



## **Impact of Pfeffer Seven Human Resource Management practices on firm performance in Manufacturing Small and Medium Enterprises, Sri Lanka**

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### **Abstract**

*To satisfy most of their needs, Sri Lankans continue to depend on small and medium-sized businesses, but they are increasingly distrustful of their results. If workers are better handled by managers and leaders, it is possible to move towards a productive workforce and to fulfill the general standards of individuals. The purpose of this study is to explore how the model of Pfeffer's from human resource management research to clarify and examine human resource management practices impacts the small and medium enterprise's firm performance. The population of the study was 6053 manufacturing small and medium-sized enterprises in the Western Province. The analysis was performed concerning Sri Lanka's 448 manufacturing small and medium-sized enterprises selected by using simple random sampling technique. To cover 448 human resource managers/executives or responsible authorities in different small and medium-sized enterprises in Sri Lanka, the standardized questionnaire was administered; however, data could only be collected from 135, giving a response rate of 30.1 percent. Correlation analysis and regression analysis were used with the assistance of the Social Science Statistical software package to analyze quantitative data. The results of the study showed a significant and low positive relationship with seven human resource management practices: employment security; selective hiring; use of self-managed teams and decentralization; use of compensation contingent on organizational performance; the extent of training; reduced status distinctions and sharing of information with manufacturing small and medium-sized enterprises performance in Sri Lanka. Regression analysis analyzed the influence of the variables and it was found that 32.4 percent of the variance in the dependent variable was collectively and substantially explained by the combined variance in all the independent variables considered in the sample. This study recommends that, as a way to enhance organizational efficiency, managers should pay more attention to their human resource management practice. Furthermore, this study indicates that potential researchers should cover other sectors to better understand the relationship between the variables.*

**Keywords:** *Compensation, employment security, organizational performance, selective hiring, sharing of information, training, use of self-managed teams and decentralization.*

## 1. Introduction

Given contemporary financial market constraints and limited growth in demand, smaller firms refocusing increasingly on how to utilize existing resources more efficiently and effectively (Gallego, Rubalcaba, & Hipp, 2012). Given their resource limitations, small and medium-sized firms have fewer options than their larger counterparts to improve performance. However, one resource that is common to all organizations, which has been the focus of increasing theoretical, empirical, and practical attention in small and medium-sized enterprises (SMEs), is that of human resources. Pfeffer (1998), Wimbush (2005) noted that the most valuable asset that an organization can possess is its human resource. Subsequently, human resources in the organization can vitally contribute to the success (or failure) of the organization. Hence, scholars have suggested that adopting specific human resource management (HRM) practices can improve small firm performance and sustain competitiveness (e.g., Michie and Sheehan, 2008; Patel and Cardon, 2010; Razouk, 2011; Williamson et al., 2002).

Most Western-based studies (Delaney & Huselid, 1996; Delery & Dot, 1996; Huselid, 1995; MacDuffi, 1995; Pfeffer, 1998; Wimbush, 2005; Vlachos, 2008; Michie and Sheehan, 2008; Patel and Cardon, 2010; Razouk, 2011, Sheehan, 2013) have revealed that human resource practices can enhance organizational performance. Besides, prior empirical studies have indicated that some human resource practices are positively associated with organizational performance. Researchers in the field of human resource management suggest that more future empirical investigations need to be carried out to ascertain and validate these findings (Givord & Mauri 2004). This is an important consideration as human resource practices are found to vary across countries and these variations are postulated to cultural values a country possesses (Ngo, et al., 1998, and also organizational size (Heneman, Tansk & Camp 2000). Majority of findings from human resource management – performance research in large firms point in the direction of a positive relationship (Combs et al., 2006). There are reasons to assume that these are not necessarily applicable to SMEs. In comparison with large organizations, SMEs lack economic scale, less number of employees, and HR decisions in SMEs are usually taken by owners/managers in an informal and personalized manner (De Winne & Sels, 2013).

