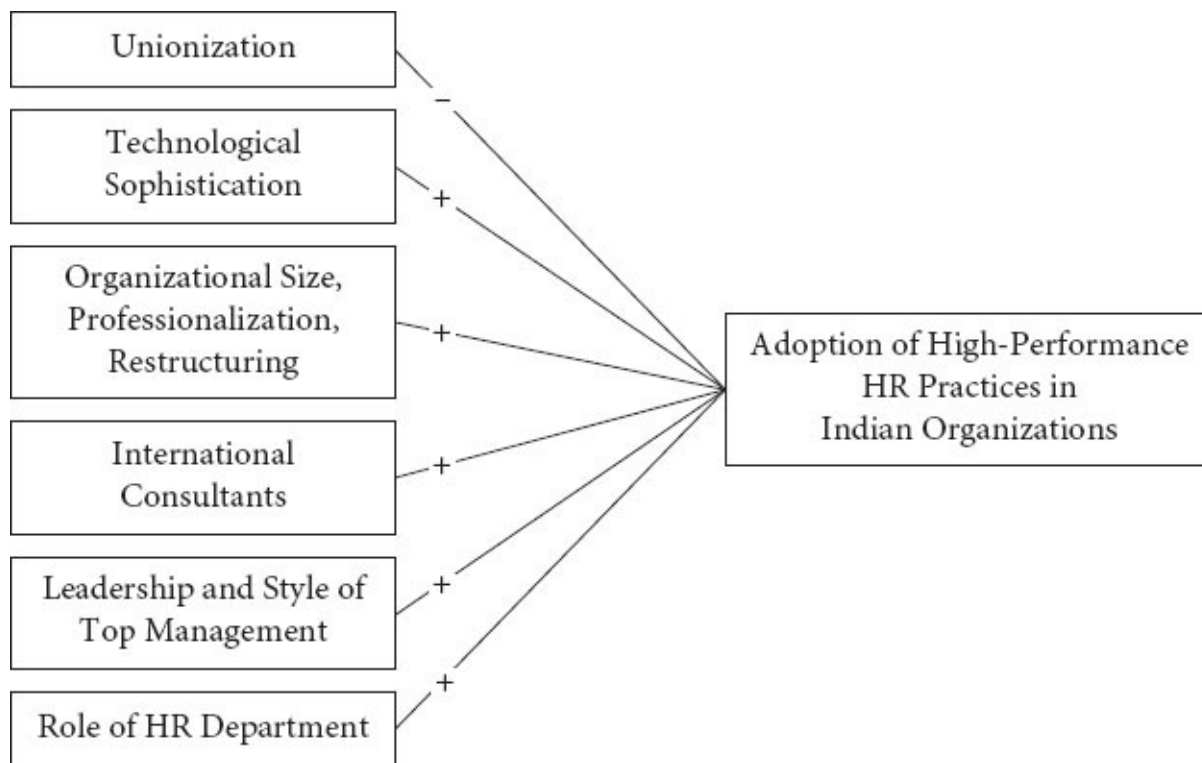
promotion and pay. Low masculinity might indicate that most Indian organizations follow a paternalistic management style and preference for personalized relationships rather than a more divorced performance orientation. Low individualism implies that family and group attainment take precedence over work outcomes.

Such a cultural context presents a significant challenge to organizations seeking to adopt and institutionalize global standards in HR policy and practice. Nevertheless, the empirical evidence suggests that most Indian organizations are finding a way to adapt these standards and practices in a manner consistent with Indian culture, thus enhancing employee relations, strengthening internal communications and enhancing innovation (Budhwar, 2001, Som, 2006). For example, in the past three years, many Indian organizations (e.g., Bank of India, Wipro, the Tata Group of companies, and the Aditya Birla Group) have implemented 360-degree performance appraisal systems, merit-based recruitment and promotion systems, incentive-based pay systems, team building, corporate-wide employee development and deployment frameworks, and web-based training and integrated knowledge management systems with the aims of enhancing productivity and performance. Whereas Indian HR managers were aware of such practices already at the start of liberalization, they lacked the influence within their own organizations to integrate these practices into their own HR infrastructures. However, with the growing understanding of the role of human capital as a basis for competitive advantage, the adoption of global benchmarking by Indian enterprises, and the intervention of foreign consultants, these practices have recently become more widespread in the Indian economy.

The discussion above provides important insights that may be useful in explaining the variance in the adoption of high-performance HR practices across enterprises. Scholars have largely attributed such variance to conditions in the firm's external environment, such as industry-level differences (Kossek, 1987). Those studying the diffusion and adoption of innovation (Kimberly, 1981; Rogers, 2003) suggest that institutional forces are critical in this regard. However, most of the research on the diffusion of administrative innovations has been conducted in developed nations, leaving many unanswered questions about how such practices spread to and within developing and transition economies. Our analysis suggests that in postliberalization India, it was a combination of factors in the broader institutional environment of Indian organizations—namely those shown in [Figure 11.1](#)—that accounts for this variance.

## *Summary and Conclusion*

In this mini-chapter, I examined Indian HR strategies and more specifically, the adoption of high-performance HR practices in Indian organizations. Consistent with prior research, the overview found that institutional pressures have influenced the adoption of HR practices in postliberalization India. It demonstrated that organizations adopt such practices for a variety of reasons. Among the factors explaining the variance in the adoption of high-performance HR practices in India are sector-level characteristics, such as the extent of unionization and technological sophistication, organizational governance factors, such as ownership structure, and normative influences, such as the tendency to take on international consultants, organizational culture, and regional/ethnic cultural differences.



**Figure 11.1** Factors Contributing to the Adoption of High-Performance HR Practices in Indian Organizations

This mini-chapter highlighted some of the primary factors driving the adoption of high-performance HR practices within Indian firms, placing primary emphasis on shifts in the macro environment. From a contingency-based framework, the adoption of such practices represents a strategic choice. As the country liberalized, the conditions governing employment relations changed as well, with organization leaders making system-wide choices in organizational structure, culture, and processes in order to respond to these changes. Although the HR policies and practices that were ultimately adopted are largely global standards, the mode of adoption as well as the form ultimately implemented and institutionalized, reflect the unique contingencies of the broader institutional and regulatory context of India.

