

**AN EXAMINATION OF THE RELATIONSHIP BETWEEN  
STRATEGY AND HUMAN RESOURCE MANAGEMENT  
PRACTICES AMONG SMALL BUSINESSES**

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**ABSTRACT**

*Although it has been asserted that an organization's strategy is, or should be, a major determinant of its human resource management practices, little empirical research has addressed this linkage in small businesses. Therefore, we do not know whether managers of small firms have devoted resources to design, implement, and support human resource management practices that are aligned with firm strategy. Accordingly, the purpose of this paper is to examine the nature and extent of the relationship, if any, between strategy and human resource management practices among small businesses. The results offer little evidence of a consistent relationship. This suggests that an opportunity to build future competitive advantage may be realized through strategically managing human resources.*

**INTRODUCTION**

Over a decade ago, articles encouraging managers to tailor human resource practices to match business strategies began to appear (e.g., Fombrun, Tichy & Devanna, 1984; Schuler & MacMillan, 1984). This approach to human resource management (HRM), labeled Strategic Human Resource Management (SHRM), details the mechanisms by which human resource managers can positively influence the "fit" between a firm's strategy and the environment (Jennings, 1994). Beginning with a flurry of activity in the mid-1980s, both conceptual and empirical investigations of HRM have explored its strategic potential (e.g., Dyer, 1985; Fombrun et al. 1984; Lengnick-Hall & Lengnick-Hall, 1988; Schuler & Jackson, 1987a; Schuler & MacMillan, 1984; Wright & McMahan, 1992). Collectively, these articles propose that organizations can and should use human resources strategically, that organizations operating under different strategies require different HRM practices, and that organizations creating an alignment between strategy and human resource management will enjoy a competitive advantage over those that do not.

Over the past several years, scholars have studied the role that human resource management practices can play in enhancing the performance of larger firms. Until recently (e.g., Watts & Ormsby, 1990), however, the potential strategic importance of human resources to the overall success of small businesses has been ignored. Although small businesses are a

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major employer in the United States and a source of most of the nation's recent job growth, little is known about the role of strategically-managed human resources in small businesses. This is troublesome because small firms are more likely than their larger counterparts to face unique human resource challenges, while at the same time they often lack the staff to support a formal HRM function (Little, 1987). Furthermore, because of their limited human resources, small firms, even more than their larger counterparts, cannot afford even one ineffectively managed employee (cf., Gatewood & Field, 1987). Further, given the espoused benefits of strategically managed human resources (e.g., improved profitability, better employee attitudes, lower accident rates, reduced labor costs, increased productivity-- Walker & Bechet, 1991; Wright & McMahan, 1992), small firms could benefit greatly from the synergies associated with the integration of human resource management into the strategic management process. Until now, however, there has not been a systematic study of the degree to which small businesses have tried to develop human resource systems that are supportive of strategy.

The purpose of this paper is to explore the extent to which small businesses are tailoring their HRM practices to support their strategy, as has been encouraged for over a decade. If this message has been heard by managers in small firms, we would expect variation in HRM practices in these firms to be explained by strategy. If not, this would suggest an important area for strategic development in small firms -- at least to the extent that academic prescriptions are appropriate (cf. Fairfield-Sonn, 1987).

## BACKGROUND AND HYPOTHESES

Much of the literature examining the strategic potential of HRM has taken a "behavioral perspective" (e.g., Jackson, Schuler, & Rivero, 1989; Schuler & Jackson, 1987a, 1987b). The basic premise of this perspective is that employers use HRM practices as a means of eliciting employee attitudes and behaviors that support the strategic intentions of the firm (Fisher, 1989; Jackson et al. 1989). In general, this perspective argues that firms attempt to design human resource management practices that will elicit employee behavior supportive of their particular strategy.

