

Andronicus TORP
Politehnica University of Bucharest
Simona ALBULESCU
HR Director, Porsche Romania SRL
Anca Alexandra PURCAREA
Politehnica University of Bucharest

HUMAN RESOURCE MANAGEMENT & COMPANY PERFORMANCE: WHAT DO WE ACTUALLY KNOW?

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Abstract

This article examines the – presumed – link between Human Resource Management (HRM), more exactly the High Involvement Work Systems (HIWS) and Company Performance, also known as the HR-P link. It does so in a somehow historical way, showing the development of the Human Resource Management field and how the presumed link with company performance slowly, slowly emerged and became a foundation in the way people think about Human Resource Management.

In the end of the article the possibility of making Human Resource Management an objective, quantitative science, based on one of the principles of Quantum Physics; electromagnetism, is introduced as a future study topic.

Introduction

Did you ever hear the “fact” that the Eskimos have 54 words for “snow”? This “fact” is one of the foundations for the philosophy of language, which is a very accepted and prestigious philosophical domain. Now, accordingly to one of the authors Philosophy professor at Copenhagen Business School, Asger Sørensen, there is a little problem with that “fact”. It is not a fact at all! He once told that he decided to trace the origin of that “fact” and did so by following one reference after the other until he discovered the origin of this “fact”. He might have made his work a lot easier if he had just gone to the library and taken a Danish/Eskimo dictionary and looked up the word “snow”, but that is not really the point. This famous “fact”, he said, came from a conference held in 1954 where someone stated, “What if the Eskimos have 54 words for snow? Does that mean that their perception of snow is different than ours?” Now, to us it seems that the same way of thinking, which we assume that nobody in their right mind would ever call scientific, has sneaked into the thinking of Human Resource Management (HRM), where it, in our opinion, threatens, to a certain extend, to undermine the field from within. In order to counteract this we choose to write this paper, so we can bring some of the preconceived ideas and misunderstandings into the “light” and see what we truly know about the connection between Human Resource Management and Company Performance, known as the HRM-P link.

A Short History of HRM

Accordingly to Lengnick-Hall et al. (2009), Human Resource Management started in the 1920's where a group of visionary American business owners were seeking to replace the traditional command & control systems with systems, which included the employees and their knowledge and ideas in a more constructive way. However, as Lengnick-Hall et al. continues, it wasn't until the 1980's when the academic research into Human Resource Management really started.

Huselid's pro-HRM approach

One of the most famous names you encounter in almost any pro-HRM article is that of Professor Mark Huselid who in 1995 wrote an article called “*The impact of human resource management practices on turnover, productivity, and corporate financial performance*”. It is a very interesting article where he concludes that the use of High Performance Work Practices - which to the best of our knowledge are synonymous with High Performance Work Systems (HPWS) and High Involvement Work Systems (HIWS) – will be reflected in improved company performance. He continues that this improvement is valid across

different industries, and that “*such practices are associated with lower employee turnover and greater productivity and corporate financial performance.*” (Huselid, 1995: 667) Finally he states that, “*the magnitude of the returns for investments in High Performance Work Practices is substantial. A one-standard deviation increase in such practices is associated with a relative 7.05 per cent decrease in turnover and, on a per employee basis, \$27,044 more in sales and \$18,641 and \$3,814 more in market value and profits, respectively.*” (Huselid 1995: 667)

Based on this it makes perfect sense, especially from a financial point of view, for a company to invest in HRM; the more the better it seems.

Already here Huselid introduces a way of thinking within the HRM domain, which in our opinion becomes very dangerous for its credibility. He is introducing implicit assumptions about connections, which he doesn't clarify. For example the fact that there should be a connection between lower employee turnover and higher company performance! It might be that there is such a connection, yet science is not about “might be's” it is about facts. A colleague has told that for example Wal-Mart is known to pay below market average salaries and to have above market employee turnover, yet that is not a problem, because the company doesn't invest much in its employees and thus by acting how it does, it has a cost efficient work force, which, according to Boxall & Purcell (2011), is a goal of HRM.

Guest's questioning of HRM and performance

Two years later, in 1997, Guest writes an article called “*Human Resource Management and performance: a review and research agenda*” where he states that there are theories which claim an association between company performance and HRM and thus HPWS, yet it is not clear why this connection exists and thus the theoretical foundation of HRM needs to be established so it can clearly be shown which practices have which consequences.

