CHAPTER

Human Resource Management and Performance: Adding Value through People

Learning Objectives

After studying this chapter, you should be able to do the following:

- ❖ Identify the potential impact of human resource management (HRM) on performance
- ❖ Review the concept of competitive advantage and sustained competitive advantage of an organization
- ❖ Outline the ultimate business goals of an organization
- ❖ Discuss human resource (HR) practices, HR outcomes and performance (the HR value chain)
- ❖ Understand the different stages of the HR value chain, including intended, actual and perceived HR practices

CASE STUDY: NOKIA

Nokia is a leading company in the mobile phone and telecommunications industry. The firm as we know it today is the result of a merger in 1967 between three businesses: Nokia Ab (paper industry and electricity generation), Finnish Rubber Works and Finnish Cable Works. A major crisis in the 1970s and 1980s forced the company to revise their business activities (a so called strategic reorientation). In the late 1990s major challenges and new business opportunities were identified mainly related to the emerging attention for mobile phones and the network industry (Merriden, 2001; Haiko, 2002). A national Finnish economic crisis (linked to a transition from a highly regulated economy to deregulation, liberalization and privatization) and an internal company crisis created a momentum for organizational change. General support from top management, government, social partners (trade unions) and employees enabled Nokia's transition in the 1990s to become a global player in telecommunications. Nokia today is a global market leader in mobile phones and telecommunications, ranked in *Business Week*'s Best Global Brands list of 2007 reflecting its global brand value. The firm is ranked 20th in *Fortune*'s World's Most Admired Companies list of 2007 and ranked 8th in *Business Week*'s top 100 Most Innovative Companies in 2006.

The success is also reflected in excellent financial performance and their market share worldwide. The organization is technology driven and its culture appears to be fully assimilated with networks and information technology. Nokia's corporate philosophy is focused on ‘The Nokia Way’ reflecting equality amongst employees, openness to people and sharing new ideas. Selective recruitment and selection, training and development, employee involvement and compensation are the key HR practices applied to achieve the organizational goals. Applicants are selected on the basis of their skills and knowledge in relationship to the job’s technical requirements (person–job fit) and on the basis of the fit between a candidate and Nokia’s culture (person–organization fit). Diversity management and the inclusion of minorities are key issues in the recruitment and selection process, because it is a corporate belief that a diverse workforce (different nationalities, men and women, different ethnic minorities) contributes to creativity, innovation and success. Training and development is mainly facilitated through intranet with eLearning opportunities and personal coaching by more experienced Nokia employees. Promotion opportunities are available online and called internal job market intranet. Employee involvement is reflected in job autonomy, self responsibility for personal development, regular feedback sessions, coaching new employees, regular employee surveys (called ‘listening to you survey’) and general participation in decision-making. The HR department operates a forum for all personnel management questions raised by employees (called ‘ask HR’ feedback channel). Every answer from the HR department on these questions is openly published on the intranet. Compensation within Nokia is mainly focused on two aspects: financial compensation in terms of high salaries, bonuses and stock options and compensation in terms of a variety of possibilities to create a personal work–life balance reflecting special attention to flexible working arrangement in line with employees’ interests and preferences. Teleworking, mobile working, flexible working hours, study leaves and sabbaticals are illustrations of the latter HR practices applied to motivate Nokia’s employees.

Overall, the firm can be characterized by a flat organizational structure and a culture that is highly affected by the technological nature of the business. The HR practices appear to be aligned with the technological environment and the company’s culture. The downside of Nokia’s success are the regular reorganizations and layoffs (e.g. in the Spring of 2003 downsizing 1800 jobs worldwide) in order to remain efficient and effective, at that time resulted in a 10 per cent job loss and several court cases, negatively affecting the corporate image, in particular at the home market in Finland.

Kloeg (2007)

? Discussion questions

Nokia applies specific HRM practices that focus on attracting and retaining good employees. These HR practices include selective recruitment and selection, extensive employee development, internal promotion opportunities and career development, employee involvement in decision making and pay for performance. Empirical research shows that these practices enhance employee satisfaction, organizational commitment, employee retention, employee presence (obverse of absenteeism) and loyalty (Boselie et al., 2005). In other words, part of Nokia’s success might be caused by good people management. However, how do reorganizations and massive layoffs, for example in the spring of 2003, affect Nokia’s employees in terms of their attitude and behaviour? And how do these critical incidents affect the employees’ perception of Nokia’s HR practices listed above? Finally, discuss how certain HR practices can overcome problems caused by reorganizations and massive layoffs. In other words, how can HRM contribute to firm performance and general employee well-being in times of organizational change (reorganization, downsizing)?

Introduction

According to Christian mythology, the Holy Grail was the cup used by Jesus at the Last Supper. It is said that this cup possesses special powers and those who drink from it will gain everlasting life and/or knowledge. Over time, the Grail myth has been an inspiration for numerous legends, including that of King Arthur, and more recently best-selling books such as J.R.R. Tolkien's *Lord of the Rings*, J.K. Rowling's *Harry Potter and The Philosopher's Stone* and Dan Brown's *The Da Vinci Code*. The Holy Grail was lost and the everlasting search for it has made the myth even stronger. The added value of HRM, also known as the HRM and performance debate, is often linked to 'the search for the Holy Grail', in a symbolic way of course, representing potential unique ways of managing people to gain organizational success. Some companies might have found their grail for success in people management and perhaps the Finnish Nokia is one of them. The unique organizational culture, the specific technological environment and the Finnish model of industrial relations (IR) in which multiple stakeholders (including trade unions and government) have a significant impact on the organization have contributed to Nokia's success. But how did they do it? What are their secrets of success, in particular with respect to people management? More than 15 years of worldwide empirical research on the added value of HRM and performance in different sectors shows that HRM matters. This chapter focuses on the contribution of HRM to the success of an organization using illustrations from practice and literature.

The majority of articles and books on HRM and performance start off with discussing HRM first and then link HRM to performance (Boselie et al., 2005). This book applies a reversed technique that is much more in line with goal-setting and strategic decision making. Firm performance is the starting point, reflected in organizations' search for competitive advantage and **sustained competitive advantage**. Determining (sustained) competitive advantage for an organization enables us to reveal the critical success factors that lead to success. These critical success factors – later on specified in critical HR goals and critical non-HR goals – are thought to be affected by employee attitudes (e.g. employee commitment and motivation) and employee behaviours (e.g. low employee absence rates). Finally, these employee attitudes and behaviours can be influenced by HRM. The reversed approach of what I will call 'the human resource value chain' can be summarized as follows (see also Figure 3.1):

1. Determine the competitive advantage and sustained competitive advantage of an organization.
2. Determine the critical factors that create (sustained) competitive advantage (e.g. high service quality, productivity, innovation, flexibility and social legitimacy).
3. Determine the employee attitudes, behaviours and cognitive factors that positively affect the critical success factors (e.g. high organizational commitment, motivation and overall job satisfaction).
4. Determine the HR **practices** that positively affect employee attitudes and behaviours (e.g. selective recruitment and selection, extensive training and development, performance-related pay (PRP), performance management (PM) and evaluation, employee participation and teamwork).

