International Journal of HRM and Organizational Behavior

www.ijhrmob.com

editor@ijhrmob.com

ISSN 2454 - 5015

Strategic Human Resource Management and Workforce Differentiation: Linking the Micro and Macro Worlds

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Abstract

This article examines the benefits and drawbacks of combining the micro and macro domains of strategic human resource (HR) management literature. Their special emphasis is on the creation of a distinctive HR architecture in support of strategy execution as a major organizing topic. Workforce management systems that put key competencies and roles front and center may provide a substantial boost to a company's bottom line. Management may have difficulty with the implementation of differentiation based on strategic competence rather than hierarchical organizational level, while researchers have theoretical and empirical difficulties.

Keywords: high-performance work systems; workforce differentiation; strategic human resourcemanagement; strategic capabilities

Introduction

In many fields of the organizational sciences, there is a clear gap between the micro and macro levels of theory and study. When it comes to answering pressing questions in today's increasingly global and complex business context, scholars will need to draw on the strengths of both perspectives, but this trend of increasing specialization is often associated with disciplinary growth and maturity, which can have unintended consequences.

Our own topic of study, strategic human resource (HR) management, is a prime example of this void. Over the last two decades, the body of literature on human resources strategies has exploded, attracting the attention of both HR professionals and academics (Becker & Huselid, 2006). Numerous disciplines, including economics, human resource management, industrial relations, sociology, and strategy, have contributed to the publication of more than three hundred publications on HR strategy since the early 1990s. Financial benefits to investments in high-performance work systems (HPWS) are both economically and statistically significant, according to the key findings of this line of study (Becker & Huselid, 1998, 2006; Combs, Ketchen, Hall, & Liu, 2006; Huselid, 1995). When a company adopts (a) recruiting and selection systems that are in line with its competitive strategy, (b) reward systems that reflect successful strategy implementation in performance appraisals and employee compensation, and (c) training and development strategies that are guided by performance management systems and business objectives, the literature finds that the firm's performance is more likely to improve (Becker & Huselid, 1998).

Although we have come a long way, there are still some major obstacles to overcome. One of the most pressing issues in this field is the need for a more thorough and comprehensive causal model between HR management systems and company performance. For instance, Huselid and Becker (1998) created a causal model that connects HR expenditures to bottom-line results for businesses. Specifically, business and strategic initiatives drive the design and implementation of HR management systems, which in turn affect the skill and motivation of the workforce and the design of the work, which in turn affects productivity, creativity, and discretionary effort, which in turn drives profitability, growth, and ultimately shareholder value. However, more development of this model is necessary for the field to advance (Becker & Huselid, 2006).

The micro (concerning the design of recruitment, selection, performance appraisal, rewards systems, etc., and individual responses to those systems) and macro (concerning the strategy formulation and implementation processes) domains that provide a basis for these constructs should be more fully integrated to address this challenge, as we describe below. Facilitating these results will need theories, research methodologies, and qualitative and quantitative data acquired from many viewpoints and levels of analysis, both micro and macro. We present some of the most major obstacles and prospects for this area of study and a strategy that we feel will be useful in bridging the micro-macro gap, drawing on our empirical work and practical experiences with numerous companies.

Workforce Differentiation and Strategic Success

Wright and Boswell (2002) note that traditional micro (functional) research in HR has focused on the impact of individual HR practices on individuals, while macro (strategic) HRresearch has focused on the impact of HR management systems on groups or organizations.We agree with Wright and Boswell about the importance of integrating the micro and macrodomains in future HR strategy research. However, we also believe that to move the literature
forward, scholars not only should integrate the functional and strategic *across* firms but alsoshould focus on the need for workforce differentiation and integration *within* firms.

As an example of this concept, consider how a focus on workforce differentiation wouldhelp to answer one of the central questions facing this literature: After nearly two decades ofempirical research support for a positive HPWS–firm performance relationship, why do we still observe such substantial differences in HR management "quality" across firms (Becker,Huselid, & Beatty, 2009)? Said differently, if the financial returns to HPWS are so substan-tial, why aren't more firms using them?

