HR practices or HR capabilities: which matters? Insights from the Asia Pacific region

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In the human resource management literature there is an ongoing debate about which is the key organizational resource: human resource (HR) practices or HR capabilities. Our study attempts to address this debate by examining which resource HR executives in the Asia-Pacific region find to be important for the future organizational and people needs of their firms. Results indicate that HR capabilities are central to organizations. Development of core competencies, agile organizations, and effective management of human resources will be pivotal to responding effectively to future business needs. Results also indicate that the lingering effects of the Asian financial crisis and competition from local and global competitors will affect organizational and people management in the years to come. These findings inform HR practitioners and shed light on the application of the resource-based view of the firm to the study of human resource management.

Keywords: Asia-Pacific region, HR capabilities, HR practices, resource-based view of the firm

* The authors would like to thank Helen De Cieri for her helpful comments and suggestions.

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The ultimate goal of organizations is to find organizational rents (Amit and Schoemaker 1993). The resource-based view (RBV) of the firm seeks to explain the variance in rents attained by firms, focusing on the different sets of organizational resources acquired as a source of those rents.

Traditional models of competitive advantage, such as Porter's 'five-forces' framework, which take a product market perspective, state that the identification and/or neutralization of external environmental threats and opportunities will lead to higher firm performance (Porter 1980; Barney 1991). These models assume that firms within an industry or strategic group are identical in the strategic resources that they control and in the strategies that they pursue. These models take a 'outside-in' perspective where only 'outside' environmental factors affect the internal operations of the firm.

On the other hand, the RBV takes an 'inside-out' perspective where the distinct characteristics of the resources internal or 'inside' the firm and resource market imperfections lead to firm heterogeneity and organizational rents (Oliver 1997). The RBV focuses on the rents accruing to the owners of scarce firm-specific resources rather than the economic profits from product market positioning (Teece, Pisano, and Shuen 1997, 513). The RBV suggests that firms obtain competitive advantage by implementing strategies that exploit their internal strengths when responding to environmental opportunities, while neutralizing external threats and avoiding internal weaknesses (Barney 1991, 99). Therefore, in line with the RBV, this paper examines the critical internal resources necessary to gain and maintain a competitive advantage for companies operating in the Asia-Pacific region.

**SHRM and the resource-based view of the firm**

The resource-based view of the firm, a theoretical paradigm originating in the field of strategic management, is useful for understanding the contributions firm-specific assets can make to firm performance and the role managers can play in creating and deploying these resources (Barney 1991, 1997). The domain of strategic human resource management is a set of theories that attempts to understand the role of the firm's pool of human capital and the mechanisms by which the human capital pool is acquired and deployed in achieving sustained economic performance (Boxall 1996).

Contrary to traditional models of strategy, the RBV assumes that resources and attributes of the firm are more important to sustained competitive advantage than industry structure and competitors' actions (Barney 1997). Resources have been defined as 'the tangible and intangible assets a firm uses to choose and implement its strategies' (Barney 2001, 54). This broad definition includes human, organizational, financial, and physical resources. Researchers (Barney 1991; Teece et al. 1997) have outlined a framework for determining if a resource can be considered a source of sustained competitive advantage.
which includes determining if the resource creates value, is rare, imperfectly imitable, and can be embedded in an organizational context to maximize its value.

The internal resource of interest for this study is human resources which are defined as the 'pool of human capital under the firm's control in a direct employment relationship' (Wright, McMahan and McWilliams 1994). In the field of human resource management (HRM), the organization's human capital pool is generally considered to be the primary source of sustained competitive advantage. However, strategic human resource management (SHRM) scholars have not reached a consensus on whether HR practices (Huselid 1995; Schuler and MacMillan 1984) or human resource capability (Ulrich and Lake 1990) should be considered a key 'resource' under this resource-based paradigm. Human resource practices, especially when combined into bundles and matched to business strategy, can be argued to meet the above definition of a resource (MacDuffie 1995; Arthur 1992). Recent empirical research in SHRM suggests that a firm's HRM practices are related to higher firm performance in terms of sales, profitability, and turnover and is a source of competitive advantage (Arthur 1994; Delaney and Huselid 1996; Huselid 1995; Huselid et al. 1997; Boudreau and Berger 1985; Huselid, Jackson and Schuler 1997).

HR capability can be defined as the routines embedded in the tacit and explicit knowledge of members of an organization functioning to acquire, develop, nurture, deploy, and redeploy human resources in a dynamic, competitive environment (Boxall 1998; Kamoche 1996; Teece et al. 1997; Ulrich and Lake 1990). An argument can also be made that HR capability is a source of competitive advantage as it is embedded in the collective knowledge of firm members (imitable), is developed over time (rare), and valuable as the firm’s routines for managing people can direct employees’ talents and behaviors to meet objectives and create value (Wright et al. 1994).

