A Corporate Governance Lens on Strategic Human Resources Management (SHRM)

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ABSTRACT
Corporate governance is one of the most important topics in strategic management research and practice. Yet human resource management has been relatively silent on the problems that corporate governance addresses, which are the generation, protection and distribution of wealth. In this paper, we develop a new conceptual framework for analyzing the links among corporate different corporate governance theories, their ethical and strategic management assumptions and how organizational climate and the HR function is/should be governed. In doing so, we propose some new directions for research that may help human resource management academics and practitioners make a bigger impact with their respective constituencies.

Key Words
Strategic human resource management, Corporate governance, Role of organizations in society, Strategy and culture

One of the most important questions currently facing corporations is how best to ensure that investors and other key stakeholders get a fair return for their contribution of financial, human and social capital. This defines the scope of modern day corporate governance research, which seeks to understand ‘the institutions that make such investments possible, from boards of directors, to legal frameworks and financial markets, to broader understandings about the place of the corporation in society’ (Davis, 2005, p. 143). Contemporary definitions have sought to extend the traditional focus of the corporate governance literature on shareholders and company boards to ‘to ensure that executives respect the rights and interests of company stakeholders, and that those stakeholders are held accountable for acting morally and responsibly for the generation, protection and distribution of wealth invested in the firm’ (Aguilera, Filatochev, Gospel & Jackson, 2008, p 475). These developments in corporate governance are associated with recent cases of company fraud and the 2007/8 financial services crisis, which demonstrated that some senior executives have failed to act responsibly and ethically in balancing their wealth generation and wealth protection roles (Cooper, 2008; Davis, 2009; Filatochev & Wright, 2005). Moreover, trends in executive pay, effectively created by the banking industries in Anglo-Saxon economies during the 1990s, have resulted in a heated debate over distributional issues, especially over whether high amounts of variable pay linked to shareholder value can be ethically and economically justified (Core & Guay, 2010; Filatochev & Allcock, 2010).
Thus, how company boards run their organizations and the systems they use to ensure that stakeholders are protected and rewarded, clearly influence (and are influenced by) the way in which human, social and organizational capital are managed (a point recently underscored by developments within the Strategic Management Society, whose 2010 annual conference introduced two new streams of research – human capital and stakeholder theory). Yet the mainstream SHRM literature has been relatively silent on these governance-related topics (exceptions include: Boxall and Purcell 2008; Farndale, Paauwe & Boselie, 2010; Filatochev, Jackson, Gospel & Alcock, 2007; Pinnington, Macklin & Campbell, 2007; Martin & McGoldrick, 2009; Martin & Gollan, forthcoming; Pfeffer, 2010; Spector, 2003). Instead, SHRM and human capital research has had an arguably myopic focus on economic performance (Boselie, Brewster & Paauwe, 2009; Galbreath, 2006; Khurana, 2007; Pfeffer, 2010; Walsh, Weber & Margolis, 2003), and the employee attitudes, behaviors and HR governance arrangements (Authors, 2009; Wood, 2009) that underpin them. Thus, our paper is intended to provide a richer view of the links between SHRM and corporate governance research by incorporating explicit links between these two relatively separate bodies of literature to show how different corporate governance models and their ethical and theoretical justifications are configured with different SHRM and organizational climate governance approaches (on this last issue, we draw on Farndale et al (2010) definition of organizational climate governance as how integrity, ethics, trust and pro-active behaviours are managed in a firm to mitigate risk). We do this by systematically reviewing and synthesizing key ideas from the corporate governance, SHRM and the organizational climate literature, and relating them to ethics and strategic management to develop a new conceptual framework for SHRM. This framework shows how SHRM can be realigned with its original concerns for social value as well as economic value (Authors, 2009; Pfeffer, 2010) by providing a critique of why the broad thrust of SHRM research and practice may be moving in the wrong direction and proposing some new directions for research for HR scholars (Cropanzano, 2009).

