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Market competition, HRM, and firm performance: The conventional paradigm critiqued and reformulated

Bruce E. Kaufman *

Department of Economics, Georgia State University, Atlanta GA USA
Department of Employment Relations & Human Resources, Centre for Work, Organization, and Wellbeing, Griffith University, Brisbane, QLD, Australia

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ABSTRACT

A proposition in the HRM literature is that to survive intensifying competition firms need to more effectively use their human capital by implementing high-performance work practices (HPWPs). This proposition is anchored on both extensive empirical evidence of a positive HPWP effect on performance and a theoretical model which incorporates ideas from strategy, RBV, AMO, behavioral, human capital, and organizational capability perspectives. This paper argues that on deeper examination both empirical and theoretical arguments have significant flaws and weaknesses which undercut the 'more competition → more HPWPs → higher firm performance' proposition. Indeed, using an alternative economics-based model the paper concludes the likely effect of intensified competition is, on balance, the opposite of the standard model; that is, more competition leads to less HPWPs. The model also demonstrates why the positive HPWP effect found in empirical studies is likely upward biased and more association than causation. The paper reconciles a number of empirical anomalies, such as why high-performance work systems are not more widely adopted, and explains why the conventional advice given to managers – invest in more HPWPs – needs revision.

1. Introduction

"Competition affects personnel policies and procedures so greatly that it forms the proper background for our analysis." (Balderston, 1935: 222).

The human resource management (HRM) field is broad and multi-level but at its core is the subject of how HRM systems and practices affect organizational performance. The recent eleven-chapter book *HRM & Performance*, edited by Paauwe, Guest, and Wright (2013), provides a state-of-the-art survey and synthesis of this literature, particularly as it has developed and evolved since Huselid's (1995) pioneering study.

In the conclusion chapter, Paauwe, Guest and Wright (hereafter PGW) summarize the themes and findings from their volume and the HRM research literature at large. On the central question of HRM and performance, they state, "reviews of research findings have consistently shown that, irrespective of business strategy and context, there is a strong association between the adoption of more 'progressive,' 'high-performance' or 'high commitment' HR practices and organizational outcomes" (pp. 197–98). In a wrap-up statement several pages later, PGW observe, "while there are still many gaps to be filled…, we can be more certain that research findings demonstrate that an association exists. On this basis, we can generally recommend that a *full use* of HRM is good for organizations…" (p. 204, emphasis added). These conclusions are quite close to Huselid's (1995) original formulation, stated as: "All else being equal, the use of High Performance Work Practices [HPWPs] and good internal fit should lead to positive outcomes for all types of

* Tel.: +1 404 217 4649.
E-mail address: bkaufman@gsu.edu.

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firms" (p. 644). The positive HRM/HPWP effect (note both terms are used in the quotations) and its 'full use' implication are framed by De Winne and Sels (2013: 181) in their chapter in the PGW volume as the *more is better* proposition (their words).

The proposition that more HRM/HPWPs are better is a straightforward implication of the positive HPWP regression coefficient which PGW indicate is widely found in empirical HRM–performance studies. However, researchers have also long noted that the positive main effect and the adoption and configuration of high performance work systems (HPWS) may be modified, although typically not reversed, by numerous mediating, contingent, and contextual factors (Boxall & Purcell, 2011; Delery & Doty, 1996; Lepak & Snell, 1999). The contingency getting the most attention is the firm's business strategy. Numerous other internal and external contingent factors have also been examined; for example, Datta, Guthrie, and Wright (2005) ask in the title of their paper: Does Industry Matter?

This paper asks: Does Market Competition Matter? HRM researchers take a bifurcated position on this question. Formal analysis is sparse (reviewed in Patel & Cardon, 2010) but informal statements abound. In the latter category, studies frequently cite increased competition as a major reason why companies need to get more value from their human capital by shifting from a traditional to transformed HRM system. For example, Wright and Kehoe (2008) observe, "In a world increasingly characterized by globalization of product markets, the importance of human capital as a resource that can potentially provide competitive advantage has become more important because a firm's people are integral to success" (p. 6). In the formal category, Jackson, Schuler, and Jiang (2014) put forward this conclusion from a literature review: "Firms facing high levels of market competition… are more likely to implement high-performance HRM systems" (p. 16). This proposition can be restated as: more competition → more HPWPs.