Perhaps the most widely cited work from the behavioral perspective is that of Miles and Snow (1978). A key assumption inherent in this work is that knowledge about strategy in particular, and organizations in general, is best developed by identifying groups of firms (strategic types) that share important characteristics, rather than focusing on the idiosyncratic aspects of each firm (Miles & Snow, 1978). Later, Miles and Snow (1984) argued that HRM practices should differ across strategic types. Specifically, they discuss different human resource practices required by organizations characterized as defenders, prospectors, or analyzers (cf. Miles & Snow, 1978). Defenders attempt to "seal off" a stable market domain. They do not appeal to all potential buyers, preferring instead to cultivate a set of repeat customers that desire a steady, consistent set of products. This emphasis on stability over time suggests that the basic human resource strategy for the defender is to build human resources, in other words, to create a set of dedicated, long-tenured employees with a particular array of organization-specific skills. In contrast, prospectors consistently seek out new market opportunities and later abandon them as they become less lucrative. This "hit and run" approach means that the set of human skills needed is subject to rapid shifts. Accordingly,

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prospectors should focus on acquiring those human resources demanded by their present business emphasis. As suggested elsewhere (Miles & Snow, 1978), analyzers take a dualistic approach; operating as a defender in some markets and as a prospector in others. Likewise, analyzers' HRM practices reflect those of both defenders and prospectors.

Several researchers have relied on the Miles and Snow (1978) typology to illustrate potential linkages between strategy and HRM. Olian and Rynes (1984), for example, use the Miles and Snow typology to develop tentative propositions about the likely compatibility of staffing practices and strategy. More recently, Wright and Snell (1991) present a series of alternative integrative approaches to the human resource system in organizations. Wright and Snell then develop propositions to address how these integrative approaches fit into the Miles and Snow strategic type framework. To date, no studies have examined such propositions in the context of small businesses, despite the fact that the Miles and Snow typology has been viewed as valuable for studying small firms (e.g., Davig, 1986).

To address this gap in the literature, we empirically examine a number of HRM practices that have been linked to strategy in conceptual articles. Given our focus, we examine practices which are clearly important in small firms (Hornsby & Kuratko, 1990; Gatewood & Field, 1987). Specifically, we consider aspects of employee selection, compensation, and benefits because these practices are fundamental in determining the degree to which firms acquire and retain their human resources.

### Selection

Based on previous literature, we expect the selection practices in small firms to vary by strategic type. Defender organizations are expected to focus selection efforts on selecting out undesirable employees (Miles & Snow, 1984). The stability associated with defenders affords the time to invest in skill building and succession planning for internal candidates (Olian & Rynes, 1984); thus, complex selection efforts are deemed to be less important. Defenders are more likely to focus on identifying individuals who will have long tenures with the organization; individuals typically enter defenders at low levels and then receive considerable on-the-job training to develop the skills that help the organization maintain a stable market niche.

In contrast, prospectors, given the dynamic nature of their approach to the market and their consequent human resource needs, are more likely to focus on more sophisticated selection in order to bring desired competencies into the organization, rather than developing these knowledge, skills, and abilities once the employee has been selected. For example, prospectors' "frequent incursions into novel markets" increase their need to identify individuals with unique characteristics (Olian & Rynes, 1984: 175). A prospector's selection system, then, will likely be designed to carefully identify individuals with required competencies. Accordingly, we expect that prospectors, due to their need for flexibility in job requirements, are likely to use initial screening services to assess initial criteria. In this investigation, the focal selection tools are, respectively, pre-employment drug screening and employment agencies. Thus, the first and second hypotheses are:

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Hypothesis 1: Firms pursuing a defender strategy are more likely to use pre-employment drug screening than are other organizations.

Hypothesis 2: Firms pursuing a prospector strategy are more likely to use employment agencies than are other organizations.

### **Compensation**

Strategy has been postulated to be a primary determinant of compensation strategy (e.g., Balkin & Gomez-Mejia, 1987; Milkovich, 1988). Based upon the arguments of Miles and Snow (1984), we expect that compensation in defender organizations will concentrate on internal equity. Because defenders are thought to emphasize the development of firm-specific skills, they might be expected to be less concerned about employee mobility than prospectors. Instead, the focus will be on pay associated with position in the organization hierarchy and seniority; both reward longevity. Prospectors, on the other hand, are thought to emphasize "acquiring" human resources. As a result, we expect that their compensation packages will be oriented toward external competitiveness; prospector firms should be more concerned about the market and what other firms are paying. In addition, prospectors should focus reward systems on short-term behavior, rather than seniority, leading us to expect prospector firms to emphasize incentive-based pay programs. Thus, the third and fourth hypotheses are:

Hypothesis 3: Firms pursuing a prospector strategy are more likely rely on wage surveys in developing compensation practices than are other organizations.

