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## HUMAN RESOURCES MANAGEMENT AND THE COMPANY'S INNOVATION

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### **Abstract**

*This paper analyses the relationship between innovation and human resource management (HRM), attempting to establish whether innovation determines the company's human resource management or, conversely, human resource management influences the level of innovation of the company. Based on this review, some research hypotheses are formulated. The results mentioned in the present paper provide evidence that, in order to affect employee behaviour, the firms must develop a bundle of internally consistent HRM practices.*

**Keywords:** innovation; small and medium-sized enterprises; human resource management;

**JEL Classification:** L26, M12, M50

### **1. Introduction**

Innovation and human resources management play an increasingly important role in sustaining “leading edge” competitiveness for organisations in times of rapid change and increased competition. “Discontinuous change requires discontinuous thinking. If the new way of things is going to be different from the old, not just an improvement on it, then we need to look at everything in a new way”.

The continuous hegemony of innovation and creativity arises from organisations recognising that correctly harnessed creativity can offer companies a competitive advantage (Porter, 1980). The analysis of the strategies of the top companies of the future, the structural flexibility and innovative power were listed among the top drivers of future success.

Today, companies are facing a competitive and continuously changing situation. In this context the performance, and even the survival of companies depend more than ever on their ability to achieve a solid and competitive position and on their flexibility, adaptability and responsiveness. Therefore, it is hardly surprising that there is growing interest in innovation as a strategy that allows the enterprise to improve its flexibility, competitive position and performance.

A company will create new products for a variety of reasons, but usually in an

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attempt to increase profits. The most profitable new products will be those that meet the customer needs more effectively than competitors' products, and are therefore preferred by more customers. Companies need to identify those needs, and then generate ideas and solutions to address them.

Many articles on innovation and creativity begin with a general statement that companies must innovate or they will die. While this is generally true, any company that is inefficient in vetting and implementing new product ideas or a company that continually introduces the wrong products will consume its own resources and will also fail.

In the management field, a host of variables has been identified as influencing organisational innovation:

- having a vision of what the organisation wishes to be,
- searching for opportunities, experience and technological potential
- following market orientation,
- market evolution and segmentation and the promotion and management of creative resources.

Human factors and, in particular, human resource management, are today considered key elements of successful innovation, since the human element is involved in the whole innovation process. Specialists state that there are no good technologies or good innovations without competent people who can adequately use them and get benefit from them. At the same time, no competent people can be available if there is not, first, a business project defining the role that technology and innovation must play and creating the necessary and sufficient conditions for channelling aptitudes, capacities and attitudes of the individuals towards the established direction.

Considering that HRM determines and modifies, to a large extent, these aptitudes, capacities and attitudes, it seems clear that it becomes a crucial element in the development of innovation activities. Human resource management has been, up to now, scarcely treated in studies on innovation in the firm. Although there have been some empirical studies in recent years, their conclusions are heterogeneous and most of them have focused on U.S. firms.

## **2. SMEs in the European economy**

Given their importance in the European economy, the European Parliament acknowledges that SMEs are among the key elements in ensuring the success of the objectives of the single European market, relating to growth, employment, quality, diversification and flexibility in business. In so doing the Parliament implicitly recognizes that SMEs are better able to react to changes in policy, and in economic and social conditions.

Europe continues to offer potential to generate competitive advantage. Economic convergence means that firms must think of new ways of thinking about services and products, and take innovative approaches to markets. Such market-led change requires restructuring of business organization and operations.

There is a clear need for European organizations of all sizes to respond to this evolving environment. Leaders and managers need to think and act across European national and cultural borders. There are signs of an acceleration in Europeanization in a number of areas, for example in human capital and mobility, in innovative business practice and in new patterns of management.

The single European market requires a new outlook of business managers and owners. Markets are generally now multi-cultural and trans-national. Large companies have responded to this by adopting a similar cultural profile and by internationalizing their operations. The challenge to SMEs is not whether or not to follow, but how?

The Euromanagement paradigm can be seen as contingent on the development of the single European market. Indeed, Specialists argue that the development of management in western Europe is the key to economic revival and survival.