A FRAMEWORK LINKING SHRM AND CORPORATE GOVERNANCE

Key Corporate Governance Questions.
Our framework addresses two categories of descriptive and normative questions that raise key technical and ethical issues concerning the future of market economies and the ‘US business model’ (Davis, 2009; Whitley, 2009), the nature of top leadership (Finkelstein, Hambrick & Cannella, 2009; Hamel, 2007; Mintzberg, 2009), ‘sustainable’ organizations (Pfeffer, 2010), and the nature of SHRM and people management in organizations (Huselid & Becker, 2005, 2010; Boselie, Brewster & Paauwe, 2009; Storey, 2008). These questions are:

1. Whose rights and interests should be paramount in corporate governance and who should be held accountable for the generation, protection and distribution of wealth (Donaldson & Preston, 1995; Freeman, Harrison & Wicks, 2007; Greenwood, 2002; Jones, Felps & Bigley, 2007)?

2. What is the correct balance that organizations and their boards should/do seek between economic performance and social legitimacy (Author, 2004; Belkin, 2003; Davis, 2009; Deephouse, 1999; Marchand, 1998; Reich, 2007; Wirtenberger, 1969)?

**Whose Rights Should be Paramount?**

Although these questions cover some similar territory, we distinguish between them because the first set of questions are largely moral in nature and closely informed by different ethical perspectives, while the second is a more technically-rational question, to which different strands of economic and strategic management research offer different answers. Thus, the answers to the first questions can be framed by often-made distinction in governance research between a shareholder value perspective versus a stakeholder perspective (Freeman et al., 2007). While shareholder value has a strong technical/rationalist underpinning (Cooper, 2008; Fama & Jensen, 1976), it is also justified by a line of ethical reasoning which argues that self-interest or egoism is an inherently moral position, in much the same way that advocates of capitalism proposed that the virtues of market-based capitalism was a morally superior answer to the creation and distribution of wealth. More pragmatically, it also makes life easier for managers because allows them to ignore a myriad of potential moral claims and responsibilities that could be placed before them. Thus from a shareholder value perspective company boards should only be
accountable to shareholders and exercise their wealth creation, protection and distribution roles in the interests of shareholders (Sundaram & Inkpen, 2004). On the other hand, stakeholder theory, especially as it was originally conceived was premised on a pluralist and morally complex view of how economies and organizations should be run. For example, Clarkson (1995, p. 112), proposed that ‘the economic and social purpose of the corporation is to create and distribute wealth and value to all its primary stakeholder groups, without favoring one group at the expense of others.’

What is the Correct Balance between Economic Performance and Social Legitimacy?

The second, more technical, question is framed at one end of a continuum by Milton Friedman’s (Sept 13th, 1970) classical free-market dictum that companies maximize social welfare by using resources and engaging in activities which maximize profits over time, so long as they do so ‘in open and free competition without deception or fraud’ (p. 4). Sundaram & Inkpen (2004: 350) in their much-cited paper, ‘The Corporate Objective Re-visited’ put the case succinctly by arguing that creating value for shareholders is the preferred option not because of legal, ethical or expedient reasons, which some argue for, but because it is the ‘best among all available alternatives and thus the preferred goal for managers formulating and implementing strategy’. Their economic and strategic case was based in part on an argument, that (a) maximizing shareholder value was also ‘pro-stakeholder’ because managers were encouraged under such a system to increase the size of the pie for all constituencies’, (b) it created appropriate incentives to encourage managers to take risks, and (c) it made it easier for managers to focus on a single objective rather than diffuse ones.

At the other end of the continuum is an economic argument rooted in neo-Keynsianism (Cooper, 2008) and a strategic management argument associated with contingency theory and institutional theory (Scott, 1995) that sustainable organizational performance is only achieved when organizations and their corporate boards elevate societal expectations for meeting social obligations, especially to employees and the environment, to the same plane as economic performance (Davis, 2009; Jones, et al, 2007; Pfeffer, 2010). For example, the most recent versions of stakeholder theory are based as much on economic
arguments as moral ones because they have been tied to value creation, especially sustainable value creation. For example, Freeman, Wicks and Parmar (2004) claim that, regardless of the ultimate aim of a corporation, managers have no option but to have regard for the legitimate interests of different kinds of stakeholders who are shaped by and shape what the corporation does and how it is managed.

