

TRANSFORMING CATERPILLARS INTO BUTTERFLIES: THE ROLE OF MANAGERIAL VALUES AND HR SYSTEMS IN THE PERFORMANCE OF EMERGENT ORGANIZATIONS

ABSTRACT

Using the resource-based and dynamic capability perspectives, this project examines three factors that likely affect the performance of emerging firms: high performance work systems (HPWS), partnership philosophy, and an entrepreneurial orientation. Each of these may produce a sustainable competitive advantage by allowing firms to dynamically configure and reconfigure resource bundles. Results indicate that HPWS and partnership philosophy are positively associated with sales growth and innovation. Additional findings suggest that partnership and entrepreneurial orientation both increase the likelihood of implementing HPWS. Finally, results suggest that firms utilizing HPWS in conjunction with an entrepreneurial orientation achieve higher levels of sales growth.

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EXECUTIVE SUMMARY

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TRANSFORMING CATERPILLARS INTO BUTTERFLIES: THE ROLE OF MANAGERIAL VALUES AND HR SYSTEMS IN THE PERFORMANCE OF EMERGENT ORGANIZATIONS

Emerging firms are the foundation for economic growth in today's business world, yet relatively little is known about the factors that contribute to the success or failure of developing organizations. This research study helps to address this broad question by examining the role that managerial values and practices play in the performance of high-tech start-ups. Using the resource-based and dynamic capability perspectives, this research project examines three critical factors that are likely to affect the performance of emerging firms: human resource policies and practices, an overarching philosophy of partnership, and an entrepreneurial orientation. Each of these is argued to produce a sustainable competitive advantage by providing firms with the ability to dynamically configure and reconfigure resource bundles.

This is a particularly salient issue as emerging firms are frequently thought of as the primary movers that help to build viable economies and boost job creation (e.g., Fischer, Reuber, Hababou, Johnson, & Lee, 1987; Kuratko, Goodale, & Hornsby, 2001; Markman & Gartner, 2002). As a result, it is important to understand the mechanisms that build successful emergent firms. While a small body of research suggests that management values and practices may play a key role in the ultimate success of small and growing firms (Burton & O'Reilly, 2004; Way, 2001; Welbourne & Andrews, 1996), much remains unknown.

Thus, the aim of this project is to help redress this deficiency by examining the role that managerial values and work practices have in the performance of emerging organizations. Of specific interest is the role that people management practices play in the success or failure of developing organizations. More specifically, this dissertation examines the role of *high performance work systems* (HPWS) in emerging organizations and their part in building

successful young firms. HPWS refers to the constellation of selection, training, development, performance management, employee involvement, and compensation practices that have been linked to financial performance in studies of larger organizations (e.g., Huselid, 1995; Guthrie, 2001). Though human capital has long been recognized as critical to the success of new organizations (Cardon & Stevens, 2004; Deshpande & Golhar, 1994; Hornsby & Kuratko, 1990), many outstanding questions remain regarding the practices that encourage the development of this valuable resource in emerging firms.

In addition to the specific role of HPWS, this project also examines the role that a *partnership philosophy* has in affecting the performance of young and emerging firms. A partnership philosophy represents a more general approach to managing people and is less formally instituted than HPWS. A philosophy of partnership represents a high level of commitment and trust between management and employees in the decision-making of the firm. It is likely that young and small firms have fewer of the formal pieces found in HPWS, but a general philosophy of commitment may still affect the performance of nascent firms.

Finally, also of significant interest to the study are the managerial values that spur firms to continually emphasize and focus on innovation as they grow over time. This mindset has generally been referred to as an *entrepreneurial orientation*, and it emphasizes the strategic posture that entrepreneurial organizations seek to maintain and develop as they continue to expand. While new firms are by definition entrepreneurial at the beginning of their life-cycle, the role that a continued entrepreneurial orientation plays in ongoing success remains unclear.

