



University of Twente

**HRM SOPHISTICATION AND SME PERFORMANCE:  
A CASE OF READYMADE GARMENT MANUFACTURERS AND  
EXPORTERS IN LAHORE, PAKISTAN.**

PROJECT FOR A DOCTORAL THESIS

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# **1. INTRODUCTION: SUMMARY OF THE RESEARCH PROJECT**

## **1.1. Title of the Research Project**

**HRM SOPHISTICATION AND SME PERFORMANCE:  
A CASE OF READYMADE GARMENT MANUFACTURER AND EXPORTERS IN  
LAHORE, PAKISTAN.**

## **1.2. Abstract**

The focus of this study<sup>1</sup> is to investigate HRM sophistication (application of formal HRM policies and practices) in successful SMEs and comparing it with poor performing and/or unsuccessful SMEs. Our assumption is that more formal HRM policies and practices lead to better firm performance (Nguyen and Bryant, 2004). The aim is to investigate the current state of HRM policies and practices employed in SMEs in Pakistan, in order to identify the HRM systems adopted by successful SMEs. We will also study the relevant factors (contextual, institutional and cultural) that may influence HRM sophistication in this specific context of Pakistan. A survey will be conducted with the help of preliminary interviews with 5-10 % of the sample SMEs at the start. The survey will explore the HRM sophistication (HRM system, policies and practices) and firm performance with a focus on identifying possible dissimilarities of HRM policies and practices between successful and unsuccessful SMEs. Finally, results of this study will provide information about 'HRM sophistication' that have a positive association with firm performance for recommendation and benefit to unsuccessful SMEs.

## **1.3. Motivation for the Research and Research Objectives**

Small and Medium enterprises (SMEs) are considered as an important component of the economy in some developing countries like Pakistan. The SME sector is a less formally organized sector in the country and the economic environment also creates structural problems which hinder enterprise competitiveness. SMEs are considered as backbone of Pakistani economy as according to SMEDA it is fair to say that our economy is an economy of SMEs. Small firm management comes across several challenges which badly impact firm productivity and performance. Since last decade, the government of Pakistan is continuously engaged in formulating and implementing policies to assist SME sector so that it can play its role in the economic development of this country. The current government has tried to boost this sector's performance by establishing various institutions facilitating small business operations. It is clear that the government alone cannot succeed in its efforts to make this sector healthy and successful. Institutions and other concerned bodies for small businesses emphasize the role of public private partnership to initiate various tasks including research and development (which is rare in this sector) to help entrepreneurs and owner-managers in better business operations management.

The majority of the SMEs struggle to increase productivity, organizational effectiveness, sustained competitive advantage and satisfactory rate of return on investment. It is not an easy task to achieve such kind of objectives in an economy where traditional and informal practices of business management are still applied. It is evident from research that employees are key resource for gaining competitive advantage, but it is also a

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<sup>1</sup> Study and Research, are used interchangeably in this report for same meaning.

challenging task to manage it. Human resource management is a recent phenomenon in SME management in Pakistan and many questions about good HRM structure remain unanswered. SME owner-managers might be using different practices to manage their people but there is not even a single specific study conducted to investigate SMEs in Pakistan. Research on HRM sophistication and/or formalization, and firm performance in small businesses (e.g. Nguyen and Bryant, 2004), has addressed questions like which HRM practices, why these and what impact these can have on the HRM system and firm performance. They have found a positive association between firm size, HR formality and better firm performance (Nguyen and Bryant, 2004). Research reveals that when firm size increases informality becomes apparent as informal styles of management communication stretch. In such a situation, entrepreneurs make some efforts to gain required sophistication in management practices to recruit, motivate and retain best talent, to achieve organizational objectives optimistically. As mentioned above, HRM sophistication has an impact on firm performance and as firm size increases there is requirement of more formal practices. For gaining better firm performance owner-managers of poor performing firms may attempt to achieve that certain level of HRM sophistication which in turn leads them to the successful category of SMEs.

This proposed study will investigate HRM system (policy, structure and practices) in SMEs. Investigation and evaluation of HRM sophistication and its association with SME performance, is an interesting and challenging job especially when investigating this for SMEs of an under-researched developing country. Recommendation of this study will be very important for poor performing and/or unsuccessful SMEs. This study will add to the scientific knowledge on HRM and SME performance by providing empirical finding for HRM Sophistication and its association with firm performance. This issue is highly recommended in a number of latest studies as critical for future investigation especially in SMEs (e.g. Huselid and Becker, 2000; Zheng et al., 2006). Moreover, it will also contribute to existing knowledge on HRM and SME performance in a different political, institutional and cultural context as this study will be conducted in the sector of Readymade Garments Manufacturers and Exporters in Lahore, Pakistan. Pakistan's economy is one of the top growing in South – Asia in last five years or so and Textile (including garments) is considered to be the major industry in the country<sup>1</sup>. Lahore is considered to be one of the hubs of SMEs in Pakistan. Thus findings of this study will help both policy makers and owner-managers in deciding valuable managerial practices for managing their employees to achieve what is optimistically desired.

#### **1.4. Problem Statement**

Research on HRM practices in small and medium-sized businesses has captured increased attention in recent years (De Kok and Uhlaner, 2001; Koch and De Kok, 1999; and Torben Andersen, 2003). However, shortcomings in definition and measurement in current and past research suggest the need for further validation of HRM practices in small firms, and a more careful definition of what is meant by HRM 'sophistication' and/or 'formalization' (De Kok and Uhlaner, 2001). A number of researchers has also identified that HRM practices in SMEs have not received significant attention in management research; they further stress the need for future studies on these issues. This study will explore SME management issues and challenges i.e. state of human resource management practices in SME management in the country. The Study will focus on exploring the HRM sophistication especially any association with SME

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<sup>1</sup> Economic Survey of Pakistan 2006-07, Ministry of Finance, Government of Pakistan;  
<http://www.finance.gov.pk/survey/home.htm>

performance. This research can at the most provide some evidence that pursuing the suggested general sophistication in the HRM system may influence certain outcomes including organizational performance (Ehrnrooth, 2002). In the next section, the main research question is inscribed.

### **Main Research Questions**

This study is going to answer this main research question using below mentioned sub-questions and proposed conceptual model (see figure 5.1):

“What type of HRM policies and practices lead to better firm performance in Pakistani SMEs?”

Sub-questions:

- § What HRM policies and practices (leading to HRM sophistication) do Pakistani SMEs formally employ?
- § What are the various different stakeholders, situational and contingent variables that affect HRM sophistication in these SMEs?
- § All else being equal, do successful SMEs employ the same or other HRM practices than unsuccessful SMEs in Pakistan?

### **1.5. Organization of the Thesis**

The rest of the paper is structured as follows. Chapter 2 presents information related to research background; for example, Pakistan's economy, Textile & Apparel industry and SME with some used definitions. In chapter 3, theoretical framework is presented by explaining selected theories for this research and in the next half of this chapter organizational environment is explained keeping in mind these selected theories. Chapter 4 consists of relevant information related to the first variable of HRM sophistication. This chapter includes detailed information on HRM policies and practices with a short discussion on HRM system approach using relevant literature. In the end organizational context is explained including some contextual and control variables. Chapter 5 covers the discussion about organization performance which is the second variable in this study. This chapter starts with a general discussion on HRM and performance and includes an analysis of six well-known theoretical models of HRM, followed by a discussion on empirical studies on HRM and performance and then HRM and SME performance. Last section of the chapter includes some information related to performance measurement. Chapter 6 discusses about research methodology. It includes a detailed discussion on research process including, research philosophy, approach, strategy, time horizons and Data collection methods with some choice decision for selection of certain methods for conducting this study. Chapter 7 concludes the thesis by giving final words and future recommendation for similar studies. In the second part, some general information are given like scientific and social relevance of this study. Chapter 8 is used to give reference list for this thesis. Last and final chapter 9 is used for appendix which provides relevant information concerning this study.

## 2. Research Background

### 2.1. Introduction

This section of the thesis contains general information related to the research background. Particular information related to the research location (e.g. Pakistan) its economy, SMEs, Textile industry and Apparel sector and their vital role in the economy, are given below. This chapter will increase reader's interest about the topic and give valuable information which are equally important for our study to know.

### 2.2. Pakistan as Research Location

Located in South Asia, Pakistan shares an eastern border with India and a north-eastern border with China. Iran makes up the country's south-west border, and Afghanistan runs along its western and northern edge. The Arabian Sea is Pakistan's southern boundary with 1,064 km of coastline. The country has a total area of 796,095 sq km and is nearly nineteen times the size of the Netherlands. From Gwadar Bay in its south-eastern corner, the country extends more than 1,800 km to the Khunjab Pass on China's border<sup>1</sup>. Pakistan is considered as key country in South-Asian region in current global political scenario. It is also ranked as number six country in the world according to population<sup>2</sup>. Unfortunately it remains politically unstable right from the independence in 1947, with continuous military takeovers. Western influence can also be seen in the



Figure: 2.1 Map of Pakistan<sup>3</sup>

political setup of the country which is considered as bad for the stability and economical uplift in the country. However, current military regime has shown an apparent growth and prosperity but some stakeholders consider it as temporary due to the heavy aid by US in the war against terror.

<sup>1</sup> <http://www.pak.gov.pk/profile.aspx>

<sup>2</sup> <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2119rank.html>

<sup>3</sup> <http://www.google.com/search?hl=en&q=Map+of+Pakistan>

According to some recent statistical figures, Pakistan's economy continues to maintain its strong growth momentum for the fifth year in a row in the fiscal year 2006-07. With economic growth at 7.0 percent in the current fiscal year, Pakistan's economy has grown at an average rate of almost 7.0 percent per annum during the last five years. This brisk pace of expansion on sustained basis has enabled Pakistan to position itself as one of the fastest growing economies of the Asian region (its better to say in the south-Asian region). The growth that the economy has sustained for the last five years is underpinned by dynamism in industry, agriculture and services, and the emergence of a new investment cycle supported by strong growth in domestic demand. Real gross domestic product (GDP) grew strongly at 7.0 percent in 2006-07 as against the revised estimates of 6.6 percent for last year and 7.0 percent growth target for the next year. Given the significance of the SME sector, recent years have witnessed increasing government/ private sector focus. Studies have been undertaken to identify the constraints SMEs face, an SME policy has been announced, commercial banks are now enhancing their lending to SMEs, some universities are offering programs in Entrepreneurship and SME Management<sup>1</sup>.

It is evident that Pakistan requires considerable attention of scientific research to help SMEs' management produce better results in its specific cultural context, where 'best practices' transferred from western economies are considered difficult to produce that result as in first setting. The cross-cultural applicability of North American and Western HRM practices is highly questionable (Wasti, 1998) these may not be directly adjustable in non-western economies like Pakistan. In such a situation a study like this can be of high value to an economy which is striving hard to increase its momentum with serious efforts from various stakeholders, especially the government. This study may be having a limited scope but can be a turnaround and real value addition to emerging scientific research effort in this subject and in this specific vicinity.

### **2.3. Pakistan's Economy and SMEs**

Despite its unique cultural set-up, a large and capable workforce educated and well versed in English, liberal privatization and investment policies, and strategic geographical importance (the gateway to the Central Asian Republics, bordering China and Russia in the North and adjoining India on its eastern borders), Pakistan has been largely ignored in management research. However, findings of rare research on HRM suggest that HRM holds a promise for employees in Pakistan and is the way forward. Employees recognize the significant role of HRM and aspire towards it (Khilji 2000).

Pakistan is an economy comprising mainly of SMEs. Small and Medium Enterprises Development Authority (SMEDA) is the only official managerial authority for small business management in Pakistan (see section 3.5.2. for details). SMEDA has formulated an SME policy for further implementation to boost up this sector in the country. It is important to note that Government of Pakistan approved this SME policy for the first time in January 2007<sup>2</sup>. This government has recognized the importance of

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<sup>1</sup> Economic Survey of Pakistan 2006-07, Ministry of Finance, Government of Pakistan.

<http://www.finance.gov.pk/survey/home.htm>

<sup>2</sup> APP (2007) Jan, 22. at

[http://www.app.com.pk/en/index.php?option=com\\_content&task=view&id=2534&Itemid=2](http://www.app.com.pk/en/index.php?option=com_content&task=view&id=2534&Itemid=2) accessed on 19 April 2007



this sector in the national economy by approving policy to implement several measures for the development of this sector. SME policy also address various issues relating to human resource development and its impact, these include inadequate and generic education and insufficient, poorly focused and under-serving training infrastructure.

Furthermore SMEs mostly draw their employees (including the owners) from either the higher education institutions or the technical training infrastructure, both of which are not attuned to the SME needs nor equipped to address them. This situation limits the capacity and capability of SMEs to innovate, add value, upgrade technology and devise new marketing strategies. According to the recent Economic Census of Pakistan (2005) for Establishments conducted by the Federal Bureau of Statistics (FBS) there are about 3.2 million economic establishments in Pakistan. Out of these small and medium size enterprises (with employment base up to 99) constitute about 90% of all private enterprises employing approximately 78% of non-agriculture labor force. SMEs contributed over 30% to GDP, 25% in export earnings besides sharing 28% in manufacturing value addition<sup>1</sup>.

## **2.4. HRM and Pakistani SMEs**

Pakistan is facing a big challenge to manage its human resource in many aspects, especially for small business management which constitutes up to 78% of all private enterprise employment as mentioned above. Small business constitutes major part in any economy which can play key role in developing country's economy but how and what are the ways which can lead to that development is still unidentified and lack of interest to disclose is continued at both government and private level in this country. There are some efforts now going on to start some programs with private public partnership as Lahore University of Management Science (LUMS) has opened up an entrepreneurship and SME center in private sector. Efforts like establishment of SMEDA as mentioned above and SME Bank on the government side are worth but quite a lot work is ahead to do, specifically on education and scientific research to really boost this sector up, for value addition that is truly necessary for the development turn.

It is very hard for these institutions and supporting bodies for SMEs to directly add quality to management practices, with its efforts by eliminating impediments to successful working of these small units. Unfortunately, there is evident lack of scientific empirical studies in this sector due to several reasons for instance, lack of sound collaboration between educational institutions and SMEs for conducting research through any kind of mutual cooperation, true scientific research institutions for business with exceptions of LUMS and Institute of Business Administration Karachi (IBA). Currently few initial studies in this sector explain various concerns, including human resource development and management. It is quite difficult to manage low qualified employees, with old traditional management practices.

One study in this sector in Pakistan shows that SMEs lack formal training and performance appraisal practices to manage its key resource (Arif et al., 2005). Findings of the same study also depict positive relationship (correlation) between HRM formalization and firm performance in Pakistani SMEs. These results make sense that entrepreneurs do realize the positive impact of formal HR; however it's hard for them, to

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<sup>1</sup> Economic Survey of Pakistan 2005-06, Ministry of Finance, Government of Pakistan.  
<http://www.finance.gov.pk/survey/home.htm>

decide what kind of formal HRM policies and/or practices. Additionally, there is no framework available to choose in a specific contextual, institutional and cultural setting. These management concerns require adequate empirical studies to explore and recommend framework and findings which might help this sector. Institutions and concerned bodies for SMEs lack real theory for drafting and enforcing business friendly policy as they focus on general debates and observation of management policies and practices of some developed nations for drafting SME policies. This simply won't work without clear understanding of in-depth system of local SMEs in Pakistan because local SMEs have different institutional and cultural setup. Current research is limited and show severe concerns for long term success of this sector in the country.

Beside other studies Heneman et al. (2000) have identified some articles from various sources, in which 129 out of 403 explicitly address HR management issues and they concluded that HRM studies in SMEs are rich in prescription rather than sound descriptive studies and without analytical analyses. I am afraid to see, that not even a single article is related to or from Pakistan on this issue, even in all 403 selected articles by the author. Similar depiction can also be seen in the paper (Cardon and Stevens, 2004) 'managing human resource in small organizations' for review of research on managing people, which includes no article or research work related to Pakistani SMEs in all selected 83 articles for the study. In such a situation an exploratory study on HRM in Pakistan is conducted back in 2000 by Khilji<sup>1</sup>; a PhD student from University of Cambridge. She is continuously engaged in HRM studies in Pakistan, from starting study in her PhD and these are mainly in the single banking industry (large companies) of Pakistan with research focus on cultural impact on HRM. She has added valuable findings to scientific knowledge on HRM and culture in Pakistan.

Pakistani SMEs having dynamic and varied characteristics, possessing some sort of HRM picture is still a question mark. HRM sophistication and/or formalization within SMEs research in Pakistan is highly demanded for valuable findings for scientific researchers and policy makers in this area. The proposed study can add something important and valuable to the empirical work on this specific context. At the same time, cross cultural applicability of different management practices is also questionable. Current studies emphasize on difficulties in cross culture applicability of management practices. Noorderhaven and Tidjani (2001: 32) argue as 'it is becoming more and more obvious to scholars as well as practitioners that governance systems and theories from one culture are not transferable to another culture without modifications and adjustments according to the values prevalent in the receiving culture.' In this situation researchers can not advocate 'best practice' as suitable for gaining competitive advantage.

It is necessary to investigate inside into management practices, what systems this specific SME sector has and most importantly the question 'why'. It is possible that these might possess wide variety of HRM policies and practices due to non availability of uniform system, lack of information and resources. On the other hand, there might be some factors which hinder SME owners to use 'best practice' in its real form due to political, economic, institutional and/or cultural differences and limit for a certain HRM system. The purpose of this study is to investigate this situation within SMEs in Pakistan to further recommend the framework and/or practices which can positively impact firm performance, in this unique setting.

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<sup>1</sup> <http://gsehd.gwu.edu/?kat=Search+faculty&c=20&pid=006f52e9102a8d3be2fe5614f42ba989>

Findings of HRM formalization research within SMEs in Pakistan will help to improve management control, for policy and strategy concerns shown by SMEDA, beside contemporary initial efforts started in this sector in Pakistan. SMEDA has also warned the availability of scientific and empirical findings in SMEs for various utilization purposes to address policy issues in a right manner. Research work clearly depicts lack of interest or scarcity of work by scientist and with the newness theme of HRM within SMEs in Pakistan. Several studies conducted in various other developing countries on such issues, address and recommend managerial control issues for efficient and effective management of key resource leading to the development of this high growth SME sector for any transitional economy.

Recent studies of Nguyen and Bryant (2004); De kok and Uhlaner (2001); and De Kok et al., (2003) on HRM formalization (some also call it sophistication) in SMEs are worth to mention here as first study is somewhat exactly conducted in almost same setting, as we are intended to conduct in Pakistan but this is on particular country Vietnam (which is also a developing country) and on the other side second study has taken a deep look into the theory with the help of some case studies in Dutch SMEs. Nguyen and Bryant, (2004) studied formalization of HRM practices in 89 private Vietnamese SMEs. They focus on three points for investigation in this study; formal HR policy and practices, factors influencing that formality and how these influence firm performance. We can not say that they have measured and defined HRM formalization in an ideal way as they only count written HR practices used by SMEs.

Moreover, research depict that small firms are often difficult to access by researchers and usually reluctant to reveal financial information. It won't be easy to convince SME owner-mangers for this study in Pakistani context where empirical studies are rare. It is also expected that they might not have some systematic ways of registering data, even for their own purpose. Summing up, it is unlikely to expect radical change from a single study in a situation like this. However this endeavor would be a milestone initiative to stimulate and start an ongoing epoch of scientific research complimented with further studies by similar and other authors on identified future research.

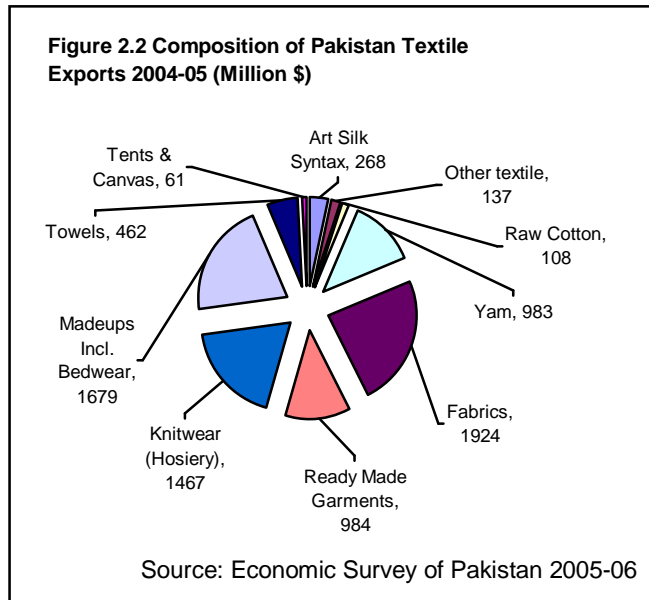
## **2.5. Textile Industry and its vital role in Pakistan's Economy**

Pakistan's textile industry ranks amongst the top in the world. Pakistan is world's fourth largest producer of cotton and the third largest consumer of the same. Cotton based textiles contribute over 60% to the total exports, accounts for 46% of the total manufacturing and provide employment to 38% manufacturing labor force. The availability of cheap labor and basic raw cotton as raw material for textile industry has played the principal role in the growth of the Cotton Textile Industry in Pakistan.

With the broad focus on framework of a knowledge, technology and value-addition improvements, the Ministry of Textile (MINTEX) is striving hard to achieve the objectives of availability of high quality cotton, developing the entire textile value chain at par with international best practices, expanding the textile sector to produce value-added garments along with new innovative products, developing a state of the art infrastructure, augmenting investment in human resource management and enlarging country's textile and clothing exports. The Industry's market competitiveness is dependent to a considerable degree on the operating environment in Pakistan as shaped by factor costs, gas, human resource development (academic/vocational); marketing support;

taxation and investment policies and infrastructure development. At the moment, a relatively small number of companies match international levels for quality however most companies are aiming to improve their competitiveness via cost and quality control in the changing market environment of today<sup>1</sup>.