Guest writes that, “*If we are to improve our understanding of the impact of HRM on performance, we need a theory about HRM, a theory about performance and a theory about how they are linked.*” (Guest 1997: 263)

He continues that, “*the distinctive feature of HRM is its assumption that improved performance is achieved through the people in the organization. Any theory of linkages should explicitly build on this.*” (Ibid: 269)

In philosophy there is a concept called “reductio ad absurdum” which states that a statement must be true because its negation is absurd. Building on this, obviously a company's performance is obtained through its employees, because if you

remove all the employees there is no performance whatsoever. It is evident that this link, the employees & performance, should be the foundation for any and all HRM theories. If not the HRM field might not bring any value to the company; because what is actually the point of having for example engaged employees, if that doesn't affect the financial outcome of the company?

Guest continues that since not all the theories, which attempt to link HRM and performance are having the same perspective they are only cumulative in a very general sense.

This is a big challenge for HRM, which is yet to be resolved, to find a scientific foundation, which can support the construct of the entire domain, not just individual links between a certain practice and the outcome of that practice. This subject will be discussed in detail in the end of this article.

In the end of his article Guest raises an interesting issue, the fact that there are some companies, which he defines as the “ugly” companies, which had very bad HR practices, yet, which in the same time generated equivalent financial results with other companies in their category.

Thus, logically we may conclude, that a HPWS cannot be the only solution to any HRM problem, and that it becomes necessary to understand all the links between HRM and company performance in order to make a theory explaining them. If not, we are just shooting in the dark.

Then, in 2005, almost a decade after Guest's article, Wright et al. continues the discussion about the HRM-P link in their article called “*The Relationship Between HR Practices and Firm Performance: Examining Causal Order*”. In other words, after 20 years of HRM the causal relation between HRM and Company Performance is still not clarified.

The originality of this article is that it questions the previous work with the HRM-P link, due to “*the lack [of] sufficient methodological rigor to demonstrate that the relationship is actually causal ...*”. (Wright et al., 2005: 410)

Wright et al. continues by discussing what a causal relationship actually is, based on the philosophy of John Stuart Mill, stating that three criteria needs to be fulfilled in order to infer cause: **co-variation**, **temporal precedence**, and the **exclusion of alternative explanations**.

It is worth explaining these three concepts further, as they (ought) to be the foundation of any scientific theory, including HRM theories.

Co-variation suggests that whenever the cause is present the effect is also present, and further that when the cause is not present the effect isn't present either.

Temporal precedence indicates that the cause must take place in time before the effect.

Finally, the exclusion of alternative explanations suggests that any interference must be ruled out. These three criteria makes a lot of sense when trying to come up with a scientific theory, yet they might constitute paramount challenge when making a theory where people are involved. More about this later.

Where Wright et al. truly does HRM a favour is by analysing some of the theories (66 to be exact) stating a HRM-P link based on these three criteria. They came up with a very interesting conclusion. Most of the theories stating that improved HRM, meaning HPWS, lead to improved performance, actually measured the exact opposite! Wright et al. write “... such designs ask respondents for their firm's current HR practices but measure their past performance presenting a logical inconsistency for arguing that HR practices cause performance.” (Wright et al., 2005: 412)

Such a research design negates, at least, temporal precedence, and actually only states that company performance leads to larger investments in HR systems. According to the list of studies in the HRM-P link which Wright et al. provides only 3 from 66 tests for reverse causality, meaning if the performance was actually the cause of the HR. Logically one may argue that there seems to be a certain possibility that a company which is doing well financially *also* will invest more in HR, but that doesn't necessarily tell anything about the effects of those investments on company performance.

According to Wright et al. (2005: 415) “*The strongest design for actually arguing a causal relationship, the predictive, has been used in only 10 [from the 66] studies.* “Thus we can not, a priori, exclude that there *might* be a HRM-P link, that claim would just have more integrity if the research stating it would actually have a solid scientific foundation.

Wright et al. concludes that “*the literature on the HR performance relationship has (a) universally reported significant relationship between HR and performance, (b) almost exclusively used designs that do not logically allow one to draw causal conclusions, and (c) very seldom actually tested for a reverse causal order.* (Wright et al., 2005: 416)

Hopefully it is clear that our scope is not to prove that there is not any HRM-P link, just that the theories stating such a link, in certain cases, lack a methodological design which enables them to make such a claim.

