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The Impact of HRM on Performance

Key concepts and terms

- The AMO formula
- Discretionary effort
- Organizational capability
- Performance
- Contingency theory
- Expectancy theory
- Organizational effectiveness
- Reversed causality

Learning outcomes

On completing this chapter you should be able to define these key concepts. You should also know about:

- Outcomes of research on the link between HRM and firm performance
- HRM and individual performance
- How HR practices make an impact
- Problems of establishing a link
- The link between HRM and organizational performance

Introduction

As Guest (1997) argues: ‘The distinctive feature of HRM is its assumption that improved performance is achieved through the people in the organization.’ If, therefore, appropriate HR policies and processes are introduced, it can also be assumed that HRM will make a substantial impact on firm performance. To back up these assumptions three questions need to be answered: What is performance? What impact does HRM make on performance? How does HRM make that impact?

The concept of performance covers both *what* has been achieved and *how* it has been achieved. Firm performance can be measured in a number of different ways. The most obvious way to measure what has been achieved, and the approach used in many studies, is by reference to key performance indicators (KPIs), which are usually to do with financial results (profitability) or productivity. Measuring the ‘how’ is more difficult. It has to rely extensively on qualitative assessments of organizational capability or effectiveness. Organizational capability is defined as the capacity of a firm to function effectively in order to compete and deliver results. Organizational effectiveness is defined as the capacity of an organization to achieve its goals by making effective use of the resources available to it.

What impact HRM makes may be nice to know, if only to demonstrate to dubious chief executives and line managers that HRM is a good thing. A considerable amount of research has been conducted recently on the impact of HRM, which is discussed in the first section of this chapter. But it is also necessary to understand how that impact is made in order to justify, develop and implement effective HR policies and practices. Ulrich (1997a) comments that managers and HR professionals ‘need to be able to explain conceptually how and why HR practices lead to their outcomes’.

The impact made by HRM

The holy grail sought by many human resource management researchers is to establish that HRM practices demonstrably cause improvements in organizational performance. Practitioners too would like to be able to justify their existence by saying to their bosses and their colleagues that this is the case. Much research as summarized in Table 7.1 has been carried over the last decade or so, most of which at least shows that there is a link between good HRM practice and firm performance.

Table 7.1 Research on the link between HRM and firm performance

Researcher(s)	Methodology	Outcomes
Arthur (1990, 1992, 1994)	Data from 30 US strip mills used to assess impact on labour efficiency and scrap rate by reference to the existence of either a high commitment strategy or a control strategy	Firms with a high commitment strategy had significantly higher levels of both productivity and quality than those with a control strategy

Table 7.1 *continued*

Researcher(s)	Methodology	Outcomes
Huselid (1995)	Analysis of the responses of 968 US firms to a questionnaire exploring the use of high performance work practices	Productivity is influenced by employee motivation; financial performance is influenced by employee skills, motivation and organizational structures
Huselid and Becker (1996)	An index of HR systems in 740 firms was created to indicate the degree to which each firm adopted a high performance work system	Firms with high values on the index had economically and statistically higher levels of performance
Becker <i>et al</i> (1997)	Outcomes of a number of research projects were analysed to assess the strategic impact on shareholder value of high performance work systems	High performance systems make an impact as long as they are embedded in the management infrastructure.
Patterson <i>et al</i> (1997)	The research examined the link between business performance and organization culture and the use of a number of HR practices	HR practices explained significant variations in profitability and productivity (19% and 18% respectively). Two HR practices were particularly significant: (1) the acquisition and development of employee skills and (2) job design including flexibility, responsibility and variety
Appelbaum <i>et al</i> (2000)	Study of the impact of high performance work systems (HPWSs) in 44 manufacturing facilities – over 4,000 employees were surveyed.	HPWSs produced strong positive effects on performance. They are associated with workshop practices that raise the levels of trust, increase workers' intrinsic reward from work and thereby enhance organizational commitment.
Guest <i>et al</i> (2000a)	An analysis of the 1998 WERS survey which sampled some 2,000 workplaces and obtained the views of about 28,000 employees	A strong association exists between HRM and both employee attitudes and workplace performance