Organizations must also rethink commonly held competences to take in global and cross-cultural perspectives, in terms of language, of cultural values, of political and economic infrastructure, and, not least, business practices. None of this can be properly achieved without the full involvement of employees. To build an international workforce requires the development of a shared mind set, making use of best management and human resource practices, all driven by a leadership that has an appetite and capacity for change. In essence European managers are looking for a reflection of social values in their employment:

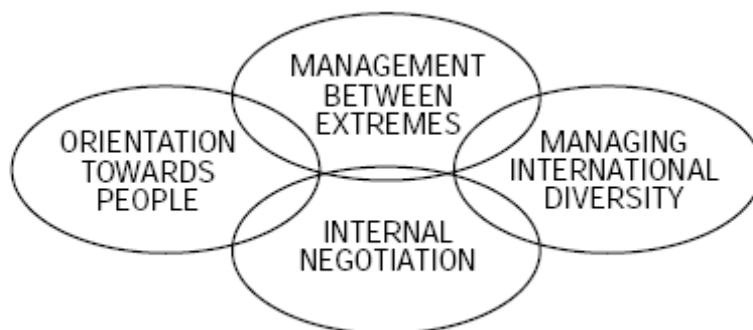
- *affective, pleasant aspects of job conditions and work environments;*
- *for personal development opportunities in a job;*
- *equitable rewards for work (for example pay, job security and promotion).*

The requirement for change needed to bring about effective managerial leadership, the need for a sense of European management identity, not running counter to national identity, but one building on the variety that so effectively characterises Europe. Such change they see as necessary because of the proliferation of “bad habits” in management:

- *the tendency towards risk aversion;*
- *continuing conflicts between professional groups;*
- *solving only safe issues;*
- *the failure of firms to avoid disputes.*

The advent of the single European market is the opportunity to develop Euromanagers, and so to clarify the ambiguity over the role of manager in Europe. In so doing they forecast the need for a realistic assessment of managerial practice, to gain a social understanding of management. The goals of a properly established school of management they see as:

- *the integration of different systems [of management];*
- *the acceptance of pluralism;*
- *the combination of scientific and rational thinking.*



**Figure 1 - Common characteristics of European management**

Building on these basis experts identify the so-called common characteristics of European management (see Figure 1):

- “*an orientation towards people* – a common inclination towards the fulfilment of individuals, caring for people and social responsibilities ... partly based on the notion that profit is not all ...”;

- “*internal negotiation* ... the top management has power, but it has to consult, to discuss, to negotiate, to convince ...”;

- “*skills in managing international diversity* – European business leaders are better equipped to deal with cultural diversity, geographical diversity than most American managers ... Europeans have more respect for foreign cultures and for foreign management styles ...”;

- “*managing between extremes* – Europe is in-between ... it is halfway between the US model of management and the Japanese model”; coupled with two lesser traits:

- “*product (engineer) orientation* – the domination by brilliant engineers (designing wonderful products) over marketers (leading to a lack of customer orientation and uneven skills in marketing)”;

- “a more intuitive and less formalised management – it seems that the Europeans ... rely more on agreement, dialogue and conviction, on experiences and the sense of responsibility of people”.

There are many and varied models of management of SMEs. The main difficulty in deciphering all of these is the blurring between the notion of SME management and entrepreneurship.

Experts in analysing many of the various models of competences and skills (and this is by no means an exhaustive sample) found a wide range of competences that are covered in training and development (see Table I).

**Table I – Competences in training**

	<i>Communication skills (listening, consulting, explaining, dialogue)</i>
<b>Ability to involve people</b>	<i>Skills in psychology (understanding people, cultural differences)</i>
	<i>Capacity to work in teams (multi-national, multi-level, multicultural)</i>
	<i>Capacity to co-ordinate, to create enthusiasm and to motivate</i>
	<i>International experience</i>
<b>International skills</b>	<i>Competence in several languages (three minimum)</i>
	<i>Geographical mobility</i>
	<i>Global thinking</i>
	<i>Aptitude to manage change</i>
<b>Flexibility</b>	<i>Aptitude to manage diversity</i>
	<i>Tolerance to ambiguity and uncertainty</i>
	<i>Capacity to learn (self-evaluation and openness)</i>
<b>Intuition</b>	<i>Intuition</i>
	<i>Creativity, ability to innovate</i>
	<i>Aptitude to have a general view of a situation (combining</i>
<b>Broad vision</b>	<i>several disciplines, considering the historical context, and taking a systematic approach)</i>
	<i>Deep understanding (sociological, philosophical, ethical)</i>

