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HIGH PERFORMANCE WORK SYSTEMS: A NECESSITY FOR STARTUPS

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ABSTRACT

New businesses are an important part of any economy, yet the key elements to achieve startup success are often unclear or up for debate. Attracting, selecting, and training employees are often critical activities for most startups. Research suggests that high performance work systems (i.e., a bundle of human resource practices) enhance organizational performance. However, we posit that most startups lack these systems at the onset, yet with minimal effort can establish a system to improve their likelihood of meeting their goals, enhancing capabilities, and ensuring long-term survival.

Keywords: Startups; human capital; high performance work systems (HPWS)

INTRODUCTION

Human capital and human resources are valuable not only to established organizations, but also to startups and new ventures (Hornsby & Kuratko, 1990). The primary growth mechanism of the firm is the human capital that the firm possesses, which resides in the individual workers in the firm as well as the joint relationships they form (Nahapiet & Ghoshal, 1998). Human capital determines the quality of the products and services that a firm offers (Nahapiet & Ghoshal, 1998). The primary focus of human resource management is on the development, selection, compensation, and performance management of workers. Over the last 20 years scholars have gone beyond traditional human resource management and began to analyze the strategic value of human resources. The primary focus of this approach has been the study of the bundling together of various practices. When bundled, human resource practices can create synergies among the practices deploying human capital. Despite the various differences and contextual factors in play, there is agreement among scholars on what are considered to be best practices and how well those best practices are determined by contextual factors (Becker & Huselid, 2006). We seek to extend this literature by proposing a set of propositions about the role of strategic human resource management in developing startups.

Such an approach is important because startups, new ventures, and new businesses are an important part of the economy and are often the source of job creation and new economic growth (Baumol & Strom, 2007; Birch, 1987; Mazzarol, Volery, Doss & Thein, 1999). Yet startups face a wide set of problems including lack of both financial and human resources. We believe that startups can utilize superior human resource management to experience

higher rates of growth and survival. Accordingly, we seek to address two research questions in order to better understand the use of human resources, particularly high performance work systems (HPWS), as a necessary aid and component to startups. The first research question addressed is: do startups simply address various human resource practices on as needed bases or do they more holistically develop HPWS? Secondly, might more emphasis on HPWS ensure greater outcomes for startups and new ventures?

Prior research has investigated related issues, yet not specifically addressed our questions. For instance, Cardon & Stevens (2004) review what we know about human resources in small businesses. Other scholars suggest human resources can enhance innovation in startups (De Winne & Sels, 2010). In addition, research has demonstrated the need for human resource practices in small and medium sized enterprises (Bendickson, Liguori, Muldoon, Newport & Weaver, 2013) but only looks at individual practices instead of an integrated system (i.e., HPWS) and does not identify the role of startups. Furthermore, other research contemplates whether these practices matter at all since high-tech startups are often built to flip (Baron & Hannan, 2002).

In some ways, the debate contingency factors and best practices in startups mirrors the debate in established companies regarding HPWS. The initial research performed by Huselid and Becker argued that regardless of company size or industry, HPWS would lead to superior performance (Purcell, 1999). Other researchers were more skeptical regarding the use of HPWS and suggested that contingent factors (such as size or industry) limited the efficiency of the HPWS (Purcell, 1999). While these scholars accept the general notions of Huselid and Becker's argument,

they rejected what they consider to be Huselid's naïve arguments regarding HPWS (Kaufman, 2010). For instance, would an industry in food service have the same need for HPWS as would a company in the technology industry (Wright & McMahon, 1992)? There is some evidence that companies in which a focused or differentiation strategy is applied are more likely to use HPWS than companies that use cost leadership (Buller & McEvoy, 2012).

