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# BUSINESS STRATEGY AS A MODERATING FACTOR ON PERFORMANCE OF SHRM PRACTICES AND FIRM PERFORMANCE: A THEORY BASED REVIEW

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## Abstract

Due to the highly volatile and competitive business environment, today organization realizes that the human resource is the effective utmost important resource to keep a competitive edge over others. Then, the modern practice of strategic human resource management has come to the context as a remedy to the prevailing situation. However, it is evident that the SHRM practices of the firm moderated by the business strategy of the firm. Therefore, this paper examines the effect of business strategy on the firm SHRM practices and firm's performance. This paper examines the existing literature in relation to the focal focus of the study. The study reveals that the SHRM practices of the firm moderated by the business strategy of the firm.

**Key Words:** Business strategy, Strategic human resource management and Firm performance

## Introduction

Today's business organizations, creation and exploitation of competent strategy have become a competitive advantage. Moreover, the global competition has been strengthened due to the rapid developments in HR competency. Thus, its proven that human capital of the firm enables to bring the competitive advantage to the firm. Hence, organizations are seeking for innovative practices, processes, and systems to win the markets due to the dynamic and competitive nature attached to the word of work setting. In the era of competent-based economy, the proverb in the competitive in the area of strategic human resource management. Even, SHRM practice is contemporary catch up phrase to excellence the firm performance, it can be seemed that the practices of SHRM ultimately mediated by the business strategy of the firm. Hence, this paper attempts to study the role of the busines strategy of the firm in order to deploy the success SHRM practices of a firm.

## What Business Strategy is?

For organisations to be successful, they need to have a strategy. The strategy that an organisation in a single business adopts is often referred to as its business strategy. The business strategy that firm implement can be determined by the contingencies of the external environment (Chandler, 1962). As competition increases, firms are forced to make an explicit choice about what strategy will be pursued. A more explicit choice needs to be made because not doing so will result in a lack of focus where resources, goals and workforce efforts are divided, a phenomenon referred to as being 'caught in the middle' (Porter, 1980).

A fundamental requirement in developing HR strategy is that it should be aligned to the business strategy (vertical integration) (Armstrong, 2006). The literature suggests that the set of SHRM policies of an organisation will be effective if it is consistent with other business strategies (Gomez-Mejia & Balkin, 1992; Katou, 2008). Integration refers to the involvement of HRM in the formation and implementation of organisational strategies and the alignment of HRM with the strategic needs of an organisation (Buyens & Devos, 1999; Schuler & Jackson, 1999).

There are a number of strategies that managers have developed as they try to find the unique value mixture that maximises performance for their organisation in their environment, but the majority involves a competititve strategy that involves some form of cost reduction and/or differentiation (Porter, 1980). Accordingly, companies adopting cost reduction strategy demands workers to work harder, whereas innovation strategy requires workers to work differently, whilst quality strategy needs them to work smarter. In the case of innovation-based strategy, impetus is to be given to free thinking and for bringing in new ideas (Schuler & Jackson, 1987). Some of the strategies include innovation leading to product or service differentiation, productivity gains, improved quality or customer service, cost reduction and downsizing.

## Business Strategy and SHRM Practices

There are several theories which discussed the relationship between SHRM and organisational business strategy (Bird & Beechler, 1995; Delery & Doty, 1996; Huang, 2001; Huselid, 1995; MacDuffie, 1995; Miles & Snow, 1984; Lee et al., 2010; Prince, 2015; Schuler & Jackson, 1987a, b), but very few have tried to study this relationship empirically (e.g. Arthur, 1992; Guthrie, Spell & Nyamori, 2002; Krishnan, 2005; Paul & Anantharaman, 2003; Richard & Johnson, 2001; Sanz-Valle et al., 1999; Takeuchi, 2009). Empirically, Prince (2015) and Takeuchi (2009) have shown that the business strategy that organisations take will influence the effect that the HR systems of organisations have on their performance. Even so, there are only a handful of empirical studies that investigated the effect that business strategy has on the use of SHRM by organisations (Arthur, 1992; Guthrie, Spell & Nyamori, 2002).

In their studies, Takeuchi (2009) and Prince (2015) included three different measures of business strategy. They are cost-reduction, differentiation and quality management. This is in line with the works of Porter (1985) and Schuler and Jackson (1987) where SHRM practices are determined by the type of business strategy that a firm pursues in terms of cost, quality and innovation. Aligning

HRM policies with business strategies will positively affect the effectiveness of HRM policies and thus will improve organisational performance (Katou & Budhwar, 2010). Huang (2001) found that companies that closely coordinate their business strategy and SHRM practices achieve better performance than the companies that do not (Huang, 2001). The three strategies are discussed in the following sub-sections.

