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Strategic HRM: 'best fit' or 'best practice'?

Perhaps one message – more than any other – has been communicated in job advertisements for HR directors over the last few years: whatever you do, help the firm to make its HRM consistent with its strategic direction, *integrate* HR strategy with the wider business strategy. To many people this piece of advice seems obvious and straightforward. But is it? Could it be interpreted in quite different ways? Building on the concepts clarified in the previous chapter, our task in this one is to explain the main ways in which it has been argued that HRM should be integrated into strategic management and to consider the evidence for these claims.

The theory of strategic HRM does not, in fact, advocate a single way of linking HRM to strategy. Most theoretical debate around this nexus has been consumed with a contest between two approaches. One approach – the 'best fit' or contingency school – argues that firms must adapt their HR strategies to other elements of the firm's strategy and to its wider environment. This school invites a string of questions about which are the most critical contingencies in this complex context and how they are best connected. The other approach advocates 'best practice' or universalism. It argues that all firms will be better off if they identify and adopt best practices in the way they organise work and manage people. This is not straightforward either: it begs questions about how best practice models are defined and about who is best served by them. This chapter subjects these two approaches to a thorough review. We examine in each case what the research and theoretical critiques have to say and we reach an assessment of the relative merits of each approach. Readers will find that we take a very broad view of the research in reaching our conclusions and laying a basis for subsequent analysis in this book. To begin with, we need to flesh out our definition of strategic HRM and its companion term, human resource strategy.

Defining 'strategic HRM' and HR strategy

As Chapter 1 made clear, we do not associate HRM with any particular philosophy or style of management. Simply in terms of work organisation and opportunities for employee voice, we see all sorts of variations in employer behaviour. Work organisation varies from highly prescribed 'command and control' models through to high-involvement or high-discretion ones and employer strategies towards employee voice vary from very paternalistic and anti-union styles through to union–management 'partnerships'. The practice of HRM incorporates all of these patterns and many more. We are interested in identifying, analysing and tracking trends in all significant patterns of managerial behaviour over time.

What difference does it make, then, when we apply the adjective *strategic* to HRM? As explained in Chapter 2, our understanding of strategy is based on a 'strategic choice' perspective – something which can be applied to the whole of strategy and to its constituent parts, including human resource strategy. In this interpretation, the application of the adjective 'strategic' implies a concern with the ways in which HRM is critical to the firm's survival and to its relative success. There are always strategic choices associated with labour management in the firm – whether highly planned or largely emergent in management behaviour – and these choices are inevitably connected to the firm's performance. These choices are made over time by the whole management structure, including line managers and HR specialists (where they exist).

As explained in Chapter 2, it is helpful to think of strategic choices on two levels: they either play a role in underpinning the firm's viability (make-or-break choices) or they help to provide some kind of sustained competitive advantage, accounting for major, ongoing differences in the quality of business performance. In adopting this understanding, we follow Dyer (1984) in referring to a firm's *pattern* of strategic choices in labour management (including critical ends and means) as its 'organisational human resource strategy' – or its 'HR strategy', for short.

To illustrate what we mean by strategic choices in HRM, take the case of a management consulting firm that aims to join the elite cluster of firms which are global in their reach (Boxall and Purcell 2000). Firms such as PricewaterhouseCoopers, McKinsey and KPMG are among the leaders in this sector. What might it take to join them? There is no doubt that firms in this 'strategic group'[1] must have highly selective recruitment and strong development of staff to ensure they can consistently offer clients high quality service on complex business problems. In this elite group of professional firms, a synergistic blend of certain human resource practices – such as proactive recruitment channels, high entry standards, challenging, high-discretion work, high pay, the prospect of entering into partnership, and extensive professional education – is critical to business credibility. Firms of this type which are focused on competing through advanced and rare expertise need these sorts of HR practices to attract and retain the talented people they want (Dooreward and Meihuizen 2000). On the other hand, we can draw something of a line between these critical elements of HRM and other aspects which are not really important. It is unlikely, for example, that there is much hanging on the firm's choice of job evaluation systems. Job evaluation systems allocate jobs to pay grades based on the skill, effort and responsibility they involve. If any one of a range of such systems supports its remuneration goals in recruiting and retaining highly qualified consultants, or does not perversely undermine them, then the choice among different systems is not critical. Similarly, the contracting out of payroll or benefits administration in such a firm is not a strategic dimension of its HRM. It is not difficult to meet the requirements of employment contracts in these areas and elite firms are not differentiated from lesser firms on this basis. What is vital, however, is that the firm's leaders put together the *system* of truly critical HR practices and investments that will help the firm to join the elite group of professional firms in this sector. However, it would be unwise to think that the firm's labour market reputation will be made quickly or that viability in the sector will be achieved solely through HR strategy (as our discussion of the resource-based view of the firm in the next chapter will make clear).

Def.

As a field of study, then, strategic HRM is concerned with the strategic choices associated with the organisation of work and the use of labour in firms and with explaining why some firms manage them more effectively than others. It is helpful to spell out this definition in a very practical manner. Suppose an HR Director is asked by a chief executive to conduct a review of the quality of HR strategy in a firm. What should such a review entail? We suggest the questions shown in Figure 3.1:

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1 A strategic group is a cluster of firms in the same industry that compete for clients in the same kind of way and develop strong 'mutual understandings' (Suarez and Utterback 1995, Peteraf and Shanley 1997).

1. *Strengths and weaknesses in human resources*
   How well does the firm's human and social capital help it to perform? In terms of cost-effectiveness, social legitimacy and organisational flexibility, what strengths and weaknesses are apparent in the firm's management of its main employee groups?
2. *Competitive risks and potential in HRM*
   What threats does the firm face in its HRM (e.g. from under-performing work systems, from employee dissatisfaction or from labour market competition)? What opportunities does the firm have to improve its HR performance relative to its industry rivals? Does the firm have the potential to generate some form of sustained competitive advantage through HRM? If so, how?
3. *Assessment of strategic HR management processes*
   How effective are the firm's HR planning and reporting processes? What data are available on HR performance and how are they used for evidence-based strategic decisions, especially when linked to data on other critical variables like customer satisfaction, product quality etc? How can such strategic management processes be improved?

Figure 3.1 Three sets of questions for a review of HR strategy in a firm

As the three sets of questions in Figure 3.1 make clear, this kind of analysis is far from straightforward. In many firms, a major effort in data gathering would be needed to answer the questions. A study of these questions nearly always reveals the need for better ways of measuring HR performance in the firm, as advocates of the 'balanced scorecard' have noted (Kaplan and Norton 1996: 144–5). There is still a marked tendency in firms to treat HR practices as ends in themselves and a lot of work is needed to map their links to one another, to other management activities and to important performance variables (an issue we explore in Chapters 8 and 11). The second question involves not only data analysis but some kind of theory about how to make HRM more effective in the firm, about how to improve the strategic management of human resources in it. This is the nub of the debate between advocates of 'best fit' and 'best practice', which is the focus of this chapter.

Before exploring this interesting debate, we should note some complications in our conception of human resource strategy. First, as noted in our definition of HRM in Chapter 1, we should not assume that HR strategies are uniform within firms. It is wrong to conjure up the image of HR strategy as a single set of critical practices for managing work and people in the firm. The vast bulk of the evidence suggests otherwise: firms rarely adopt a single style of management for all their employee groups (see, for example, Osterman 1987, Pinfield and Berner 1994, Harley 2001). It is better to think of HR strategy as a cluster of HR systems, as depicted in Figure 3.2. Questions of social legitimacy and internal political pressures mean there

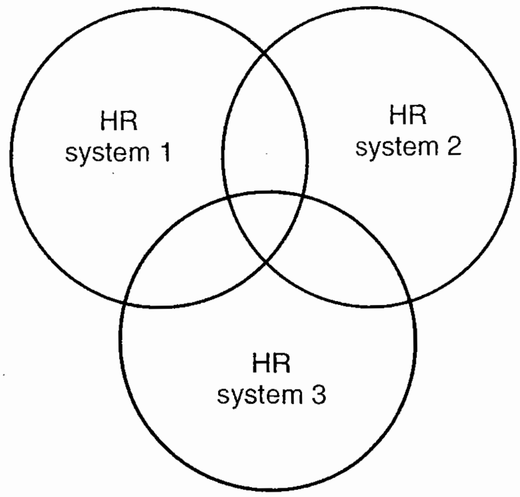


Figure 3.2 An organisation's HR strategy as a cluster of HR systems

will usually be some overlaps in HR practices across HR systems within an organisation: for example, there may be common ways of handling leave entitlements and common ways of dealing with personal grievances. There are some companies in which opportunities for shareholding are opened to all employees, and so on. However, there are also substantial differences across HR systems. Each HR system is aimed at organising the work and managing the employment of a major workforce group. It is quite common for there to be one HR system for management, another for core operating staff, and one or more models for support workers of various kinds. This is something we explore more fully in Chapters 4 and 8.

Secondly, we have been talking as if the firm is a single business unit. As explained in our definition of strategy in Chapter 2, this is the easiest way to develop theory in strategic management. Reality, however, is much more complicated. Difficulties arise with multidivisional firms, operating across a variety of market or industry contexts. To what extent should lower levels of management be free to adapt HR strategies suited to their unique contexts? If they do this (and it is common), is there a role for corporate HR strategy in such firms and, if so, what should it be? Can corporate HR strategy provide some form of 'parenting advantage' which adds value to what business units can achieve without corporate influence? This question is explored in Chapter 10.

A third complication arises with international firms (as many multidivisional firms are). Where firms compete across national boundaries, in what ways should they adapt their HR strategies to local conditions? How should HRM be organised when the firm operates in more than one society? This is one of the key concerns of the field of international HRM

Human resource (HR) strategy:

- consists of critical goals and means for organising work and managing people
- inevitably affects the firm's chances of survival and its relative performance
- is made by the whole management structure and not simply by HR specialists (where they exist)
- is likely to be partly planned and partly 'emergent' in management behaviour
- is typically 'variegated' – while there are some overlaps, firms typically have different HR systems for different employee groups (e.g. different models for management, for core operating workers, and for support staff)
- like strategy generally, is easiest to define at the business-unit level
- is more complex in multidivisional firms in which different business units face different market or industry contexts and in which there are political interactions between the corporate and the divisional and business-unit levels
- is more complex in firms that operate across national boundaries because of the impact of different societal contexts

Figure 3.3 Key characteristics of human resource strategy

(e.g. Brewster and Harris 1999, Evans, Pucik and Barsoux 2002, Dowling and Welch 2004). We address this problem in the course of this chapter and extend our analysis in Chapter 10. Overall, our understanding of HR strategy is summarised in Figure 3.3.

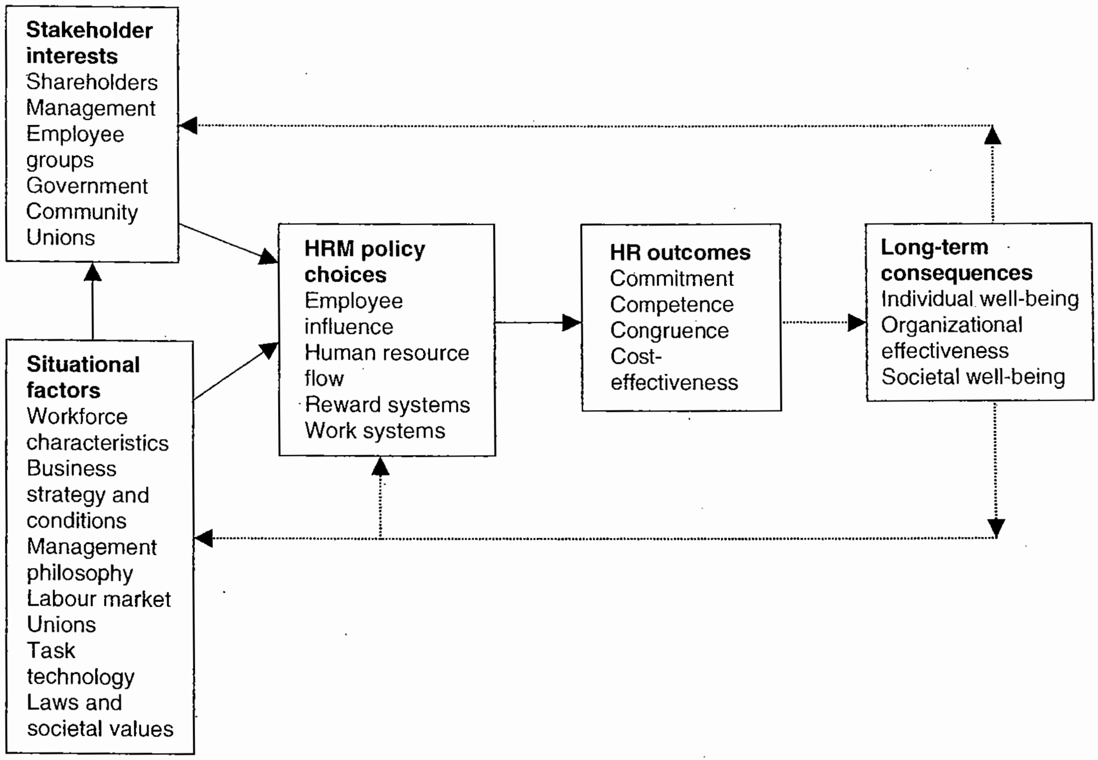
On the basis of these definitions and clarifications, we are now in a position to examine the debate between 'best fit' and 'best practice' in strategic HRM.

