

**HRM PRACTICES AND ITS IMPACT ON PERFORMANCE –
EXPLORATORY LITERATURE REVIEW IN THE CONTEXT OF INDIAN
SMEs**

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ABSTRACT

Human Resource Management (HRM) involves all management decision and practices that directly affects the people, or human resources, who work for the organization. Prior studies have found substantial positive evidence for statistical associations between HRM practices and improved firm performance. The role of SMEs in the economic growth and development of emerging countries like India is significant. However, the current state of knowledge and practice in the field of HRM practices and its impact in SMEs in the Indian context is limited. The objective of this paper is to explore existing literature for establishing relationship between HRM practices and firm performance. Performance can be measured in many ways but present study is to measure operational performance, financial as well as non-financial performance. Research methodology used here for this paper is secondary data as it is for building the concept of HRM practices and performance. Research construct like management style, Social capital as well as culture are used to find the moderating effects on this relationship. Implications of this study will be for SMEs, Policy makers as well as for academic research in finding the impact of HRM practices on the firm.

Keywords: HRM practices, organizational performance, financial and non financial performance, Trust, SMEs.

I INTRODUCTION:

In the 21st century, as the businesses often expand beyond domestic borders, not only multinational corporations (MNCs) and International entities but even small and medium sized enterprises (SMEs) endeavor to gain and sustain competitive advantage by addressing the issue of “people and their potential” with much vigor. In this context, strategic importance of managing and developing human resources effectively for future prosperity of organizations can be emphasized.

Former President of United States of America, Ronald Reagan had stated that “Entrepreneurs and their small enterprises are responsible for almost all the economic growth in the U.S.”. In the revised 2007 figures, based on increased and sustaining growth, more inflows into foreign direct investment, Goldman Sachs predicts that "from 2007 to 2020, India's GDP per capita in US\$ terms will quadruple", and that the Indian economy will surpass the United States (in US\$) by 2043 (Kundu, 2010).

While people constitute the most appreciable asset, they could also become a burden if their abilities and attitudes are not aligned with organizational needs. Hence, in an environment of fierce competition, in global as well as local markets, finding and nurturing appropriate human resources for implementing company strategy is a significant success factor. “Effective human resource management -HRM - is essential, especially for SMEs when international expansion places additional stress on their limited resources, particularly people” (Dowling et al. 2002, p.1).

Despite the fact that small and medium-sized enterprises account for an important part of total employment and production, even less is known about the impact of HRM practices within these organizations. After a brief introduction into the concept of HRM and a discussion of relevant theories, this paper discussed about some of the HRM practices various researchers have used as independent variable for linking it to the organizational performance.

I.A. SME and Indian Economy

Small and medium sized enterprises play a central role in the Indian economy. They are a major source of entrepreneurial skills, innovation and employment. SME businesses are the biggest contributor to the economy of any country and the same goes with Indian economy. In fact, SME is one of the most crucial sectors of Indian economy as far as the number of employments generated from this segment. As more than 65% of Indian population lives in rural and semi-rural areas, small business becomes a major source of income for many residing in these areas. After agriculture, small business in India is the second largest employer of human resources.

In India, SSIs account for 95 per cent of the country's industrial units, 40 per cent of industrial output, 80 per cent of employment in the industrial sector, 35 per cent of value added by the manufacturing sector, 40 per cent of total exports

and 7 per cent of net domestic product. Clearly, after agriculture, this is the single biggest group in the country's economic activities (Bhavani, 2004).