‘It is quite natural to suggest that the very idea of value creation and trade is intimately connected to the idea of creating value for stakeholders. Business is about putting together a deal so that suppliers, customers, employees, communities, managers, and shareholders all win continuously over time. In short, at some level, stakeholder interests have to be joint—they must be traveling in the same direction—or else there will be exit, and a new collaboration formed.... The best deal for all is if managers try to create as much value for stakeholders as possible.....’ (p. 365)

We argue that the pattern of answers to these two questions have different implications for SHRM, organizational climate governance, and the governance and role of the HR function in organizations. These implications refer to the ways in which corporate governance is socially constructed and enacted in organizations and its consequences for human resource management and organizational behavior. However, this relationship among governance, ethics, strategy, SHRM, organizational climate and HR is mutually constitutive. Just as the shareholder value model of corporate governance has implications for talent management by selecting, developing and rewarding executives whose values fit share price maximization, the questionable methods of selecting and incentivizing these same executives has had a significant effect on the soul and governance of these corporations (Khurana, 2002). By intersecting these ethical and technical dimensions, we propose four organizational configurations or ideal types (see Figure 1 and Table 1), bringing together different governance theories, their ethical and strategic management justifications, and accompanying SHRM strategies, organizational climate governance structures and HR governance arrangements. These ideal types are theoretical abstractions,
facilitating contrast and comparison of ideas for future SHRM research. These are outlined in the following paragraphs, figure and table.

*Insert Figure 1 and Table 1 about here*

**Linking Corporate Governance and SHRM in Four Configurations**

**Quadrant 1: The Traditional Shareholder Value Model.** As Davis (2009) argued, an era of shareholder capitalism, brought about by the rise of pension and mutual funds in America, was justified by a new set of technical economic and financial theories privileging markets, shareholders, self-interest and egoist ethics, restrained only by a moral and legal requirement to ‘do no harm’ (Greenwood, 2002). The contribution of agency theory to this process cannot be underestimated (Ghoshal, 2005; Khurana, 2007). This theory viewed share prices as the best guide to the future worth of the firm through the efficient markets hypothesis (Fama & Jensen, 1983; Jensen & Meckling, 1976). It further argued societal welfare could be only be maximized by pursuing shareholder value. However, managerial agents sometimes follow their natural self-serving interests unless they were strictly supervised and incentivized—so called agency loss. Corporate social responsibility was seen to be just such a self-serving interest of managerial egoism, unless justified by a business case. Thus the main aim of corporate governance and related research shifted to a focus on how to solve the agency problem through governance mechanisms designed to constrain opportunistic managerial actions, with the typical response being to link managerial pay to shareholder value. The ethical basis of shareholder value was accepted, and governance research was largely reduced to technical arguments about board structure, composition, and rewards to ensure that managerial agents acted in the best interests of shareholders (e.g. Dalton & Dalton, 2010).

The SHRM and organizational climate governance implications of agency theory became all too evident in the 1980s. Classical strategic management theory outlined by Porter (1980) and popular ecology theories of strategy (Whittington, 2000) focused on costs and cost control as one or, indeed, the only way in which a firm could earn superior profits or remain in business. Thus, the organizational climate of many firms was characterized by ‘hard’ bureaucracy and the exercise of ‘hard power’
(Courpasson, 2000). For the majority of firms’ workforces, this led to old style relational psychological contracts being replaced by transactional or employability contracts (Cappelli, 1999), so that employees were socially constructed (and, in some cases, began to construct themselves) as ‘human capital’ or ‘human resources’ rather than ‘resourceful humans’ (Wright & MacMahan, 2011). Later in the 1990s, when shortages of unique and valuable labour began to appear in developed western economies, the metaphor of an (exclusive version) of talent management was applied to firms’ internal labour markets, which led to proportionately higher rewards for these employee segments, covering knowledge workers, senior executives and occupations such as investment banking, traders and financial analysts (Atkinson, 1984; Martin & Gollan, forthcoming). Segmented internal labour markets, best typified by the Cornell architectural model (Lepak & Snell, 2002), became the guiding SHR M framework, in turn leading to arguments for workforce differentiation and a heavy premium being placed on leaders (Boudreau & Ramstad, 2007; Huselid & Becker, 2010). On this last point, a ‘romance’ developed with celebrity leaders who were frequently recruited from a small inner circle and seen as a key part of the solution, especially when constrained from pursuing their natural self-interest by linking their pay to share performance (Grint, 2010).