Several type of textile items (both industrial and consumer) are produced in Pakistan like, cotton ginning, cotton yarn, cotton fabric, fabric processing grey dyed-printed, and consumer items these includes, home textiles, towels, hosiery & knitwear and readymade garments. These components are being produced both in the large scale organized sector as well as in organized cottage/small and medium units (Economic Survey, 2006-07).



## Reforms in the Textile Sector

The Ministry of textile Industries (MINTEX) is currently in the process of implementing and finalizing various initiatives in the following areas: contamination-free cotton to cater to the demand of quality raw material for the finished products; technological up-gradation at the ginning, weaving, processing and garment production level; product diversification and value-addition through better materials, accessories and design inputs; up gradation of the weaving sector with air jet and water jet looms along with zero rated duties; encouragement of integrated as well as horizontal garment industries on the basis of R&D and technological support for the garments sector; introduction of cotton hedge trading to promote marketing of cotton; testing facilities for increasing compliance and conformity assessment; and augmenting the institutional capacity in the field of research by setting up R&D cell within the Ministry (Economic Survey, 2006-07).

## 2.6. Apparel Industry in Pakistan

Pakistan with total exports of around US\$ 1 billion has a meager share of 1% in the global apparel market. The apparel export product mix from Pakistan is heavily tilted towards men's wear and knitted garments. The Garment Industry provides highest value addition in Textile Sector. This industry is distributed in small, medium and large scale units most of them having 50 machines and below, large units are now coming up in the organized sector of the industry. We have selected readymade garments sector as our sample for this research as this sector is mainly comprised of SMEs. The industry enjoys the facilities of duty free import of machinery and income tax exemption. According to

<sup>1</sup> Economic Survey of Pakistan 2006-07, Ministry of Finance, Government of Pakistan.  
<http://www.finance.gov.pk/survey/home.htm>

some official projections, this sector has tremendous export potential for the future (Economic Survey, 2006-07).

The Government also announced the setting up of three garment cities at Karachi, Lahore and Faisalabad under the Trade Policy 2003-04. The purpose of these projects is to provide facilities and necessary infrastructure to the textile sector with a view to promoting value added garments (woven and knitted), home textiles, made ups and accessories to the international markets. The board of Export Development Fund (EDF) has approved a sum of Rs.1.425<sup>1</sup> billion for the three garment cities. This project is expected to attract foreign investors who would be willing to rent state-of-the art manufacturing factory space rather than commit their capital in land, utilities and construction. It will also increase the proportion of value added products in textile exports, generate employment and lead to higher per capita productivity and reduced wastage because of in house training and laboratory testing facilities provided by the project. The Textile Garments Skill Development Board; was set up in October, 2005 and is primarily charged with carrying out skill development of workers for the garments industry within the garment units including the objectives of production of contamination-free cotton, project financing for small and medium entrepreneurs in high value added textile sectors, review of domestic and international prices of cotton to ensure a fair return to growers, maintaining stability in domestic prices and establishing liaison with all stakeholders from cotton growers to textile exporters for removing any bottlenecks in implementation of the recommendations (Economic Survey, 2006-07).

## **2.7. SME Definition**

The definition is an important tool for implementing efficient measures and programmes to support the development and success of SMEs<sup>2</sup>. Small and medium enterprises can be defined as those entrepreneurial units in business operations which operate and serve at a limited scale in limited vicinity, with limited means for operations, usually owned and controlled by single individual as owner-manager and some time owned as family business. Moving towards the formal definition of an SME, it is difficult to put SME definition right away, as due to the nature and structure of SMEs several definitions are available for use. For this study, we will use a sample from the SMEs of manufacturing and exporting sector in Pakistan. For this reason, we need a comprehensive definition of SME from this country's point of view which is operational and currently implemented there, and also appropriate for this research. First, we will look how developed and industrialized nations in the West define SMEs and then operational definition from Pakistan's point of view will be inscribed.

### **2.7.1. SME Operational Definition in West**

#### **United States (U.S.)**

The definition of small business is set by a government department called the Small Business Administration (SBA) in U.S. According to the Small Business Act, a small business concern is "one that is independently owned and operated and which is not

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<sup>1</sup> Rs., is the abbreviation of Pakistan's currency Rupees, according to current convergent rate 1 US = 60.4000 Rs. as on 10-08-2007 (<http://www.xe.com/ucc/convert.cgi>).

<sup>2</sup> The new SME definition, User guide and model declaration, European Commission Recommendation 2003/361/EC, published in the Official Journal of the European.

dominant in its field of operation." The most widely used one in the entrepreneurship literature is the definition provided by the SBA. The SBA defines SMEs as stand-alone enterprises with fewer than 500 employees (Beamish, 1999).

### **United Kingdom (U.K.)**

Sections 247 and 249 of the Companies Act 1985 define an SME for the purpose of accounting requirements in the U.K. According to this an SME is one that has a turnover of not more than £5.6 million, a balance sheet total of not more than £2.8 million and not more than 50 employees. A medium-sized company has a turnover of not more than £22.8 million, a balance sheet total of not more than £11.4 million and not more than 250 employees<sup>1</sup>. According to the research, it is worth noting that even within the UK this definition is not universally applied.

### **European Union (EU)**

EU has define SMEs in three distinct categories; medium-size, small and micro<sup>2</sup>.

"The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro".

"Small enterprises are defined as enterprises which employ fewer than 50 persons and whose annual turnover or annual balance sheet total does not exceed 10 million euro".

"Micro enterprises are defined as enterprises which employ fewer than 10 persons and whose annual turnover or annual balance sheet total does not exceed 2 million euro".

### **2.7.2. Pakistan**

Pakistan does not have a single definition of SMEs as depicted in some western definitions above. Various Government agencies, e.g. State Bank of Pakistan (SBP), Federal Bureau of Statistics (FBS), and Provincial Labour Departments etc. use their own definitions. Absence of a single SME definition makes it difficult to identify target firms, align development programs, collect data and monitor progress<sup>3</sup>. It is extremely important to have single uniform SME definition which supports institutions to implement assistance programs for all enterprises in lieu of resource constraints. Such a clarification is not to be found in Pakistan. SMEDA defines SME according to the dual criterion of productive assets and number of employees. It is good to know some issues relating to SME definition in Pakistan before we present SME definition and also any efforts if taken to solve these so far.

Despite the fact that it is understood that being an SME refers to a state of disadvantage as a business entity within Pakistan's economy, as a direct result of its relative size and

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<sup>1</sup> <http://www.opsi.gov.uk/si/si2004/20040016.htm>

<sup>2</sup> The new SME definition, User guide and model declaration, European Commission Recommendation 2003/361/EC, published in the Official Journal of the European.

<sup>3</sup> SME Policy 2007. First comprehensive policy drafted by SMEDA and approved by government of Pakistan in January 2007 for implementation.

the ensuing characteristics. The issue of SME definition therefore requires careful consideration, taking into account the position of SMEs in the national economy, the level of economic development, industrial structure, level of technology, the character of labour market and more importantly, the value which society attributes to the concept of public policy (Mustafa and Khan, 2005). For these reasons first SME Policy has recommended a single definition to be used for all the objectives with a comprehensive criteria see table 2.1.

Table 2.1 SME definition proposed in SME policy

Size	Sector	Employment (a)	Total Assets (Excluding Land & Building) (Rs. Millions) (b)	Annual Sales (Rs. Million) (c)
Small	Manufacturing	≤ 50	Up to 30.0	≤ 100.0
	Service	≤ 50	Up to 20.0	≤ 100.0
	Trade	≤ 20	Up to 20.0	≤ 100.0
Medium	Manufacturing	51-250	30.0 to 100.0	100.0 to 300.0
	Service	51-250	20.0 to 50.0	100.0 to 300.0
	Trade	21-50	20.0 to 50.0	100.0 to 300.0

Source: SME Policy (2007)

Implementation of single definition recommended in SME policy (2007) can benefit SMEs in various ways like formal and legal procedures. Discussion on various SME definitions leads us to the main SME definition which is considered of SMEDA. SMEDA defines SME as:

*“Small enterprise is defined as an enterprise which employs 10 - 35 employees and has productive assets of Rs. 2 - 20 million.”*

*“Medium enterprise is defined as an enterprise which employs 36 - 99 employees and has productive assets of Rs. 20 - 40 million.”*

For this study, we will use single most authenticated definition of SME in Pakistan which is considered of SMEDA as it is practically applicable to all the SMEs and widely used for business operations. SMEDA is also the first official authority of government of Pakistan, for administration of SME issues and it is wise to use this official definition mostly adopted for similar uses. In addition, research suggests that informality becomes apparent in firms with 20 or more employees (Roberts et al., 1992) and it is assumed that at this stage firms try to use some kind of formal practice especially for managing their employees. So, our sample will include, all the firms in Readymade Garments Manufacturers and Exporters Sector (RGMES) having more than 20 employees using SMEDA's definition in this study from the city of Lahore Pakistan (location details are given in section 2.2). This means that this sample includes firm between 20 and 100.

### **3. Theoretical Framework/Literature Review**

#### **3.1. Introduction**

The purpose of this section is to provide theoretical discussion about organizational theories used in this study. These theories are explained in subsequent sections and their deployment for HRM studies and importance is drawn here. Organizational environment is explained to show any direct influence these theories may have for the development of HRM system. In the end combine perspective of these theories is summarized.

#### **3.2. The resource-based view and HRM policies and practices**

If all companies had the same resources, they would develop and create the same products and services, thus can not create competitive advantage (Peteraf 1993). Sustained competitive advantage of firm depends on the resources and their durability. Resources can be complex to build, or to obtain, what determines their differentiation power. During 1980s, the dissatisfaction with the emphasis on industry structure and competitive positioning leads to increased interest in the role of firm resources for strategy formulation and the appearance of a number of contributions under the name resource-based view of the firm (Grant, 1991). It was Wernerfelt, who used resource-based view of the firm (RBV) for the first time in 1984. Wernerfelt (1984) has defined firm's resources "as tangible and intangible assets which are tied semipermanently to the firm such as brand names, in-house knowledge of technology, employment of skilled personnel, trade contacts, machinery, efficient procedures, capital, etc". He also focuses on the performance element as he argues that one can identify specific type of resources leading to high profits.

Peteraf (1993) explains the four conditions for sustained competitive advantage: heterogeneity, imperfect mobility, ex-ante and ex-post limits to competition and believes that these conditions could make any resource as key resource of the firm. Furthermore, the RBV proposes that internal organizational resources that are valuable, rare, inimitable, and without a strategically equivalent substitute are a source of sustainable competitive advantage (Barney, 1991). This approach suggests that some specific concerted efforts might aid in developing these durable characteristics in firm resource, for gaining sustained competitive advantage for real success. Many researchers in this field have recognized the importance of human resources for sustained competitive advantage (Barney, 1991; and Prahalad and Hamel, 1990; Wernerfelt 1984) and consider human resource as the key resource any firm has. Authors also attempt to identify the contextual resources that can build up human resource competencies (De Kok and Uhlaner, 2001).

During the last decade, there has been considerable interest in the notions that employees are an important source of competitive advantage for firms (Barney, 1991; Pfeffer 1994) and, as a result, that it is important for firm to adopt HRM practices that makes the best use of its employees (Bjorkman et al., 2006). Boxall and Purcell (2003) put some light that when we take a resource-based perspective on the strategic problem, questions of human resource strategy are going to loom large. How to attract, deploy, motivate and develop people is going to be central. So is the question of how to manage workplace culture. They regard this as entirely appropriate as they aim to build



on the RBV while staying alert to its conceptual weaknesses (Boxall and Purcell, 2003 p. 88).

### **3.3. Institutional theory and HRM policies and practices**

Institutional theory is a theoretical lens which has been widely used to study the adoption and diffusion of organizational forms and practices (Bjorkman et al., 2006). Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction. These constraints are two types, formal constraints - such as rules that human beings devise and informal constraints - such as conventions and codes of behavior. The major role of institutions in a society is to reduce uncertainty by establishing a stable (but not necessarily efficient) structure to human interaction (North D., 1990). Cross-national dissimilarities in institutional structures are likely to create management practices that vary from country to country, regardless of the fact that management theories are often rapidly disseminated across national borders (Gooderham et al., 1999).

Organizations have to understand and interpret social legitimacy in management practices where they are operating. In simple words, the typical firm is concerned with its standing as an employer in society, or with its 'employment citizenship' (Boxall, 1999). As Boxall and Purcell (2003), depict that firms operate in societies, making use of human capacities that citizens and the state have nurtured and generated (for example, through public education). In this light, governments often exercise their right to regulate employment practices. Workers may also exercise sanctions against firms that offend social norms (either as individuals who decide not to work for certain kinds of firms or to work for them only with very limited commitment, or as unions which campaign against certain kinds of employment practices), (Boxall and Purcell, 2003, P. 11). Summing up, legitimacy should be seen as an employer goal alongside the more market-oriented ones (Lees, 1997) and three 'bottom lines' are useful for planning in HR strategy: one for productivity, another for flexibility and yet another for legitimacy (Boxall and Purcell, 2003, P: 246).

According to institutional theory, survival opportunities of an organization are improved significantly by conformity demonstrations to rules, norms and social aspects of the institutional environment (Meyer and Rowan, 1977; Chauvet, V. 2002). Moreover, institutional theory indicates that an organization that develops relations with institutions and follow institutional prescriptions, can survive easily, have a greater stability, allowing a better access to resources (Meyer and Rowan, 1977; Oliver, 1990; Chauvet, V. 2002). North (1990), the Nobel laureate, depicts as, there is a growing evidence that institutional considerations are likely to be particularly relevant to HRM policies and practices adoption. According to Wright and McMahan (1992), institutionalism theory can help in understanding the determinants of HRM policies and practices and we believe that institutional setup has an impact on HRM Sophistication (See section 4.1 for elaboration of this point) in small firms. In this context, the proposed study attempts to extend current views on the dynamics of HRM Sophistication by focusing on the institutional role played by various environmental stakeholders. We are interested in looking at the impact of institutional setup on HRM System and its association with firm performance. Examples of stakeholders are professional organizations and certifying bodies (Baron et al., 1988; De Kok and Uhlaner 2001; and Tolbert and Zucker, 1983).

### 3.4. Culture Theory and HRM policies and practices

Samovar and Porter (1994), define culture as 'the cumulative deposit of knowledge, experience, beliefs, values, attitudes, meanings, hierarchies, religion, notions of time, roles, spatial relations, concepts of the universe, and material objects and possessions acquired by a group of people in the course of generations through individual and group striving'. Furthermore, culture can be defined as the "transmission from one generation to the next, via teaching and imitation, of knowledge, values, and other factors that influence behavior" (Boyd and Richerson, 1985). In studies of larger multinationals it is explained that countries have unique cultures (i.e. values, norms, and customs), and it is widely presumed that multinational enterprises must understand the culture(s) of the region(s) in which they operate in order to effectively manage their human resources (Jackson and Schuler, 1995). Geert Hofstede is an influential Dutch writer on the interactions between national culture and organizational culture and its effects on management practices.

Hofstede G. (1984) invented four dimensions of culture: Power distance, Individualism vs. collectivism, Masculinity vs. femininity, Uncertainty avoidance and then added long vs. short term orientation realizing its importance in a later study. These dimensions usually are seen in organizational management in terms of their formalized structures and practices for managing its resources and operations. Employee are one of the key resources which are managed by HRM through various HRM policies and practices and it is unlikely to manage this key resource optimistically with 'best practice' identified by some researchers especially (Pfeffer, J., 1994), across cultures. According to Boxall and Purcell (2003) 'the staunchest advocates of best practice argue that all firms will see performance improvements if only they identify and implement best practices but they believe that this brings quite a different understanding of the problem of integrating HR strategy with the rest of business strategy'. Organizational environment requires different strategies in different settings and some specific setting might not support the best practices to produce similar results. Cross cultural studies also stress the need for identification of specific aspects of national culture impacting HRM to recommend culture specific HRM policies and practices in different cultures (Khilji 2000, 2003; Tayeb 1995). Boxall and Purcell (2000) argue that there is a complex relationship between HRM and the achievement of organizational outcomes and, those HR strategies are strongly influenced by national, sectoral and organizational factors.

Proceeding further, there are some informal constraints as discussed above in the institution part, these are rules; they come from socially transmitted information and are a part of the heritage that we call culture. The author claims that social norms dictate the choice, not formal rules (North D., 1990: P. 37). In organizations, the emotional need for rules (even if they are not actually kept) means a preference for formalization of structure, standardization of procedures, and "ritualization" of behavior. In the process of transferring management skills, differences in the cultural need for formalization, standardization and ritualization may lead to deep misunderstandings and to the ineffectiveness of practices developed in one culture whenever transferred to another. There is a need for the application of anthropological concepts to the field of management in order to help in the development of locally effective ways of management and planning (Hofstede G., 1984) and these can assure effective human resource management practices as well as, value addition to firms. It is important to note

that the cross-cultural applicability of North American and Western HRM practices is highly questionable in different economic, political and cultural context (Wasti, 1998).

Summing up, these organizational theories will help in exploring the contemporary picture of the HRM in this proposed study and level of HRM sophistication. Furthermore, these theories will make it easy as how organizational environment impact on management practices and especially in selecting HR policies and practices which leads to HRM sophistication (HRM sophistication is discussed in an independent section, see section 4.1). We believe that “Human resource management is a distinctive approach to employment management which seeks to achieve competitive advantage through the strategic deployment of a highly committed and capable workforce, using an integrated array of cultural, structural and personnel techniques (Storey, 1995)” see figure 3.1 for elaborative depiction.

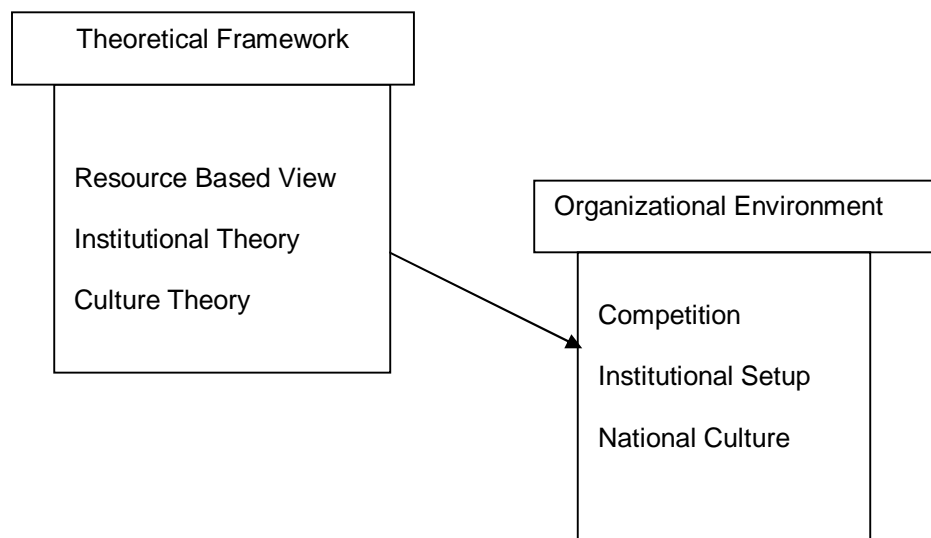


Figure 3.1 HRM Sophistication and SME Performance (sub-model component)

### 3.5. Organizational Environment

This section is used to explain, how above mentioned theoretical framework help in scanning the organizational environment concerning HRM policies and practices in the context of Pakistani SMEs. Starting from definition, organizational environment is defined as all elements that exist outside the boundary of the organization and have the potential to affect all or part of the organization (Daft, 1997). Furthermore, he has divided environment into two types namely *task* and *general environment*. Daft explained both type of organizational environment in the following words:

‘The task environment includes sectors with which the organization interacts directly and that have a direct impact on the organization’s ability to achieve its goals. The task environment typically includes the industry, raw materials, and market sectors, and perhaps the human resources and international sectors.’

'The General environment includes those sectors that may not have a direct impact on the daily operations of a firm but will indirectly influence it. The general environment often includes the government, sociocultural, economic conditions, technology, and financial resources sectors. These sectors effect all organization eventually' (1997: P. 83-84).

We can not distinguish as which one is important because both are equally important to consider for exploration of HRM policies and practices in this study. Employment relationships are the outcome of the fluid interaction of social, economical and geographical contexts (Ram et al. 2001; Nguyen and Bryant 2004). SMEs operating in Pakistan face several unique contexts that might impact the possible adoption and use of HRM policies and practices. 'At the broader, societal level, there are many factors that affect the way in which people are managed within organizations. It is through the mediation of the 'organizational environment', however, that these broader environmental changes are made meaningful to individual organizations' (Truss and Gratton, 1994).

Jackson and Schuler explaining environment and its possible effects on organizations, believes that much research is needed to understand how internal and external environments shape

- (a) the nature of human resource philosophies, policies, and practices;
- (b) the employee behaviors and attitudes that should be valued, and which are likely to be exhibited;
- (c) the criteria that define employee effectiveness and achieved levels of employee effectiveness; and
- (d) the criteria that define organizational effectiveness and achieved levels of organizational effectiveness.

Further they state that future research needs to recognize that contexts may moderate the observed relationships between HRM and various outcomes (1995; P. 255). Subramony (2006) argued in his concluding remarks in a recent study on selection of HRM practices that 'it is indeed possible to influence the adoption of scientifically grounded HR practices, if both the rational and non-rational forces influencing the adoption process are understood and harnessed'. Jackson et al., suggest for developing a better understanding of how organizational contexts influence personnel practices may be one route to narrowing the gap between personnel research and practice. Furthermore, this assertion is based on their premise that context-rich personnel research will lead to an improved understanding of how organizational demands and constraints shape personnel practices (1989: P. 782). In the subsequent section we have explained that how above mentioned theories can guide to the development of context specific HRM system for achieving organizational objectives, explaining the environmental context of Pakistan. Next section starts with the first element of competition.