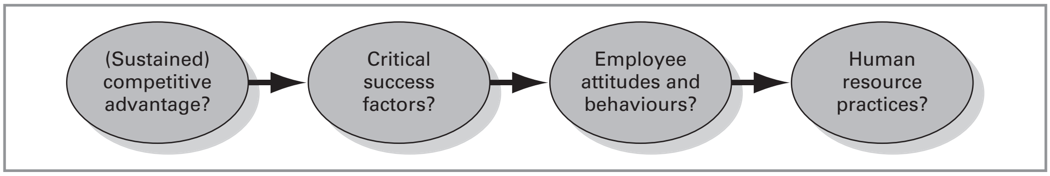


FIGURE 3.1 A reversed approach to creating an HR value chain

> **! *Stop and reflect***
> Can you think of any factors that created the (sustained) competitive advantage of Nokia in the last two decades?

The reversed approach in the creation of an HR value chain, starting with the **ultimate business goals**, pushes us to the heart of the performance debate and the search for the grail in HRM: the organization's search for (sustained) competitive advantage.

According to Delery and Shaw (2001), there is general agreement that (1) human capital can be a source of competitive advantage, (2) that HR practices have the most direct influence on the human capital of an organization, and (3) that the complex nature of HR systems of practice can enhance the inimitability of the system. Human resources are among an organization's most valuable assets. Since the late 1990s there has been a growing body of literature focused on creating (sustained) competitive advantage for organizations through the development of core competences, tacit knowledge and dynamic capabilities. One of the dominant theories in the debate on the added value of HRM is the *resource-based view (RBV) of the firm* (Boselie et al., 2005). The RBV has its roots in the early work of Penrose (1959) and was picked up and applied by Wernerfelt (1984) and Barney (1991) in the 1980s (Boselie and Paauwe, 2009). The RBV led to a change in strategic management thinking from an *'outside-in' approach* – with an emphasis on external, industry-based competitive issues (Porter, 1980) – to an *'inside-out' approach* (Baden-Fuller and Stopford, 1994), in which internal resources constitute the starting point for organizational success. Barney (1991) argues that sustained competitive advantage of an organization is determined by internal resources that are *valuable, rare, inimitable* and *non-substitutable*. Financial resources (equity, debt and retained earnings), physical resources (e.g. machines, a factory or cranes in a harbour), organizational resources (e.g. information technology (IT) systems, organizational design and management information systems) and human resources (in terms of their knowledge, skills, abilities and social network) are potential sources of organizational success when Barney's (1991) four criteria are met.

'Human resources are among an organization's most valuable assets'

The concept of '*value'* in the RBV represents the economic condition of a resource. For example, a supermarket chain owns property in terms of the local supermarket stores. The buildings and the building plot can be considered resources of an organization and represent economic value. Sometimes this value can be enormous as a result of the scarcity of building plots in villages and cities where the supermarket chain operates. The concept of '*rare*' in the RBV reflects the scarcity of a resource. Supermarket stores potentially possess economic value, for example, and can be rare when the property is built on a scarce building plot, in the centre of a big city. Banks and financiers will take these issues into account when an organization wants additional capital (loans, mortgages, etc.). The concept of *'inimitability'* in the RBV focuses on the degree to which resources are very hard to copy or imitate. Complex chemical production processes (e.g. within the German BASF) and oil refineries (e.g. within BP and Shell) are difficult for competitors and potential new entrants in particular to imitate. Inimitability can also be embedded in non-tangible resources; for example, the culture of an organization based on specific values, a unique history, the potential role of founding fathers and all other aspects that contribute to a social setting that influences the way an organization operates. The Swedish IKEA is an example of an organization with a unique organizational culture. The concept of *'non-substitutability'* in the RBV represents resources that 'are very hard to neutralize with other resources which will meet the same ends' (Boxall and Purcell, 2003: 75). Chemical engineers with both general and company-specific knowledge, skills and abilities are often very difficult to replace by others or by other resources (e.g. computers and IT systems).

RBV illustrations in practice

The US Black & Decker company, the world's largest producer of home improvement products including drills and sanders, created sustained competitive advantage through continuous innovation built around the same reliable electro motor, found in different home improvement products. The valuable and difficult to imitate resource of Black & Decker is the basic electro motor.

The Dutch amusement park *Efteling* – winner of the Applause Award for best park in the world (1992), winner of the Big-E Award as best park shows in the world (1999, 2001 and 2003) – continues to build its success on exploiting the heritage of illustrator Anton Pieck, who was the inspiration for the Fairy Tale Forest. The valuable, rare and difficult to imitate resource of the Efteling is embedded in Anton Pieck's heritage.

Barney and Wright (1998) discuss the **VRIO framework** – **v**alue, **r**areness, **i**nimitability and **o**rganization – based on earlier literature, consulting activities and input from executive training. This is a hierarchical framework for determining potential organizational success through internal resources. The first level in the framework focuses on the question of whether a resource is valuable or not. According to the model, internal resources without value are a source of competitive *dis*advantage. When resources are valuable the model suggests the possibility of competitive parity linked to normal performance. Valuable and rare resources can take an organization to the next level, creating temporary competitive advantage and above-average performance. The highest level is achieved when resources are valuable, rare and difficult to imitate. According to the VRIO framework, this is caused by intensive organizational support. The highest level potentially creates above-average performance and sustained (or long-term) competitive advantage. Only a few companies are capable of reaching this highest level.

The VRIO framework makes a distinction between different sorts of **performance** (see Table 3.1). The lowest level represents resources that do not have any value and are therefore likely to result in below-average performance. This does not automatically mean that these resources will have a dramatic negative impact on firm performance. Some resources need to be installed or in place because of legislation without any potential added-value effect; for example, health and safety procedures. Linked to the key business processes of an organization, the VRIO framework suggests it is best to avoid the use of resources that have no (economic) value and therefore do not contribute to firm performance. Nowadays, these types of resource are often outsourced to other organizations in order to reduce costs and focus on the core business activities of the organization. For resources that are valuable without being rare, for example in terms of labour supply or raw materials available for production processes, the framework suggests normal performance outcomes.