This is an issue in small business research as well (e.g., Bamberger, Bacharach & Dyer, 1989). What scholars have examined regarding HPWS in startups have been narrow studies that focused on industries (e.g., banking, Bamford, Dean & McDougall, 2000). More definite and generalized conclusions have not been drawn. Some scholars have suggested that startups lack the resources needed to possess HPWS whereas others have suggested the opposite (Becker & Huselid, 2006) For these reasons, we find it necessary to describe why we believe HPWS can enhance outcomes in startups and/or new ventures, in an effort to address our questions and contribute to the literature. The purpose of the paper is to develop propositions regarding the relationship between HPWS and various types of outcomes for startup businesses. Our argument is that HPWS are an important part of the organization during the startup process. Those organizations that possess HPWS will grow more quickly, have higher rates of goal achievement, be more likely to survive, and more likely to develop capabilities than startups in which HPWS are not used.

High Performance Work Systems

High Performance Work Systems (HPWS) are a bundle of Human Resource Management (HRM) practices that typically include the following emphases: staffing, self-management teams, decentralized decision

making, training, flexible work assignments, communication, and compensation (Evans & Davis 2005). Staffing includes the processes whereby abilities for job fit and organization fit are evaluated. There are different levels to the extensiveness of this procedure. These evaluations are based on knowledge, skills, and abilities (KSAs), which result in then selecting the best candidate for the position. Startups cannot wait until there is more time to conduct more rigorous staffing procedures and we argue staffing is a fundamental portion of HPWS that can give startups a competitive advantage. Examples of staffing procedures include selective screening of employees and assessment of technical and interpersonal skills. Attitudes and personality may provide other measurements for desired characteristics. Additionally, performance-based promotions represent internal candidates (Evans & Davis, 2005). Though KSAs are mentioned, more specific findings support selection based on general mental ability (Schmidt & Hunter, 1998). Relatedly, Lepak and Snell (1999) provide a quadrant of the HR architecture implying appropriate uniqueness and value vary across an organization. This is a useful consideration for selective staffing. Upmost, KSA value and uniqueness is perhaps not necessary for every position, but the importance is in finding the appropriate job fit and organization fit to enhance individual and organizational performance. Lastly, as a prelude to selective staffing, attention to attracting applicants from an organizational level (Rynes & Barber, 1990) may be an important and intertwined aspect to ensure selection from the best talent pools.

Self-managed teams address a power relationship at an individual level. With self-managed teams, power is shifted down the chain of command granting many different teams authority over their decision making.

While startup owners may fear relinquishing control, allowing employees to work autonomously often leads to positive outcomes as well as increasingly motivated employees (Pink, 2011). Examples of self-managed teams include employee participation programs, teams with task and decision-making authority, and extensive use of teams in general throughout the organization (Evans & Davis, 2005). Teams provide success in various ways. For example, Gibson, Porath, Benson and Lawler (2007) demonstrated that team-enabling practices significantly predicted quality. Delegation to self-managed teams not only provides empowerment for employees, but also gives employees a chance to demonstrate initiative and achieve personal growth and development (Heimovics, Herman & Jurkiewicz, 1993).

Similar to self-managed teams, decentralized decision making offers employees more control and power in the decision making process. Employees gain autonomy under this practice and also gain access to resources. This is accomplished in numerous ways, some of which include: creating tasks for employees that aren't as clearly defined, granting employees the authority to make decisions, involving employees in the decision making process, and through participative management which essentially grants employees access as a collaborator rather than a subordinate (Evans & Davis, 2005). Eisenhardt and Bourgeois (1988) determined that top management teams overly engaged in centralization and internal politicking, and that power games were likely to decrease firm performance. This helps create the case for decentralized decision making and also explains a unique internal power relationship. Startup owners need to rely on others to ensure the success of their business and hence realize the importance of decentralized decision making at early stages of inception.

Training and development are programs designed to help employees increase KSAs. These are generally formalized procedures that are pertinent for current and/or future necessary skills and knowledge. Different outcomes of training may include the enhancement of technical skills or the development of interpersonal skills. Cross training allows for employee growth as well as internal dependency reduction. Though training is often designed for new employees, it's an imperative component for experienced employees as well (Evans & Davis, 2005). Of course there are many considerations. Some of these are at the individual level such as personality characteristics (Major, Turner & Fletcher, 2006) or differences between passive and active learners (Bell & Kozlowski, 2008). Some training is carried out at a more organizational level such as training design and effectiveness (Arthur, Bennett, Edens & Bell, 2003). Training has gone through dramatic changes (Salas & Cannon-Bowers, 2001) but remains an important feature for improving individuals, organizations, and society (Aguinis & Kraiger, 2009) and is beneficial for startups as well as established corporations.