## HR STRATEGY IN BRAZIL

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With over 190 million inhabitants in 2010 (Instituto Brasileiro de Geografia e Estatística [IBGE], 2010), Brazil has one of the world's largest civilian workforces, totaling over 100 million people (IBGE, 2013). As one of the world's most robust and vibrant emerging economies, the Brazilian labor market has changed dramatically over the past decade. For example, unemployment in Brazil has fallen dramatically, from 12.5 percent in 2003 to 5.8 percent in 2013 (IBGE, 2013). Additionally, there has been a significant growth in inflation-adjusted income, rising from R\$1433.01 (or 669.63 American dollars<sup>2</sup>), in 2003, to R\$1643.30 (767.90 American dollars), in 2012, an increase of 14.7 percent (IBGE, 2013). But these

changes go well beyond the growth in employment and income. Dramatic structural shifts have occurred as well, manifested in a wide range of labor market attributes. One of the main indicators of such a structural shift is the nature of employment, with the past decade manifesting significant growth in the proportion of the workforce employed in private sectors of the economy. More specifically, whereas registered (i.e., private sector) employment accounted for 79 percent of the workforce in 2003, it accounted for nearly 85 percent of the workforce in 2012; an increase of nearly 11 percent. Much of this growth has come in the commercial sector, which, despite accounting for 40 percent of registered workers in 2003, currently accounts for 53 percent of registered workers (an increase of 3.3 percent). Additionally, over the past decade, there has been a significant improvement in the level of education of the Brazilian workforce, with the percentage of workers with 11 or more years of schooling rising from 53.5 percent in 2003 to 68.7 percent in 2012 (a nearly 30 percent increase) (IBGE, 2013). Finally, women are playing an increasingly important role in the private sector workforce, with women currently accounting for nearly 45 percent of registered workers (an increase of over 33 percent from 2003). Still, as can be seen in [Table 11.2](#), increased participation of women in the Brazilian labor market has not been evenly distributed across sectors. Women continue to outnumber men in the domestic services sector, whereas men continue to vastly outnumber women in the construction sector.

**Table 11.2** Workforce Distribution in Brazil by Economic Sector

| Group of Activities  | Men % | Women % |
|--|-------|---------|
| Extractive industry, transformation and distribution of electricity, gas, and water                | 19.0  | 12.6    |
| Construction   | 13.5  | 1.1     |
| Commerce, restoration of auto vehicles and personal and domestic objects, and retail trade of fuel | 19.7  | 17.5    |
| Services provided to companies, rental, real estate activity and financial intermediation          | 17.0  | 15.2    |
| Education, health care, social services, public administration, social defense, and security       | 10.7  | 22.9    |
| Domestic services  | 0.6   | 13.9    |
| Other services (accommodation, transport, urban cleaning, and personal services)                   | 18.9  | 16.5    |
| Other activities   | 0.7   | 0.3     |

Source: IBGE (2013).

These shifts have created new human capital challenges for Brazilian enterprises. Research suggests that Brazilian managers are now paying closer attention than ever to aligning their human capital with their business model, enhancing employee engagement, commitment and retention, and developing high potential leaders (Deloitte, 2004; Fischer & Albuquerque, 2011). In the following sections, we briefly review some of the recent efforts undertaken by Brazilian enterprises to accommodate the structural shifts in the labor market noted earlier and leverage their human resources as a basis for enhanced global competitiveness.

## *Recruitment and Selection*

Similar to firms in other countries, Brazilian enterprises are increasing their reliance on social media and the internet as a means to attract talent. Brazilian enterprises also make widespread use of peer referral, headhunters, and employment outsourcing agencies, each for different types of talent (Deloitte, 2004). For example, headhunters serve as a primary means to recruit executives from outside the firm, whereas specialized professionals are often recruited on the basis of peer referral (Deloitte, 2004). Increasingly, Brazilian firms appear to be relying on internships and training programs to attract and develop talent internally.

Screening of initial candidates is typically done on the basis of an evaluation of candidates' resumes,

with interviews focusing on evaluating technical, job-related experience and knowledge. Research on selection processes in Brazilian firms suggest that for operational, administrative, and intermediate management positions, professional experience is the most critical factor in selection, whereas for technical and professional position, education is the most critical selection determinant (Deloitte, 2004).

Two recent legislative initiatives have influenced the hiring practices of Brazilian firms. The first is a 2008 amendment to the basic law, originally passed in 1943, governing private-sector employment relations, namely the CLT (Law n° 11.644, March 10th, 2008). According to this amendment, employers cannot require proven experience of one type or another as a condition for employment. Far from motivating enterprises to drop relevant work experience as a bona fide job requirement, Brazilian companies have adjusted to this new reality by assessing candidate experience in more indirect and tacit ways. The second law (Law n° 8.213, July 24th, 1991) requires firms to hire individuals with disabilities. The exact proportion of employees that must be filled by people with disabilities varies as a function of company size. For example, individuals with disabilities must account for 2 percent of the workforce in enterprises employing up to 200 individuals, 3 percent in firms employing between 500 and 1000 employees, and 5 percent in firms employing 1000 or more workers. Many enterprises have found it difficult to comply with this regulation, because many of those that the law was intended to serve are not qualified to fill the available positions, and also because government aid may discourage many of these people from seeking employment.

### *Training and Development*

The structural shifts in the Brazilian labor market as well as the increasingly global nature of Brazilian enterprises have created tremendous demands on Brazilian employers in terms of employee training and development (T&D). As in any emerging economy shifting from production driven by import replacement and commodity extraction to low-end and eventually high value-added export, key economic actors have little choice but to rapidly upgrade their human capital to ensure alignment with business and market needs. Yet, training and development remains among the main challenges in human resources management faced by many Brazilian companies. This is largely due to the politics associated with how training and development resources should be allocated and the uncertainty regarding how these resources might be most effectively utilized given a business environment marked by constant, high velocity change.

An important indicator of the intensity with which Brazilian firms have been forced to engage in training and development is the change in the number of training hours employees receive. In the past decade, there has been an increase in the amount of training allocated to the average worker with training costs as a proportion of direct payroll cost rising from 2.7 percent at the beginning of the millennium to 3.2 percent by 2007. This comes to an average annual training and development investment of R\$1342.00/employee, the equivalent of USD 627.10 in training and development investment/employee each year (Associação Brasileira de Treinamento e Desenvolvimento [ABTD], 2007). The amount of training varies by sector/industry (e.g., firms in the industrial sector provide an average of 49 hours of training per year, while firms in the commercial sector provide only 42 training hours per year) and firm size (larger firms offer a greater number of training hours on average) (ABTD, 2007).