We believe that there are two categories of answers to this question, one simple, the sec-ond, much more nuanced and complex. The first response reflects what we would describe asa "best practice" explanation (Becker & Huselid, 1998). The key point here is that the impactof HPWS on performance is both economically and statistically significant, but most HR managers are either unaware of these effects or unable to persuade (or help) their firms adoptthem. As a result, we observe substantial variance in HR management quality across firms, and therefore, firms that effectively adopt HPWS are able to achieve a competitive advan- tage. In the long run, we would assume that the discipline of the market will encourage firmsto improve the quality of their HR management systems and that the coefficient on HR management quality would fall over time (Becker & Huselid, 1998, 2006). But in the short run, there is substantial evidence to support the assertion that HR best practices affect firm performance (Becker & Huselid, 1998, 2006; Combs et al., 2006; Huselid, 1995), reflectinga market failure in the design and implementation of HR management systems.

The second category of answer we would describe as the "alignment" explanation. Here the key question is whether or not there is a potential source of economic returns to care- fully aligning a firm's HR management system with its strategy, beyond the potential returns to implementing HR best practices efficiently and effectively. The theoretical lit- erature in HR strategy, often drawing on the resource-based view of the firm, would suggestan answer. Aligning HPWS with competitive strategy and operational goals can potentially create wealth because alignment is causally ambiguous: It is hard to decipher from outside the organization, and it is path dependent; that is, there is an implementation to benefit lag, especially in the acquisition, development, and deployment of talent, that affords a "first mover" advantage to firms that effectively align HPWS with strategy (Collis & Montgomery, 1994).

As a consequence, we believe that the arguments for best practices and alignment are notmutually exclusive but, at least in theory, cumulative. We would expect that the returns to alignment are much greater as the overall levels of best practices improve. Indeed, it is likelythat a threshold level of HR management quality is required to facilitate alignment (Becker & Huselid, 1998). Thus, it may be likely that higher quality HR management systems will become a necessary, but not sufficient, form of organizational infrastructure to provide a long-term source of competitive advantage.

In any case, we believe that the alignment argument will need to be significantly better developed to be useful for both science and practice. For us, the answer lies in a more com-plete explanation of the processes through which investments in the workforce—and in workforce management systems—help firms to implement their strategies and to create wealth. Our recent research has focused on workforce differentiation as a key component of
successful strategy execution and, ultimately, firm performance (Becker & Huselid, 1998,2006; Becker et al., 2009; Beatty, Huselid, & Ulrich, 2001; Huselid, Beatty, & Becker, 2005;Huselid, Becker, & Beatty, 2005). The essence of our argument is that some jobs are morevaluable (strategic) than others, and they should be managed accordingly. This means thatdisproportionate investments must be made in strategic roles, ensuring that the organizationplaces top talent in these positions. For less value-added roles, the organization must makeinformed decisions about the *right* level of talent that it needs in these roles, and the answermight well be that top talent is not needed in many jobs. Attracting, selecting, developing,and retaining world-class talent represents a very significant investment for most organiza-tions, and the harsh reality is that most organizations simply do not have the time orresources to do this for all organizational roles. This means that a decision about where and how to invest must be made, which we believe should focus predominately on strategic jobs.For us, strategic jobs are those that affect a firm's overall business success though devel- oping the requisite strategic capabilities needed to execute strategy. How does this happen?A key attribute of strategic jobs is that the incumbents holding those roles exhibit substantialvariability in the job performance, thus providing a *context* for business impact through afocus on improving individual employee performance (Huselid, Beatty, & Becker, 2005;Huselid, Becker, & Beatty, 2005). A focus on strategic capabilities and strategic jobs as thefocal point of workforce

management system design represents a significant potential sourceof value creation for most firms. But also, differentiation by strategic capability instead ofhierarchical level in the organization represents implementation challenges for managers,
and theoretical and empirical challenges for academics.

Key Research Questions on Workforce Differentiation

The belief that the same job may contribute to strategic success in dramatically different ways across firms, as well as within firms, depending on its location within the firm's stra- tegic capabilities, is likely to have significant implications for both the science and the practiceof HR management. As a result, we believe that a focus on the antecedents and consequencesof workforce differentiation represents a significant new opportunity for the HR strategy literature, one that has the potential to provide the theoretical and empirical foundation for adeeper understanding of the causal processes linking HR management systems with firm performance.

A focus on workforce differentiation raises many new and potentially interesting ques- tions for both scholars and practitioners. Specifically: How do we identify strategic jobs? What are the implications of interdependencies between strategic and nonstrategic jobs? Whatare the implications of workforce differentiation on HR elements such as job design, recruit-ment, selection, performance management, promotions and exits, and so forth? What are theeconomic returns to workforce differentiation? What are the social and psychological con- sequences of making disproportionate investments in a few strategic jobs? Finally, what arethe implications of strategic jobs for HR professionals? Realizing this promise will require cross-discipline as well as cross-level theory, data collection, and analysis. We highlight some of the key opportunities for scholarship in this domain below.

