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## Contextualizing human capital theory in a non-Western setting: Testing the pay-for-performance assumption

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### ABSTRACT

Human capital theory is the dominant theoretical framework used to explain objective intra-organizational career success. However, the economic assumption that human capital development results in greater pay due to enhanced performance is challenged in non-Western contexts. Therefore, this study examines how the components of human capital influence pay in a non-Western setting where local companies commonly face salient socio-cultural and institutional pressures. In this vein, a formal model including performance evaluation as a partial mediator between human capital components and pay in a Latin American setting is developed and tested. The findings indicate that human capital development influences pay, but not due to enhanced performance as posited by human capital theory, suggesting that social and institutional pressures seem to influence the relationships. Furthermore, pay-for-performance compensation mechanisms appear to work only at the general employee level but not at the managerial level.

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### 1. Introduction

In today's knowledge-rich global environments, individual career success increasingly rests on employability across organizations (Dries, Pepermans, Hofmans, & Rypens, 2009). Despite this growing trend, many individuals continue to develop their human capital and pursue career success within the same organization (Verbruggen, Sels, & Forrier, 2007). Objective intra-organizational career success has traditionally been examined in Western settings using the explanatory frame of human capital theory (Ng & Feldman, 2009). However, there is a paucity of research on the relationship between human capital and objective intra-organizational career success in non-Western settings (Fang, Zikic, & Novicevic, 2009). Researching careers in these novel contexts entails the need for theorizing and conducting empirical research in a manner that accounts for context-specific effects (i.e., contextualizing theory) (Tsui, Nafedakar, & Ou, 2007; Whetten, 2009). In particular, May & Stewart (2013, p. 148) argue that “there is potential for cross-fertilization from international management research not only to ascertain the generalizability of inferences, but also to capitalize on contextual contingencies for insights concerning construct additions that enrich theory's ability to describe and predict phenomena of interest more thoroughly and robustly across boundaries.” An illustrative construct is pay-for-performance which, based on

human capital theory, is influenced by individual education and training. To model and test this influence in the local context, it is necessary to contextualize human capital theory.

Contextualizing theory involves identifying the conditions under which a theory developed in one context holds within another context (McGuire, 1983). Theory contextualization is different from theorizing about context, which involves examining how differences among contexts may influence a change in an established theory. This distinction is particularly important because contemporary research suggests that human resource (HR) notions typically have components of universal validity while also incorporating contextualized cultural particulars that are manifested in specific HR policies and practices (Bonache, Trullen & Sanchez, 2012). Hence, the purpose of this paper is to contextualize human capital theory by examining how institutional (i.e., socio-cultural) factors may influence the relationship between human capital and objective intra-organizational career success in a firm operating within a Latin American context.

Within the examined institutional context, sociocultural norms reflect the “common Roman law heritage, a common Iberian colonial past, and present day patterns of social organization” (Rosenn, 1988, p. 128). As a result, individuals working in this context tend to share a strong awareness of social stratification, paternalism and in-group collectivism (House, Hanges, Javidan, Dorfman, & Gupta, 2004) that may suppress the importance of technical competence in performance evaluations and inflate the importance of symbolic aspects of human capital for objective intra-organizational career success. If empirical results

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indicate this institutional rationale explains level of pay better than the traditional economic model, we could infer that human capital leads to objective intra-organizational career success in the novel context but operates differently than the typically theorized economic mechanism. Thus, by examining human capital theory within a relatively novel context, we may derive novel insights about the existing theory and the phenomenon that it espouses to explain.

## 2. Theoretical grounding

Human capital theory is widely used to explain objective career success in Western settings (Becker, 1962; Forstenlechner, Selim, Baruch, & Madi, 2014; Sullivan & Baruch, 2009). Objective career success reflects observable achievements of an individual, such as pay and promotion (Judge et al., 1995), and has typically been related to human capital and socio-demographic antecedents (Ng, Eby, Sorensen, & Feldman, 2005). Although multiple factors are considered to be indicators of objective career success (e.g., salary and number of promotions), we focus on pay, which has been designated as a global dimension of career success across multiple cultural settings (Demel, Shen, Las Heras, Hall, & Unite, 2012).

The main prediction of human capital theory is that increases in human capital translate into greater pay through increased job performance. However, only in ideal cases do performance evaluations offer an “objective, rational, and systematic way for organizations to manage workforce performance” (Chiang & Birtch, 2010, p. 3) because managers often experience institutional pressures that introduce bias into the relationship between human capital and performance evaluations, as well influencing the combined impact of human capital and performance on objective career success (Parboteeah & Cullen, 2003). In other words, while economic rationality implies that investments in human capital may lead proximally to increased performance and distally to greater pay, this does not take into account the political, socio-cultural, and institutional context in which the investments in human capital are embedded (Peng, 2003).