Brazilian firms are allocating training resources in different ways. For example, an increased emphasis is being placed on executive and leadership development, particularly in the form of public and in-house MBA programs. Large firms are also partnering with foreign institutions to develop their own, internal corporate education programs (adopting the model of corporate universities). These internal development programs tend to focus on such themes as leadership development, team work, people management,

negotiation, and customer service (ABTD, 2007). In contrast, innovative learning and development processes such as mentoring and distant education have yet to be widely adopted in Brazil (Fischer & Albuquerque, 2011).

## *Compensation and Performance Management*

Despite the growing interest in enhancing employee competencies, compensation frameworks in most Brazilian firms are governed on the basis of the job-based (i.e., point) system, such that the nature of job contribution serves as the primary determinant of fixed pay. However, performance-based, variable pay is becoming an increasingly important element of Brazilian compensation.

Compensation in Brazil is subject to fairly strict regulation. One form of regulation concerns equal employment opportunity (EEO). According to Brazilian EEO regulations, job content, rather than the job title, serves as the primary determinant of pay discrimination. Thus, jobs of equal value performed for the same firm and at the same location must be compensated on an equivalent basis, regardless of gender, age, or nationality of the job incumbent. However, the law goes significantly further than similar EEO legislation in many Organization for Economic Co-operation and Development countries in that it applies a seniority test. More specifically, it requires that pay among those performing jobs of similar value and hired within two years of one another be identical regardless of any performance differential.

This factor, along with the fact that a high proportion of Brazilians work under collective agreements (discussed in more detail below) has resulted in a tendency of firms to adjust pay more on the basis of cost of living and market shifts than on the basis of productivity or performance differentials. Indeed, for a large proportion of Brazilian workers, salary adjustments are collectively negotiated annually, with the resulting adjustment driven largely by inflation. These adjustments have typically been applied across the board with a consistent shift in company pay rates across pay levels, particularly during times of heightened inflation. Increasingly however, these shifts have been performance based, with pay increases granted across all pay levels on the basis of enhanced business performance. A variety of unit- or firm-level metrics typically serve as indicators of productivity or performance, including product quality, customer satisfaction, absenteeism, safety, market share, and production/sales volume, as well as such financial indicators as operational profit (EBITDA, EBIT, etc.), revenues, profit growth, and return on investment (Towers Watson, 2010).

Most recently, with the expansion of the Brazilian economy, these negotiated adjustments to fixed pay have generally outpaced inflation (particularly in the construction, finance, and retail sectors), running at between two to two and a half percent a year in real terms, thus accounting for the growth in real income noted earlier (Towers Watson, 2010).

In addition to adjusting base pay on the basis of firm performance, a large portion of Brazilian enterprises implement some form of profit sharing. The growth in profit sharing in Brazil can be directly attributed to legislation adopted in 2000.<sup>3</sup> This legislation requires that the nature of the profit share be negotiated between management and some elected representative of the employees (such as a union representative), and distributed no more than twice a year and no less than every two years. Most importantly, it specifies that profit sharing payments are not subject to payroll tax. With other forms of compensation taxed in one way or another at 40 percent or more, this legislation made profit sharing a particularly attractive form of compensation for many employers.

Several important trends can be seen in the compensation strategies of Brazilian enterprises. First, despite the legal restrictions on compensation noted above, the pay gap in Brazil appears to be widening. Indeed, whereas executives on average received up to 80 times the pay of the lowest paid employee in



Brazilian firms in 2011 (in multinational enterprises), executive remuneration (including variable pay) increased nearly 300 percent in the last ten years (Hay Group, 2008).

Second, despite the regulations noted above, Brazilian firms are increasingly applying pay-for-performance practices, particularly for exempt workers (i.e., technical, professional, and managerial employees). For these employees, performance-based variable pay at the individual level (i.e., excluding across-the-board merit increases or pay for performance) accounts for an average of between 20 percent and 30 percent of total pay (Towers Watson, 2010).

## *Industrial Relations*

Employee-employer relations in Brazil through the 1930s were often highly conflict ridden and violent, characterized by direct suppression of employee attempts to organize trade unions. Such instability ushered in a framework of largely statist industrial relations during the 1940s, with the CLT legislation noted above aimed at providing a basic means by which to regulate employment relations. The period of 1945–1960 saw the institutionalization and expansion of trade unions in Brazil, with unions engaging in a wide range of social assistance activities in addition to more traditional workplace governance activities. Military control in 1964 resulted in the severe limitation of union activity in Brazil, with trade union activity limited to largely administrative functions (Abranches, 1985) in order to attract greater foreign investment and increase export competitiveness. Unions largely acquiesced to government domination through the late 1970s, but widespread strikes in 1978, and in particular, those in the *ABC Paulista* region, ushered in a decade of union renewal and activism. Indeed, the 1980s saw greater organizing activity and the growth of union membership and density in Brazil, as well as heightened militancy on the part of unions and their members. By the end of the 1980s, Brazilian unions achieved a number of important victories, including a constitutional right of Brazilian works to organize freely without the need for formal government approval, and the right to collect dues from represented employees regardless of their union status (i.e., a union shop).

Since the 1990s, however, the so-called *new unionism* in Brazil is placing a premium on political action and emphasizing issues of reducing unemployment and increasing employment security rather than wage enhancement.

## *Summary and Conclusion*

HR Strategy in Brazil is characterized by numerous paradoxes and enigmas. On the one hand, Brazilian enterprises are increasingly concerned with enhancing their human capital and adopting contemporary HR practices aimed at facilitating better attraction, retention, development, deployment, and utilization of human capital. On the other hand, many enterprises in Brazil are still family owned and managed. In these companies, HR management is dominated by a family-based rather than professional orientation, with the result being that in many of these companies, despite substantial size, there is no formal HR function. Similarly, although managers are paying increasing attention to human capital issues and are interested in investing in hiring, training and compensation practices designed to enhance the alignment of their human resources with the strategic interests of their firm, their freedom of action remains restricted by a relatively strict set of government regulations and oversight. Finally, a more strategic approach to managing HR on the part of Brazil's enterprises is constrained by the country's complex history of industrial relations.