Operationalizing strategy. The first challenge is to develop and validate new measures oforganizational strategy. While prior work has often focused on identifying strategic type or positioning strategy, we believe that new work will be needed to focus on extracting the workforce implications of a given competitive strategy. The key differentiating point is thatthese measures need to be diagnostic in nature; namely, future work must move beyond simply identifying what a strategy *is* to identifying what *must happen* for it to be executed effectively. While such work has historically been outside the domain of the HR strategy literature, progress on this front is important to facilitate the next step in this process, opera-tionalizing strategic capabilities.

Operationalizing strategic capabilities. Strategic capabilities represent the bundle of infor-mation, technology, and people needed to implement a firm's strategy (Collis & Montgomery,1994). Strategic positions, as we describe below, are nested within a firm's strategic capa- bilities. As such, the second challenge is to develop and validate new measures of strategic capabilities, as a precursor to the identification of strategic positions. As a corollary, it will also be important to develop intermediate measures of strategy implementation based on performance of individual strategic business processes, which can help to locate strategic jobswithin a firm's value chain.

Operationalizing strategic jobs. The third challenge involves developing better measuresof the strategic jobs construct. Strategic jobs are positions that affect strategy (through a firm's strategic capabilities) and exhibit high variability in employee performance. In fact, itis the high levels of variance in employee performance that make strategic jobs so importantto identify and manage effectively. From a manager's perspective, variance equals opportu-nity, and the goal is to identify and invest in strategic jobs, increasing mean performance while reducing its variance.

As a corollary, strategic jobs can exist at any level in the organization. In fact, given the effort and energy devoted to jobs located at the higher levels of an organization's hierarchy,in our experience the most strategic roles in any organization are midlevel, and not senior- level, jobs. What is important in this context is to understand the role of each job (or clusterof jobs) in implementing the firm's strategy. Inherently, it can take years to recover invest- ments in people, as talent is the first-level investment in the firm's value chain. Thus, under-standing how a firm creates wealth through workforce investments can be complicated, andthe line of sight to valued firm-level outcomes is not always direct. Yet, developing such anunderstanding is key for both practitioners and academics.

Measuring workforce differentiation. We use the term *HR architecture* to describe the HRpractices, systems, employee competencies, and employee behaviors that together help to implement the firm's strategy (Becker & Huselid, 1998, 2006; Huselid & Becker, 1995).A key theme in this conceptual framework is the recognition of the important potential of positive and negative complementarities or synergies in business results. We use the term *internal fit* to describe the relationship among HR management practices, while the term *external fit* is used to describe the relationships between the entire HR management archi- tecture and the organization's strategy (Huselid, 1995).

Prior work on the measurement of the HPWS construct is extensive (for reviews, see Becker & Huselid, 1998, 2006). Most of this work attempts to develop an overall measure of HR management quality; related work also has focused on measuring the effects of complementarities and fit within and among HR management policies and systems. In con- trast to this “average main effects” focus, developing an effective measure of workforce differentiation will be necessary to assess the extent to which firms have really optimized their investments in HR and differentially invested in strategic positions. The key point is that scholars will need to measure HR practice variation *within* strategic capabilities, not theaverage level of HR practice quality *across* the firm. Evaluating this model will require measurement of the HR practices used for strategic as well as nonstrategic positions and the construction of measures of fit for each of these value chains.

Implementing an HR architecture. Introducing the strategic job construct means that both scholars and practitioners will also need to think differently about the design and implemen-tation of the HR architecture. We believe that an important focus for future work is rethink-ing HR practices in light of strategic jobs. An important source of tension to be addressed inthis process is the relative emphasis on differentiation versus integration of HR management practices such as job design, recruitment, selection, performance management, rewards, and promotions and exits. Indeed, one of the key challenges in this line of research is that the choice is not *whether* to recruit, select, appraise, reward, and so on, for strategic versus non-strategic jobs (which would dramatically simplify the construct development and measure- ment processes) but, rather, *how* these practices will differ across categories of employees. Thus, a key research question is, What do we do the same for everyone (e.g., staffing, per- formance management, compensation), and where do we differentiate (e.g., in which roles do we invest additional resources to ensure the attraction, selection, development, and reten-tion of top talent)? What HR practices are likely to be the most effective in reducing the variance and increasing the mean in strategic positions? What is now important is not the average level of HR quality in a firm but, rather, the purposeful variance across jobs and strategic capabilities. Indeed, we would argue that the relative impact of alignment for stra- tegic jobs is much greater than for nonstrategic jobs.