The RBV argues that resources such as HR capabilities are what are important for firm performance. But without proper implementation or utilization, these resources may not result in a competitive advantage. For example, 3M had the technology for creating adhesives that could be easily removed from material to which it was applied, but until they combined this technology with pads of paper to create Post-It Notes, this technology was not adding to the profitability of the organization. In this paper, we analyze data gathered from interviews with HR executives in the Asia-Pacific region to determine if HR practices or HR capabilities are the key levers for creating firm value in organizations. We attempt to add to the existing literature examining the link between HR and firm performance (Huselid 1995; Huselid, Jackson and Schuler 1997) by considering the possibility that HR capabilities play a role in creating sustained competitive advantage. We examine the issues perceived to be important to HR practitioners, how they are responding to these issues, and how they are adapting to change. Our study
provides insight into the role of HR practices and HR capabilities as well as a summary of the key issues facing practitioners in the region.

In particular, this study is interesting because during the period of study participating companies were coping with the after-effects of the Asian financial crisis that hit the Asia-Pacific region in 1997. The Asian miracle that had propelled many of the countries of the region to rapid industrialization and economic growth took a drastic turn as Asian currencies came under increasing pressure. During the one-year period from 23 December 1996 to 22 December 1997, the Malaysian exchange rate dropped 33.6%, the Singaporean exchange rate dropped 16.3%, the South Korean exchange rate dropped 50.7%, and the Thai exchange rate dropped 42.8% against the US dollar (Pettway 1999). This sudden souring of the Asian economy came as a surprise to many since for the three previous decades these countries had an impressive record of economic performance highlighted by fast growth, low inflation, macroeconomic stability, strong fiscal positions, high saving rates, open economies, and thriving export sectors. Executive responses will provide insight into how companies are coping with the economic turmoil and meeting the business challenges in the process to economic recovery.

Method

Sample

The data collection for this analysis was conducted from March through July of 1999. Thirty-five high level executives in the area of HRM from 32 different companies operating in China, Hong Kong, Japan, Korea, the Philippines, Singapore, and Thailand participated in the study. Of the participants, 33 were HR executives, and two were management consultants. Approximately 68.6% of the participants were male, and on average the participants had spent 12.6 years with their firm, and 2.2 years in their present job. Table 1 provides the number of participants by country.

<table>
<thead>
<tr>
<th>Country</th>
<th># participants</th>
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<tr>
<td>China/Hong Kong</td>
<td>5</td>
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<td>Japan</td>
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<td>Singapore</td>
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<td>Philippines</td>
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<td>Thailand</td>
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<td>Total</td>
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Data collection

The data from the participants was gathered via personal interviews (either face-to-face or by telephone) or, in some cases when personal interviews could not be conducted, via open-ended, written questionnaires. Interviewers documented the content of the interviews and the information was summarized into a standard interview content sheet. Multiple responses were allowed for each question. Respondents to the written questionnaires indicated their responses on a sheet similar to the interview content sheet. Whenever necessary, the written questionnaires were translated into the national language of the respondent before the questionnaires were administered. The surveys were initially translated from the English version and then back-translated into English by two qualified individuals to ensure the quality of the translations.

The interviews sought to explore what HR executives and consultants perceived to be the critical success factors for their organizations in the near future. The research design assumes that environmental trends have implications for organizational capabilities and people issues. Therefore, the HR function must play an integral role in responding to these environmental issues by facilitating the building of appropriate organizational capabilities, and by delivering effective solutions to the corresponding people issues. The interviewers posed three basic questions to study participants:

1. As you look over the next 3 to 5 years, what are the three major trends or issues in the external environment that will have the greatest impact on your firm?
2. Looking within your firm, what are the three most important organizational capabilities/critical success factors that your firm needs to develop and/or maintain in order to respond to these trends?
3. What are the people issues that are most critical to the maintenance/development of these capabilities/critical success factors?