# CHAPTER SUMMARY AND CONCLUSION

In this chapter, our invited contributors presented four different perspectives on global HR strategies. Griaznova argues that Russian employers tend to follow an overarching approach to employment relations that has changed little since the Soviet era. That approach, combined with a disappointing experience with Western management practices in the immediate post-Soviet era and cultural norms making employees reluctant to place too much trust in their employer or any of the institutions governing employment relations, has led to a context that, by its very nature, is rather antithetical to the adoption of the kinds of HR policies and practices dominant in the West. Nevertheless, as Russian enterprises are increasingly competing in the global economy, systemic forces appear to be exerting a countervailing force, leading some Russian organizations, while looking for alternatives from other countries such as China, to be more open to the adoption of high-performance HR practices developed and widespread in Japan, Europe, and the United States.

The view from China suggests the widespread recognition of the importance of effectively managing human capital as a means by which to enhance competitive advantage. Accompanying this perspective has been the widespread adoption of dominant, high-performance HR practices developed in the West (and particularly in the United States). However, as noted by Lei, Ma, and Li, and consistent with the SSD model discussed in the introduction of this chapter, accompanying the widespread adoption of high commitment HR policies and practices has been the continued reliance upon HR systems ensuring workplace control. In this respect, Chinese norms and values together with the broader institutional environment continue to exert a strong influence on the nature of HR strategy in China.

Similarly, Som's analysis of the development of HR strategy in Indian organizations also suggests the interplay of the forces of convergence and divergence. While liberalization unleashed the forces of globalization on India over 20 years ago, it is only recently that Indian organizations have begun to more widely embrace the highperformance HR practices dominant in the West. According to Som, a combination of factors including an entrenched trade union movement, cultural traits somewhat antithetical to the norms underlying such practices, and organizational governance structures giving little legitimacy to HR and having a vested interest in maintaining the status quo were responsible for the relatively slow adoption of what are often referred to as "best practices" by the HR community in the West.

Finally, in their examination of HR strategy in Brazil, Barbosa and Rodrigues argue that convergent forces are strong, with a particularly strong interest on the part of enterprises and policy makers in enhancing the quality of human capital through training and education. However, the adoption of Western HR practices has been hampered by a history of problematic labor-management relations, family-dominated organizational governance structures, and a stringent regulatory environment.

Although we have limited our examination of the impact of globalization on the emergence and nature of HR strategies in only four countries, several important points may be gleaned from the analysis. First, as noted in the previous chapter, the discussion above suggests that in understanding the origins of HR strategy at the enterprise or country level, attention must be paid to both forces of convergence and divergence. At both levels, HR policies and practices are often deeply embedded and difficult to shift. In every country and community, a variety of institutional factors appear to simultaneously operate in the interests of both change and the maintenance of the status quo. Accordingly, our analysis suggests that there is no one dominant manner in which HR strategies emerge or transform. Nor is there one dominant set of HR policies and practices. In each of the countries examined, society-based influences appear to have put their own "spin" on even the most dominant of HR policies and practices adopted.

Second, perhaps because of these local influences, it appears unreasonable to expect that the same configurations of HR policies and practices that we argued are dominant, serving as “ideal types” of strategies in the West, are likely to be manifest in other countries. Thus, for example, while, consistent with a commitment strategy, enterprises in Brazil may place a heavy emphasis on training and development, Barbosa and Rodrigues’ analysis suggests that we are unlikely to observe other commitment-type characteristics.

Finally, the analysis above suggests that while, as suggested in [Chapter 10](#), it may be in the interest of some MNCs to apply a common set of HR policies and practices in every country in which they operate, this may be difficult to execute. Cultural differences such as the need for control in China, the entrenched sense of mistrust in Russia, and strong norms of power distance in India may make it simply impossible to apply the same set of policies and practices on a global basis.

## NOTES

1. According to the 2007 amendments to Chinese labor law, employers must apply with supporting evidence to the relevant authorities at least 30 days prior to any individual or collective dismissal. Additionally, employers are unable to dismiss employees with 15+ years of tenure and within 5 years of retirement. Finally, with the exception of those dismissed for-cause, employers are required to pay one month severance for each year employed (Labor Contract Law of the People’s Republic of China).
2. 1 US\$ = 2.14 B\$
3. Law 10.101/2000

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# SUGGESTIONS FOR FURTHER INFORMATION

## CHAPTER 2: STRATEGY RESEARCH

### **The Strategy Research Foundation (SRF)**

<http://srf.strategicmanagement.net>

The Strategy Research Foundation (SRF), an independent, nonprofit corporation, and public charity initiated by the Strategic Management Society, exists to support the generation, retention, and dissemination of new knowledge in the field of strategic management. Support, primarily in the form of research grants, will be provided to academic researchers in order to leverage their research or attract them to problems and issues defined by the SRF.

### **Strategy Research Initiative—High Quality Research in Strategy**

<http://strategyresearch.net/>

The members of SRI share a view on the characteristics of high quality research in strategy. We share these characteristics here in hope that doctoral students and other strategy scholars will aim for them in their own work.

Theory Development, Empirical Work, Building Knowledge

### **CIPD—Strategic HR**

[www.cipd.co.uk/hr-topics/strategic-hr.aspx](http://www.cipd.co.uk/hr-topics/strategic-hr.aspx)

You'll find here information on HR strategy, HR capability, alignment of the HR function with business strategy, and the contribution of HR to business performance.

Factsheets, Podcasts, Survey Reports, Guides, Researches, Books

### **Society of Human Resource management—USA**

[www.shrm.org/HRDISCIPLINES/Pages/default.aspx](http://www.shrm.org/HRDISCIPLINES/Pages/default.aspx)

SHRM Online's Business Leadership Discipline deals—from an enterprise perspective—with the processes and activities used to formulate objectives, practices, and policies aimed at meeting short- and long-range organizational needs and opportunities, and focused in particular on human capital issues.

### **Academy of Management**

<http://aom.org/>

The Academy of Management is a professional organization that thrives on member-driven efforts to further the scholarship of management across many categories, publications and journals, learning and sharing conferences, placement services, student assistant, and more.