I.B. HRM and SME Performance

Only few studies (Bryant, 2004; Welbourne 1996) identified the link between adoption of HRM practices and small firm performance. Research explains acute shortage of identifying and validating human resource practices in small firms, and even less research focusing on the relationship between strategy, human resource practices, and small firm performance (Chandler and McEvoy 2000). Furthermore, in larger firms only recently has research begun to document the relationship between HRM practices and organizational performance (Boselie et al 2001; Delaney and Huselid, 1996; Delery and Doty, 1996; Huselid, 1995; Paauwe and Richardson 1997; Pfeffer, 1998; Youndt et al., 1996). According to Chandler and McEvoy (2000) 'most of the studies seek to investigate the human resource/performance relationship using large companies as research sites. It is important to note that research has suggested that smaller organizations present a "unique opportunity for studying human resource management" and its relation to firm performance (Welbourne and Andrews, 1996). Delery and Doty's (1996) contingency mode explains that the relationship between the relevant independent variable and the dependent variable will vary relevant to such influences as company size, company age, technology, capital intensity, the degree of unionization, industry/sector, ownership and location. However, where there was a focus upon SMEs, such studies tended to examine the existence of HRM practices without examining the impact of the HRM practices on firm performance. While there has been very little research into the performance effects of HRM adoption on SMEs, a common thread in the arguments presented in prior studies on HRM in SMEs is that as SMEs grow, unsophisticated people management approaches become increasingly inadequate (Kaman et al., 2001; Kotey and Slade, 2005; Zheng et al. 2006). When this occurs, SME owners-managers may come to realize the importance of formally adopting HRM systems (may be called step towards development of HRM sophistication) and the associated benefits of nurturing people's creativity, and even the creation of competitive advantage, growth and success through people (Bacon et al., 1996; Kaman et al., 2001; Kotey and Slade, 2005; Zheng et al., 2006). Even though there appears to be recognition of the importance of HRM among SMEs, the empirical evidence on the extent of the impact of HRM practices on SME performance is inconclusive (Zheng et al., 2006), and there appears to be no empirical testing in the context of Indian SMEs. It is crucial to

address the development of HRM practices in Indian SMEs working in a different cultural, political and legal context. This study will investigate the relationship between HRM and SME performance, taking into account moderating variables of business operations, culture and social capital and control variables like, firm size and firm's age. Dependent variable used for study is Firm performance which includes financial and non financial performance.

II RESEARCH METHODOLOGY:

II A. Research Objectives:

1. To review the HRM practices used by previous researchers.
2. To explore the HRM practices in the SMEs registered under MSME act 2006.
3. To assess the impact of HRM practices on the firm's performance in existing literature available.
4. To compare the relationship between HRM practices and operational performance and HRM practices and firm performance.
5. To explore effective content of HRM practices which lead to improve firm's operational performance and firm performance.
6. To see moderating effects on HRM- performance relationship.

II B. Research Design: The research design used is exploratory for reviewing the existing secondary data. It is an effort to know the impact of HR practices on the firm's operational performance & firm's performance.

II.C. Sources of Study: Source of study is secondary. Data is reviewed in the form of previous research papers, articles in research journals, newspapers, website related to study.

III REVIEWING HUMAN RESOURCE PRACTICES: AN INDIAN CONTEXT

HRM Practices and its impact on productivity found that through the use of strategy-based HR policies and practices, firms create a more competent and committed workforce, which in turn provides a source of sustainable competitive advantage.(Khera, 2010). Organizational learning in Indian organizations: a strategic HRM perspective reveals that, reveals that there is a positive relationship between organizational learning, strategic HRM and sustainable competitive advantage Khandekar , 2005). HRM and Indian epistemologies: A review and avenues for future research (E Pai,2007) integrates and discusses research on HRM in India with a focus primarily on the past fifteen years. It is within this complexity that research on India and its

workforce is presented by illuminating HRM as embedded in the Indian environment with its intricate epistemologies and transitions in a period of dynamic change.

Study on 137 Indian manufacturing firms have suggested that, number of significant correlations between a set of contingent variables (i.e., age, size, ownership, life cycle stage and HRM strategies of an organization, type of industry and union membership) and four HRM functions of recruitment and selection, training and development, compensation and employee communication. Similarly, four national factors (namely national culture, institutions, dynamic business environment and business sector) are suggested, which influence Indian HRM policies and practices.(Budhavar, 2000).

Human resource management practices in Indian hospitality enterprises revealed that, harmonized terms and conditions, formal manpower planning, flexible job description, formal system of induction, production/service staff responsible for their service, social appreciation and recognition may constitute the most important HRM practices in the Indian hospitality enterprises.(Chand, 2010).

