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Value Creation Through Strategy Implementation: The “Black-Box” in SHRM Theory

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Abstract

This paper argues that prior theoretical work on the topic of strategic human resource management (SHRM) has not fully elaborated the link between a firm’s HR *architecture* - or overall system of human capital management - and its subsequent financial performance.

Drawing on the strategy literature we propose explicitly including effective strategy implementation as the key mediating variable in this relationship. This also requires a new focus on the idiosyncratic dimension of HR’s strategic fit. These extensions of SHRM theory more completely articulate the HR’s impact on value creation by increasing the inimitability of the HR architecture’s influence on firm performance.

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For more than a decade academic research as well as management practice has increasingly focused on intangible assets as sources of value creation. Attributes such as brand value, research and development, and customer relationships have become widely recognized for their long-run financial value (Lev, 2001). Likewise managers and scholars have increasingly included human capital, and the human resource management systems that produce it, among the intangible assets that potentially have strategic value (Becker and Gerhart, 1996). Within the organizational sciences, the strategic human resources management (SHRM) literature has focused on the relationship between human capital, human resource management systems, and firm performance. While the SHRM literature has developed a rich body of empirical results at different levels of analysis (see Delery & Shaw, 2001 for a review), the underlying theoretical framework has not developed at the same pace (McMahan, Virick, & Wright, 1999).

The notion of human resources as a strategic asset is a significant change in perspective for a field where the focus on performance has traditionally has been at the micro level. The domain of strategy in contrast involves more macro level phenomena where value creation and superior financial performance are ultimately based on sustainable competitive advantage (Barney, 2002; Schendel, 1996). This poses a special challenge for SHRM theory as it seeks to integrate these two literatures. As an interdisciplinary theory, SHRM theory draws on the human resource management (HRM) literature to explain *what* HR practices and systems produce potentially valuable human capital, but then must rely on the strategy literature to explain *why* that human capital can be a source of value creation. What’s missing in SHRM theory is the *how*. In short, any strategic human resources theory must have at its core a clearly articulated mechanism by which an organization’s human resources are a source of sustained competitive

advantage. According to Becker and Gerhart (1996), our understanding of this “black box” remains a significant gap in the SHRM literature. They concluded (p. 793):

“Unless and until researchers are able to elaborate and test more complete structural models – for example, models including key intervening variables – it will be difficult to rule out alternative causal models that explain observed associations between HR systems and firm performance.”

Instead, HR scholars have tended to focus on a further elaboration of the HR architecture - or overall system of human capital management; namely *what* HR practices and systems produce potentially valuable human capital (e.g., Delery and Doty, 1996; Huselid, 1995; Wright and Snell, 1998). Empirical research has examined various elements of the HR architecture with attention to role behaviors (Schuler and Jackson, 1995), employee commitment and involvement (Batt, 2002), and high performance work systems (Huselid, 1995; MacDuffie, 1995; Youndt, Snell, Dean, & Lepak, 1996). This research has generated a set of empirical results that are *consistent* with the theoretical implications of the strategy literature, but do not follow from an SHRM theory that directly integrates that theoretical literature. As Barney (2001) observes, the strategy literature simply provides a theoretical context for examining the implications of HR for firm performance. With a few exceptions (Becker and Huselid, 1998; Wright, Dunford, & Snell, 2001) there has been little effort to extend SHRM theory in a way that formally integrates the mechanism by which the HR architecture actually influences firm performance.

We address this theoretical gap in the SHRM literature in two ways. First, we propose a theoretical model for SHRM that formalizes the widely held view that HR’s strategic impact occurs through the process of strategy implementation (Becker and Huselid, 1998; Schuler and Jackson, 1987; Wright and Snell, 1998). Our approach extends SHRM theory by explicitly incorporating effective strategy implementation as the mechanism through which

HR contributes to new value creation. While the prior SHRM literature expressly mentions strategy implementation as the source of HR's impact on firm performance, the nature of that theoretical relationship has never been clearly articulated. Strategy implementation has implicitly been treated as the result of an appropriate match between the HR architecture and the firm's competitive strategy, rather than an independent theoretical construct. We argue that the HR-firm performance link is not as direct as suggested by the prior literature. Instead intermediate outcomes, as part of an *indirect* link, are central to a more complete understanding of *how* the HR architecture can be a source of new value creation (Becker and Gerhart, 1996). This extension of SHRM theory complements recent work in the strategy literature (Barney, 2001; Porter, 1996) that emphasizes the nature and contribution of strategy execution as source of competitive advantage.

Incorporating effective strategy implementation as the central intervening variable in SHRM theory is only the first step in removing the theoretical black box in the HR architecture – firm performance relationship. Despite considerable attention at both the conceptual and empirical levels, the nature and role of “fit” in the SHRM literature needs further theoretical elaboration as well, because the *how* of HR's strategic potential turns on HR's strategic fit. While the SHRM literature has always acknowledged the importance of an HR-strategy fit (Schuler and Jackson, 1987; Wright and Snell, 1998), the nature of that fit implies a generic relationship between the HR and the larger competitive strategy. Irrespective of the strategic framework being used (Miles and Snow, 1994; Porter, 1985) there are typically three or four competitive strategies available to the firm. We use the term generic relationships because the logic implies that there is an appropriate HR architecture for each of these competitive strategies. For example, an HR focus on rewarding outcomes rather than procedures is suggested as an

appropriate fit with a Prospector (innovation) strategy (Miles and Snow, 1994). Similarly role behaviors that emphasized risktaking were deemed an appropriate fit with an innovation strategy (Jackson and Schuler, 1995). Since there are only a limited number of competitive strategy types, there are a limited number of appropriate HR architectures. This notion of strategic fit, however, limits the uniqueness of HR architectures across firms, makes them easier to imitate, and reduces their value as sustainable sources of competitive advantage. The empirical evidence bears this out. Despite a general consensus that fit ought to play a central role in SHRM theory, empirical tests of this generic HR-competitive strategy contingency have provided little support for a fit hypothesis (Becker and Gerhart, 1996; Becker and Huselid, 1998; Delery and Doty, 1996; Huselid, 1995).