Hypothesis 4: Firms pursuing a prospector strategy are more likely to use incentive pay plans than are other organizations.

### **Benefits**

We expect prospectors to focus heavily on employee benefits with immediate value. This is consistent with both prospector firms' focus on "buying" human resources, as well as their short-term, dynamic approach to the market. As noted, defenders focus more on employees' long term commitment to the organization. We expect, therefore, that defenders focus benefits toward rewarding long-term employee commitment. In other words, we expect that prospectors design benefits with immediate payoff, such as stock ownership, so that they play a role in the acquisition of individuals with desired competencies, whereas defenders support employee benefits that reward longer tenure, such as pension plans. Thus, we predict that:

Hypothesis 5: Firms pursuing a defender strategy are more likely to offer pension plans that reward seniority than are other organizations.

Hypothesis 6: Firms pursuing a prospector strategy are more likely to offer employees stock ownership than are other organizations.

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## METHOD

### Sample and Data Collection

For our sample, we relied on a list of 400 work sites with between 15 and 250 employees drawn randomly from the population of employers in Louisiana. The data base from which this list was created represents the population of employers in the state. During 1992, 211 of the 243 organizations contacted (87%) agreed to participate in our research. Given our focus on strategic human resource management, we eliminated 34 organizations that did not, according to the top manager, have primary responsibility for either their human resource management policies or their strategic decision making because they were part of a larger corporate structure. As a result, 177 organizations representing 51 different four-digit SIC codes are represented in our data. Eighty percent of the organizations in the sample employed between 15 and 50 individuals.

Face-to-face interviews were conducted at each organization with the person most responsible for the site's HRM practices. In all, 51% of the respondents held the position of human resource manager, and 49% held 'general' manager positions. In addition, two mailback questionnaires were left at each site: the 'human resource manager' questionnaire was completed by the interview respondent, the 'top manager' questionnaire by the highest level manager at the site (e.g., owner, CEO, president, plant manager). Surveys were returned by 104 (73%) of the human resource managers and 78 (55%) of the top managers. These response rates compare favorably to those usually reported, particularly as response rates on surveys of top managers are typically in the range of 10 to 12 percent (Hambrick, Geletkanycz, & Fredrickson, 1993).

### Measures

Independent Variable. Top managers were asked to describe their organization's strategic type using a six-item measure ( $\alpha = .78$ ) developed by Segev (1989). The items addressed the degree that the site was "innovative in the way products / services are delivered," "offers a wide variety of products / services," "has a diverse customer group," "is innovative in terms of the number of new products / services offered," "is innovative in terms of the novelty of new products / services offered," and "allots a large amount of resources to marketing." The scale was trichotomized using equal intervals to classify those with low scores as defenders ( $n=18$ ; 23%), those with mid-range scores as analyzers ( $n=34$ ; 44%), and those with high scores as prospectors ( $n=22$ ; 28%). As is typical when using nominal variables in multivariate analysis, three strategic type variables are represented in our analysis by two dummy-coded (0,1) variables. The first dummy variable is coded such that a '1' indicates the firm is classified as a defender. In essence, this variable describes how defenders and analyzers compare while controlling for prospectors. The second variable is coded such that a '1' indicates the firm is classified as a prospector. This describes how prospectors and analyzers compare, while controlling for defenders. By including both of these variables in the logistic regression analysis, we are able to identify the role that strategic type plays in relationship to the focal human resource practices.

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Dependent Variables. The presence or absence of several HRM practices was determined through the interview with the human resource manager. For each practice, we created dummy variables (0,1) coded so that a '1' indicates the practice was present at that organization. In the area of selection, two variables were used to examine predictions that selection practices should vary by strategic type. Pre-employment drug testing was used to address those selection systems aimed at selecting out undesirable employees. Pre-employment drug testing has been used with increasing frequency in workplaces to screen out potentially unreliable employees (e.g., Normand, Salyard, & Mahoney, 1990). We expect that defenders, which typically treat employees as long-term investments, have a special interest in screening out unreliable employees. We should note that those firms who performed drug testing as a part of a compliance agreement were not included in the analysis. This was done so that we considered only those firms where drug testing was a strategic choice.