Strategic HRM: the 'best fit' school

As indicated in our chapter introduction, the 'best fit' or contingency school of strategic HRM argues that the variety we see in HRM across hierarchical levels, occupations, firms, industries and societies implies that managers inevitably tailor their HRM to their specific context. Furthermore, they are wise to do so: firms under-perform and may fail if they do not adapt to their environment. The 'best fit' literature contains both broad analytical models and more specific theories. In this section of the chapter, we will outline these and consider the research evidence and conceptual critiques.

'Best fit': broad analytical frameworks

As was widely noted in the late 1980s and early 1990s (e.g. Poole 1990, Boxall 1992), the Harvard framework (Beer *et al.* 1984) provided one of the first major statements in the HRM canon on the issue of how managers should



Source: Beer *et al.* (1984)

Figure 3.4 The Harvard 'map of the HRM territory'

make strategic choices in HRM (Figure 3.4). In this analytical framework, managers in firms are encouraged to set their own priorities in HRM based on a consideration of stakeholder interests and situational factors. HR outcomes, in turn, are seen as having longer-term impacts on organisational effectiveness and on societal and individual well-being.

In terms of our understanding of HR strategy, the most important chapter in the Harvard text was the last one in which the authors sought to integrate the huge range of HR choices that might be adopted by considering the differences between 'bureaucratic', 'market' and 'clan' models of HRM, a set of categories that draws on the work of Ouchi (1980). The bureaucratic model is seen as concerned with 'control and efficiency', using traditional authority and such staples of personnel management as job descriptions and job evaluation to provide order and equity (Beer *et al.* 1984: 179). This HRM approach is regarded as relevant to markets with stable technology and employment levels. The market HRM approach, on the other hand, aims to treat employees more like sub-contractors, fostering short-term exchanges and performance-related pay systems. This is seen as relevant to fast-changing environments such as high-fashion merchandising, advertising and professional sports (*ibid.*: 180). Finally, clan HRM systems are seen as building more diffuse kinship links, fostering shared values, teamwork and strong commitment in organisations seeking 'long-term adaptability' (*ibid.*: 181). This is seen as relevant to firms pursuing quality and innovation. Combining aspects of two or even three models is seen as useful when facing complex environments (*ibid.*: 184).

While the links between HRM goals and the firm's business strategy and environment are only very briefly sketched in the book, the main message is that HR strategies can, and should, vary based on contextual factors and that firms should aim to develop a relatively consistent style. Beer *et al.* (1984: 178, 184) argue that 'HRM policies need to fit with business strategy' and with 'situational constraints' while also envisaging a role for management values (*ibid.*: 190–1). The goal of fit with broader business strategy and context, followed by internal consistency in HR choices, was argued to be the essential purpose of HRM.

The Harvard framework was followed by a range of similar models (e.g. Dyer and Holder 1988, Baron and Kreps 1999). In Dyer and Holder's (1988) framework, management is advised to aim for 'consistency between HR goals . . . and the underlying business strategy and relevant environmental conditions' (with the latter, like the Harvard framework, including influences such as labour law, unions, labour markets, technology and management values). In Baron and Kreps's (1999) framework, managers are advised to consider the impact of 'five forces' on HR policy choices: the external environment (social, political, legal and economic), the workforce, the organisation's culture, its strategy and the technology of production and organisation of work. This advice is not offered in a simple, deterministic fashion: managers still have choices (such as where to locate plants in manufacturing) but once some choices are made, certain environmental consequences do follow: so, if you locate in the USA, rather than Honduras, US laws, culture and workforce characteristics inevitably come into play. The goal of achieving internal consistency in whatever model of HRM is adopted – otherwise known as 'internal' or 'horizontal' fit – is then strongly emphasised by Baron and Kreps (1999).

Like the Harvard authors, if not more emphatically, Dyer and Holder (1988) and Baron and Kreps (1999) argue for a contingent understanding of HR strategy or the necessity of moulding HRM to the firm's particular context. Dyer and Holder (1988: 31) conclude that 'the inescapable conclusion is that what is best, depends'. Baron and Kreps (1999: 33) assert that 'in HRM, there is no one size that fits every situation' and argue that no model should be adopted unless the benefits outweigh the costs. None of these frameworks is inherently anti-union or takes the view that HRM is restricted to one style. The message in terms of HR strategy is one of fit or adaptation to the firm's broader business goals and its environmental context.

'Best fit': research and critique

The broad frameworks just described have been important as analytical models that help managers to identify options and make choices in their own environments. In terms of theoretical development, however, progress depends on picking particular variables in these frameworks and subjecting them to formal research (typically through surveys and/or case studies). Theorists tend to be motivated by a desire to reduce complexity and seek to build more tightly defined, 'parsimonious' models.

In one of the earliest sources, Baird and Meshoulam (1988) claimed that HR activities, like structure and systems, should fit the organisation's stage of development – something they call 'external fit' and which others sometimes call 'vertical fit'. Developed from in-depth case studies, their argument is that while start-up firms exhibit more informal, more flexible styles of HRM, more sophisticated, professionalised styles become necessary to handle greater complexity as firms become larger and more mature.

Does research support this proposition? There is clearly strong support for the idea that the size of an organisation makes a major difference to the kind of HR policies and practices management adopts. In a major review of research on contextual influences in HRM, Jackson and Schuler (1995) show that larger organisations are more likely to have 'due process' procedures, use more sophisticated staffing and training practices and have more developed 'internal labour markets' (i.e. a structure of more specialised jobs and more extensive career hierarchies which provide greater scope to promote and develop people from within), among other features. None of this will come as a surprise to anyone who has worked in both small and large firms or in the same organisation which started small and became much bigger. Larger firms inevitably need more formalised practices to manage larger numbers of people and to cope with more diverse occupational groups. Individuals being recruited to larger organisations are likely to be screened through multiple channels and will often ask to see a job description and ask questions about how their pay fits into the job hierarchy. Those joining a small firm are much more likely to agree the details directly with one person – the owner – and are much less likely to see formal documentation.

There is also research support for the idea that the HR problems managers respond to vary across organisational life-cycle stages. For example, in a study of 2,903 small to medium-sized US family firms, Rutherford, Buller and McMullen (2003) find that managers in firms experiencing high rates of growth consider employee development their biggest problem but perceive much less difficulty with employee retention. This is not surprising: fast growth can make a company exciting to join but stretches managers in terms of trying to develop the employee capabilities they need. In comparison, firms not experiencing growth have the greatest difficulty recruiting. These could be failing firms which are stymied in terms of their ability to grow precisely because no one wants to join them. We think life-cycle theory is an important line of analysis in HR strategy and explore it more fully in Chapter 9.

Theoretically, however, most models of 'best fit' in HRM did not follow Baird and Meshoulam's (1988) emphasis on adapting HRM to organisational size and stage of development but argued that the key goal was to achieve fit with the firm's competitive strategy. The notion of external or vertical fit in strategic HRM is more often used in this sense. In this line of thinking, the basic recipe for strategic HRM involves bringing HR strategy into line with the firm's desired position in its product market. There are some complexities here and we need to be careful with the language we use. First, when theorists advocate fitting HR strategy to competitive strategy, they are usually talking about matching HR practices to the competitive strategy of a *particular business unit* which operates in a particular industry. This should not be confused with the role of HRM in the corporate strategy of a parent company, something we discuss in Chapter 10. Second, theorists are generally talking about how management should manage *core operating workers*: those most intimately involved in making the product or providing the service. Theoretical models in this area are not generally about how managers themselves should be managed, which is a different question altogether (Boxall 1992, Boxall and Gilbert 2007).

The most heavily cited work on external fit in strategic HRM is associated with a theoretical model developed by Schuler and Jackson (1987). This model, and a subsequent stream of papers (e.g. Schuler 1989, 1996), has proven very influential for the way it spells out the connections between competitive strategies, desired employee behaviours and particular HR practices. Schuler and Jackson (1987) argue that HR practices should be designed to reinforce the behavioural implications of the various 'generic' competitive strategies defined by Porter (1985). A giant in the strategy field, Porter (1985) advises firms to specialise carefully in competitive strategy (Figure 3.5). In his view, firms should choose between cost leadership (achieving lowest unit costs in the industry), differentiation (based, for

Competitive scope		Competitive advantage: Lower cost	Competitive advantage: Differentiation
	Broad target	Cost leadership	Differentiation
	Narrow target	Focus: Cost leadership	Focus: Differentiation

Source: Porter (1985)

Figure 3.5 Porter's typology of competitive strategies

example, on superior quality or service) or focus (a 'niche play' in cost or differentiation). They should avoid getting 'stuck in the middle' or caught in a strategic posture which is mixed – neither fish nor fowl, one might say.

Schuler and Jackson (1987) used Porter's framework to argue that performance will improve when the HR practices in a business mutually reinforce competitive strategy (Figure 3.6). To arrive at a desirable set of HR practices, Schuler and Jackson (1987) argue that different competitive strategies imply different kinds or blends of employee behaviour. These inferences are drawn from a major review of existing literature. If, for example, management chooses a competitive strategy of differentiation through continuous product innovation, this would call for high levels of creative, risk-oriented and cooperative behaviour. The company's HR practices would therefore need to emphasise '. . . selecting highly skilled individuals, giving employees more discretion, using minimal controls, making greater investment in human resources, providing more resources for experimentation, allowing and even rewarding occasional failure, and appraising performance for its long-run implications' (Schuler and Jackson 1987: 210).

On the other hand, if management wants to pursue cost leadership (i.e. to attain lowest unit costs in the sector), the Schuler and Jackson model implies something a lot less attractive to the average employee. It suggests designing jobs which are fairly repetitive, reducing employee numbers and wage levels, training workers as little as is practical, and rewarding short-term results.

Although competitive posture can be complex and typologies such as Porter's can oversimplify it (Murray 1988, Miller 1992, Cronshaw, Davis

Desired competitive strategy
(cost leadership, differentiation or focus)

↓

Required employee skills and behaviours
(for example, extent of predictability in behaviour, degree of teamwork, extent of concern for quality, propensity for risk taking)

↓

Supportive HR practices
(choices in staffing, appraisal, remuneration, training etc)

↓

HR outcomes
(employee skills and behaviour relevant to desired competitive position)

Source: Adapted from Schuler and Jackson (1987)

Figure 3.6 Linking HR practices to competitive strategy

and Kay 1994), the fundamental premiss is that business performance will be better when there is alignment between competitive strategy and the management of core operating workers inside the business. Clearly, there are two issues here. First of all, do managers relate their HR policies and practices to their competitive strategies? Secondly, are they wise to do so? In line with our emphasis on 'analytical HRM' (Boxall, Purcell and Wright 2007b), our task first of all is to answer the descriptive question: what do managers in firms actually do? We will come back to the question of whether they are wise to behave in a certain way when we examine research and critique on the notion of 'best practice' later in the chapter.

In answering the first question, we need to distinguish between firms operating in service sectors and those operating in manufacturing. This is because research suggests that the links between competitive strategy and HRM are stronger in services than they are in manufacturing. A leading study in services is Batt's (2000) analysis of four market segments in call-centre work in the US telecommunications industry. These segments vary in terms of the complexity and value of the employee–customer interaction. At the low end, there are low-margin interactions of short duration, typically with predetermined scripts and with strong technological monitoring of call-centre workers. At the high end, there are high-margin, low-volume interactions relying far more on employee skill and discretion where technology is much more of an enabler than a monitor. One statistic alone is telling: at the low-margin end, operators deal with an average of 465 customers per day, in the two mid-range segments they deal with 100 and 64, and at the top end they deal with an average of 32 (Batt 2000: 550). Batt (2000) finds significant differences in the contours of HR strategy across these market segments with skill requirements, the degree of discretion allowed to employees and pay levels all higher among firms competing at the high-margin end of the call-centre market.

Studies of specific service industries like this one on call centres generally support the notion that HR strategy is closely related to competitive differentiation in services. Other compelling examples can be found in US studies of rest homes (Eaton 2000, Hunter 2000) where HR investments (in training, pay, career structures and staffing levels) are greater in firms that target higher-value niches and in studies of hotels where those at the luxury end invest more heavily in their staff in order to deliver superior customer service (Lashley 1998, Haynes and Fryer 2000, Knox and Walsh 2005). A close relationship between competitive strategy and HRM can also be discerned in professional services. In their study of Dutch and German management consultancies, Dooreward and Meihuizen (2000) discern two broad strategic types: firms oriented to efficiency and firms oriented to expertise. The former offer 'standard solution(s) to familiar problems in an efficient way' while the latter promote 'an individual professional's ability to offer new, client-specific solutions to new, unusual problems' (Dooreward and Meihuizen 2000: 43). These are tendencies, not hard and fast categories, but they are associated with differentiation in HR strategies. Expertise-driven firms try to hire highly intelligent 'free spirits' and retain them through challenging, high-discretion work, while those oriented to efficiency have a much more bureaucratic model of HRM. *

When it comes to firms operating in services, then, research suggests there are quite strong links between competitive positioning and patterns of HRM. What about manufacturing? As indicated in our discussion of cost-effectiveness in Chapter 1, we cannot really answer this question without considering the role of technology. Unlike service workers, employees in manufacturing do not generally deal directly with customers: instead, they work with machinery to make products (Combs *et al.* 2006). As a result, how managers try to organise HRM for a manufacturing firm's core workers tends to be related to technological choices, which form a key part of operating strategy (Purcell 1999). Snell and Dean's (1992) study of 512 US metal manufacturing plants shows that heavier investments in individual employees, including more extensive screening and training practices, are associated with plants using advanced technologies such as computer-integrated manufacturing systems. When a manufacturing firm has expensive investments in advanced technology, which requires highly skilled and careful handling, managers are likely to spend money building employee competencies and fostering employee commitment, *even if* their competitive goal is to achieve the lowest unit costs in the industry (Steedman and Wagner 1989, Godard 1991). In effect, where there are high 'interaction risks' between specialised capital assets (in which the firm has major 'sunk costs') and the behaviour of workers, managers are likely to adopt employment models that foster greater expertise and buy greater loyalty and care. The value of such investments, however, is likely to be questioned by managers when the industry they are operating in is characterised by a stable, low-technology environment (Kintana, Alonso and Olaverri 2006). Labour-intensive, low-tech manufacturing is much more likely to be associated with pressures to outsource production to low-wage countries, as we shall explain in Chapter 5.

