

RESEARCH NOTES AND COMMENTARIES

STRATEGIC HUMAN RESOURCE MANAGEMENT, INSTITUTIONALIZATION, AND EMPLOYMENT MODES: AN EMPIRICAL STUDY IN CHINA

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This study compares the predictions of institutional theory with those of the contingency perspective of strategic human resource management (SHRM) on the selection of an employment mode. Empirical data were collected from multinational enterprises, including the electronics and garment industries, that operate in China to test the relative importance of the determinants of the selection of an employment mode. The results provide greater support for the SHRM predictions than for the institutional theory predictions. The implications of the findings for researchers and practitioners are discussed. Copyright © 2007 John Wiley & Sons, Ltd.

INTRODUCTION

Research has identified different employment modes (Davis-Blake and Uzzi, 1993; Lepak and Snell, 1999). For example, Rousseau (1995) pointed out that firms either internalize employment and build the skills base of their employees through internal training and development initiatives, or externalize employment by outsourcing certain functions to market-based agents. However, it remains unclear why firms select the internal or external mode when making strategic decisions on human resources. Some researchers have related

the selection of an employment mode to the competitive strategies of firms (Bird and Beechler, 1993), and others have suggested that it may also be explained by institutionalization (North, 1981). The study of this matter will increase our understanding of many issues that are related to strategic decision making in firms, such as the effect of institutionalization on decisions. Institutional theory is posited to offer a powerful explanation for both individual and organizational action (Scott, 2001), but there is insufficient empirical evidence of whether institutionalization influences the selection of employment mode. Thus, it would be a contribution to the literature to study this issue to help answer many important questions about strategic management, such as whether multinational enterprises (MNEs) that invest in emerging economies such as China should select their employment strategies based on their competitive

Keywords: strategic human resource management; institutions in China

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strategies or on the demands of the institutional environment.

THEORY AND HYPOTHESES

According to research, the internal employment mode should be characterized by long-term or lifetime employment and promotion from within the organization, and is associated with the training and development of knowledge or skills, the socialization of employees, and an emphasis on loyalty to the organization. The external employment mode, on the other hand, should be characterized by short-term employment, the recruitment of human resources from outside the organization, little or no training or development of knowledge or skill, little or no socialization, and little or no emphasis on loyalty and commitment to the organization (Edwards, 1979).

Institutional factors may influence the behavior and performance of firms (North, 1981), including their selection of an employment mode. This influence can occur 'when powerful organizations force their immediate relational networks to adapt to their structures and relations' (Meyer and Rowan, 1977: 348). In China, such organizations include the state and state-owned firms. Before the current economic reforms, these firms adopted a system that resembled an internal employment mode, which was often called the 'iron rice bowl' and was characterized by the centralized assignment of labor, unified wage standards, internal training and promotion, and lifelong employment (Li, 1992). Since the reform process began, many firms have set up joint ventures with MNEs, which can be seen as part of their immediate relational networks. When these joint ventures are established, the Chinese side may insist that the employment mode be consistent with that of the firm or institution. As a result, joint ventures, as part of the immediate network on the Chinese side, are more likely to adopt an internal employment mode than are firms that are wholly owned by MNEs, which are much more independent from the Chinese network.

Hypothesis 1: Among MNEs in China, those that run joint ventures with Chinese firms are more likely to adopt an internal employment mode than are those that run wholly owned firms.

The home country culture of an MNE is also an important institutional factor that may influence the selection of an employment mode through the cultural-cognitive element of the institutionalization process (cf. Scott, 2001). For example, many Japanese MNEs have adopted an internal employment mode at home, in which the MNE maintains lifetime employment for the majority of male employees, trains and promotes its human resources mainly from within the firm, and avoids focusing on short-term performance on the basis that it is detrimental to the firm's long-term interests (Ornatowski, 1998).

Hypothesis 2: Among overseas investors in China, Japanese MNEs are more likely than their Western counterparts to adopt an internal employment mode.

However, according to the contingency perspective of strategic human resource management (SHRM), there is a best human resource management practice for a given situation. Good human resource management practices depend on the number of distinct contingencies that exist (Sherer and Leblebici, 2001), of which the competitive strategy of firms is the most commonly studied (Arthur, 1992). For example, Arthur (1992) suggested that a differentiation strategy is likely to be matched with high-commitment human resource management practices, whereas a low-cost strategy is more likely to be matched with low-commitment practices. Hannan, Burton, and Baron (1996) showed that technology or quality differentiation strategies are often associated with high-commitment human resource management practices, and that a low-cost strategy is often associated with low-commitment practices.