A Study of Indian and Multinational Companies” concluded that, Competitive advantage of a company can be generated from human resources (hr) and company performance is influenced by a set of effective hrm practices.(Kundu, 2009).

A study among software professionals in India” reveals that HRM practices such as employee-friendly work environment, career development, development oriented appraisal, and comprehensive training show a significant positive relationship with organizational commitment (Paul, 2011).

"HRM systems architecture and firm performance: Evidence from SMEs in a developing country “In their study shown that the attitude of the firm’s owner(s) towards its employees is a major determinant of the firm’s profitability. The effect of HRM philosophy on productivity is smaller, albeit still highly significant. (Prahlad Kasturi, et al, 2006).

Innovative recruitment and compensation practices have a significant relationship with firm performance. It was observed that, recruitment, role of

the HR department and compensation practices seem to be significantly changing within the Indian firms in the context of Indian liberalization (Som, 2009).

Level of Formalization of Human Resource Management in Small and Medium Enterprises in India reveals that, level of formalisation of HRM systems in SMEs was low and owner-managers played a central role in the HR functions of their enterprises. Compared to small enterprises, the level of formalisation was found to be higher for medium enterprises (Joshi & Vohra, 2009).

“HR Determinants of Organizational Success amongst Small & Medium Enterprises in Indian Automobile Sector” Three scales have been developed by the researchers- Engaging Leadership (from the leader’s perspective), Engaging Leadership (from the subordinate’s perspective) and Employee Engagement. At a later stage a full scale research can be carried out on a larger sample size and in more number of firms. One of the direct uses could be 360 degree feedback based on these scales in these SMEs for developmental purposes. (Akhuri & Sharma, 2010).

IV OPERATIONAL PERFORMANCE

In the past years, scholars argued a number of criteria of operational performance measures used to find a relationship between HRM practices and operational performance. Authors including Wheelwright, Schmenner, Hays, and Hill have contributed various dimensions of operational measures such as cost, quality, delivery, product launching, innovation, flexibility, dependability, and efficiency & Time duration. HRM practices like, Effective training & development, selection, rewards and performance appraisal have positive relationship with product quality, Productivity efficiency and overall perceived performance (Khan, 2010). The present study covers operational performance measures as, Product Quality, Product Cost, and Delivery & Flexibility. Later on Vickery has introduced rate of new product launching, so called “Speed” as another dimension of the measures (Vickery et al, 1997). Skinner (1974) mentioned short delivery, superior quality, dependable delivery, fast new product development, volume flexibility, and low cost. Wheelwright (1978) emphasized efficiency, dependability, quality, and flexibility. After the previous research, Wheelwright, in work with Hayes in another research agreed upon changing efficiency factor into cost (Hayes & Wheelwright, 1984). Leong et

al(1990) in his literature review mentioned five main aspects: cost, quality, delivery, flexibility and responsiveness.

Besides those scholars, there are more contributors to the operational performance (manufacturing performance) measures (Krajewski & Ritzman, 1987; Ferdows & DeMeyer, 1990; Droge et al,1994; Vokurka et al, 1998; Youndt et al., 1996 and; etc) Youndt et al.(1996) suggested four dimensions: Cost, quality, delivery flexibility and scope flexibility. Delivery flexibility was a timing of the introduction of new products and ontime delivery. Scope flexibility was about variety of things: adjusting product mix, handling non-standardized orders and producing product in small lot (Jayaram, et al., 1999).

IV. A. Product Quality: Product quality is strongly required by customers. Product quality includes several dimensions such as product specifications (standard product). Product performance (Product functions) product reliability. Product serviceability (reparability of service) product durability (time period of product), etc.(Kotler, 2003, Hill and Jones, 2007).

IV. B. Low Cost Production: Low cost production is the ability to reduce costs through efficient operations, process technology and/or scale economies (Porter, 1985, Vickery, Droge, & Markland, 1997,Hill and Jones ,2003), cost leadership provides two advantages: first, if its closest competitors compete in the same price range or market segment, the total cost leader is able to capture more benefits due to its low cost structure. Second, cost leader can charge low price than competitors as a result, gaining more market share.