Next, to address selectivity, we used the presence or absence of the use of a private employment agency; it has been suggested that due to their need for flexibility, prospectors are more likely to use initial screening services (e.g., Olian & Rynes, 1984). More specifically, it would often be more efficient for prospectors to use a private employment agency to screen for specific, changing skills, rather than to develop and continually revise such routines internally. In contrast, defenders' stability should offer them the luxury of routinizing and internalizing screening procedures.

Next, in the area of compensation, two kinds of compensation systems were considered. We predicted that prospectors would be prone to use compensation practices focusing on fulfilling recruitment needs (i.e., by offering wages that are competitive with other firms) and driven by incentives. To operationalize these predictions, we focused on wage surveys of other firms and the use of incentive-based pay. First, prospectors' focus on "buying" human resources suggests that compensation surveys of other firms play an important role in remaining externally competitive. Second, prospectors depend on creativity and the generation of new ideas; incentive based pay encourages these activities.

Finally, in the area of benefits, two practices were examined. Given prospectors' focus on changing situations and short-term results, coupled with their frequent need to attract employees to their firm, it is likely that these firms will focus benefits on short-term pay-offs. Accordingly, the use of employee stock ownership plans was assessed. Because such programs reflect day to day variations in performance, we expect prospectors to use them more frequently than other firms. On the other hand, given that defenders typically focus on long-term employee participation, we expect them to offer benefits that reward such behavior. Thus, pension plans, which reward employee longevity, are more likely to be found among defenders.

Control Variables. Although the primary focus of this study is to explain how HRM practices vary by strategic type, we recognize the potential importance of alternate, non-strategic determinants of human resource management practices (cf. Dyer, 1985; Wright & McMahan, 1992). Therefore, we include in our analyses two variables that past research points to as potentially important determinants of HRM practices: size, and industry type.

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Size, the number of employees and managers at the worksite, was gathered from company records. The view that size is an important constraint on the activities of an organization has long-standing roots in the organizational literature (e.g., Blau & Schoenherr, 1971; Hall, Haas, & Johnson, 1967). The general consensus seems to be that the potential role of size needs to be accounted for in empirical analyses of the relations among other organizational variables (e.g., Finklestein & Hambrick, 1990; Keats & Hitt, 1988). Previous research has also found size to be an important correlate of HRM practices (Jackson et al. 1989). Empirical research has found size to be positively related to the early adoption of a variety of HR programs (e.g., Tolbert & Zucker, 1983), as well as with the quality of employee benefits offered by firms (e.g., Villemeze & Bridges, 1988). Although our focus on a set of small firms might mitigate these concerns, the variation in size across members of the sample could still be important.

In addition, industry type has a bearing on the adoption of a variety of HR programs. Specifically, the distinction between manufacturing and service firms has important implications for personnel practices (Jackson et al. 1989). First, the intangible nature of services means that employee performance is difficult for supervisors to monitor directly. Also, the simultaneous nature of production and consumption make it necessary to control the process of service production, rather than the outputs. Firms were classified as either manufacturing ( $N = 30$ , 17%) or service ( $N = 147$ , 83%) based on their four-digit Standard Industrial Classification. This variable is coded such that a '0' indicates the firm is engaged in manufacturing, a '1' in service.

### Analyses

Because each of our dependent variables is dichotomous, a series of logistic regression analyses were conducted. The dependent variables in these analyses were the presence or absence of specific HR practices that were proposed to vary with strategic type, controlling for size and industry type.

## RESULTS

A correlation matrix and descriptive statistics for all study variables appear in Table 1. This research set out to consider whether variations in human resource management practices across small firms are predictably associated with variations in strategic type. Logistic regression analysis was used to estimate the relationship between the independent variables (intended strategy) and the dependent variables (presence or absence of specific HRM practices, proposed to vary with strategic type). Results of the logistic regression analyses conducted to examine our hypotheses are reported in Table 2. Hypothesis 1 proposed that firms pursuing a defender strategy are more likely than other firms to use selection devices that screen out undesirable employees. In support, a defender strategy was associated with the presence of pre-employment drug testing ( $b = .52$ ,  $p < .05$ ). Support was also found for Hypothesis 3, which proposed that firms pursuing a prospector strategy are more likely to use wage surveys as a compensation practice. A prospector strategy was associated with the use of wage surveys ( $b = .73$ ,  $p < .01$ ). The regression coefficients ( $b$ ) shown in Table 2 for both defender strategy (Hypothesis 1) and prospector strategy (Hypothesis 3) indicate that the presence of drug testing and wage surveys are significantly influenced by the firm's intended strategy.