### **3.5.1. Competition**

Today's business operates in an environment of fierce competition as customer expectations are becoming challenging and demanding for organization. On the other hand easy entry to business, new markets and access to latest technology bring new entrant on frequent basis. In such a situation, it is becoming difficult for any business enterprise to retain its competitive position over long time. All organizations in one

industry operate in similar environment with almost similar access to resources, technology and markets. Pakistan's local business environment is highly competitive even though majority of the readymade garment manufactures export their production in the international market. These manufactures operate in almost similar environment thus gaining competitive advantage in specific local territory might be difficult, and this further lead to poor position in international competition due to difficult entry for small firms operating on small scales.

People seem obvious choice for gaining sustained competitive advantage with the notion of resource-based perspective in such an area. It is clear that employees are the most valuable asset any firm has, the ideal use of the workforce by developing their abilities, skills and motivation through HRM system can lead any firm to sustained competitive advantage (see resource-based view above). This is easier said than done, we have to identify which HRM system can be of high value to this context specific situation for gaining long-term success. For this, we have given some detail discussion in the subsequent section on HRM practices. Bernardin and Russell (1993) have developed a fourth approach, outlining three alternative ways that human resource management can lead to sustainable competitive advantage. First, human resource management can take an active role in the organization's change process, as the organization adapts to the continuously changing environment. Second, human resource management can help the organization that wants to survive and remain competitive to look continually for environmental threats and opportunities and internal strengths and weaknesses, so that the appropriate strategies are designed. Third, human resource management can lead to sustainable competitive advantage by acting as the linking-pin between stakeholders and the business by creating strategic unity through the appropriate practices.

In Pakistan it is assumed that markets are saturating rapidly with increased local entry and Chinese made low cost imports, hence majority of the SMEs operating in this category try to export their product directly or through large firm associations. It seems difficult for these SMEs due to several barriers like sufficient finance, latest technology and skilled workforce. It is obvious that there might be several requirement from importing countries and/or large firm association with respect to management practices specifically transparent personnel practices to follow local as well as international labour rules. Our task in this research will be to identify those context specific HRM policies and practices, the implementation of which might help organizations for gaining competitive position for their survival and long term success in this developing economy. Next to this is specific institutional setup in which these SMEs operate.

### **3.5.2. Institutional Setup**

Institutionalists (e.g. Hall and Soskice, 2001; Whitley, 1999) argue that national factors such as economics, governance, financial and legal systems and trade unions, which together form the national business system, are the source of the main differences in HRM between nations. We will shed some light on the national business system of Pakistan, with an objective to look how and/or what type of impact these can have for the development of HRM in SMEs. Moving ahead in this part first is SMEDA.

#### **SMEDA**

The Small and Medium Enterprise Development Authority (SMEDA) is a first and premier institution of the Government of Pakistan under Ministry of Industries,

Production & Special initiative for facilitation and regulation of SMEs. SMEDA was established in October 1998 to take on the challenge of developing SMEs in Pakistan. With a futuristic approach and professional management structure it has focus on providing an enabling environment and business development services to small and medium-sized enterprises. SMEDA is not only an SME policy-advisory body for the government of Pakistan but also facilitates other stakeholders in addressing their SME development agendas<sup>1</sup>. SMEDA provides facilitation and regulation to SMEs in their business operations; but our curse is, does it provide any facilitation or regulation in terms of HRM policy making and/or certain HR practices. In other words, does it play any role in the development of HRM system in Pakistani SMEs?

### **Financial Institutions (Banks)**

Banks are considered as capital markets for SMEs as majority of the SMEs usually borrow money from banks at a time of need. Some time banks hesitate to lend money to very small entrepreneurs due to informal and non-transparent nature of their business operations. Research shows that such credit markets (banks) might influence for implementing transparent HRM practices to qualify for loans (Nguyen and Bryant 2004). We will look what type of role Pakistani financial institution especially banks play for the development of HRM practices in the process of business lending.

### **Industrial and Labour Laws**

Pakistan's labour and industrial laws dates back to their origination to legislation inherited from India at the time of partition of the Indo-Pak subcontinent and independence from Britain in 1947. 'Since independence, four labour policies have been announced by the government in the years 1955, 1959, 1969 and 1972, which laid-down the parameters for the growth of trade unionism; the protection of workers rights; the settlement of industrial disputes; and the redress of workers grievances. Historically, the 1960s and the 1970s were a turbulent period in the history of Industrial Relations in Pakistan. Militant trade unions and equally intransigent managements were locked in endless disputes and conflicts over pay and working conditions. Strikes, lockouts and litigations were the most distinctive features of employer-employee relations. The concept of employers and employees working together in close cooperation to ensure productivity, profitability and growth of businesses and security of employment was largely non-existent. There was no realization that job security and appropriate wages were critically dependent on profitability and continued competitiveness of businesses'<sup>2</sup>.

The laws have evolved through a continuous process of trial to meet the socio-economic conditions, state of industrial development, labour force explosion, growth of trade unions, government's commitment to development and social welfare. To meet these several type of objectives, the government of Pakistan has introduced a number of labour policies as mentioned above, since its independence to reflect the shifts in governance from martial law to democratic governance. Under the constitution labour is regarded as a 'concurrent subject', which means that it is the responsibility of both the federal and provincial governments. However, for the sake of uniformity, laws are enacted by the federal government, stipulating that Provincial Governments may make rules and regulations of their own according to the conditions prevailing in or for the

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<sup>1</sup> SMEDA, Pakistan

<sup>2</sup> Labour Policy 2002

specific requirements of the provinces. The total labour force of Pakistan is comprised of approximately 37.15 million people, with 47% within the agriculture sector, 10.50% in the manufacturing & mining sector and remaining 42.50% in various other professions<sup>1</sup>.

### **Contract of Employment**

While Article 18 of the Constitution affords every citizen with the right to enter upon any lawful profession or occupation, and to conduct any lawful trade or business, the Industrial and Commercial Employment (Standing Orders) Ordinance was enacted in 1968 to address the relationship between employer and employee and the contract of employment. The Ordinance applies to all industrial and commercial establishments throughout the country employing 20 or more workers and provides for security of employment. In the case of workers in other establishments, domestic servants, farm workers or casual labour engaged by contractors, their labour contracts are generally unwritten and can be enforced through the courts on the basis of oral evidence or past practice<sup>2</sup>.

Every employer in an industrial or commercial establishment is required to issue a formal appointment letter at the time of employment of each worker. The obligatory contents of each labour contract, if written, are confined to the main terms and conditions of employment, namely nature and tenure of appointment, pay allowances and other fringe benefits admissible, terms and conditions of appointment<sup>3</sup>.

### **Workers' Representation in the Enterprise**

Pakistan had a three different kind of systems of participation in management (i.e., the Works Council, the Management Committee and the Joint Management Board), independent of each other and each having its own sphere of activities till 29 October 2002, on this date when the Industrial Relations Ordinance, 2002 (IRO, 2002) was adopted, which repealed the Industrial Relations Ordinance, 1969. The new text simplifies the system, introducing a single body in place of the three previous ones: the Joint Works Council (Article 24 of the IRO 2002). A joint works council must be set up in any establishment employing fifty persons or more. It consists of no more than ten members, forty per cent of which are workers' representatives. In the previous system, the management committee and the works council were composed of an equal number of representatives of the employer and workers, whereas the joint management board had a workers' participation of 30 per cent. The convener of the joint works council is from the management.

The joint works councils are dealing matters, relating to competency of the earlier joint management board, such as the improvement in production, productivity and efficiency, provision of minimum facilities for those of the workers employed through contractors who are not covered by the laws relating to welfare of workers. It has also taken up tasks of the previous works council, i.e. promoting settlement of differences through bilateral negotiations, promoting conditions of safety and health for the workers, encouraging vocational training within the establishment, taking measures for facilitating good and

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<sup>1</sup> Labour Unity Organization Pakistan.

<sup>2</sup> Labour Unity Organization Pakistan and Labour Ordinance 1968.

<sup>3</sup> Elaboration of law by Labour Unity Organization Pakistan.

harmonious working conditions in the establishment, provision of educational facilities for children of workers<sup>2</sup>.

The basic principles regulating law are embodied in the Industrial Relations Ordinance (2002) which is currently implemented throughout the country. Both employee and employer rights are protected under this ordinance but it is observed that there is no clear system for implementing or monitoring HRM policies and practices under this law. We will check whether this law has any kind of legal influence on HRM system and what type of influence this has to implement certain specific HRM system for better personnel management in the country. It is observed that Pakistan always made high quality policies and systems but usually lacks in effective implementation. We will check whether this depiction is true or not in this study.

### **3.5.3. National Culture**

Third and last element in organizational environment is culture. We started this by explaining, what is culture, in the next section.

#### **What is Culture?**

Culture has many definitions, but generally it is used to refer to societal forces that shape behavior. Members of a cultural group share a distinct way of life founded on common values, attitudes, ways of viewing the world, and behaviors (see section 3.4 for detailed explanation). Members socially transmit these elements of culture across generations, often with little reflection or even intention. Culture can be so subtle that we are unaware of its effects on us (see Jackson and Schuler 1997).

National culture as a factor plays crucial role in transferring HR practices across borders. Budhwar and Sparrow (2002) assert that the last two decades of the 20th century witnessed the emergence of a stream of research showing the influence of national culture on HRM policies and practices. Bjorkman (2004) also refers to studies that have been designed to scrutinize the influence of national culture upon HRM practices and points out that the cultural dimensions of Hofstede (1980) have been used to hypothesize how HRM practices may vary across national borders. Budhwar (2000), asserts that HRM practices are context specific and that national HRM practices are determined by both culture free and culture bound factors. The HRM practices normally used by employing organizations in a particular country are therefore likely to be influenced by both culture and institutional arrangements. However, as Budhwar and Sparrow (2002) point out, it is difficult to deconstruct the various cultural and institutional influences upon managerial behaviour (Leat and El-Kot, 2007).

Laurent (1986) suggested that HRM approaches in any particular country can be seen as cultural artifacts reflecting the basic assumptions and values of that specific national culture in which organizations are embedded and many studies have sought to use this variable as the major explanatory variable (e.g. Hofstede, 1993; Huang, 2000). In the next two sections, we have inscribed Pakistan's national culture and its impact on HRM policies and practices in Pakistani organizations.



## Pakistan's National Culture<sup>1</sup>

Khilji (1999) describe Pakistani culture as an amalgam of Islam religion, Indian origins, British inheritance and American influences. In another study Khilji (2003) describe each of these influences to explore their relevance in the understanding of HRM system and practices.

The Islam religion: Assumption about religion seems to be prominent in the minds of people because the ideology of the creation of Pakistan emerged from the belief that Muslims of the Indian sub-continent are a separate nation based on their religion and their Islamic cultural heritage. Tayeb (1997) argues that in a predominantly Muslim country, Islam, through national culture, influences organization. Research shows that even though Islam plays key role but it has a limited impact on the business practices (Khilji 2001). She describes it as the Islamization of macro institutions (to facilitate Islamic practices within the society) extends only to a limited degree to organizations. For example, allocation of prayer rooms where employees can say their prayers during office hours, extended lunch breaks for Friday prayers and shorter office hours during Ramadan, the holy month of fasting.

Indian Origins: Pakistan is actually once part of the India (Indian sub-continent before separation) and people came originally from this sub-continent or living under Indian influence for many generations in the same location. As a result she describes a large number of the customs and traditions fundamental to the society, such as the roles expected of women, the manner in which a child is raised, and so on, are similar to those of the Indian culture. Family system is collective and people feel high family ties as Lyon (1993) explains that life is built within a group; community life and conformity to this group have great value.

British legacy: The British, who maintained a colony on the sub-continent for almost a century, are thought to be responsible for creating elite classes in the society, notably feudal and civil servants. According to her the best schools and other facilities are available only for the elite, while the majority of the public are still trying to obtain the basic necessities of life such as electricity and clean drinking water.

American influences: Since the creation of Pakistan, the United States has been perceived as the most significant foreign player in its politics, and probably the most vital element in the formulation of various economic and foreign policies (Hussain and Hussain, 1993). Zakaria (1994) and Khilji (1999) observed that Pakistani managers want to follow the American management style, which is considered to be more progressive and results-oriented.

From the above discussion it appears that Pakistani society holds three distinct fundamental elements that sometimes conflict. The first comes from the social set-up, the second from religion and the third from the West. However she believes that Islam appears to be the least significant influence at work, despite the verbal importance attached to it (Khilji 2003). Next section helps in understanding how and in what sense national culture impact on the development of HRM system by facilitating or hindering certain practices in Pakistani context.

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<sup>1</sup> Khilji, S.E. (2003). Social Cultural institutions. Exploring the role of national culture in human resource management in Pakistan.

## Culture's impact on HRM in Pakistan<sup>1</sup>

Pakistan's culture is primarily collective as mentioned above that emphasizes on social relationships. According to Khilji (2003) 'the success of HRM practices in one country cannot ensure their success in another culture.' For example, Laurent (1986) points out that HRM practices and philosophies are deeply grounded in the surrounding *national cultures*. Parent company HR managers may desire to apply consistent HR practices across nations in the interests of fairness or in order to promote a uniform corporate culture. But it is not practically an easy job as it seem beneficial to the head office due to cultural factors mentioned by various studies because 'HRM of an organization is influenced by the *national culture*' (Newman and Nollen, 1996). *National culture* factors must be considered, to be successful especially for possible best implementation of intended HRM system.

One can think, a specific HRM system (like 'best practice') as good and dynamically viable with different company settings and structures but according to studies of Khilji (2003, 2004, and 2006) to make it as effective as in first setting one must consider the element of *national culture* along some other contingent factors. Noorderhaven and Tidjani (2001: 32) argue that 'it is becoming more and more obvious to scholars as well as practitioners that governance systems and theories from one culture are not transferable to another culture without modifications and adjustments according to the values prevalent in the receiving culture.' One might think that how *national culture* influence this and what are the factors that affect cross boarder expediency of effective HRM systems. Khilji and Wang (2006) besides pointing out some *cultural* aspects, has tried to identify how these can have an impact on HRM system with respect to a specific cultural setting as she has focused on the context of Pakistan in various earlier studies on HRM.

As mentioned above some of the factors and definition of Pakistani culture, mentioned in Khilji's studies, Aycan et al (2000) also sketch the similar picture of Pakistani collective culture, a culture having high power difference and loyalty towards community. How and in which way these factors may influence HRM system in specific cultural context of a country like Pakistan is critical to understand. Khilji (2003) study of exploring national culture's impact on HRM in Pakistan showed some implementation concerns similar to some other studies in this field as she argues 'lack of implementation seems to be true reflection of national culture'. A sketch of various institutions on national values and its impact on HRM practices and employee attitude in organizations is summarized in appendix 2. 'Many of Pakistan's economic policies, such as investment policy, have been appreciated at international levels and yet contextual factors, such as bureaucracy, lack of vigor and political uncertainty, hinder their local implementation. Employees can not approach their HR departments directly; going through the proper channels is considered standard protocol.' She also mentioned communication gap between employees and management and another points she mentioned in her various studies is difference between policy and practice as she articulate 'the 'talk ' of management does not always match their 'walk' due to which employees distrust management's promises because they are rarely implemented.

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<sup>1</sup> Majority of the studies (Culture's impact on HRM practices in Pakistan) discussed here are conducted using large firms as sample. We have used these findings with caution as results may be different in the case of SMEs.

From this discussion and findings of Khilji beside some other authors, one can depict the crucial impact of *national culture* in implementation of HRM as whenever it is neglected it has its effects on implementation process and increases the gap between implemented and intended HRM. Due to large power distance Khilji (2004) witness that there is limited employee autonomy; top to bottom communication is minimal and bottom-up communication is unheard of. In addition she has identified a clear gap between the value systems possessed by younger and older employees in Pakistan, as 35 year of age or less have aspiration to opt these latest HR practices as compare to older employees because they have obtained business education and information about latest MNCs management practices through internet and other means of communication. Here it is also clear that older employees, who are mostly on managerial positions itself creates problems for implementation as they fear to lose their position if these practices truly implemented and suppose they do not have the leadership capabilities as compare to their younger employees.

In this scenario where Pakistani *national culture* put biggest impact on the implementation of HRM, Khilji (2006) have pointed out four points that possibly contribute to minimizing this gap between intended and implemented HRM. These include: incorporating the use of cultural and structural changes in developing effective HRM systems, ensuring employee involvement, developing employee-friendly policies and making HR departments accessible, and providing management support and commitment in implementing changes throughout the organization. On the other side this study also put light on some contingency factors (like environment, industry trends, organizational strategy, culture and political scenario) as these play an important role in determining the implemented element of HRM. She further suggests that 'in order to develop a more comprehensive picture of the global HRM in face of convergence researchers should in fact incorporate both in their analyses' because 'the cross-cultural applicability of North American HRM practices is highly questionable (Wasti, 1998) as discussed above. Evaluating factors for transferring these North American HRM practices is interesting and challenging job especially when one is investigating this for SMEs of a developing economy (e.g. Pakistan). In the next section, we have tried to conclude all these above mentioned perspective with respect to relevant literature and also focused on the operational aspect of these theories and the variables derived from these.

## **4. HUMAN RESOURCE MANAGEMENT and SMES**

### **Introduction**

Starting with a general overview on HRM in SMEs, this chapter describes HRM sophistication and HRM policies and practices, including role of HR department and HR-functions in detail. First part of this chapter is concluded with HRM system approach and a pictorial depiction of HRM sophistication as sub-component of the conceptual model. In the second part of this chapter, organizational context is explained taking into account various elements (e.g. firm size, large firm associate, business plan, exports, age of the firm and ownership). These all variables help in understanding organizational context and its impact on HRM as depicted in figure 4.3 as sub-model component.

### **HRM and SMEs**

Research suggests that smaller entrepreneurial firms generally have key challenges with HRM because the small size of the firm often does not warrant hiring professionals exclusively dedicated to HRM activities (Hornsby and Kuratko 2001; Hornsby and Kuratko 1990; Wager 1998; Bacon et al. 1996). SME sector face many challenges in business administration, particularly efficient and effective utilization of resources to achieve organizational objectives. Research shows concerns for owner-managers' managerial practices and their impact on firm operations. Few studies in this sector draw attention to traditional management practices including HRM and stress for a solid framework to manage firm resources especially human resource which is consider as key resource. According to Brand and Bax (2002) many small firms encounter serious human resource problems, while at the same time; human resources play a vital role in developing and sustaining their competitive advantages. They have also concluded that the available knowledge on HRM in small firms is highly descriptive and fragmented.

The question here is why small firms encounter such kind of serious problem. Larsen (2000, p. 11) explain this phenomenon from Danish companies perspective as we still lack the conceptual framework and methods applicable for the majority type of companies – small and medium-sized companies'. These factors badly impact performance of small business and make it very difficult to add reasonable and required value from this vast sector in economic development of any country. It seems unfeasible to manage small business and especially its key resource with old traditional management practices at a time when gaining competitive advantage is not the foremost for owner-managers but real struggle is to sustain it over a long time. Reid and Adams (2001) believe that human resource management has, until recently, been seen as inappropriate for the smaller firm and consequently little research on the practices within the small firm sector have been documented. Next section put some light on HRM policies and practices starting with HRM sophistication.

#### **4.1. HRM Sophistication/formalization**

HRM Sophistication and/or formalization, and its association with firm performance in SMEs, requires clear explanation and operationalization. This section is devoted to explain the first variable i.e. HRM sophistication and/or formalization. First of all, it is likely that answers to some basic questions for clarification of the HRM sophistication phenomenon will contribute towards clear understanding i.e. whether HRM

sophistication and formalization are the same in meaning? What is HRM Sophistication? Some researchers in this field have used HRM sophistication and formalization in similar meaning interchangeably. For instance, De Kok and Uhlaner (2001) state that “sophistication” and/or “formalization” of HRM practices, has been studied by a number of scholars and in spite of its extensive use, there appears to be no universally accepted definition of formalization (or sophistication)”.

It seems that researchers have used different terminologies, actually to explain HRM sophistication and/or formal use of HRM practices in organizations. As Huselid (1995) gives some indication of the possibility of HRM sophistication and firm performance that the wider certain formally defined HRM practices are applied in the organizations, the better the outcome in terms of certain financial results will be. Further he concludes that “across a wide range of industries and firm sizes, I found considerable support for the hypothesis that investments in such practices are associated with lower employee turnover and greater productivity and corporate financial performance. The impact of High Performance Work Practices (HPWP) on corporate performance is in part due to their influence on employee turnover and productivity. The identification of some of the processes through which these practices affect firm profits helps to establish the plausibility of a link with corporate financial performance”. Here Huselid is referring as HPWP and creating a link with firm performance. Researchers has used different set ‘bundle’ of HRM practices to depict the organizational use of HRM practices for employee management.

Simply, its hard to find a valid single definition of Sophistication (formalization) specified in the various studies conducted so far, majority of these studies have defined this from different prospective for their own use in a particular context. They refer sophistication and/or formalization in the magnitude of a written rule or procedure, its regular applicability and an intended HR activity. On the other hand, Marlow (2002) explained that as firms grow they develop formal, identifiable policies, rules and regulations that define and oversee the employment relationship.

According to Nguyen and Bryant, (2004) ‘one important dimension in how HRM practices are adopted is the level of formality in HR management’. They define formalization as ‘formal HRM practices have identifiable policies, rules and regulations that are documented and integrated into the firm’. This latest explanation of formalization seems to some what rectify the elusive state of formalization but not entirely yet requires some special attention in future studies. On the other hand, Kotey and Slade (2005) signify formalization that a move in their study from simple structures with highly centralized and informal systems to functional structures with specialized functions and greater standardization and formalization of activities’ which again states the particular depiction of formalization.

Proceeding further, there is a detailed analysis of HRM sophistication and its possible impact on organizational performance using a ‘restrictive HRM definition’ with some relevant typologies to specify HRM sophistication (Ehrnrooth, 2002). This restrictive definition appears to help in understanding this phenomenon more clearly as it describes HRM sophistication in an ideal way. However for finalization of HRM variables and performance indicator in the conceptual model, we have devised a three point formula which is inscribed before the conceptual model.