Data analysis

Standard grounded theory analytic techniques were used to summarize the content of the interview sheets (Strauss and Corbin 1990). First, each response to each question was printed on a separate slip of paper with a code identifying the case ID of the respondent. Starting with the first question, all the response slips were mixed together into one grouping. One of the authors sorted the responses into smaller groupings based on similarity of content. After the groupings were sorted into different categories by content, another author reviewed the clusters for appropriateness. There was disagreement with fewer than 2% of all responses which were resolved through negotiation. This process was repeated for each of the three questions.
Results

Future environmental trends and issues

The predominant environmental trend/issue identified by 62.8% of the participants was the domestic and global economic situation. Of the respondents mentioning economic issues, over half (56%) mentioned the economic slowdown in Asia. Participants seemed to be concerned with the economic reforms and retrenchment that typically follow regional economic crises. Many pointed to the ‘current economic situation in Asia’ and the ‘inactivity of the domestic market after IMF’.1 The economic slowdown has led to a drastic decrease in the demand for exports by countries in the region. Further decreases in demand by manufacturers and consumers are expected as customers continue to cut back on spending to stay financially afloat. The increasing number of bankruptcies of businesses is causing a chain reaction of decreasing sales, production, and increasing unemployment (Business Week 1998).

It should be noted that a small but significant group of respondents predicted economic opportunities rather than problems in response to the economic downturn. Approximately 10% of respondents mentioning economic issues forecasted the resurgence of the region’s economy and the need to prepare for ‘increased business opportunities through the revival of the economy’. These opportunities may occur as a result of a change in demand through increased globalization of domestic markets, and expansion into markets made vacant by failed businesses. Companies that survive the economic downturn may be in the best position to rebuild and expand during an economic recovery.

The second most commonly mentioned environmental trend was the increase in technological advances, such as the use of information or telecommunications technology. Of the HR executives interviewed, 48.6% pointed to the growth of electronic commerce, information technology, and the need for knowledge management as a result of the increasing free-flow of information. Issues of concern revolved around changes in new technology and new business opportunities that occur as a result of new technology. For instance, the internet provides an instant global network for businesses to expand and has made information freely available. A Japanese executive stated that the ‘advancement of information/computer technology requires us more quick decision making to maintain our competitiveness’.

The concern over globalization was cited by 42.6% of respondents. HR executives were concerned with global networks, alliances, mergers and acqui-

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1 ‘IMF’ refers to the bailout loans provided by the International Monetary Fund. Countries receiving loans must implement economic restructuring programs as a pre-condition for receiving IMF loans.
sitions, and the opening of global markets. The 'mobility of people', global financial conditions, and the internet have lowered barriers to international markets, making business possibilities endless. Organizations must adjust to the changing scope of business by focusing on the 'borderless operation of business' and by creating 'effective cross-country teams/networks to meet more complex market needs'. People must be developed to effectively cope with and take advantage of the opportunities.

With the increase in the scope of the market comes an increase in competitive pressures from all parts of the world. Almost half (45.7%) of the respondents specifically pointed to competition (other than globalization) as an external factor that their business will continue to face in the future. Countries such as Korea, the Philippines, and Thailand (those hit hardest by the Asian crisis) saw mergers and acquisitions, corporate restructuring, the 'entry of new players into the market' and the need to maintain low costs and high quality as factors affecting competition. Executives in China tended to point to changes in competition due to economic reforms and regulations rather than the global economic situation as they face more internal pressures to change their economy and business practices. In particular, they pointed to the problems of industry regulations, deregulation, and the inconsistency of government policies as the country continues to move from a planned economy to an open economy.

Another environmental pressure discussed by HR executives in Singapore and South Korea was the competition for and the problems in retaining the best people and the changing labor market. Participants from Singapore overwhelmingly (67%) pointed to skill shortages as an important external factor. The executives cited 'competition for world class, self-motivated people' and the 'retention of high quality staff' as creating significant challenges. This is not surprising, as in the Singaporean and South Korean economies, the number of positions open for qualified managers far exceeds the number of qualified managers to fill these positions.

HR executives in Singapore and Korea also pointed to the 'changing mentality of the workforce' and the increased use of outsourcing. This reflects the growing change in the psychological employment contract and increased flexibility of the labor market. The philosophy of 'life-time employment', where employees remain loyal to a company and are employed until retirement, has slowly been changing and has been greatly accelerated by the large number of layoffs that occurred as a result of the Asian crisis (Song 1997).

Organizational capabilities organizations need to maintain and develop

The dominant response to the question regarding which organizational capabilities are needed to achieve competitive advantage in the next three to five years was the effective management of human assets, cited by 60% of respon-
HR practices or HR capabilities: which matters?

dents. Foremost in importance was the development and retention of high potential employees, strengthening leadership and management abilities, and sustaining performance through people strategies. Executives in Japan emphasized the 'identification and development of competencies to meet diverse business needs' and the retention of high potential employees. Executives in Korea emphasized the 'development of human resources and core competencies'. Executives in Singapore emphasized skills/leadership acquisition and retention, along with HR strategies such as 'pay for performance programs,' communication, and diversity. Executives in China emphasized the need for mature individuals with managerial and technical skills to fill upper level jobs.