**Quadrant 2: ‘Enlightened’ Shareholder Value and Stewardship Models.** Recently, finance capitalism, the judgments of financiers, and agency theory prescriptions have undergone severe questioning. It is increasingly argued that society has ‘fallen out of love’ with business and business leaders (Grint, 2009). In its place, some academics have proposed stewardship theory (Davis, Schoorman & Donaldson, 1997; Lee & O’Neill, 2003) and/or an ‘enlightened shareholder value’ model (Clarke, 2007), both of which recognized the need for senior executives to align their interests with those of owners by taking into account potentially conflicting interests of stakeholders, and for these executives to behave virtuously. However, neither sets of ideas have relaxed the key assumptions of agency theory - that shareholders are the principal stakeholder - and both are universalistic in their assumptions and ethical underpinnings (Jones, et al., 2007).
Consequently, according to researchers such as Davis (2009) we are witnessing a revised form of welfare capitalism, based on a re-energized, sophisticated HRM approach (Guest, 2002; Storey, 2008) and underscored by a (re)introduction of virtue ethics and the Kantian moral imperative to treat people with dignity. Both leaders and HR managers are exhorted to promote shareholder value but also to role model virtuous behaviors in their capacity as corporate stewards, resulting in high commitment/high involvement SHRM (Boxall & Macky, 2009), privileging employee engagement and a balance between exclusive and inclusive talent management. The reputation of the firm as an ‘employer of choice’ is seen as a key issue, resulting in balancing acts over reward management and performance management. This enlightened human relations perspective has been evidenced by recent approaches to lay-offs, balanced scorecards, and by senior managers forgoing bonuses to role model acceptable standards (Martin & Gollan, forthcoming). Much of the recent leadership literature has emphasized a need for a revised management 2.0 (Hamel 2007), the application of soft power and more dispersed forms of leadership to incorporate key professionals into the running of knowledge-based enterprises (Courpasson, 2000)

**Quadrant 3. Stakeholder Theory.** Both of the above configurations originate in the USA and are firmly located in a unitary ideology of the firm (Fox 1974). In contrast, the continental European tradition has been characterized by a different version of capitalism (Whitley, 1999) rooted in pluralistic stakeholder theory (Freeman, 1984; Ferrary, 2009). This theory recognizes a wide range of legitimate interests in the firm, including the rights of trade unions to express and co-manage employee and environmental interests. These ideas reflect a utilitarian approach to ethics and duties, in which leaders are mandated to act in the best interests of the majority and to follow Kantian moral imperatives and Rawlesian justice by treating people as ‘subjects within themselves’ (Jones, et al., 2007). Stakeholder theory addresses a different set of governance questions from shareholder value, focusing on ethics, legitimacy, fairness and tolerance (Laplume, Sonpar & Litz, 2008). However, depending on the definition and power of stakeholders and other contingencies, this may justify rather different approaches to SHRM. Typically, however, these approaches model pluralistic values, citizenship, distributed leadership and help create a moral basis for employee advocacy of the corporate brand through their emphasis on distributive justice. Increasingly,
stakeholder theory is being proposed as a realistic alternative model, especially given the fall from grace of financial services and the growing importance of government in key industries that are vital to economies’ national interest (Davis, 2009; Jensen & Sandström, 2011).

Quadrant 4. Context-dependent organizational theories of governance. Organizational sociologists (e.g. Aguilera et al., 2008) researching in the field of corporate governance take an open systems perspective linking governance to key contexts, for example by drawing on contingency, national business systems and resource-dependency theories (Pfeffer & Salancik, 1977; Whitley, 2009). Their aim is to show how different corporate governance arrangements and goals may be more or less acceptable in different organizational, sectoral, regional or national business systems contexts, and what this implies for organizations and HRM practices (Davis, 2009). Contingency theory is based on ethical relativism or integrative social contracts theory (ISCT) (Donaldson & Dunfee, 1999; Jones et al., 2007), with morality seen as context dependent. Thus it accepts a range of ethical claims, including egoism, utilitarianism, duties and rights, virtue, feminism. As such, it proposes that there is no ‘best practice’ in HRM and that ‘fit’ is the key organizing principle.