Over the years, researchers have suggested many HRM practices that have the potential to improve and sustain organizational performance. These practices include an emphasis on employee selection based on fit with the company's culture, behavior, attitude, and necessary technical skill (Ahmad & Schroeder, 2003). Same time growing number of empirical studies have confirmed that not every HR practice can impact firm performance or organizational sustainability (Ahmad & Schroede, 2003; Cardon & Stevens, 2004; Barring, Jones & Neubaum, 2005, Boxall, 2013). Pfeffer (1998) has proposed seven HRM practices that are expected to enhance organizational performance. The practices proposed by Pfeffer (1998) are; employee security, selective hiring of new personnel, self-managed teams of decision making as the basic principles of organizational design, comparatively high compensation contingent on organizational performance, extensive training, reduced status distinctions and barriers, including dress, language, office arrangements, and wage differences across levels and extensive sharing of financial and performance information throughout the organization. Wickramasinghe and Wickramasinghe (2020) examined the relationship between HRM practice

and lean production practices and lean duration on performance. However, the examination was limited to HRM practices that are relevant to lean production. Rathnaweera and Fernando (2019) examined the impact of HRM practices on machine operators' performance in the large scale apparel sector in the Kalutara District. A growing quantity of empirical evidence suggests that the HR practices proposed by Pfeffer (1998) have a significant effect on various settings. For instance, Ahmad and Schroedent (2003) and Vlachos (2008) attempted to generalize the findings of the impact of seven HRM practices, proposed by Pfeffer (1998), on operations management across countries and industries. The findings provide overall support for Pfeffer's HR practices. These prior studies in HRM practices and performance by using the Pfeffer model were mainly focusing on large scale firms Ahmad and Schroedent (2003) and Vlachos (2008). With exception to Subramaniam, Shamsudin and Ibrahim (2011), the above study was oversea based. But in the Sri Lankan SMEs, there are few studies (i.e., Rathnaweera, 2017; Gamage and Takayuki, 2013) relevant to the topic but there is no study examining the relationship between HRM practices on firm performance by using the Pfeffer model. Within the Sri Lankan manufacturing SMEs, it is very rare to come across studies that have been conducted on HRM practices on firm performance (Rathnaweera, 2017; Rathnaweera & Fernando, 2019). Thus this study aims to examine Pfeffer's seven HRM practices are effect firm performance in manufacturing SMEs, Sri Lanka. The findings of the present study would provide new insights for manufacturing SMEs in Sri Lanka.

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## **2. Literature review**

HRM practices – HRM practices have aimed at the acquisition, development, and motivation of employees as a key to attaining firm performance. Barney (1991) argued that human resource practices are the key to attaining sustainable competitive advantages and that HRM practices should, therefore, be treated as a central part of organizational strategy. Many theories in the extant literature support this notion that staff is to be treated as an integral resource of any organization; most importantly, the resource-based view (RBV) and knowledge-based view (KBV) theories have both presented this argument, and weighted human resources equal with other organizational resources in generating firm performance (Chang & Huang, 2005). Organizational managers have responded over recent decades by adopting a range of human resource practices to support their business performance, including in the areas of employee staffing, performance management, staff development, and compensation and benefits. Analysis of these highlighted HRM practices has provided many insights for the field of strategic management, and led to developments in the economics of organizations, firm competitiveness, and the working dynamics of employees.

Firm Performance- In general terms, performance is a prominent achievement in one specific field of activity. The idea of performance defines how a person or group concludes to accomplish a goal. Referring to Yucesoy and Barabási (2016), performance represents the totality of objectively measurable achievements in a certain domain of activity. The term “performance” is applied in several areas: economic, financial, technical, sporting, or social performance. A performance measurement system is one of the determinants which creates an enterprise's value and is often indicated as an important supporting tool for a SMEs' managerial development (Garengo et al., 2007). It is supposed to lead to an enterprise maintaining or improving its performance in the long-term perspective. Performance measurement systems are widely used by large companies, but they have not yet gained much recognition among small and medium enterprises (Chalmeta et al., 2012). It is pointed out that despite their limitations, small enterprises in the information era should link strategy with performance measurement and use a performance measurement system in decision-making processes (Chalmeta et al., 2012). Performance is multidimensional, and it is therefore advantageous to integrate different dimensions of performance (Wiklund & Shepherd, 2005).