**Source: Dufour (1994)**

### **3. The relationship between innovation and HRM**

There are no best HR practices, because in order to be effective, HR practices must be consistent with other aspects of the organisation, specifically its strategy. The most suitable HRM practices for firms trying to develop a competitive advantage based on innovation will be different to those practices suitable for firms seeking other kind of competitive advantage.

Some studies have focused on some isolated HRM practices while others have focused on the HR system adopted by the firms. The underlying assumption of these studies is that the impact on organisational performance of sets or “bundles” of interrelated HR practices can be greater than the cumulative impact of all the individual practices comprising the bundle. Most of the above mentioned studies are based on the models proposed by well-known specialists (Miles and Snow and Schuler and Jackson). Their model proposes the development of a market-type HRM system for those firms defined as prospectors, firms characterised by the search for new products and markets, which are, therefore, the innovators. They argue that it is very difficult for the firm to provide the necessary abilities for a new market or product from inside the company and, more importantly, to provide them quickly.

Therefore, these authors recommend searching outside for these abilities whenever the organisation needs them, i.e. developing a market-type HRM system.

Other specialists (Schuler and Jackson) establish a connection between HRM practices and three types of strategy: costs, quality and innovation, defined from Porter's (1980) classification of competitive strategies. Their model starts by analysing the employees' behaviour required by each kind of strategy; subsequently they propose HRM practices for the development of these behaviours. In their view, when contemplating an innovation strategy, the enterprise needs creative employees who are flexible and tolerant of uncertainty and ambiguity; people who are able to take risks and assume responsibilities, very skilful, able to work in a cooperative and interdependent way and with a long-term orientation.

The HRM practices that those systems include are listed in Table I.

We can say that, between specialists, there is agreement, firstly on the importance of linking HRM and innovation and, second, regarding the form of some HRM practices, particularly the use of external sources of recruitment, performance appraisals and incentives. There is no consensus regarding other HRM practices such as employment security, training, career paths or employee participation. Furthermore, empirical research conclusions are also heterogeneous.

For this reason, can be formulated propositions about the relationship between innovation and HRM practices following both Miles and Snow (1984) and Schuler and Jackson (1987).

The first hypothesis refers to isolated HRM practices.

**1. The strategy developed by a company determines the HRM practices it carries out.** Thus, innovative companies will carry out HRM practices consistent with this strategy.

This hypothesis is broken down into two according to the theoretical model employed:

*a. Companies following an innovation strategy will be characterised by the use of external sources of recruitment, low employment security, narrow application of training, very little use of internal career paths, the use of performance appraisal systems, incentive-based compensation and low employee participation.*

*b. Companies following an innovation strategy will be characterised by the use of external sources of recruitment, high employment security, broad application of training, the use of internal career paths, the use of performance appraisal systems, incentive-based compensation and high employee participation.*

The second hypothesis is formulated from a configurational perspective:

**2. The strategy developed by a company determines the HRM system it implements.** Thus, innovative enterprises will implement an HRM system consistent with this strategy.

As in the previous case, alternative hypotheses are formulated according to the reference models, Miles and Snow (1984) or Schuler and Jackson (1987):

*a. Companies following an innovation strategy will adopt an HRM system characterized by*

*the use of external sources of recruitment, low employment security, narrow application of training, very little use of internal career paths, the use of performance appraisal systems, incentive-based compensation and low employee participation.*

*b. Companies following an innovation strategy will adopt an HRM system characterized by the use of external sources of recruitment, high employment security, broad application of training, the use of internal career paths, the use of performance appraisal systems, incentive-based compensation and high employee participation.*

The assumption that strategy determines the firm's HRM practices is implicit in these hypotheses, as most of the contingent literature suggests.

**3. The HRM practices developed by a firm determine its strategy.** Thus, firms that carry out HRM practices consistent with innovation will follow an innovation strategy.