This dissertation examines these basic questions and ideas by carefully analyzing the effect that high performance work systems, a philosophy of partnership, and entrepreneurial values have on the performance of developing organizations. Specifically, the following research

questions were analyzed in the context of dynamic, high-tech industries. These relationships are also graphically presented in Figure 1.

RQ#1: What impact do high performance work systems have on various measures of firm performance?

RQ#2: What role does a philosophy of partnership play in the performance of growing firms?

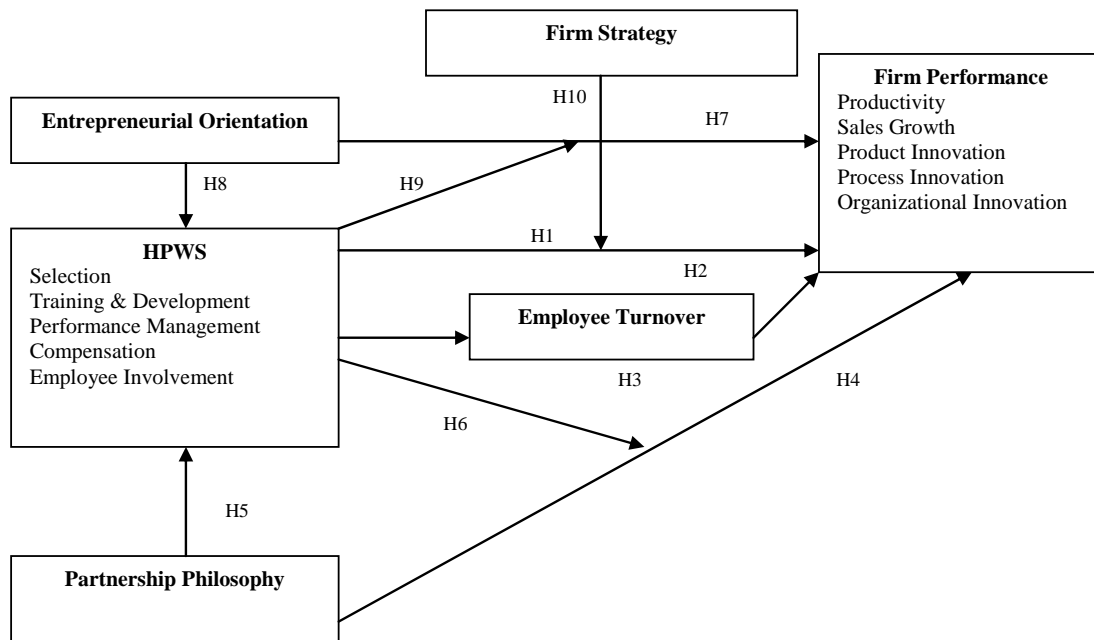
RQ#3: What impact does an entrepreneurial orientation have on the performance of emerging organizations?

RQ#4: Do high performance work systems moderate the relationship between entrepreneurial orientation and firm performance in emerging firms?

RQ#5: Do high performance work systems moderate the relationship between partnership and firm performance?

RQ#6: Does firm strategy moderate the relationships between HPWS, partnership philosophy, EO, and measures of firm performance?

FIGURE 1 – CONCEPTUAL MODEL



Methods & Data Collection

An online survey was utilized to collect data from executives of small organizations across the United States with respect to their utilization of HR practices, their entrepreneurial proclivity, and their views toward partnership, firm sales growth, turnover rates, strategic orientation, and several other demographic characteristics. Approximately 2,000 firms operating within the computer hardware, software, and services industries were invited to participate in the survey. 215 firms responded to the survey, however, usable data for analysis ranged from 113 firms to 190 firms depending upon the particular relationships being assessed. All firms participating in the study were less than 10 years old, were listed as single business units, and had greater than 10 employees according to the National Establishment Time Series (NETS) database. The firms in the study were primarily being led by one of the individuals that founded the firm (84.3%), not interested in an initial public offering (92.6%), and did not receive venture capital financing (83.8%) to create their business. In addition to the survey tool, follow-up interviews were conducted with executives from six of the responding organizations to provide a more rich understanding of the relationships of interest.