The RBV is mainly focused on the next two levels of the VRIO framework: the creation of (temporary) competitive advantage and (sustained) competitive advantage. The framework suggests that above-average performance can be created when resources are valuable, rare and difficult to imitate. Without any structural support by the organization, the framework suggests these three resource qualities are not likely to result in long-term success (sustained competitive advantage). For example, an organization that is first with the introduction of a new

Is a resource …					
Valuable?	**Rare?**	**Difficult to imitate?**	**Supported by organization?**	**Competitive implications**	**Performance**
No	–	–	↕	Competitive Disadvantage	Below average
Yes	No	–		Competitive Parity	Normal
Yes	Yes	No		Temporary Competitive Advantage	Above average
Yes	Yes	Yes		Sustained Competitive Advantage	Above average

TABLE 3.1 The VRIO framework
Source: Barney and Wright (1998).

product (think of the introduction of the digital camera) might be quite successful, generating above-average performance for a couple of years (temporary competitive advantage). However, eventually competitors introduce their own products in response to the leading organization. The leader then runs the risk of losing the initial position and above-average performance outcomes if the unique resources are not 'nurtured' or supported by the organization. Therefore sustained competitive advantage is not merely the result of valuable, rare and inimitable resources, but is also the result of how these resources are acquired, managed, developed and supported by other organizational systems.

! ***Stop and reflect***

Can you think of organizations that have gained temporary competitive advantage through valuable, rare and difficult to imitate resources (e.g. related to the emergence of digital photography, mobile phones, software and/or the Internet)? Was their temporary competitive advantage sustained? If so, do you have any idea how the organization created long-term success (sustained competitive advantage)?

Inimitability is one of the most important 'qualities of desirable resources' (Boxall and Purcell, 2003: 75) in the RBV theory. That is why Barney and Wright (1998) put it on the third level of their VRIO framework. An organization's resource can be imperfectly imitable (and difficult to substitute) for one or a combination of three reasons (Dierickx and Cool, 1989): the ability of an organization to obtain a resource is dependent on unique historical conditions (*path dependency*) (see Figure 3.2), the link between resources possessed by an organization and its sustained competitive advantage is causally ambiguous (*causal ambiguity*) (see Figure 3.3), and the resource generating an organization's advantage is socially complex and difficult to understand (*social complexity*) (see Figure 3.4). Path dependency captures the idea that valuable resources are developed over time and the fact that their competitive success does not simply come from making choices in the present but have their origin and starting point in a chain of past events, incidents and choices. According to Barney and Wright (1998), 'resource support by organization' is linked to the concept of path dependency. The chain of events and managerial choices over time in combination with the complexity of social interactions of the actors involved form the basis of the second barrier to imitation according to the RBV: social complexity (Dierickx and Cool, 1989). Unique networks of internal and external connections are natural barriers for imitation by rivals. The third type of barrier in RBV is causal ambiguity: it is difficult for people who have not been involved in the decision-making process to assess the specific cause–effect relationships in organizations.

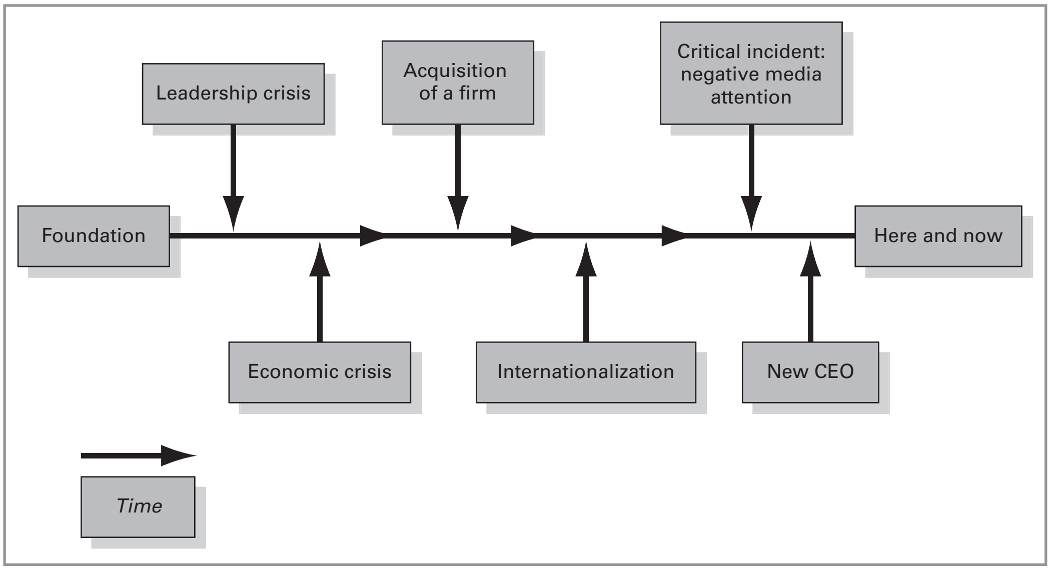


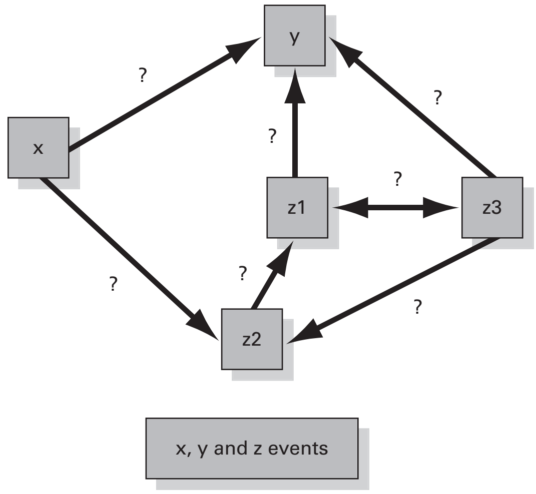
FIGURE 3.2 Path dependency illustration: history, incidents and decisions

SUMMARY
Temporary competitive advantage can be created by resources that are valuable, rare and difficult to imitate. Sustained competitive advantage can be created by resources that are valuable, rare, difficult to imitate and supported *by organization*.

The next step in the creation of a value chain in HRM is linking the notion of competitive advantage to firm performance. Boxall and Purcell (2003) provide a very useful approach in which they link competitive advantage to (1) ultimate business goals and (2) organizational performance represented by critical HR goals (e.g. labour productivity) and critical non-HR goals (e.g. market share). In this approach we also find a concrete link to HRM. Boxell and Purcell (ibid.) consider the ultimate business goals of an organization to be twofold:

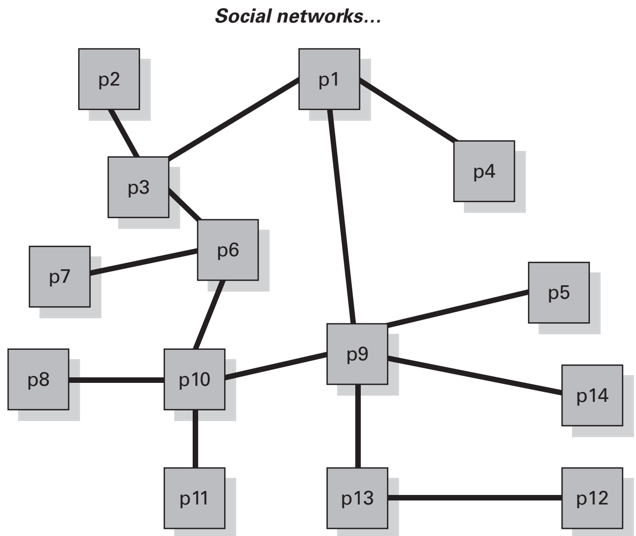
1 Creating and maintaining viability with adequate returns to shareholders.
2 Striving for sustained competitive advantage.

