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# The HR system, organizational culture, and product innovation

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## Abstract

This paper outlines the critical role of organizational culture in the link between the HR system and development of new products and services. While it has been generally accepted that an innovation-oriented HR system would lead to higher level of innovation, the literature does not lend full support to this link. This paper is to point out the inadequacy of such simplified view. It is suggested that a developmental culture is the missing link in-between HR system and innovation outcomes. An HR system which emphasizes extensive training, performance-based reward, and team development is necessary to create an organizational culture that is conducive to product innovation. The empirical findings from a survey of 332 firms in Hong Kong confirmed that organizational culture acted as a mediator between a firm's HR system and product innovation. © 2004 Elsevier Ltd. All rights reserved.

*Keywords:* Firm performance; Innovation; Organizational culture; Strategic human resource management

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## 1. Introduction

For some years now, the notion of best practices in human resource management (HRM) has received a lot of attention. It has been suggested that there is a universal set of human resource (HR) best practices that can enhance a firm's performance (Pfeffer, 1998). However, this notion of HR best practices is not well supported in the research literature (Delaney & Huselid, 1996; Wright & McMahan, 1992), including in studies using international samples (Lui, Lau, & Ngo, 2004). Marchington and Grugulis (2000) called

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this ‘the illusion of best practice’. They claimed that in order to determine the effectiveness of HR, the context in which HR is practiced must be included in the analysis.

McMahan, Virick, and Wright (1999) reviewed the theoretical development of strategic human resource management (SHRM) and concluded that SHRM could be viewed as a configuration of HR practices, which must be internally and externally consistent, and hence integration and fit is needed. It is understandable that HR practices seldom lead directly to a high level of firm performance (Delery, 1998). Instead, they influence firm resources, which are ultimately linked to performance. Moreover, different types of HR practices commonly employed by organizations may bring about different outcomes for organizations (Ulrich, 1997). We contend that the simple relationship between HR and firm performance as suggested in some literature is inadequate.

The current literature indicates that it is not fruitful to examine just a single type of HR practice and its influence on a firm’s performance. Instead, bundles of HR practices and their contingent effects have to be analyzed (Bowen & Ostroff, 2004; Delery & Doty, 1996; Wright & Boswell, 2002). In this paper, therefore, the effect of HR on organizational outcomes is examined by considering the integration of complementary HR practices as an HR system, and the fit of HR practices with organizational culture. Since developing innovative products and services is critical for a firm’s competitiveness in the market, we therefore focus on product (and services) innovation as an important indicator of firm outcomes.

Innovation represents an orientation fundamentally different from traditional financial or market-based outcomes of a firm. Muffatto (1998) suggested that in the innovation process, the creation of an innovative climate and related professional knowledge and capabilities are needed to support innovation activities. Hence, there is a need to change organizational arrangement and culture in order to foster innovation. This argument is in line with human capital theory used to explain an organization’s competitiveness in innovation outcomes (Chacko & Wacker, 2001; Chan, Schaffer, & Snape, 2004; McMahan et al., 1999). For innovation-oriented firms, HR must then be practiced with innovation-enhancing HR policies (Searle & Ball, 2003). These policies may differ from conventional HR practices in stable environment (Ulrich, 1997).

We first review the link between HR and firm outcomes in Section 2. The review identifies a missing critical process variable in the link in the current literature. The necessary components of a HR system for innovation are then presented, followed by a discussion of the critical role of organizational culture in this link. Two hypotheses are first developed according to the conventional arguments, a third hypothesis focusing on the mediating role of organizational culture is then suggested as a better alternative. It is suggested that there must be an integration of HR systems and organization cultures in order to have effects on innovation performance. The empirical findings of a study testing the proposed relationships are reported with some suggestions for further research.

A firm-level conceptual framework is developed in this study to explain how HR is related to innovation performance, as a response to the call for more theoretical development in HR research (Ferris et al., 1998). Two issues about the relationship between HR practices and firm effectiveness are explored. First, several HR practices are suggested as the necessary components of an innovation-oriented HR system. These practices are identified and their impacts on product innovation are evaluated.

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