A study which, as we shall see later, has been misused to indicate a HRM-P link, is that of Fulmer, Gerhart, and Scott (in Wright et al., 2005: 417-418) who examined the 100 Best companies to work for in 1998, and found that these companies “*outperformed their comparison group on most of the dependent variables in 1998*” however they had also done that in the years 1995, 1996, and 1997.

Thus it is obvious that investing in these companies were a financially profitably action, yet that was also true before they became noted for their employee climate, thus it can logically be concluded that the employee climate was not the factor leading to their higher performance.

The last element in the deconstruction of the HRM-P link which shall be included in this paper is the article by Fleetwood & Hesketh (2006) called "*HRM-performance research: under-theorized and lacking explanatory power*".

According to Fleetwood & Hesketh the "hope" of the HRM researchers is that if they just collect enough empirical data then suddenly a theory uniting it will occur. According to them, this has not worked out well, and the root cause is that there is no philosophical discussion about the lack of an HRM theory.

There is no reason to go through their argumentation regarding a scientific theory, the interested reader can just refer to their article, or book. Their whole point is – like stated by Wright et al. before them – that there needs to be a solid theoretical foundation for a unified HRM field theory to emerge and that this theory has to be based on the existence of "*event regularities*". (Fleetwood & Hesketh, 2006: 1979) They continue that "*To observe a firm introducing HR practices, while also observing increases in productivity, is not very illuminating; whereas to observe that the introduction of HR practices and increases in productivity occur in regular succession, such that whenever HR practices are introduced, productivity increases, is illuminating.*" (Ibid: 1980)

According to them there needs to be developed a theory which explains that $y = f(x_1 \dots x_n)$ (Ibid: 1908) and not $y = \text{sometimes } f(x_1 \dots x_n)$. Y being company performance and $f(x)$ being implemented HR practices. It is hard to imagine much disagreement between scientists about this.

The problem, they continue, is that HRM is not a closed system. This seems intuitively correct; as HRM deals with people it is going to be relatively difficult to exclude all other factors, which might influence their performance, than just the implementation of certain HR practices. Although we do dare to come with a suggestion of one possible way of doing this in the end of the article. Furthermore, they state, HR needs a theory that can give a robust explanation of complex causality, in other words a theory, which gives more than just a one-factor explanation of something, which was observed happening.

Fortunately for anybody who wishes to work with HRM, Fleetwood & Hesketh continue giving indications of a theory, something, which according to them is not even settled in philosophy so far. It has to answer what, how, and why, in other words, it has to describe and predict. Our personal

impression is that most HRM theories we have seen to a certain extend deals with the "what", but both "how" and especially "why" often remain unsolved.

Fleetwood & Hesketh (2006: 1987) ends by saying that "*We believe it is time the HR community stopped implicitly, and uncritically, accepting the 'scientific' approach and the philosophy that underpins it, and started seeking alternatives that might provide theoretical justification and robust explanation about why HR practices might actually improve organizational performance.*"

Now, after such a, one might even say "total annihilation" of any underlying HRM theory, we have to admit that a lot of the following HR research actually surprises us. The following research within the HRM-P field seems to ignore the necessity of a unifying theory, and instead start introducing elements as the mediators between HRM and company performance, in some cases even without relating them to performance at all.

We shall give two examples of this.

In 2010 Wei et al. publish the article "*High-Performance HR practices and OCB: a cross-level investigation of a causal path.*" They start by arguing that "*we believe that organizational effectiveness is composed of individual representation, careful examination of the mediating factors at the individual level will make meaningful contributions to further understand the black box of the HR practices-effectiveness linkage.*" (Wei et al., 2010: 1632) We have already logically concluded that there is a connection between the employees and the performance; without any employees no performance. And logically it might be that the different HR systems, including HPWS, are mediated by something, for example culture, or OCB, or whatever, yet all the connections need to be clarified, especially the ones connecting, in this case, OCB with performance, not just the ones connecting HPWS with OCB.