SHRM plays an important role in creating fit by balancing cost, contingencies, and complementarities of the firm (Aguilera et al., 2008) to ensure effective governance, which often necessitates flexible approaches to talent management, rewards, performance management and employee relations, depending on the industrial, economic or life-cycle context (Boon et al., 2009). The complex/open systems assumptions of this approach emphasize ‘wicked problems’ (Rittel & Weber, 1973) that are not easily resolved, including the integration-responsiveness problem facing multinational enterprises (Rosenzweig, 2006) and the need for firms to be simultaneously different and socially legitimate in their corporate and employer branding (Martin & Hetrick, 2006, Martin, Gollan & Grigg, 2011, Deephouse, 1999). HR has a key role in advising on complementary practices that meet these key contingencies, especially in advising leaders on exercising a judicious mixture of hard and soft power.

CONCLUSIONS
Our principal aim in this paper was to set out a new conceptual framework linking different corporate governance theories and SHRM and to invoice some directions for empirical research for HR scholars. We are also setting out the basis for case for a more soulful or value laden approach to governance and SHRM, but recognize the tensions between economic and social goals, the long history in organizational studies of trying to effect a balance between them, and the problems this has created for SHRM legitimacy. However, SHRM is now well-placed to step up to the plate if it is able to answer key questions concerning the contribution of HR policies on key issues regarding organizational climate and its likely impact on board level and senior executive behavior. These questions, as the last column in Table 1 indicate, focus on the role of the HR function in relation to the approach to corporate governance adopted. For example, under the traditional shareholder value model, research questions could focus on how the HR function might manage an exclusive focus on managing the talent of the top cadre of employees, or how it might address the issue of incentives based purely on share performance (which arguably led to the 2008 global financial crisis). On this theme, future research might also explore how the ‘hard’ approach to HRM can or should be balanced against softer, more developmental approaches, especially in a context where employee voice is restricted through the absence of unions or new social media.

In the enlightened shareholder value model, questions for future research might focus more on how the HR function might contribute to balancing the interests of employees and investors. One approach may be to explore appropriate corporate cultures that can support differentiation and legitimacy (Martin & Hetrick, 2006). Another question is how HR might support the development and promotion of employer brands that balance the needs to develop human and social capital (Martin & Gollan, 2011).

Considering the stakeholder model, the HR department has a much stronger basis here given the inherent acceptance of multiple stakeholders in the interests of the business. Questions connected with this model could address the extent to which HR can support a multi-stakeholder, pluralist view of the firm, given its desire to gain a ‘seat at the top table’ and whether HRM practices actually reflect the need
to address both economic and social goals. Corporate culture can play a key role again here, especially in promoting corporate citizenship and ethical policies.

Finally, from a contingent perspective, questions need to be asked around the extent to which HR is able sensitise itself to different contexts whilst reflecting different business priorities. The extent of the HR department’s role in advising on appropriate local contingencies may also be affected by issues of power and influence within the organization (Batt & Banerjee, 2011).

Our recent research into the role of HR in the global financial services crisis suggests that there is some way to go before HR can contribute positively to corporate governance (Martin & Gollan, forthcoming). For example, the causes of the failure of Royal Bank of Scotland in 2008, the most significant and largest company collapse in UK in corporate history, can be attributed, in part at least, to the HRM function’s inability to influence the organizational climate and rewards systems that encouraged excessive risk taking. This can be seen as a display of lack of moral courage and failure to speak up to power among HR professionals or as a consequence of blindspots in HR agenda setting, depending on how you view it. One thing is for sure: the HR function and HR research needs to focus on its own responsible followership as well as its role in developing responsible leadership.
References