The notion of fitting HR strategy to competitive strategy, therefore, stands up better in services than it does in manufacturing but in both cases we see contingencies in play. Whether it is about organisational size, life-cycle stage, competitive strategy or technology (or all of these), we are seeing a process of adaptation to context. The importance of fit is further emphasised when we consider the characteristics of employees and the state of labour markets (e.g. Boxall 1996, Lees 1997). Firms with complex workforces often have multiple HR systems: they may adopt one model for managing their management and professional cadres, another for core operating staff and yet another for support workers (e.g. Pinfield and Berner 1994, Kalleberg *et al.* 2006). Some of these differences reflect different union contracts and some reflect differences in the degree to which the type of labour is critical to production (e.g. Osterman 1987, Godard 1991). When economic growth is strong and labour markets are tight, we see firms adjusting their models of HRM to cope: managers tend to respond with more generous employment offers and more motivating conditions (e.g. Jackson and Schuler 1995).

Furthermore, as explained in Chapter 1, labour regulation, social norms and national educational/training institutions have a major impact on the process of adaptation to context that takes place in a firm's HRM, as emphasised in reviews and studies conducted by Tayeb (1995), Gooderham, Nordhaug and Ringdal (1999), Paauwe and Boselie (2003, 2007), Rubery and Grimshaw (2003), Pudelko (2006), Winterton (2007) and many others. In respect of social norms, there is now a major body of literature on international and cross-cultural HRM which underlines the way in which different cultures affect HR practices. All societies contain one or more major cultures: deep-seated value structures and belief systems that reflect the ways groups of people have learnt to live and work together. In a major review of this literature, Aycan (2005) describes a wide range of research showing that practices in such areas as selection, performance appraisal and pay are affected by such dimensions of culture as the extent to which individualism is fostered over collectivism and the extent to which it is considered legitimate to challenge authority. In Anglo-Saxon and in Dutch cultural contexts, it is common to consider people as individuals who can be selected, evaluated, rewarded and dispensed with on their individual merits but such assumptions risk failure in more collectivist cultures where an over-emphasis on individuals can threaten group harmony and challenge important status differences. In a celebrated study, *Riding the Waves of Culture*, Trompenaars and Hampden-Turner (1997: 4–5) comment that:

cultural impact

> Pay-for-performance . . . can work out well in the USA, the Netherlands and the UK. In more communitarian cultures like France, Germany and large parts of Asia it may not be so successful, at least not the Anglo-Saxon version of pay-for-performance. Employees may not accept that individual members of the group should excel in a way that reveals the shortcomings of other members. Their definition of an 'outstanding individual' is one who benefits those closest to him or her . . . .

Managers operating within only one society, especially a monolingual one, can be blind to much of this but those working in firms operating across national boundaries soon become aware of it. What do they do? How do they cope? The evidence suggests that managers in multinational firms adapt to national institutions and cultural norms while still seeking to take advantage of their proprietary technologies and production systems to make desired rates of economic return.

This process is well illustrated in a study by Doeringer, Lorenz and Terkla (2003) of the HR practices of Japanese multinationals with transplants in the USA, the UK and France. These plants are required to meet Japanese productivity benchmarks and usually have Japanese managers appointed to them to lead and monitor local management. Examination of the ways they have sought to organise work and employment over the last 20 to 30 years provides a kind of 'natural experiment' on the interaction between HRM and societal institutions and cultural norms. Doeringer *et al.* (2003: 271) conclude that there is 'almost no evidence' of Japanese management practices 'being transferred intact to Japanese transplants'. What they do show, however, is that *work* processes associated with Japanese quality-oriented production systems (such as problem solving in quality circles, teamworking, and worker responsibility for quality) are much more likely to have been diffused than *employment* practices associated with pay, skill, promotion systems and the like. This makes a lot of sense: the transplants need work processes that are consistent with the economics of production in the industry but can be much more flexible in relation to employment practices. The latter are much more driven by national laws, by union contracts and by established social attitudes.

In the UK, for example, Japanese firms have learnt to work with a higher level of unionisation than they find in the USA and have been found to adapt to British attitudes to bonus systems (which often favour simpler and 'less subjective' systems to those found in Japan) and to the status differences between technicians and production workers. In France, among other things, Japanese firms have learnt to accept that supervisors will typically be appointed directly to a position of responsibility based on their personal achievements in France's national system of educational qualifications and without any prior experience. The French elite model of education, with all its hierarchical rungs, is not easily sidestepped. This contrasts sharply with the Japanese practice of promoting from within based on extensive shopfloor experience.

Overall, Doeringer *et al.*'s (2003) study is useful in two ways. On the one hand, it helps us to see that national boundaries are far from impermeable barriers in HRM: multinational firms find ways of making money through transferring the core elements of production systems across them and, indeed, search out national regimes that will offer them better profit opportunities. On the other hand, national labour laws, cultural attitudes, educational systems and trade unions all act as filters in HRM, ensuring that a large measure of adaptation to the customary employment practices in the particular production locality takes place.

Readers will have noticed that we are back into complexity. The idea that we can develop parsimonious models of the factors that influence HR strategy is attractive but flawed: we do need to incorporate a wide range of factors. Bearing in mind our discussion so far, but trying to keep complexity to a minimum, Figure 3.7 offers our view of the range of factors that research suggests affect HR strategy in a firm (more accurately, a business unit in a firm). For convenience, it organises the relevant factors into two broad categories. Economic factors, both inside and outside the firm, do influence many of the choices managers make in HR strategy. Here we include the firm's competitive strategy but we also include the economics of production in the industry concerned, including the kind of technologies involved. We then include the firm's size, structure and life-cycle stage, general economic

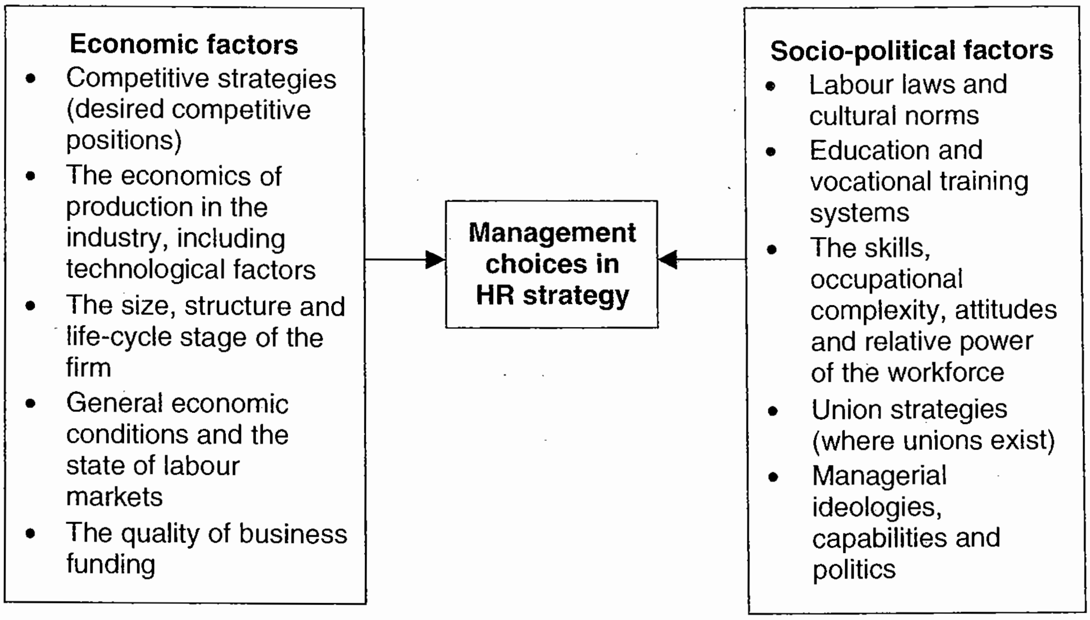


Figure 3.7 Major contextual factors affecting management choices in HR strategy

conditions, the state of the labour market, and the quality of the firm's funding. The figure also recognises that HR strategy will be shaped by a range of socio-political factors. Labour laws and cultural norms exert a major influence, as do national educational and training systems. Very importantly, employee skills, occupational complexities, attitudes and power must be considered, as we have just noted in the case of Japanese transplants in the West. Employees are rarely passive: they will not necessarily buy into management policies if they offend cultural norms or if they feel betrayed by past events. In any initiative in HRM, likely reactions from current and potential employees ought to be considered, and an assessment made of union strategies where unions exist. Management itself has issues to do with ideology, capability and politics which inevitably affect HR decision making. As noted in Chapters 1 and 2, management does not necessarily make a good set of choices in HRM: limitations in ideologies and cognitive abilities and debilitating politics within the management structure will lower performance and may lead to outright failure.

Before leaving the picture offered in Figure 3.7, a key point should be emphasised about it. Anyone deciding to use it as an analytical framework would be advised to bear in mind, as we argued in Chapter 1 and above, that firms have multiple goals in HRM. It is unwise to treat the notion of 'fit' as simply about alignment between HRM and economic performance. Managers do need to achieve healthy levels of cost-effectiveness. They must survive in markets where they compete for revenues and face cost pressures while public sector agencies must work within government-imposed budget constraints. But, at the same time, organisations need an adequate fit with the socio-political environment to achieve acceptable levels of social legitimacy. Both economic and social goals should be 'bottom lines' for formal organisations. They are priorities that ought to be worked on simultaneously. Furthermore, firms that want to survive into the longer run need some HR practices that will enhance organisational flexibility, as Wright and Snell (1998) emphasise. HR strategy should give effect to the firm's current competitive goals, by recruiting, developing and retaining people with the sort of skills needed in the firm's industry. However, it is also highly desirable that HR strategy encourages staff to think 'outside the square', that it helps to build the sort of skills needed for business capabilities in the future. Managers, at the very least, should not be managed in such a way that they are locked into only one kind of strategy (Boxall 1992). In effect, the firm needs multiple fits with its environment.

Strategic HRM: the 'best practice' school

Those who advocate the 'best practice' approach start from a different premiss to contingency theorists. In best-practice thinking, a universal prescription is preferred. The staunchest advocates of best practice argue that all firms will see performance improvements if they identify and implement best practices. This brings quite a different understanding of the problem of integrating HR strategy with the rest of business strategy. Integration with strategic management, in this conception, is about top management identifying the 'leading edge' of best practice, publicising commitments to best practices, measuring progress towards them and rewarding lower-level managers for implementing them consistently.

Before proceeding, we should note an initial difficulty with this school of thought: a lot of writing on 'best practice' moves fairly quickly into prescription without making its basic assumptions explicit. In a classic critique of the 'best practice' genre in what was then personnel management, Legge (1978) asked the question: for *whom* is 'best practice' best? *Whose* goals or interests are being served? If 'best practice' serves both shareholder and worker interests, it is hard to object to it.[2] Similarly, if we agree that

2 Although consumers and environmentalists might still object to some practices (for example, when a firm is making high profits and paying high wages but prices are extortionate or the firm is a bad polluter).

some practice is bad for both parties and should be avoided. But what if a practice is good for corporate returns but bad for workers? This is often the case with downsizing: sharemarkets seem to rate companies more highly for doing it, a cold comfort for the workers laid off and for those left behind whose workload may just have become much more stressful. When this kind of trade-off emerges, do workers get a real voice in deciding the issue (Marchington and Grugulis 2000)? Best-practice models are typically silent on these sorts of tensions. Those emanating from the United States do not typically mention or argue for the sort of strong employee voice institutions seen in Europe, such as unions and works councils, which can help to protect employee interests when trade-offs occur. This point is explored in Chapter 6.

Furthermore, what if a practice is good for executives but not good for either shareholders or waged workers? This is the problem, arguably, with many exit packages used for senior executives dismissed or 'let go' because of disappointing performance: *they* benefit but the company and its other employees typically lose out. In fact, the whole area of executive remuneration – staying or going – has become controversial, particularly in the USA. As Kochan (2007: 604) explains, American 'CEO pay relative to the average worker (has) exploded from a ratio of 40:1 in the 1960s and 70s to over 400:1 today'. This trend may be best for senior US executives but many others, both within the USA and looking at US practices from the outside, regard the trend as an aspect of American HR practice which is socially divisive and undesirable.

How are we going to proceed with a discussion of 'best practice' in the light of the problem of interest conflicts? Given that explicit assumptions are largely lacking, we need to consider implicit ones. In our view, the most common implicit assumption in the 'best practice' literature is that 'best practices' as those that enhance shareholder value. We think, however, that a useful test of any best-practice claim is the extent to which it also serves employee interests. One would not expect to see a perfect alignment of interests but it is likely that the most sustainable models of HRM over the long run are those that enjoy high levels of legitimacy within the firm and in wider society. On the basis of this caveat, we step gingerly forward.