Briefly told Wei et al.'s conclusions are that HPWS lead to better psychological climate, job satisfaction, and OCB. Yet they don't in any way discuss how these elements link with company performance. Is it an underlying implicit premise for them that people, who work in a nice psychological climate, are happy with their job, and act like organizational citizens also are better performers? Possibly, yet that contradicts what Guest wrote about "ugly" companies. They base their research on, amongst others, Allen and Rush, 1998, who's research is about OCB and performance judgements, meaning how peoples performance is judged based on their display of OCB. Thus there seems to be no evidence that there is a link between OCB and company performance, or even individual performance.

Wei et al. also based their research on that of Mossholder, Settoon&Henagan 2005, who examined the relation between OCB and employee turnover. In order to draw a conclusion between any possible connection between a low employee turnover and company performance it is needed to establish if the highest performing companies have a lower turnover, once again Guest's reference to "ugly" companies seems to counter argue that connection.

The second and last example which we shall include in this paper is the article "*Promoting effective psychological contracts through leadership: The missing link between HR strategy and performance*" by McDermott, Conway, Rousseau, & Flood. Their underlying argument is that "*When managers' styles are out of sync with HR strategy, this mismatch can lead to poorer performance through ineffective and unfulfilled psychological contracts with workers.*" (McDermott et al. 2013: 289)

Their underlying premise, that HR leads to company performance is based on Huselid's (1995) research, "*which demonstrated the link between adopting SHRM practices and higher firm performance.*" (McDermott et al., 2013: 291) Huselid did not demonstrate that. All Huselid showed was that the companies, which invested in HPWS, *in average* had an increase in performance, but his research did not, as we have already discussed, show if this happened to be due to reverse causality or other factors, as Wright et al. have pointed out.

McDermott et al. continue that, "*a connection [between HPWS and company performance] clearly exists.*" We hope that it has become clear through this paper that this connection does not necessarily "*clearly*" exist, and that most of the research done trying to clarify it, is not performed in a way which lets us conclude if it is HPWS which causes company performance, or company performance which causes the investment in HPWS.

The line of thought in McDermott et al.'s article is very clear and straightforward. The managers, influences by the HR practices of the company, create a psychological contract with the employees, which then transforms into individual contribution. Logically though one may ask if company performance is just the outcome of individual contribution? Can it not be imagined that a person is contributing with a lot, just that those contributions are not integrated in the mission of the company, and thus not supporting the overall company performance? For example doBoswell et al. (2006: 500) state that in order "*to translate strategic goals into tangible results, employees must not only understand the organization's strategy, but must also accurately appreciate the actions aligned with realizing that strategy.*"

Thus it can logically be concluded, that an individuals contribution is not enough to generate company performance in itself, it must also be aligned with the overall strategy of the company.

Rounding up

We hope that it has become clear that we are in no way doubting the importance of HR systems in order to generate company performance; as we have already shown, it follows logically that without any employees a company will not have any performance either. The point has been to show that (1) there is a need for an underlying HR theory, and (2) that at least some of the literature suggesting a connection between HR practices and company performance is based on underlying premises (which might be correct, but in that case need to be clarified further) of a connection between certain behaviours of the employees and company performance.

A possible solution for an underlying HR theory

We are not deconstructionists, although so far it might have seemed like that. We truly believe in a glorious future of HR and thus take the liberty of giving a suggestion of a theory, which might one day be applied within HR.

HRM is, per definition, involving human beings. In the English grammar the word to the left defines the word to the right, and thus, taking the concept from behind we can say that it is the *management of resources*, which happen to be *human*. Now, what is a human being? According to Aristotle it is the only animal, which walks on two legs and doesn't have feathers. More poetically Foucault expressed it as nothing but a drawing in the sand on the beach. According to Quantum Physics there are four forces governing everything in this universe; Gravity, the Strong, and the Weak Nuclear force, and Electromagnetism. Stephen Hawking (2010: 133) writes that, "*Electromagnetic forces are responsible for all of chemistry and biology.*" Building on this we can say that since the human being is a biological being, which we assume that nobody disagrees with, then it must have an electromagnetic background. The interesting thing with electromagnetism is that we can measure it objectively; like the battery on the Mac indicating that there are 99% battery left.

Would it be possible to make a unified HRM theory based on the principle of electromagnetism? The research of for example Hunt (1996), Motoyama (1978), and Torp, Marosy&Purcarea (2014) indicates this.

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