**Measures of Business Strategies**

When SHRM is properly implemented and assimilated, the incremental benefits accrued can be extremely relevant, leveraging most of the key strategic drivers in organisations (Crosby, 1979; Feigenbaum, 1951; Juran et al., 1974). Case studies have revealed that successful SHRM practices enable different ways to manage business products and services, inducing a positive impact on business performance. Other studies have also analysed the impact of SHRM practices on revenue-creating core processes, such as customer services, sales and distribution, resulting in a strong bottom line (Sila & Ebrahimpour, 2003).

***Cost-reduction***

Cost reduction applies to efforts by companies to reduce their cost structure (Porter, 1980). Improved organizational productivity can be achieved by increasing profitability by lowering costs throughout the value chain. Organizations will increase profits by introducing more cost-control measures. If they become a cost-leader in their business, they will take strategic measures, including a cost-leader.

The basic goal of the cost-reduction strategy is to increase profit and productivity by incorporating competitive cost-reduction measures Although SHRM will often improve the organization's efficiency (Combs et al., 2006; Huselid, 1995), the introduction of SHRM may also increase the overall labor costs of the organization (Cappelli & Neumark, 2001; Way, 2002). Increased labor costs associated with SHRM that dissuade organizations that have implemented a cost-reduction strategy from implementing HPWS at the same time. The converse of this argument is that SHRM would encourage organizations to do more with fewer people. It is possible that even when compensation costs per employee are higher, the overall compensation costs of the firm could be contained by hiring fewer employees, but employees, who are competent, informed, incented and have greater discretion on decisions than employees would be if the organisation did not implement a SHRM. However, given the logic presented by Cappelli and Neumark (2001), it is expected that an organisation pursuing a cost-reduction strategy will be less likely to adopt a SHRM compared to those that are not pursuing a cost-reduction strategy.

Literature suggests that firms pursuing a cost strategy aimed at minimising overheads and maximising economies of scale are expected to achieve positive financial results (Katou, 2011; Katou & Budhwar, 2007; Schuler & Jackson, 1987).

***Innovation***

Institutions are working on developing a number of HR practices that complement business strategies outside the HRM field with the idea that efficiency will be enhanced if the best alignment or match between business strategy and HR practices is achieved. For example, in general, when implementing an innovation strategy, companies concentrate on HR activities that promote cooperative, interdependent actions. This refers to the creation of an innovative program, product or process that allows organizations to offer a unique product to their customers (Porter, 1980). Organizations are pursuing this business strategy by developing new goods to introduce to the market. This is achieved either by providing a new product to customers or by adapting an existing one. It is also done by introducing an innovative new process earlier in the value chain. A good example of this is the numerous innovations that Apple has released such as the iPhone, iPad, etc. and the Tesla electric car. In both cases, their innovations have helped them to gain competitive advantage in their industry, each time changing the underlying structure of their industry.

***Quality Management***

The differentiation (quality management) strategy refers to organisations which compete based on the quality of their products or services (Schuler & Jackson, 1987a). Quality may come as a result of optimizing the process used to make a product or by improving the quality of the resources used. Organizations that use this approach can achieve competitive success by increasing sales by attracting quality-sensitive consumers or by reducing the number of ineffective services and thus reducing the surplus, which leads to increased productivity. The emphasis of the quality strategy seeks to enhance quality through ensuring highly reliable behaviour from individuals who identify themselves with the goals of the organisation. In contrast, for a cost leadership strategy, HR seeks to maximise efficiency through managerial monitoring and close control of employee activities (Schuler & Jackson, 1987). External fit, best fit and strategic fit are considered to be alternative expressions of vertical fit that determine the so-called contingency model (Delery & Doty, 1996). Firms pursuing a quality strategy aimed at delivering high-quality goods and services to customers emphasising resource effectiveness and productivity, characteristics that fit the rationale of a goal model (Cameron & Quinn, 1999).

A good example of a firm that uses a quality management strategy is the Japanese auto firms of Honda and Toyota. They empower their employees through total quality initiatives to fix problems that come up at any point in the manufacturing process. This strategy has led these organisations to several decades of dominance in the automotive industry. Empowering employees with this responsibility and power requires the employees of these organisations to have both the skills and motivation to effectively implement such a programme.

Quality of services is the most important aspect in the banking industry. Business success can be reinforced if one conscientiously searches for newer and more effective ways of improving the quality of ways of serving customers. Effective quality measures bring in a transition from the good old good to the novel better or best from the internal department of the banks to its front-line employees. If quality management is effectively formulated and practised, it provides extreme ease and clear direction to a bank employee in understanding what makes his or her bank the first choice to its customers before other banks.