Table 7.1 *continued*

Researcher(s)	Methodology	Outcomes
Guest <i>et al</i> (2000b)	The Future of Work Survey covered 835 private sector organizations. Interviews were carried out with 610 HR professionals and 462 chief executives	A greater use of HR practices is associated with higher levels of employee commitment and contribution and is in turn linked to higher levels of productivity and quality of services
Thompson (2002)	A study of the impact of high performance work practices such as team working, appraisal, job rotation, broad-banded grade structures and sharing of business information in UK aerospace establishments	The number of HR practices and the proportion of the workforce covered appeared to be the key differentiating factor between more and less successful firms
West <i>et al</i> (2002)	Research conducted in 61 UK hospitals obtaining information on HR strategy, policy and procedures from chief executives and HR directors and mortality rates	An association between certain HR practices and lower mortality rates was identified. As noted by Professor West: 'If you have HR practices that focus on effort and skill; develop people's skills; encourage co-operation, collaboration, innovation and synergy in teams for most, if not all employees, the whole system functions and performs better'.
Guest <i>et al</i> (2003)	An exploration of the relationship between HRM and performance in 366 UK companies using objective and subjective performance data and cross-sectional and longitudinal data	Some evidence was shown of an association between HRM, as described by the number of HR practices in use, and performance, but there was no convincing indication that the greater application of HRM is likely to result in improved corporate performance

Table 7.1 *continued*

Researcher(s)	Methodology	Outcomes
Purcell <i>et al</i> (2003)	A University of Bath longitudinal study of 12 companies to establish how people management impacts on organizational performance	The most successful companies had 'the big idea'. They had a clear vision and a set of integrated values. They were concerned with sustaining performance and flexibility. Clear evidence existed between positive attitudes towards HR policies and practices, levels of satisfaction, motivation and commitment, and operational performance. Policy and practice implementation (not the number of HR practices adopted) is the vital ingredient in linking people management to business performance and this is primarily the task of line managers.

Comments on the research

The methodology used in many of the studies listed in Table 7.1 was to measure the association between the number of HR practices used by the firm and the financial results achieved by the firm, treating the number of practices as the input variable and profit or market value as the dependent variable. Purcell *et al* (2003) have cast doubts on the validity of this approach.

SOURCE REVIEW

Validity of HRM and performance research, Purcell *et al* (2003)

Our study has demonstrated convincingly that research which only asks about the number and extent of HR practices can never be sufficient to understand the link between HR practices and business performance... It is misleading to assume that simply because HR practices are present they will be implemented as intended.

In 1997 David Guest commented that: 'At present the studies report a promising association between HRM and outcomes, but we are not yet in a position to assert cause and effect'. Ulrich (1997a) has pointed out that: 'HR practices seem to matter; logic says it is so; survey findings confirm it. Direct relationships between performance and attention to HR practices are often fuzzy, however, and vary according to the population sampled and the measures used.' And Purcell *et al* (2003) noted that 'Measures which use profit or shareholder value are too remote from the practice of people management to be useful.' Any attempt to prove that good HR practice generates high economic returns has to confront the objection that there might be any number of reasons for high economic performance which have nothing to do with HRM.

Wood and Paauwe produced comprehensive analyses of studies of the HRM/performance link.

SOURCE REVIEW

A view on HRM/performance link studies, Stephen Wood (1999)

This empirical work (15 studies) 'has concentrated on assessing the link between practices and performance, with an increasing disregard for the mechanisms linking them. This has meant that there has been no systematic link between HR outcomes and performance. Moreover, there has been an increasing neglect of the psychological processes that mediate or moderate the link between HR practices and performance'.

Another view on HRM/performance link studies, Jaap Paauwe (2004)

Research on HR and performance has been based on a narrow-minded definition of performance which involves the use of limited analytical frameworks based on simple input/output reasoning. So there is a substantial negligence of the process itself, the actors and stakeholders involved, the administrative heritage and institutional values. A systems based approach is required which includes HRM practices and policies as input variables, HRM outcomes as intermediate variables and firm performance indicators as the dependent variables. Contingency variables such as size and technology need to be used as control variables.

Reference was made by Boselie *et al* (2005) to the causal distance between an HRM input and an output such as financial performance: 'Put simply, so many variables and events, both internal and external, affect organizations that this direct linkage strains credibility.'

