

## EMPIRICAL GAPS IN THE RELATIONSHIP BETWEEN HRM AND FIRM PERFORMANCE: FUTURE RESEARCH PERSPECTIVES

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**ABSTRACT:** *HRM is the backbone of any business since it is the systematic and continuous mechanism of molding the most important human resource in any organization. Effective HRM helps stimulates employees' discretionary effort towards higher firm performance. Though the link is well theorized conceptualized, it has been a less credible assertion in practice. The reasoning behind this debate is evidenced by three most pressing knowledge gaps highlighted in the extant literature which are: (1) narrow focus of contextual factors, (2) abstract and conventional measures, and (3) unclear process of value creation. In the circumstance, it doesn't show the true picture of this relationship. Therefore, the purpose of this paper is to review these three gaps in order to draw future research attention to convince that the HRM-firm performance relationship is not an isolated phenomenon. In conclusion, this paper stimulates future research interests to view the underpinning relationship in a holistic approach.*

**KEYWORDS:** Human Resource Management (HRM), HRM-Firm Performance Relationship, Empirical Gaps

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## INTRODUCTION

The relationship between Human Resource Management (HRM) and firm performance has been theoretically well established in the extant literature. For instance, Resource Based View (RBV) of the firm (Barney, 2001; Wright et al., 2001) is found as a dominant tool for describing how firms' internal resources make differences in their performance (Sheehan & Foss, 2007). The core concept behind the RBV is that firms with unique resources may enjoy superior performance than those who do not. In other way, the costly-to-copy attributes of firm resources have long been identified as fundamental drivers of firm performance (Barney, 1986; Conner, 1991). Therefore, scholars stressed the need of effective and efficient use of human resource management practices towards positive organizational outcomes than any other resources of the firm (Jackson & Schuler, 1995).

In support, there is a great wealth of empirical studies from the long past supporting the relationship that firms' HRM practices enhance overall firm performance (Bae & Lawler 2000; Delery & Doty 1996; Delaney & Husehild 1996; Katou & Budhwar 2006, 2007; Waiganjo et al. 2012). The fact behind this assertion is that the employees in any contemporary organization is the most valuable asset that executes organizational strategies. Thus, effective management of employees is critical for firm performance (Wang et al. 2003). Williams (2003) also asserted that HRM practices as powerful predictors of firm performance and hence highlighted the need of evaluating firms' HRM practices to improve overall firm performance. Wright and colleagues (2005) also found that HRM practices are strongly related to firm performance. Takeuchi (2009) examined HRM-performance relationship in Japanese manufacturing context and found that individual-oriented HRM policies are significantly and positively associated with firm

performance. Fabling and Grimes (2010) observed a positive relationship between HRM practices in New Zealand firm performance and noted that the firms adopting high performance HRM practices experience increased profitability, productivity, and market share. Katou and Budhwar (2007) found that the HRM policies were significantly associated with the overall firm performance. In particular, the findings showed that the HRM practices are more powerful in strengthening organizational performance among diverse industries world over. Also, these findings promote managers to regard HRM as an investment to be exploited rather than just expenses to be minimized.

However to date, overall past empirical research on this relationship reveals mixed results which thus being an ongoing debate. Accordingly, research evidence negative as well as not or less significant and weak relationships between HRM and firm performance (Chan, Shaffer, & Snape, 2004; Delaney & Huselid, 1996; Guest et al., 2003; Katou & Budhwar, 2007; Panayotopoulou & Papalexandris, 2004). In support, MacDuffie (1995, p. 197) shows that only few empirical studies have been able to confirm the positive HRM-firm performance relationship. Hence, there is a debate on the theoretical relationships between HRM practices and firm performance due to these contradictory empirical findings. Therefore, the empirical findings so far on the relationships between diverse HRM practices and firm performance are not conclusive. Consequently, despite the impressive research on this phenomenon over the last two decades, eminent scholars have pointed out number of diverse gaps in the extant literature (Oladipo & Abdulkadir, 2011). Therefore, the practical aspect of the HRM-firm performance relationship is vague and complex than assumed in most of the past empirical studies (Gerhart, 2005; Guest, 2011; MacDuffie, 1995; Paauwe, 2009; Paauwe & Boselie, 2005). In the circumstance, future researchers need to pay attention on the following dubious areas where empirical gaps still retain.