'Best practice': micro foundations and macro models

Despite their tendency to gloss over basic assumptions, studies of individual best practices within the major categories of micro HRM – such as selection, training and appraisal – do have a very long tradition in

Western psychology and management theory. During both World Wars, for example, a lot of British and American energy went into improving practices for officer selection and also into the training and motivation of (non-combatant) production workers (Eilbert 1959, Crichton 1968). The academic discipline of Industrial Psychology gained great momentum as industrial psychologists studied the prediction and development of human performance. In the area of employee selection, for example, they usefully compared different practices for selecting individual employees (such as ability tests, personality inventories, 'biodata' obtained through application forms or from an individual's curriculum vitae ('cv'), references, and various types of interviews), assessing their validity in terms of subsequent performance (usually as rated by supervisors).

Based on this tradition of work, some micro aspects of best practice *are* widely acknowledged by researchers and practitioners (Delery and Doty 1996: 806, Youndt *et al.* 1996: 838). In the selection area, hardly anyone would advocate unstructured interviewing over interviews carefully designed around job-relevant factors. Similarly, no one would advocate input-based performance appraisal for senior executives (such as measures of timekeeping) over processes that examine results achieved (such as profit generated and growth in market share) or the kind of behaviour demonstrated in working with colleagues and clients. The selection and performance appraisal fields are two areas where we can point to an extensive body of research that assists management to carry out these processes more effectively. While there are still major debates and a raft of new problems, as recent reviews attest (Latham, Sulsky and MacDonald 2007, Schmitt and Kim 2007), there is quite a lot of agreement on what constitutes 'bad' or 'stupid' practice when we talk about practices in selection and performance appraisal.

At least, this is a fair generalisation *within* our specific cultural mind-set or 'blinkers'. We are talking here about selection and appraisal within a Western cultural frame of reference, dominated by US and British research. In this cultural tradition, we are generally comfortable with the idea that management should try to predict, appraise and reward *individual* performance (Trompenaars and Hampden-Turner 1997). In fact, a lot of high-performing employees will be angry and disloyal if their individual merit is not recognised (e.g. Trevor, Gerhart and Boudreau 1997). The sort of research discussed earlier helps us to remember, however, that such a high emphasis on individualism may be considered counter-cultural or subversive in societies which place a heavier emphasis on group identification and interpersonal humility. As a result of this, many industrial psychologists nowadays will acknowledge that cultural factors are important and will identify themselves as working on a specific HR practice *within* a particular cultural domain. Within this tradition, they will usually focus on problems relating to a restricted micro domain of HRM, such as selection processes for executives or performance management techniques for sales representatives.

The interesting and difficult question we face in a book about strategic HRM is whether 'best practice' thinking can work on a more macro level, on the level of *HR systems* (Becker and Gerhart 1996), a notion that is critical to our understanding of HR strategy. As noted in the definitions at the beginning of this chapter, firms often have more than one HR system. HR systems are aggregations of HR practices that managers have built over time to organise the work and manage the employment of a major workforce group. In most theoretical models, the key group of workers is the firm's core operational workers: the largest category of workers who make the products or deliver the services. Research often tries to identify what proportion of this core group is covered by a particular set of practices (e.g. Osterman 1994, 2000). A key theme that these models share with the literature on 'best fit' discussed above is the idea that HR systems should be synergistic (e.g. Dyer and Reeves 1995, Delery and Shaw 2001): that practices should be 'bundled' or clustered to reinforce desired effects.

There are, in fact, writers who have set out to offer models at this higher, more systemic level. In the United States, one model that has attracted a high profile is associated with Jeffrey Pfeffer's (1998) seven practices 'for building profits by putting people first', shown in Figure 3.8.

What comes through Pfeffer's list is a desire to carefully hire and develop talented people, organising them into highly cooperative teams, and employing them in a way that builds their commitment over the long run (through high pay, employment security and as much egalitarianism

1. Employment security
2. Selective hiring
3. Self-managed teams or teamworking
4. High pay contingent on company performance
5. Extensive training
6. Reduction of status differences
7. Sharing information

Source: Pfeffer (1998)

Figure 3.8 Pfeffer's 7 practices

and openness as possible). Recruiting and retaining talented, team-oriented, highly motivated people is seen to lay a basis for superior business performance or competitive advantage. This is one well-known model which has been widely propagated through books and conferences.

It does not, however, stand up well on a reality test – that is, when we look at the actual HR strategies of US firms. There are cases of individual firms aiming to behave in the way Pfeffer advocates but when we observe the general trends in pay in the US, noted above, the trend is actually towards executive elitism and away from the egalitarianism that Pfeffer (1998) advocates. Similarly, the US data on the diffusion of HR practices suggest that employee insecurity grew in the 1990s and teamworking, present in around 40 per cent of firms with at least 50 employees, did not expand (Osterman 2000, Batt 2004). This is not, however, the point with best-practice models. Pfeffer (1998) is making a normative argument, an argument about what *ought* to be, not what is. He is challenging the wisdom of the contingency position we outlined in the first half of this chapter.

There is now a major body of literature in which various academics have attempted to define macro models of best HR practice. This literature is very diverse and at least three terms have been employed. One stream of literature stems from the work of the Harvard academic, Walton (1985), and is commonly called 'high-commitment management' (HCM) (Wood 1996). As this implies, the emphasis in this model is on winning employee commitment to the organisation's goals through positive incentives and identification with company culture rather than trying to control their behaviour through routine, short-cycle jobs and direct supervision. Another school of thought traces back to Lawler (1986) and is concerned with 'high-involvement work systems' (HIWSs). Here, the emphasis is on redesigning work to involve employees more fully in decision making and on the skill and motivational practices that are needed to support this process (e.g. Vandenberg, Richardson and Eastman 1999). A third term, 'high-performance work systems' (HPWSs) has sparked widespread interest over the last 10 to 15 years and is now the terminology many people use when they talk of 'best practice' models of HRM. Cappelli and Neumark (2001) trace the term's popularity to an influential public report, *America's Choice: High Skills or Low Wages!* (Commission on the Skills of the American Workforce 1990). This report, concerned about the fate of US jobs and highly critical of traditional work organisation, argues the case for substantial investment in 'high-performance work organisation' and higher skills. HPWSs are commonly understood to involve reforms to work practices to increase employee involvement in decision making and companion investments in employee skills and changes to performance incentives to ensure they can undertake these greater responsibilities and want to do so (Appelbaum *et al.* 2000). They constitute an attempt to roll back the kind of 'Taylorist' or highly specialised, de-skilled jobs which were a key part of the US system of mass production (something we will discuss further in Chapter 5).

'Best practice': research and critique

What, then, does research and theoretical critique have to say about the best-practice approach to HR systems? The first and most obvious difficulty with the approach was pointed out early on by Becker and Gerhart (1996): there is too much diversity in lists of best practices. Pfeffer's (1998) list of seven practices is actually reduced from an earlier list of 16 practices (Pfeffer 1994) and there have been major variations between theorists not only in the number of practices needed for an HR system but in which ones to include. A big part of the problem, as Becker and Gerhart (1996) and Purcell (1999) point out, is that many theorists simply list practices and do not specify the pathway or intervening variables through which they are supposed to improve business performance.

Leaving aside definitional issues, the major objection to the idea of a universally valid set of best HR practices is the socio-cultural one. As emphasised in our review of the best-fit literature, there is overwhelming research evidence that firms adapt their HR practices to their unique contexts. And this is the key point: they are *wise* to do so because social legitimacy is an important aspect of a firm's multidimensional HR performance. Some practices – such as an employee grievance procedure and forms of consultation – are legal requirements in countries like the UK. Governments have decided they should form part of employer practice for ethical and political reasons. Simply on the fact of societal regulation of labour markets, we must discount the idea that there can be universally valid lists of best practice.

Similarly, as Trompenaars and Hampden-Turner (1997) and many others remind us, there really is a problem with trying to specify a set of cross-culturally best HR practices because there are significant differences in cultural values. Even if we are talking about the same practice, such as selection interviewing, the application of it can vary very significantly across cultures. In New Zealand, for example, where government policy supports biculturalism (English and Maori are both official languages), it is not uncommon for Maori job applicants to request a *whanau* (family, kinship-supported) interview. In such an interview, family members and close friends speak to the merits of the job applicant because it is considered culturally offensive to indulge in self-praise or 'blow your own trumpet'. This is still a selection interview but it is not what American or British writers think of when they use the term.

As Becker and Gerhart (1996) imply, we would be wise to dispense with the idea that there can be lists of HR practices that are universally relevant. A more appropriate line of thinking is to accept that there will always be socio-cultural variations in how HRM is organised and look to systems or configurations of HR practices that have a kind of 'functional equivalence' or 'equifinality' (Delery and Doty 1996). In other words, it is possible to envisage systems that are designed to serve certain underpinning principles (such as supporting high levels of employee involvement in decision making) but which recognise variety in the actual practices that are used in different industries and different societies to express these principles.

In effect, Appelbaum and Batt (1994), whose work on models of high-performance work systems has been highly influential, adopt this kind of approach. When looking beyond the USA for HPWS models, they identify four that are worth discussion: Swedish 'socio-technical systems', Japanese 'lean production', Italian 'flexible specialisation' and German 'diversified quality production'. Each of these models (all of which have internal variations) are embedded in national laws, customs and management styles that vary from those of the USA. Just comparing three of these countries shows major differences (Figure 3.9). As Appelbaum and Batt argue, it is very difficult to transplant foreign models of high-performance work systems to the USA

	USA	Japan	Germany
Unionisation	Very low level (below 10% of private sector workers)	Well-established enterprise unions in the large corporations	Strong, industry-based unions with key involvement in vocational training (among other areas)
Power sharing: institutions	Collective bargaining only in workplaces where there is majority worker support	Collective bargaining at set annual time ('shunto' – the Spring Offensive) plus well-established consultative processes	Industry-based collective bargaining plus very established tradition of codetermination (works councils and worker directors)
Management attitudes to joint governance	Apart from some cases of union–management 'partnerships', strong management resistance to any form of power sharing with unions	Japanese executives work with strong cultural norms that emphasise consultation and have often been officials in the enterprise union	German managers have adjusted to codetermination and, while grappling with flexibility problems, see advantages in consensual decision making

Sources: Taira (1993), Appelbaum and Batt (1994), Wever (1995), Towers (1997), Freeman (2007)

Figure 3.9 Some key differences in employment relations in three national contexts greater voice mech

because of these socio-political contexts. While they support the idea of greater voice mechanisms for US workers, they realise that this will have to be worked out in an American way. Most commentators on the USA recognise that the chances of major reform there towards European-style works councils or worker directors are extremely small (e.g. Towers 1997, Freeman 2007).

The line of argument found in the work of Appelbaum and Batt (1994) has now been reinforced with the publication of *Manufacturing Advantage* (Appelbaum *et al.* 2000). This book looks at US-style HPWSs in three industries: steel making, clothing manufacturing and medical electronics manufacturing. The studies in this book were all conducted at the plant level, identifying the particular HR practices used in each industry and measuring performance as objectively as possible in terms of the productivity indices relevant to the production processes concerned. They involve surveys of worker responses to HR reforms and do not rely on managerial reports of either company results or worker attitudes. In the main, the studies are supportive of the idea that both companies and employees have benefited where HPWSs have been implemented in these industries. There are other influential studies in the steel industry (Ichniowski, Shaw and Prennushi 1997, Ichniowski and Shaw 1999) and in automobile manufacturing (MacDuffie 1995). The latter studies have actually looked at HR systems in similar plants across countries (most notably comparing the US and Japan). This has enabled these studies to pick up principles of work design that have become common across the two countries while also observing culturally embedded HR practices that have not.

evidence

As Ichniowski and Shaw (1999) show in their study of US and Japanese steel plants, the US plants that have achieved similar operational performance to Japanese ones have done so through adopting the principles of employee-driven problem solving seen in Japanese plants while customising employment practices (such as selection tests and pay systems) in a way that is more compatible with US law and cultural norms. Their work indicates the way in which the debate about best practice needs to evolve: away from the idea that we can have 'exact replicas' of 'best practices' in all industries towards studies of HR systems or models that are established on a core set of common principles but inevitably show intelligent adaptation of specific practices across contexts.

way ahead

Do studies such as those by Ichniowski and Shaw (1999) in steel plants and MacDuffie (1995) in automobile manufacturing give us a basis for asserting that there are best HR practices which will deliver higher value across all industries? No, they do not. These studies have the virtue of identifying the technologies, work processes and employment practices actually used in these industries and measuring the operational outcomes relevant to them. Understanding these distinctive features means we are less likely to assume they will work in other production environments. Appleyard and Brown (2001) underline this point in a study of the semiconductor manufacturing industry, contrasting the role of key occupational groups in this industry with that described by MacDuffie (1995) in automobiles and Ichniowski *et al.* (1997) in steel. In semiconductor production, problem-solving processes are dominated by highly skilled professional engineers and not by operators or technicians. The latter two occupational groups have an important role to play but the production process is more technologically intensive than in either steel or automobile manufacturing. While operators and technicians bring their knowledge into problem-solving activities, it is the involvement and skills of highly qualified professional engineers, including software and equipment engineers, which are decisive in finding solutions to production quality issues and breakdowns.

What the sets of studies we have just cited offer is a thorough examination of production and HR systems *in the field* and a rigorous assessment of whether new HR systems will pay off in terms of the economics of production *in that industry*. We can be pretty confident from studies of steel-finishing production systems that HR approaches which significantly enhance operator engagement in problem solving do improve machine up-time, quality and on-time delivery in this industry (Ichniowski *et al.* 1997, Ichniowski and Shaw 1999, Appelbaum *et al.* 2000). Within this particular environment, we can envisage improvements in shareholder value from these HR systems.