## **StudyMode.com's—Tools for learning**

[www.studymode.com/features.php](http://www.studymode.com/features.php)

The [StudyMode.com](http://StudyMode.com) library features an extensive collection of model essays and term papers to help you streamline the writing process.

Topics on Human Resource Management Essays and Term Papers Essays, Book Notes, Study Tools Including Course Notes, Study Guides, Sample Tests, Videos

## **Report Linker—Human Resource Industry Reports, Company Data and Country Profiles**

[www.studymode.com/subjects/hot-topics-on-human-resource-management-page1.html](http://www.studymode.com/subjects/hot-topics-on-human-resource-management-page1.html)

Human Resources Industry Market Research Reports, October 2013–2016

## **Human Capital Institute—The Global Association for Strategic Talent Management**

[www.hci.org/](http://www.hci.org/)

HCI provides rigorous, insightful analysis and actionable reporting that helps decision makers move the needle and drive results. Our research agenda focuses on the most critical and rapidly evolving talent management practices and systems, including the following:

Workforce Planning, Talent Acquisition, Onboarding and Engagement, Learning and Development, Succession and Retention, Talent Management Technologies

## **CASE STUDIES:**

### **Walmart Stores**

[www.better-essay.com/UploadFiles/20101023193215883.doc](http://www.better-essay.com/UploadFiles/20101023193215883.doc)

Case study of strategic human resource management in Walmart stores.

### **The BIG Lottery Fund**

### **shl.com—People Intelligence Business Results**

[www.shl.com/images/uploads/cs\\_biglotteryfund.pdf](http://www.shl.com/images/uploads/cs_biglotteryfund.pdf)

An example of best practice HR strategy—Case Study: The BIG Lottery Fund

### **IBM**

<http://profi20.livejournal.com/11631.html>

IBM human resource practices and HRM theories: Integration of HRM theories into IBM's practices

### **HP**

[www.academia.edu/3493066/Managing\\_Diversity\\_at\\_Workplace\\_a\\_Case\\_Study\\_of\\_HP](http://www.academia.edu/3493066/Managing_Diversity_at_Workplace_a_Case_Study_of_HP)

## **CHAPTER 3: STRATEGIC MODELS, TYPOLOGY**

### **HR Models—Lessons from Best Practice**

Henley Business School 2009

[www.henley.ac.uk/web/FILES/corporate/cl-Henley\\_Centre\\_HR\\_models\\_desk\\_research\\_October\\_2009.pdf](http://www.henley.ac.uk/web/FILES/corporate/cl-Henley_Centre_HR_models_desk_research_October_2009.pdf)

Nick Holley Slide Presentation: The Classic HR Model Challenge of Deciding what HR Model; Issues in Implementing the Overall Model; Addressing These Issues; Common Elements and Skills of the Business Partner Role; Identifying and Addressing the Business Partner Issues; Issues and Solutions in Considering Shared Services; Common Issues in Implementing Centers of Expertise; An Emergent Global HR Model

### ***Rethinking Human Resources in a Changing World***

KPMG International, 2013

[www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/hr-transformations-survey/Documents/hr-transformations-survey-full-report.pdf](http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/hr-transformations-survey/Documents/hr-transformations-survey-full-report.pdf)

KPMG International commissioned the economist Intelligence Unit to conduct a study to investigate the forces influencing the human resources function, how technology is shaping HR's response, and what HR might look like a decade from now. *Rethinking Human Resources in a Changing World* is the report from that study. This study of executives across the globe to probe more deeply into the challenges the HR function is facing to better enable preparing the fitted HR strategy and to gain a deeper understanding of the opportunities that lie ahead.

### **It's Time for the Next Generation HR Service Delivery Model**

Mercer Report, 2013

[www.mercer.com/next\\_generation\\_HR\\_report](http://www.mercer.com/next_generation_HR_report)

Recognizing the critical linkage between talent management and business success, business leaders are asking their HR functions to play an increasingly strategic role in achieving business objectives. At the same time, they are looking to wring costs from HR service delivery, as well as manage program spend, in order to redirect funds to other business imperatives in response. HR departments in many organizations around the world have implemented a service delivery model in which transactional services, program design, and strategic business support are carried out by groups within the HR function. This work, with many organizations unsatisfied with the impact of their efforts around HR transformation, identifies seven key obstacles to business success.

### **HR Strategic Implementation at CISCO**

Cisco Systems: 10 Questions for Brian Schipper, Senior Vice President, Global Human Resources

[www.towerswatson.com/en/Insights/Newsletters/Global/strategy-at-work/2009/10-Questions-for-Brian-Schipper-senior-vice-president-global-human-resources-Cisco-Systems](http://www.towerswatson.com/en/Insights/Newsletters/Global/strategy-at-work/2009/10-Questions-for-Brian-Schipper-senior-vice-president-global-human-resources-Cisco-Systems)

Emphasis is on global strategy, downsizing, change management, connecting the organization's overriding business strategy with the people strategy, top three human capital challenges facing Cisco globally, and more.

### **Strategic Management**

[www.slideshare.net/anicalena/strategic-management-business-presentation-slides](http://www.slideshare.net/anicalena/strategic-management-business-presentation-slides)

100 slides of Strategic Management models and diagrams

### **Strategic Management at Sears Stores**

[www.ukessays.com/essays/management/strategic-human-resource-management-at-sears-stores-management-essay.php](http://www.ukessays.com/essays/management/strategic-human-resource-management-at-sears-stores-management-essay.php)

This is a case analysis of Sears' transformation from the external and internal environment and its effect on their approach to reward management; main issues of the old reward management are discussed. Then the case review several elements that are essential for building up reward management and explain reasons.

## **CHAPTER 4: PEOPLE FLOW**

### **Selecting Winners “Employee Hiring Does Not Need to Be a Mystery”**

[www.selectingwinners.com/](http://www.selectingwinners.com/)

Practical information, suggestions, and articles provided on the following: Employee Recruitment Process, Hiring Process/Interview Process, Employment Interview Questions, Interview Training, Training, Tools, Resources and Articles, Hiring Salespeople, Interview and Hiring Blogs.