### **2.1 Theoretical framework**

HRM Practice – Firm performance Relationship - For firms to sustain competitive advantage, the RBV of the organization postulates that better performance is the result of the mix of human resource practices (Barney, 1991; Sheehan, 2013). Razouk (2011) said that an organization can develop a sustainable competitive advantage only by creating value through

internal resource and RBV emphasizes the internal characteristics of the firm (Sheehan 2013), Barney (1991) noted that resource that is rare, valuable, inimitable, and non-substitutable can provide sources of sustainable competitive advantages. In contrast with other resources that are easier to imitate, the management of human resources is complex, ambiguous, and dynamic, and thus a potential source of significant competitive advantage (Barney & Wright, 1998; Backer & Huselid, 1998, Razouk, 2011, Sheehan, 2013). Several researchers (Cappelli & Singh, 1992; Wright et al., 2001) showed the relationship between the RBV and the HRM is widely and finally, its effect on the firm performance (Ahmad & Schroedent, 2003; Cardon & Stevens, 2004; Barring, Jones & Neubaum, 2005, Razouk, 2011; Boxall, 2013; Sheehan, 2013). Besides that human resources are regarded as a crucial input to the resource base of the firm (Barney & Wright, 1998; Backer & Huselid, 1998; Huselid, 1995) because better management of human resources contributes to sustained competitive advantage. But the management of human resources is different in SMEs and larger firms. But several researchers have called for more research on HRM in SMEs, especially given the role and pervasiveness of SMEs in the economy (Cassell et al., 2002).

There is little agreement as to which HRM best practices can be considered as strategic in an organization (Paauwe, 2004). Much of the prior research on the relationship between HRM practices and organizational performance has concentrated on a single HR practice (Wattanasupachoke, 2009; Tessema & Soeters, 2006) however, a growing number of researchers have argued for instituting complementary bundles of HRM practices to enhance organizational performance (Osterman, 1994; Sheehan, 2013). The first works on HRM in SMEs have claimed for a long time that these last invest less in human capital and that their HRM practices remain informal (Mayson & Barrett, 2006). One reason for this fact is the concentration on the financial aspects in SMEs. Marlow and Patton (1993) argue that the concentration on financial criteria for SME success has led to an imbalance in research towards financial investigation and away from human capital and reinforced the argument that HRM within SMEs may not be real. However, as SMEs control their fate and involve everyone in the business, they are the best image for the involvement-oriented approach (Lawler, 1992). A further issue complicating analyses of the HRM–performance relationship is the potential for the difference between rhetoric and reality regarding policy presence and implementation (Legge, 2005). Specifically, a human resource practice may formally be in place, but it may be delivered only sparingly, especially when delivery has been devolved to line managers and/or is not consistently applied to all employees (Legge, 2005; Bowen & Ostroff, 2004; Guest & Conway, 2011). In the small firm context, given the importance of informal practices, any survey about whether a formal practice is in place or not has the potential to underestimate, and possibly misrepresent, the extent to which human resources are managed in practice since the use and effectiveness of informal management will not be captured in a survey.