Another problem is the assumption some people make that correlations indicate causality – if variable A is associated with variable B then A has caused B. It might, but again it might not. This is linked to the issue of 'reversed causality' which is the assumption, as Purcell *et al* (2003)

put it, 'that more HR practices leads to higher economic return when it just as possible that it is successful firms that can afford more extensive (and expensive) HRM practices'. They also comment that when successful firms invest heavily in HRM they may do so to help sustain high performance.

How HRM strategies make an impact

As Guest *et al* (2000b) comment, much of the research has demonstrated an association between HRM and performance but leaves uncertainties about cause and effect. However, they do state that 'HRM is essentially concerned with achieving results through full and effective utilization of human resources.' They go on to suggest that: 'This is only likely to be achieved through a set of appropriate practices resulting in high quality, flexible and committed employees.'

Wood (1999) noted that the quality of the research base supporting the relationship between HRM and performance is weak. Even if it were stronger, it is not enough simply to produce evidence that HR practices lead to high performance; it is necessary to understand how they produce this effect. This was the subject of research by Rogg *et al* (2001) who suggested that HRM affects performance by first influencing climate, which then determines performance. They also argued that the direct links between HRM practices and performance are relatively weak as it is not HRM practices themselves that affect performance, but rather the extent to which they lead to a favourable climate. In 2003 the 'black box' research by Purcell *et al* explored the unknown link between inputs and outcomes. Their conclusion was that HR practice feeds in as an 'ingredient' in the workplace and, through various mechanisms, feeds out through the other side as improved performance.

The HRM factors affecting high performance for both individuals and organizations need to be considered.

HRM and individual performance

There are three factors that affect the level of individual performance: motivation, ability and opportunity to participate. The first two factors were highlighted by Vroom (1964) who made the following suggestions on the basis of his research.

Factors affecting individual performance, Vroom (1964)

The effects of motivation on performance are dependent on the level of ability of the worker, and the relationship of ability to performance is dependent on the motivation of the worker. The effects of ability and motivation on performance are not additive but interactive. The data presently available on this question suggest something more closely resembling the multiplicative relationship depicted in the formula: $\text{Performance} = f(\text{Ability} \times \text{Motivation})$.

Vroom is therefore suggesting that people need both ability and motivation to perform well and that if either ability or motivation is zero there will be no effective performance.

Vroom also pioneered expectancy theory which, as developed by Porter and Lawler (1968), proposes that high individual performance depends on high motivation plus possession of the necessary skills and abilities and an appropriate role and understanding of that role. From this, as Guest (1997) claims:

It is a short step to specify the HR practices that encourage high skills and abilities, for example careful selection and high investment in training; high motivation, for example employee involvement and possibly performance-related pay; and an appropriate role structure and role perception, for example job design and extensive communication and feedback... We therefore have a theory that links HRM practices to processes that facilitate high individual performance.

Research carried out by Bailey *et al* (2001) in 45 establishments focused on the 'opportunity to participate' factor as it affects performance. They noted that 'organizing the work process so that non-managerial employees have the opportunity to contribute discretionary effort is the central feature of a high performance work system'. (This was one of the earlier uses of the term 'discretionary effort'.) They stated that the other two components of a high performance work system were incentives and skills.

The 'AMO' formula put forward by Boxall and Purcell (2003) is a combination of the Vroom and Bailey *et al* ideas. This model asserts that performance is a function of Ability + Motivation + Opportunity to Participate (note that the relationship is additive not multiplicative). HRM practices therefore impact on individual performance if they encourage discretionary effort, develop skills and provide people with the opportunity to perform.

HRM and organizational performance

It may be possible to detect an association between HRM practices and the economic performance of firms. But because of all the other factors involved, it may be difficult if not impossible to demonstrate that the HR practices caused the high performance. As contingency theory tells us, what happens in organizations will be influenced, even governed, by their internal and external environment. There is also the problem of reversed causality – HR practices may have resulted in high performance but high performance may have encouraged the use of sophisticated HR practices.

Any theory about the impact of HRM on organizational performance must be based on three propositions:

1. That HR practices can make a direct impact on employee characteristics such as engagement, commitment, motivation and skill.
2. If employees have these characteristics it is probable that organizational performance in terms of productivity, quality and the delivery of high levels of customer service will improve.
3. If such aspects of organizational performance improve, the financial results achieved by the organization will improve.