### **Pros and Cons of Internal and External Recruiting**

[www.msbillings.edu/BusinessFaculty/larsen/MGMT321/Recruiting%20-%20internal%20v%20external%20hiring.pdf](http://www.msbillings.edu/BusinessFaculty/larsen/MGMT321/Recruiting%20-%20internal%20v%20external%20hiring.pdf)

List of potential advantages and disadvantages of internal and external recruiting.

### **Explore HR—Sets of PowerPoint Slides, Tools, and Practical Write Up on Various Subjects of HR and Management—Focus on Selection**

[www.explorehr.org/category/Selection+\\_Recruitment/Recruitment\\_and\\_Selection.html](http://www.explorehr.org/category/Selection+_Recruitment/Recruitment_and_Selection.html)

This section focuses on the following:

Recruitment and Selection, Types of Selection Methods, Key Indicators for Recruitment Process, Validity of Selection Method, Recruitment and Job Analysis, Realistic Job Preview (RJP), Selection Error, Validity of Appraisal Instrument, Utility of Selection, Talent Brand, Sample Job Interview Questions.

### **American Staffing Association (ASA)**

[www.americanstaffing.net/about/](http://www.americanstaffing.net/about/)

ASA and its affiliated chapters advance the interests of staffing and recruiting firms of all sizes and across all sectors through legal and legislative advocacy, public relations, education, and the promotion of high standards of legal, ethical, and professional practices. The Web provide information for job seekers, information and educative articles for staffing organizations, and data and research information.

### **Retaining Talent: A Guide to Analyzing and Managing Employee Turnover—Society for Human Resource Management**

[www.shrm.org/about/foundation/research/documents/retaining%20talent-%20final.pdf](http://www.shrm.org/about/foundation/research/documents/retaining%20talent-%20final.pdf)

SHRM Foundation prepared this report—to summarize the latest research findings on employee turnover and retention and offer ideas for putting those findings into action in the organization. This report explores several major themes related to retention management, such as why employees leave and why they stay.

A model is provided depicting how employees make turnover decisions.

How to develop an effective retention management plan? To create a sound plan, how to diagnose turnover drivers, and formulate retention strategy's.

These sections explain how to take these steps and include summaries research on strategies.

### **Internal Talent Mobility**

[www.slideshare.net/acquire/internal-talent-mobilit](http://www.slideshare.net/acquire/internal-talent-mobilit)

A. Courtois, a workforce planning consultant, presents 29 slides that explain what is internal talent mobility and its importance to the strategic direction of the firm. The lecture guides the reader to various articles and books in that field and highlights the major message driven by the various writers on the subject.

## **CHAPTER 5: PERFORMANCE**

### **Business-in-a-Box™**

[www.biztree.com/company/](http://www.biztree.com/company/)

This do-it-yourself document templates software has been created to increase at-work productivity and efficiency. It includes tools such as questionnaires, system flows to conduct employee performance evaluation, checklist of giving job performance feedback, employees appraisal forms, applicant appraisal forms, performance evaluation, self-evaluation, and more.

### **The Performance Management & Appraisal Help Center**

<http://performance-appraisals.org/>

The mission of the group is “To provide you with the information you need to transform one of the most uncomfortable parts of working life—the performance appraisal—into a productive, comfortable and effective tool for improving performance.” It provides articles, books, and free library on performance management, performance management tools, frequently asked questions on performance management,

performance tutorials, and more.

### **Performance Appraisal: The Case of Microsoft**

[www.management-issues.com/opinion/6557/microsoft-and-dumb-decision](http://www.management-issues.com/opinion/6557/microsoft-and-dumb-decision)

Microsoft and dumb decisions, a write up by Bob Selden, posted on August 24th, 2012. It is a short description of Microsoft approach to performance review and what we can learn from it.

### **Performance and Potential Appraisal—Methods of Performance Appraisal**

[www.openlearningworld.com/books/Performance%20and%20Potential%20Appraisal/Performance%20and%20Potential%20Appraisal](http://www.openlearningworld.com/books/Performance%20and%20Potential%20Appraisal/Performance%20and%20Potential%20Appraisal)

An online course, describing the three categories of performance appraisal techniques. It describes the individual evaluation methods, multiple person evaluation methods, and other techniques.

### **Guide to 360 Review**

[www.surveygizmo.com/survey-blog/guide-to-360-reviews-what-is-a-360-how-do-you-administer-360-feedback/](http://www.surveygizmo.com/survey-blog/guide-to-360-reviews-what-is-a-360-how-do-you-administer-360-feedback/)

This guide describes what a 360 review is, how to administer it, its usefulness, the role of each player, and more.

### **Team Appraisal System versus Individual Appraisal Essays**

[www.studymode.com/subjects/team-appraisal-system-versus-individual-appraisal-page1.html](http://www.studymode.com/subjects/team-appraisal-system-versus-individual-appraisal-page1.html)

Source of 1000 essays on various subjects of performance appraisal.

## **CHAPTER 6: COMPENSATION**

### **Professional Association—Compensation—American Payroll Association**

[www.americanpayroll.org/](http://www.americanpayroll.org/)

The association vision is to create opportunities and forge a community by providing the education, skills, and resources necessary for payroll professionals to become successful leaders and strategic partners within their organizations. Its benefits include membership, certification, professional publications, professional education, payroll metrics, and more.

### **Society for Human Resource Management SHRM—Compensation Data Center**

[www.shrm.org/Research/SHRMCompensationDataService/Pages/default.aspx](http://www.shrm.org/Research/SHRMCompensationDataService/Pages/default.aspx)

SHRM, in collaboration with Towers Watson Data Services, provides SHRM members with accurate and customized salary information for an entire spectrum of jobs ranging from top executive to entry level positions through the SHRM Compensation Data Center.

Compensation Trends, Online Compensation Reports, Compensation Data Center FAQ, Compensation Data

## **CIPD (Chartered Institute of Personnel and Development—Reward Management)**

[www.cipd.co.uk/hr-topics/reward-management.aspx](http://www.cipd.co.uk/hr-topics/reward-management.aspx)

The CIPD in the United Kingdom is the world's largest Chartered HR development professional body. You'll find here information on reward strategy and remuneration, pay structures, pay policy and practices, salary and payroll administration, total reward, minimum wage, executive pay and team reward. There are other pages for bonuses and incentives, employee benefits, equal pay, pensions, performance related pay, and salary surveys.