Level two (average performance through valuable resources) and level three (above-average performance through valuable, rare and difficult to imitate resources) in the VRIO framework potentially create and maintain viability with adequate returns to shareholders. If organizations do not meet these criteria, they run the risk of going bankrupt. The second ultimate business goal is only for those organizations that are capable of managing and maintaining valuable, rare and difficult to imitate resources in a structural way. In reality, this might only be the case for the top 5–10 per cent of organizations in a sector or population. The majority of organizations in reality



Note: For example: What is the impact of performance-related pay (x) on employee commitment (y) in an organization? The figure suggests an impact of PRP (x) on commitment (y). However, PRP (x) can also affect perceived distributive (in)justice (z2) among employees. Perceived distributive (in)justice (z2) has an impact on employee satisfaction (z1), and this employee satisfaction (z1) can affect employee commitment (y). Other factors, including employee trust (z3), can influence commitment (y), satisfaction (z1) and perceived justice (z2). Therefore, multiple 'events' can effect an apparently simple relationship between pay and commitment suggesting potential causal ambiguities.

FIGURE 3.3 Causal ambiguity illustration



Note: p = person in the organization

FIGURE 3.4 Social complexity illustration

strive for survival in meeting the standards according to the first ultimate business goal in Boxall and Purcell's (2003) approach.

The approach has one disadvantage and that is related to the fact that it only focuses on profit organizations ('adequate returns to shareholders'). Public organizations do not have shareholders; however, there are good arguments for general application of Boxall and Purcell's (2003) twofold distinction to a much broader range of organizations in different sectors. For example, hospitals are under pressure to perform according to the standards of financiers (health insurance companies) and other actors (government). When hospitals do not meet the viability standards according to these actors, they run the risk of decreasing financial support and negative publicity. Therefore the ultimate business goals approach can easily be adapted to a broad range of organizations.

The next step is linking the ultimate business goals to critical HR and critical non-HR goals. From an HR perspective it is important to be modest and realistic. Though it is tempting to attribute general organizational success to employees, it is important to realize that much success has little or nothing to do with employees and good people management. Excellent sales of an organization as a result of a growing economy or because of a big sports event (e.g. a World Cup football match and the number of flat screen televisions sold) have hardly any relationship with employees or HRM. Therefore the concept of *critical non-HR goals* is introduced. These goals might include desired outcomes for sales, market share, and so on (Boxall and Purcell, 2003). An excellent brand name, for example Coca-Cola, Heineken or Mercedes, can produce economic value and therefore be a critical non-HR goal. Interestingly enough, there is a growing awareness of the potential negative impact employees on the shopfloor and at the highest levels of the organization can have on the organization's reputation. Recent organization scandals, including Enron, Parmalat and Ahold, have shown how employees can affect firm performance negatively and damage corporate reputation. Some of Boxall and Purcell's (ibid.) critical non-HR goals (e.g. reputation, corporate image) might become the domain of the critical HR goals in the years to come.

The *critical HR goals* in Boxall and Purcell's (ibid.) basic framework focus on three desired types and levels of outcome:

1. labour productivity (cost-effectiveness);
2. organizational flexibility;
3. social legitimacy and employment citizenship.

Of all the outcome variables in HRM and performance research over the last decade, productivity has proved to be the most popular outcome variable overall (Boselie et al., 2005). In general, productivity represents the amount of output per unit of input (labour, equipment and capital). Strangely enough, Boxall and Purcell (2003) do not include quality as a critical HR goal. Quality represents the effectiveness of the organization's services and products, often directly linked to customer demands and satisfaction. From this point of view, quality can be linked to the concept of productivity. If we combine the two, cost-effectiveness (productivity and quality) represents an efficient and optimal way of delivering products or services that meet the demands of customers. In this book, *cost-effectiveness* is a combination of labour productivity and product/service quality for customers.

The second critical HR goal is *organizational flexibility*, defined as the capacity to change and/or adapt. A further distinction can be made by three types of flexibility related to employees:

1. *Numerical flexibility* representing flexibility in the use of employees; for example, during different shifts and during fluctuations in production output. An ice cream producer, for example, can be affected by extremely warm weather (meaning above-normal ice cream

consumption) versus extremely cold and wet weather (meaning below-average consumption). In both situations the producer's numerical flexibility of employees is important (more employees in case of warm weather and less employees in case of structural bad weather).

2 *Functional flexibility* representing the degree to which employees are capable of performing multiple tasks and functions. This type of flexibility is often manifested in organizations through job rotation, teamwork, job enlargement and job enrichment.

3 *Mental flexibility* representing the employees' ability and willingness to change without resistance. This concept is also linked to *agility*, reflecting the organization's capability of adapting easily to changes in its external environment. Agility has its roots in ballet and in that context refers to the flexibility of dancers' bodies to bend in all directions as necessary in a performance. Willingness and ability are two key necessary conditions for mental flexibility.

The third critical HR goal is *social legitimacy*. This concept is manifested on a more macro-level, referring to the legitimacy of an organization to the outside environment; for example, in relation to society, consumers, trade unions and the government. But it is also manifested in a more micro-level, reflecting the organization's legitimacy to its own employees. Paauwe (2004) labels this micro element 'fairness to individuals'. He considers the macro element (legitimacy) and the micro element (fairness) to be part of the moral side of managing people in organizations, essential for creating unique approaches through HRM in organizations and not just an obligatory part (due to, for example, legislation) of the critical HR goals. Social legitimacy is highly underdeveloped in the majority of SHRM literature (Paauwe and Boselie, 2007). The main focus has always been on firm performance in financial terms, with an increased emphasis on flexibility. Legitimacy issues are often considered a necessary evil from the employer's perspective, necessary because of labour legislation and the influence of trade unions. Paauwe (2004) places much more value on the social legitimacy aspect, emphasizing the potential added value of it to the organization's success. To some extent, Boxall and Purcell (2003) do acknowledge and subscribe to this notion as well. Scandals related to child labour used for the production of an organization's products, for example in the case of Nike several years ago, directly affect the social legitimacy of an organization, with a potential negative impact on corporate image. This might have serious effects on consumer behaviour and the organization's reputation for potential future employees. Social legitimacy is a serious business, although most organizations do not see its full potential in relationship to employees and HRM yet. It is worth noting that the approach by Boxall and Purcell (2003) on the three critical HR goals can be extended with other potential critical HR goals, for example innovation.