Advances in KSAs again appear in *flexible work assignments*. Here, individuals often have the opportunity to broaden KSAs. This may occur through job rotation, which may happen in a team, or with counterparts of an individual's position. While larger teams may not be present in startups, another example of a flexible work assignment includes job enrichment allowing for employees to use the array of KSAs in their repertoire (Evans & Davis, 2005), something startups can more likely participate in. As mentioned, these work practices are highly interconnected. Flexible work assignments can improve work-related attitudes, organizational commitment, job and organizational satisfaction, reduce

absenteeism, and reduce turnover; many of which are items thought to impact performance (Scandura & Lankau, 1997).

Communication within organizations is on a spectrum between closed and open. Open communication provides opportunities for employees to express their opinions, concerns, and suggestions whereas closed communication does not. Beyond the open/closed spectrum, open communication can be both horizontal and vertical within an organization. When horizontal and vertical communication are both open, the greatest amount of information will be shared and the greatest number of viewpoints will be represented. This occurs through relatively simple initiatives such as explaining business strategy throughout the organization. Open communication may also occur through available access to information and/or an employee suggestion system (Evans & Davis, 2005). Employees involved in the open system have a better understanding of the competitive position and are able to participate which creates environments where employees can identify with the organization and will have the desire to help it succeed (Wright, Gardner & Moynihan, 2003). Because startups typically have fewer channels, not only is this important, but it also is more feasible than in larger established organizations.

Compensation is addressed in a few different ways. Pay and compensation structures all provide opportunities for organizations to use compensation as a mechanism to steer employees. More specifically, these compensation initiatives may occur through profit sharing, employee ownership, a comparatively high level of pay, performance-contingent pay, and/or team-based pay (Evans & Davis, 2005). Compensation has many elements but clearly impacts satisfaction, fairness, and turnover (Tekleab, Bartol & Liu,

2005). Brown, Sturman and Simmering (2003) found that pay level practices and pay structures interact to affect financial performance as well. Pay for performance (i.e., performance-contingent compensation) has also shown the ability to increase productivity (Cadsby, Song & Tapon, 2007). Startups may be limited in cash but can take part in better compensating individuals through equity options, a powerful incentive with a large upside if the company is successful. This can also help align the goals between owners and employees.

In total, these seven human resource practice categories are commonly found in High Performance Work Systems (HPWS) and are critical and interdependent. Although most companies use some, if not all of the best practices, the real benefit of HPWS comes when there is synergy between the various practices (Subramony, 2009). In fact, Delery and Doty (1996) suggested that the best performance comes through an interaction between strategy and practice. It is important to note that many scholars accept the fact that best practices provide a basic ground level for performance (Becker & Huselid, 2006). They help explain why and how human resources can positively impact organizational performance, and help enhance startup performance in a variety of ways.

One problem is that HPWS research has a lack of theoretical development between HPWS and firm performance—treating it as if it is a black box (Becker & Huselid, 2006). Yet scholars also seem to have an understanding that firms that use HPWS will have a better time recruiting high quality workers; selecting workers that actually fit both the organization and job; have more skills through training; be more likely to stay in the organization; have higher levels of commitment and satisfaction; and be more likely to be engaged with

organizational goals (Pfeffer, 2007; Gong, Chang & Cheung, 2010). In addition, the general combination of those practices will lead to an increased level of human capital in the organization (i.e. through training and selective hiring) and also the social capital of the organization (i.e. through proper incentives) will combine to produce intellectual capital. Intellectual capital is the ability to develop new products and services that create greater value than competitors.