The socially-embedded nature of intra-organizational career success has recently attracted growing interest from career researchers (Kats, Van Emmerik, Blenkinsopp, & Khapova, 2010; Khapova, Vinkenbunrg, & Arnold, 2009). Societal processes and cultural influences impact career success in non-Western settings through HR policies and practices (Thomas & Inkson, 2007) because HR systems are “often based on customs, imitation of other firms, administrative convenience, and ad hoc programs developed through narrow functional lenses,” (Gomez-Mejia, Berrone, & Franco-Santos, 2010, p. 55).

## 3. Hypothesis development

Human capital theory posits and empirical evidence supports the relationship of education (Fleisher, Hu, Li, & Kim, 2011; Ng et al., 2005; Singh, Ragins, & Tharenou, 2009), tenure (Altonji & Williams, 2005; Ng et al., 2005; Williams, 2009), and training (Singh et al., 2009) with pay. However, relatively little work explicates differential influences and mechanisms via economic, as opposed to socio-cultural and institutional, forces. Our model extends current thought by examining these paths of influence.

Fig. 1 illustrates the mechanisms through which the three human capital components are hypothesized to influence pay. The lower path depicts an indirect influence and stipulates that the impact of human capital on pay is mediated by the degree to which greater human capital translates into improved performance ratings. This represents an economic, or rational, view in that the relationship between pay and human capital is a function of pay-for-performance systems that recognize value added through increased productivity. The upper path depicts a direct influence of human capital on pay implying that greater human capital leads to increased pay regardless of its impact on performance. That is, compensation is based on the symbolic, or potential,

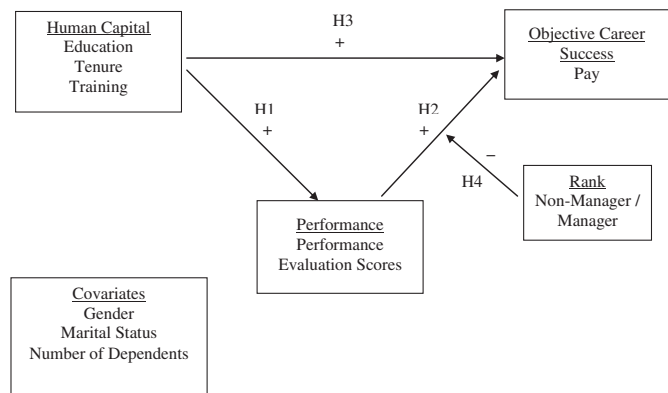


Fig. 1. Hypothesized relationships.

value of human capital, rather than on evaluated performance. The model also incorporates a boundary condition, rank, which is proposed to moderate the relationship between performance evaluations and pay.

### 3.1. Economic perspective of human capital on objective career success

The economic perspective of human capital theory posits that the three human capital components influence performance and thus result in greater pay. In other words, the paths from human capital components to objective intra-organizational career success, are mediated by performance evaluation scores.

#### 3.1.1. Education

A fundamental assumption of the economic perspective is that investment in education leads to greater productivity, which is reflected in improved performance evaluation scores (Mason & van Ark, 1994), and subsequently to increased pay. In a recent meta-analysis conducted by Ng & Feldman (2009), the authors found that education was a significant predictor of core task performance. Therefore, based on human capital theory and previous empirical research, performance evaluation scores are likely to explain how education is mapped onto objective career success in terms of pay. Hence, the following is hypothesized:

*H1a. Education has an indirect, positive relationship with pay via a positive relationship with performance evaluation scores.*

#### 3.1.2. Tenure

Longer tenure results in greater firm-specific knowledge, which subsequently is related to increased productivity. Several empirical studies support the positive tenure-performance relationship (Sturman, 2003; Van Iddekinge, Ferris, Perrewe, Perryman, Blass, & Heetderks, 2009). In effect, it is likely that through a gradual process longer tenure results in performance improvements and ultimately to increases in pay. Therefore, the following is hypothesized:

*H1b. Tenure has an indirect, positive relationship with pay via a positive relationship with performance evaluation scores.*

#### 3.1.3. Training

Training typically develops job- and firm- specific skills that enhance individual employee performance (Salas et al., 1999), thus contributing to greater productivity (Hatch & Dyer, 2004). Longitudinal studies (Van Iddekinge et al., 2009) and studies involving multiple levels of analysis (Bartel, 1994) indicate a significant impact of training on employee performance scores. Furthermore, training and skill development

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