This lack of empirical support may in part follow from an incomplete theoretical articulation of the mechanism by which fit enables the HR architecture to create strategic value. We refer to the broad-based relationship between HR and competitive strategy as “generic” fit to distinguish it from the “idiosyncratic” fit that needs further theoretical and empirical attention. Idiosyncratic fit focuses on the firm-specific dimensions of the firm’s strategy implementation system emphasizing the unique features of a firm’s HR architecture. Generic fit focuses commonalities of the HR architecture within a limited set of strategy types. Drawing on a review of the strategy literature, we argue that *idiosyncratic* fit has more of the attributes necessary for sustained value creation than *generic* fit. Therefore, the second purpose of this paper is to develop the theoretical rationale for the significance of idiosyncratic fit in the SHRM literature. We argue that such a construct follows directly from the strategy literature and offers an additional theoretical basis for *how* HR might be expected to be a source of new value creation.

Put Figure 1 about here

The HR Architecture

An interdisciplinary theory that integrates both human resources and strategy inevitably implies the following causal logic: An effective strategy enables an organization to achieve a competitive advantage and to sustain that advantage over the long run. To the extent that the human resources (the function, the system and/or the people) in that organization contribute to that strategic outcome it represents a source of new value creation and rises to the level of a strategic asset. The theoretical challenge for SHRM is to articulate the conditions under which HR makes this contribution and the mechanism by which this strategic impact is realized.

We rely on the term HR Architecture to reflect the relevant aspects of HR for SHRM theory. The SHRM literature has focused on the strategic role of behaviors (Schuler and Jackson, 1987) and the system of policies and practices that produce those behaviors (Delery and Doty, 1996; Huselid, 1995; MacDuffie, 1995; Wright, et al., 2001). The architectural metaphor is commonly used in this literature (Becker and Gerhart, 1996; Becker & Huselid, 1998; Lepak and Snell, 1999; Wright and Snell, 1998) for good reason. It captures both the breadth and causal flow of the human capital value creation process. Similarly we define the term *strategic HR Architecture* as the organizational system that produces the performance behaviors required to implement a particular firm's strategy. Amit and Shoemaker (1993) provide a typology for understanding how intangible assets like a firm's HR architecture become a strategic asset. They distinguish between factor stocks (*resources*), like human capital attributes, that must be organized and linked with other organizational systems that can then be transformed into an organizational *capability*. We argue that the link (or fit) between strategic performance

behaviors and firm's strategy implementation system is the mechanism of that transformational process for HR. Therefore, while every firm will have an HR architecture, it only rises to the level of a *strategic asset* when it produces a set of "specialized resources and capabilities that bestow the firm's competitive advantage" (Amit and Shoemaker, 1993, p. 36).

The strategic HR architecture includes three components. First is the system of HR policies and practices that attract, retain, motivate and develop *strategic* human capital; namely, the human capital required to implement the firm's strategy. Second are the human capital *attributes* produced by this system. These would typically include such outcomes as skills or competencies, motivation and commitment. Third are the strategic performance behaviors that actually implement the firm's strategy. These performance behaviors are made possible by the human capital attributes, but simply having high levels of skill or commitment among the work force does not guarantee that those competencies can or will be translated into the behaviors required to implement the firm's strategy. Therefore when we speak of the strategic value of human capital it is not enough to talk about the stock of human capital (i.e., attributes like competencies and commitment), or the system of practices that generates those human capital attributes. The discussion must also include the productive results of human capital, which in SHRM theory must be the performance behaviors that implement the firm's strategy. In a model that emphasizes a generic fit between the HR architecture and competitive strategy, role behaviors and strategy performance behaviors are equivalent, because those role behaviors apply to all employees in the same firm and all firms that have adopted a particular competitive strategy. By contrast, to the extent that idiosyncratic fit is a more important source of value creation, strategic performance behaviors would be much more differentiated within the same competitive strategy and within the same firm.

Strategy Implementation as an Intervening Variable

Parsimony and Operational Validity

SHRM is an interdisciplinary theory that will naturally draw more on the strategy literature as the causal logic moves away from the structure of the HR architecture toward organizational outcomes like value creation, competitive advantage and firm performance. Therefore, the specification of the intervening variables between HR and firm performance, and their theoretical rationale, will draw heavily on the theoretical literature in strategy. Wright et al. (2001) provided one possible direction based on an integration of the SHRM and resource-based view of the firm (RBV) literatures. They develop a framework that links the HR architecture (they use the term People Practices) with Core Competencies, through three intervening variables: dynamic capability, knowledge management and intellectual capital. While the framework is intended more to highlight opportunities for integration than provide a well-developed theoretical statement, the core proposition seems to imply that People Practices drive firm performance through their influence on many of the strategic resources and capabilities associated with the RBV literature. However, the nature of the ultimate link to firm performance is not discussed and is therefore a limited framework for extending SHRM theory. This omission is critical for the “strategic” dimension of SHRM theory because the linkage to firm performance is so central to the strategy literature.¹

For several reasons, we suggest a more parsimonious model as a point of departure. While the RBV literature has much to offer to the development of SHRM theory, much like the SHRM literature the meaning of RBV constructs and terminology are sometimes inconsistent and “confusing” Peteraf (1993, p. 180). Priem and Butler (2001, p. 34), for example, recently

expressed concern about “the current high level of abstraction” that characterizes the RBV literature and urge that “the specific mechanisms purported to generate competitive advantage” be more carefully delineated. In a related vein, they point out that strategy research must provide “actionable prescriptions” (p. 31) for managers. Thomas and Tymon (1982) more generally refer to this characteristic as operational validity and emphasize the need to construct theories with independent variables that managers can control. The RBV literature’s reliance on constructs that are difficult to operationalize in practice limits the prescriptive value of the theory for managers (Priem and Butler, 2001). SHRM frameworks (Wright, et al., 2001) that are articulated in terms of RBV constructs like dynamic capability and core competencies may similarly lack the operational validity necessary to guide managerial practice. SHRM researchers have a unique opportunity to influence organizational policy discussions in a way not traditionally available to HR managers (Becker and Gerhart, 1996, p. 791-792). Efforts to extend SHRM theory should respond to this challenge.

We propose locating *strategy implementation* as an independent theoretical construct in SHRM theory. Not only does it provide a more parsimonious explanation for HR’s strategic value, but the construct also offers practicing managers operational levers to execute the firm’s strategy. Barney (2001, p. 53) acknowledges that strategy implementation was omitted from the development of the RBV framework as a “theoretical convenience” under the assumption that “implementation follows, almost automatically.” This convention is clearly reflected in the SHRM literature as well. Barney (2001) now concludes, however, “the ability to implement strategies is, by itself, a resource that can be a source of competitive advantage” (p. 54). SHRM theory would benefit by incorporating this same insight.