We argue that HPWS will have the same effect on startups as they do on large companies. Many of the practices provide for advancement in KSAs and allow for greater flexibility in employee decision making. Further, these practices that are part of the system enhance aspects for the individual (i.e., compensation, internal promotion, and job enrichment) and in turn provide positive outcomes for startups. Accordingly, all else equal, we believe that startups with HPWS in place will experience better outcomes. These outcomes are similar to other outcomes in the HPWS literature including: higher goal accomplishment, enhanced capabilities, and long-term survival.

GOAL ACCOMPLISHMENT

Goals are an extremely important consideration in strategic performance (Teece, Pisano & Shuen, 1997). As goals determine the focus, effort and intensity that individuals will display and are not only important for firm performance (Locke & Latham, 1990). Yet, goals are often not completed either due to worker disengagement or a lack of skills (Pfeffer, 2007). HPWS can lead to higher levels of goal completion for several reasons. Firstly, improved selection should allow the organization to identify workers who have a higher fit to the organization's culture and have a better fit to the job (Becker & Huselid,

2006). Secondly, increased and improved communication would increase goal commitment, since workers would have a greater understanding of what needs to be done (Pfeffer & Veiga, 1999). Thirdly, compensation would align worker behavior to firm goals, providing incentives for workers to maintain goal alignment (Pfeffer & Veiga, 1999). Finally, the synergistic interplay of those practices should lead to higher goal accomplishment. Thus we propose:

***Hypothesis 1:** New ventures with high-performance work systems in place will be more likely to meet their goals than startups without high-performance work systems.*

CAPABILITIES

Capabilities are those characteristics which allow the organization to comfort and adapt to changing outside environments (Teece, et al, 1997). Capabilities are unique resources that the organization could deploy that are difficult to imitate, substitute for, have value, and are rare (Barney, 1991). Capabilities consist of knowledge, routines, and competencies which allow the organization to produce greater value than the organization's competitors. HPWS create capabilities through superior selection of workers, increasing human capital (Pfeffer & Veiga, 1999). Status reduction, increasing training, and incentives create superior social networks throughout the organization providing motives for workers and management to share important information, which is an important consideration in the development of capabilities (Nahapiet & Ghoshal, 1998). The improved social networks and information will lead to the development of social capital in the firm (Nahapiet & Ghoshal, 1998). The combined relationship between human capital and social capital will produce intellectual capital—meaning that the firm will now will

have higher degrees of flexibility in dealing with environmental factors—such as new products and innovative methods (Wright, Dunford & Shell, 2001). Thus, startups that use HPWS should have a more fluid experience in creating capabilities. Accordingly we propose:

***Hypothesis 2:** New ventures with high-performance work systems in place will grow capabilities better than startups without high-performance work systems.*

SURVIVAL

Resources are necessary for the survival of the firm (Pfeffer & Salancik, 1978). They are also necessary for growth (Barney, 1991). Through superior selection, development, compensation and sharing of information, firms that use HPWS are more likely to develop internal resources that are difficult to replicate by outside organizations (Barney, 1991). HPWS will develop these resources through superior selection of workers; improved training and skill development; improved commitment and motivation; and through the synergistic effects of each of the best practices (Becker & Huselid, 2006). These internal resources will provide the basis for the startup to produce superior products and services, enabling the firm improved survival and growth potential (Barney, 1991). These internal resources are able to promote organizational survival and create added growth. Thus, based on the findings from the HPWS literature, we propose the following propositions related to startups:

***Hypothesis 3:** New ventures with high-performance work systems in place will have a better chance of survival than startups without high-performance work systems.*

DISCUSSION

Based on previous research regarding major corporations we developed a series of propositions regarding the role of HPWS for startup companies. The propositions state that startups that use HPWS will be more likely to experience higher levels of growth, survival, development of capabilities, and goal achievement. The reason for this higher level of performance in startups is the same in larger more established firms. Namely that superior human capital and social capital is the accelerator of the firm's growth as better human capital leads to products that create more value for customers than competitors. As established firms will have a greater chance of meeting certain desirable organizational outcomes. Such a proposal is significant because it suggests that HPWS are universal, rather than one based on contingency. Such a statement should be taken broadly rather than in depth. Nevertheless, based on the development of the propositions in the paper, generally speaking, there are best practices.