IV. C. Product Delivery: The act of transferring or delivering the goods and services through any mode of transportation to ultimate consumers or buyers. Service organizations can differentiate from others by designing fast delivery network(Kotler, 2003). Zeithaml and Brinter (2003, p.472).

IV.D. Flexibility: Flexibility is about the reduction of production lead times and set-up times, the development of new processes for new products and offering workers a variety of tasks (Meyer, Nakane, Miller, & Ferdow, 1989). According to the work of Vickery, Droge & Markland (1997).

V FIRM PERFORMANCE

Defining firm's performance is a very broad term as many researchers in past have used various indicator to measure firm performance. Firm performance or organizational performance can be defined as "firm's progress in achieving increase in productivity (employee as well as production), employee efficiency, employee turnover, financial performance (Return on investment, Return on asset, Profitability, Turnover) and market share, economic performance & customer satisfaction level. Some non-financial indicators also used to define firm's performance such as employee absenteeism, employee turnover, rework cost, defective rate, scrap rate & sales per employee.

Past studies have investigated impacts of HRM practices on Productivity (Chen, et al 2003) on efficiency and employee turnover (Huselid, 1995) on financial performance (Delery & Doty, 1996, Huselid, et al., 1997) on customer satisfaction (Koys, 2003) on turnover, absenteeism, productivity and quality (Richard & Johnson, 2001).

The relationship between trust, HRM practices and firm performance" have used firm performance as dependent variable in which he used set of questions pertaining to quality of product/service, new product development, the ability to attract and retain employees, customer satisfaction, market share, & profitability. S.Tzafrir (2005).

Study on 63 SMEs in turkey found that there is strong link between HR practices, human resources management (HRM) - firm strategy fit and the firm Performance. In their study the firm performance was measured by, Success , Market share, Growth, Profit, Innovativeness, Size. (Oya Erdil & Aye Günsel ,2006).

May-Chiun Lo (2009) research uses a sample of 85 firms surveyed in Sarawak, Malaysia. The findings suggested that incentives and information technology are positively related the firms' performance.

The proposed study will measure firm's performance; the indicators used in this study are increase in employee productivity and reduction in employee absenteeism as non financial parameters where as financial performance indicators used in this study are Market share percentage, Rate of sales growth,

Rate of return, Rate of profit growth and Overall performance. see annexure for dimensions of firm performance table-3.

VI. BUSINESS OPERATIONS MODES

Defining Moderating Variables:

Moderating variables are indicators which help in identifying firm's outcome. Present study aims to identifying impact of HRM practices on firm's performance hence; in present study the researchers have used three moderating variables as Management style (Centralization Vs Decentralization), Social capital (Trust Vs Distrust) and Culture (Proactive Vs Reactive).

VI.A Management Style: Centralization Vs Decentralization:

Centralized leaders can bring about demoralization in work place, disgruntled employees, high turnover rate, and unproductive workers, leading to low productivity as a final result. Comparing the democratic leader to the concept of decentralization, we can find compatibility. Decentralization is about sharing power to lower level, encouraging team work, motivation of transferring and broadening responsibilities to lower level, and authorizing greater involvement in communication and decision making etc. (Hoogendoorn & Brewster, 1992; Vancevic & Donnelly, 1975). Everyone has his/her own responsibility for doing jobs. So, decentralizing line of authorities to low level of management becomes an effective tool of management. Another advantage of decentralization is power dissemination to low level management, so top level management can take time and effort to think of drivers of success of an organization rather than spending much time to deal with some negligible staff activity. Unlike centralization, decentralization can encourage employees to work. It covers dimensions like transfer of responsibility & communication among employees.

VI.B Social Capital: Trust Vs Distrust

Social capital (SC) is defined as the combined value of the relationship with customers, suppliers, industry association and markets, and SC represents the potential an organization possesses as a result of external intangibles (Bontis, 1999). It is strongly associated with trust. According to Shockley-Zalaback, Ellis and Wonograd (2000), trust significantly influences on change processes and risks: whereas the lack of trust results in poor communications and quality (Owen, 1996). Erden, Ozen and Atsan (2003, p.337) say, " A climate or culture of trust which is built by the ongoing intensive relationships among the

organization's members is much more likely to provide the required levels of trust and flexibility.”