## **Research and Data Sources on Compensation—The Bureau of Labor Statistics**

[www.bls.org/](http://www.bls.org/)

The Bureau of Labor Statistics is the principal fact-finding agency for the federal government in the broad field of labor economics and statistics. Overview of BLS Wage Data by area and occupation, latest publications, overview of BLS statistics on employment, and more.

## **Employee Benefit Research Institute**

[www.ebri.org](http://www.ebri.org)

The mission of EBRI is to contribute to, to encourage, and to enhance the development of sound employee benefit programs and sound public policy through objective research and education. EBRI provides credible, reliable, and objective research, data, and analysis.

## **Compensation & Benefits Review**

[www.sagepub.com/journalsProdDesc.nav?prodId=Journal200811](http://www.sagepub.com/journalsProdDesc.nav?prodId=Journal200811)

*Compensation & Benefits Review* is a leading journal for executives and professionals, who design, implement, evaluate, and communicate compensation and benefits policies and programs. The journal supports human resources and compensation and benefits specialists and academic experts with up-to-date analyses and information on salary and wage trends, labor markets, pay plans, incentive compensation, legal compliance, retirement programs, health care benefits and other employee benefit plans.

## **Compensation Strategy—Slide Show**

[www.slideshare.net/CreativeHRM/compensation-strategy-26707048](http://www.slideshare.net/CreativeHRM/compensation-strategy-26707048)

Definition and importance of the compensation strategy, key components, and implementation approach.

## **Compensation Today—On Google's Compensation System**

[www.payscale.com/compensation-today/2011/06/google](http://www.payscale.com/compensation-today/2011/06/google)

"Did Google change my views on across the board increases? Yes, they did, and here's how." A short case on Google compensation system, by Stacey Carroll, SPHR, CCP, June 06, 2011.

## **Creative HRM**

[www.creativehrm.com/](http://www.creativehrm.com/)

Creative HRM collects all relevant information about the modern and innovative HR management. Models and Strategies, HR Development, HR Processes, Innovation Management, Change Management, HR Blog

### **WorldatWork, The Total Rewards Association**

[www.worldatwork.org](http://www.worldatwork.org)

Main purpose is to provide education, surveys, and research papers and certification for human resources professionals in the areas of compensation, sales compensation, executive compensation, benefits, work-life, and total rewards. Their products and services are periodicals/news, research & surveys, public policy, conferences, book store, training, education and certification, and worldwide professional community development.

## **CHAPTER 7: EMPLOYEE RELATIONS**

### **AFL-CIO**

[www.aflcio.org/](http://www.aflcio.org/)

The AFL-CIO is the umbrella federation for U.S. unions, with 57 unions representing more than 12 million working men and women. The website includes the section of learning about unions, raising and discussing issues, updates on legislations and politics, focus on corporations, data about the unions, and more.

### **American Arbitration Association**

[www.adr.org](http://www.adr.org)

Provides services in the field of alternative dispute resolution to individuals and organizations that wish to resolve conflicts out of court. The AAA role in the dispute resolution process is to administer cases, from filing to closing. The AAA provides administrative services in the United States and abroad. Their services include assisting in the appointment of mediators and arbitrators, setting hearings, and providing users with information on dispute resolution options, including settlement through mediation. Additional AAA services include the design and development of alternative dispute resolution (ADR) systems for corporations, unions, government agencies, law firms, and the courts. The association also provides services as education, training, and publications for those seeking a broader or deeper understanding of alternative dispute resolution.

### **Organization Culture—Slide Presentation**

[www.slideshare.net/satyabits2010/organisational-culture-with-examples](http://www.slideshare.net/satyabits2010/organisational-culture-with-examples)

The slides address the meaning of culture, presenting an overview of the cases of Ford and Tata. The slides emphasis the importance and perception on culture, the relation and influence on employee relation, ethics, and more.

### **The Nestlé Employee Relations Policy**



[www.nestle.com/Asset-library/Documents/Library/Documents/People/Employee-relations-policy-EN.pdf](http://www.nestle.com/Asset-library/Documents/Library/Documents/People/Employee-relations-policy-EN.pdf)

A detailed description of Nestle approach to its employee relation strategy in relation to its culture, corporate labor priorities, compliance and forms of dialogues.

### **Employee Relations Institute—UK**

[www.erinstitute.com](http://www.erinstitute.com)

A membership organization that has been set up in 2012 to improve employee and workplace relations in the United Kingdom. It provides professional qualifications and continuous development to managers, HR professionals, and trade union and employee representatives. It undertakes research into employee and workplace relations and engagement, provides benchmarking and best practice across all sectors of employee relations, and more.

### **Work and Family Researchers Network (WFRN)**

<https://workfamily.sas.upenn.edu/content/about>

The WFRN was formed in response to the need for a membership association of interdisciplinary work and family scholars. Unique among professional societies, the WFRN provides an online peer-community with tools to strengthen connections among the global audience interested in work and family. These include the only open access work and family subject matter repository, the work and family commons, a news feed, a calendar of events, the early career scholars program, and more.

### **Employee Involvement Association (EIA)**

[www.eia.com](http://www.eia.com)

A U.S.-based international organization serving professional managers and administrators.

It promotes the role of employee involvement as a keystone of organizational development through the empowerment of people.

### **American Society for Training and Development (ASTD)**

[www.astd.org/](http://www.astd.org/)

ASTD is the association for workforce learning professionals. Members receive exclusive access to research tools, timely publications, networking opportunities, conferences, and professional development.

## **CHAPTER 8: IMPACT OF STRATEGY**

### **HR's Evolving Role in Organizations and Its Impact on Business Strategy: Linking Critical HR Functions to Organizational Success—A Survey Report by the Society of Human Resource Management 2008**

[www.shrm.org/research/surveyfindings/documents/hr's%20evolving%20role%20in%20organization](http://www.shrm.org/research/surveyfindings/documents/hr's%20evolving%20role%20in%20organization)

This report presents an analysis of the HR in Organizational Context Survey results and examines differences among organizations by organization staff size and employment sector. The survey was

conducted among HR professionals employed by organizations operating in the United States. The survey instrument included questions regarding organizational practices and HR staffing related to human resource functions within respondents' organizations. The top three critical HR functional areas that contributed to organizations' current business strategies were (1) staffing, employment, and recruitment; (2) training and development; and (3) employee benefits. One-half of HR professionals reported that their organization's business strategy contributed to the decision of whether to staff, outsource, or eliminate various HR roles and responsibilities.