Table 1  
**Descriptive Statistics**

	$\bar{x}$	$sd$	1	2	3	4	5	6	7	8	9	10	11
<b>Selection</b>													
1. Pre-employment drug screening	.34	.48											
2. Employment agency	.35	.48	.12										
<b>Compensation</b>													
3. Wage survey	.51	.50	.06	.22**									
4. Incentive pay	.51	.50	.09	.02	.12								
<b>Benefits</b>													
5. Employee stock ownership plan	.10	.30	.11	.07	.10	-.04							
6. Pension		.47	.50	.14	.14	.13	-.02	.17*					
<b>Strategic Type</b>													
7. Defender		.21	.41	-.13	.25*	.25*	.09	.06	.10				
8. Prospector		.29	.46	.05	-.07	.06	-.18	-.01	-.04	-.33**			
<b>Control Variables</b>													
9. Core sector	.51	.50	-.17*	-.06	-.10	.18*	.22**	.28**	.09	-.18			
10. Number of employees (log)	4.18	1.33	-.45**	-.12	-.21**	-.09	-.39**	-.23**	-.16	.12	.12		
11. Service industry	.83	.38	.18*	.06	.01	-.04	.10	-.01	-.01	.13	-.29**	-.23**	

$n = 177$ . \*  $p < .05$ ; \*\*  $p < .01$ .

Table 2  
**Results of Logistic Regression Analyses**

	Dependent variables													
	<u>Selection</u>				<u>Compensation</u>				<u>Benefits</u>					
	Pre-employment drug screening		Employment agency		Wage survey		Incentive pay		Pension plan		Employee stock ownership plan			
	<u>b</u>	<u>se</u>	<u>b</u>	<u>se</u>	<u>b</u>	<u>se</u>	<u>b</u>	<u>se</u>	<u>b</u>	<u>se</u>	<u>b</u>	<u>se</u>	<u>b</u>	<u>se</u>
Control Variables														
Service industry	.21	.35	.07	.32	.41	.32	.29	.31	.80	.56	.39	.31		
Core sector	.27	.27	.15	.24	.27	.23	-.53	.23	1.70**	.69	.69**	.24		
Number of employees (log)	1.38***	.35	.00	.15	.33*	.19	.49**	.20	.93	.29	.26	.17		
Strategic Type														
Prospector	-.29	.34	.00	.25	.73**	.29	.24	.25	.02	.45	.06	.26		
Defender	.52*	.32	-.89*	.40	.42*	.25	.07	.28	.11	.50	-.31	.28		
Model $\chi^2$	40.19***		7.64		14.48*		14.66*		29.89***		15.06*			
Pseudo- $\underline{R}^2$	.19		.04		.08		.08		.15		.08			

$n = 177$ . \*  $p < .05$ , \*\*  $p < .01$ , \*\*\*  $p < .001$ ; one-tailed tests are reported.

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We were unable to find support for the remaining hypotheses. The independent effects of the intended strategy variables (listed under  $\underline{b}$  for each equation) were not significant in any of the remaining regression equations. Specifically, we found that prospectors were not more likely than other firms to use (a) employment agencies (Hypothesis 2), (b) incentive-based pay (Hypothesis 4), or (c) stock ownership plans (Hypothesis 6). Additionally, we did not find that defenders were more likely than other firms to offer pension plans (Hypothesis 5). Two significant effects for which hypotheses were not offered indicate that defenders were (a) less likely than other firms to use employment agencies ( $\underline{b} = -.89, p < .05$ ) and (b) more likely to use wage surveys ( $\underline{b} = .42, p < .05$ ).

## DISCUSSION

Our results indicate that small businesses are failing to capitalize on the purported opportunities for competitive advantage provided through an alignment of HRM with firm strategy. Although many researchers and consultants have touted the importance of developing practices that support strategy, our results indicate that this message has not been heard, or at least that it has not been translated into practice. These results may strike some as disconcerting, given the suggested benefits of the strategic design of HRM practices, as well as the potential problems that may arise when these practices are not aligned with strategy.