The response from Chinese executives is not surprising as China continues to suffer from a lack of qualified or skilled personnel. The Cultural Revolution, which demeaned and derogated formal university education, has led to the current lack of qualified candidates for middle-management positions (Tsang 1994). This labor market condition has incapacitated organizations’ efforts at matching current staff with strategic business needs (Mitsuhashi, Park and Wright 2000).

In response to the increased competition, identified as an external environmental factor, 31.4% of respondents indicated the need for competencies in product development, sales, and marketing. The ability to identify new business markets and remain competitive in the global market through the development of superior products and cutting-edge marketing is critical to keeping ahead of the competition. Executives in Korea emphasized the need to produce high-quality products, improve production efficiency, and increase technological competitiveness. Executives from the remaining countries were concerned with maintaining and expanding their markets. The responses indicate that HR executives are looking outside of their departments or functions to determine organizational needs and what must be done to support these needs. These HR executives realize that thinking outside of functional silos and working closely with line managers is more critical than ever for business success.

Agility, flexibility and speed within the organization were identified as a necessary competency to deal with competition (34.3%). One executive pointed to the need for his organization to 'morph'. These competencies are necessary for continuous innovation and to quickly handle changes and challenges in the business environment identified through increased 'marketplace awareness'.

Finally, executives in China and Singapore pointed to the need to balance corporate and local culture. This is particularly true in these countries where there is a large presence of multinational corporations whose operations consist of expatriate executives managing local employees. In these cases, maintaining the balance between and integrating corporate and local culture is a task that executives, particularly HR executives, must deal with on a daily basis (Chua 1997).
People issues most critical to the development and maintenance of organizational capabilities

Looking more closely at the people issues that companies will face in the future, HR executives indicated the need to increase the quality of their internal talent pools. First, respondents noted the importance of possessing a high-quality pool of human talent. The need for continual learning and development of core employees’ skills and competencies was an issue noted by almost one-half (48.6%) of the respondents. The learning and development required in today’s business environment consists of more than the simple acquisition of skills in a formalized training environment, but rather requires the continual gathering of core knowledge from work processes, training/educational opportunities, colleagues, and customers. Thus, respondents discussed the need for learning, flexibility, adaptability and the ‘enhancing of competencies that the company needs to bring it forward’.

In addition, 45.7% of the respondents indicated that they needed to improve the tools necessary to develop higher quality human capital pools. These respondents noted the need to develop mechanisms to attract, select, and retain high performers in the years ahead. Executives stated that the ‘retention of key players’, ‘recruiting excellent human resources’ and ‘flexibility, adaptability, and learning’ were important people issues. Again, these issues draw attention to the need to have effective human resource practices to support identified business needs.

The development of the leadership talent pool, mentioned by 22.9% of the respondents, focuses attention on the attraction, selection, retention, learning and development of people who comprise the next generation of organizational leaders. The development of a leadership pipeline is needed to focus on new markets and to drive company culture. This emphasis on training, development, selection, and retention is not surprising as countries in the region continue to face a shortage of skilled labor and executives.

Second, respondents described issues focusing on mobilizing employee talent to act in the firm’s interests. A quarter (25.7%) of executives stated the need for development of appropriate performance management and compensation programs to ‘upgrade staff and managers and weed out weak performers’. The establishment of a performance oriented appraisal and compensation system is a natural tie to the development and retention of core employees. For example, many Korean companies are beginning to shift away from seniority-based pay systems where very little variance in pay exists to merit-based pay systems where compensation is based on ability and performance. This shift will open the door for increased competition in the labor market for employees to obtain the highest paying jobs and for employers to recruit the most qualified people.

The development of a high commitment work environment was indicated by 25.7% of executives, of which 55.6% were Chinese HR executives.
Due to changes in the Chinese economy and politics, employees have greater opportunities and freedom to pursue employment resulting in a decrease in employee commitment and loyalty. Recognizing these trends, executives from China and Singapore suggested developing an open and trusting culture with employees as a means of increasing employee commitment. This is consistent with research that has found that creating an environment of trust and open communication will lead to a more committed workforce (MacDuffie 1995).