“According to this definition “Human resource management is an approach to employment management which seeks to achieve competitive advantage through the strategic development of a capable and motivated workforce, using an integrated array of generic human resource management techniques (Ehrnrooth, 2002 p. 9).”

The purpose of above mentioned definition is to provide more clarification about the HRM variable as it explains relevant phenomenon. Ehrnrooth, (2002) has used three corollaries to explain the restrictive HRM definition for explanation of HRM sophistication, as Ehrnrooth illustrate three focal points in this definition, specifically: generic HRM, internal and external fit. We have put his explanation of these three focal points in his own words without any addition, below:

**First corollary for generic HRM:**

The term 'generic human resource management techniques' refers to the apparently straightforward activities and principles listed below:

- § Adequate selection processes. Ideal goal: the employment of motivated and technically, psychologically, socially competent employees.
  - § Adequate socialization processes. Ideal goal: employees should get to know the organization, its history, its philosophy, its people and its strategy.
  - § Adequate performance appraisal processes: Ideal goal: employees should know and agree about what they have done, should do and why.
  - § Adequate development processes. Ideal goal: employees should be further developed on topics and by means they view as relevant.
  - § Adequate communication processes. Ideal goal: employees should feel that they are given adequate and sufficient information.
  - § Adequate compensation and general benefits. Ideal goal: employees should feel that they are sufficiently and meaningfully rewarded.
  - § Adequate employment security: Ideal goal: employees should feel security in their employment relationship
- (Ehrnrooth, 2002)

Ehrnrooth has used the term 'the sophistication of the HRM system' to refer to the degree to which an HRM system is characterized by these features (Ehrnrooth 2002). Even including only the generic HRM practices in an HRM system, he feels that the definitions of these practices are still very loose.

Additionally, HR practices are regarded as effective when they are both vertically and horizontally aligned. Horizontal or internal fit refers to the alignment of HR practices into a coherent system of practices that support one another (Delery, 1998) and horizontal fit implies congruence among the various HRM practices (Baird and Meshoulam, 1988). Vertical or external alignment refers to the fit of HR practices with a specific organizational context particularly with organizational strategy (Schuler and Jackson, 1987). It has been argued that certain general properties of the HRM practices influence their effectiveness. More specifically, the internal and external integration of these practices have been viewed as important for how well they will contribute to organizational performance (Becker and Huselid, 1998; Ehrnrooth 2002; Huselid, 1995). As internal fit in Huselid's (1995) words 'the returns from the use of valid selection procedures are likely to be greater when a firm's performance appraisal and incentive compensation systems can recognize and reward good employee performance, and incentive compensation systems should perform best when linked with high-quality performance appraisals'. The strategic integration of the HRM system will influence the

sophistication of the HRM system (Ehrnrooth, 2002). Below next two corollaries for internal and external fit are given as mentioned (exactly in the same way) in the Ehrnrooth, (2002):

**Second corollary for internal fit:** The term 'integrated' in their definition above refers to internal fit which they define as:

Internal fit: The HRM practices should support one another in producing consistent kinds of competence, behavior and attitudes

**Third corollary for external fit:** The term 'strategic' in their definition above explicitly refers to external or strategic fit which they define as:

External fit: The HRM practices should support competencies, behavior and attitudes which are important for the achievement of strategic business goals

In exploring the HRM sophistication and its impact on firm performance with the proposed model, rather than taking individual HRM practices, "HRM systems (see section 4.3) are the most appropriate level of analysis because they more accurately reflect the multiple paths through which HRM policies will influence successful strategy implementation" (Becker and Huselid, 1998 ). Further, the level of "sophistication" of HRM practices has also been used to refer to the extent to which the HRM practices conform to legal requirements (e.g., equal employment opportunity), comply with professional standards (e.g., the Society for Human Resource Management in the United States), and/or are properly validated against some performance criteria (e.g., validated selection tests).

According to MacDuffie "any single practice may play a multifaceted role in the overall human resource system, and there is no clear conceptual basis for separating practices affecting, motivation from those affecting, skill" (MacDuffie, 1995). However as Ehrnrooth, (2002) witness from an empirical review of Delery and Doty (1996) that there may be considerable complexities and variations with reference to the importance and influence of individual practices. To the problem of the specification of the correct number and identity of HRM practices to be included in an HRM system we have no clear solution and most writers do not outline the theoretical structure (or cause-effect chain) that underpins their perceptions of which practices to include (Boxall and Purcell, 2003). However an influential study by Appelbaum et al. (2000) depict that they base their prescription on an old rubric called the 'AMO' theory of performance. This explains that performance is a function of employee ability, motivation, and opportunity (Boxall and Purcell, 2003).

Performance = f (employees' ability, motivation and opportunity to perform).

This above mentioned model argues that organisational interests are best served by an HR system that attends to employees' interests, namely their skill requirements, motivations and the quality of their job (Boselie et al., 2005). It is not enough just to be concerned with one's favourite HR practice (this is better understood as 'micro-HRM'). One must be concerned, at the very least, with the impacts of practice – or better still, clusters or bundles of HR practices – on desired outcomes (Boxall and Purcell, 2003). We have tried to include a set of generic practices which should cover the most central HRM areas exhibited in the conceptual literature and empirical work so far (Ehrnrooth,

2002). Broadly speaking, HRM study is concerned with the selections that organisations make from the myriad policies, practices and structures for managing their employees (Sisson, 1990; Boxall and Purcell, 2003). Strategically thinking, HRM is conceptualised in terms of carefully designed combinations of such practices geared towards improving organisational effectiveness and hence better performance outcomes (Boselie et al., 2005).

Golhar and Deshpande (1997) believe that “the purpose of good HRM program is to recruit, select, motivate, and retain employees”. Thus, factual HRM sophistication lies in the adoption and implementation of specific HRM practices (recruitment and selection, training and development, performance appraisal and, compensation and reward) these four are explained below in light of the published research first, following HR department (with an assumption that the formal use of these lead to HRM sophistication in SMEs).

## **4.2. HRM Policies and Practices in SMEs**

The purpose of this section is to explain HRM policies and practices in detail for better conceptualizing, with respect to the relevant academic literature. According to a study of organizational characteristics as predictors of personnel practices, they believe that past calls for personnel studies that include organizational characteristics appear justified, as results showed clear differences in the personnel practices used by organizations of different types. Furthermore, developing a better understanding of how organizational contexts influence personnel practices may be one route to narrowing the gap between personnel research and practice (Jackson et al 1989). The challenge for growing firms is to establish HRM policies and practices that are fairly flexible and do not extend bureaucracy in an arena of scarce managerial resources (McElwee and Warren 2000). Human resource management practices are especially critical for encouraging entrepreneurial behaviors (Jones et al, 1995).

### **4.2.1. Importance of HR Department**

The human resource department is the group formally established by an organization to help manage the organization's people as effectively as possible for the good of the employees, the company, and society (Schuler and Jackson, 1997). Entrepreneurship is a process of value creation in which an individual or team brings together a unique package of resources to exploit an opportunity (Jones et al, 1995). In small firms, where resources are likely to be scarce, there may be a very small number of formal HR departments or professionals, increased difficulty in recruiting and retaining employees due to lack of financial resources, and an increased reluctance to engage in costly or restrictive practices (Cardon and Stevens, 2004). Most small businesses do not have formal HR departments; all firms have recruitment and HR policies, even if they are only implicit (Aldrich and Von Glinow, 1991).

Schuler and Jackson (1997) assuming critical role of HR department, explains the many roles of the human resource departments as “Effective firms in the highly competitive environments of today encourage their HR departments to play many roles. The more roles they play well, the more likely they will be to help improve the organization's productivity, enhance the quality of work life in the organization, comply with all the necessary laws and regulations related to managing human resources effectively, gain competitive advantage, and enhance workforce flexibility.”



Baron and Kreps (1999) cautioned that the implementation of formal HRM procedures should not be aimed at ensuring conformity with what is perceived as “best practice” but rather at developing systems that increase the net benefits associated with human resources. Reid and Adams explain the inherent ambiguity linked with best practice, as ‘a significant problem with the various lists of “best practice” HRM is that there are inconsistencies between studies, with some ignoring one factor but including another. For example, despite the importance attached to employment security by Pfeffer, this is not included in quite a number of the other lists (e.g. Delaney and Huselid, 1996; Wood and de Menezes, 1998). Also, “best practice” is largely a wish list of descriptors and may seem unreal or unattainable in some SMEs’ (2001, p. 311).

A study on exploring HR practices in UK SMEs Cassell et al., (2002), characterize the use of HRM practices in SMEs as essentially, given the diverse nature of the SMEs included in this study, it would appear that key managers in SMEs, rather than taking a coherent, strategy based approach to the implementation of HRM, are taking a more ‘pick and mix’ contingency approach. Which practices are chosen, and the extent to which they are used and formalized is based on a number of characteristics about the SME and the current business climate within which they find themselves.

Firm size is considered as a major determinant of a number of human resource management practices in small firms (Deshpande and Golhar, 1994; Hornsby and Kuratko, 1990; Nguyen and Bryant, 2004; Wagar, 1998). Hendry and Pettigrew (1992) depicts that firm size will have an indirect effect on the formalization of HRM practices and in other words firm size lead to HRM sophistication. But some recent studies also notify that taking certain contextual determinants into account, the firm size effect becomes substantially less, and even insignificant for the formalization of compensation and appraisal practices (De Kok et al 2003). However, it is assumed that firm size determines the informality concerns for the management of its key resource leading towards an individual full time responsible for personnel management. Hornsby and Kuratko, (1990), identify that presence of personnel department in SMEs increases with firm size. Research shows that owner-managers tend to keep key personnel responsibilities in their own hands, even after shifting the personnel responsibilities to a specialist person (HR manager).

A study on “patterns of strategic change in the development of HRM” Hendry and Pettigrew (1992), have developed a model of strategic change and HRM. This model shows connections between strategy, structure and HRM in terms of context, content and process (Pettigrew, 1985; Hendry and Pettigrew, 1987). They have distinguished HRM context and HRM content from operationalization standpoint in this model. HRM context contains and explains the role of HRM, definition, organization and HR outcomes. This includes the presence of an HRM department or HRM manger (De Kok et al., 2003). This can be described as vertical fit of HRM with organization context. According to Schuler and Jackson, (1987) vertical fit involves the alignment of HRM practices and the strategic management process of the firm as discussed above. On the other side, the HRM content contains labour supply and demand, work systems, rewards systems and employee relations. These are actually the HR-functions (see next section for details) which can be a way in implementing HRM, utilizing some specific HRM practices consequently lead to HRM sophistication. HRM content shows orientation in such a way that depicts the horizontal fit (mentioned above). Vertical fit is viewed as directing human resources toward the primary initiatives of the organization, whereas

achievement of horizontal fit is viewed as instrumental for efficiently allocating those resources (Wright and Snell 1998).

According to De Kok et al. (2003), it seems obvious that organizational context (see next section for explanation of organizational context) influences HRM context, which impact HRM content to determine HRM practices in this model of strategic change and HRM. This depiction shows that in such scenario, organizational characteristics may influence the presence of an HRM department or HRM manager, which in turn helps in determining the level of HRM sophistication (De Kok et al., 2003). It might be HR manager in first step for these responsibilities and then realizing the importance of full HR department for better implementation of HRM policies and practices in small firms. As mentioned above, subsequent sections are used to give details about HRM content starting from HR-functions to specific HRM practices in light of academic literature.

### **HR-functions**

As firms grow, there is a need to administer the HR function. HRM department is considered responsible for executing all HR function in best interest of the firm. Human resource functions can be defined as the way all tasks and responsibilities regarding HRM are organized within organizations. HR-functions include all roles, tasks and responsibilities from the staffing process, to the training and development via the performance planning and appraisal to remuneration and other rewards to finally the termination of employment. The HR-function does not only involve managers in general or at HR departments, but also line management and even the employees themselves.

Various organizational contextual factors determine the need for some specific HRM practices causing HR function (as principal task of HRM department) to play their role effectively. However, HR functions depend on some other factors, as Hendry and Pettigrew (1992) explain that “while changes in human resource practice can be conceived as a response to business strategy, the scope of the HRM function to respond effectively is therefore limited by its role and resourcing”. It is the job of HRM manager and/or department within any organization to define their HR function through need analysis survey for helping business operations and gaining sustained competitive advantage. These may comprise of Fombrun et al (1984)’s “generic” HRM functions: for example;

- § HRM policies: developing policies relating to personnel management of the firm;
- § Employment: defining recruitment and selection procedures for staffing needs;
- § Development: developing strategies for training and development of employees;
- § Performance: developing performance appraisal programs;
- § Compensation: Designing reward systems for the employees.

These HR functions are actually performed via different HRM practices in organizations. From above discussion, these generic HRM practices are explained below with the help of available literature for exploring the level of HRM sophistication in selected SMEs to investigate its association with firm performance.

#### 4.2.2. Recruitment and Selection

A stringent recruitment and selection system provides those employees who are selected a sense of elitism, imparts high expectations of performance and sends a message of the importance of the people to the organization (Pfeffer, 1995). Recruitment and selection is perhaps the HR topic most widely examined in the context of new and small ventures, although it depicts that most small businesses do not have formal HR departments (Cardon and Stevens 2004) and selection is also recognized as very important for small ventures (Hornsby and Kuratko, 1990). Smaller firms pay less attention to formal recruitment and training practices (Barron, Black and Loewenstein, 1987). Patton (1993), reveals that SMEs prefer informal recruitment sources because they are cheaper. SMEs try to use those sources for recruitment and selection that are convenient, inexpensive, and directly controllable by the company (Heneman and Berkley 1999; Hornsby and Kuratko, 1990; McEvoy, 1984) and small firms also believe recruitment to be one of their major problems (Scott, 1989). Barber et al (1999), depicts the difficulty in attracting and retaining key talent and skills in SMEs. Thus in a state of informality, 'the fundamental recruiting challenge for small firms is effectively attracting and selecting candidates in the absence of trained HR personnel or significant managerial expertise in this area (Arthur, 1995).

According to Cassell et al., (2002) recruitment and selection procedures are used more than any other practice in SMEs. Small firms heavily rely on individual one-to-one interviews for selection of employees (Golhar and Deshpande, 1997) and more likely means used are personal and employee referrals, and newspaper ads (Heneman and Berkley 1999). Heneman et al. (2000) stress that SMEs owner-managers focus on competencies of applicant and organizational fit rather than job fit for gaining more flexibility in the workforce due to multi-tasking in SME operations and a firm needs a well-motivated, skilled workforce if it is to compete effectively in the global marketplace (Holt, 1993). It is evident that the staffing issues are relatively less covered in the literature that they are found to be of interest or importance to entrepreneurs (Heneman et al., 2000).

Informal recruitment practices can mean that the 'right' person is not employed as the pool of suitable applicants is untapped, leaving the firm open to accusations of discrimination (Timpothy 2005). It is considered that it depends on the labour market that plays a key role in terms of labour supply possibilities. As MacMahon and Murphy (1999) explains this from Ireland economic boom perspective, if small firm owner-managers wish to compete for scarce labour they must themselves be capable of attracting and retaining staff in terms of their recruitment skills, ability to create attractive conditions, and attitudes to employees. A study on HRM practices in SMEs (Heneman et al. 2000), reveal that several CEO/founders mentioned the high cost of selection errors and how they wish, they had been aware of the costs prior to making an incorrect selection decision. Furthermore, they state 'at a theoretical level, staffing research needs to adopt new perspectives in order to serve the needs of SMEs. New perspectives are needed to further develop the concept of person-organization fit as it relates to SMEs'. Koch and McGrath (1996) also found that sophisticated recruitment and selection procedures are positively related to labour productivity.

Hence, from the above discussion, it seems clear that recruitment and selection plays an important role in the success of SMEs and there is no 'best practice' available in this

regard especially for SMEs. So we are concerned here to investigate that which recruitment and selection practices are in the best interest of SMEs located in the population of our sample. To identify the context specific recruitment and selection practices, having an association with better firm performance, we will include questions on both parameters (recruitment and selection) independently. Thus average score of recruitment and section scale will help us in identifying the overall scale of HRM sophistication. The second variable determining the level of HRM sophistication is mentioned next.

#### **4.2.3. Training and Development**

Training and development is part of the human resource development (HRD) in organizations. According to Ghebregiorgis and Karsten, an integral part of most organizations is a greater commitment to training and employee development. Furthermore, a substantial body of research has been developed that investigated the impact of training on firm performance (Ghebregiorgis and Karsten, 2007). According to the definition of Smith (1990) HRD is the process of determining the optimum methods of developing and improving the human resource of an organization and the systematic improvement of the performance and productivity of employees through training, education and development, and leadership for the mutual attainment of organizational and personal goals. It is the essential element for any organization through which they can optimize the utilization of their key resource to gain sustained competitive advantage for higher and better firm performance. Since employee roles and responsibilities shift rapidly in small and new firms, it follows that some sort of training and development concerning new roles is vital to the success of the employees and the business (Cardon and Stevens, 2004). Additionally, their analysis showed that development and advancement of employee skills are quite important to small firm managers.

Training and development in SMEs is considered as informal and on the job, with little or no provision for management development (Kotey and Slade 2005; Marlow and Patton 1993; Storey 1994). That's why, unstructured training, informal on the job instruction and organizational socialization are considered quite important and are often seen as substitutes for formal training processes (Chao, 1997). There is another depiction favouring informal training as 'it is widely accepted that not all employee learning occurs during formal training' (Ford, 1997). Despite the perceived importance of training to improved SME performance, there is a general reluctance among SMEs to provide formal employee training (Kotey and Folker, 2007). This suggests that research on training in small firms could usefully address both formal and informal learning processes, including within organization knowledge transfer, learning-by-doing, and retention of knowledge within the organization throughout turnover events (Cardon and Stevens 2004). In a study on differences in formal training between large and small firms, Banks, Bures, and Champion (1987) revealed that for small firms, the cost of training programs and time spent away from productive work are important considerations for determining, what training opportunities to provide to workers, as resources of both money and worker time are constrained (Banks et al., 1987).

However, training has been given significant attention in scientific research (Arthur and Hendry, 1990; Banks, Bures and Champion, 1987; Bishop, 2003; Storey and Westhead, 1997;), with a general conclusion that groups of employees in small firms are less likely to have access to structured training provision, than their large firm counterparts (Cardon and Stevens, 2004). Some researchers in the field explain that training often is

perceived as an unaffordable luxury involving not only course fees but also the cost of unproductive labour in small firms (Kotey and Slade, 2005; MacMahon and Murphy, 1999). However, some of them have also revealed that firms that invest in training and development engage in formal performance appraisal, and link these to incentive compensation and reward are likely to have lower employee turnover, higher productivity, resulting in enhanced financial performance (Chandler and McEvoy, 2000). From this discussion, we reached at a point that training in SMEs is informal and very limited even though few researchers have explained its importance and benefits for small business. In this research our task will be to investigate how and through which training programmes firms try to enhance abilities and skills of talented employees recruited using so called sophisticated recruitment and selection techniques. Further what type of planning and training techniques are associated with better firm performance in a specific context. Various questions related to training and a scale for measurement will be used to identify how these lead to overall HRM sophistication.

#### **4.2.4. Performance Appraisal**

Performance appraisal and compensation are the pivotal mechanisms for fostering entrepreneurship. HR practices in these two areas, more than any other, communicate performance expectations and reinforce desired behaviors. Furthermore, the greatest differences between entrepreneurial and non-entrepreneurial firms are found in performance appraisal practices, compensation practices and training practices (Jones et al., 1995, p. 88). Interestingly (but its better to say unfortunate, due to SMEs significant role), virtually no work has been done concerning performance management in entrepreneurial organizations (Cardon and Stevens, 2004). A study on exploring HRM practices in SMEs in UK, suggest that, although some form of appraisal is used by half of the respondents, overall, formal systems are rare. Furthermore, in some SMEs appraisal is considered for senior managers only but on the other hand some think as appropriate for all the employees. In this study one interviewee pointed out as it is one of the problems that SMEs specifically suffered (Cassell et al 2002). Perhaps this is due to the rarity of formalized procedures in small firms for managing performance reviews, disciplinary processes, or dismissals of workers (Cardon and Stevens, 2004). Depiction of Bacon et al., (1996) seems interesting to note that SMEs make performance reviews of employees using formal schemes informally.

This depiction can be due to the fact that SMEs occasionally use performance management and there are few studies, which show preference to formal procedures for performance management in small firms. "Because people most often associate sophisticated methods and techniques with large businesses, however, many readers may find it surprising that small businesses expressed such a strong preference for performance appraisal (Banks et al., 1987). Another study on HRM practices describes variance in performance appraisal by firm size and industry sector (Hornsby and Kuratko, 1990) identified that performance appraisal increases with firm size but performance appraisal rating period has no link with size as most appraisals are conducted annually. Furthermore, they identified that small businesses use multiple method for employee appraisal and medium-sized businesses tend to use rating scales, narrative essays, and goal settings. They also explained that industry type can impact appraisal procedures as manufacturing and service showed more sophistication in performance appraisal methods as opposed to retail and wholesale firms (Hornsby and Kuratko 1990, p. 14 & 15).

Timmons (1999) reveals that owner-managers of small firms perform most business activities themselves or directly supervise the performance of these activities. On the other hand, owner-managers usually lack the skills necessary to carry out effective performance reviews and may perceive formal performance appraisal systems as time consuming (MacMahon and Murphy, 1999). This scenario is also destructing the health and success of SMEs, and our proposed research model is considering such behaviors of owner-managers resulting in restricting to some specific formal and/or informal HRM practices. To control performance effectively, owner-managers would shift their emphasis from operational staff to middle managers (Kotey and Slade, 2005). Our intention with respect to this specific variable of HRM system is to identify the state of performance management in Pakistani SMEs with further identification of performance appraisal practices having association with higher HRM and firm outcomes. Next the last element of HRM system is discussed using relevant literature.