Pfeffer's seven HRM practices are internally consistent with one another. The seven practices are expected to foster such inimitable attributes in human resources and, thereby help an organization attain a competitive advantage. Several researchers (Delery & Doty, 1996; Huselid, 1995; Arthur, 1994; Osterman, 1994) including Pfeffer (1998) have argued why these practices are expected to enhance organizational performance. According to Vlachos

(2008), results provide overall support for all HR practices except for job security. Selective hiring was found to be a key practice that improved organizational performance. Compensation policy, information sharing, decentralization of decision making, and extensive training were significant predictors for all performance variables. Directions for further research are provided. However, Ahmad and Schroedent (2002) noted, empirical validation of the findings in operations across countries and/or industries is nearly non-existent and very limited at best. But, the impact of HRM practices on organizational performance as proposed by Pfeffer (1998) can be generalized across manufacturing plants operating in different industries and countries. Therefore, the present study set of a hypothesis as;

H<sub>1</sub>: HRM practices will be positively related to manufacturing SMEs performance in Sri Lanka.

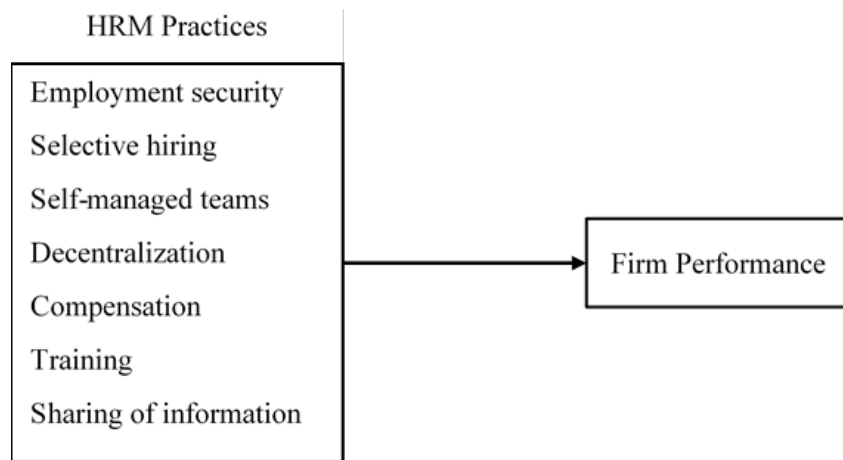


Figure 1 Conceptual framework

### 3. Methodology

#### 3.1 Sample and data collection

To achieve the research objective, a survey was carried out amongst SMEs in the Western Province of Sri Lanka only because more than 46 percent of manufacturing SMEs are located in this area. According to Chelliah, Sulaiman, and Yusoff (2010), SMEs are usually defined by the socioeconomic development of each country. For example, in the US, Carusgil, Knight, and Riesenberger (2008) defined SMEs as a company with 500 or fewer employees while in Taiwan SMEs it is 650 employees or less (Lin & Chen, 2007). However, Sri Lanka does not have a nationally accepted definition for small and medium enterprises. For example, the Department of Small Industries defines SMEs as those with a capital investment of less than Rs. 5 Million, and which employ less than 50 employees; Export Development Board defines SMEs as those with a capital investment of less than Rs. 20 Million in the plant, machinery, and equipment excluding land and buildings and an annual export turnover not exceeding Rs. 40 Million and a total annual turnover not exceeding Rs. 100 million ([www.srilankabusiness.com](http://www.srilankabusiness.com)); Department of Census and Statistics has defined an establishment with less than 10 persons engaged as considered as a small establishment and an establishment with 10 or more persons engaged was considered as a large establishment

(Census of Industry, 2010). Therefore, the researcher adopted the definition given by the World Bank in 1997 for this study. According to them, a small enterprise was defined to include 1-49 workers, and a medium enterprise with 50-99 (Ayyagari et al., 2003). At the initial stage, six hundred manufacturing SMEs were selected for the sample by applying a random sampling procedure. After cross-checking with particular firms researcher was identified that hundred and fifty-two SMEs have not come under the World Bank definition. Hence, these SMEs were dropped from the sample.

