

Best Practices and Performance-Based HR System in Korea

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Abstract

The purpose of this paper is to review major changes in the HR system in Korea and to suggest five propositions that need to be studied for better understanding of the configuration of performance-based HR system in Korea. The HR system in Korea went through great transformations after the financial crisis in the late 1990s. The performance-based HR system, which many Korean companies currently claim to have, is thought to have originated from the notion of so-called 'best practices' of leading U.S. companies. In the framework of best practices, there is one universal HR practice set that can be applied to any situations. Although Korea maintained much of its unique organizational culture and HR practices, Korea also modified its HR system after the 'best practices' to a great extent.

By understanding the similarities and differences between the performance-based HR system and best practices, we will be able to better understand the current Korean HR system. In this study we call for empirical work on the changing configuration of HR system in Korea. We suggest five propositions that will be crucial in understanding the similarities and differences between the performance-based HR system

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and best practices.

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INTRODUCTION

Many Korean firms went through fundamental changes in their management paradigms, systems and practices since the financial crisis in late 1990s. Like other managerial functions, human resource management (HRM) in Korea has changed greatly right after the financial crisis began. The direction of changes in Korean HR system was toward 'performance-based HRM'. The concept of performance-based HRM is characterized by the mechanism in which HR practices such as performance appraisal, promotion or compensation are tightly linked to individual or group performance. This concept is contrasted with the traditional seniority-based HR system where job security is emphasized and promotion and remuneration rules depend basically on seniority.

Performance-based HRM is thought to have originated from the notion of so-called 'best practices', which mainly originate from the U.S. companies and are becoming the model for a great number of companies in the world (Rowley and Bae 2002). In the framework of 'best practices', there is one universal HR practice set which can be applied to any situations, which ensures high performance (Arthur 1992, 1994; Huselid 1993; MacDuffie 1995; Delaney and Huselid 1996; Ichniowski et al. 1997; Pfeffer 1994, 1998). With the trend of globalization, 'best practices' have obtained a wider logical foundation for application in global dimension, and the recent HR changes in Korean firms also owe their main direction to this trend. However, while U.S.-type best practices are said to be popular among Korean firms, it should be noted that the unique social and cultural contexts in a country have influence on the adoption and activation of new HR practices. Especially, considering the contrast between traditional seniority based-HRM and new performance-based HRM in Korean firms, it is expected that current form of Korean firms' performance-based HRM would contain various unique aspects that reflect characteristics from both practices.

The purpose of this paper is to review major changes in the HR system in Korea and to suggest five propositions that need to be studied for better understanding of the configuration of performance-based HR system in Korea.

THORETICAL BACKGROUND AND PROPOSITIONS

Configuration of the HR System in Korea

There is still no consensus on a term to describe current form of HR systems in Korea. Although the term is not officially approved, 'performance-based HRM' is generally used among the researchers and practitioners in Korea. Terms such as 'new HR practices' and 'innovative HR practices' are also widely used. These terms refer to a new HR system, which is different from the traditional seniority-based HRM.

Traditional Korean HRM is characterized by seniority-based HR practices and lifetime employment relying on internal labor market. Such traditional HR policies and practices have been thought to be useful for the rapid growth of Korean firms since 1960s (Yu, Park, and Kim 2001). However, these traditional HR practices were frequently criticized as ineffective and unfit for changing business environments from the 1980s. As a result, so-called 'new HR system' emphasizing 'performance' has begun to emerge since late 1980s and early 1990s. Moreover, fierce international competition and economic distress especially since the financial crisis in late 1990s have demanded more efficient and flexible utilization of human resource with lower labor costs (Kim, Bae and Lee 2000).

The popularity of U.S.-type best practices increased after the financial crisis in the 1990s because Korean firms had to adopt 'global standards', which induced fundamental paradigm shift in HRM. Thus, it seems that current pattern of the changes in Korean firms' HRM is characterized as the new 'transformation' rather than as only continuous gradual improvement from the past HR practices (Park and Noh 2001). The traits of the paradigm shift in HRM are summarized as following: (1) from internal labor market-based to external labor market-based, (2) from group?seniority-based to individual?performance-based, (3)

from people-based to work-based, (4) from staff-based to line manager-based, (5) from domestic-based to international-based, (6) from vertical structure-based to horizontal structure-based, (7) from generalist-based to specialist-based one. Although there exists such a paradigm shift, it does not mean a thorough replacement of the old paradigm with the new one, but means the coexistence of two paradigms (Jeong 2000). Actually, researchers debate over whether the change is a fundamental paradigm shift or a transient change, and over whether it is a part of global HR convergence or the emergence of newly unique Korean pattern (Park and Noh 2001; Yu, Park, and Kim 2001).