#### **4.2.5. Compensation and Reward**

Compensation is particularly an important topic because often compensation significantly affects recruiting and retention efforts of small firms; if they cannot pay applicants enough, then they cannot recruit or retain critical skills or knowledge they need to operate effectively. It is also the second most investigated topic in human resource management and entrepreneurship (Cardon and Stevens, 2004). Compensation is viewed from total rewards perspective as it encompasses psychological rewards, learning opportunities, and recognition in addition to monetary rewards in the forms of base pay and incentives (Heneman et al., 2000). In compensation practices, firms with a more entrepreneurial orientation tend to base pay rates on market comparisons more so than on internal equity concerns. These firms frequently provide a lower base pay, but are significantly greater opportunities in the form of performance-based pay incentives, including a greater variety of pay incentives in higher dollar amounts. Entrepreneurial firms also tend to base pay on a balance of short-term and long-term accomplishments by both the individual and his or her work group (Jones et al., 1995).

Some time SMEs categories their compensation and reward systems as short-term and long-term pay. Short-term pay incentives in small firms may include profit sharing and stock sharing, where a significant portion of employee pay is only given when organizational-level profits meet specific preset targets (Cardon and Stevens, 2004). Graham et al., (2002) explains long-term pay incentives may include some form of equity ownership, such as stock, stock options, or incentives based on venture stock performance since stock options are an excellent retention tool (at least in large organizations), and because employees who have an equity stake in the firm may better identify with firm management, thinking more like owners than employees. Jones et al, (1995) suggest another scheme as pay plans should have a lower salary and a higher incentive mix. The total potential financial package must be enough to provide incentives for entrepreneurial employees and encourage them to stay with the company. This type of mix controls fixed operating costs while varying the bulk of expenses in direct proportion to entrepreneurial successes, thus freeing current financial resources for new ventures. Furthermore, the research also stress on the importance of unique, non-financial rewards and therefore evaluation and reward programs should focus on end results, not the methods used to produce them (Jones et al., 1995).

Some empirical studies on this subject also draw attention towards other side of the picture as Cassell et al., (2002) reveal in the results that “the impression given from the analysis of the face-to-face interviews is that managing incentives is not necessarily a priority for the SMEs in this research. In some cases specific incentives were seen to do more harm than good”. As with recruiting, there is some evidence that compensation is different in small firms, not only because of scarce resources, but also because of the great ambiguity concerning the firms’ future (Cardon and Stevens, 2004). Different compensation practices based on firm size and age have been observed in both the popular and academic press (Graham et al., 2002). More research is needed on compensation from a total rewards perspective and SMEs may be an excellent place to study these approaches (Heneman et al., 2000)

Summing up, this section covered the discussion concerning the first variable (HRM sophistication) but still main task of operationalization remains to answer questions like: How we will measure these factors (HRM policies and practices) to determine the level of HRM sophistication and decision on selection of items and scales to be used for measurement. Although this will be discussed in-detail in the research methodology part but we have mentioned the formula for selection of variables before the conceptual model. Here, we believe that HRM sophistication can serve better with a system approach rather than individual HR practices to demonstrate this we explained it in detail in the next section. After HRM system arguments we have put a sub-component of our conceptual model demonstrating HRM sophistication relating to our complete discussion.

### **4.3. HRM System Approach**

As mentioned in HRM sophistication part above, it is believed that HRM system approach is more appropriate than using different HR practices individually. How and what practices make an HRM system more valuable needs to be understood. Hornsby and Kuratko (2001) explained that creating a high-performance workplace and developing employees that embrace change are important responsibilities of the HRM function (referring to Burk 1997). Research suggests that critical to the viability of smaller entrepreneurial firms is fostering the climate of embracing change and making change work to the firm's advantage (referring to Duberley and Walley 1995) as we intend to identify such an HRM system which leads to viable HRM sophistication among small firms having an impact on firm performance. De Kok and Hartog (2006) describe that various studies have related certain types of ‘bundles’, ‘systems’ or ‘configurations’ of HRM practices to different indicators of organizational performance. Examples of such studies can be found in Arthur (1994), Batt (2002), Becker and Gerhart (1996), Delery and Doty (1996), Den Hartog and Verburg (2004), Guthrie (2001), Huselid (1995), Ichniowski and Shaw (1999) and MacDuffie (1995) (an analysis of several of these studies is given in a subsequent section on HRM and organizational performance).

Different authors have used different labels to examine a bundle of HR practices (for example; High performance work systems, high performance work practices, innovative HRM practices, productivity HR systems, high commitment HR practices, etc.). It seems that all intend to create such a system which produces high performance using different bundles of HRM practices. Bae and Rowley (2001) explain that these high performance work systems (HPWS) consist of many ingredients classified into three generic factors: competence enhancement; commitment and motivation; and opportunity to participation.

We assume that it's better to use a bundle or system approach rather than individual HRM practices to achieve such outcome as these might have an effect on firm performance. Below we have presented HRM system and/or 'bundle' approach for further elaboration of this point.

Based on research evidence to date, it is becoming increasingly clear that the HRM system is one important component that can help an organization become more effective and achieve competitive advantage (Becker and Huselid, 1998; Bowen and Ostroff, 2004). Bowen and Ostroff (2004) explain guiding logic that a firm's HRM practices must develop employees' skills, knowledge, and motivation such that employees behave in ways that are instrumental to the implementation of a particular strategy. Bowen and Ostroff (2004) haven't focus on the discussion of HRM system contents (e.g., the specific set of HRM practices necessary for achieving an organizational goal) but on the process (for achieving desired responses to form a collective sense of what is expected) because they were interested in HRM and performance link. This is further explained in their words as:

"Two interrelated features of an HRM system can be distinguished: content and process. By content, we mean the individual practices and policies intended to achieve a particular objective (e.g., practices to promote innovation or autonomy). The content of the HRM system refers to the set of practices adopted and, ideally, should be largely driven by the strategic goals and values of the organization. That is, given some strategic goal such as service, efficiency, or quality, a set of HRM practices should be devised to help direct human resources in meeting this goal. To be effective in terms of content, the foci of the HRM practices must be designed around a particular strategic focus, such as service or innovation (Bowen and Ostroff, 2004, p. 206)."

Here they appear to suggest the strategic element of human resource management (SHRM) with internal and external fit. These two fit are explained earlier in detail; here we will try to put some light on the SHRM and its significance from an HRM system perspective. Jackson and Schuler used HRM as an umbrella term that encompasses (a) specific human resource practices such as recruitment, selection, and appraisal; (b) formal human resource policies, which direct and partially constrain the development of specific practices; and (c) overarching human resource philosophies, which specify the values that inform an organization's policies and practices. Furthermore, they believe that these comprise a system that attracts, develops, motivates, and retains employees who ensure the effective functioning and survival of the organization and its members (1995: P. 238).

Continuing on system and strategy link, Miles and Snow (1984) in their portfolio model argued that 'the human resources management system must be tailored to the demands of business strategy'. They have categorized organizations into four types, depending on the particular strategy they are pursuing, as either Defenders, Prospectors, Analysers or Reactors, and advocate a particular set of HR practices designed to support each of these mentioned strategies. It is likely that there is not a single most appropriate set of practices for a particular strategic objective (Bowen and Ostroff, 2004). Rather, different sets of practices may be equally effective (Delery and Doty, 1996) as there are contingencies in HRM systems due to various contextual factors explained below.



Similarly, researchers have taken a contingency perspective, with the assumption that the effectiveness of the HRM system depends on contextual features such as industry, firm size, or manufacturing policies (e.g., Delery and Doty, 1996; MacDuffie, 1995; Youndt et al., 1996). Bowen and Ostroff, (2004) have proposed that when HRM system is perceived as high in distinctiveness, consistency, and consensus, it will create a strong situation. Using social cognitive psychology and social influence theories, they have proposed a set of characteristics that allow HRM systems to create strong situations in which explicit messages are communicated to employees about what is appropriate behavior. These characteristics refer to the process by which a consistent message about HRM content can be sent to employees. As Way and Johnson (2005) explains a similar depiction that, the HRM system(s) employed by an organization are a product of the extent to which the organization's actual HR outcomes match those HR outcomes necessary for the organization to achieve its goals and objectives.

Concluding these comments, Bowen and Ostroff, proposed that a strong HRM system process can enhance organizational performance owing to shared meanings in promotion of collective responses that are consistent with organizational strategic goals (assuming the appropriateness of those goals). More specifically, they believe that an HRM system high in distinctiveness, consistency, and consensus should enhance clarity of interpretation in the setting, thereby allowing for similar “cognitive maps” or “causal maps” to develop among people, as well as to create an “influence situation” whereby individuals yield to the message and understand the appropriate ways of behaving (Bowen and Ostroff, 2004, p. 206). As Paauwe (2005) linking HRM system with performance depicted that ‘a real contribution to performance (in its multidimensional meaning) will happen only once we approach HRM from a more holistic and balanced perspective, including part of the organisational climate and culture, aimed at bringing about the alignment between individual values, corporate values and societal values. This will be a unique blending for each organisation, which is difficult to grasp by outsiders (including competitors) and thus contributes to sustained competitive advantage. Current discussion guides us in deciding that using HRM system (bundle of HRM practices) can be better as compare to taking isolated HR practices. So we aimed to identify a context specific HRM system having some association with firm performance. Additionally, this intact discussion on HRM policies and practices lead to the sub-component of HRM sophistication in the conceptual model shown in figure 4.1.

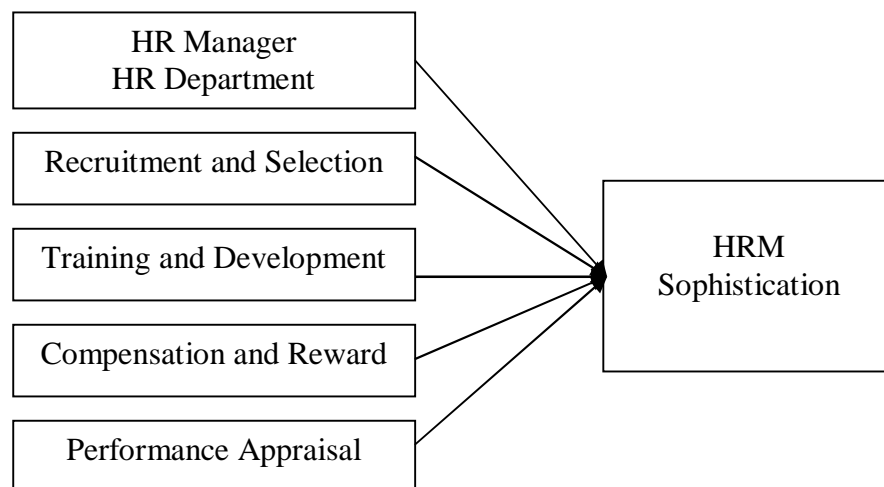


Figure 4.1 HRM Sophistication and SME Performance (sub-model component)

## **4.4. Organizational Context**

### **Organizational Contextual/Control Variables**

In many studies the amount of control variables have in fact been very limited. This problem has been acknowledged by e.g. Gerhardt and Becker (1996, 795). The controls that mostly have been used are organization age and size, industry, union status, (in some cases) business strategy, (in some cases) geographical area of the organizations or units studied, sometimes R&D and prior sales growth (Ehrnrooth, 2002). There are several contextual and control variables that can impact on HRM sophistication. However, it is difficult to consider all these contextual and control variables but we have tried to include several important variables mentioned in the literature and in light of the context of our study sample. These selected variables are discussed in detail below for further explanation and presented in figure 4.3 to show their impact on HRM sophistication.

#### **4.4.1. Firm Size**

Research has shown a positive relationship between firm size and performance (Delery and Doty, 1996; Huselid, 1995). Firm size had a significance influence on the adoption of HRM practices (Hornsby and Kuratko, 1990; Little 1986; Wagar, 1998). Need to decentralize and communicate between employees and departments increases, in the process of organization expansion. This requires a certain level of standardization, specialization and formalization (Daft, 1998; De Kok et al., 2003; Nooteboom, 1993). It is clear that the firm size (increase in number of employees) can impact on HRM sophistication, as firm growth might require formal structure for gaining legitimacy in challenging internal and external environment for labour relations. HRM sophistication/formalization dimension and its relationships with firm size have emerged from previous studies of HRM in SMEs (Nguyen and Bryant 2004). According to Jackson and Schuler (1995) 'institutional theory suggests that larger organizations should adopt more sophisticated and socially responsive HRM activities because these more visible organizations are under more pressure to gain legitimacy'.

A study on management effectiveness conducted in Pakistan, made an analysis at various organizational levels (Afghan, 1998) explains four variables which are considered as dependant on the organization/unit size. These are portrayed in figure 4.2 below; these are the degree of formalization, the degree of centralization, the level of standardization and the division of labour within an organization. He is in the opinion that changes in the size of the organization influences the degree of centralization, formalization, standardization and division of labour. Furthermore, changes in these variables can lead to changes in the span of control in the organization and this might be the sophistication of management practices in organizations. Daft (1986) explains that smaller firms distinguish themselves by lower levels of vertical and horizontal complexity, formalization, specialization, decentralization and staff support. HRM systems reflect these distinctions, and are obviously less formalized in smaller firms (Jackson et al., 1989). It is usually assumed that divisions of labour in SMEs may not be usually desired for operational flexibility and to avoid bureaucratic and hierarchical systems.

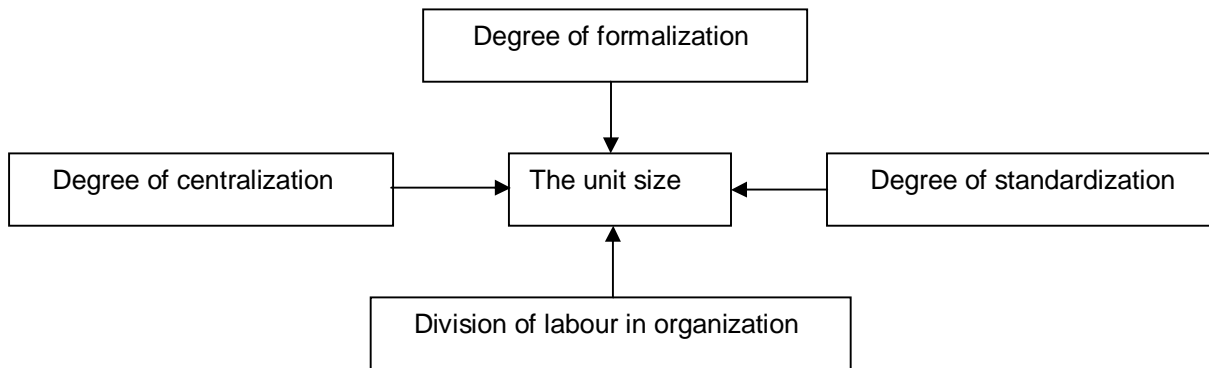


Figure 4.2  
Source: (Afghan, 1998)

De Kok et al. (2003, p. 7), considered three points as key for justifying the investigation of relationship between firm size and HRM sophistication/formalization in a similar study but in Dutch SMEs context. First, if organizations become larger, the need to decentralize and communicate between employees and departments increases. Second is the financial resource perspective, as formalized HRM practices require considerable development costs (Klaas et al., 2000). This provides cost advantage to large firms as many small firms countenance tight supply of financial resources. Finally, they believe that the requirements from external stakeholders will also differ between small and large firms: legislation is often differentiated by size class. Some studies even depict the partial relationship between firm size and HRM sophistication/formalization link only with few HRM practices (De Kok et al., 2003) but various studies have identified firm size as a main organizational factor influencing HRM policies and practices in SMEs (Child, 1986; De Kok and Uhlaner 2001; Hornsby and Kuratko, 1990; Kotey and Slade, 2005; Nguyen and Bryant, 2004; Wagar, 1998).

Firm size is used as control variable in this study and we have selected SMEDA's definition for selecting firms in our sample. Firm size is operationalized by using the number of employees. According to the selected SME definition, two types of firms included in our sample both small (10 - 35) and Medium-size (36 - 99). Research shows that formality begins when firm size reaches at 20 or more employees, so our sample does not include firms having fewer than 21 employees. As a result our sample will be all firms between 20 -100, in this sector from Lahore Pakistan. This will help in exploring of the impact of size on HRM sophistication.

#### 4.4.2. Large Firm Associate

Although considerable debate exists regarding the risks and benefits of building relationships with other organizations for commercial purposes, few would disagree that forming and managing external relationships is an important strategy for small business development (Street and Cameron, 2007). Today new transportation and communications technologies allow even the smallest firms to build partnerships with foreign producers to tap overseas expertise, cost-savings, and markets. The scarce resource in this new environment is the ability to locate foreign partners quickly and to manage complex business relationships across cultural and linguistic boundaries (Saxenian A., 1999). At present, independent enterprises produce all of the components that were once internalized within a single large corporation from application software,

operating systems and computers to microprocessors and other components (Saxenian A., 2002) and similar situation is with many other technology intensifies product. Street and Cameron (2007), explains from RBV perspective that future research can determine what types of resources are best accessed and shared through relationships with larger partners, as well as the conditions under which sharing is facilitated and inhibited.

James (2001) has explained firm association using two figures (Gereffi, 1999) as there are two types of chains: "producer-driven" and "buyer-driven". In the former, large manufacturers play the central roles in coordinating the production networks. Producer-driven chains are typical in capital and technology-intensive industries such as automobiles, aircraft, semiconductors, and heavy machinery. In the latter, large retailers, branded marketers, and branded manufacturers play the coordinating roles. Buyer-driven commodity chains are typical in labor-intensive, consumer goods industries such as garments, footwear, toys, house-wares, and consumer electronics. These explanations also justify the use of this organizational contextual variable as our study sample consists of garment manufacturers and exporters, and according to James (2001) and Gereffi (1999) classification of firm association/network includes in "buyer-driven" association. Many manufacturers in Pakistan hold strong ties with top brand manufacturing and retailing companies in the global apparel products market.

SMEs in this sector considered large firm association beneficial in many ways for example: gaining access to global markets through exports, learning opportunities through knowledge of experienced large associates. This in response helps small firms to develop advance management systems. Taking into account the institutional theory and resource-based view, various institutions demand for transparent management practices for ensuring place in the international trade and these large firm associate thus help them to use standardize HRM practices due to scarce resource availability. According to De Kok and Uhlaner, (2001), smaller companies that work closely with a larger company, either as a supplier, customer, or franchiser, may gain access to relevant HRM programs (training module or performance appraisal instrument) from the larger firm. The large firms may also communicate higher expectations to their associated small firms regarding the value of more sophisticated HRM practices due to institutional legitimacy (e.g. through ISO 9000 standards, etc.). Finally, close contact with a larger firm associate may result in a better understanding by the small firm CEO of some of the benefits of such practices (De Kok and Uhlaner, 2001). Large firm association will be used as dummy variable (0 = No, 1= yes) to check its impact on HRM sophistication.

#### **4.4.3. Business Plan**

A detailed examination based on various studies by Bracker and Pearson (1986) described success and failure of small businesses. According to this detailed examination, a lack of planning or inadequacies in a firm's planning process may contribute to a firm's failure, while planning processes that are well-developed, soundly implemented, and properly controlled contribute to a firm's success. Research also reveals that operational and managerial flexibility seems feasible for small firms due to inexpensive and productive for such kind of small firm operations. This phenomenon seems true as research show that SMEs plan short term as compare to large organizations.

Bracker and Pearson (1986) have classified the sophistication of strategic and operational planning in small firms. Furthermore, four distinct levels of sophistication in the strategic planning process were identified in this research:

- Structured strategic plans (SSP);
- Structured operational plans (SOP);
- Intuitive plans (IP) and;
- Unstructured plans (UP).

From these four, first two (SSP and SOP) are rare in small firms and intuitive plans normally are seen in entrepreneurial organizations. They have explained intuitive plans in table 1 as “these informal plans are developed and implemented based on the intuition and experience of the owner of the firm. They are not written and are only stored in the memory of the firm's owner. They are of a short-term duration, no longer than one year in nature. They depend on objectives of the owner and the firm's present environment”. Research reveals that small firms having structured strategic plans (formalized, written, and long-range plans) have effect on HRM policies and practices and business plan can be interpreted as a characteristic of organizations with a relatively long planning horizon (De Kok et al., 2003). Bracker and Pearson (1986) hypothesized that three primary factors contribute to financial performance in small, mature firms. Two of these factors are the managerial orientation of top management and the sophistication of the strategic planning process they employ. Managerial orientation for sophisticated strategic planning (HRM) is depicted in our conceptual model as ‘perceived value of HRM practices by the CEO’ in a competitive environment.

It is assumed that CEO and stakeholder can perceive HRM policies and practices valuable and will be more eager to use relevant HRM practices for fulfilling the requirement of formal business plan to achieve business objectives. This variable will help to investigate the planning span of small firm and give empirical evidence whether or not small firms plan their business operations strategically and does existence of a written business plan have any impact on the HRM sophistication. Robinson and Pearce (1984), a detailed literature review study on strategic planning in small firms, identified that small firms do not plan. Furthermore, this research has explained that strategic planning in small firms can be divided into four major thrusts. We can justify that variable of business plan is important as two of the mentioned four divisions of Robinson and Pearce (1984) witness: (1) to confirm empirically the presence or absence of strategic planning practices; (2) to provide empirical evidence of the value of strategic planning. We expect that this variable will provide twofold evidence first, for strategic planning and second, its impact on HRM policies and practices leading to HRM sophistication in SMEs. Business plan will be used as dummy variable (0= No, 1=yes) to check its impact on HRM sophistication.

#### **4.4.4. Exports**

‘Exporters by definition target growth by seeking new markets outside the boundaries of their own countries’ (De Kok et al. 20003). Penrose (1959) has observed that firms are able to grow and develop only when excess ‘managerial services’ are released to exploit the productive opportunities of the firm. Penrose theorized that the managerial limits on firm growth could not be simply overcome by hiring in the market. Growth limits are placed by the time required for organizational learning and social integration, within an extended management or human resource group (Thakur 1999). Furthermore, De Kok

et al., describe that exporting may indicate a relatively long planning horizon of the organization. Exporting often involves additional administrative burdens and getting acquainted with legal and other requirements in different other countries. They believe that willingness to overcome these specific difficulties and start-up costs suggests a relatively long planning horizon which can lead to an increased awareness of the importance of HRM (2003, p. 8).