High-commitment human resource management practices are consistent with the internal employment mode that is outlined in this paper. When a human resource is both valuable and unique, or when the skills of employees are specific to a firm, firms are more likely to employ people internally (Lepak and Snell, 1999). Consistent with this policy, firms will also invest significantly in developing the firm-specific skills of employees through extensive training (Becker, 1976). To complement such training, firms may sponsor career development programs to encourage organizational loyalty and commitment. In addition, according to research that has been carried out in China, where

an abundance of cheap labor is available, there is a positive relationship between the adoption of a differentiation policy and the investment in advanced production equipment (Li, Lam, and Qian, 2001). Accordingly, we propose the following:

Hypothesis 3: Among MNEs in China, those that invest heavily in production equipment are more likely to adopt an internal employment mode than are those that invest little in equipment.

The character of the industry may also influence the selection of the employment mode. In some industries, such as electronics, firms face a rapid change in technology, which makes it difficult for them to obtain qualified human resources from outside. Hence, they need to provide constant training to their employees. It is in these industries that firms are more likely to adopt an internal mode of employment (Davis-Blake and Uzzi, 1993). Because the technological change in the electronics industry is faster than that in the garment industry, we predict the following:

Hypothesis 4: Among MNEs from industrialized countries, those in the electronics industry are more likely than are those in the garment industry to adopt an internal employment mode.

Finally, regarding the effects of an internal employment mode on firm performance, institutional theory predicts that employment modes have no significant effect on short-term profit, because firms select a given mode mainly for legitimacy. In contrast, the contingency view of SHRM predicts good financial performance if a firm's employment mode matches its strategy. In this study, a preliminary exploration of this issue is conducted.

METHOD

Sample

The sample for this study consisted of firms with MNE investment in some of the most developed provinces and cities on the east coast of China ($N = 153$). About half of these firms had Japanese investment ($N = 71$), and the others had investment from firms from the United States or Western European countries ($N = 82$). These firms were operating either in the electronics industry

($N = 90$) or in the clothing and footwear industry ($N = 63$). They were randomly selected from a list of firms that participated in a recent Chinese industry survey, which gave the addresses of the firms and detailed information about their investors and performance (see State Statistics Bureau of China, 1996). The survey was organized by the central government, and all firms in China were required by law to report accurate information about their ownership, assets, employees, performance, and other firm data.

To test the validity of the data and to collect more information, we visited these firms between 1998 and 2000 and talked to three middle managers in each firm. The questions that we asked were mainly concerned with the changes that had taken place in the firms and their current strategies. We also asked the managers to respond to a list of questions, which will be discussed later.

Measurement

The key variable—the internal employment mode of firms—was treated as a Bi-model and tested with seven Likert scale items. Some examples of the items include 'In this organization, managers are mainly promoted from inside the organization rather than recruited from outside the organization' and 'People in this organization enjoy a long-term employment policy.' The items were pretested in a class of MBA students in South China. The assumption, which has also been posited by Davis-Blake and Uzzi (1993), was that firms use a combination of both internal and external employment modes, and thus these items test the balance of the two modes. The lower the score, the more the firm is characterized by an internal employment mode; the higher the score, the more a firm is characterized by an external employment mode. A pretest of these items showed that the reliability alpha was 0.73 and the intraclass correlations between the three sets of data from each firm ranged between 0.68 and 0.93. To further test the validity of this measurement, we computed the correlation between this score and another measurement from the Chinese survey: the proportion of long-term employed workers to all workers. The correlation between the two measurements supports the validity of the questionnaire (-0.35 ; $p < 0.05$).

To obtain the measurements of the performance of each firm since 1996, we also asked the middle managers to respond to three items: (1) Since 1995, the profit (or productivity) of this firm has (a) not changed, (b) decreased, or (c) increased; (2) Since 1995, the market share of this firm has (a) not changed, (b) decreased, or (c) increased; and (3) Since 1995, the number of employees who have been disciplined or fired has (a) not changed, (b) decreased, or (c) increased. These three items allowed us to create six dummy variables: profit improvement (1 = Yes; 0 = No), market share improvement (1 = Yes; 0 = No), employee performance improvement (1 = Yes; 0 = No), profit deterioration (1 = Yes; 0 = No), sales deterioration (1 = Yes; 0 = No), and employee performance deterioration (1 = Yes; 0 = No).

Other variables were measured by the data from the 1996 industry survey (State Statistics Bureau of China, 1996). For example, equipment per employee was tested by the ratio of the value of the equipment to the total number of employees; Chinese institutional influence was tested by the share of a firm that was controlled by the Chinese party; joint venture was tested as a dummy, with a joint venture coded as 1 and a firm wholly owned by an overseas investor coded as 0; and the nature of industrial competition was measured as a dummy variable, with electronic firms coded as 1 and clothing and footwear manufacturers coded as 0.