Note, however, that there are two intermediate factors between HRM and financial performance (employee characteristics affected by HRM and the impact of those characteristics on non-financial performance). According to these propositions, HRM does not make a direct impact. The relationship is further complicated by the other two factors mentioned above: the contingency variables and the possibility of reversed causality. A model of the impact of HRM taking all these considerations into account is shown in Figure 7.1.

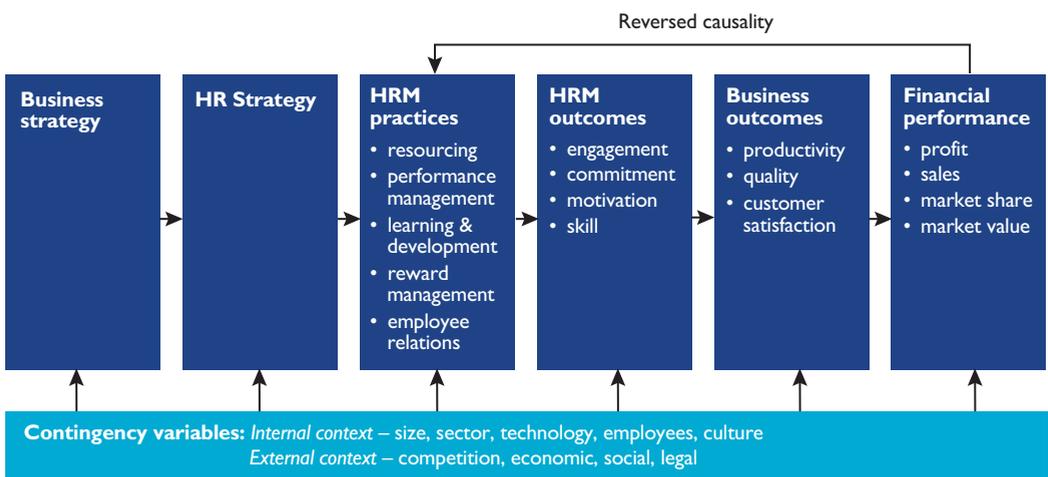


Figure 7.1 Impact of HRM on organizational performance

The case-based research by Purcell *et al* (2003) strongly indicated that the key to activating what they called the ‘People–Performance’ link lies not only in well-crafted ‘bundles’ of HR practices, but in their conjunction with a powerful and cohering organizational vision (or ‘Big Idea’) and corporate leadership, together with front-line leadership’s action and use of its discretionary power.

How HRM practices make an impact

How HRM practices make an impact is summarized in Table 7.2.

Table 7.2 The HR practices that impact on performance

HR practice area	How it impacts
Attract, develop and retain high quality people	Match people to the strategic and operational needs of the organization. Provide for the acquisition, development and retention of talented employees, who can deliver superior performance, productivity, flexibility, innovation, and high levels of personal customer service and who ‘fit’ the culture and the strategic requirements of the organization
Talent management	Ensure that the talented and well motivated people required by the organization to meet present and future needs are available
Job and work design	Provides individuals with stimulating and interesting work and gives them the autonomy and flexibility to perform these jobs well. Enhance job satisfaction and flexibility which encourages greater performance and productivity
Learning and development	Enlarge the skill base and develop the levels of competence required in the workforce. Encourage discretionary learning which happens when individuals actively seek to acquire the knowledge and skills that promote the organization’s objectives. Develop a climate of learning – a growth medium in which self-managed learning as well as coaching, mentoring and training flourish
Managing knowledge and intellectual capital	Focus on organizational as well as individual learning and provide learning opportunities and opportunities to share knowledge in a systematic way. Ensure that vital stocks of knowledge are retained and improve the flow of knowledge, information and learning within the organization

Table 7.2 continued

HR practice area	How it impacts
Increasing engagement, commitment and motivation	Encourage productive discretionary effort by ensuring that people are positive and interested in their jobs, that they are proud to work for the organization and want to go on working there and that they take action to achieve organizational and individual goals
Psychological contract	Develop a positive and balanced psychological contract which provides for a continuing, harmonious relationship between the employee and the organization
High performance management	Develop a performance culture which encourages high performance in such areas as productivity, quality, levels of customer service, growth, profits, and, ultimately, the delivery of increased shareholder value. Empower employees to exhibit the discretionary behaviours most closely associated with higher business performance such as risk taking, innovation, and knowledge sharing, of knowledge and establishing trust between managers and their team members
Reward management	Develops motivation and job engagement by valuing people in accordance with their contribution
Employee relations	Develops involvement practices and an employee relations climate which encourages commitment and cooperation.
Working environment – core values, leadership, work/life balance, managing diversity, secure employment	Develop ‘the big idea’ (Purcell <i>et al</i> , 2003), ie a clear vision and a set of integrated values. Make the organization ‘a great place to work’