### **Explaining the Link between HRM and Organizational Performance—Work Session CIPD**

[www.cipd.co.uk/NR/rdonlyres/3574F0BF-BA92-44C6-86F7-7145E4DECFFBB/0/SampleAdvancedLevelWorksession.pdf](http://www.cipd.co.uk/NR/rdonlyres/3574F0BF-BA92-44C6-86F7-7145E4DECFFBB/0/SampleAdvancedLevelWorksession.pdf)

It takes a look at research studies that have explored at the nature of the link between HRM and organizational performance. These are concerned with establishing how exactly HR activity can have a positive influence on an organization's performance. It highlights the HR practices that the researchers found to have a particularly positive impact on performance.

### **How HR Manager Can Improve Performance?**

[www.citehr.com/123448-how-hr-manager-can-improve-performance.html](http://www.citehr.com/123448-how-hr-manager-can-improve-performance.html)

This short essay highlights some of the challenges that an organization faces while nurturing a performance-driven culture.

### **The Contribution of Human Resource Management to Organizational Performance**

<http://voices.yahoo.com/the-contribution-human-resource-management-organisational-5580683.html?cat=>

There are many opportunities for HRM to influence organizational performance as HRM plays an important part for the functioning of every single department in an organization. This essay summarizes the HRM main practices and classifies them according to their impact on the organizational performance, through employee's skills, ability, motivation, and the way that work is structured.

### **An Introduction to Performance and Skill-Based Pay Systems—International Labor Organization (Act/Emp) Publication**

[www.ilo.org/public/english/dialogue/actemp/downloads/publications/srspaysy.pdf](http://www.ilo.org/public/english/dialogue/actemp/downloads/publications/srspaysy.pdf)

The paper discusses pay reform: the move to performance pay. Information is provided on types of schemes, performance criteria, choices of types of performance pay, problems and issues. The paper also elaborates on what is skill-based pay and the reasons for skill-based pay.

### **Impact of Training and Development on Organizational Performance**

[www.congresspress.com/Journals/index.php/AJHSS/.../](http://www.congresspress.com/Journals/index.php/AJHSS/.../)

Training and development of organization in relation to organizational performance are discussed. The essay lists the typical reasons for employee training and development, the typical topics of employee training, the general benefits from employee training and development, the methods of performance measure, and the training process. A list of resources on the subjects is recommended.

# CHAPTER 9: DIVERSITY

## The U.S. Department of the Interior—EEO and Diversity Training Requirements

[www.doi.gov/pmb/eo/training/index.cfm](http://www.doi.gov/pmb/eo/training/index.cfm)

Descriptive information on the legal requirements for EEO and Diversity Training has been provided with recommended subjects that can be used to fulfill the training requirement, and a sample EEO/Diversity Training Portfolio.

## U.S. Department for Veterans Affairs—Office of Diversity and Inclusion (ODI)

[www.diversity.va.gov/training/](http://www.diversity.va.gov/training/)

Provides detailed training resources for diversity: mandatory requirements, barrier analysis, cultural competencies, diversity and inclusion, EEO compliance, sexual harassment in the workplace, diversity and inclusion for new employees, people with disabilities, a list of training institutions on the subject, etc.

## Workforce Diversity at IBM

[http://www-07.ibm.com/ibm/au/corporateresponsibility/pdfs/GL\\_9833\\_diversity\\_nocov.08.pdf](http://www-07.ibm.com/ibm/au/corporateresponsibility/pdfs/GL_9833_diversity_nocov.08.pdf)

A Detailed description of IBM's approach to diversity. It lists the philosophy, values, and areas of focus as Women in the Workforce, People with Disability, Work Life Integration, Gay, Lesbian, Bisexual and Transgender (GLBT), Cultural Diversity, Generational Diversity, the program structure, and IBM's Diversity Networking Groups.

## The State of Diversity in Today's Workforce

[www.americanprogress.org/issues/labor/report/2012/07/12/11938/the-state-of-diversity-in-todays-workforce/](http://www.americanprogress.org/issues/labor/report/2012/07/12/11938/the-state-of-diversity-in-todays-workforce/)

This section examines the state and strength of diversity in the U.S. workforce, specifically, looking at the **number and proportion** of people of color, women, gay and transgender individuals, and people with disabilities in the workforce today.

## Global Diversity and Inclusion -Perceptions, Practices and Attitudes

[www.shrm.org/research/surveyfindings/articles/documents/diversity\\_and\\_inclusion\\_report.pdf](http://www.shrm.org/research/surveyfindings/articles/documents/diversity_and_inclusion_report.pdf)

A study for the Society for Human Resource Management (SHRM) conducted by the Economist Intelligence Unit. The study was launched to provide a deeper understanding of diversity and inclusion issues on a global scale, and to offer insight into diversity, and inclusion best practices worldwide. This study included surveying over 500 executives. In addition, the Economist Intelligence Unit researched the diversity readiness of 47 different countries to create the Global Diversity Readiness Index.

# CHAPTERS 10 AND 11: INTERNATIONAL

## The Conference Board

[www.conference-board.org/about/](http://www.conference-board.org/about/)

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[www.oracle.com/us/products/applications/ebusiness/human-capital-management/oracle-global-strategy-ebs-wp-450251.pdf](http://www.oracle.com/us/products/applications/ebusiness/human-capital-management/oracle-global-strategy-ebs-wp-450251.pdf)

Oracle E-Business Suite—Human Capital Management Global Strategy. An Oracle White Paper, February 2011.

### **The Challenges of International Human Resources**

[www.youtube.com/watch?v=](http://www.youtube.com/watch?v=)

This learning unit, published on June 25th, 2013, sets the stage for a course by outlining the challenges facing multinational firms and pointing to the importance of human resource management in how multinationals respond to these challenges

# **The Challenges and Opportunities for Human Resource Management in a Globalized World**

By Robin Kramar, December 11th, 2012

[www.europeanfinancialreview.com/?p=6035](http://www.europeanfinancialreview.com/?p=6035)

This short write-up summarizes the main issues facing HR in its role of managing the function in international organizations facing new challenges due to changing environment. The article includes 30 references in support of the ideas presented.

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