We can be more confident of such findings when research exercises use longitudinal methodologies that rule out or heavily discount other causes of performance variation. We have this with the steel industry studies just mentioned but it is far from easy to conduct this kind of study (Wright *et al.* 2005, Gerhart 2007). The only research we have that addresses the cost-effectiveness of HPWSs across a broad swathe of industries over time, and at a high level of rigour, is not flattering. This is the work of Cappelli and Neumark (2001), who use a national probability sample of US manufacturing establishments, assessing work practices and outcomes in firms in 1977 and then again some 20 years later. They conclude that HPWSs raise labour costs and that this implies that employees benefit through average remuneration rises, a picture reinforced by Osterman's (2006) study of the wage impacts of high-performance work organisation in US manufacturers. However, the statistical case for productivity benefits is weaker and the effects on profitability are unclear. In this context, firms would be wise to be sceptical about the economics of such systems, as Godard (2004) argues. They may well offer benefits but they will not be costless and the relationship between benefit and cost needs careful assessment in their *particular* context.

Conclusions: reconciling 'best fit' and 'best practice'

In the light of all this, where do things stand in the debate between 'best fit' and 'best practice'? If we want to identify a winner, it is obviously a clear win to the best-fit camp on the evidence of what firms actually do. Research on what firms do – descriptive research – makes life very difficult for the more extreme advocates of 'best practice'. It demonstrates that methods of labour management are inevitably influenced by context, including a range of economic and socio-political factors. And it also shows that there are very good reasons for adaptation to context including the needs to fit in with social values and to adapt to industry characteristics. Does this fact invalidate all best-practice thinking? Should the best-practice people pack up their tents and go home?

We think there are three ways in which it is possible to take some value out of the best-practice approach rather than discarding it completely. First, as we explained above, there are aspects of 'best practice' in the micro domains of HRM which are important. When companies commit to an executive selection process, for example, they are well advised to avoid invalid predictors and to learn from research on how to make the process effective for both the firm and the chosen candidate. Similarly, if they commit to performance appraisal, they are well advised to work hard on dealing with the 'rating errors' that research has shown will inevitably rear their ugly heads (Latham, Sulsky and MacDonald 2007). However, all of this takes place within a cultural and legal context. The relevant best-practice prescriptions in these domains have been developed in an Anglo-American frame of reference and should have regard to Anglo-American laws on discrimination and equal opportunity (e.g. Kossek and Pichler 2007).

Second, when we come to study specific industries, it is clearly possible to identify HR systems that embody a set of principles while fostering astute local adaptations in different production sites around the world. The research by Doeringer, Lorenz and Terkla (2003) and by Ichniowski and Shaw (1999), among others, shows the way in which management might emulate a core set of principles while cannily adapting to the specific context. Tayeb (1995: 600), for example, underlines the astute capacity of Japanese managers in Britain to implement their core philosophies on 'quality and built-in control . . . and harmonious employee-management relationships' while adjusting sensitively to 'British employees' cultural attitudes and values'. In a high-tech firm she studied, Japanese managers did not require 'the famous morning rituals performed in many Japanese companies . . . nor did they experiment with just-in-time or plant-based unions' (*ibid.*: 600). There is a role for identifying better HR systems within particular industry contexts as these evolve, bearing in mind that such systems will more likely be based on 'equifinality' (applying the same kind of principles and aiming to achieve similar performance outcomes) than on exact lists of practices.

The second point leads us to a third, more general one. Following Becker and Gerhart (1996), we think there is scope to identify some general principles in HRM and, in fact, much of this book is dedicated to this task. Building on the arguments in this chapter, it is helpful to make an analytical distinction between the surface level of HR policy and practices in a firm and an underpinning level of HR principles (Figure 3.10). This is not a perfect distinction but it helps to reconcile the tension between 'best fit' and 'best practice' in strategic HRM. We are most unlikely to find that any theorist's selection of best practices (the surface layer) will have universal relevance because context always matters. It is, however, possible to argue that at the level of the underpinning layer there are some desirable principles which, if applied, will bring about more effective management of people. In effect, it is possible to argue that, *ceteris paribus* (other things being equal), all firms are better off when they pursue certain principles in HRM (Youndt *et al.* 1996: 837, Edwards and Wright 2001). 3

Principl

What sort of principles do we have in mind? We have, in effect, already been arguing for three underpinning principles. First, both in this chapter and in Chapter 1, we have claimed that a good performance in HRM involves dealing with multiple goals. There are multiple 'bottom lines' in HRM, including economic and social legitimacy goals which involve managing trade-offs and dynamic tensions. This is a fundamental perspective or principle that informs all of our analysis. Second, the pursuit of economic and socio-political goals means that firms inevitably adapt their HRM to their specific context *and* they are wise to do so. This is the 'law of context', if you like. Third, we have argued that all models of HRM work through their impacts on employees: they all work through the 'AMO' variables, on the individual level, and through employee attitudes, on the collective level, as we described in Chapter 1. At the heart of this is a principle concerned with alignment: with the need to align management and employee interests, 1 2 3

Surface layer : HR policies and practices – heavily influenced by diverse contexts (economic and socio-political)

Underpinning layer: general principles of labour management

Figure 3.10 The 'best fit' versus 'best practice' debate: two levels of analysis

at least at the level of a contract that meets the baseline requirements of both parties. As a general rule, all firms benefit from policies and practices that help them to align their interests with those of employees. In any context where workers have good labour market choice or develop powerful organisation or enjoy strongly enforced labour market standards, this principle becomes more apparent – but it is always there. Research on how employees respond to different kinds of managerial policy and behaviour, and the links from these responses to the firm's performance, is going to be very important in this book and is likely to lead us to other important principles.

In Part 2 of the book, we engage in a process of 'searching for general principles' in the management of work and people and in the final part we look at how these play out in dynamic and complex contexts. In effect, the book is grounded on the assumption that *both* general principles *and* specific contexts play an important role in the theory and practice of strategic HRM. No one can seriously argue against the importance of 'best fit' or contextual thinking in HRM. However, there is still a valuable role for a concept of 'best practice' if it means a concern for underpinning principles of labour management which help all firms to manage work and people more effectively.

4

Strategic HRM and the resource-based view of the firm

In this part of the book, we are concerned with fundamental concepts of strategic management and with their links to the management of work and people in firms. Chapter 2 established our preferred definitions of the major terms involved in studying strategy. It made the point that strategic management is a human process, dependent on human strengths, but also affected by our cognitive weaknesses and political agendas. This means that, at the very least, key choices about *whom* to place in leadership roles and *how* to build strategy-making processes are critical to the success of firms. Chapter 3 built on this basis to define what we mean by strategic HRM and HR strategy. It discussed the debate in the strategic HRM literature between contingency theory ('best fit') and universalism ('best practice'). The chapter underlined the compelling evidence in favour of a contingency approach but also argued that it is possible to identify some underpinning *principles* of labour management which managers will benefit from following if they aim to make the firm more successful.

The broad debate around the merits of contingency theory and universalism dominated the field of strategic HRM as it emerged into the limelight in the 1980s and remains very important in any kind of theory building. Since the early 1990s, however, another body of thought has grown in significance. The strategic HRM literature has increasingly been influenced by a branch of strategic management known as the resource-based view of the firm (RBV). Relating the RBV to the best-fit/best-practice debate we have just been discussing, one might say that strategy theorists who work with the RBV aim to discover how a firm can build an *exclusive* form of fit. How might a firm develop and manipulate its resources – human and non-human – to become the *best adapted*, the most consistently profitable of all firms in its industry? This chapter aims to explain what is meant by the RBV, defining key concepts and exploring major models. In so doing, it examines the implications of the RBV for the strategic management of labour, helping to lay the basis for the rest of this book.

The resource-based view: origins and assumptions

The resource-based view is usually sourced to a remarkable book by a University of London Professor of Economics, Edith Penrose (1959). At the time, texts on the economics of the firm were dominated by discussion of 'equilibrium' conditions under different forms of competition. The main focus of these texts was on the relative merits of different types of market, including 'perfect competition', oligopoly and monopoly. While valuable in debates about market regulation, the traditional analysis ignored very important issues inside the 'black box' of the firm's operations, leaving the study of entrepreneurship and business management in a very rudimentary state within the discipline of Economics.

Arguing that her interest was different from that of the standard texts on the firm, Penrose set out to build a theory of the growth of firms. She made the basic, but critical, observation that the firm is 'an administrative organisation and a collection of productive resources', distinguishing between 'physical' and 'human resources' (Penrose 1959: 31, 24).[1] Her understanding of the quality of the firm's human resources placed heavy emphasis on the knowledge and experience of the 'management team' and their subjective interpretation (or 'images') of the firm's environment (showing an early grasp of the kind of cognitive problems of strategic management discussed in Chapter 2). Her analysis proceeded from what has become a fundamental premiss in the theory of business strategy: firms are 'heterogeneous' (Penrose 1959: 74–8). As Nelson (1991: 61) puts it, competition ('perfect' or otherwise) never entirely eliminates 'differences among firms in the same line of business' and these differences account for major performance variations.

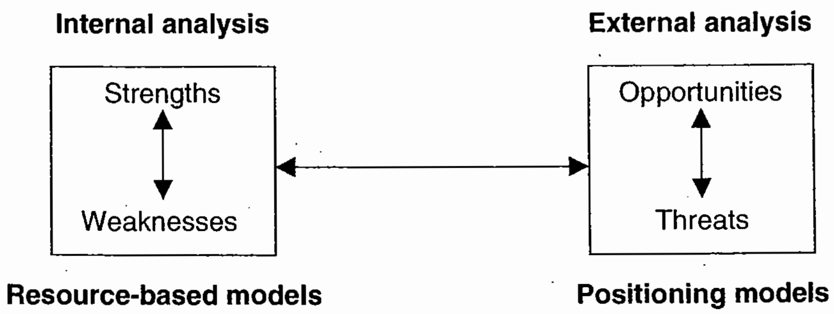
Penrose's ideas lay dormant for some time. Her work was not brought within the mainstream of strategic management theory until it was

1 In passing, we might note that Penrose was one of the first theorists to adopt the 'human resources' terminology.

rediscovered by Wernerfelt (1984) and then by a string of other strategy writers from the late 1980s (e.g. Dierickx and Cool 1989, Barney 1991, Conner 1991, Grant 1991, Mahoney and Pandian 1992, Amit and Shoemaker 1993, Peteraf 1993). The result has been an explosion of interest in the resource-based perspective, focusing on the ways in which firms might build unique clusters or 'bundles' of human and technical resources that generate enviable levels of performance. Major reviews of the strategic management literature now routinely recognise the RBV as a major body of thought concerned with explaining sources of competitive advantage (e.g. Hoskisson *et al.* 1999).

In effect, the growth of the RBV has provided a counterweight to the marketing-oriented models of strategic management which were dominant in the strategy textbooks of the 1980s. The best known of these models was associated with the works of Michael Porter (1980, 1985), discussed in the context of best-fit theory in Chapter 3. These models place greatest emphasis on critical choices associated with competitive strategy – primarily, choices about which industry to enter and which competitive position to seek in it. In so doing, these models make some fairly heroic assumptions (Boxall 1992, 1996). For example, they assume that the firm already has a clever leadership team which can make these sorts of choices effectively. They assume that the human resource issues that arise when particular paths are chosen, such as hiring and motivating a capable workforce, are straightforward. They assume that culture change, when it might be needed to shift direction, is also unproblematic. In contrast, it is *exactly* these sorts of people issues that the resource-based view regards as strategic. In the RBV, the quality of the management process and of the firm's workplace culture are seen as major factors that explain enduring differences in business performance (e.g. Barney 1991).

It can, however, be argued that the RBV is itself imbalanced, placing undue emphasis on the internal side of the old SWOT acronym (strengths, weaknesses, opportunities, threats). In a response to criticism from resource-based theorists, Michael Porter argues that 'resources are not valuable in and of themselves, but because they allow firms to perform activities that create advantages in particular markets' (Porter 1991: 108). Similarly, Miller and Shamsie (1996: 520) argue that the RBV needs 'to consider the contexts within which various kinds of resources will have the best influence on performance.' In a study of the Hollywood film studios from 1936 to 1965, they demonstrate how knowledge-based resources (such as the exceptionally creative skills of key writers and cinematographers, and big-budget coordinating abilities) were more valuable to the studios in the



Source: Adapted from Barney (1991)

Figure 4.1 Internal and external dimensions of the strategic problem

relatively uncertain and turbulent environment of the 1950s when the advent of television seriously affected movie-going habits. On the other hand, in the more stable conditions of the late 1930s and the 1940s (Wasn't everyone watching films in the war?), property-based resources (such as networks of theatres and long-term, exclusive contracts with particular actors) were more valuable for studio performance. In other words, the human talents that helped the studios to 'think and act outside the square' were indeed valuable when the context became less predictable.

Wernerfelt (1984: 173) did recognise the interplay of resources and markets when he said there is a 'duality between products and resources'. In other words, the strategic problem has both internal (strengths, weaknesses) and external (opportunities, threats) dimensions (Figure 4.1). These dimensions – what Baden-Fuller (1995) calls the 'inside-out' and the 'outside-in' perspectives on the strategic problem – are interactive over time. The point is well made. One should not get carried away with either external or internal perspectives: both are necessary for a sufficient view of a firm's strategy. It seems safe, however, to suggest that what the resource-based perspective has achieved is a *re-balancing* of the literature on strategy, reminding people of the strategic significance of internal resources and their development over time.

Resources and barriers to imitation

What, then, are the basic definitions and concepts associated with the RBV? In the resource-based perspective, resources are not simply understood as assets in the formal accounting sense (which can be disclosed on a balance sheet) but include any feature of the firm with value-creating properties (Hunt 1995: 322). This means that aspects of the business that are not formally owned by it, such as the talents and interactions of the people who work in it, are not ignored but come within the realm of analytical interest. Wernerfelt (1984: 172) defined resources in the following way:

> By a resource is meant anything which could be thought of as a strength or weakness of a given firm. More formally, a firm's resources at a given time could be defined as those (tangible and intangible) assets which are tied semipermanently to the firm. Examples of resources are: brand names, in-house knowledge of technology, employment of skilled personnel, trade contacts, machinery, efficient procedures, capital etc.