Using employee compensation as an example, a mismatch between a firm's reward system and its strategy may have a variety of negative consequences. As documented by Kerr (1975, 1995), examples of reward systems that elicit one behavior while hoping for another abound. A small firm that is dependent on innovation, for example, should be interested in encouraging team work and a long-term orientation toward performance. A compensation system that is designed to reward cooperative behavior and process (e.g., team-based incentives), rather than independent behavior and results, would support such a strategic need. In fact, the latter system is likely to encourage employees to act in their own interests -- an outcome that may well be counter to that firm's strategic needs.

Failure to match selection practices to strategic type may also lead to problems. Firms that implement staffing practices without consideration of future organizational objectives and direction are less likely to capitalize on HRM advantages. Trends in the internal and external environment, and subsequent changes in strategic direction, dictate differences in the types and numbers of employees needed. Firms in their early stages, for example, may require employees with entrepreneurial flair, financing, and research skills; over time, marketing and even cost control skills may become more important (e.g., Dyer, 1983). Integrating staffing and strategy will reduce both the chances of hiring employees with obsolescent skills and the likelihood of situations in which there are employee shortages / surpluses. Recognizing the costs associated with the recruitment of new talent and the displacement of those employees who are no longer needed, it becomes more important for managers to integrate the staffing function with the goals and directions of their firms.

Overall, small businesses are forced to confront a variety of complex challenges, including market changes, scarce financing, and changes in access to distribution channels. Any of these can cause changes in the composition, quantity, and quality of human resources

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needed (Dyer, 1983). Despite this, across the majority of firms in our study, there was no consistent link between strategic type and human resource management practices. Interestingly, follow-up conversations with HR executives in our sample suggest that the main influence on any single firm's human resource management practices is often those practices used by other employers in the area. It seems that many small firms pay close attention to what others in the area are doing and then adopt those practices. This approach may seem efficient for a busy small business manager because it involves a low front-end cost. It does, however, beg the question of why so many small business managers believe that what works "across the street" should also work for them, especially given the likely differences in strategy between the firms. It appears that for now, small business managers have tried to cope with human resource management problems by looking to other firms for guidance. If, however, these managers look more carefully at their own firms, they will likely find the strategic management of human resources to be an important, overlooked source of competitive advantage for their businesses. Additionally, researchers interested in this relationship should be encouraged to develop a more refined understanding of the particular organizational circumstances most likely to produce a benefit from strategic management of human resources. Of particular value would be carefully grounded case studies that explore the experiences of small businesses in integrating human resource practices and strategy.

## CONCLUSION

This study examined the relationship between strategic type and HRM practices in a sample of small firms. By empirically testing the extent to which small businesses strategically manage their human resources, this study provides one of the first pieces of empirical evidence which evaluates prescriptions in the SHRM literature in a sample of small businesses. In general, we found little support for our hypotheses, which focused on the relationship between intended strategy and specific human resource management practices. Overall, there was little evidence of a relationship between strategic type and the presence of HRM practices, with only two of six hypotheses receiving support.

Though we did not detect a consistent relationship between strategy and HRM, we cannot say conclusively whether these results necessarily generalize to all small businesses. That is, it may be that this sample is, though representative of small business in Louisiana, somehow different than small businesses elsewhere. If, in fact, our results indicate that small businesses are not taking advantage of an alignment between strategy and HRM, it is important for future research to more closely examine the benefits associated with this alignment. Typically, literature in SHRM has been based on the notion that organizations which strategically manage their human resources will enjoy superior performance (e.g., Delery & Doty, 1996). This question has not yet received attention in the small business literature. Specifically, future research could benefit from an empirical examination of other parts of the human resource strategy model in samples of small businesses. For example, what are the benefits or the performance effects of strategically managed human resources in small businesses?

It is also important to recognize that current academic expectations of the relationship between strategy and human resource management may be incorrect. Certainly, small firms

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face many unique human resource issues, and it is possible that these firms match strategy and human resources in ways that have not yet been identified. Overall, more research is required before any definitive conclusions can be reached regarding the strategic management of human resources in small businesses. This research provides a base on which a better understanding of SHRM in small businesses may be developed. The extent to which small businesses strategically manage their human resources and the benefits associated with this process is an area that clearly deserves further study.

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