Barney identifies two possible mechanisms for more formally integrating strategy implementation into RBV theory. The first is recognizing that the capability to implement strategy effectively is a separate strategic resource. The second is to examine organizational resources that are not by themselves a source of competitive advantage, but contribute to strategy implementation when they complement other resources that are a source of competitive advantage. As a first step towards incorporating strategy implementation more formally into SHRM theory we draw on each of these theoretical directions. We first consider strategy implementation as strategic capability. Makadok (2001) highlights the distinction between resource-picking and capability-building in the RBV literature. We argue that incorporating strategy implementation into SHRM theory follows from the “capability-building” domain of the RBV literature because the HR architecture follows from the larger strategic choices in the organization. According to Makadok (2001, p. 390), when capability-building is the source of rents, “managers make their contribution largely through constructing capabilities internally...[with a focus on] the structural principles for appropriate design of capabilities.” The prior SHRM literature largely focused on the design principles of the HR architecture, but more attention needs to be given to formalizing the link between the HR architecture and strategy implementation.

The appropriate structural principles for developing a strategy implementation capability are reflected in Porter’s (1996) concept of the strategy-activity system. While the SHRM literature tends to focus on Porter’s notion of market positioning, emphasizing a mix of differentiation or cost-leadership, Porter argues that the underlying strategic activities that drive that position are in fact the essence of strategy. For example, at Wal-Mart an integrated combination of distribution, logistics, just-in-time order fulfillment, considerable focus on

stocking stores differentially to meet customer needs in each area, and very close relationships with suppliers helped to create an organizational resource and first-mover advantage that was difficult for competitors to imitate. The important point is not simply that a system of internal organizational activities might have strategic value in any organization, but rather that this strategic activity system has value in large part because it will differ across competitors. In other words, simply choosing a generic positioning strategy does not imply a particular strategic activity system. Just as we will argue, choosing a generic positioning strategy does not imply a particular HR Architecture. “Competitive strategy...means deliberately choosing a different set of activities to deliver a unique mix of value” (Porter, 1996, p. 64). Following Makadok (2001), this is a strategic capability that needs to be developed rather than copied. We propose formalizing effective strategy implementation in SHRM theory as a strategic capability located in the black box between the HR Architecture and firm performance.

The organizational capability to develop an appropriate strategic activity system, and thereby effectively implement the firm’s positioning strategy is a strategic asset (Amit and Shoemaker, 1993). It meets the criteria used in the RBV literature to describe a strategic resource. First, a properly constructed strategic activity system has value by virtue of its position in the firm’s value chain and direct links to market positioning success. Second, it is not easily copied. Strategic activity systems, and by implication the capability to effectively implement strategy, are unique, firm specific and causally ambiguous because of the underlying linkages among the activities. Finally there is at least anecdotal evidence that the ability to effectively implement strategies is not a widespread capability among U.S corporations.²

This analysis suggests that strategy implementation includes two dimensions of relevance to SHRM theory: structure and effectiveness. The structure of strategy implementation is

reflected in Porter's concept of the of the strategic activity system, the firm-specific set of activities uniquely configured to implement the firm's strategy. The strategic activity system follows from the intended positioning strategy, though this relationship is not as deterministic as implied by the notion of generic fit (Figure 1). The structure of the strategic activity system in turn drives the structure of the HR architecture. This leads to the following proposition:

Proposition 1: Strategy implementation structure is an intervening variable between the intended positioning strategy and the firm's HR architecture.

Implications for the Concept of Fit

The second dimension of strategy implementation, its effectiveness, follows from the appropriate fit between the structure of the strategic activity system and the HR architecture. The central focus on strategy implementation necessarily increases the strategic role of alignment skills. Porter's (1996) focus on organizational fit in his definition of strategy, like Barney, implies that the ability to align and execute the organizational imperatives required to sustain a successful market position is a key strategic resource. This is an important distinction for SHRM theory that typically identifies strategy implementation, rather than strategy formulation, as HR's path to firm performance. It reinforces the notion that strategy implementation is not a second order, or less valuable, strategic outcome for SHRM theory. More importantly, it suggests the need to refocus the concept of fit within SHRM theory. Going forward SHRM theory should focus at least as much on the fit between HR and strategy implementation as between HR and competitive strategy types (e.g., low-cost competitor, differentiation).

While fit has received considerable attention in the SHRM literature, the emphasis has either been on the distinction between internal and external fit (Huselid, 1995; Wright and McMahan, 1992; Wright and Snell, 1998), or how to appropriately measure it (Delery and Doty,

1996). Internal fit is typically defined by the degree to which the separate HR practices in the HR system work together to reinforce the same outcome. External fit, by comparison, describes the extent to which the HR system is consistent with the firm's strategy. The SHRM literature treats these two types of fit as separate and independent constructs (Huselid, 1995). By contrast, in our model the degree of internal fit follows directly from the degree of external fit, but not vice versa. If the HR architecture is appropriately aligned with a particular strategic activity system, or even a particular competitive strategy, the elements of the HR architecture within the domain of that activity will be internally consistent. Alternatively, just because all of the elements of the HR architecture within the domain of a specific activity are internally consistent, it does not follow that the HR architecture is appropriately fitted to either the firm's strategic activity system or its larger competitive strategy.

The development of our theoretical framework focuses on external fit, of which there are three types. Each type of fit reflects how the HR Architecture ought to vary with a firm's competitive positioning strategy and its strategic activity system. The conventional perspective we term *generic* fit because it describes a universal fit between the HR architecture and the larger competitive strategy (Figure 1). *Generic fit* implies that the HR architecture will vary across competitive strategy, but not within strategy types. Just as there might be a very limited number of strategy types, there would be a similarly limited number of appropriate HR Architectures. In the previous discussion we argued that the prior theoretical and empirical work in SHRM has largely been limited to this type of fit. The fit is strategy specific rather than firm specific, or idiosyncratic.