Impact of HRM – key learning points

Outcomes of research on the link between HRM and firm performance

- Firms with a high commitment strategy had significantly higher levels of both productivity and quality than those with a control strategy. (Arthur, 1992)
- Productivity is influenced by employee motivation; financial performance is influenced by employee skills, motivation and organizational structures. (Huselid, 1995)
- Firms with high values on the index had economically and statistically

Impact of HRM – key learning points (continued)

- higher levels of performance. (Huselid and Becker, 1996)

 - High performance systems make an impact as long as they are embedded in the management infrastructure. (Becker *et al*, 1997)
 - HR practices explained significant variations in profitability and productivity. (Patterson *et al*, 1997)
 - High performance work systems produced strong positive effects on performance. (Appelbaum *et al*, 2000)
 - A strong association exists between HRM and both employee attitudes and workplace performance. (Guest *et al*, 2000a)
 - A greater use of HR practices is associated with higher levels of employee commitment and contribution and is in turn linked to higher levels of productivity and quality of services. (Guest *et al*, 2000b)
 - The number of HR practices and the proportion of the workforce covered appeared to be the key differentiating factors between more and less successful firms. (Thompson, 2002)
 - If you have HR practices that focus on effort and skill; develop people's skills; encourage cooperation, collaboration, innovation and synergy in teams for most, if not all employees, the whole system functions and performs better. (West *et al*, 2002)
 - Some evidence was shown of an association between HRM, as described by the number of HR practices in use, and performance, but there was no convincing indication that the greater application of HRM is likely to result in improved corporate performance. (Guest *et al*, 2003)
 - Clear evidence existed between positive attitudes towards HR policies and practices, levels of satisfaction, motivation and commitment, and operational performance. (Purcell *et al*, 2003)
- Problems of establishing a link**
- At present the studies report a promising association between HRM and outcomes, but we are not yet in a position to assert cause and effect. (David Guest, 1997)
 - HR practices seem to matter; logic says it is so; survey findings confirm it. Direct relationships between performance and attention to HR practices are often fuzzy, however, and vary according to the population sampled and the measures used. (Ulrich, 1997a)
 - Measures which use profit or shareholder value are too remote from the practice of people management to be useful. (Purcell *et al*, 2003)
- HRM and individual performance**
- The factors that affect the level of individual performance are motivation, ability and opportunity to participate.

Impact of HRM – key learning points (continued)

Link between HRM and organizational performance

Three propositions on the link: a) HR practices can make a direct impact on employee characteristics such as engagement, commitment, motivation and skill; b) if employees have these characteristics it is probable that organizational performance in terms

of productivity, quality and the delivery of high levels of customer service will improve; and c) if such aspects of organizational performance improve, the financial results achieved by the organization will improve.

How HR practices make an impact

Summarized in Table 7.2.

Questions

1. The research conducted by Guest and King (2004) elicited the following response from one HR director: 'We read ad nauseum about why aren't HR directors on the main board and my answer to this would be, because not enough of them have been able to prove that HR can contribute. It is there, it is there to be done.' How can it be done?
2. Guest *et al* (2003) noted that: 'Much of the published research has shown an association between HRM and performance, either at the same point in time or over time. The demonstration of an association is an important step in advancing research but leaves uncertainties about cause and effect.' The research conducted by Guest and his colleagues did reveal a positive association between HRM and profitability but did not support the assumption that HRM led to the higher profitability. Can you identify any research projects that have established cause and effect? If not, what is the point of all this research?
3. What are the practical implications of the following comment made by Hope-Hailey *et al* (2005) made in introducing the findings of their research on HR and organizational performance? 'Sustained competitive advantage thus lies in the employees themselves, not in HRM practices, as these do not meet the criteria of value, rarity, inimitability and non-substitutability. Therefore, the HR department needs to go beyond designing effective HRM policies and practices to ensure that these practices are implemented appropriately and are accepted by employees to achieve the intended results.'

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