These detailed characteristics of individual current HR practices reveal that each system contains mixed traits of old and new, thus making it difficult to conclude about the identity of HR changes in Korean firms now.

Recruitment and selection. Recruitment patterns have changed from mass recruitment of new graduates to recruitment on demand, and from generalist orientation to specialist (Bae and Rowley 2003). Mass recruitment of new graduates two times a year (in spring and fall) was an appropriate form in traditional Korean HRM relying on internal labor market and job security. However, changes in business environments have required recruitment on variable demands, and a lot of Korean firms have accepted this new recruitment practice (Lee 2002). Workers who used to stay with a firm for a long time-frequently all of their careers-also began to change employers more often (Jung et al., 2003; Park and Noh 2001).

Another change in recruitment is that experienced ones with special skills are preferred over new recruits (Jeong 2000). In the past, most jobs were assigned or substituted internally due to the rigid organizational culture. However, increasing global competition, growing importance of specialist owing to technology development, increased importance of lifetime job over lifetime employment induces the horizontal mobility of workers among companies, with emphasis on external labor market and flexibility in staffing.

It is also remarkable that Korean firms are trying to open doors to women since the late 1990s and more and more women are entering into labor force. Since the financial crisis in 1990s, the

increase in female labor force participation has been greater than that of man and the female labor force participation exceeded 50% in 2005 for the first time in history (Jung 2006).

Training and development. With increasing emphasis on 'performance' in HRM, training and development is also under the influence of current performance-based HRM trend. Specifically, many companies emphasize training specialists with specific skills related with corporate strategy rather than training generalists. They operate training programs that are intended to form a specialist pool (Noh et al. 2003). As a result, for workers, new pattern of training and development increases their employability, and for companies, it contributes to the improvement of employee capability and firm performance by tightly linking the training programs with corporate strategic aims.

Companies also spend more money to train employees and are found to be very strategic in choosing whom to train. Fourteen percent of regular workers received some form of training in 2003, but only 2.7% of part-time workers had such opportunities (Lee 2005). Companies also report good return on training expenses and plan to expand their training budget over time (Lee 2005).

Compensation. Compensation is an area in which the most important changes have been taking place in Korean firms after the financial crisis (Yu, Park, and Kim 2001). Traditionally, seniority has been an important element in determining base salary and annual increase in Korean firms, but this system has been criticized continuously because it did not reflect the performance of employees or companies. Since mid-1990s, firms have moved from a seniority-based system toward performance-based one with *Yeon-bong je* (Korean-style merit pay) and group incentive system such as profit sharing, and the financial crisis significantly accelerated this trend. Actually, the 2000 survey of Korean firms by Korea Labor Institute (KLI) reveals that companies that adopted *Yeon-bong je* from 1998 to 2000, which is right after the financial crisis, occupy 78.3% of all companies that adopted it (Park and Noh 2001). However, although the overall direction of the change in compensation system is from seniority to performance, 56.6% of Korean firms in 2002 still

have *Ho-bong* table (pay table that reflects seniority). Also the fixed wage determined with *Ho-bong* table occupies as much as 65.7% in total wage. These practices show that seniority still matters in Korean firms' compensation practices (Jung et al., 2003).

In 2005, 48.4% of firms had adopted *Yeon-bong je* and 32.1% of firms have some form of group-based, performance-based pay system (Kim 2006). Also adoption of these performance-related pay system was found to be related to increases in labor productivity. Therefore, it is expected that these performance-related pay system will gain more popularity among Korean firms over time (Kim 2006). Whether the increased use of performance-related pay systems in Korea is related with increased sales, profits, or other financial performance indicators is an important research issue, but there seems to be a lack of studies in this area.

Evaluation. Related to the expansion of performance-based compensation, performance evaluation is another area that went through substantial changes in Korea. Traditionally, evaluation was not quite important under the seniority-based compensation system, and it was mainly used for the promotion decision. However, Korean firms began to apply evaluation results to both employee development and compensation decision. Management by objectives (MBO) plays a key role for the evaluation of individual performance, which applies to both compensation decision and individual development in Korean firms. The adoption rate of MBO rapidly increased from 35.0% in 1998 to 49.0% in 2000 (Yu, Park, and Kim 2001). Also, most of the Korean companies make use of both performance appraisal and competency appraisal in HR decision-making. For decisions related to compensation and promotion, the result of performance appraisal plays a more important role, and concerning individual development, that of competency appraisal is more important (Park and No 2001). Additionally, more and more Korean firms are adopting 360-degree appraisal and feedback system. In particular, upward appraisal has seen increased adoption for compensation decision and leadership development (Yu, Park, and Kim 2001).