By introducing strategy implementation as the key theoretical construct between the intended positioning strategy and the HR architecture, the theoretically appropriate level of fit

shifts to a focus on the relationship between the HR architecture and the strategic activity system. This shift in focus implies two new forms of idiosyncratic or firm-specific fit: *core* and *flexible* fit. *Idiosyncratic core fit* implies that the fit between the HR architecture and the strategic activity system varies within competitive strategies, because not all competitive strategies have the same strategic activity system as the mechanism by which they are implemented. However, it assumes that the HR architecture is implemented homogeneously across the elements of a particular strategic activity. The HR Architecture is fitted to the strategic activity system, rather than the competitive strategy. Since firms will choose unique strategic activity systems to implement the same competitive strategy, it follows that they will require unique HR Architectures (Figure 2). By contrast, *idiosyncratic flexible fit*, also specifically focuses on the firm's unique strategic activity system, but the level of the focus is each element in that system. The result is an emphasis, or at least acceptance, of different HR systems and performance behaviors within the same strategic activity system (Figure 3).

This analysis implies that strategy implementation effectiveness is a direct result of an HR architecture properly fitted to the firm's strategic activity system. Implementation effectiveness is not equivalent to successful market positioning or firm performance, though it has a direct influence on those outcomes. Instead it is an intermediate outcome reflecting the performance of elements of the strategic activity system. Taken together this discussion implies following proposition:

Proposition 2: Strategy implementation effectiveness is an intervening variable between a firm's HR architecture and firm performance.

Figure 2 about here

Figure 3 about here

Extending the Nature of Fit in SHRM Theory

In the last section we introduced and defined the constructs of generic and idiosyncratic fit. In this section we elaborate on the theoretical rationale for their importance in SHRM theory. The focus on external fit in SHRM theory tends to emphasize the fit with corporate positioning strategy. Much of the theoretical work in SHRM (Wright and McMahon, 1992, and Wright and Snell, 1998) focuses more generally on the elements within the HR architecture that should be emphasized. For example, should the emphasis be on individual HR practices, a system of practices, employee behaviors, commitment, etc.? Lengnick-Hall and Lengnick-Hall (1988) are notably skeptical about SHRM's emphasis on strategy implementation and narrowly proscribed notions of fit. Nevertheless, while they argue that SHRM should give more attention to HR's role in strategy formulation, the focus of that role is the firm's competitive strategy (p. 467). Wright and Snell (1998) explore the relationship between fit and flexibility. The discussion of fit emphasizes the alignment between elements of the HR Architecture and the "demands of the competitive environment" (p. 758) and is consistent with their theoretical model that posits a direct relationship between elements of the HR architecture and firm performance (p. 760). Delery and Doty (1996, p. 807), in their comprehensive analysis of universal and "fit" models within SHRM, emphasize that strategy is the "primary contingent factor" where the focus is on how HR "will interact with firm strategy." Consistent with the tradition in the SHRM literature, Delery and Doty (1996) go on to focus their empirical analysis on just one type of strategy – innovation. In short, an externally focused corporate mission and set of strategic goals drives the organization's efforts to strategically align the HR architecture. Like the Miles and Snow (1994)

typology the match between HR and strategy occurs at a very high level, suggesting that the organization will deduce the appropriate HR architecture from the larger mission and strategic goals.

Fully elaborating the theoretical SHRM framework requires a more careful analysis of the strategic nature of the HR architecture as well as its relationship to effective strategy implementation. Following Barney (2001) we argue that the HR architecture should be considered a complementary resource in the strategic value chain. No matter how rare the skills, how complex the system of HR practices, how committed the employees, those resources do not have strategic value in and of themselves, and neither does the HR architecture that develops them. Those resources only become strategic resources when they contribute to the effective implementation of strategy. This is one of the distinctions between traditional HR and SHRM theory. Traditional HR largely focuses on what Porter (1996) terms operational effectiveness, doing existing HR activities better. New reward systems or new appraisal systems may well improve organizational performance, but they quickly become the new market benchmark, improving the performance of all firms and providing sustained competitive advantage to none. Strategic HR is much more about the *focus* of those HR practices and policies. Recognizing the HR architecture as a complementary asset implies that this focus has to be on the fit between the HR architecture and the larger strategic activity system.

The concept of fit is so central to the strategy literature because so much of the focus of strategy research is intended to explicate the sources of sustained competitive advantage. As that focus has increasingly shifted to the role of organizational resources in recent years, it is only natural that both theoretical and empirical work would begin to look to the fit among those resources as evidence of the qualities that contribute to sustained competitive advantage. Indeed

in answer to the question regarding the basis of strategy, Porter concludes that “strategy is creating fit among a company’s activities” (Porter, 1996, p. 75). Fit is the lynchpin in a value creation process that begins with internal resources and connects to a successful market position, and ultimately firm performance. As Porter (1991) notes, an effective low-cost market position “is an outcome not a cause” (p. 98) that follows from an appropriately organized set of internal resources and activities. The RBV literature has extended the analysis to include “alignment skills” as a strategic resource separate and apart from the strategic resources that might be linked together. These skills are capable of generating economic rents because they are scarce, imperfectly tradeable and difficult to imitate (Powell, 1992).

Generic Versus Idiosyncratic Fit

Venkatraman (1984; 1989) provides some of the earliest and most systematic discussions of fit, emphasizing the importance of fit in middle range theories like SHRM theory. Venkatraman (1984) distinguished between the *content* and *process* of fit, as well as the domain of fit (internal, external and integrated) resulting in six different perspectives. Our concept of *idiosyncratic* fit falls into the internal domain of strategy implementation and a content focused conceptualization. This implies that SHRM theory should focus on the elements to be aligned (content rather than process) and at the level of the internal domain (strategy implementation). This is similar to Porter’s concept of fit among strategic “activities” except that while that system of activities links directly to the organizations external positioning strategy, SHRM theory should focus on the *idiosyncratic* link between the Strategy HR Architecture and the system of strategic activities. We distinguish this link as idiosyncratic, rather than generic, because it will

reflect the firm-specific character of the strategic activity system. This suggests the following propositions:

Proposition 3: Idiosyncratic fit between the HR architecture and a firm's strategic activity system will have a positive effect on strategy implementation effectiveness and firm performance (Figure 2).

Proposition 4: The *idiosyncratic* fit (Figure 2) between the HR architecture and a firm's strategic activity system has a more important influence on strategy implementation effectiveness and firm performance than the *generic* fit (Figure 1) between the HR architecture and the firm's competitive strategy.