The survey information was compiled and screened to assess the violations of statistical assumptions, nonresponse bias, and issues of multicollinearity. Following this process, indices were created in regard to each firm's utilization of high performance work systems, entrepreneurial orientation, partnership philosophy, levels of innovation, and general business strategy. These indices were then used to statistically assess the research questions of interest using both ordinary least squares regression and structural equation modeling.

Descriptive Results

From a descriptive standpoint, the results of the survey of high performance work systems indicate that the most frequently utilized practices include: merit based promotions ($M = 88\%$, $SD = .19$), merit-based compensation decisions ($M = 87\%$, $SD = .22$), providing employees with strategic information ($M = 81\%$, $SD = .24$), providing routine performance feedback ($M = 80\%$, $SD = .26$), and structured interviews ($M = 78\%$, $SD = .31$). The most infrequently utilized practices are generic skills training ($M = 26\%$, $SD = .28$), employment tests ($M = 36\%$, $SD = .36$), job security ($M = 39\%$, $SD = .35$) and telecommuting ($M = 40\%$, $SD = .35$). Approximately 25% of the responding organizations indicated that they employ professional employer organizations or use other outsourcing arrangements for one or more of their HR functions. The most frequently outsourced functions are payroll administration and HR forecasting.

The data were further broken down by strategic orientation. Three general strategic archetypes were found in this sample of firms: 1) quality differentiators, 2) price competitors, and 3) equivocators. Price competitors are those firms that are competing primarily on the basis of low cost products and services. Quality differentiators are those that “rely more heavily on distinctive products, superior service, and high technology....” (Carter et al., 1994: 33). Finally, equivocators are those that fail to compete strongly on the basis of either cost or differentiation. As Porter (1985) and Carter et al. (1994) point out, these firms tend to be ‘stuck in the middle’ with an uncertain strategic model. Survey results indicate that quality differentiators tend to be larger, focus more on partnership, utilize a higher degree of HPWS and are more entrepreneurially oriented than either cost leaders or equivocators. Quality differentiators also have lower overall levels of voluntary turnover than either cost leaders or equivocators.

Research Question Results

The results of the study indicate that a greater utilization of high performance work systems is associated with higher levels of sales growth in subsequent time periods. Results also indicate that a greater emphasis on high performance work systems is associated with higher levels of product and organizational innovation. The statistical analyses failed to find support for a relationship between high performance work systems and either productivity or voluntary turnover.

With regard to partnership philosophy, the results of the study support a positive relationship between partnership and sales growth. Those firms emphasizing trust between management and employees, high levels of commitment, and communication tend to outperform those with lower indices of partnership. The study results also supported a negative relationship between partnership and voluntary turnover, where firms with higher scores on the partnership measure exhibited lower overall turnover and voluntary turnover rates. As expected, partnership was also found to be a significant predictor of high performance work system adoption. The results of the study fail to find support for a relationship between partnership philosophy and productivity.

An entrepreneurial orientation was not found to be related to either sales growth or productivity in this sample of firms. It may be that the firms studied were all relatively new enough and competing in such dynamic industries that an entrepreneurial orientation was a necessary, but not a sufficient source of competitive differentiation. Supporting this conclusion is the finding that firms that emphasize an entrepreneurial orientation and also utilize high performance work practices outperformed all firms with respect to sales growth. This finding

supports the logic that more entrepreneurial firms benefit the most from a system of employment practices that are designed to build a more decentralized and organic organizational structure.

Finally, it is important to note that among this sample the generic strategic typology of a firm was not found to have a direct effect on sales growth nor did it moderate the relationship between the three key constructs of interest (HPWS, partnership, & EO) and either sales growth or productivity.