It is also observed that strategies fostering growth may result in a greater emphasis on formal HRM development (De Kok and Uhlaner, 2001; De Kok et al. 2003; Lengnick-Hall and Lengnick-Hall, 1988). Thakur (1999) in a case-based research of several Indian establishments from diverse industries concluded that companies with a goal of new venture growth tend to have more professional HRM practices. De Kok et al. describing a study of Matthews and Scott (1995) in 130 small firms finds that entrepreneurial firms (defined as those aiming at higher growth) engage in more sophisticated planning than small firms in general; although they find that as the perception of environmental uncertainty increases, strategic and operational planning decrease (2003, p. 8). From this discussion, our assumption is that SMEs exporting to various other countries use more sophisticated HRM practices than non-exporting and without growth oriented SMEs. We will use exports as a dummy variable (0= No, 1=yes) to check its impact on HRM sophistication.

#### **4.4.5. Age of the Firm**

Evans (1987) find that firm age is an important determinant of firm growth and the variability of firm growth. Age of the firm impacting the growth of the firm lead to assume that it might be having an association with the formalization of management practices especially management of its employees. It is widely held that new ventures experience different kinds of problems as they grow and mature (Rutherford et al., 2003). We are interested in exploring the relationship between how long an employer has been in business (firm age) and its possible impact on the HRM system. As whether mature firms use more sophisticated HRM system and practices as compare to new ones and/or start up. No doubt it is very important question in this field to be answered with a detailed focus but here we will only check the variation between sophistication of HRM in different categories of firms with respect to their age. Firm age will be determined with a simple measure that how long firm has been in current business operations.

Elaborating this point further, several researchers have given a useful way to think about organizational growth and change through a provided concept of a life cycle, and they explain that as organizations mature, they may develop unadaptive patterns of thinking and behavior. According to Daft (1998) the founders of any business are entrepreneurs and they devote their full energies to the technical activities of production and marketing in the initial entrepreneurial stage of life cycle. In this stage organization activities are considered as informal. After some time organizations moves towards formalization and involves the installation and use of rules, procedures and control systems. Engineers, human resource specialists, and other staff may be added with a more formal communication (Daft 1998, P. 173-176). This is the general idea about how organizations move from their business starting through various stages and hence with the passage of time and growth, they choose formal procedure. Here as mentioned above we will check the impact of age of the firm on HRM sophistication and whether HRM sophistication has any link with the difference in age.

#### 4.4.6. Ownership

Ownership here refers and used to differentiate between family and non-family business and further to identify ownership's possible impact on HRM practices in SMEs. In previous research, the definition used to distinguish a business as a family firm was if any family own more than 50 percent of the shares and participate in the business activities. According to Reid and Adams (2001) family business should be regarded as a special case regardless of its size, as the long-term commitment of the CEO and family members involved in management require the balance of not only management but ownership. Family businesses employing family members need to address both these issues in many cases. Owing to the unique organisational structure of the family business HRM policies may require greater clarity in the areas separating ownership and management.

Reid and Adams depict that the search by SMEs for a “competitive edge” through more effective utilisation of human resource practices appears to put family firms, in particular, under even greater stress. Family businesses may be pressured at times to employ, promote or end employment for close or extended family members. It is also extremely difficult for a CEO who is the father, mother or uncle to practice HRM management objectively with family members (2001). In another study, Mintzberg and Waters (1990) suggest that all companies will professionalize with increasing size, the family firms in this study have tended to operate their HR practices in a more distinctive fashion compared to their non-family counterparts. This is characterized by informality despite the push for formalization typical of larger sized firms to improved efficiency (Reid and Adams, 2001).

Findings of some studies related to this issue generally support that family businesses, perhaps partly due to their limited organisational capability, have lagged behind their non-family counterparts in implementing HRM policies and practices (Astrachan and Kolenko 1994; Reid and Adams (2001). Our interest here is to look whether Pakistani SMEs posses similar picture or family owned businesses are practicing HRM practices as their non-family counterparts. We will use ownership as a dummy variable and if that is family business or not (0 = No, 1= yes) to check its impact on HRM sophistication.

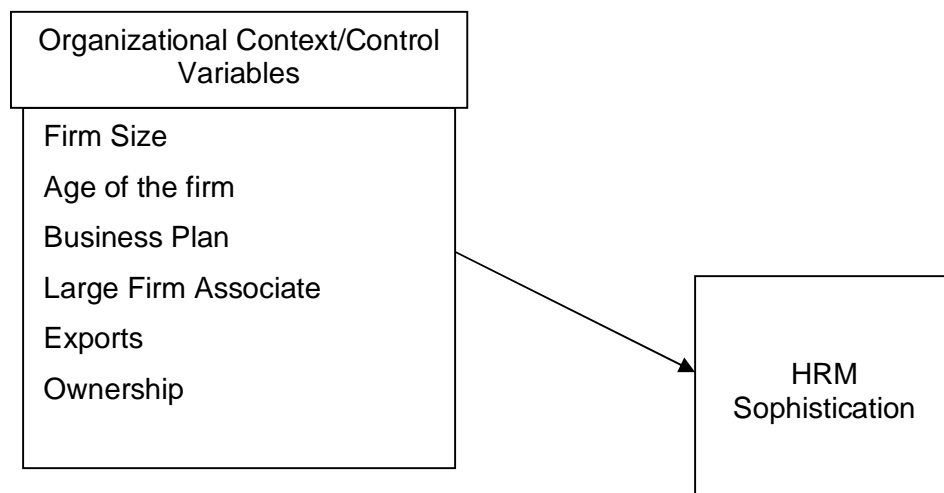


Figure 4.3 HRM Sophistication and SME Performance (sub-model component)

## **5. ORGANIZATIONAL PERFORMANCE**

### **Introduction**

It is virtually impossible to read a business periodical or newspaper anywhere in the world without seeing stories detailing that the success of a firm is due to how effectively it manages its people (Schuler, 2000). Organizational performance can be explained from several different kind of perspectives and there are several aspects which mutually be considered to define organizational performance comprehensively, rather than an alone financial measure of profits which is heavily criticized. According to Daft (1998), 'profitability reflects the overall performance of for-profit organizations. Profitability may be expressed in terms of net income, earnings per share, or return on investment'. Employee moral, market share and social legitimacy (see institutional theory part) may be considered as part of the overall performance in the highly competitive business world demanding more corporate social responsibility with satisfactory financial rewards.

Achieving better organizational performance requires efficient and effective use of organizational resources to gain sustainable competitive advantage. This involves strategic element of organizational planning which creates and increases organizational effectiveness and competitive advantage to achieve overall performance goals. According to Guest et al., (2003) a major challenge for organizations in the future seems likely to be an ever more urgent search for competitive advantage. It is increasingly argued that the organizations best able to meet this challenge will be those that can acquire and utilize valuable, scarce and inimitable resources (Barney, 1995). Employees can fall into this category, it is argued, particularly if they are effectively deployed through appropriate human resource practices and the management of organizational culture (Barney and Wright, 1998; Guest et al., 2003).

Hence for assessing organizational performance it is difficult to choose the right performance indicator as performance refers to several organizational outcomes. These can be objective and/or subjective; consequently it is helpful to select a blend of some key organizational outcomes. This chapter explains organizational performance in detail with respect to theoretical literature, showing a link between HRM and organizational performance, with a focus on performance perspective as we have already explained HRM variable in depth in the previous chapters. First, a general analysis of HRM and performance is given. Then six theoretical models of HRM are explained, next to this several empirical studies on HRM and performance are inscribed following some discussion on HRM and SME performance. Final part includes discussion about performance measurement with relevant issues for measurement of this variable. In the end, sub-components lead to conceptual model in line with the complete discussion, including all previous chapters.

### **5.1. HRM and Organizational Performance**

The impact of human resource management on performance has become the dominant research issue in this field (Guest, 1997: p. 263). The interest in quantifying the impact of HR practices on financial performance has led to a number of studies which linked the impact of HR practices to specific firm outcomes. Ulrich in a review of previous studies



on HRM and results concludes that HRM practices seem to matter; logic says it is so; survey findings confirm it (Ulrich, 1997), this depiction is shown in detail in section 5.1.2.

Strategic perspective on HRM pertains to how the overall set of HRM practices is generally associated with firm performance and competitive advantage (Ferris et al., 1999). As discussed in the theoretical framework section RBV perspective (Barney 1991; Wernerfelt, 1984), human resource which is believed to be the most valuable asset any organization have and key tasks for organizations will therefore be the effective management of employees (Guest et al., 2003) to create organizational effectiveness for gaining sustained competitive advantage. It is notable that gaining competitive advantage seems fairly possible but sustaining it over a long time requires considerable managerial effort and strong planning horizon with dynamic resources, in highly challenging world of today's business.

A similar depiction is made in the concluding remarks by Paauwe and Boselie, (2005), 'a real contribution to performance (in its multidimensional meaning) will happen only once we approach HRM from a more holistic and balanced perspective, including part of the organisational climate and culture, aimed at bringing about the alignment between individual values, corporate values and societal values. This will be a unique blending for each organisation, which is difficult to grasp by outsiders (including competitors) and thus contributes to sustained competitive advantage'. Next section demonstrates the link between HRM and performance using six theoretical models from several developed so far in previous studies.

#### **5.1.1. Theoretical models of HRM**

Way, (2002) suggests that the theoretical and empirical HRM research has led to a general consensus that the method used by a firm to manage its workforce can have a positive impact on firm performance. Establishing that HRM practices are linked with firm effectiveness is an important first step in this line of research. However, there is still little understanding of the mechanisms through which HRM practices influence effectiveness (Delery 1998, p. 289) which may result in better firm performance. Several theoretical models have been developed to demonstrate this. We have selected and used few of them for further analysis to reach on any consensus to develop a better conceptual model that can serve for investigation of possible relationship between HRM and firm performance in this study.

These models address key ideas about HRM and effectively offer quite a comprehensive map of the field. They classify HRM practices and outcomes, and indicate the relatedness between practices, outcomes and performance (Zheng et al. 2006). The point to mention here is that there seems variance among HRM practices, outcomes and performance indicators in various models of HRM and firm performance. They are unable to specify a single list of effective HRM practices, outcome and/or performance indicators for future empirical testing. According to Sonnenberg, (2006) these researchers thus assume that adopting commitment systems (or whatever terminology they use) are best for all organizations and do not specify alternative systems which could be equally effective but on the other hand they differ in one list of HRM practices, outcomes and performance indicators. These commitment systems are supposed to generate high commitment as a result of their focus on enhancing skills and motivation of employees. The assumption is that organizations cannot be high performing without the commitment of employees (Sonnenberg 2006). There are substantial differences

between the earlier and later models in terms of the HRM practice variables, with greater elaboration in the later models. That said, even among the later models, there is substantial variation in specification and treatment of the HRM practices, outcome variables and measures of performance that are addressed (Zheng et al. 2006).

In this section, we will continue our previous discussion, focusing on the link between HRM and performance, and will analyze these models in published research. The last decade of empirical research on the added value of HRM, also known as the 'HRM and performance' debate, demonstrates evidence that HRM does matter (Huselid, 1995; Guest et al, 2003; Paauwe and Boselie, 2005; Wright et al, 2003). There are now a growing number of studies which make a serious attempt to link HRM and performance (Guest, 1997) which provide evidence to show an association between HRM and corporate performance (Appelbaum et al. 2000; Arthur 1994; Guest et al. 2003; Huselid 1995; MacDuffie 1995). It is interesting to note these finding but we have to bear in mind Guest et al.'s (2003), study which assert that 'most of the published research supporting this association is American; however there are some published studies on this relation are from UK. Some selected theoretical models are inscribed below for further understanding on the topic.

First of these models, Beer et al. (1984) provided broadly defined HRM practices linking to organizational effectiveness through specific HRM outcomes. Zheng et al (2006) interpret as they argued that it is critical to choose HRM policies carefully so as to balance stakeholder interests with situational factors such as business strategy, work force characteristics, management philosophy, and the legal and social context of operations. They advocate that employee groups and unions be considered as stakeholders; in much the same way they advocate consideration of individual well-being as an important outcome (Guest, 1987). It was posited that the adoption of appropriate HR policies would result in favourable HR outcomes and, in the long-term, desirable organizational performance effects. While emphasizing the potential long-term benefits to be gained from the adoption of HRM practices, the HRM inputs and performance indicators were very broadly defined and, therefore, do not offer clear direction about how to operationalize either (Zheng et al., 2006).

Second model in this list is Devanna et al., (1984), which provide broad range of HRM practices as compare to Beer et al. They have selected four generic functions covering major HRM activities: Selection, development, appraisal and rewards. Zheng et al., (2006) observe that this model emphasized the importance of the inter-relatedness and coherence of HRM activities and a coherent HR system should reflect and support organizational structure and strategy. However beside Beer et al. model they were able to comprehend HRM practices but no indication of HRM outcomes is given in this model. This model also lacks in specifying any procedure for measuring performance.

At a time, when almost entire writing and advocacy of human resource management was American in origin, David E. Guest (1987) presented a theoretical framework for further analysis of this approach. In this model, he has presented some policies with specific and detailed HR activities, HR outcomes and organizational outcomes. Consistent application of HRM policies was seen as the only means by which four key policy goals (integration, employee commitment, flexibility/adaptability and quality) could be achieved, thereby delivering enhanced HRM and, in turn, organizational outcomes (Zheng et al. 2006). There is no doubt in saying that he received criticism on adding turnover, absence and grievance in organizational outcome as researchers argue that

these are HRM outcomes. Shortfall in HRM practices and outcomes measurement was similar with both above mentioned two models.

Moving on to a possible broader framework linking HRM and outcomes, Schuler and Huber (1993) model also provides a more detailed view of HRM practices, arguably these covers employees and organization comprehensively. Zheng et al. (2006) explain unique characteristic of this model as they argue and believe that Schuler and Huber (1993) differentiated between several levels of HRM goals that clearly identify how HRM can serve different levels of an organization, and model includes three 'general' goals (attract, retain and motivate employees) which impact 'specific' goals (productivity, work-life quality, legal compliance, competitive advantage and workforce flexibility) and in turn impact the 'bottom line' (survival, competitiveness, growth, profitability and adaptability).

Next to Schuler and Huber, is the model of Guest (1997); he argued that neither the strategic nor the descriptive model provided much insight into how HRM policy and practice translates into high performance. He sensibly views HRM as only part of the explanation for high performance and suggested that, when the various subsystems including the HRM sub-system are aligned and supporting each other, superior performance is likely. Furthermore, the right people will be in the right place doing the right things (Guest, 1997) which can provide enhanced productivity and efficiency for organizational effectiveness to gain competitive advantage. His model comprises of six components: HRM strategy, HRM practices, HRM outcomes, behaviour outcomes, performance outcomes and financial outcomes. Compared to the models discussed above, Guest (1997) more effectively maps the field of HRM, classifying HRM inputs and outcomes and clarifying the relationship between HRM practices, HRM outcomes and organizational performance. HRM outcomes lead to organizational performance which he believes should be both subjective and objective for better measurement of this element possibly: behaviour outcome, performance outcomes and financial outcomes and additionally may be social responsibility and legitimacy. However the criticism made of Guest's earlier model, that several of the performance indicators can be seen to be HRM outcome variables, can also be said of this model (Zheng et al. 2006).

The last model included in the table 5.1 is of Paauwe and Richardson, (1997), which shows a clear link among HRM activities (HR practices), HRM outcomes and organizational performance. In this model, they have place various (other than profit), indicators of firm performance. In the end they have shown the reverse causality assuming that increased firm performance lead to increased HRM activity in the firm. This requires being tested using empirical data whether this holds same picture in the practical scenario of firm operations. They have listed turnover and absenteeism in the right place under HRM outcomes as Guest received criticism for including these variables under organizational performance. In this effort of developing a theoretical framework of HRM and performance link, they pointed out that if we are really to improve on our understanding of the impact of HRM on performance, we need a theory about HRM, a theory about performance and a theory about how they are linked (Paauwe and Richardson, 1997).

Summing up, this is an ideal framework provided by these researchers (see table 5.1) by providing various theoretical models on HRM and firm performance. Though, there are some deficiencies in these models and a main point is identified as incapability of providing unanimous framework for future HRM and performance testing. We believe that still these models can sufficiently provide a baseline for development of new

Table 5.1 HRM practices, outcomes and firm performance indicators in selected six HRM models

Authors/models	HRM practice variables	HRM outcome variables	Performance indicators
Beer et al. (1984)	Broadly described as four main HRM policies: <ul style="list-style-type: none"> <li>• employee influence</li> <li>• Human Resource flow</li> <li>• reward systems</li> <li>• work system</li> </ul>	Specifically mentioned as: <ul style="list-style-type: none"> <li>• commitment</li> <li>• competence</li> <li>• congruence</li> <li>• cost effectiveness</li> </ul>	Broadly defined as: organizational effectiveness, individual and social well-being
Devanna et al. (1984)	Specifically considered generic four areas of HRM: <ul style="list-style-type: none"> <li>• selection</li> <li>• rewards</li> <li>• appraisal</li> <li>• development</li> </ul>	No specific indication in this regard	Broader categorization as: performance
Guest (1987)	Specifically examined HRM polices on: <ul style="list-style-type: none"> <li>• job design</li> <li>• recruitment/selection</li> <li>• appraisal</li> <li>• training and development</li> <li>• reward systems</li> <li>• communication</li> <li>• manpower flows</li> <li>• change management</li> </ul>	Specifically defined as: <ul style="list-style-type: none"> <li>• integration</li> <li>• commitment</li> <li>• flexibility</li> <li>• adaptability</li> <li>• quality</li> </ul>	Specifically defined as: <ul style="list-style-type: none"> <li>• high job performance</li> <li>• high problem-solving skills</li> <li>• high cost-effectiveness</li> <li>• low absence</li> <li>• low staff turnover</li> <li>• low grievance</li> </ul>
Schuler and Huber (1993) (In Zheng et al., 2006)	Specifically defined HRM activities: <ul style="list-style-type: none"> <li>• job analysis and HRM planning</li> <li>• recruitment and selection</li> <li>• appraisal</li> <li>• compensation</li> <li>• training and individual and organizational development</li> <li>• safety and health</li> <li>• union-management relationships</li> </ul>	No specific indication in this regard	General <ul style="list-style-type: none"> <li>• attract, retain, motivate</li> </ul> Specific <ul style="list-style-type: none"> <li>• productivity, quality of work life, legal compliance, gaining competitive advantage, workforce flexibility</li> </ul> Bottom line <ul style="list-style-type: none"> <li>• survival, competitiveness, growth, profitability, adaptability</li> </ul>

Guest (1997)	Specifically HRM practices cover: <ul style="list-style-type: none"> <li>• selection</li> <li>• training</li> <li>• appraisal</li> <li>• rewards</li> <li>• job design</li> <li>• involvement</li> <li>• status and security</li> </ul>	Specifically defined as: <ul style="list-style-type: none"> <li>• employee commitment</li> <li>• quality</li> <li>• flexibility</li> </ul>	Specifically defined as <ul style="list-style-type: none"> <li>• high productivity</li> <li>• high quality</li> <li>• high innovation</li> <li>• low absence</li> <li>• low labour turnover</li> <li>• low conflict</li> <li>• less customer complaints</li> </ul>
Paauwe and Richardson, (1997)	Specifically defined HRM activities: <ul style="list-style-type: none"> <li>• Recruitment/selection</li> <li>• HR planning</li> <li>• Rewards</li> <li>• Participation/consultation</li> <li>• Decentralisation</li> <li>• Training</li> <li>• Opportunity for internal promotion</li> <li>• More autonomy</li> <li>• Formal procedures Coaching</li> <li>• Internally consistent HR 'bundles'</li> </ul>	Specifically defined as: <ul style="list-style-type: none"> <li>• Employee satisfaction</li> <li>• Employee motivation</li> <li>• Employee retention (obverse of turnover)</li> <li>• Employee presence (obverse of absenteeism)</li> <li>• 'Social climate' between workers and management</li> <li>• Employee involvement</li> <li>• Trust</li> <li>• Loyalty/commitment</li> </ul>	Specifically defined as: <ul style="list-style-type: none"> <li>• Profit</li> <li>• Market value</li> <li>• Market share</li> <li>• Increase in sales</li> <li>• Productivity</li> <li>• Product/service quality</li> <li>• Customer satisfaction</li> <li>• Development of products/services</li> <li>• Future investments</li> </ul>
Based on Zheng et al., (2006)			

approaches in future analysis on this subject. Indeed, these helped us in developing our conceptual model, but before we put our model or final thought, it is better to give some light on several empirical studies, which are presented next. After this discussion on empirical some empirical studies, HRM and SME performance is presented for further precise understanding of the topic related to this study.

### **5.1.2. Empirical Studies on HRM and Performance**

Various researchers in this area have demonstrated that HRM practices can influence organizationally relevant outcomes such as productivity and profitability (Arthur, 1994; Delery and Doty, 1996; Guest et al. 2003; Huselid, 1995; MacDuffie, 1995; and Youndt et al. 1996). Majority of these studies have been conducted in the American context. A summary from a number of these empirical studies showing the impact of a 'bundle' of HRM practices on organizational performance is presented in table 5.2.

The results of some of these studies are described by Ehrnrooth as 'Studies of so called high performance work systems vary significantly as to the practices included and sometimes even as to whether a practice is likely to be positively or negatively related to high performance. For instance, Arthur's (1994) study on high performance employment system, which he termed a "commitment" HRM system, indicates a low emphasis on variable pay, whereas the high performance employment systems defined by Huselid (1995) and MacDuffie (1995) have strong emphases on variable pay. Another example would be HR strategies that rely on internal promotions and provide access to employee grievance procedures. Huselid (1995) and Pfeffer (1994) described such practices as high performance. Other studies (Arthur, 1994; Ichniowski et al., 1994) have included these practices as elements of more rigid HRM systems often associated with less productive unionized environments' (Ehrnrooth 2002).