In an interesting study of chief executive opinion about the value of different kinds of resource, Hall (1993) found that CEOs rated the quality of employee know-how and their firm's reputation with customers as their most strategic assets. It is easy to see why the RBV is so attractive to human resource specialists – here at last is a body of thought within strategic management in which people issues figure prominently.

Clusters of resources, understood in this broader way, can be sources of competitive advantage. Barney (1991), one of the most influential and accessible theorists in the RBV school, distinguishes between a competitive advantage which a firm presently enjoys, but which others will be able to copy, and 'sustained competitive advantage', a characteristic which rivals find themselves unable to compete away, despite their best efforts. In his conception, resources are valuable when they enable the firm to take advantage of market opportunities or deal particularly well with market threats in a way that competitors are not currently able to. The task is to manage these valuable resources in such a way that rivals are frustrated in their efforts to imitate or out-flank them.

Using some fairly awkward terminology, RBV theorists are interested in the conditions that make desirable resources 'inimitable' and 'non-substitutable' (Barney 1991). What can be done to ensure others do not simply imitate or copy a firm's strengths or find ways of substituting for them that achieve the same ends? The key characteristics of desirable resources, then, are that they are valuable and inimitable (with inimitability covering both direct and indirect forms of copying) (Hoopes, Madsen and Walker 2003).

As Coff (1997, 1999) and others point out (for example, Grant 1991, Kamoche 1996), it is important to add 'appropriability' to this list of traits. Not only must the firm be able to generate and defend sources of high

Desirable resources are:

- valuable: capable of delivering superior competitive results
- inimitable: very hard to imitate or copy, either directly or indirectly
- appropriable: capable of benefiting the firm's shareholders

Figure 4.2 Qualities of desirable resources

performance,[2] but the RBV assumes that the firm is able to capture the benefits for its shareholders. This is easier said than done because the firm is a network of *stake*holders. Some stakeholders, such as senior executives, have access to the kind of information and power which can enlarge their share of the firm's bounty. Where they are concentrated in a small geographical area, such as the City of London, the result can be quite extreme competition for very high bonus payments in millions of pounds. Qualities of desirable resources are shown in Figure 4.2.

Having defined these sorts of desirable traits, Barney (1991) notes that such resources are not immune to 'Schumpeterian shocks'. The great Austrian economist, Joseph Schumpeter, referred to the propensity for capitalism to generate 'gales of creative destruction' – radical breakthroughs which disturb technologies or basic concepts of business in the particular business sector (Schumpeter 1950). In the transportation sector, for example, inventions such as railroads, automobiles, and airplanes have had enormous impacts on the ways of providing transport that preceded them. We are currently living through a time when computerisation, telecommunications and the internet are making a major impact across various sectors of business. The vast majority of firms cannot insulate themselves from such radical trends but there is scope for firms to differentiate themselves in ways which are relatively sustainable in a *given* competitive context.

The issue is one of how management might build valuable, firm-specific characteristics and 'barriers to imitation' (Rumelt 1987, Reed and deFillippi 1990), which make it hard for others to copy or ape what the successful firm is doing. What, then, are the key barriers to imitation noted by resource-based theorists?

2 In the RBV literature, high financial performance is often described as 'rent', an old-fashioned term in Economics for profits above the normal level in competitive markets.

Unique timing and learning

Models proposed in the RBV typically place emphasis on the way that historical learning acts as a barrier to newcomers and slower rivals. Theorists cite the value to firms of 'unique historical conditions' (Barney 1991: 107), 'first mover advantages' (Wernerfelt 1984: 173) and 'path dependency' (Leonard 1998: 35). They argue that valuable, specialised resources (sometimes called 'asset specificity') are developed over time through opportunities that do not repeat themselves (or not in quite the same way). Competitive success does not come simply from making choices in the present (as positioning models of strategic management seem to imply) but stems from building up distinctive capabilities over significant periods of time.

In simple terms, RBV theorists argue that a sense of time and place matters: if you are not there at the time things are happening, you cannot expect to be successful. Others will take up the unique learning opportunity. As Woody Allen once quipped, 'fifty percent of success is turning up'. Shakespeare expressed the same sentiment in a famous line from *Julius Caesar*: 'there is a tide in the affairs of men, which taken at the flood, leads on to fortune'. Or as Wernerfelt (1984: 174) puts it, in the rather prosaic language of business theory, 'if the leader executes the experience curve strategy correctly, then later resource producers have to get their experience in an uphill battle with earlier producers who have lower costs'.

The special value of timing and learning is widely understood in the business community. The difficulty of securing a firm's presence in an area where it has no experience is often a reason for take-overs. Directors of firms often feel they cannot make a mark in a new sector (or a new region) without buying an established player who has built up the necessary client base, employee skills and operating systems. The international accounting firms very often expanded this way in the 1970s and 1980s, taking over much smaller, but well-regarded, firms around the world. The small firms thus absorbed provided important political connections, a pool of appropriately qualified staff and a well-established client base. Naturally, the owners of these firms also benefited enormously from the learning of the international firm, gaining access, for example, to special audit techniques, management consulting methodologies, and training systems developed at considerable expense elsewhere.

Social complexity

The phenomenon of historical learning or 'path dependency' is intimately linked to a second barrier to imitation – 'social complexity' (Barney 1991, Wright, McMahan and McWilliams 1994). As firms grow, they inevitably become characterised by complex patterns of teamwork and coordination, both inside and outside the firm. As we emphasised in Chapter 1, successful firms become strong clusters of 'human and social capital' (Lovas and Goshal 2000: 883). Productive work communities, such as outstanding schools and universities, take time to build and are inherently complex systems. The network of these internal and external connections is a kind of natural barrier to imitation by rivals, a prime reason why firms in some industries try to recruit an entire team of employees. Loss of all or most of an outstanding team of staff can decimate an organisation's reputation. Something like this happened in 1957 when eight scientists and engineers working on the development of the silicon chip resigned from the Shockley Semiconductor Laboratory, a research and development company led by the Nobel laureate physicist, Bill Shockley: 'Their mass departure cut the productive heart out of the laboratory, leaving behind a carcass of men working . . . on the four-layer diode project plus a bunch of aimless technicians and secretaries . . . ' (Riordan and Hoddeson 1997: 252). The group left to form Fairchild Semiconductor. The rest, as they say, is history.

Mueller's (1996) discussion of 'resource mobility barriers' is one that places strong emphasis on socially complex attributes of firms. Mueller argues that sustained advantage stems from hard-to-imitate routines deeply embedded in a firm's 'social architecture' (Mueller 1996: 774). By contrast, he sees little enduring value accruing to the firm from top management's codified policy positions (which are easily imitated because of their public visibility). Indeed, he implies that little value is created by those senior managers who are highly mobile:

> Corporate prosperity not seldom rests in the social architecture that has emerged incrementally over time, and might often predate the tenure of current senior management. . . . The social architecture is created and re-created not only or even primarily at senior management levels in the organization, but at other levels too, including at workgroup level on the shopfloor. (Mueller 1996: 771, 777)

According to Mueller, outstanding *organisational* value is more likely to come from persistent, patient management processes that, over time, encourage skill formation and powerful forms of cooperation deep within the firm. These processes generate valuable new combinations or 'bundles' of human and non-human resources for the firm.

Causal ambiguity

A third type of resource barrier noted in the RBV literature – causal ambiguity – is more controversial. As with social complexity, ambiguity about the cause/effect relationships involved in the firm's performance is an inevitable outcome of firm growth (Reed and deFillippi 1990, Barney 1991). It can take some time to figure why an established firm has become successful and to discern how successful it really is. There is no doubt that firms wanting to acquire other firms should be very careful in the 'due diligence' process that precedes (or ought to precede) the purchase of another business. There are inevitably elements of ambiguity about a firm's performance, as there are about the performance of individuals and teams.

Having said this, it is likely that causal ambiguity is over-rated as a barrier to imitation (McWilliams and Smart 1995). Human rationality is always bounded, as was noted in Chapter 2, but if one pushes the notion of causal ambiguity too far, management is virtually meaningless, as is theory (Priem and Butler 2001). The 'paradox of causal ambiguity' has been explored by a study in two US industries: textiles and hospitals (King and Zeithaml 2001). This study examined the way senior and middle managers perceive the competencies of their organisations and their links to competitive advantage. Interestingly, the study was one in which chief executives were very keen to participate (which is quite unusual given 'survey fatigue' among managers in the USA). It involved finding out how other members of their senior team and a cross-section of middle managers understood the firm's resources and their impacts. CEOs were interviewed and the other managers selected in the 17 firms were surveyed (with very high response rates). The study contains evidence that high-performing firms benefit from building consensus across management levels about the resources that enable them to out-perform rivals. Understanding of the key competencies and the most important links among them *ought* to be high. This does not mean, however, that all the micro aspects of particular competencies will be transparent because there is always some degree of ambiguity embedded in organisational culture and employee know-how. As we explore further below, 'tacit knowledge' is always present in organisations.

The findings of this study are consistent with the arguments of advocates of the 'balanced scorecard' (Kaplan and Norton 1996, 2001, 2004, 2006) who claim that, given enough effort, it must be possible within business units to evolve a broad theory of how the business works or might work better (see Chapter 11). Not only this, but the benefits of having agreement about where we are going and how we can get there must be more valuable than confusion and working at cross-purposes! It seems, then, that while causal ambiguity will always be present to some degree, it is likely to be a less important barrier to imitation than the processes of historical learning and social interaction that characterise established firms.

Applying the resource-based view

The discussion so far might convince us that the RBV contains some important insights but leave us wondering what we can do about it. How can all this talk of valuable resources and barriers to imitation be made useful?

One of the more popular frameworks is associated with the work of Hamel and Prahalad (1993, 1994). They argue that competitive advantage, over the long run, stems from building 'core competencies' in a firm which are superior to those of rivals. Their notion of core competence is very close to the concept of 'distinctive competence' discussed in the older strategy texts as something the firm does particularly well. Their definitions of the term (shown in Figure 4.3) place strong emphasis on analysing a firm's collective skills: skills found in the complex teamwork embedded in the firm.

The writings of Hamel and Prahalad are important for leaders of multidivisional firms (discussed in Chapter 10). CEOs and directors of these firms are encouraged to identify the underlying clusters of know-how in their companies which transcend the artificial divisions of 'strategic business units' – or which might do so, if they were appropriately managed. Sony's 'unrelenting pursuit of leadership in miniaturisation' – manifesting itself in various products over time – is one of Hamel and Prahalad's standard examples (Hamel and Prahalad 1994: 119). Another example,

A 'core competence':

- is a bundle of skills and technologies that enables a company to provide particular benefits to customers
- is not product specific
- represents . . . the sum of learning across individual skill sets and individual organisational units
- must . . . be competitively unique
- is not an 'asset' in the accounting sense of the word
- represents a 'broad opportunity arena' or 'gateway to the future'

Source: Excerpted from Hamel and Prahalad (1994: 217–28)

Figure 4.3 Hamel and Prahalad's notion of 'core competence' offered by Goold, Campbell and Alexander (1994) is that of Canon which has deliberately sought to integrate development engineers in different strands of the business to exploit fibre-optic technology. Hamel and Prahalad (1994) argue that companies which make the effort to understand their core competencies (and envision the core competencies they ought to build) are much less likely to get left with outdated products or miss important new applications of a knowledge base. In effect, their work is an argument for developing a 'knowledge-based', rather than a product-based, understanding of the firm. This might be a simple distinction to make but it suggests quite a profound change in the way corporate directors review company strengths and analyse their strategic opportunities.

A similar analysis is advanced by Leonard (1998) who uses the word 'capability' instead of 'competence' (but is concerned with the same idea). Her framework helps executives to identify the distinctive or 'core capabilities' underpinning their products or services. Core capabilities are 'knowledge sets' composed of four dimensions: the 'content' dimensions which include the relevant employee skills and knowledge and technical systems, and the 'process' dimensions which include managerial systems, and values and norms (Figure 4.4). Her framework is perhaps the most helpful in terms of spelling out the HR implications. This is because managerial systems include the critical HR policies needed to recruit, develop and motivate employees with the relevant skills and aptitudes (Leonard 1998: 19). Employee development and incentive systems are a key part of her notion of core capability. She also emphasises the interlocking, systemic nature of the

1. *Employee knowledge and skill*: This dimension is the most obvious one.
2. *Physical technical systems*: But technological competence accumulates not only in the heads of people; it also accumulates in the physical systems that they build over time – databases, machinery, and software programs.
3. *Managerial systems*: The accumulation of employee knowledge is guided and monitored by the company's systems of education, rewards, and incentives. These managerial systems – particularly incentive structures – create the channels through which knowledge is accessed and flows; they also set up barriers to undesired knowledge-creation activities.
4. *Values and norms*: These determine what kinds of knowledge are sought and nurtured, what kinds of knowledge-building activities are tolerated and encouraged. These are systems of caste and status, rituals of behavior, and passionate beliefs associated with various kinds of technological knowledge that are as rigid and complex as those associated with religion. Therefore, values serve as knowledge-screening and -control mechanisms.

Source: Reprinted by permission of Harvard Business School Press. From Leonard, D., *Wellsprings of Knowledge: Building and Sustaining the Sources of Innovation*, p. 19.