There are several important aspects to note regarding the HPWS. Firstly, although scholars have a strong idea that there are universal practices, how those practices are implemented and the various contingencies that exist may make the implementation of HPWS very different in startups than more established companies. For instance, incentives, such as stock options—designed to eliminate agency problems, may have greater salience and influence in startups than they would have in larger companies due to the fact that workers have more control in a startup. Another potential difference would be in status reduction. It is difficult to have a great deal of status in a smaller firm with fewer employees than a larger one with multiple layers of bureaucracy and regulations. Yet there could still be status in a smaller firm (i.e.

a family-owned firm) and how a startup handles status differences issues could vary when compared to an established firm.

One particular thing to note is that many aspects of HPWS—such as status reduction and sharing of information—speak to company culture. Although culture can be changed, it is often difficult to do so. Therefore, startups that use HPWS may have an easier time implementing and continuing to use them when they mature than companies that did not use them during the initial phase. Another important issue is that HPWS requires trust between workers and management. It is especially difficult to create trust where none had existed previously. Thus it is also possible that firms that use HPWS early in their tenure should have an easier time deploying them in the future as the firm goes from a startup to an established company. For that reason alone it would make sense to maintain a set of best practices from the commencement of the firm. It would be interesting to note how the HPWS change as the size of the company changes. One of the primary problems within HPWS research is that scholars have often argued there is a gap between HPWS and firm performance (Kaufman, 2010). To the point that some scholars have suggested that firms embrace HPWS for institutional factors—namely that having HPWS is a sign of legitimacy rather than higher performance (Wright and McMahan, 1992). Hence it may be HPWS leads to higher performance in firms only when they are young rather than when they are older.

Our limitation is that we developed hypotheses for best practices but did not examine potential moderators. Nor did we discuss a precise mechanism for superior research. Future research—both empirical and theoretical—is needed to develop the

contingencies that exist in the formation and deployment of HPWS in startups. It is clear that while there are best practices, how they are implemented and their exact nature remains an unknown (Becker & Huselid, 2006) in the general literature of HPWS, as well as in the literature on startups. There are several reasons for this.

Firstly, what configurations do HPWS take in startups? For example, in terms of selective screening—is this a formal process or an informal process? Does the startup have an in-house program or do they outsource? Would there be a potential difference between who takes different types of implementation? These would be interesting theoretical questions that warrant further development and analysis.

Secondly, does the type of strategy selected by the company play a role in the development of HPWS? For example, firms that pursue a cost leadership strategy probably would not spend a tremendous amount of time on selection of certain employees (Wright & McMahan, 1992). How would a generic strategy influence the selection in startups that pursue in terms of HPWS configuration? Such work is needed for HPWS in established firms and will certainly be needed for startups (Kaufman, 2010). A final potential area of research is to examine if there are industry differences in the use of HPWS and the various outcomes predicted. There are three potential findings here. One potential finding is that HPWS may not make a difference in certain industries. For instance, companies in technology or bio-tech may not invest in HPWS since they would be selling to company soon. However, another argument could be made that they may need to invest in HPWS to produce new technology (Nahapiet & Ghoshal, 1998). Research could produce answers to that question.

The major practical implication gleaned for this paper is the need for startups to consider HR as a strategic component. Generally speaking, a great many companies do not look to HR for value creation within the organization; rather they view HR as a means of controlling costs or maintaining legal requirement. The biggest take away from the paper is that firms should, from the start of inception, use HPWS as a means of growing the firm.

Despite our limitations such as a lack of empirical evidence, we believe our review of common human resource practices that make up HPWS helps to answer our questions and demonstrates the following: human capital is essential to startups; startups need HPWS to enhance and develop excellent human capital; and rather than focusing on human resources practices on an as needed bases, systems of high performance work can enhance organizational level outcomes. Thus we advocate for scholars, managers, and entrepreneurs to put such systems in place in the early stages of new ventures.

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