! ***Stop and reflect***

Can you think of any other critical HR goal linked to a specific organizational context? For example, innovation within the chemical German company BASF (www.basf.com) and health and safety within the British-Swedish pharmaceutical company AstraZeneca (www.astrazeneca.com).

Boxall and Purcell (2003) make an important remark about the three critical goals mentioned above (productivity/cost-effectiveness, flexibility and legitimacy). There is a natural tension between these three in organizations. High cost-effectiveness might be negatively associated with flexibility because of its efficiency focus and negatively associated with social legitimacy because of its potential neglect of human issues (e.g. work–life balance practices). Too exclusive a focus on flexibility might damage the financial performance from an efficiency point of view. And too much focus on social legitimacy does not meet efficiency and flexibility standards, as seems to be the case in some public organizations. There appears to be an optimum point at which the three critical goals are balanced. Chapter 5 of this book is partly devoted to tensions and balanced approaches in HRM.

SUMMARY

- Ultimate business goals cover two types of goal; the first focused on viability of adequate returns to shareholders, financiers and/or other relevant parties (e.g. the government) and the second focused on achieving sustained competitive advantage.
- Ultimate business goals can be affected by (1) critical non-HR goals and (2) critical HR goals.
- Critical HR goals consist of three parts: labour productivity (cost-effectiveness), flexibility and social legitimacy.
- There is a natural tension between the three critical HR goals.

HRM and performance: lessons

How do critical HR goals become affected by employees? In other words, what kinds of employee attitude and behaviour have a positive impact on cost-effectiveness, flexibility and/or social legitimacy? For example, highly committed and motivated employees are potentially more productive and more flexible (think of eagerness to learn different functions through job rotation) than employees that score very low on employee commitment and motivation. Perceived organizational justice by employees of, for example, the appraisal and compensation systems potentially have a positive impact on the social legitimacy of an organization. The issues above can be linked to the extensive HRM and performance debate that started some 15 years ago with publications by Arthur (1994), Huselid (1995) and MacDuffie (1995).

Before we get to the heart of this discussion, we need to link Boxall and Purcell's (2003) critical goals to **HR outcomes**. According to Guest (1997), these HR outcomes are much closer to actual HR practices and interventions than, for example, performance indicators such as sales, profits and market value. The latter are called *distal outcomes* because of their distance from managerial practices, including human resource practices. The risk of linking distal measures to HRM is an overestimation of the HR effect caused by other potential factors outside HRM influencing these outcomes. For example, global oil prices directly affect Shell's yearly profits without any HRM interference. Guest makes a plea for using *proximal outcomes* in studying the impact of HRM. Proximal outcomes are directly or almost directly affected by HR interventions or practices. The so-called HR outcomes are proximal outcomes. For an overview of these HR outcomes, see Paauwe and Richardson (1997). These outcomes include employee satisfaction, commitment, motivation, trust, loyalty, retention and turnover, absence due to illness and social climate between employees and managers. In Chapter 4, the performance indicators and HR outcomes are discussed in more detail and in more concrete terms.

The HRM and performance debate of the last 15 years is actually threefold. First, the majority of HR research in this area is focused on empirically testing the impact of HRM on performance. These studies were performed in different countries, in different branches of industry, with input from different respondents (including HR professionals, line managers, employees and employee representatives), on different levels of analysis (including the individual employee level, the team level, strategic business unit level and company level), in profit and non-profit organizations, using different theories and a diversity of outcome measures. For an extensive overview and critical review of over 104 empirical journal articles in international academic journals on HRM and performance, see Boselie et al. (2005). Second, there is a stream of HR research from 2000 onwards on the methods used to determine the added value of HRM; for example, reflected in the article by Gerhart et al. (2000) on measurement error in previous empirical HR research. Finally, recently overview articles and meta-analyses on HRM and performance were published, including the studies by Wall and Wood (2005), Paauwe and Boselie (2005), Combs et al. (2006), Becker and Huselid (2006) and Fleetwood and Hesketh (2006).

The first and the third stream within the HRM and performance debate generated the most output, with empirical evidence that HRM mainly has a modest positive impact on performance and in some cases no impact at all (Purcell, 1999). Huselid and Becker (2000) suggest that the effect of one standard deviation change in an HR system (a statistical way to describe the variation in HR variety and intensity among organizations) is 10–20 per cent of an organization's market value. Combs et al.'s (2006) meta-analysis on 92 empirical studies found that an increase of one standard deviation in the use of a special type of HRM called 'high-performance work practices' (HPWP) (See Chapter 6 of this book) is associated with a 4.6 per cent increase in return on assets (ROA). Therefore these authors conclude that the relationship between HRM and performance is not just statistically significant, but also managerially relevant (Paauwe, 2007).

Overall, there is general agreement among HR scholars that HR practices are at least weakly related to firm performance (Purcell, 1999; Wright and Gardner, 2003; Paauwe and Boselie, 2005; Wall and Wood, 2005); however, the results should be treated with caution (Boselie et al., 2005; Wall and Wood, 2005). The second stream is much more critical towards the findings because of serious doubts about the research designs (e.g. surveys sent to organizations to fill in), the quality of the data (e.g. input from single HR respondents; cross-sectional data), the research methods (e.g. using simple regression analysis) and the interpretation of the data (e.g. neglecting contextual factors such as the organization's size, sectoral differences and country differences caused by institutional differences). Boselie et al. (2005) conclude that there is no general agreement and consensus about (1) what constitutes HRM, (2) what performance is, and (3) what the link is between the two, although much progress has been made since Guest (1997) noted the need for good theory on these three issues.

Empirical evidence for the added value of HRM

Below are some illustrations of findings from empirical studies on the relationship between HRM and performance. *HR planning* is positively associated with labour productivity (Koch and McGrath, 1996). *Selective recruitment and selection* of new employees is positively related to labour productivity (Huselid, 1995; Koch and McGrath, 1996) and negatively related to employee turnover (Huselid, 1995). Selective recruitment and selection is often considered to be one of the key best practices in HRM and this is discussed in more detail in Chapter 7. Excellent *rewards* and *PRP* are positively related to product quality (Kalleberg and Moody, 1994), labour productivity (Lazear, 1996), customer satisfaction (Banker et al., 1996), employee motivation (Dowling and Richardson, 1997), organizational commitment and employee trust (Appelbaum et al., 2000), and negatively related to employee turnover (Arthur, 1994). PRP and compensation is another important best practice in contemporary HRM and is further discussed in Chapter 9. *Employee involvement, participation* and *consultation* are positively associated with employee commitment (Wallace, 1995) and negatively related to employee turnover (Arthur, 1994) and employee absence due to illness (Boselie et al., 2003). Employee participation is discussed as a best practice (or HPWP) in more detail in Chapter 11. *Training and development* decreases employee turnover (Arthur, 1994), increases the social atmosphere between managers and employees, also known as social climate (Kalleberg and Moody, 1994), and increases employee trust in an organization (Appelbaum et al., 2000). Employee development is another best practice that is discussed in more detail in Chapter 10. Creating *internal promotion opportunities* is positively related to organizational commitment and job satisfaction (ibid.). *Employee autonomy*, for example in job planning and decision making, increases job satisfaction (Wallace, 1995). The illustrations above indicate a positive impact of certain HR practices on performance.