Organization structure. The direction of recent changes in organization structure in Korean firms was toward a more flat structure. Traditionally, Korean firms' organization structure was characterized by long hierarchy and concentration of authority at the top. This often brought about negative effects including stagnant and bureaucratic attitudes (Cho 2000). Recently, Korean firms are flattening the structure by reducing the grade system and decision making procedure and by delegating authority to employees down in the hierarchy (Yu, Park, and Kim 2001). Team-based work system is a very significant trial to flatten the traditional hierarchical structure. Under the team-based system, long grade hierarchy is removed, and decision-making line is simplified into two steps: a team leader and team members. The 2000 survey of Korean firms by KLI presents that 80% of respondent companies adopted team-based work system (Park and Noh 2001). Self-supporting accounting system in business units and outsourcing of some HR functions have also influenced recent structural changes in Korean firms as well.

Employment adjustment. After the financial crisis, many Korean firms began to abandon lifetime employment principles and adopt flexible employment principles. While adjustment can come via reduced hiring, the speed of employment adjustment couldn't be fast enough under the lifetime employment system. Therefore, firms have also used dismissals and so-called 'honorary retirement plans' (Bae and Rowley 2001). The 2000 survey of Korean firms by KLI demonstrates that 66% of respondent companies answered that they implemented employment adjustment since financial crisis, and especially in 1998, almost one third of Korean firms had employment adjustment (Jung et al. 2003).

The use of a contingent labor force (e.g., part-timers, temporary workers and leased workers) became widespread after the crisis. Accordingly, the Law on Protecting Dispatched Workers was enacted in February 1998 to regulate and control the use of contingent workers (Bae and Rowley 2003). It is even argued that temporary and part-time workers now outnumber full-time workers (Burton 2000).

Employment adjustment mainly aims at cost reduction rather than productivity improvement or HRM efficiency, and it is

doubtable that it has the ultimate positive impact on firm and national competitiveness (Jung et al. 2003).

Prior Empirical Works. As mentioned above, the financial crisis in the late 1990s stimulated radical changes in Korean HRM, and the direction of the change was toward 'best practices.' At the same time, the influence of Korean culture and institutional inertia has led Korean firms to modify those best practices to fit with the Korean situation. Despite globalization, varied national HR systems remain as distinctive political, economic, institutional, and cultural frameworks (Bae and Rowley 2001).

Yu, Park, and Kim (2001) pointed out that Korean firms still have their traditional HR traits because only a few years have passed since the destruction of seniority-based HR system. Arguing that there are some limits in analyzing radical changes in Korean firms' HRM with western viewpoints, they tried to examine the emerging pattern of HR systems in Korea, considering Korea's unique circumstances. By employing two key dimensions, the relationship-transaction continuum and the high utilization-low utilization continuum, they clustered Korean firms into four HR systems. They found that relationship-low utilization type is the major form of Korean firms, which means many of Korean firms' HRM still remain in traditional practices in spite of globalization.

Nho et al. (2003) studied the factors that affect the adoption of innovative HR practices such as recruitment on demand, career development, independent career path of specialist, 360-degree appraisal, appraisal feedback, management by objectives, merit pay, profit sharing and gain sharing. With this set of innovative HR practices, they examined the antecedents of innovative HR practices adoption, considering the overall effects of rational choice and institutional isomorphistic variables. They found that both variables are positively related with the adoption of innovative HR practices, which means that both institutional factors and rational choice mattered when innovative HR practices are adopted.

Bae and Rowley (2003) compared traditional HR practices with emerging practices in Korea in the following four main HR functions: recruiting competences (recruitment selection), reinforcing competences (evaluation and rewards), retaining

competences (training/development and job design), and replacing competences (employment flexibility and outplacement). Analyzing the changing patterns of HRM, they diagnosed that Korean HR systems are in a medium-level of numerical flexibility. They also found that Korean firms have mixed remuneration systems, which are based on both seniority and performance.

A survey of previous studies suggest that the performance-based HR system in Korea is different from traditional HR system, but at the same time it is not the same as best practices. It is important to understand how the performance-based HR system in Korea is different from best practices.

In this paper, Korean HR practices are composed of performance-based HR practices and traditional practices. These two sets of HR practices could overlap with best practices as shown in Figure 1. If there is a lot of overlap between best practices and performance-based HR system, it means that Korean performance-based HR practices were mostly replaced by western HR practices. If the overlap is not big, it means Korean HR practices are still different from western HR practices. In any case, the performance-based HR practices in Korea will have some overlapping area with best practices due to recent changes.

Hence, we suggest the following proposition.

Proposition 1. The performance-based HR system in Korea and the best practices will have common practices.