Huselid himself concluded in the discussion that 'across a wide range of industries and firm sizes, I found considerable support for the hypothesis that investments in such practices are associated with lower employee turnover and greater productivity and corporate financial performance. The impact of high performance work practices on corporate performance is in part due to their influence on employee turnover and productivity. Furthermore, he found only modest evidence of any effect for internal fit and little evidence for external fit even though arguments suggest that these can increase firm performance' (1995, p. 667).

Delery and Doty (1996) used three dominant modes of theorizing: universalistic, contingency, and configurational perspectives to demonstrate the strategic HRM as predictor of performance in different organizational settings. Contingency theorists argue that, in order to be effective, an organization's HR policies must be consistent with other aspects of the organization, in other words the "fit" between various HRM practices and organization's competitive strategy, (Miles and Snow, 1994). Contingency perspective gives way to the configurational perspective for creating the both fit of horizontal and vertical. According to Delery and Doty (1996) in order to be effective, an organization must develop an HR system that achieves both horizontal and vertical fit. Horizontal fit refers to the internal consistency of the organization's HR policies or practices, and vertical fit refers to the congruence of the HR system with other organizational characteristics, such as firm strategy (these are mentioned earlier in detail). Some believe that, an ideal configuration would be one with the highest degree of horizontal fit. These are the main notions of strategic human resource management

(SHRM) which might help in understanding the link of HRM and performance as theorists believe that when HRM is ideally linked with organizational strategy it might produce better results.

Youndt et al., (1996) conducted their study on 97 metal plants in the United States, which primarily support a contingency approach to HRM. An HRM system focusing on human-capital enhancement was directly related to employee productivity, machine efficiency, and customer alignment. However after later analyses they argued that this evidence was misleading as this effect was predominately the result of linking human-capital-enhancing HRM systems with a quality manufacturing strategy.

Bowen and Ostroff, (2004) explained that the guiding logic as a firm's HRM practices must develop employees' skills, knowledge, and motivation such that employees behave in ways that are instrumental to the implementation of a particular strategy. Furthermore, they state that researchers have taken a contingency perspective, with the assumption that the effectiveness of the HRM system depends on contextual features such as industry, firm size, or manufacturing policies (e.g., MacDuffie, 1995; Youndt, Snell, Dean, and Lepak, 1996). HRM systems (see earlier section for detailed understanding) are the primary means through which HR strategy can communicate to human resources which behaviors (outcomes) the organization expects and values (Jackson and Schuler, 1995; Way and Johnson, 2005).

On the other hand, it has been posited that to create value, produce sustainable competitive advantage, and enhance organizational effectiveness, the deployed HRM system must be linked with other organizational resources (Delery and Doty, 1996; Huselid et al., 1997; Way and Johnson 2005). There seems consensus among scholars (Way and Johnson, 2005), that the value of SHRM, and the impact of SHRM on organizational effectiveness, will be enhanced when an organization has deployed an HRM system comprised of practices that are consistent with each other and work to elicit those behaviors (outcomes) from the organization's human resources, necessary for the achievement of organizational goals and objectives (Schuler and Jackson, 1987; Wright, 1998).

Some recent studies on this link, Wright et al. (2005), have examined 45 self-contained business units of a large food-service multinational company operating in the US and Canada, and observed a positive casual relationship between HRM practices and organizational performance. On the other hand another extensive study Stavrou and Brewster, covering 3,702 organizations from most of the European Union member countries, concluded the link of strategic HRM 'Bundles' to business performance and they concluded that it is not a myth but rather a work in progress (2005: 197).

Our assumption here is that such an HRM system (able to select, motivate, develop employees ideally) or 'bundle' of HRM practices pose the way to increase HRM sophistication and/or formalization in organization. The more use of coherent HR practices the more HRM sophistication. Ehrnrooth, (2002) proves that 'HRM sophistication' is directly, significantly and positively related to the 'Organizational performance'. Model 42 indicated that, including all controls, there is a strong and significant direct relationship also between 'profitability' and 'HRM sophistication', thus offering support also for hypothesis 5a, (the sophistication of the HRM system will be positively related to organizational profitability).

When we talk about sophisticated and/or formalized HRM, we have to bear in mind that latest available HRM practices may not produce better results simply without effective integrated planning. As research reveal that 'innovative human resource practices are likely to contribute to improved economic performance only when three conditions are met: when employees possess knowledge and skills that managers lack; when employees are motivated to apply these skills and knowledge through discretionary efforts; and when the firm's business or production strategy can only be achieved when employees contribute such discretionary effort' (MacDuffie, 1995). He argued that all three conditions must be met for HR practices to contribute to performance (MacDuffie, 1995: 199).

Here we confront a problem as we lack any specific procedure for explaining which 'bundle' of HRM practices creates holistic HRM system and can have association with better firm performance beside the identified value of 'bundle' approach. Zheng et al., (2006) state as the value of the 'bundle' approach is that, within a holistic HRM system, the factors that most contribute to performance can be identified, and the interaction between different HRM practices can be observed (referring to, MacDuffie, 1995; Snell et al., 1996; Youndt et al., 1996). While several studies have been undertaken in this area, what constitutes a 'bundle' has not been unanimously agreed upon in the literature, as it is also evident in the Table5.2 (Becker and Gerhart, 1996; Stavrou and Brewster, 2005; Wood, 1999; Zheng et al. 2006). For this study we have formulated a selection criterion as mentioned and used in some previous empirical studies for testing HRM and performance link. This is discussed before presenting the conceptual model subsequently after HRM and performance review.

It is also apparent that most of these empirical studies have focused on large organizations and mainly in the American context with few exemptions of other Western countries. Hence, the generalization of these results to SMEs and other developing economies is likely to be subject to error because there may be substantial differences in HRM practices between small and large firms (Kotey and Sheridan, 2004; Watson et al., 1994; Zheng et al., 2006). So, we have used an independent section to understand HRM and SME performance link below.



Table 5.2 A summary of empirical studies on the effects of a 'bundle' of HRM practices on performance

Author	HRM practices	HRM outcomes	Performance Indicator	Size of firms selected for study
Arthur (1994)	<ul style="list-style-type: none"> <li>Decentralized decision-making</li> <li>Employee participation program</li> <li>General training</li> <li>Skill level, supervision</li> <li>Due process</li> <li>Social activities</li> <li>Wage level</li> <li>Benefits and bonus</li> </ul>	<ul style="list-style-type: none"> <li>Control system</li> <li>Commitment system</li> </ul>	<ul style="list-style-type: none"> <li>✓ Employee turnover</li> <li>✓ Scrap rate</li> <li>✓ Labour hours</li> </ul>	30 American steel minimills
MacDuffie (1995)	<ul style="list-style-type: none"> <li>Hiring criteria</li> <li>Contingent compensation</li> <li>Status differentiation</li> <li>Training</li> </ul>	No outcome indicators	<ul style="list-style-type: none"> <li>✓ Labour productivity (the hours of actual working effort required to build a vehicle)</li> <li>✓ Quality (the number of defects per 100 vehicles)</li> </ul>	62 international large automobile manufacturing plants
Huselid (1995)	<ul style="list-style-type: none"> <li>Selection with employment test prior to hiring</li> <li>Selection for non-entry level jobs</li> <li>Performance appraisal as determinant for compensation</li> <li>Formal performance appraisal received by the workforce</li> <li>Incentive compensation</li> <li>Job design</li> <li>Grievance procedures</li> <li>Information sharing</li> <li>Attitude survey and assessment</li> <li>Labour-management participation</li> <li>Intensity of the firm's recruiting efforts (selection ratio)</li> <li>Average number of hours of training per employee per year</li> <li>Promotion criteria (seniority versus merit)</li> </ul>	<ul style="list-style-type: none"> <li>Employee turnover</li> <li>Productivity</li> <li>Employment skills and organizational structure</li> <li>Employee motivation</li> </ul>	<ul style="list-style-type: none"> <li>✓ Accounting profits (GRATE and price-cost margin)</li> <li>✓ Economic profits (logarithm of Tobin's q and total shareholder return)</li> </ul>	495 American firms with over 100 employees

Delaney and Huselid (1996)	<ul style="list-style-type: none"> <li>• Selectivity in hiring</li> <li>• Employee training</li> <li>• Incentive compensation</li> <li>• Grievance procedures</li> <li>• Job or work structure</li> <li>• Internal labour market for employee promotions</li> <li>• Provision of employment security</li> <li>• Vertical hierarchy</li> </ul>	No indicators of outcomes	<ul style="list-style-type: none"> <li>✓ Perceived organizational performance: product quality, customer satisfaction, staff retention and new product development</li> <li>✓ Perceived market performance: profitability and market share</li> </ul>	727 US organizations
Youndt et al. (1996)	<ul style="list-style-type: none"> <li>• Staffing</li> <li>• Training</li> <li>• Performance appraisal</li> <li>• Compensation</li> </ul>	<ul style="list-style-type: none"> <li>▪ Administrative HR system</li> <li>▪ Human-capital-enhancing HR system</li> </ul>	<ul style="list-style-type: none"> <li>✓ Machine efficiency</li> <li>✓ Customer alignment</li> <li>✓ Employee productivity</li> </ul>	97 US manufacturing plants
Lähteenmäki et al. (1998)	<ul style="list-style-type: none"> <li>• HR planning span</li> <li>• HR development span</li> <li>• Relative proportion of HRM investment</li> <li>• Evaluation of the significant of HRM investment</li> <li>• Estimates of importance of management involvement in HRM</li> <li>• Career planning</li> <li>• Organizational status of the person in charge of HRM</li> <li>• Strategic role of HR as evaluated by HR manager</li> <li>• Integration of personnel policies with competitive strategy</li> <li>• HRM awareness</li> <li>• HRM goals</li> </ul>		<p>Three perceptual performance indicators:</p> <ul style="list-style-type: none"> <li>✓ Change of business results in past three years</li> <li>✓ Forecast business results for the next three years</li> <li>✓ Estimated changes in market share</li> </ul>	428 small (with 10-49 employees), medium (50-499) and large (>500) Finnish companies
Ngo et al. (1998)	<p>25 items of HRM practices factored into four categories:</p> <ul style="list-style-type: none"> <li>• Structural training and development</li> <li>• Retention-oriented compensation</li> <li>• Seniority-based compensation</li> </ul>	<ul style="list-style-type: none"> <li>▪ Employees satisfaction</li> <li>▪ Employees retention (inherent as HR outcomes)</li> </ul>	<p>Perceptual firm performance in the areas of</p> <ul style="list-style-type: none"> <li>✓ Sales</li> <li>✓ Net profit</li> </ul>	332 Hong Kong-based multinational companies

	<ul style="list-style-type: none"> <li>Diversity</li> </ul>	<ul style="list-style-type: none"> <li>Employee retention (measured by annual turnover)</li> </ul>	<ul style="list-style-type: none"> <li>✓ Development of new products/services</li> <li>✓ Productivity (calculated by log of sales per employee)</li> </ul>	
Guthrie (2001)	<p>High-involvement work practices including:</p> <ul style="list-style-type: none"> <li>Internal promotions and performance-versus seniority-based promotions</li> <li>Skill-based pay, group-based (gainsharing, profit-sharing) pay, and employee stock ownership</li> <li>Employee participatory programmes, information sharing, attitude surveys and teams</li> <li>Cross-training or cross-utilization, and training focused on future</li> <li>Skill requirement</li> <li>Average annual training hours</li> <li>Use of formal dispute resolution</li> </ul>			164 New Zealand companies with more than 100 employees
Chang and Chen (2002)	<ul style="list-style-type: none"> <li>Training and development</li> <li>Teamwork</li> <li>Benefits</li> <li>Human resource planning</li> <li>Performance appraisal</li> <li>Employment security</li> </ul>	<ul style="list-style-type: none"> <li>Employee turnover</li> </ul>	Employee productivity	62 Taiwanese high-tech companies
Stavrou and Brewster (2005)	<ul style="list-style-type: none"> <li>Training and career development bundle</li> <li>Pay for performance bundle (incl. profit sharing, merit-pay, share-options, group bonuses)</li> <li>Wider-jobs bundle</li> <li>Joint HR-management bundle</li> <li>Communication on organization of work bundle</li> </ul>	<ul style="list-style-type: none"> <li>No HR outcome Indicators</li> </ul>	<p>Business performance measured using a composite of</p> <ul style="list-style-type: none"> <li>✓ Profitability</li> <li>✓ Productivity and</li> <li>✓ Service quality</li> </ul>	3,702 business from 15 EU member states
Source: Zheng et al. (2006)				

### **5.1.3. HRM and SME Performance**

Only few studies (Nguyen and Bryant, 2004; Welbourne and Andrews, 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 Pakistani SMEs. It is crucial to address the development of HRM practices in Pakistani SMEs working in a different cultural, political and legal context. This study will investigate the relationship between HRM sophistication and SME performance, taking into account various organizational contextual variables and organization environment, using above mentioned theoretical framework. Furthermore, we will explore context specific HRM sophistication impacting SME performance, which unsuccessful SMEs might neglect and intend to apply. We assume that a certain level of HRM sophistication will have an effect on firm performance and our recommendation can be of high value to unsuccessful SMEs in this industry and new area for such important analysis.

#### 5.1.4. Performance Measurement

Performance measurement is a current issue in academia, as well as in business community (Wegelius-Lehtonen, 2001). The conceptualization and measurement of organizational performance is a complicated area (Wright and Sherman, 1999, p. 64-65) and various performance outcomes identified and used in empirical research, have been relatively unproblematical but do not yet tell us anything about the overall financial performance of organizations (Ehmrooth, 2002). HR measurement is complex, difficult, and at times confusing, but it can and must be done. When HR professionals start with a clear understanding of business goals (often measured in financial terms), they can turn those business goals into measurable HR practices (Ulrich, 1997).

Traditionally organizational performance was seen as financial results any organization produces, in the course of achieving goals and objectives. Despite the attractions of financial indicators for any attempt to convince senior managers of the impact of HRM, we need to use a greater range of outcome measures if only to understand how and why HRM has an impact on financial results (Guest, 1997). As discussed above organizational performance and its measurement can be difficult to define when it includes both subjective and objective elements. 'The balanced scorecard' explained by Guest (1997) as stakeholder analysis for HRM concept can be helpful for investigation of HRM and performance relationship in a superior manner. This can help in investigation of any association between HRM sophistication and SME performance in this study. It is also notable that the items on the scorecard are those of importance to the financial, customer and employee constituencies, covering this measure comprehensively. Furthermore, Guest, (1997) stresses that if we accept this; we need multiple criteria of performance which indeed is difficult.

Understanding this thought further, Guthrie (2001), draw attention to the role and value of subjective and objective indicators. Guest et al. (2003) believe that there are clear attractions in objective measures, the accountancy protocols on which financial indicators are based have recently come under critical scrutiny in the context of a number of corporate scandals. It is also noteworthy that the level of theory specification implies that performance will be measured mainly through financial criteria (Guest, 1997). In addition, managers are likely to act on the basis of their subjective perceptions of firm performance, (often in relation to competitor's performance). Research to date has used both objective and subjective indicators, and a case can be made for both and we will use both measure to investigate the expected association of HRM with firm performance in this proposed study. We will operationalize organizational performance in terms of the profit, rate of return as compare to their rival and expected growth (Nguyen and Bryant, 2004) as these measures are already used in similar study. Performance scale and items for measurement are further discussed in detail in the research methodology section.

HRM and performance discussion in the previous sections lead to the development of conceptual model that will be used for exploring the HRM and SME performance in Pakistan. This is presented in the Figure 5.1. Various relevant studies discussed above generally affirm the idea that HRM has a positive impact on firm performance, there has been less agreement about which HRM practices and outcome variables for the conceptual model is not straightforward (Zheng et al., 2006). The selection of variables for inclusion in the conceptual model is based on three point criteria as mentioned and

used in a previous study on HRM and SME performance. First, they must have been used in previous studies in the literature. Second, they must be relevant to SMEs, and third they must reflect recent development of HRM practices in Pakistani SMEs. Using first two standards we have proposed our conceptual model. For the third criteria we have to conduct some interviews as pilot study to confirm the variables in this model as sufficient studies on this subject from Pakistan's point of view are not available. In addition, several contextual and control variables have also been included in this conceptual model based on previous related studies.

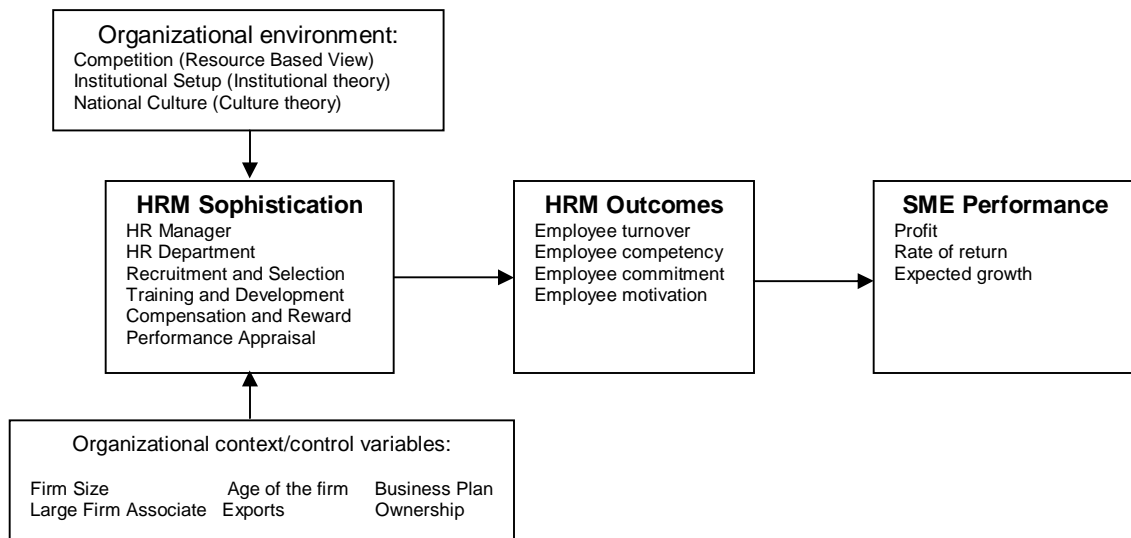


Figure 5.1 Conceptual Model of HRM and SME performance in Pakistan

## Operationalization of conceptual model

In figure 5.1 above, conceptual model is placed. It is our main conceptual model for this proposed study and we reached on this model with a detailed literature review on this subject and with the help of a formula on the basis of various theoretical models and empirical studies on HRM and firm performance. It is notable that only very few studies are on SMEs for investigation of this relationship. We kept this in mind at the time of selection of these variables in the model to make its relevance to SMEs. Definition and operationalization of conceptual model variables is next step in this cross-sectional study. Readers might be aware that through out this paper we have provided less information about HRM outcomes besides their significance for such kind of studies. As already mentioned about objective and focus of this study we are interested first in context specific HRM sophistication (HRM policies and practices) and its association with SME performance. So, we are interested in exploring context specific HRM sophistication having any association with SME performance. In simple words, this study comprises of two parts, first exploration of HRM sophistication and possible factors influencing such sophistication in this context. Second, which type of HRM sophistication (HRM policies and practices) has a positive association with firm performance? Doing so, we may independently define HRM outcomes as mentioned in our above mentioned conceptual model but due to time constraint and questionnaire length, it is wise to skip HRM outcome from this model. However, these clearly provide the real process through which HRM sophistication impact firm performance and our procedure will be different but assumptions and procedure will be same to identify HRM and firm performance association. Assuming this and taking into account some relevant previous studies on HRM and firm performance without HRM outcomes, we will operationalize our model as mentioned below in figure 5.2.

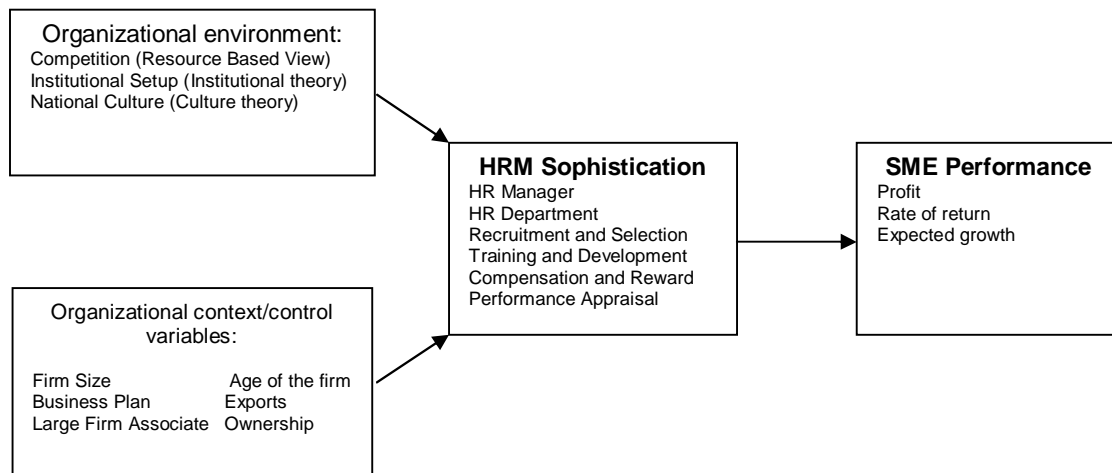


Figure 5.2 Conceptual Model

## **6. RESEARCH METHODOLOGY**

### **Introduction**

Research methodology refers to a systematic way of solving research problem. Essential feature of a good research is its pursuit for reality. It is difficult to reach on reliable and convincing results with out good research methodology, as it aspires for the essential knowledge. Mystics, saints and philosophers, like Imam Ghazali, define this knowledge as the “taste” i.e., the lingering affect of knowing. According to him, “he who has tasted, knows”. Research process explains in proceeding further for conducting research in a better way. According to Easterby-smith (1991) before the decisions on research design choices are made, it is wiser to understand “philosophical issues” around the research process. They have outlined three benefits of understanding research process before making any decisions:

- § First, the study helps researchers understanding the overviews of research design components and procedures.
- § Second, it helps researchers in making the right choices that work well with specific research problems.
- § Third, learning can improve confidence and competencies of researchers in the area where they do not have past experience.