Figure 4.4 The four dimensions of a 'core capability' four dimensions and the resulting tendency of core capabilities to become 'core rigidities' over time, unless firms learn to practise continuous renewal. According to Leonard (1998: 30), every strength is also simultaneously a weakness. The recognition that firms can also have weaknesses or 'distinctive inadequacies' is an aspect of the RBV that ought to be given greater attention (West and DeCastro 2001). Some weaknesses can result from having 'too much of a good thing', as Leonard implies, while others can simply be 'bad things' (such as not developing sufficient skills in environmental analysis and change management).

In outlining her model of how firms might develop outstanding capabilities, Leonard (1998: 5–16) discusses the interesting case of Chaparral Steel, a very successful US 'minimill'. While only the tenth largest steel producer in the USA at the time of this study, Chaparral enjoyed a reputation as a world leader in productivity:

> . . . in 1990, its 1.5 person-hours per rolled ton of steel compared to a US average of 5.3, a Japanese average of 5.6, and a German average of 5.7. Chaparral was the first American steel company (and only the second company outside of Japan at the time) to be awarded the right to use the Japanese Industrial Standard certification on its general structural steel products. (Leonard 1998: 6)

With strong values and incentives supporting the creation of new knowledge, Chaparral employees have pushed the company's equipment well beyond its original specifications:

> The rolling mill equipment its vendor believed (was) limited to 8-inch slabs is turning out 14-inch slabs, and the vendor has tried to buy back the redesign. The two electric arc furnaces, designed originally to melt annual rates of 250,000 and 500,000 tons of scrap metal, now produce over 600,000 and 1 million tons, respectively. (Leonard 1998: 11)

Leonard explains how Chaparral has achieved these results through building an 'interdependent system' of employee skills and technical systems supported by HR policies, practices and cultural values:

> Chaparral's skills, physical systems, learning activities, values and managerial philosophies and practices are obviously highly interdependent. Competitively advantageous equipment can be designed and constantly improved *only* if the workforce is highly skilled. Continuous education is attractive *only* if employees are carefully selected for their willingness to learn. Sending workers throughout the world to garner ideas is cost-effective *only* if they are empowered to apply what they have learned to production problems. (Leonard 1998: 15–16, italics in the original)

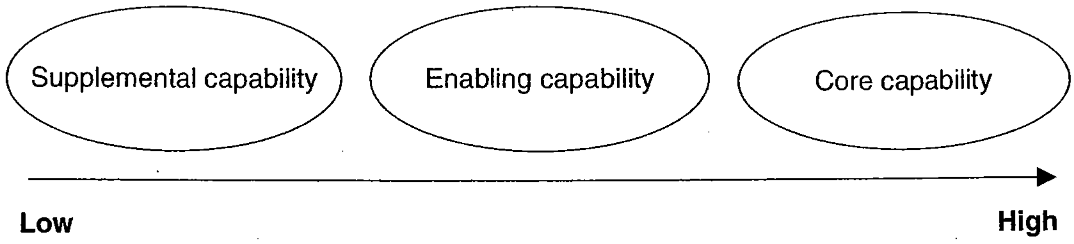
Leonard's model, then, places emphasis on the fact that cleverly developed systems of this kind – where the parts do reinforce each other in powerful ways – are very hard to imitate. This is certainly the view within Chaparral. Leonard (1998: 7) notes that the CEO is happy to give visitors a full plant tour, showing them almost 'everything and . . . giving away nothing because they cannot take it home with them'. This kind of story lends some support to the argument made earlier that even if we have a good understanding of why a firm is successful (low 'causal ambiguity'), the unique path that company has travelled and the social complexity this brings remain significant barriers to imitation.

'Table stakes' and distinctive capabilities

While sources of valuable differentiation are very important in the RBV, it is worth injecting a note of caution here. A problem with some writing in the RBV is the tendency of authors to focus only on sources of idiosyncrasy, thus exaggerating differences between firms in the same industry. As we argued in Chapter 2, all viable firms in an industry need some similar resources in order to establish their identity in the minds of customers and to help secure legitimacy in broader society (Carroll and Hannan 1995, Peteraf and Shanley 1997, Deephouse 1999). For example, banks must act like banks (having the requisite information technology and the typical range of services, for instance). They must satisfy investors and regulators that they can behave as responsible repositories and lenders of funds. Without these baseline features, banks lack recognition in their industry and legitimacy in wider society.

Some writers in the RBV are so focused on the firm that they do not recognise these wider connections. However, it is a strength of the frameworks outlined here that the authors do see the importance of 'table stakes' (Hamel and Prahalad 1994) or 'enabling capabilities' (Leonard 1998). These are features of the business which enable participation in the industry but which do not make the firm distinctive or account for superior performance.

Leonard (1998) makes useful distinctions among three kinds of capabilities: core (which are superior and cannot be easily imitated), supplemental (which add value to core capabilities but can be easily copied) and enabling (which are necessary conditions of being in the industry). These distinctions are shown in Figure 4.5. Both Leonard (1998) and Hamel and Prahalad (1994) note the dynamic nature of capabilities: over time: one company's distinctive or core capability (such as outstanding quality) tends to be emulated by other firms. It then becomes part of the 'table



Source: Reprinted by permission of Harvard Business School Press. From Leonard, D., *Wellsprings of Knowledge: Building and Sustaining the Sources of Innovation*, p. 4. © 1998 Harvard Business School Publishing Corporation. All rights reserved.

Figure 4.5 Strategic importance of capabilities to the firm

stakes' in the industry and firms that seek superior performance must search for other ways to differentiate themselves. Hamel and Prahalad (1994: 232) note this dynamic in a case most of us can attest to – that of automobile manufacturing:

> . . . in the 1970s and 1980s quality, as measured by defects per vehicle, was undoubtedly a core competence for Japanese car companies. Superior reliability was an important value element for customers and a genuine differentiator for Japanese car producers. It took more than a decade for Western car companies to close the quality gap with their Japanese competitors, but by the mid-1990s quality, in terms of initial defects per vehicle, has become a prerequisite for every car maker. There is a dynamic at work here that is common to other industries. Over long periods of time, what was once a core competence may become a base-line capability.

From an HR perspective, 'table stakes' or 'enabling capabilities' include the minimum HR policies and practices required by each firm to play the competitive game (including similar types of work organisation and employment conditions) (Boxall and Steeneveld 1999, Boxall and Purcell 2000). The types of minimum 'HR system' needed inevitably vary by industry or, more accurately, strategic groups or customer segments within industries (Boxall 2003). There are, for example, strong similarities in the way car plants employ labour and strong similarities among retail chain stores. The differences between these two industries in skills required, working conditions, team processes and so on are very significant. The key point is that viable firms in a particular industry are *partially* rather than totally idiosyncratic. Valuable resources, then, include some elements in common with other firms in the industry and some differences.

Dynamism in the RBV: the role of knowledge and learning

Standing back from the commentary so far, it should be clear that the management of knowledge plays a key role in resource-based models of the firm. For Hamel and Prahalad (1994), building a focus on knowledge management is much more important than the historical focus of Western firms on product management. For Leonard (1998), understanding the 'wellsprings of knowledge' is the key issue in the long-run renewal of the firm. On a practical level, a lot of interest in the area is directed towards models of knowledge management, of how to identify, protect and enlarge a firm's 'intellectual capital' (e.g. Edvinsson and Malone 1997, Stewart 1998).

The RBV, then, encourages researchers to focus on knowledge and its creation and exploitation within firms (Grant 1991, Hoskisson *et al.* 1999). How to build the organisation's capacity for learning or its *dynamic* capability becomes the fundamental issue (Teece, Pisano and Shuen 1997, Helfat and Peteraf 2003). Some go so far as to talk of a 'knowledge-based view' (KBV) of the firm (e.g. Grant 1996) but we think this is generally unwise: knowledge is extremely important to organisational success but access to money, properties and natural resources also continue to be vital. In an energy-strapped world, for example, companies which can access cheap and plentiful energy sources are definitely at an advantage.

Where the KBV comes into its own is in those companies where the knowledge and brain-power of employees is the only substantial source of competitive advantage (Kinnie *et al.* 2006). These are 'professional service companies' in such sectors as consultancy practice, media, law and IT. They own very few assets in terms of natural resources and property yet often have a very high market value, like Microsoft. In these firms, professionally qualified employees often have distinctive needs concerned with multiple identities. Do they, or indeed should they, identify with their employer, their major client, their team or their profession (Swart 2007)? The assumption of the KBV is that the firm is able to leverage this professional knowledge and intellectual capital in a unique way that others cannot copy, to gain competitive advantage and appropriate value. However, rival firms will seek to poach talented staff, often forcing up pay and rewards, thus challenging the level of appropriation. And managing talent is not just about pay. It includes ensuring that professionals work on stretching projects with other talented colleagues in project teams at the forefront of their profession. This in turn will have a strong influence on the business strategy of these knowledge-intensive firms since the need to keep talented staff drives the search for innovative and creative work.

It is clearly important that we build an analysis in which we are able to explain why some firms are better at learning and renewal than others. Why do some firms have greater dynamic capability? A large part of the answer must be associated with the people involved and with how they are managed.

The RBV and human resource strategy

It should be obvious, then, that resource-based models of strategic management are replete with references to the human dimensions of resources. A major part of any firm's strengths – and weaknesses – does stem from the calibre of the people employed and the quality of their working relationships.

At the most elementary level, the resource-based view of the firm provides a conceptual basis, if we were ever in any doubt about the matter, for asserting that key human resources can be sources of competitive advantage. Taxonomies of valuable resources always incorporate an important category for 'human capital' (Barney 1991) or 'employee know-how' (Hall 1993) and resource-based theorists stress the value of the complex interrelationships between the firm's human resources and its other resources: physical, financial, legal, informational and so on (e.g. Penrose 1959, Grant 1991, Mueller 1996). This much is self-evident: as we emphasised in Chapter 2, a firm is a system of interconnected parts and the firm's human resources form a necessary (though not a sufficient) part of this system.

But this does not get us very far. The key questions raised by the RBV are twofold: *what* is it that can be exceptionally valuable about human resources and *how* might a firm develop and defend these sources of value? Identifying what is most valuable and protecting it with 'barriers to imitation' is at the heart of resource-based thinking.

We can certainly rule out the value of formal policy positions in HRM (what top management says the firm should do in managing work and people). These can simply be run off on a photocopier or downloaded from the internet. As Muller (1996) argues, it is hard to see any distinctive and inimitable value in policy positions *per se*. Furthermore, when there are major disconnections between senior management's formal HR policy and the actual HR practices of line managers, this can be a source of competitive *dis*advantage (Purcell 1999). There is always a danger in gaps between management rhetorics and workplace reality (Legge 1995, 2005, Grant 1999).

Since people vary in their capabilities and cannot work for all firms at once, Wright *et al.* (1994) argue that we are more likely to find value residing in the human resources themselves, in the human capital pool. Human capital is the quality of the individual human talent recruited to the firm and retained in it. All firms need certain kinds of individual talent relevant to implementing the organisation's mission and, if they wish to survive over the long run, capable of helping the organisation to adapt to change or, better still, lead it (Boxall and Steeneveld 1999). As we noted in

Chapter 2, all firms need a relevant set of human resources to be viable, in order simply to survive or attain 'competitive parity'. Firms which recruit and retain exceptional individuals have the possibility of generating 'human capital advantage' (Boxall 1996, 1998).

Why can individuals be so valuable? The answer lies in Polanyi's (1962) classic distinction between 'tacit' and 'explicit' (or 'articulated') knowledge. Tacit knowledge is 'nonverbalized or even nonverbalizable, intuitive' while explicit or articulated knowledge is 'specified either verbally or in writing, computer programs, patents, drawings or the like' (Hedlund 1994: 75). Figure 4.6 illustrates this distinction with examples across four levels of analysis, starting with the individual and moving up to the 'inter-organisational' domain. The distinction helps to explain why firms are vulnerable to labour turnover (Coff 1997, 1999). They can never entirely capture what individuals know. Some of what and whom we know – including many of our best skills – cannot be reduced to writing or to formulas. When we leave the firm, we take our job know-how and networking knowledge with us. No two individuals are exactly alike and the differences are particularly noticeable in high-skill jobs: as job complexity increases, so does the range of human performance (Hunter, Schmidt and Judiesch 1990). When whole teams of highly talented individuals leave, as was noted earlier in a case from the semiconductor industry, the effect can be devastating.