Discussion & Practical Implications

Taken together the results of this dissertation offer a number of theoretical and practical implications. From a research perspective, this study adds to the growing body of literature on high performance work systems. The relationship between utilizing more sophisticated forms of management within more organically structured firms and firm performance was extended to the context of young and small high-tech businesses. This helps to further build this line of research and move HR studies out of large and traditionally manufacturing based businesses into more service and technology based organizations. In doing so, the results of this study further build upon the logic of the resource-based view of the firm, by showing a strong connection between people management practices, the values underlying these practices, and firm performance. In doing so, this dissertation helps to build knowledge in an area that has received multiple calls for investigation (i.e., Baron, 2003; Katz, Aldrich, Welbourne & Williams, 2000), but relatively few empirical studies.

An additional contribution of this study was the demonstration of a strong connection between an entrepreneurial orientation and high performance work systems. A number of scholars have theorized about the relationship between HR systems and corporate entrepreneurship (e.g., Hayton, 2005; Schuler, 1986), but few studies have been completed that

examine the relationship between these constructs. Results of this study indicate that more entrepreneurial firms are also more likely to utilize high performance work systems.

Furthermore, the results indicate that there is a significant interaction between EO and HPWS in predicting firm sales growth. This finding suggests that more entrepreneurially oriented firms benefit most from the use of high performance work systems. From a practical standpoint this suggests that organizations adopting an aggressive posture toward entrepreneurship benefit from developing bundles of employment practices that support the selection and retention of talent. Firms that are able to match their strategic posture to the specific set of practices are more aptly configured to compete in dynamic environments.

Study results are also instructive to the entrepreneurship field, as this study begins to take steps toward understanding the internal firm-level processes that help to build successful ventures, which has been recognized as a need in the study of entrepreneurship (e.g., Lumpkin & Dess, 1996). Furthermore, the comments of the business leaders who participated in the semi-structured interviews suggest that finding ways to select and retain talented employees is a key concern. This study may help to answer these questions by showing the link between managerial practices and firm performance.

From a descriptive standpoint the overall usage of the high performance work systems items in this sample of firms is also noteworthy. In particular, the focus on merit as a means of rewarding employees both financially and with promotions is clearly a priority for this segment of firms. Nearly 50% of the firms indicated that 100% of their employees were compensated and promoted based upon merit. Given the competitive nature of the industries these firms compete in, it is expected that they would demand high levels of performance from their employees and are willing to reward employees accordingly. Of particular interest is the significant relationship

between performance-based compensation and sales growth. In this sample of firms, companies that primarily rewarded employees on the basis of individual, team, and firm performance exhibited stronger growth in sales.

Also of note is the relatively small percentage of firms that offer any type of generic skills training or that utilize employment testing. While the former is likely to be considered a luxury that simply cannot be afforded, one would expect that small companies may benefit from rigorous employment testing. Indeed, the semi-structured interviews suggest that this sample of firms relies heavily on employee referrals followed by some type of interviewing procedure to recruit and select new employees. While this is likely an easy path for entrepreneurs to follow early in the firm's life cycle, it is likely that these firms would benefit from a more rigorous selection process as they continue to grow and expand.

Conclusion

One of the survey respondents put it best when he said that "finding and keeping the right people is the biggest challenge we face." The bottom line from this study is that people matter. The results of this analysis support the basic logic that systems and values designed to select, develop, motivate and retain talented individuals have implications for firm performance. Moreover, these policies and practices seem to play an even more salient role in firms that rely on innovation and an entrepreneurial spirit to compete in today's dynamic business world. Given the recognized importance of entrepreneurial firms (Drucker, 1985; Phelps, 2007), the findings of this study help to build knowledge in regard to the key factors that help new ventures engage in the "metamorphosis" that transforms start-ups into successful and sustainable businesses.

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