VI.C Proactive Vs Reactive Culture:

According to Lim (1995,p.16). “ The term ‘ culture’ refers broadly to relatively stable set of beliefs, values and behaviors commonly held by a society. “ Even though a lot of researchers have provided multiple definitions of culture, those are subject to ambiguity (Schneider, 1988). “The powerful, pervasive role culture plays in shaping organizational life lends plausibility to speculations that cultural factors may be linked with exceptional levels of organizational performance. Sadri and Lees (2001) say that positive culture can have significant impact on competitive advantage. Lim(1995) claims the relationship between culture and firm performance. Quick (1992) tends to suggest that culture moderates between culture can help boost organizational performance. However. Creating a new culture is difficult and a time-consuming task (Lysons, 2000) Gueera, Martinez, Munduate, and Meidna (2005) found goal oriented culture moderates the impact of task conflict in private organization.

VII. CONCLUSION

Based on previous literature on application of HRM practices in SMEs and its impact on firm is analyzed, which says that there is positive effect of HRM practices like HR planning, Recruitment, Selection, Incentives, Counseling, Leadership & Motivation. Many researchers have studied HRM practices and operational performance of firm, in those studies it has found that, practices like incentives and training have positive co-relation with product quality and reducing the cost of product. In another study on HRM practices and firm's performance it is found that firm's financial performance like profitability, Return on investment, and sales turnover improves with HRM practices like employee participation, communication and high morale. In one study it is also find that HRM practices have positive relation with employee productivity which leads to reduce the employee absenteeism. Variable like trust, management style and social capital is used to check the moderating effect of HRM practices on firm's performance it has found that, when decentralization is used as preferred management style than employees productivity is increased while in the organization when trust is prevailed among employees it has positively impacted the firms performance.

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Table-1 Dimensions of HRM practices

Authors HRM Practices	Aurthor (1992)	Pfeffer (1994)	MacDuffie (1995)	Deleany Hueslid (1997)	Pawan S Budhawar (2000)	Ashok Som (2008)	Shikha Khera (2010)
Appraisal				✓			✓
Communication	✓	✓		✓	✓	✓	✓
Employee Participation	✓	✓				✓	✓
Empowerment		✓	✓	✓			
Incentive practices	✓	✓	✓	✓	✓	✓	✓
Job Description		✓	✓	✓			
Recruitment		✓	✓	✓	✓	✓	
Selection				✓	✓		
Teamwork	✓		✓				✓
HR Planning	✓						✓
Training & Development	✓	✓	✓	✓	✓	✓	✓
Motivation							✓



Table-2 Dimension of Operational Performance:

Author Operational measure	Wheel right (1978)	Arthur (1994)	Youndt, Snell, Dean Jr.& Leepak (1996)	Vickery Droge & Marklan d (1997)	Jayaram Droge & Vickery (1999)	Ahmed & Schroeder (2003)	Fons Kortekaas (2007)	A. Khan (2010)
Quality	✓	✓	✓		✓	✓	✓	✓
Efficiency	✓	✓	✓			✓		
Flexibility	✓		✓	✓	✓		✓	✓
Dependability	✓					✓		
Innovation			✓	✓			✓	
Cost					✓	✓		
Time			✓	✓		✓		

Table-3 Dimension of Firm's Performance:

Authors Financial & Non- financial indicators	Huselid (1995)	Delery & Doty (1996)	Richard & Johnson (2001)	Chen & Chang (2003)	Koys (2003)	Tzafrir (2005)	Normala Binti Daud (2006)	Ashok Som (2008)
Employee productivity	✓		✓	✓	✓			✓
Employee absenteeism			✓	✓				
Employee turnover	✓		✓				✓	
Profitability	✓	✓	✓			✓	✓	✓
Market Share	✓	✓		✓		✓		✓
Rate of return		✓			✓	✓		
Sales growth	✓	✓			✓	✓	✓	✓

(Source: Integrated by Authors)

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