There is also an enormous body of empirical evidence suggesting significant and relevant relationships between outcome variables. Job satisfaction is positively related to organizational commitment (Wallace, 1995). In other words, employees who are happy about their job are more committed to the organization and vice versa. Employee turnover is negatively related to labour productivity (Huselid, 1995), although we have to be very careful with the employee turnover outcome measure because turnover often shows a so-called non-linear relationship with other factors. High turnover rates are not good for an organization, for example because of the loss of valuable (human) resources, but extremely low turnover rates might also be bad for the organization, indicating little or no flexibility and mobility of employees. Employee trust and employee motivation decrease job stress in organizations (Appelbaum et al., 2000). Employee commitment increases productivity and quality (Guest, 2001). Overall, these illustrations indicate potential relationships between outcome variables, in particular significant relationships between HR outcomes (e.g. commitment, trust, motivation) and critical HR goals (e.g. productivity and quality).

The evidence for a relationship between HR practices, HR outcomes and critical HR goals is also visually presented in the model by Paauwe and Richardson (1997). The overview and framework by Paauwe and Richardson (1997) synthesizes the results of previous empirical research (see Figure 3.5). HRM practices give rise to HRM outcomes that influence the performance of the organization. A further distinction between distal financial performance indicators such as profits and market value versus more proximal critical HR goals such as productivity, flexibility and legitimacy is not made in this framework. The model does acknowledge potential *reversed causality* reflecting the possibility that excellent firm performance or poor firm performance affects HRM and vice versa. Excellent profits in a given year can have a strong positive effect on HRM in terms of top managers being more willing to invest in employees (higher budgets for employee development) and higher compensation for all employees. Poor firm performance, for example as a result of a country's economic crisis, might result in decreasing training budgets and a cessation of recruitment. The Paauwe and Richardson (1997) framework also acknowledges the impact of contextual factors on the relationship between HRM and performance. Contextual factors include the type of industry, the organization's size, age and history, capital intensity and the degree of unionization, but also include the employees' background (gender, level of education, age, etc.). Some HRM activities or practices influence the performance of the employees directly. PRP, for example, can have a direct positive effect on labour productivity (Lazear, 1996) without any mediating role of HRM outcomes such as employee motivation and commitment.

Looking back at the Nokia case, we might conclude that the success of that company may be at least partly based on the positive impact of its selective recruitment and selection practices, extensive training and development, the creation of internal promotion and career opportunities,

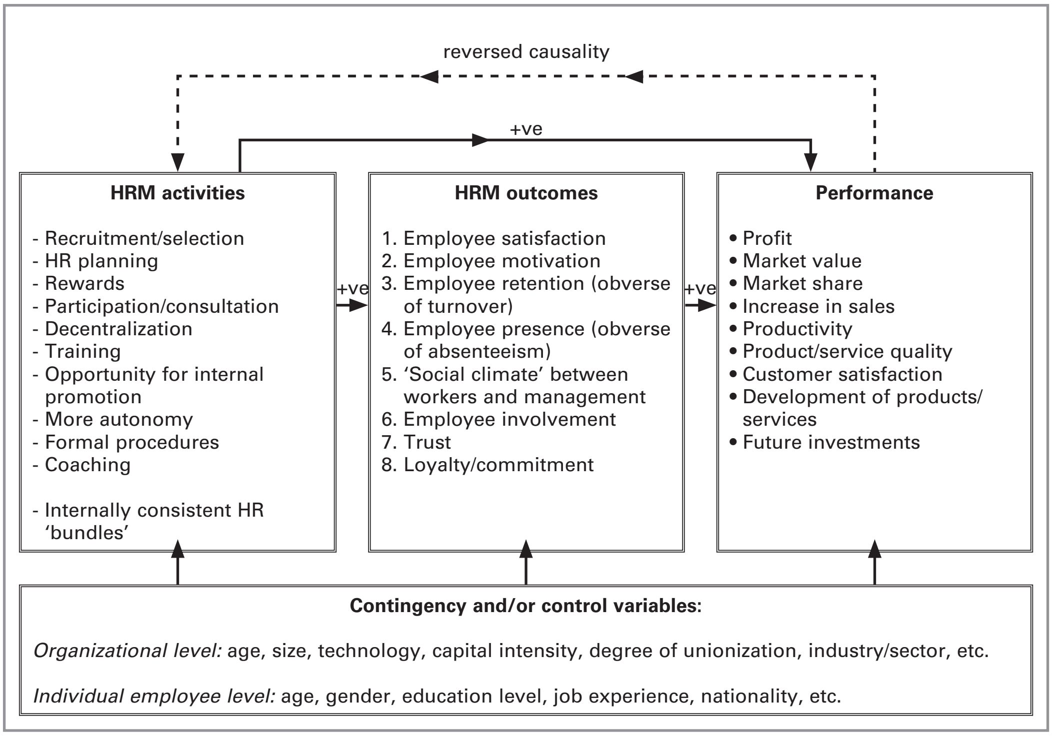


FIGURE 3.5 HRM activities in relation to HRM outcomes and performance
Source: Reproduced with permission from Paauwe and Richardson (1997).

employee involvement, job autonomy principles, good communication throughout the organization and information sharing. However, if it was that simple competitors could easily copy Nokia's success if they had the money available for HR investment for these HR practices and if they knew how to do it.

The potential competitive advantage of an organization, as discussed, uses the concepts of ultimate business goals, critical HR goals, critical non-HR goals and HR outcomes. This brings us to the next step in the model: the HR activities.

HR activities

Guest (1999), Purcell (1999) and Wright and Boswell (2002) were some of the first authors to acknowledge the lack of attention paid to the individual employee in the HRM and performance debate. The research was dominated by organization-level research focused on studying the impact of HR policies and practices reported by HR professionals on firm performance. The enactment or implementation of HR practices was almost completely ignored. Policies and reports full of ideas of excellent HR practices are just a first small step towards HR success. As suggested by Becker and Huselid (2006) and Wright and Boswell (2002), the implementation and perceptions of HRM are probably much more important.

To fully understand HR practices, a further distinction can be made between (Wright and Nishii, 2007):

1 *Intended HR practices* (policies and intended new HR practices).
2 *Actual HR practices* (practices implemented mainly by line managers).
3 *Perceived HR practices* (employees' experiences and perceptions of HR practices implemented by their direct supervisor).

'line managers (direct supervisors) are the hands that rock HRM's cradle.'