The questionnaire was prepared to be in line with the research objective and variables. Closed questions are used since the research outcome is mostly quantitative study than qualitative. Structural questionnaires were sent out to selected four hundred forty-eight firms namely to the human resource manager and in some instances the owner or proprietor of the organization. The questionnaire was pilot tested with randomly selected twenty SMEs first before final distribution and several changes were incorporated based on the feedback received. The participants were given three weeks to respond to the questionnaire and a follow-up call was made to remind them also. After the stipulated period given to them, only a hundred and thirty-five questionnaires were returned and used for analysis, making a response rate of thirty percent. According to Wijesinghe, Foreman, and Ten (2011), the usable response rate is mostly less than 30 percent in South Asian SME research. Hence, the response rate of the present study satisfied to carry out the analysis.

The items used to measure seven HRM practices (employment security, selective hiring, self-managed teams, decentralization, compensation, training, and sharing of information) were adapted from Pfeffer (1998) and Ahmad and Schroeder (2003) respectively. A set of Likert scales was used to measure pertinent constructs. Each item of a construct was answered using the following five-point scale: strongly agree (5), agree (4), neutral (3), disagree (2), and strongly disagree (1). Firm performance was measured using Vlachos's (2008) instrument, which tapped the categories of self – reported measures on organization-specific, market-specific, and overall organization. Past empirical research has mostly investigated the effects of HRM practices on financial performance (Delery & Doty, 1996) and some on efficiency and employee turnover (Huselid, 1995). However, very few studies have examined the impact of HRM practices on operational performance measures, such as quality, cost, or delivery (MacDuffie, 1995) or intangible performance measures, such as organizational commitment (Kalleberg & Moody, 1994). According to Backer and Gerhart;

*“The appropriate dependent variable will vary with the level of analysis, but in each case, the focus should be on variables that have inherent meaning for a particular context” (Backer & Gerhart, 1996).*

Because the unit of analysis for this study is a manufacturing SME, Hence, HRM practices will impact the operational performance measures at the organizational level. Therefore, this study investigates the impact of HRM practices on operational performance measures. The content validity of a construct was ensured through pre-testing of the questionnaires and structured interviews with the managers in the field. Each scale was evaluated for its reliability and uni-dimensionality. A value of Cronbach's alpha of 0.7 or more was used as a criterion for a reliable scale (Nunnally, 1978).

#### 4. Results

The data has been analyzed in Statistical Package for Social Sciences (SPSS). Correlation analysis technique is used to find out the relationship among the variables and their relative strength. The results are given in Table 1.

Table 1  
Mean and correlation of HRM practices and organization performance

HRM Practices	Mean	1	2	3	4	5	6	7	8
employment security	3.35	1							
selective hiring	4.32	0.31**	1						
self-managed teams	4.08	0.24*	0.38*	1					
decentralization	3.32	0.27*	0.33*	0.28*	1				
compensation	4.58	0.39*	0.42**	0.39*	0.32*	1			
training	4.19	0.40**	0.53*	0.47*	0.35**	0.37*	1		
sharing of information	3.40	0.29*	0.27*	0.32*	0.43*	0.42*	0.41*	1	
firm performance	4.21	0.38*	0.47*	0.36*	0.34*	0.56*	0.47*	0.39*	1

Significance at \* $P < 0.05$ ; \*\* $P < 0.01$

Table 1 presents the means and correlation values of the variables. High mean values indicated that most organizations agreed the HRM practices are important. The correlations show a low to moderate correlation between organization performances. It obtained for the values were employee security 0.38, selective hiring 0.47, self – management teams 0.36, decentralization 0.34, compensation 0.56, training 0.47, and sharing information 0.39.

Multiple regression analysis was applied to test the hypothesis which is set in this study. Multiple regression analysis is used to determine what proportion of the variance in the dependent variable is explained by the independent variables are entered into the regression analysis (Cramer, 2003).

Table 2  
Result of multiple regression analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	F	Sig
1	0.395	0.324	0.312	0.67413	12.623	0.000

a) Predictors: (Constant), employment security, selective hiring, self-managed teams, decentralization, compensation, training, sharing of information.