Idiosyncratic Core and Flexible Fit

We have suggested that the link between the HR Architecture and the strategic activity system can occur at two levels, and reflects two types of idiosyncratic fit: core (Figure 2) and flexible (Figure 3). The difference between two is the extent to which the HR architecture is uniquely structured for the performance behaviors required for each *element* in the firm's strategic activity system. This distinction follows from Porter's (1996) emphasis on the fit among strategic activities as the essence of strategy, where the activities that comprise a firm's value chain "are the basic units of competitive advantage" (p. 62). One of the attributes or drivers, to use Porter's term, giving these activities strategic value is their linkages with one another (Porter, 1991, p. 104). Those linkages in turn create an activity system that is internally consistent and externally focused on creating a successful market position. When the HR architecture is designed to increase idiosyncratic fit, those linkages are reinforced, and the HR architecture serves as a complement to effective strategy implementation. As Porter observes (1996, p. 62) "strategic positioning means performing *different* activities from rivals or performing similar activities in *different ways*." The implication is that there are multiple ways,

or activity systems, to implement a particular competitive strategy. In order for the HR architecture to appropriately fit the firm's strategy it must *idiosyncratically* fit the firm's unique activity system, either at the level of the entire system (core) or at the level of each element in the system (flexible).

Introducing the distinction between idiosyncratic core and flexible fit in SHRM theory highlights the important difference between structure and function. As Gresov and Drazin (1997) observe, "where some contingency theorists may err is in assuming a 1 to 1 function-structure correspondence, and in testing for 'fit' at the level of the structure instead of at the level of the function" (p. 408). They use the term function to describe a "capacity" to meet a particular organizational demand. By contrast there are multiple structures available to provide that functional capacity. SHRM theory must distinguish between the *function* of the HR architecture and its *structure*. The function of a *strategic* HR architecture is to maintain, motivate and develop strategic employee performance. To the extent that there is a common set of behaviors required to implement the firm's strategy, *core* fit is appropriately emphasized. However, to the extent that those performance behaviors vary significantly across elements of a strategic activity system, the fit between the HR Architecture and the strategic activity system should be *flexible*. By implication the *structure* of the HR architecture may also vary across elements of the strategic activity system within the same firm, and across different firms with the same competitive strategy. Core fit, by comparison, implies the same HR architecture structure across all elements of the firm's strategic activity system. Matusik and Hill (1998) make a similar distinction for another intangible asset, organizational knowledge. They differentiate between "component" knowledge and more broadly focused "architectural" knowledge. This suggests the following proposition:

Proposition 5: Idiosyncratic *flexible* fit will have a more positive impact on strategy implementation effectiveness and firm performance than idiosyncratic *core* fit.

The concept of equifinality follows from the notion of flexible fit in SHRM theory.

Gresov and Drazin (1997) develop a classification system for four different equifinal situations that can be applied to SHRM. The four equifinal situations represent the intersection of two functional dimensions: conflict in functional demands and latitude for structural options within the function. From the perspective of the strategic human capital *function* most firms are most likely characterized by high functional demand conflict and little latitude for structural options. Rather than approaching human capital as an organizational asset, the HR architecture is largely controlled by the HR function (i.e., the administrative home of HR professionals). HR professionals in the administrative function normally face multiple and competing demands, including the need to act as strategic partner, administrative expert and employee advocate Ulrich (1997). Creating value through strategy implementation and the pressure to emphasize cost-control through administrative efficiency are competing functional goals that are not easily reconciled. Likewise, HR functions tend to emphasize uniformity and best-practices that are fair and equitable (i.e., similar) policies and practices for all employees. This perspective is reinforced when the functional demand is for administrative efficiency. The result is more, rather than fewer, constraints on HR system variability within the firm. Following Gresov and Drazin (p. 409) the result is sub-optimal equifinality and poor (flexible) fit.

By contrast, when the strategic HR architecture is developed with a clear emphasis on strategy implementation, functional conflict will be low. With a dominant functional focus on strategy implementation, the HR architecture is “unconstrained” so the HR system is flexible enough to be focused as appropriate on key elements in the strategic activity system. The result

is a more appropriate fit between HR and strategy that Gresov and Drazin (p. 409) have termed “tradeoff equifinality.” The HR system will be flexibly fit to each element in the strategic activity system to provide the strategic employee performance required in that specific element. This leads to the following propositions:

Proposition 6: As a firm imposes conflicting functional demands on HR, idiosyncratic flexible fit will decrease.

Proposition 6a: As a firm imposes conflicting functional demands on HR, idiosyncratic core fit will increase.

Proposition 6b: As a firm imposes conflicting functional demands on HR, the influence of idiosyncratic core fit on effective strategy implementation will decrease.

Proposition 7: As idiosyncratic *flexible* fit increases, the HR architecture will have increasing structural equifinality.

Proposing a key role for *idiosyncratic flexible* fit between the HR architecture and the strategic activity system in SHRM theory also provides a different perspective on an important issue raised by Lepak and Snell (1999). They note that the HRM literature has tended to emphasize a “holistic” view of human capital and “the extent to which a set of practices is used across employees of a firm as well as the consistency of these practices across the firm” (p. 32). This parallels our notion of both generic fit and idiosyncratic core fit since both imply little variation in the HR Architecture within firms. The emphasis for Lepak and Snow is human capital sourcing decisions and their model does not extend beyond the HR architecture. Their key insight, however, is the need to recognize that not all employees, or employee skills, are inherently strategic and employees with different roles in the value creation process ought to be managed differently. While Lepak and Snow base their analysis within the context of the HR

architecture, we come to a similar conclusion, but from a different perspective. Our approach is not to begin with the HR architecture, but end with the HR architecture. Employment sourcing decisions and other human capital decisions are only strategically important if there is a clear link between those decisions and strategic activities that directly implement the firm's strategy. Presumably not all strategic activities will be highly dependent on human capital. As that dependency increases, employee performance behaviors in that activity are increasingly a complement to effective strategy implementation. As the elements of the HR architecture within the domain of that activity are uniquely fitted (flexible fit) to produce those behaviors, the HR architecture increasingly becomes a strategic asset. This complementary relationship, in turn, identifies certain employees and certain elements of the firm's human capital as strategically important. This strategic value, however, is derived from the value of the strategic activities and, following Teece, Pisano, & Shuen (1997) could easily extend to hourly workers and manual trades. In effect, our model addresses the question of which employees would be included in Quadrant 1 (highly unique and high valuable human capital) in the Lepak and Snell framework. This implies the following propositions:

Proposition 8: The positive effect of the HR Architecture on strategy implementation effectiveness increases with the human capital content of the strategic activity system.