Impact of workforce differentiation on employees. The HR strategy literature has pre- dominately focused on firm-level outcomes such as turnover, productivity, profitability, andthe creation of shareholder wealth. More recent research has begun to focus on the impactof HR management systems on more proximal outcomes, such as employee engagement and commitment. The workforce differentiation construct is clearly an employer-focused model, which is likely to have positive impacts on high performers in strategic roles. A newfocus on workforce differentiation is likely to have the potential to have a significantimpact on levels of employee trust and engagement, for example, as well as on conven- tional levels of employee capabilities and discretionary effort—potentially in both positive and negative directions—and perhaps to exhibit significant differences by level of emp- loyee performance. Thus, the impact of workforce differentiation on individuals, groups, and teams is likely to provide a rich opportunity for research as firms increasingly adopt thismodel (Becker et al., 2009).

Integrating qualitative and quantitative data collection and analyses. Consistent with thenotion that path dependence and causal ambiguity are important sources of competitive advantage, we believe that the appropriate level of analysis is the strategic job—and the sup-porting systems of HR management practices—that is nested within each strategic capability(Becker & Huselid, 2010). There are also strong methodological reasons for such a systemsfocus, as a focus on individual HR management practices could either understate or overstatethe results. Because HR management quality tends to be correlated across HR management practices, a focus on individual HR practices is likely to overstate their individual impact. Incontrast, there is the potential for downward bias as a result of a focus on individual HR practices because it does not reflect the potential for positive complementarities or synergiesamong HR practices, in that mutually reinforcing HR management practices may create wealth beyond that which is possible by a focus on individual HR practices. In addition, itis also important to adopt a longitudinal perspective, as the nature of the phenomenon understudy would suggest that today’s workforce investments will affect a firm’s subsequent stra-tegic capabilities, which in turn affect its ability to execute its strategy, which ultimately affectsits performance.

That said, evaluating the impact of workforce differentiation will likely require a combi-nation of qualitative and quantitative data collection and analyses. For example, Siggelkow (2007) said that illustrative case studies are useful, even more so in longitudinal research. Inthe HR strategy literature this is especially true because the processes through which firms implement differentiated workforce strategies are not yet well understood. Thus, case studies(Becker et al., 2009) and new forms of learning media (Huselid, 2010) may become increas-ingly important components of the HR strategy literature.

Conclusion

The nature of work and organizations has changed dramatically over the past two decades;the practice of HR much less so. Recent work in HR strategy on workforce differentiation provides many new interesting opportunities to begin to close this gap, but scholars will increasingly need to “peer over the fence” into adjacent domains and levels of analysis to answer these questions. Specifically, we believe that significant progress in the HR strategyliterature will not be possible without a careful integration the literatures—micro andmacro—from the domains of HR management, economics, sociology, psychology, strategy,and economics. And in doing so, the field will increase the probability that it can conduct research that is both interesting and influential (Bazerman, 2005).

A new focus on workforce differentiation may have significant implications for both the science and practice of HR management. Indeed, many large firms are making substantial investments in workforce differentiation models (e.g., Avon, BMS, GSK, IBM, ITT, Johnson& Johnson, Lockheed Martin, and many others). Such a shift may provide significant new research opportunities. Indeed, this situation represents a rare opportunity, as academics and practitioners are all interested in much the same issues: How do we manage the workforce for strategic advantage? For practitioners, this is likely to mean creation of competitive advantageand wealth through workforce management away from the benchmarking and best practice approach to workforce management and toward strategic workforce differentiation. But it also involves significant managerial challenges associated with the identification, manage- ment, and communication issues associated with strategic positions.

For scholars, this means that cross-disciplinary work will likely be required. In an eco- nomic environment of diminished resources and extremely limited executive-level discre- tionary time to participate in research projects, doing this type of work will be an increasinglysignificant challenge. Indeed, our experience has been that it is more difficult, expensive, and time consuming to conduct applied research than ever before. But ultimately, we believe the workforce differentiation construct represents a significant opportunity for scholars to integrate micro and macro domains and to illuminate the causal processes linking invest- ments in HR management systems with firm performance. We also believe that this trend willultimately lead to a richer contribution to the science and practice of HR management.

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