RESULTS

Regression analyses were conducted to test the determinants of the selection of the internal employment mode. In this analysis, the internal employment mode was tested as a dependent variable. Five independent variables were entered at the same time (Model 1), of which three were institutional factors (Chinese institution, Japanese home country culture, and joint venture) and two were strategic factors (nature of competition and equipment value per employee). Two controlled variables, the firm size and the interaction between Chinese institution proportion and joint venture, were then entered (Model 2). Firm size was found to positively influence the internal employment mode. The interaction between Chinese institution proportion and joint venture, however, might also have had a positive effect on the selection of the

internal employment mode. This is because the larger the proportion of Chinese investment in a joint venture in China is, the greater the bargaining power that is available to the Chinese side to ensure that the joint venture adopts the internal employment mode. In other words, there might be a joint effect of Chinese institution proportion and joint venture. To test this effect, we created a controlled variable. The two controlled variables were entered in the order that they are presented here so that the stability of the regression coefficients could be assessed.

Table 1 shows the results of the regression analyses. The results suggest that both institutionalization and firm strategy may influence the selection of the employment mode. First, the data show a significant and negative effect of joint venture on the adoption of the external employment mode ($p < 0.05$). This result supports Hypothesis 1, which predicts that institutionalization will influence the firm's selection of an employment mode. The results also support Hypothesis 4 ($p < 0.05$), which predicts that some industry characteristics can have significant effects on the selection of an employment mode. In other words, the results suggest that fast-changing technology in an industry is more likely to lead to internal employment modes.

Table 1 also shows that the effect of firm strategy is much stronger than that of institutionalization. The effect is less robust for the variables that are predicted by institutional theory than for those that

Table 1. Factors that influence the selection of employment mode in China

	Internal employment mode	
	Model 1	Model 2
<i>Independent variables</i>		
1. Chinese institutions	-0.044	-0.138
2. Equipment/technology intensiveness	0.184*	0.205*
3. Joint venture	0.083	-0.191*
4. Japanese home culture	-0.095	0.071
5. Industry environments	-0.172*	-0.175*
<i>Controlled variables</i>		
6. Firm size		0.208
7. Interaction (1 × 4)		0.059
Overall model <i>F</i>	2.540*	2.227*
Adjusted <i>R</i> ²	0.038	0.043
Standard error	7.311	7.211

* $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$

are predicted by the SHRM theory. Specifically, the effects of two factors, equipment/technology intensiveness and nature of competition, are significant before and after the two controlled variables have been entered. Finally, the two controlled variables, i.e., firm size and interaction, have no significant effect on the selection.

To test the effects of employment mode on firm performance, we conducted two sets of logistic regressions. Set 1 tested the effect of the internal employment mode on performance improvement, and Set 2 tested its effect on performance deterioration. The most significant finding from the logistic regression analyses was that the internal employment mode had a positive and significant effect on profit improvement ($p < 0.001$) and market share improvement ($p < 0.05$). Detailed results of these analyses are available from the authors.

DISCUSSION AND IMPLICATIONS

According to the findings of this study, both institutional theory and the contingency perspective of SHRM are able to predict the selection of the employment mode of MNEs in China. Although the effects that are predicted by SHRM are more robust, the effect of coercive institutionalization is also significant, which is illustrated by the finding that joint ventures are more likely than are wholly owned firms to adopt the internal mode of employment. This finding supports the argument that it takes time for social institutions or their effects to change.

The data in the current study also suggest that when Japanese MNEs invest in China they are more likely to select an employment mode that fits with their strategy, rather than the mode that fits with the institutionalized employment mode of their home country. This finding is consistent with many empirical observations that have been reported in China in recent years. Japanese firms have often been reported to negotiate only 2-year contracts with their employees in China, and even then the contracts can be terminated earlier. For example, a Japanese electronics firm in Zhuhai, which is a Special Economic Zone in southern China, negotiated a 2-year contract with one of its employees at the end of 1999. However, on 3 January 2000, the employee was told that his contract would be terminated on 3 February 2000,

and he was given only 1 month's basic salary as compensation (*Singtao Daily*, 2000). This suggests that the human resource management practices of MNEs in their host countries can differ from those in their home countries, and that factors related to competitive strategy may have a greater effect than home country culture on the selection of employment mode. For example, when a Japanese firm adopts a labor-intensive policy in China, the maximum reduction of labor costs may become its priority. Given the abundant labor supply in China, the Japanese firm might ignore the culture or traditions of home and adopt a short-term or external mode of employment.

Future studies should test the institutional changes in employment modes among firms in China. Before the 1990s, Chinese firms used an internal employment mode. However, it remains unclear how fast this mode will be transformed in the current system and whether there are any other factors that may have a significant effect on the process of change. Testing these issues will improve our understanding of the strategic decisions of firms and their human resource policies.

For practitioners, this study suggests that, at least in the manufacturing industry in China, the internal mode of employment may lead to better firm performance, such as in profit and market share. Employment internalization seems to be a better strategy for producing good-quality products efficiently (Youndt *et al.*, 1996).

ACKNOWLEDGEMENTS

The authors wish to thank Co-editor Ed Zajac and the anonymous reviewers for their encouragement and very helpful suggestions.

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