### **Gap 1: Narrow Focus of Contextual Factors**

In fact, HRM effectiveness plays a major role in the HRM-firm performance relationship. Thus, the first and foremost requirement in this regard is therefore to understanding the complex interplay of internal and external environmental factors affecting effective adoption of HRM practices. In favour, the extant literature shows that there is a vast array of internal and external factors of the organizational context which have direct effects on the effectiveness of firm's HRM systems (Boon, Paauwe, Boselie, & Hartog, 2009; Fabling & Grimes, 2010; Harel, Tzafrir, & Baruch, 2003; Jackson & Schuler, 1992; Kotey & Sheridan, 2004; Malik & Aminu, 2011; Schuler, 1992; Sheehan, 2005; Shih, Chiang, & Hsu, 2006; Thompson & Heron, 2005). However, HRM literature shows that these factors are sometimes completely overlooked or narrowly/partially integrated in the conceptual frameworks of HRM-firm performance relationship (Singh, Darwish, Costa, & Anderson, 2012). Further, MacDuffie (1995, p.197) stated that one of the empirical problems in this stream of research is HRM practices are often studied in a vacuum. Also, an empirical dearth was highlighted in studying the nature of HRM in relation not just the presence but the design and implementation within its internal and external environments (Barney & Wright, 1998). However, one of the main challenges that organizations are facing in today's turbulent environment is to have desirable choice, adequate quantity, and required quality of HRM practices in the hope of ensuring their capacity to enhance organizational performance. This is because all HRM practices do not contribute to firm performance in the same way and thus all HRM practices are not equally effective in enhancing firm performance (Kehoe & Wright, 2010).

**Gap 2: Abstract and Conventional Measures**

Scholars point out that the choice of HRM systems is of greater significance since it has an economically significant effect on firm performance (Becker & Gerhart, 1996, p.796). Also, the number of HRM practices (quantity) and the way of their design and implementation (quality) are also contributory factors of this relationship. It senses that just trying to establish a link only between higher number of HRM practices and higher level of firm performance is meaningless. Therefore, the right choice, right number, and right quality of HRM practices are key ingredients of effective HRM, which are equally important for effective management of HR to achieve higher firm performance. Hence, eminent scholars in the line of HRM stress the need of effective HRM for successful businesses (Kalra, 1997, p.176; Opatha, 1997, p. 103; Wright & Rudolph, 1994, p. 28). However, past empirical findings on HRM effectiveness are relatively limited (Guest, 2011) thereby still vague particularly in relation to the non-Western countries as most of the HRM studies are confined to the Western context (Katou & Budhwar, 2007; Guest, 2011). Therefore, investigations on how current HRM practices are designed and implemented and then the analysis of their causes and consequences would be a dire need to predict the true picture of this relationship.

However, it can be seen that although the contemporary business organizations show a top priority on their workforce by offering a greater number and quality of HRM practices particularly in most corporate annual reports, it is contradictory with the current practice (Barney & Wright, 1998). The underlying reason is that most firms suffer with some constraints towards effective HRM (Kane et al., 1999; Maxwell & Farquharson, 2008; Truss, 2003). For instance, budgetary problems have been a major issue with the ever increasing market competition. Thus, firms have implemented cost cutting through both the reduction of HR (headcounts) as well as budgets mainly on employee wages, welfare, training and incentives, thus giving less priority on HRM (Barney & Wright, 1998, p.31). Therefore, this issue has a spillover effect from an individual to the society.

However, there is a paramount dearth of empirical investigations on the barriers of effective HRM particularly among non-western countries despite its dire need. The reason for the implementation of cost cutting from HRM budgets is being the poor credibility of the HRM-performance relationship. Therefore, it is badly required to conduct empirical investigations to ensure the effect of HRM practices on firm performance in different country contexts. In favor, Katou and Budhwar (2006, 2007) pointed out that the ultimate result of cost reduction strategies in current businesses such as low labour, suppressing the wage levels, having employed incompetent workforce with less bargaining power, and/or cut off the expenses related to employee training and development would be lower firm performance through less efficiency, effectiveness, quality, and innovation.