Perceived HR practices are thought to directly influence HRM outcomes. For example, if employees have a very positive perception about the performance appraisal (PA) and compensation linked to it, this will probably affect their job satisfaction, organizational commitment and trust in their direct supervisor. A systematic and strategic approach in creating excellent scores on perceived HR practices in an organization is at the heart of building an HR strategy within an organization, because incidental good scores on perceived HR practices do not guarantee organizational success in the long run. Wright and Nishii (ibid.) emphasize the crucial role of line managers in the success of HRM. The line managers are the ones enacting or implementing HR practices. Employee development can only be successful if direct supervisors acknowledge and stimulate talent within their own teams of employees. An appraisal system for evaluating individual performance can be effective when applied in the right way by the line manager. In other words, line managers (direct supervisors) are the hands that rock HRM's cradle. The HR department (or HR function) is mainly responsible for the HR design and the development of new intended HR practices. After the initial design the HR professionals mainly become business partners and facilitators of line managers in the HR enactment process. The new roles and positions of contemporary HR professionals are discussed in further detail in Chapter 12.

Intended, actual and perceived HR practices 'in practice'

A new 360-degree feedback system for monitoring and evaluating employees has been set up by HR professionals to increase employees' business awareness (e.g. reflected in increased customer focus, cost reduction and willingness to work harder when required). This is an intended HR practice developed and designed to link the performance management of an organization to the new corporate strategy, which is much more focused on creating shareholder value through sales, profits and market share. The HR professionals will then train all line managers and coach them in using the tool in all parts of the organization. An HR expert centre is set up for line management assistance during their use of the 360-degree feedback system on their employees. The data from this appraisal are centrally collected and stored at this HR expert centre. The HR department in close cooperation with top management communicates the introduction and relevance of the new system to all employees of the organization. Top management support in these situations appears to be crucial as well. If the CEO continuously tells employees and managers that this is very important, the chances of success will increase. After the introduction of the new system, it is entirely up to the line managers to make it work (actual HR practices). If applied correctly there is a good chance that employees will perceive these HR practices positively (perceived HR practices), resulting in a potentially positive impact on firm performance. Therefore, the best intentions in HRM will not automatically result in organization success.

It is crucial to make a distinction between the three different types of HR practice (intended, actual and perceived). This automatically implicates the awareness and involvement of multiple actors in the creation of an HR value chain in an organization, including HR professionals, line managers and employees. Intended HR practices are determined by the HR strategy and the overall organizational strategy. These two strategies were discussed in Chapter 2. In the next section the HR value chain is discussed.

SUMMARY

- Empirical research shows a positive impact of HRM on firm performance.
- HR outcomes are the employee attitudinal, behavioural and cognitive factors that mediate HR practices and critical HR goals.
- There are three types of HR practice: intended, actual and perceived.

The HR value chain

The ideas described in this chapter are combined with what is called the *'HR value chain'*. See Figure 3.6 for a visual presentation of the chain of events described earlier in the chapter. The competitive advantage position of an organization was the starting point of the discussion. Temporary or sustained competitive advantage is represented by the ultimate business goals in the model (inspired by Boxall and Purcell, 2003), which are affected by the critical HR and non-HR goals. The critical HR goals (productivity/cost-effectiveness, flexibility and social legitimacy) in turn are affected by HR outcomes in terms of attitudes, behaviours and cognitive aspects of employees. These HR outcomes can be positively influenced by HR practices through a mini-chain defined by Wright and Nishii (2007) in terms of intended, actual and perceived HR practices. It is noteworthy that the nature of practices, outcomes, critical HR goals and ultimate business goals is highly affected by (1) the nature of the business of an organization (e.g. manufacturing or services) and (2) the strategic choices made by an organization as discussed in Chapter 2. Below is an illustration of the latter notion.

Employee turnover and retention

The United Nations (UN) is a very popular employer because of its corporate image and excellent working conditions (including wages and other employee benefits). On average, 1500 people respond to a vacancy within the UN, in particular if the vacancy is an office job in New York. The popularity of the UN as an employer is not only reflected in the large number of respondents to a vacancy, but also in the very low employee turnover rates. In other words, nobody wants to leave the organization. To maintain flexibility and mobility within the UN, in combination with the ability to attract enough young newcomers, employee turnover might be a good thing for the UN. For most other organizations (both profit and non-profit), employee retention will become one of the biggest HR challenges in the next 10–15 years in Europe. There will be a serious labour shortage in Europe (and other parts of the world) as a result of an ageing population. Employee retention in contrast to employee turnover, where employee retention is defined as attracting and retaining valuable human resources for the organization, will probably be a key indicator for organizational success within the next couple of years. The sustainability of an organization will be in danger if it is unable to attract and retain talent. In contrast to the UN case, most organizations aim for retention and minimizing employee turnover. This, of course, all depends on the specific context.

The next chapter focuses on HR metrics and measurement. This chapter continues with a discussion on the measurement of HRM and performance in more detail and in a more concrete way.