Proposition 8a: As the variability of human capital demands increases within the strategic activity system, the influence of idiosyncratic flexible fit on effective strategy implementation will increase relative to the influence of idiosyncratic flexible fit.

Fit as a Source of Competitive Advantage

Articulating why and how the HR architecture can represent a source of competitive advantage is at the core of what sets SHRM theory apart from traditional HRM theory. In the

absence of this theoretical foundation, empirical work on the HR-firm performance relationship lacks a theoretical explanation for economically significant effects. The strategy literature identifies several attributes of an organizational asset that are necessary if that asset is to represent a strategic asset. A strategic resource should be valuable, rare, inimitable and effectively embedded in the firm's organizational structure (Barney, 2002). Structuring the HR architecture with an emphasis on idiosyncratic, rather than generic fit, provides a stronger theoretical basis for assertions in the SHRM literature that HR can be a source of competitive advantage. Idiosyncratic fit is more *valuable* than generic fit because HR architecture will be more tightly linked to the underlying value chain in the organization; namely, the system of strategic activities. Identifying the HR Architecture as a source of strategic value, ultimately means being able to link this organizational asset to new value creation. The link between HR and subsequent financial gains is an indirect one for most companies. This requires that any theoretical statement of HR's strategic value clearly specify how it "hones to a user need" (Teece, 1997, p. 517). Emphasizing idiosyncratic fit strengthens SHRM's theoretical focus on value. Idiosyncratic fit is a rarer resource than generic fit by definition. Idiosyncratic fit with the strategy implementation system is much more unique than the limited set of competitive strategies that would drive generic fit.

Most significantly, idiosyncratic fit is not only more difficult to imitate, there is little incentive to imitate since the value creation exists in the firm-specific relationship between the HR architecture and the firm-specific strategic activity system. While the motivation for idiosyncratic fit is based on the strategic *function* of the HR architecture, the form of the fit, like the structure of the HR architecture and the strategic activity system, is inherently firm specific. In this model, there is no single mix of HR policies and practices that is easily transferable to

other firms. Indeed the value of HR system is as much in its *link* to the underlying strategic activity system, as the HR system itself. Transferring the idiosyncratic structure of the HR architecture from one company to another would not be expected to produce equivalent results (Lado and Wilson, 1994). Therefore, even if the HR architecture were causally “obvious,” imitation would not yield the same returns to the imitating firm.

Nevertheless, because the value is created through the idiosyncratic linkages, causal ambiguity is enhanced through the complexity of the relationship between the HR architecture and firm performance (Reed and DeFillipi, 1990). The number and depth of these linkages is at once both a challenge for HR, but also a source of its strategic potential. For example, Teece, et al. (1997) argue that firm capabilities “need to be understood in terms of the organizational structures and managerial processes which support productive activity” (p. 517). They emphasize the need to recognize that there is a “hierarchy” of these capabilities from the shop floor to the executive suite (p. 518). The breadth of this hierarchy in part contributes to the causal ambiguity and inimitability of such capabilities. Making the link between the HR architecture and the firm’s strategic activity system more prominent in SHRM theory incorporates and more fully articulates the hierarchical and complex character of the HR-firm performance relationship.

Organizational leverage (Barney, 2001) is the last resource attribute required to be a source of competitive advantage. Idiosyncratic fit is entirely focused on leveraging the HR architecture in a way that focuses specifically on the function of providing the performance behaviors required to implement the firm’s strategy. This organizational relationship between the HR architecture and the larger system of strategic activities also highlights HR’s complementary role in the value creation process (Amit and Shoemaker,

1993; Barney, 2001; 2002). Using Amit and Shoemaker's analogy, the strategic employee behaviors are an "intermediate good" (p. 35). The value comes from "enhanc[ing] the productivity of other resources" (Makadok, 2001, p. 389); namely, the value of the strategic activity system. Those behaviors, and by implication the HR architecture do not have strategic value in their own right, but only as a complement to another strategic asset. They only become a strategic asset when matched with other strategic assets, such the elements of the strategic activity system.

Zajac, Kraatz, & Bresser (2000, p. 429) note that while fit "is one of the most widely shared and enduring assumptions" in the strategy literature, there has been very little research on the subject, either empirically or theoretically, in recent years. Among the reasons they give for this declining attention to fit is the nature of the concept. It is inherently multidimensional and not easily captured by simple bivariate statements. They also observe that fit requires scholars to make normative statements about what organizations *should* do rather than descriptive statements about what they *did do* (p. 430). Zajac, et al. (2000, p. 450) conclude that more attention should be given to the "*uniqueness* of strategic fit for a particular organization at a particular point in time." Introducing the concept of idiosyncratic fit responds to these concerns as they apply to the SHRM literature. Rather than generically matching the HR architecture to competitive strategy, idiosyncratic fit requires that the points of fit are much more diverse and focus on the unique set of strategic activities required to implement the firm's strategy. This is especially true for idiosyncratic flexible fit. At the same time our theoretical framework is strongly normative with clear implications for management practice.

Implications for Research

A New Emphasis on Intermediate Strategic Outcomes

The prior empirical literature has focused on a number of measures of firm performance ranging from accounting profits and shareholder value (Becker and Huselid, 1998; Huselid, 1995) to plant and unit level outcomes (Delery and Doty, 1996; Ichniowski and Shaw, 1997; MacDuffie, 1995; Youndt, et al., 1996). An emphasis on sustained competitive advantage as the basis of above average firm performance in the strategy literature argues for an emphasis on higher order measures of firm performance in SHRM research. Nevertheless methodological demands, including measurement issues (Gerhart, Wright, McMahan, & Snell, 2000; Huselid and Becker, 2000), line of sight and data access implied by an emphasis on firm level performance measures suggest the value of increasing empirical attention on intermediate outcomes.