Purcell and colleagues in 2003 argue that there are practical problems in establishing direct HRM-firm performance relationship since some conventional performance measures such as profits or shareholder value are too remote from the influence of HRM practices (c.f. Armstrong, 2009, p. 140). As Fabi et al., 2010, p.117) emphasized “although several studies show positive relationship between HRM and organizational performance, the mechanisms behind this relationship remain poorly understood”. Therefore, Fabi and colleagues highlight the need of a more systematic approach to HRM. However, it is rather dubious about why we are not yet flourished with sufficient evidence to explain how and why HRM associates with firm performance with such a sound rash of studies of this phenomenon to date, thus still searching for some answers (Guest, 2011).

### **Gap 3: Unclear Process of Value Creation**

Scholars argue that the process of value creation in the HRM-firm performance relationship or the intervening link is still unexplored or black boxed and hence gains less credibility in practice (Becker & Huselid, 1999; Boselie, Dietz, & Boon, 2005; Guest, 2011; Katou, 2011; Paul & Anantharaman, 2003; Priem & Butler, 2001). In support, Becker and Huselid (2006, p. 915) stated that the most critical theoretical and empirical challenge in the SHRM research is the requirement for a “clearer articulation of the ‘black box’ between HRM and firm performance”. As Guest (1997, p.274) highlighted, “it is not clear why this association exists”. He further asserted that “At present the studies report a promising association between HRM and outcomes, but we are not yet in a position to assert cause and effect” (p. 274), because so far there is a lack of convincing explanations on major elements of this link. Thus, Guest (1997) further asserted the need to improving theoretical and analytical frameworks explicitly for describing the HR-performance linkage (p. 263). Wright and McMahan (1992, p.315) also stressed the need of more theory based empirical research since the existing perspectives for viewing HRM have not yet been subjected to consistent rigorous empirical tests. Becker and Gerhart (1996, p.797) added that the “extant research suggests that HR systems have considerable economic potential, but there is little consensus on how to achieve that potential”. According to MacDuffie (1995, p.197), only few studies have systematically described the conditions under which the HRM-performance relationship is strongest.

Further, Ulrich (1997) revealed that the relationship between HRM practices and firm performance are often fuzzy and vary according to the population sampled and the measures used. Moreover, Barney and Wright (1998, p.41) added that even though some recent research has proved the relationship between HRM practices and financial performance, ‘...more research is needed on how, exactly, this impact is gained’. Park, Mitsuhashi, Fey, & Bjorkman (2003, p. 1392) show that “little empirical attention has been paid to exploring the processes or the so-called ‘black box’ through which this impact takes place”. Therefore, many authors have criticized HRM research for its lack of theoretical and empirical work specifying the mediating processes through which HRM practices lead to firm performance (Becker & Gerhart, 1996; Delery, 1998; Dyer & Reeves, 1995).

### **CONCLUSION AND FUTURE RESEARCH**

In conclusion, effective HRM is a universally accepted norm, thereby no one can deny the importance of HRM in contemporary organizations (Boohene & Asuinura, 2011). However, in practice, HR is the most difficult resource to manage. As a result, the cost of HRM is really high and it has been the biggest of the total operating cost in today’s organizations. On the other hand, it is not clear how HRM as an investment returns value in the long run. Therefore, significant attempts have been undertaken to explore the HRM-firm performance relationship over the last decade. However, substantial confusions leading to serious arguments still remain on what mechanism through which HRM directs excellent firm performance (Guest 2011). Past literature evidenced the process of value creation between HRM and firm performance is not yet explored or black boxed (Boselie et al. 2005; Guest 1997, 2011; Paul & Anantharaman 2003; Priem & Butler 2001). It senses that the lack of clarity on what actually leads to what. Therefore, the HRM-firm performance relationship gains less credibility in practice although it is theoretically well established by the RBV of the firm (Barney 1991). Therefore, the relationship between HRM and firm performance is still under study in search of a very

comprehensive understanding of the holistic view of this relationship. Literature highlights the extant empirical gaps have made it a pressing issue in the strategic HRM research arena and a never ending search (Becker & Huselid 2006, Guest, 2011).

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