Conclusion

At one level, these findings provide academics and HR practitioners with a view of the challenges and opportunities for the HR function as perceived by top HR executives from the Asia-Pacific region. At another level, these findings inform the debate about which is the key resource under the resource-based view of the firm. Respondents emphasized the increasingly dynamic and unpredictable nature of global competition for customers and the state of the regional economy as critical environmental trends that will impact organizations. The centrality of people as a source of sustainable competitive advantage, leading to the need to manage and develop human assets, was also emphasized. The ability to attract, select, develop, motivate, and retain valued employees will be critical for firm success. Changing conditions in product and financial markets will require balancing the need for employee commitment with the pressure to make the employment relationship more market oriented.

The primary conclusion regarding the RBV debate that can be drawn from these interviews is that HR capability is the more critical resource over HR practices. First, as should be clear from both the definition of a capability and the information provided by HR executives, a firm's set of human resource practices result from the organization's routines, beliefs, and traditions of how people are most effectively managed which stems from the organization's HR capabilities. Second, the dynamic environment described by these respondents suggests that static assets like bundles of HR practices or pools of human capital cannot produce sustained competitive advantage. Rather, as firms adjust to economic upheaval, technological changes, globalization, and increased competition, they must adjust their practices and reconfigure their collection of skills to meet these changing needs. HR capabilities allow firms to make these essential adjustments.

Since the interviews for this study were conducted, the Asia-Pacific region has implemented plans for economic recovery, working diligently to rebuild their economies. Between the second quarter of 1999 and the last quarter of 2000, South Korea, Thailand, Malaysia, and the Philippines had growth rates equal to or above those before the crisis. South Korea made the biggest gain, its GDP growing by 10.7% in 1999 and 11.2% in the first half of 2000 – this from a contraction of 6.7% in 1998. Hong Kong's first quarter growth in 2000
was 14.3%, and 10.8% in the second-quarter. GDP growth in Singapore was 5.4%. Malaysia, the Philippines, and Thailand grew at 5.4, 3.2, and 5.2% respectively (Sharma 2002, 177).

The financial crisis did not destroy the capacity for economic growth as feared at the beginning of the crisis. The event has strengthened the Asian economies beyond their pre-crisis potential. According to Goh Chok Tong, Singapore’s prime minister, the crisis has produced four positive outcomes:

First, it has speeded up the opening of economies. Second, it has forced the Asian region to be more aware of corporate governance issues and stipulations. Third, it forced the region to concentrate on its real competitive strengths. Lastly, it provided a lesson on globalization. (Kotabe and Gupta 2002, 32)

The comments of the prime minister are in tune with statements made by the executives about future trends that will affect their companies. Executives pointed to the opportunities in the post-crisis revival and the expansion of markets due to the globalization of domestic markets. Although the Asian financial crisis exacted a heavy toll in terms of lost output and socio-economic turmoil, it did not destroy East Asia's industrial and manufacturing infrastructure or its productive capacities. The significant investments these countries made in physical plant and equipment served them well as the global economy picked up. The South Korean, Malaysian, Thai, and Singaporean economies that depend heavily on the manufacture and exports of electronics, including information technology-related products, rebounded (Sharma 2002, 178). As the executives stated, being prepared for the upturn in the post-financial crisis economy has allowed these companies to revitalize their businesses.

**Practical implications**

Ulrich (1997) suggests HR capability begins with the realization that human capital can be used to gain competitive advantage. This insight provides the foundation for the practical implications of this study. As firm capabilities are embedded in the collective knowledge of firm members, this suggests that managers play a limited role in impacting HR capabilities. However, by recognizing, developing, and utilizing these capabilities, executives can play a critical role in developing human resource capabilities as a source of sustained competitive advantage.

A first step for practitioners is, as suggested by Ulrich (1997), to recognize the contribution of HR capabilities to organizational success. Identifying the source of competitive advantage with the entire organization and not a single department or leader is the first step toward effective development and utiliza-
tion of these capabilities. Developing HR capabilities must involve developing the collective HR knowledge of the entire organization. One important step is the devolution of HR activities from functional specialists to line managers. Devolving these responsibilities involves educating line managers in the theory, policies, and procedures as well as granting them the authority to make human resource decisions and holding them accountable for these decisions.

Consistent utilization of HR capabilities is the most critical step toward developing and maintaining this source of competitive advantage. The socially complex organizational routines that constitute a capability emerge as organizations close the gaps between expected and actual performance (Verona 1999). As managers consider the human resource implications of business situations such as mergers and acquisitions, competitive threats by new entrants, new product development and others, HR routines are reinforced, developed and refined, strengthening their contributions to value creation and sustained competitive advantage.

Our interviews with managers in the Asia-Pacific region suggest that firms face tremendous economic and competitive changes and pressures. Firms with stronger, more complex HR capabilities devolved into the broader organization will adapt, thrive, and achieve competitive advantage relative to competitors.

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