According to Table 2, a reliability test of the regression line was conducted, and  $R = 0.395$ . It indicates that the line is reliable. That means the multiple correlations ( $R$ ) is 0.395 an indication of low multiple correlations between the effectiveness of applicant attraction (dependent variable) and a set of independent variables. The coefficient of multiple determination ( $R^2$ ) indicated that  $R^2 = 0.324$ . This suggests that 32.4 percent of the variance in the dependent variable is jointly and significantly explained by the collective variance in all the independent variables considered in the study. Hence, HRM practices have a moderate positive impact on organization performance in manufacturing SMEs thus supporting hypothesis 1.



## **5. Discussion and conclusion**

Previously, a limited number of studies have found a positive relationship between a greater number of human resource practices and SME performance in both a cross-sectional context (Messersmith & Wales, 2013; Michie & Sheehan, 2008; Nguyen & Bryant, 2004; Verreyne et al., 2016) and longitudinally (Razouk, 2011). This study investigated the relationship of specific HRM practices which was introduced by Pfeffer (1998) and organization performance among the SMEs in the Western Province of Sri Lanka. It was discovered that HRM best practices enhance firm performance. The study found that employment security, selective hiring, self-managed teams, decentralization, compensation, training, sharing of information have a positive relationship with firm performance. The results found in this analysis are consistent with the previous studies, (Ahmad & Schroeder, 2003; Wright et al., 2005; Cho et al., 2006; Khan, 2010; Qureshi et al., 2010; Arumugam & Mojtahedzadeh, 2011; Boohene & Asuinura, 2011). Compare with other HRM practices compensation is highly influencing the firm performance. Further, it is also confirmed by Chew and Chan (2008), who said that compensation plays an important role in maintaining their employment and enhancing work commitment. The present study has shown that compensation practiced by manufacturing SMEs in Sri Lanka has an impact on firm performance. This finding is also consistent with Subramaniam, Shamsudin, and Ibrahim (2011). Nevertheless, the present study also found that training could influence significantly firm performance. Pfeffer (1998) noted training is an investment in the organization's staff and the current business environment. Successful firms that emphasize training do so almost as a matter of faith and because they believed in the connection between people and profits. The present study also confirmed it because the training of the manufacturing SMEs in Sri Lanka has a positive impact on firm performance. This finding is also consistent with Ahmad and Schroeder (2003). Besides, organizations serious about obtaining profit through people, for that organization needed a large pool of applicants, able to identify critical skills and attributes needed in its applicants and job requirements (Pfeffer, 1998) subsequently it leads to enhance the performance. The present study has shown that selective hiring also impacts firm performance. The present study also revealed that sharing information, employment security, self – management teams, and decentralization have weak moderated but positive relationship with firm performance. In conclusion, the present study has provided additional insight into the effects of HRM practices which was introduced by Pfeffer especially amongst the manufacturing SMEs in Sri Lanka.

According to the findings of the present study have managed to provide empirically Pfeffer model still valid to test the relationship between HRM practices and firm performance not in the large scale organizations but also SMEs.

## **6. Directions for future research**

The findings of this study revealed that Pfeffer's HRM practices predict the operational performance of manufacturing SMEs. This study adds to the body of knowledge in the field of HRM practices, however, there are still some limitations. Particularly, only seven HRM practices were taken for investigation in the present study and thus the other HRM practices

such performance evaluation, grievance management, discipline management, employee movement, etc. could be considered by future researchers. Also, this study was conducted in the manufacturing SMEs which are grouped under the Colombo District. The study could be extended to other regions and other sector organizations including larger samples to find the HRM practices that predict operational performance and the factors mediating and/or moderating the effect of HRM practice on operational performance.

As there are no adequate studies in the manufacturing SME sector in Sri Lanka, more research should follow with different samples from various sectors, types of businesses, and in different regions. Comparative studies also may be conducted to find out differences based on sectors, types of businesses, locations, etc.

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