*a. Companies characterised by the use of external sources of recruitment, low employment security, narrow application of training, very little use of internal career paths, the use of performance appraisal systems, incentive-based compensation and low employee participation will seek a more innovative strategy.*

*b. Companies characterised by the use of external sources of recruitment, high employment security, broad application of training, the use of internal career paths, the use of performance appraisal systems, incentive-based compensation and high employee participation will seek a more innovative strategy.*

Regarding the configurational approach, the following hypotheses are formulated:

**4. The HRM system developed by a company determines its strategy.** Thus, companies that implement an HRM system consistent with innovation will follow an innovation strategy.

*a. Companies adopting an HRM system characterised by the use of external sources of recruitment, low employment security, narrow application of training, very little use of internal career paths, the use of performance appraisal systems, incentive-based compensation and low employee participation will seek a more innovative strategy.*

*b. Companies adopting an HRM system characterised by the use of external sources of recruitment, high employment security, broad application of training, the use of internal career paths, the use of performance appraisal systems, incentive-based compensation and high employee participation will seek a more innovative strategy.*

Table 1 - HRM practices for innovation

	Miles and Snow's model	Schuler and Jackson's model
<i>Recruitment and selection</i>	Emphasis: "buy" Hiring almost exclusively from outside the organisation Selection may involve pre-employment psychological testing Very little employment security given Little if any socialisation taking place within the organisation	External sources of recruitment Technical and research competencies High employment security
<i>Training</i>	Skill identification and acquisition Limited training programmes	Broad application Employees are responsible for learning Jobs that allow employees to develop skills that can be used in other positions in the firm
<i>Development and internal career opportunities</i> <i>Performance appraisal</i>	Very little use of internal career ladders Results-oriented procedure Identification of staffing needs Division/corporate performance evaluations Cross-sectional comparisons	Broad career paths Mandatory competency growth Process and results criteria Performance appraisals that are more likely to reflect longer-term and group-based achievements
<i>Compensation</i>	Oriented toward performance External competitiveness Total compensation heavily oriented towards incentives and driven by recruitment needs	Many incentives Internal equity Low pay rates but employees are allowed to be stockholders and have more freedom to choose the mix of components that make up their package Team innovation awards Competency-based pay
<i>Other HRM practices</i>	Low employee participation Implicit job analysis Job enrichment	High employee participation Implicit job analysis Job enrichment Cross-functional teams Communication: feedback on new product sales

*source:* Daniel Jimé'nez-Jimé'nez and Raquel Sanz-Valle

Some European studies based on the models mentioned above, on small and medium enterprises, revealed the relation between HRM and innovation. According to the literature, HRM is a key element for the success of innovation, not many empirical studies have provided support for it.

Using a contingency approach, different strategies will require different employee skills, knowledge and behaviours to be implemented. Presumably, HRM policies can influence these employee characteristics.

There is agreement between specialists about, first of all, the relationship between innovation and HRM and, second, that in order to improve innovation, the



adoption of HRM bundles is superior to any of the individual HRM practices of which they are composed. On the other hand, there are inconsistencies in the literature about the contents of these bundles. Some authors suggest that employment security, extensive training or employee participation have a positive impact on innovation, while others think they have the reverse effect.

#### **4. Conclusions**

Alternative hypotheses, following the two most widely-accepted theoretical models, have been proposed in this paper. The conclusions drawn from European studies about HRM impact on companies' innovations using the above models are the following:

- There are empirical evidences that innovation explains the adoption of some HRM practices. The choice of an innovation strategy implies the use of an incentive-based compensation, the encouragement of employee participation, the use of appraisal systems and the use of broad internal career opportunities.
- The HRM practices condition the firm's orientation towards innovation. The participation and the use of promotion plans significantly explain the firm's innovation orientation.

The importance of aligning HRM practices and innovation is a clear implication for managers. Schuler and Jackson's model and Miles and Snow's explains the fit between innovation and HRM. The firms that adopt an innovation strategy are more likely to use internal labour markets than external ones.

The use of HRM practices aimed at building a stable group of employees in the company, which can adopt risks and experiment and which can participate in the adoption of the decisions that affect their jobs. This is more likely to create the conditions for the emergence of the new ideas that feed innovation.

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