HR System and Firm Performance

Bae and Sa(2003) examined the relationship between HR



Figure 1. HR System in Korea and Best Practices

systems and firm performance in Korea. This relationship has been an important topic in the field of strategic human resource management, and most of previous researches found a positive relationship between them (e.g., Huselid 1993; MacDuffie 1995; Delaney and Huselid 1996; Ichniowski et al. 1997). Accepting the viewpoint of Dyer and Reeves (1995), Bae and Sa (2003) measured various dimensions of organizational performance, using a balanced scorecard (BSC). They found HR system's positive effects on organizational performance and the moderating effects of business strategy in the relationship between HR system and organizational performance. However, in measuring HR systems, they used 7 best practices, following Pfeffer (1998), which could be different from actual Korean practices.

As mentioned above, many researchers have found the positive relationship between HR system and firm performance in various studies of strategic human resource management. This is also theoretically grounded. Based on these empirical results, we suggest the following.

Proposition 2. Each HR sub-system will be positively related with firm performance.

Strategic Human Resource Management

Universalistic perspective. In strategic human resource management, there are three different theoretical frameworks: universalistic, contingency, and configurational perspectives (Delery and Doty 1996; Yu, Park, and Kim 2001). These theoretical frameworks provided important theoretical background upon which many theoretical and empirical work flourished.

First of all, according to the universalistic perspective, some HR practices are universally effective, and firms that adopt these best practices will reap higher profits (Pfeffer 1994; Huselid 1993; Delery and Doty 1996). This perspective has many followers among practitioners and researchers alike. Also quite a number of previous studies confirmed this perspective. In this study, we focus on relative impact of best practices and performance-based HR system on firm performance in Korea.

Hence, we suggest the following proposition.

Proposition 3a. According to the universalistic perspective, best practices will be more positively related with firm performance than the performance-based HR system will.

Contingency perspective. Contingency perspective posits that the relationship between the relevant independent variables and the dependent variable will be different for different levels of the critical contingency variables (Delery and Doty 1996). This perspective negates the existence of the best practices in managing human resources. It postulates that when HRM is fit for the organizational environments or strategies, higher organizational performance is achieved (Van de Ven and Drazin 1985; Schuler 1989). Moreover, the impact of HR practices is dependent upon the congruence between HRM and contingent variables and national contexts such as institution and culture (Bae and Rowley 2001). Thus, although globalization imposes a trend of HR convergence, unique social, political and cultural contingencies that each national context has resist the convergence, resulting in the HR divergence. This logic can be applied to Korean HR system. In Korean business environments, Korean performance-based HR system that is more congruent with Korean institutional and cultural contexts could be more effective than best practices will. Hence, we postulate the following.

Proposition 3b. According to the contingency perspective, the performance-based HR system will be more positively related with firm performance than best practices will.

Configurational perspective. Finally, in the configurational framework, there are complementarities or synergistic effects among HR practices (Delery and Doty 1996). The basic assumption of configurational perspective is that HR practices interact with each other and, hence, the bundles of the practices, not individual practice, matter. According to this perspective, a variety of internally-fit HR systems can achieve high performance. This is called equifinality (Dess and Robbins 1984; Doty and Glick 1994), which means there are more than one way

to the top of the mountain. Configurational perspective suggests that both best practices and Korean performance-based HR system can lead to high performance. Hence, we postulate the following.

Proposition 3c. According to the configurational perspective, both best practices and performance-based HR system will have positive relationship with firm performance.

Three different propositions can be induced from each perspective in strategic human resource management. An empirical work will help us find which proposition is more consistent with the recent state of Korean HR practices.

CONCLUSION

In this study we reviewed major changes in the HR system in Korea and suggested five propositions that need to be studied for better understanding of the configuration of performance-based HR system in Korea. The HR system in Korea went through great transformations after the financial crisis in the late 1990s. Specifically, the performance-based HRM in Korea has become closer to the U.S.-type best practices. In the framework of best practices, there is one universal HR practice set which can be applied to any situations, which is thought to lead to high performance. With the trend of globalization, 'best practices' have obtained a wider logical foundation for application in global dimension, and the recent HR changes in Korean firms also owe their main direction to this trend. Although Korea maintained much of its unique organizational culture and HR practices, Korea has also modified its HR system after the "best practices."

However, while U.S.-type best practices are said to be popular among Korean firms, it should be noted that the unique social and cultural contexts in a country have influence on the adoption and activation of new HR practices. Especially, considering the contrast between traditional seniority based-HRM and new performance-based HRM in Korean firms, it is expected that current form of Korean firms' performance-based HRM would contain various unique aspects that reflect

characteristics from both practices.

The purpose of this paper is to theorize on and examine the configuration of performance-based HR system in Korea. Also we suggest hypotheses on the relationship between performance-based HR system, best practices, and firm performance. For this purpose, we suggest five propositions that need further examination. A comprehensive data gathering and a thorough analysis will reveal the scope of changes in the Korean HR system and its impact. Results of such a study will help us better theorize the nature and impact of performance-based HR system in Korea.

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