**Previous Studies Relating to Strategic Human Resource Management, Firm Performance and Business Strategies**

The relationship between SHRM, firm performance and business strategies may have been theorised (Miles & Snow, 1984; Schuler & Jackson, 1987a, b) but relatively little empirical work has been done to test this theory (e.g. Sanz-Valle, Sabater-Sánchez, & Aragón-Sánchez, 1999; Takeuchi, 2009; Prince, 2015). The business strategies of cost-reduction and two different types of differentiation strategies, namely innovation and quality management strategies (Porter, 1980) have obvious relevance to the connection between SHRM practices and firm performance.

Theoretically, it makes sense that organisations will try to match their HR strategy to be congruent with their business level strategy (Miles & Snow, 1984; Schuler & Jackson, 1987a, b). Empirically, there is evidence to support this assertion. Sanz-Valle et al. (1999) found that firms that pursued a quality or innovation strategy are more likely to spend more on training, whereas those pursuing a cost-reduction strategy are less-likely to spend funds on training. Similar findings were found with regards to other SHRM practices like recruitment and selection, career development initiatives and compensation.

In addition, Nankervis et al. (2005) identify three types of linkages between HR and organisational strategies. First is the accommodative type where HR strategies simply follow organisational strategies, accommodating the staffing needs of already chosen business strategies. Thus, strategies in this sense are for HRM to follow the organisational business strategy. The second is the interactive type, characterised as a two-way communication process between HRM and corporate planning in which HRM contributes to, and then reacts to, overall strategies. For this type, SHRM asserts that HRM is an active contributor to strategy development and execution. The third is a type of strategy known as the full integration type. For this type, the HR specialist is intimately involved in the overall strategic process in both formal and informal interactions which a real reflection of SHRM is in practice (Nankervis et al., 2005). The degree of involvement will extend to HRM being fully represented at the senior management group level and HR personnel actively participating in strategic decisions and it might even involve an HRM appointment to the Board of Directors.

However, one of the shortcomings that has been discussed about past research is the combination of innovation and quality management into one measure, known as a differentiation strategy (Jackson et al., 2014). It is imperative to break the dimensions of differentiation into two distinct strategies in testing the influence of business strategy on the SHRM-performance relationship.

On the other hand, one of the popular research trends of SHRM is to examine the association between HPWS and business performance (Boxall & Purcell, 2003), and many studies have reported a statistically significant relationship (Appelbaum, Bailey, Berg & Kalleberg, 2000; Batt, 2002; Delery & Doty, 1996; Guthrie, 2000; Huselid, 1995; MacDuffie, 1995). HPWS is defined as structured workplace practices that incorporate worker involvement in front-line decisions and that range from participation in production and quality management teams to employee incentives and reward schemes (Appelbaum et al., 2000). The basic aim of HPWS is to foster skills and involvement of employees. One recent review of studies on the association between HPWS and organisational performance shows that in more than 30 studies carried out since the early 1990s, there is a positive correlation between HPWS and organisational performance and that effects of HPWS are cumulative, meaning that the greater the number, the greater the effectiveness of the practices.

However, some important theoretical and methodological issues are missing in this line of research. First, there is little research on the mediating mechanisms through which this relationship takes place. Furthermore, few empirical studies examine the mediation effects of employee attitudes in the relationship between HR practices and firm financial performance. Many scholars (Dyer & Reeves, 1995; Becker & Gerhart, 1996; Guest, 1997) argue that research to uncover mediation relationships between HPWS and organisational performance is essential to rigorous elabourations of SHRM-related theories. Testing the mediation effect would increase confidence in the causality claim. Although there are some studies that focus on high performance work practices and worker outcomes (e.g. Appelbaum et al., 2000), these studies did not extend their focus to the mediation relationship. This study has included employee retention behaviour as the mediator, which is discussed in the following sub-section.

## Conclusion

Based on RBV, SHRM practices play an important role in building the human capital pool of an organisation by developing its rare, inimitable and non-substitutable internal resources. Hence, SHRM policies have a direct impact on employee attributes such as skills, attitudes and behaviour, including employee retention, which are subsequently translated into improved organisational performance (Boxal & Steeneveld, 1999). The findings point to the conclusion that organisations that can effectively influence the behaviour of their employees through HRM systems will be able to increase their performance (Huselid, 1995). However, its mediating effect on the relationship between business strategy and SHRM practices of the organization has not got much attention but the impact is great as per the analysis.

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