One of the implications of the theoretical extensions we propose is that empirical SHRM research can be refocused on key intermediate outcomes for theoretical, as well as, methodological reasons. As a middle range theory SHRM theory must ultimately be linked to the same strategic outcomes found in the strategy literature, or it risks being irrelevant to both HR and strategy. By locating effective strategy implementation as an explicit intervening variable in SHRM theory, strategically focused empirical research does not necessarily require firm financial performance as the dependent variable. Empirical work in SHRM can be extended to include a focus on measures of effective strategy implementation, while at the same time providing a theoretically clear line of sight between those dependent variables and the ultimate strategic outcomes. Particular attention should be given to those elements in the strategic

activity system that are both critical to the firm's strategic success and have high human capital content.

The challenge will be to incorporate the idiosyncratic character of the strategic activity system into the empirical tests of this model. It becomes more difficult to argue that one element, such as customer service, has generic strategic importance. For example, Porter (1996) offers examples of strategic activity systems from three disparate industries (airlines, retail furniture and financial services) and "limited" customer service is a dimension of effective strategy implementation in two of the three companies. Increasing use of unit level and plant level financial performance is not necessarily a solution. These measures might capture the effects of effective strategy implementation, but they do not measure strategy implementation directly. Intermediate outcome measures will have to be "strategically validated" demonstrating their importance to effective strategy implementation in the specific firm. This will be particularly challenging because the theory suggests that the underlying phenomena (key elements in the strategic activity system) will vary across firms. This may require more studies like MacDuffie (1995) but instead of focusing on production units, the focus is on element(s) in the firm's strategic activity system.

A New Emphasis on Fit in SHRM research

Our proposed theory suggests both a new emphasis and a new focus for fit in the empirical SHRM literature. While prior empirical work focused on the fit between the HR architecture and a firm's competitive strategy, our theory requires a new focus on the fit between the HR architecture and the elements of the firm's strategic activity system. One implication of the idiosyncratic hypothesis is that alignment skills (Powell, 1992) and fit have value independent of the HR Architecture. Fit should be measured directly rather than as a moderator

or any other synergistic based test. In other words, for a given structure of the HR Architecture, increasing idiosyncratic fit should increase the effectiveness of the firm's strategy implementation. The theory does not suggest a "best" HR architecture because there is not a "best" strategic activity system. The theory, however, does imply that for a given strategic activity system, more fit is better than less fit. Future research, therefore, must be based on measures that capture the extent to which the HR architecture provides the strategic behaviors required by the strategic activity system. This will require direct measures of alignment between the HR architecture and elements of the strategic activity system.

Implications for Management Practice

Emphasis on Intermediate Outcomes

HR professionals require a different perspective on the field if they are to play the role of strategic partner and the HR architecture is to represent a strategic asset. Schuler and Jackson (1995) described this in part as a focus on organizational analysis rather than job analysis. Barney and Wright (1998) observe that HR professionals continue to demonstrate a limited understanding of the economic rationale linking HR to valued strategic outcomes. HR professionals are particularly in need of a coherent "business case" for HR because the line of sight between HR and firm performance is rarely a direct one. HR professionals have largely been incapable bridging the gulf between a traditional micro oriented focus and the demands from CEOs to demonstrate their contribution to strategic success. A new emphasis on strategically relevant intermediate outcomes should provide HR professionals with a more tractable solution to this problem.

A New Emphasis on Idiosyncratic Fit

Our model requires that HR professionals understand the linkage between what they do and the intermediate outcomes that senior line managers value. This requires a different perspective on fit. King and Zeithami (2001) make the point that causal ambiguity has two sides. While it limits external imitation, it makes it more difficult for internal managers to implement these ideas in the first place. HR professionals need to rethink what it means for HR to be aligned with strategy. Instead of thinking in terms of a global match with the corporate strategy, they need to focus more directly on the elements of the strategy activity system. This will have several implications. First it will mean more attention to the competencies of organizational analysis and less emphasis on external benchmarking as the basis for measuring HR's strategic contribution (Becker, Huselid & Ulrich, 2001). Second, it will mean that HR professionals must do a better job of managing the competing functional demands on HR. To the extent that HR is constrained to a similar architecture across the entire organization, and within the strategic activity system, the more difficult it will be to provide optimal levels of strategic fit. Similar to Lepak and Snell (1999) HR professionals must be able to distinguish "A-level" employees and implement unique systems for them. This requires a new emphasis on "disproportional" investments in different elements of the strategic activity system and the "A-level" jobs in those elements.

Conclusion

The last decade has been characterized by considerable research interest in the field of SHRM, including Special Issues in *AMJ* and several other leading journals. Much of the empirical work has focused on the structure of the HR architecture and how that structure relates

to a particular “strategic” outcome. Following Becker and Gerhart (1996) we argue that what continues to be missing from this literature is a fully elaborated theoretical framework that identifies key mediating variables between the HR architecture and firm performance. The strategy literature has given increasing attention to the construct of strategy implementation as an independent source of competitive advantage. This is an opportunity to extend SHRM theory in a similar fashion given the implicit of role strategy implementation in the SHRM literature. This extension is important because it provides a clear theoretical rationale for the influence of the HR architecture on firm performance. We also argue that a new focus on strategy implementation requires a renewed emphasis on strategic fit, one that reflects more the idiosyncratic demands of effective strategy implementation and less the generic qualities of a few competitive positioning strategies.

These theoretical extensions have direct implications for both research and practice. The emphasis on strategy implementation calls for more research on HR’s influence on strategically relevant intermediate firm outcomes, and offers HR professionals a more solution to their challenge of demonstrating their strategic contribution. The emphasis on idiosyncratic fit requires that researchers develop new and more direct measures of HR’s strategic fit, while it increases the need for HR professionals consider how the HR architecture can be customized to the unique human capital requirements of each dimension of the strategic activity system.