Moreover, individual human capital is embedded in a social context. The quality of social capital – of human relationships in the firm and with its environment – plays a major role in whether or not firms make outstanding returns from their human capital (e.g. Goshal and Nahapiet 1998, Swart and Kinnie 2003, Collins and Smith 2006). In other words, firms need 'organisational process advantages' if they are to realise the potential of human capital (Boxall 1996, 1998). Organisational process advantage

Type	**Individual**	**Group**	**Organisation**	**Inter-organisational domain**
Explicit knowledge	Knowing calculus	A quality circle's documented analysis of its performance	Organisation chart	A supplier's patents and documented practices
Tacit knowledge	Cross-cultural negotiation skills	Team coordination in complex work	Corporate culture	Customer attitudes to products and expectations

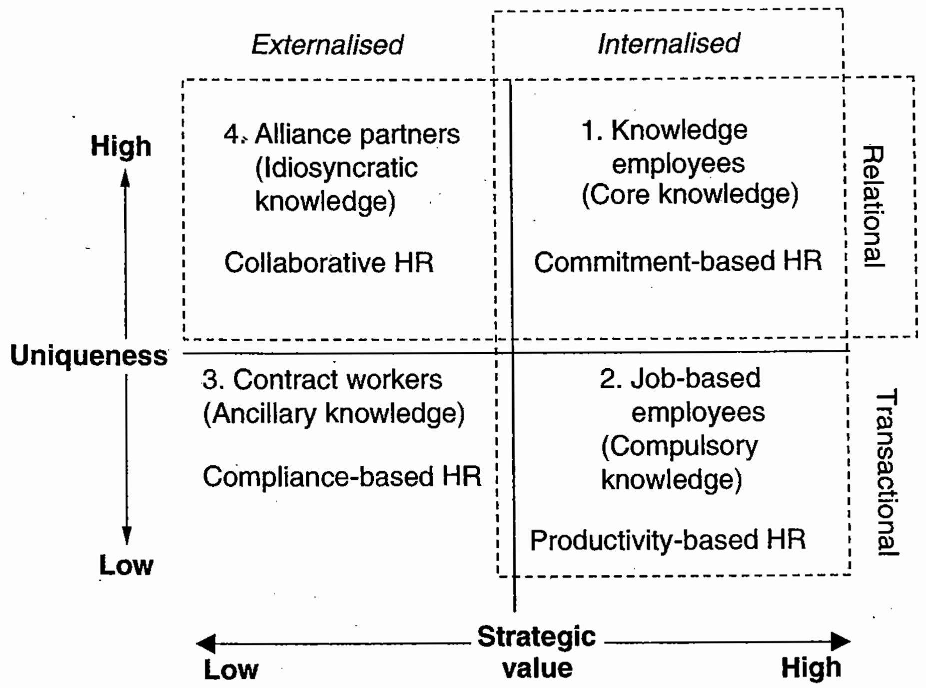
Source: Adapted from Hedlund (1994: 75)

Figure 4.6 Types of knowledge

is a function of historically evolved, socially complex, causally ambiguous *processes* such as team-based learning, and high levels of trust and cooperation between management and labour and among co-workers, processes which are very difficult to imitate. Both human capital and social capital can generate exceptional value but are likely to do so much more powerfully when they reinforce each other. Kay (1993) refers to this as the 'passing game', nicely indicating that teams may have highly talented players (high human capital) but it is the capacity to play together that is important. Thus, we can say that under the RBV, a firm's distinctive human resource advantage (HRA) is a combination of appropriately talented people (human capital advantage) and the way they work together (organisational process advantage). In mathematical notation,

$$HRA = f(HCA, OPA).$$

But does the resource-based view imply that all employee groups in a firm are strategically valuable? In a nutshell, no: it suggests that there some critical, 'core' workers in all firms, while other individuals are less critical or more peripheral (Purcell 1999). Lepak and Snell (1999, 2007) have picked up on this aspect of the RBV (and related economic theories) in developing what they call an 'HR architectural perspective' (Figure 4.7). This framework



Source: Adapted from Lepak, D. and Snell, S., 'Employment sub-systems and the "HR architecture"'. In Boxall, P., Purcell, J. and Wright, P. (eds) *The Oxford Handbook of Human Resource Management*. Oxford: Oxford University Press. © 2007 By permission of Oxford University Press.

Figure 4.7 Lepak and Snell's 'HR architectural perspective' utilises two dimensions: the extent to which the particular form of human capital represents a valuable resource for the firm and the extent to which it is unique or firm specific. This leads to four types of HR system that fit different sets of human resources.

Lepak and Snell argue that firms need a commitment-oriented HR system for employees whose skills are critical to a firm's core or distinctive capabilities (Quadrant 1). Firms should invest heavily in the motivation, empowerment and development of those who hold critical knowledge. Thus, when workers are perceived as especially valuable to the firm's strategy, the question of how to defend them turns on adopting HR systems which build their loyalty and, thus, exclusiveness to the firm. Protecting special human resources depends on building high employee commitment and low rates of employee turnover within this core group. The relationship is much more of a long-term, 'relational' kind than a short-term 'transactional' kind (Rousseau 1995). However, firms can adopt a more productivity-based approach to those, such as accounting staff, whose work is valuable in the labour market but not unique (Quadrant 2). This means hiring people who can be productive quickly and rewarding them on a more short-term, results-oriented basis. Those whose skills are low in value and generic are prime candidates for contracting out (Quadrant 3) while individuals whose skills may be 'unique in some way but not directly instrumental for creating customer value' (Lepak and Snell 1999: 40), such as a firm's attorneys, are likely to be engaged in some form of longer-term alliance (Quadrant 4).

This model, then, offers a way of helping firms to distinguish which types of HR system are appropriate for different kinds of human capital. An important, ongoing issue is the question of whom managers consider 'core' in a particular firm. We often observe strategic choice here: managers make different interpretations, as illustrated in the bottled gas market in the UK in the mid 1990s (Purcell 1996). British Oxygen was a long-established player in the market with a dominant share. Air Products was a relatively new entrant but with lots of experience in the USA. In 1992, British Oxygen needed to improve delivery, cut costs and get customers to trade up where possible. They had a large existing distribution fleet. Painful negotiations with the drivers' union led to new hours of working, wider job responsibilities including customer relations, more training and cab-based information technology. Drivers became seen as key staff in direct contact with customers. At the same time, Air Products decided to outsource distribution to a specialist haulage contractor. There was no expectation here that drivers would know anything about gas beyond safety considerations. In the case of British Oxygen, drivers were considered a core part of the firm because they always had been, not because they possessed distinctive organisational knowledge or skills. Indeed this knowledge of the customer and the skill about gas systems had to be learned once the decision was made to give them customer relations responsibilities. A similar case in New Zealand involved the privatisation of gas companies. Meters in domestic properties need to be read, but are meter readers just 'data harvesters' (carrying out single-task jobs suitable for outsourcing) or are they front-line customer service representatives (Peel and Boxall 2005)?

In practice, firms come up with different answers. Some choose the core for historical or institutional reasons and then design the jobs and the employment relationship to fit these core attributes, as in the case of British Oxygen. This seems very explicable: 'Many activities in firms . . . are so taken for granted or so strongly endorsed by the firm's prevailing culture and power structure that decision-makers no longer even question the appropriateness or the rationality of these activities' (Oliver 1997: 700). To put it another way, the moral (legitimacy) as well as the financial exit costs can be too high. Arguably, Lepak and Snell over-emphasise the potential to differentiate between types of workers within the same organisation, especially where people share the same site and where family ties are frequently found. However, Baron and Kreps (1999: 460) suggest subtly different criteria in choosing whether to externalise certain jobs or manage them internally. First, they suggest that 'the degree to which the task is strategically important for the firm, that is, whether it is a 'core competence' is critical. Here, they are on similar ground to Lepak and Snell with their emphasis on 'strategic value'. Baron and Kreps's second criterion is not the uniqueness of the skill but 'the degree to which the activity displays high technical or social interdependence with tasks done by regular employees' (Baron and Kreps 1999: 460). In this regard, Purcell, Purcell and Tailby (2004) studied a call centre where the failure to appreciate the social interdependences of staff – where agency 'temps' worked alongside permanent staff – led to escalating labour turnover among both temps and experienced staff.

Recall that Leonard (1998) made the distinction between core, enabling and supplemental capabilities. While these are analytically distinct, and similar to the knowledge categories in Lepak and Snell's quadrants, it is important to appreciate that they are, simultaneously, cumulative. Exploiting core capability requires that the firm holds enabling and supplemental capabilities. Boxall (1998: 268) makes a distinction between inner- and outer-core workforces. The 'inner core . . . provides the "adaptive capacity" of the firm while the outer core provides it with "credible operational capacity" '. One cannot operate effectively without both capabilities. In Chapters 6 and 8, we draw attention to the firm as a social entity, a community with a distinctive culture. Too much differentiation between core and periphery along the lines of Lepak and Snell's quadrants can damage the creation of a sense of community and challenge perceptions of fairness. For example, in 2005, an American company in the UK established an employee forum for the first time. One of the first items raised was the fact that management and professional staff were given free health insurance but other staff members were not. This was deemed unfair and at odds with the company's aspiration to be 'an employer of choice' and its emphasis on 'togetherness' (i.e. social interdependency). Free health insurance was subsequently extended to all employees.

Despite the point we make here, a key trend over the late 1990s and into the twenty-first century has been the rise of outsourcing or offshoring in manufacturing and in services (such as call centres), an important issue we will discuss in Chapters 5 and 8. Location on a separate site, and performance of technically different tasks from those in home base, means that both technical and social interdependencies can be minimised. Outsourced sites, especially those offshored to third-world countries, can quickly be 'out of sight and out of mind'. As Lepak and Snell (2007) recognise, many firms now locate operating workers in countries with lower labour costs. In Chapter 1, we considered the case of the British manufacturer, Dyson, which has done exactly this, offshoring its assembly operations to Malaysia. The intention in these situations might be to treat these workers as core resources employed within the firm but management is doing so within a much lower cost structure or is using either a sub-contractor or an alliance partner (Quadrant 3 or 4) who does this. The critical core in the firm is thus defined even more parsimoniously, as the firm's key executives and the R&D, marketing and logistics specialists it still employs in its home-country head office.

Leaving aside these labour cost issues, which we will explore in Chapter 5, a key implication of the argument so far must be that carefully enacted HR systems can be sources of superior and hard-to-imitate value. Arguably, the scarce and hard-to-imitate value stems from the historically developed, socially complex elements, including the way in which these have formed important systemic connections over time. Thus, while knowledge of individual HR policies is not rare, the knowledge of how to build and customise appropriate HR systems and create a positively reinforcing blend of HR systems *within* a particular context is likely to be very rare. The value is greater when these astute HR decisions are complemented by a mix of other intangible and tangible assets: senior management commitment, consistent line manager support for critical HR practices over significant time periods, (at least) adequate financial resourcing, sympathetic management accounting systems, and so on (Boxall 1998, 2003). A commitment-oriented HR strategy, which Lepak and Snell (1999, 2007) argue firms need for their core workforce, depends on a sympathetic social context within the firm (Collins and Smith 2006). We take this argument further in Chapters 8 and 9 in our discussion of the 'mediators' between HR systems and company performance and in our discussion of the role of HR strategy across cycles of change in industries.

In summary, then, human resource strategy, supported by other sympathetic elements, can enable a firm to build sources of sustained competitive advantage. In any industry, there are likely to be particular firms which have built 'human resource advantage' in this sense. The evidence discussed by Leonard (1998) certainly implies that Chaparral Steel has built human resource advantage in the US steel sector.[3] On the other hand, the majority of surviving firms in an industry are likely to have HR strategies which support their survival but which do not confer advantage. Arguably, most (surviving) firms are 'mainstream' or 'median' employers whose HRM is sufficient to underpin their viability but not otherwise impressive. And, as we have noted, this may well mean shifting production 'offshore' to keep labour costs competitive. Firms that fail altogether have often fallen short in the critical human and social capital they need to be viable, as studies of young, vulnerable firms attest (e.g. Storey 1985, Bates 1990).

Before moving on, let us recall again that there is a problem with thinking about resources only at the level of the firm. Clusters of valuable resources occur at both industry and societal levels. Industry clusters can benefit all firms through providing a skilled labour pool and networking connections across the supply chain, one of the reasons why Dyson found it attractive to locate in Malaysia, as noted in Chapter 1. In addition, countries provide variable resources of infrastructure, politico-economic systems, social order and so on. Some firms have a 'head start' in international competition because they are located in societies which have much better educational and technical infrastructure than others (Porter 1990, Boxall 1995). American, British, German and French firms, for example, are all assisted by the existence of long-established traditions of excellence in higher education which enhance the knowledge-creating capacities of business organisations.

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3 As of 2006, Chaparral Steel had become the second largest producer of structural steel products in the USA and now has two mini-mills. See: www.chaparralsteel.com/

The point here is that the potential to develop competitive advantage through human resources does not lie solely in the hands of managers within individual firms.

Conclusions

There is no doubting the fact that the resource-based perspective is an important set of spectacles for viewing the strategic problems facing the firm. It focuses on the analysis of internal strengths and weaknesses, paying particular attention to the ways in which firms can develop valuable resources and erect barriers to imitation of them. It is not, however, without conceptual weaknesses. Key strategy theorists, such as Porter (1991), remind us that firms always exist in environments: resources are not ends in themselves but are useful when they create value in markets. More broadly, resources are valuable when they win some form of stakeholder support for the firm. The stakeholders that matter include not only shareholders but also employees, the state and the public at large who have expectations that the firm will use society's resources in legitimate ways. We must also avoid getting carried away with the resource-based notion of idiosyncrasy or heterogeneity. To be sure, superior firms have distinctive features but all firms in an industry need some similar resources in order to identify their line of business and meet standard customer expectations. From the perspective of HRM, we should note that the RBV, like most of the strategy literature, can become too absorbed with the firm as the unit of analysis. Human resources vary in quality across industries and nations and this variability does affect the strengths that firms are capable of building.

As the name itself implies, resource-based frameworks present an account of strategic management which is richly laced with *human* resource issues. These HR issues include strong concerns with the management of human knowledge or with the development of learning capabilities. Managing knowledge inevitably means managing both the company's proprietary technologies and systems (which do not walk out the door at the end of the day) and the people (who do). It implies management of the ongoing interaction between these two aspects of a firm's knowledge system. Clearly, then, when we take a resource-based perspective on the strategic problem, questions of human resource strategy are going to loom large. How to build human capital by attracting, motivating and developing individuals is going to be central. So is the question of how to build the kind of organisational processes which enable individuals to function effectively. Much hinges on how firms build socially complex clusters of human and social capital. The reader will not be surprised that we regard this line of analysis as extremely important. Our exploration of the resource-based view continues in various parts of the rest of the book. We aim, however, to build on the RBV while staying alert to its weaknesses.