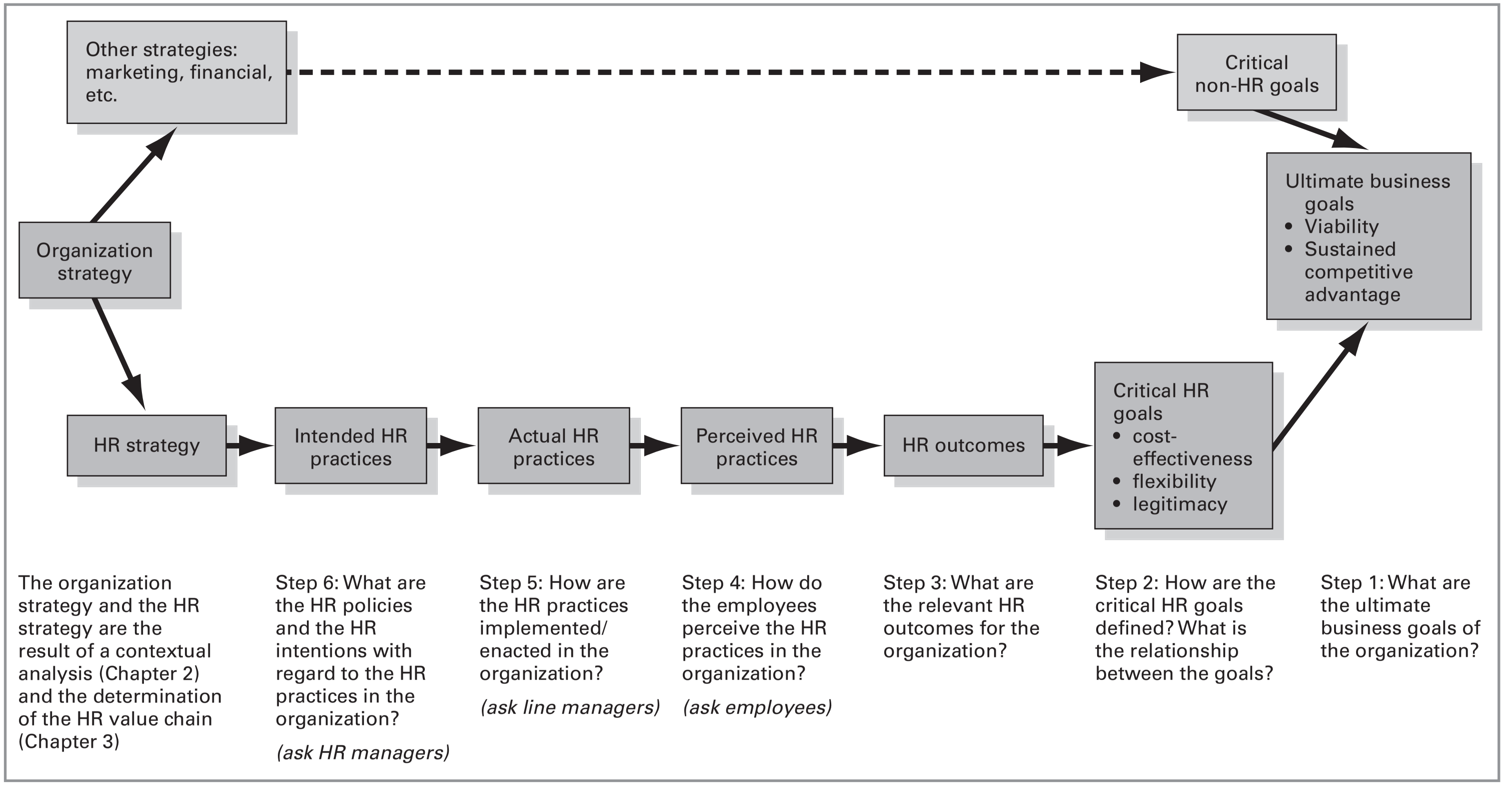


FIGURE 3.6 The HR value chain

summary

- Employees can be a source of competitive advantage for an organization.
- Internal resources that are valuable, rare, inimitable and non-substitutable can be a source of sustained competitive advantage when supported by organization.
- HRM can contribute to employees becoming a source of long-term organizational success.
- The HR value chain uses a reversed approach beginning with the organization's ultimate business goals. Next, the critical HR goals and the critical non-HR goals are determined, followed by the HR outcomes. Finally, the HR practices (intended, actual and perceived) need to be mapped, and linked to the strategy of the organization.
- The three main critical HR goals are labour productivity (cost-effectiveness), organizational flexibility and social legitimacy.
- The three types of HR practice can be linked to three different employee groups: employees (perceived HR practices), line managers (actual HR practices) and HR professionals (intended HR practices).

Glossary of key terms

Human resource (HR) outcomes are the results of people management in terms of employee attitudes, behaviours and cognitive aspects.

Human resource (HR) practices are personnel interventions or actions that contribute to shaping the employment relationship in an organization.

Performance is the final outcome of business actions.

Sustained competitive advantage is long-term organizational success reflected in continuously outperforming competitors as a result of unique resources and qualities.

Ultimate business goals are organizational targets for relevant stakeholders aimed at (1) creating and maintaining viability with adequate returns and (2) creating sustained competitive advantage.

Personal development

- What does or did your formal education (e.g. a BA degree and/or MA degree) cost you? And what are the revenues from it?
- What kind of HR practices have a positive impact on your personal HR outcomes in terms of, for example, satisfaction, motivation and retention?

Individual task

- Think of yourself as a human resource for an organization. What can you do to become valuable, rare, difficult to imitate and difficult to substitute?
- What kind of actions do you need to take?
- And if you are already in this position, you can ask yourself the question, 'How do I maintain this position?'

Team task

1. Determine the key performance indicators (KPIs) of an organization.
2. Determine the HR practices that affect these KPIs in that specific organization.

Learning checklist

After studying this chapter, you should be able to:

- Identify the potential impact of HRM on performance.
- Review the concept of competitive advantage and sustained competitive advantage of an organization.
- Outline the ultimate business goals of an organization.
- Discuss HR practices, human resource outcomes and performance (the HR value chain).
- Understand the different stages of the HR value chain, including intended, actual and perceived HR practices.

Appendix 1 HR Practices in HRM & Performance Research

HR practices:

1. Training & development
2. Performance-related pay, contingent pay & rewards
3. Performance appraisal & performance management
4. Recruitment & selection
5. Team working & collaboration
6. Participation (direct participation), empowerment, employee involvement & suggestion schemes
7. Good wages (e.g. high wages/salaries, remuneration and fair pay)
8. Communication & information sharing
9. Internal promotion opportunities & internal labour market (ILM)
10. Job design & job rotation (also job enrichment and broad jobs)

11 Autonomy & decentralization
12 Employment security
13 Employment benefits
14 Formal procedures (grievances)
15 HR planning (also career planning & succession planning)
16 Financial participation (employee stock ownership)
17 Symbolic egalitarianism (single status & harmonization)
18 Attitude survey
19 Indirect participation (trade unions, works councils, consultation committees, voice mechanisms)
20 Diversity & equal opportunities
21 Job analysis
22 Socialization & social activities
23 Family-friendly policies & work life balance (WLB)
24 Employee exit management, layoff and redundancy policy
25 Professionalization & effectiveness of the HR function – HR department
26 Social responsibility practices

Source: Boselie et al. (2005), based on 104 empirical articles, 1994–2003.

Appendix 2 Outcomes and Performance in HRM & Performance Research

Outcomes and performance:

1 Productivity
2 Employee turnover (versus retention)
3 Profits (profitability)
4 Product/service quality (e.g. scrap rate)
5 Sales
6 Organization performance (overall) & organization's competitiveness
7 Commitment
8 Market growth & growth
9 Efficiency of process (cycle time; throughput time; delivery; clerical accuracy)
10 Employee absence (sickness)
11 Satisfaction
12 Conflict (grievances) & social climate
13 ROA – return on assets
14 Intention to quit (or stay)
15 Flexibility (e.g. ability to move between jobs; adaptability)
16 Innovation (e.g. product development)
17 Costs (e.g. production, overhead, unit)
18 Motivation
19 ROI – return on investment
20 Labour costs
21 Market share
22 Quality of staff (competence)
23 Tobin's q
24 ROE – return on equity
25 Market value

26 Trust
27 OCB – organizational citizenship behaviour
28 Stress (workload; fatigue)
29 Morale
30 Effectiveness of HR department
31 GRATE – gross rate of return on assets
32 ROS – return on sales
33 Perceived security
34 Perceived fairness
35 Earnings
36 Staffing
37 Customer satisfaction
38 Attitude to change (e.g. resistance)
39 Death rates

Source: Boselie et al. (2005), based on 104 empirical articles, 1994–2003.

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