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Figure 1
SHRM with Generic Fit
to Corporate Strategy

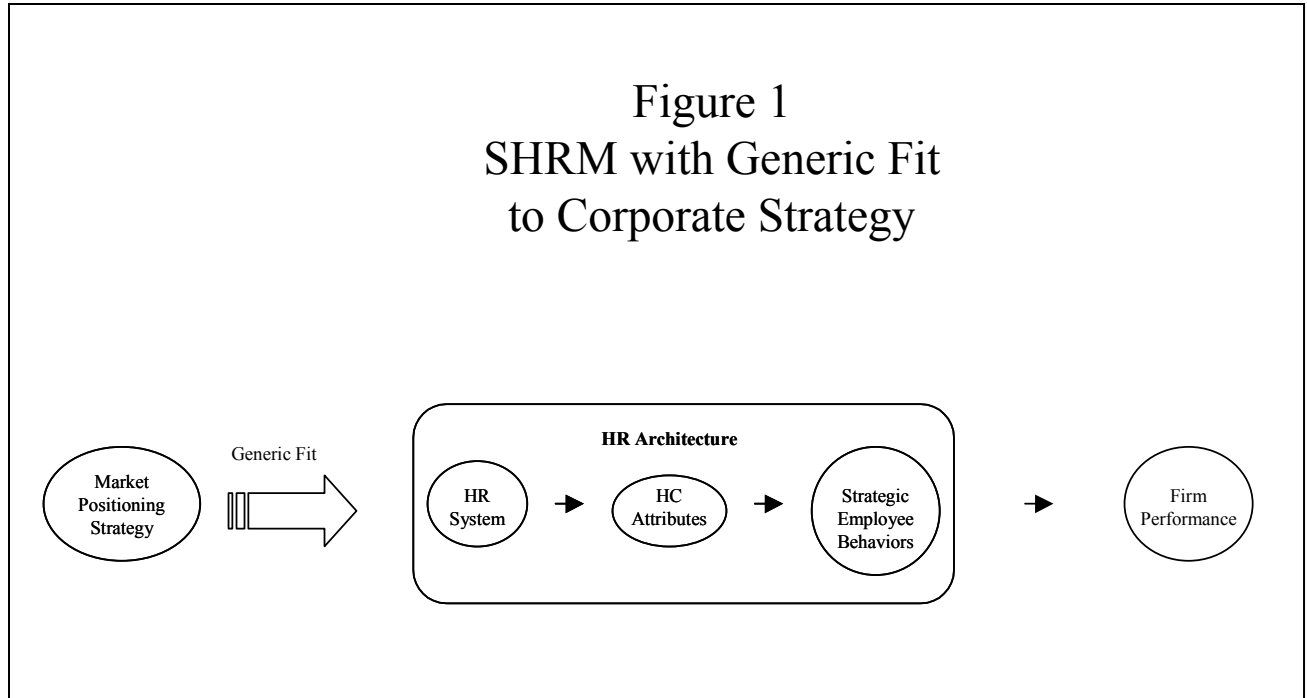
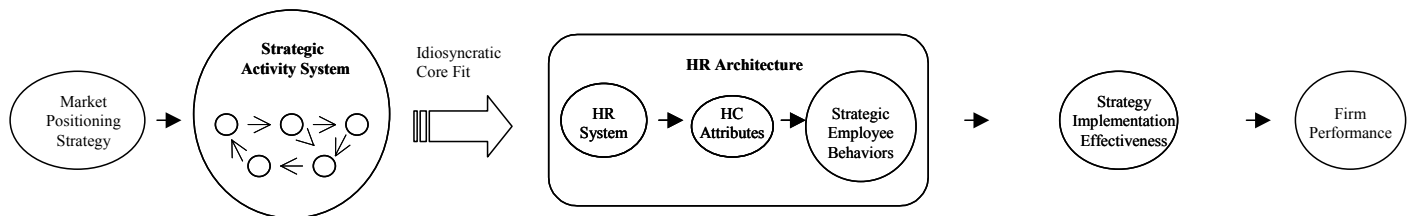


Figure 2

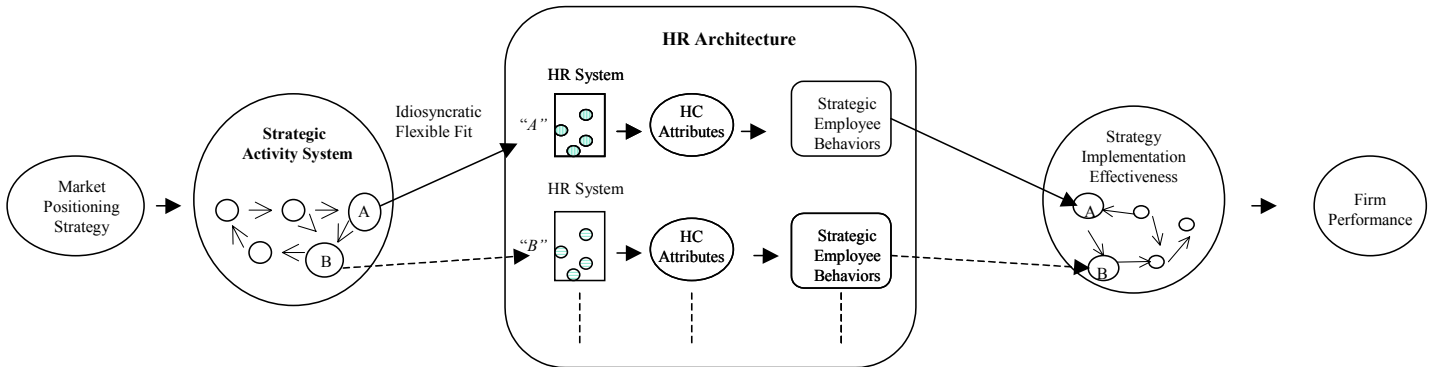
SHRM Incorporating Strategy Implementation and Idiosyncratic Core Fit



- Strategic activity system is guided by positioning strategy, but structure is firm specific rather than strategy specific
- Structure of HR architecture aligned to strategic activity system rather than market positioning strategy
- HR architecture alignment to strategic activity system focuses on *common* human capital requirements across all elements of the system
- Strategy Implementation Effectiveness is an important intermediate measure of performance

Figure 3

SHRM Incorporating Strategy Implementation and Idiosyncratic *Flexible* Fit



- Strategic activity system is guided by positioning strategy, but structure is firm specific rather than strategy specific
- Structure of HR architecture aligned to strategic activity system rather than market positioning strategy
- HR architecture alignment to strategic activity system focuses *uniquely* on the human capital requirements of *each element* of the system
- Effectiveness of individual elements in the strategic activity system are important intermediate performance measures
- Creates employee behaviors required to maximize performance of each dimension of strategy implementation effectiveness

¹ According to Meyer (1991, p. 825) “research questions [in strategy] are inherently uninteresting or trivial unless they include an explicated linkage to performance.” This quote was originally cited in Priem and Butler, 2001, p. 31.

² The popular business press highlights the inability to execute strategy as the most common reason for CEO failure. See for example, Charan (1999) and Bossidy and Charan (2002).