The relative lack of formal attention in the HRM–performance literature to market competition, and the external economic environment in general, is both understandable and surprising. It is understandable because the empirical evidence suggests that contingencies play a relatively spotty and modest role (the PGW quote). Research focus has also over the last decade increasingly shifted to a more micro focus on individual/behavioral processes and determinants in the black box connecting HRM and performance (Messersmith, Lepak, Patel, & Gould-Williams, 2011). The internal focused resource-based view (RBV) of the firm is the dominant theoretical frame (Allen & Wright, 2007), and psychology is the dominant disciplinary frame (Chadwick & Dabu, 2009). It is surprising, on the other hand, because the RBV is built from microeconomics and the model of perfect competition (Barney & Clark, 2007: Ch. 2) and important concepts, such as business strategy, competitive advantage, vertical fit, and resource value, are only explicable by reference to market constructs and forces (prices, demand/supply, etc.). Likewise, it seems difficult to empirically explain the different business strategies and HRM systems firms adopt within and across industries and nations (e.g., Walmart vs. Costco; McDonald's vs. Microsoft; Deutsche Telekom vs. Verizon) without attention to their economic environment and competitive conditions (their external 'playing field'). Indeed, the importance of competitive analysis was emphasized by Balderston, management professor and dean of the Wharton School, in the mid-1930s in his book on strategic HRM (*Executive Guidance of Industrial Relations* 1935). Nonetheless, Jackson, Schuler, and Jiang (2014) conclude, "much of the empirical research has ignored … environmental influences" (p. 25).

Accordingly, a good case can be made that the competition–HRM topic deserves more of both theoretical and empirical analysis. This paper starts with the theory side. In researching the topic, the author became convinced that the formal/informal proposition 'more competition → more HPWPs' is probably incorrect and the opposite relation is more likely on both theory and empirical grounds. Likewise, it appears that the mis-prediction problem stems from serious – perhaps fatal – logical and methodological flaws in the HRM–performance model widely used in the literature. Hence, while the paper is focused on the specific topic of competition–HRM, working out the logically correct hypothesis takes the paper into a deeper paradigm critique and development of an alternative economics-based HRM model. The scope of the article, therefore, is broader than most and brings out for discussion fundamental issues of theory, method, and empirical analysis.

The next section of the paper presents a literature review. The first part sketches the place of market competition in the HRM research stream and further documents through citations and quotations the more competition → more HPWPs hypothesis. Since this proposition is typically informally and somewhat heuristically stated, the second part of this section advances HRM theory by showing in a two-part diagram how and why the standard HRM–performance model in the literature leads to the more competition → more HPWPs hypothesis. The paper's next section presents five empirical anomalies related to competition/HRM which are inconsistent with the HRM model's maintained hypothesis. Given these shortcomings and question marks, the paper next outlines an alternative economics-based model, applies the model to analyze the Does Competition Matter? contingency, shows that the predicted effect of greater competition is less HPWP adoption, and then identifies three contingent factors which modify and possibly reverse the negative relation. Since the two models considered in the paper yield opposed predictions, attention is given to identifying the assumptions, concepts, and causal linkages which lead to this divergence; likewise, the economics-based model is used to shed light on the five empirical anomalies earlier cited. Finally, this model is also used to demonstrate why the estimated main effect in empirical studies is likely an over-estimate of the causal effect of HPWPs on performance.

To avoid unproductive controversy, considerable effort is made to accurately summarize the mainline of the HRM research literature — called the "basic accepted wisdom" by Jackson, Schuler, and Jiang (2014: 21). Naturally, around the basic accepted wisdom is a considerable amount of heterogeneity in findings and perspectives of individual authors and studies. Thus, my representation and interpretation of the 'standard model' in HRM is an attempt to draw a mean-centered straight line through a large, dispersed, and noisy set of data points (reviewed in Kaufman 2014a, 2014c). Inevitably, some readers will look at the literature and think the line should have been drawn differently, generalizes too much about a complex subject and body of evidence, or leaves out important qualifications. This problem is heightened because the paper is a critique from outside the management field which elicits defensive reactions and generates mutual misunderstandings due to different lexicons and analytical mindsets (Zyphur, 2009). Constructing a consensus portrait of HRM is also made difficult by incommensurate definition and usage of key constructs across studies (e.g., what is HRM?, what is an HPWP?) and divergent representations of research findings (e.g., PGW feature on the first page a quotation stating 'no confidence' in a positive HPWP effect yet on the second-to-last page reverse position to a 'fully confident' view).