Figure 1: Four Ideal Types of Corporate Governance

Quadrant 1: Traditional shareholder value model

Quadrant 2: ‘Enlightened’ shareholder value/stewardship model

Quadrant 3: Stakeholder Model

Quadrant 4: Context-dependent organizational theories of governance

Focus on Economic/Technical Demands

Focus on balancing Economic & Legitimacy Demands

Unitary

Pluralist
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<td><strong>Agency Theory and Traditional Shareholder Value Model</strong> (e.g. Fama &amp; Jensen, 1983)</td>
<td>Egoist Ethics, focusing on maximizing self-interest and desires of markets and senior executives</td>
<td>Unitary view of firm</td>
<td>What role does/should HR play in talent management in a shareholder value corporation: a focus on exclusive high value v all employees? What role does/should HR play in shaping incentives to deal with current criticisms? Can HR act as an authentic voice for employees? If so, how? What should be the balance between hard and soft measures in HR? How can HR add strategic value, given its minimal impact in board and senior executive selection, development and remuneration?</td>
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<tr>
<td><strong>Newer Shareholder Value Theories</strong></td>
<td>Egoist Ethics tempered by: (a) Ethics of Duties based on Kantian moral imperative to duty to treat people with human dignity, and (b) Virtue Ethics, based on the idea that morally correct actions require senior executives to have virtuous character to role model acceptable behavior</td>
<td>Essentially unitary view of the firm. Leaders as guardians of shareholder value, but with duties to act as stewards on behalf of everyone in the business ‘Soft’ HRM emphasizing employee engagement as Balance between ‘exclusive’ and ‘inclusive’ talent management policies Focus on core employees but with eye to managing peripheral staff/business partners/contractors Balance between individual and group incentives Leadership development emphasizing moral character and enlightened human relations to develop responsible followers Tolerance of collectivist labor relations but encouragement of non-union voice Reputation of firm as employer seen as key issue Relaxed business case for CSR</td>
<td>How can HR act as guardians of enlightened/sophisticated approach to HRM? Is there a role for HR as guardians of corporate culture, particularly through leadership development and board development? Can HR act as guardians of employee interests, alongside business interests? What role can HR play as promoter of employer branding, and of the balanced scorecard? Is there a greater role for HR in board selection, remuneration and development, or should HR focus on cost control and relationship management, with limited strategic role?</td>
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<td><strong>Stakeholder Theory</strong> (e.g. Freeman, 1984)</td>
<td>Utilitarianism – the greatest good for the greatest majority Kantian capitalism based on three moral imperatives Ethics of Justice (Rawls) and importance of upholding social contracts</td>
<td>Institutional theory and new institutional economics Contingency theory</td>
<td>Is there evidence of HR acting as promoters of pluralism, including economic and non-economic goals? What are the difficulties in moving from a shareholder value approach to a stakeholder model and vice versa? Can HR promote corporate citizenship and ethical policies, and distributed leadership? How can HR promote corporate as well as employer branding through advocacy of CSR, rewards distribution etc? Can HR take on a role as as promoters of information disclosure? Should/does HR manage to focus simultaneously on costs,</td>
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<td>Context-dependent Organizational Theory (e.g. Aoki et al, 2007; Pfeffer, Aguilera et al, 2007; Filatotchev, 2010; Gospel &amp; Pendleton, 2005; Pfeffer and Salancik, 1978)</td>
<td>Ethical relativism, with morality seen as context-dependent</td>
<td>‘No one best way’ of organizing corporate governance and HRM</td>
<td>To what extent is HR able to be sensitive to context and contributors to cost effectiveness, contingent and complementary HR policies and practices?</td>
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<td>Aim: To show that different corporate governance practices and goals may be more or less effective/acceptable in different organizational/sectoral/national business system environments</td>
<td>Acceptance of different ethical claims, including egoist, utilitarianism, ethics of duties and rights, virtue, feminism, etc ISCT theory justifying local and global ethics</td>
<td>SHRM’s role in balancing costs, contingencies and complementarities of firm to ensure efficient and effective governance, dependent on context, stage in life cycle</td>
<td>What is HR’s role in putting together/advising on effective combinations of practices depending on key contingencies, e.g. stages in firm’s lifecycle, sectoral, regional and national business system differences?</td>
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<td>No universal governance practices</td>
<td>Organizational sociology</td>
<td>Need to reduce resource dependencies</td>
<td>Should/does HR manage to focus simultaneously on costs, relationships and strategic role?</td>
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<td>Contingency theory and national business systems theory</td>
<td>Delineating and resolving ‘wicked problems’, e.g. integration-responsiveness problem in MNEs operating in different business systems/contexts, need for differentiation and social legitimacy</td>
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