This chapter discusses about research methodology as clear from the title. It includes a detailed discussion on research process including, research philosophy, approach, strategy, time horizons and data collection methods with some choice decision for selection of certain methods for conducting this study. The whole research process is explained in light of relevant literature in the subsequent sections.

### **6.1. Research Process**

Saunders et al. (2000) admit that it is usual if you begin thinking about your research methodology by considering whether you should, for example, administer a questionnaire or conduct interviews. However, they criticized this approach and argue that before coming to this central point there are important layers of the research process “onion” that should be understood before taking any final decision. Research philosophy is the first layer of this research process “onion” (see figure 6.1) proposed by Saunders et al. (2000). The second layer includes research approaches, third layer explains research strategies and fourth layer refers to time horizons applied to research. The fifth and vital layer is about data collection methods. These layers of research process “onion” are explained in detail in the subsequent section for reaching on a solid decision with respect to research design.

#### **6.1.1. Research Philosophy**

Research philosophy refers to the way that we think about the progress of knowledge (Mohammed 2006). This is in the first layer of the research process “onion” divided into two different categories i.e. positivism and phenomenology. These are dissimilar views about the manner in which knowledge is developed and both have an important role to play in business and management research (Saunders et al. 2000). Bryman (2001)



defines positivism as an epistemological position that advocates the application of the methods of natural sciences to the study of social reality and beyond.

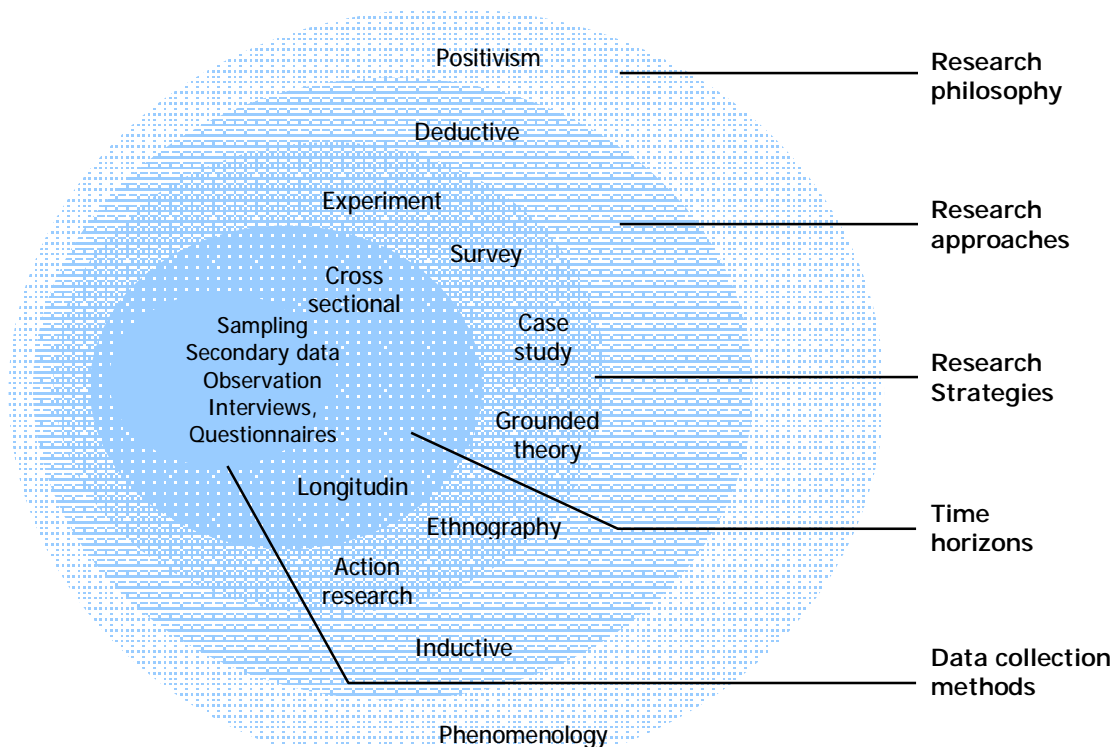


Figure 6.1 The Research Process "Onion"  
Source: Saunders et al. (2000)

Saunders et al., (2000) suggest that researcher in this tradition assumes the role of an objective analyst and there is an emphasis on quantifiable observations. Our study will explore the relationship between HRM sophistication and firm performance. Considering the positivism perspective, our conceptual model comprising of these two variables (including various influencing factors) will lead to a statistical investigation, assuming the role of an objective analysis about data that we will collect through questionnaires from the readymade garment manufacturers and exporters in Lahore.

Second category of phenomenology is described by Bryman, (2001) as a philosophy that is concerned with the question of how individuals make sense of the world around them and how in particular the philosopher should bracket out preconceptions concerning his or her grasp of that world. The strongest argument the phenomenologist mount is the necessity to discover "the details of the situation to understand the reality or perhaps a reality working behind them". This study will try to obtain sufficient information through formal and informal interviews concerning HRM policies and practices. However the dominant philosophy will be the positivism perspective. These two types of research philosophy (positivism and phenomenology) lead to two distinctive research approaches deductive and inductive mentioned in the next layer of Saunders et al. (2000), which are explained next.

### **6.1.2. Research Approach**

According to Saunders et al., (2000) deductive approach relates to the positivism and the inductive approach to phenomenology because deductive approach accentuate on the collection of quantitative data, on the other hand inductive approach emphasizes on the collection of qualitative data. Researchers usually use these terms quantitative and qualitative instead of deductive and inductive. At the moment we can not say that which technique will be applied in this research but one thing is sure that the research focus will be on deductive (quantitative) approach. Both approaches have their own strengths and weaknesses. Of course we can not say that research will totally neglect inductive (qualitative) approach as it will be use when and where necessary in this research for reaching on required finding. Sometimes it seems difficult to find out everything using only one approach as both quantitative and qualitative approaches have some attached benefits. Next section explains various research strategies concerning these two approaches.

### **6.1.3. Research Strategy**

Research strategy refers to a general plan in which researcher tries to get answer to the developed research question, explaining source of data and possible constraints. Several research strategies (survey, experiments, case study, grounded theory, ethnography and action research) are available to answer research question (Saunders et al., 2000). Veerayangkur (2002) has classified experiments and survey as quantitative research strategies while remaining four as qualitative research strategies. Precise description of all these strategies is given below.

#### **6.1.3.1. Survey**

Survey is considered a common and popular strategy in scientific finding for business and management research. This assumption is justified because this strategy permits the collection of a large data from a sizeable population in a highly economical way. Using a survey approach give more control over the research process as this method is perceived as authoritative by people in general. Survey method based most often on questionnaire; however questionnaire is not the only data collection device for survey. Structured observations and structured interviews may be used as well (Saunders et al. 2000). Looking on the importance and relevancy to our study as mentioned above we will mainly use survey for data collection in this study. Next to this, various methods are explained as possible techniques available to a research.

#### **6.1.3.2. Experiments**

The experimental approach is a research strategy that is less often used for data collection in business research as compare to other strategies. The purpose of investigation and its design are more important than the research method. According to Keppel (1991), the approach includes two types of experiments. The first one is “true experiments with the random assignment of subjects to treatment conditions” (Creswell, 1994). The second one is “quasi experiments that use non-randomized designs and single-subject designs” (Creswell 1994).

#### **6.1.3.3. Case Study**

Case study is concerned with the “development of detailed, intensive knowledge about a single “case”, or a small number of related cases (Robson 1993). The case study approach has ability to generate answers to the question “why” as well as “what” and “how”. The data collection methods may include questionnaires, interviews, observations and documentary analysis (see Saunders et al. 2000). Yin (1994, in Melvoky 2005) defines a case study as an “empirical inquiry that investigates a contemporary phenomenon within its real-life context especially when the boundaries between phenomenon and context are not clearly evident”. A case is what a researcher focuses on in order to investigate a phenomenon. It can be an individual, a group such as a family, or a class, or an office; an institution such as a school, a company, a large scale community such as a town, an industry or a profession (Gillham, 2000; Melvoky 2005). This approach is also popular in business research as it allows detailed investigation of a specific case but on the cost of generalizability.

#### **6.1.3.4. Grounded Theory**

Saunders et al. (2000) believes that grounded theory can be the best example of the inductive approach. It is also considered as a strategic approach to data collection and data analysis. Data collection starts without the formation of an initial theoretical framework. Theory is developed from data generated by a series of observations. The theory developed is then tested in further observations which may confirm, or otherwise, the predictions.

#### **6.1.3.5. Ethnography**

Ethnography is also tightly embedded in the inductive approach. Actually it relates and originates from the field of anthropology. The purpose is to interpret the social science world, the research subjects inhabit in the way in which they interpret it. This is a specific type of research process that is very time consuming and takes place over an extended time period (Saunders et al. 2000).

#### **6.1.3.6. Action Research**

Action research is essentially about a group of people who work together to improve their own work processes (Carson et al. 2001). It is usually conducted by practitioners for analysis of their own data to improve their work practices. Saunders et al. (2000) identified three common themes related to action research in literature. The first theme focuses on and emphasizes the purpose of the research. The second theme relates to the involvement of practitioners in the research and in particular the close collaboration between practitioners and researchers. The third and last suggests that action research should have implications beyond the immediate project; in other words it should be clear that the results could inform other situations. Hence, we can say that the action research varies from other types of applied research because of its explicit focus on action, in particular promoting change within the organization.

These are some of the main strategies used in now a day scientific research mentioned by Saunders et al. (2000). These are not all the strategies available for conducting scientific research; Saunders et al. (2000) admit that these strategies are not exclusive.

Saunders et al. (2000) explain that exploratory studies are a valuable means of finding out what is happening; to seek new insights; to ask questions and to assess phenomenon in a new way, while explanatory studies usually try to create causal relationships between variables therefore typically exploratory research is declared as qualitative research and explanatory research is quantitative research. Looking ahead on the other options available to scientists can be classified in terms of purpose of the research also and on the basis of purpose, study may be categorized exploratory, descriptive or explanatory (Robson 1993). Giving required importance to time in the research Saunders et al. (2000) mentioned time horizon in the next layer.

#### **6.1.4. Time Horizons**

Research can be cross sectional or longitudinal on the basis of time horizons (Saunders et al. 2000). Cross sectional study relates to a particular phenomenon at a particular time, on the other hand, longitudinal research's capacity is to consider any phenomenon over a long time as it has to study change and development over long period. In longitudinal studies the basic question is "has there been any change over a period of time?". Saunders et al. (2000), depict that majority (but not all) of the research projects undertaken for academic courses can be categorized as cross sectional studies because these research projects are time constrained. This proposed research is intended to be cross sectional as we have a time constrained as mentioned above but this will not be the first and last. This study will present a way to a non-stop research focus in this field, so we can expect that we may indulge in a longitudinal research in future due to its attached strength.

#### **6.1.5. Data Collection Methods**

Data collection methods are explained in this part of the research, which are concerned with collecting data (Hussey and Hussey, 1997). The central and last layer of the "research process onion" proposed by Saunders et al. (2000) entails the techniques of data collection. First and an important component of this last layer is sampling, and sampling may be explained as a technique to use of a subset of the population to represent the whole population. Sampling is considered as an important element because according to Maxim (1999), regardless of the process used for collecting data, some strategy is required for deciding which units ought to be measured and included in a study and which ones ought to be excluded from the research population. This technique of unit selection for data collection is known as sampling. It may be useful to shed some light on sampling, sampling frame and what are various sampling techniques before starting discussion on various data collection methods.

According to Maxim (1999), sampling is a simple process relating to the two components: the first component is a selection process that describes how individual observations or elements are to be selected. The second component describes how to make inference from the characteristics of the chosen elements to the larger population from which they are selected.

Saunders et al. (2000) separate sampling techniques into two main types i.e. probability and non-probability sampling. The difference between probability and non-probability techniques of sampling is that probability sampling does involve random selection and non-probability sampling does not. With the probabilistic sampling the probability to

represent the population well is known. There is a chance that in non-probability sampling the population may or may not be represented well and these studies are difficult to generalize. In the next two sections, we will explain our sample and sampling frame for this study. In general, researchers prefer probabilistic sampling over non-probabilistic sampling however in applied social research there may be circumstances where it is not feasible, practical or theoretically sensible to do probability sampling (Trochim, 2006). In our case, we intend to use a specific type of firms with the control variable of size and location

#### 6.1.5.1. Study Population and Sample

Research suggests that the informality become apparent when firm reaches 20 or more employees as at this point informal styles of management communication become unfeasible. This study is investigating HRM within SMEs in Pakistan, with a focus on examining the level of formalization (sophistication) and factors influencing such formalization which can have some effect on the firm performance. We have targeted a sample from a region where a similar study has never been conducted. Sample category will be the firms between 20 and 100 employees in Readymade Garments Manufacturers and Exporters (RGME) industry in the area of Lahore Pakistan which is habitat to the most SMEs in this range of employees. Punjab is home to more than 65 percent or 1.9 million businesses in Pakistan and Lahore; the provincial capital of Punjab leads with almost 786 SMEs in this employees' range (size) in different industrial categories as given in the latest official figures of the directorate of industrial establishments Punjab.

More than 20 employees limit is set as research suggest a control variable of firm size of at least 20 for such kind of study and upper limit as 100 is set due to the formal definition applied in Pakistan for SME operations by SMEDA. According to that definition two types of firms both smaller and medium are included in this sample. 90 SMEs (almost 45% of total population in this area, see table 6.1 for categories of the sample) comes under this category from total 203 in this sector of manufacturing<sup>1</sup>. This figure is manageable in 4 years study of PhD and nevertheless it will be a tough job for data collection from these SMEs where such kinds of studies are unusual. Researcher's communication will play a key role in inducing and convincing SME owner-managers in collaborating this study.

Table 6.1 Sample firms' category and size

Firm Size (Number of employees)	Total firms	Percentage
21-35	32	35.55%
36-99	58	64.45%
Total	90	100 %

<sup>1</sup> Figures are included from Directory for industrial establishments, Punjab. Directorate of Industries, Punjab.

## **Sampling Frame**

The sampling frame is closely related to the population. It is the list of elements from which the sample is actually drawn. Ideally it is a list of population members only (Cooper and Schindler, 1998). The sampling frame for any probability sample is a complete list of all the cases in the population from which the sample will be drawn (Hussey and Hussey, 1997; Czaja and Blair, 1996). In simple words, the sampling frame is available complete, accurate and systematically registered data list related to the group of study for investigation. So completeness of the sampling frame is very important.

An incomplete or inaccurate list means that some cases will have been excluded and so it will be impossible for every case in the population to have a chance for selection. Consequently, the sample may not be representative of the total population (Saunders et al 2000). We have chosen Readymade Garments Manufacturers and Exporters in Lahore, Pakistan, as population for this research to find empirical evidences for our study. The directory of industrial establishments Punjab is the most recent one, complete and accurate as compare to other available sources for sampling frame. According to Anderson et al (2002), several methods can be used to select a sample from a population. So we took all the SMEs in this category according to the specified criteria for selection i.e. size according to employees of 21-100 as a purposive sample in non-probability selection technique for sample selection.

Now turning again to data collection methods, according to Kumar (1999), if data is already available and need only to be extracted, then the data is secondary data. The secondary data may be extracted from various documents like government publications, earlier empirical and theoretical studies, census, personal records etc. However when the researcher has must to collect the information, then the data is primary data. Primary sources of data may be observation, interviewing or questionnaire. We will explain interviews and questionnaire and as this study will focus on the questionnaire for collecting information beside little use of interview (in the pilot study) for selection and finalization of variables in the conceptual model.

### **6.1.5.2. Interviews**

This method is also commonly used for gathering primary data. Interviewing can be very flexible, when the interviewer has the freedom to formulate questions as they come to mind around the issue being investigated (unstructured interview), and on the other hand it can be inflexible, when the investigator is to keep strictly to the questions decided before (structured interview). This study is intended to conduct interview of a small percentage of the sample at the start of this study for conformation of the variable as mentioned above. But the main source or method will be questionnaire for data collection which is explained in next section.

### **6.1.5.3. Questionnaire**

This is widely used technique in the survey research. Questionnaires collect data by asking people to respond to exactly the same set of questions (Saunders et al. 2000). Kumar (1999) suggests the administration of questionnaire by mail or by collective administration at the point where most of the target population is gathered. Collective administration of questionnaire ensures a very high response rate. Saunders et al.

(2000) classify questionnaire as self-administered or interviewer administered. Interviewer administered questionnaire may be by telephone questionnaire or by structured interview. Self administered questionnaire may be online questionnaire, postal questionnaire or delivery and collection questionnaire.

For this study, questionnaire will be developed with the help of previous relevant survey studies on HRM formalization and/or sophistication, & HRM and performance especially with respect to HRM and SME performance (De Kok et al 2003; Desislava, 2005; Hornsby and Kuratko 1990; Desislava 2005; Zheng et al., 2006) performance link and HRM formalization in SMEs. The questionnaire for quantitative survey will cover information about the structure of the HRM department (including HR manager), the nature of HRM function, demographic details of respondents, general information about the firm and information about HRM policies and practices in detail regarding recruitment and selection, training and development, performance appraisal, and reward system and in the end firm performance. Description of independent and dependent variable for measurement will be given at the time of questionnaire composition during development of theoretical framework.

### **Questionnaire Translation in Urdu**

Questionnaire will be composed in English first then it will be translated into Urdu (Pakistan's national and practically spoken language in the selected sample) and then back translate it into English to ensure its accuracy. This measure is taken as it is usual in similar studies (see, Nguyen and Bryant, 2004).

### **Respondent**

Data will be collected with the help of questionnaire as mentioned above and the answers to this questionnaire will be preferred by the human resource manager (HR manager) in these SMEs. In case of, non-availability (means if no one is mentioned as HR manger then responsible person for the personnel functions), the preference will be given to the owner-manager or the general manager of the firm for answering the questionnaire.

## **7. CONCLUSION AND RECOMMENDATIONS**

This thesis put some light on HRM and firm performance link with the help of available literature. Besides quite a number of research activities are underway in large organizations, but this phenomenon is turning out to be an emerging issue for understanding in scientific research on SMEs. In this detailed theoretical review of some theories and empirical studies on this issue, we can say that current momentum of research activity, if continued in a same way, might bring valuable findings for the development and understanding of concrete theory on HRM and performance link. As research identifies the need for solid framework to demonstrate HRM and firm performance such finding of continued research can be valuable for future. Here one point takes our attention is the difference between large and small firms with respect to administration of business operation especially the management of employees. This is also identified in various earlier studies conducted so far. Research stresses the need for identification of specific theories and procedures for recommendation to SME which are more appropriate and in the benefit of these firms different in nature from their large counterparts.

In this line, when we study relevant literature either it is on scant or context specific with a focus on explorations only. Emerging research in this area is considered as focused on the exploration and comparison with large firms. Several studies recommend for more future research on questions like how, and why beside what. In such a situation, few recent studies on HRM and performance link have been conducted in SMEs context (Nguyen and Bryant, 2004; Zheng et al., 2006). These mainly focus on HRM formalization and few of them have investigated the link between HRM and firm performance. The problem which we see here is their measurement of HRM formalization (some also call it sophistication: De Kok et al., 2003), few studies in this context only count written HRM policies and practices for overall scale of HRM to measure sophistication and/or formalization. We believe that this procedure may not be appropriate as it lacks the main element of strategic integration, whether these are aligned with business strategy and are also coherent with each other to produce better results. Secondly, in some studies researcher has only focused on the responses of the respondent (which is either HRM manager or general manger of SMEs), we believe that for identifying the real scenario, one has to come across the implementation of these written (formal) practices for measuring their impact on performance. This analysis suggests for more future studies on the link between HRM and SME performance keeping in mind these neglect issues for more precise and valuable findings. We hope that future studies focusing on SME as research sample will take these point in mind in conducting future research on HRM and SME performance. In the next two sections of this chapter scientific and societal relevance of proposed study is inscribed.

### **7.1. Scientific Relevance**

Young entrepreneurial leaders (owner-managers of SMEs) are actively seeking additional knowledge about human resource management issues (Heneman et al, 2000) for better management of their employees. HRM sophistication and/or formalization debate within SMEs is gaining attention at a time when researchers are busy in investigating the right level and/or balance between formal and informal management practices within small firms, hence creating value and competitive advantage for SMEs in real terms. As HRM emerges as an important function for SMEs, further research on



this topic is needed (Hornsby and Kuratko, 1990). Studies suggest introducing necessary formalization for better management while allowing informal nature of SMEs to exist, actually permits flexibility in firm operations. Several studies have been conducted on HRM sophistication and/or formalization in small firms. Some of these reveal various factors influencing HRM formalization. None of the studies has so far been able to determine the right level of formalization required by SMEs. Only few managed to depict the positive relationship between HRM formalization and firm performance. However, many still seem to suggest investigation of such relationship in future studies. Heneman et al., (2002) made an extensive review of HRM in SMEs and suggest that “the study of human resource management in SMEs needs to be strongly encouraged. The attention paid to date has been scant and this is disappointing”.

This study is going to explore context specific HRM sophistication having an association with SME performance. The proposed study is also important due to unique and unexplored institutional and cultural setting of the sample, thus enriching research in field of HRM with something new on this emerging critical issue of HRM and performance in SMEs. Identification of positive relationship between HRM sophistication and firm performance with further validation through empirical evidences can induce SMEs to opt for the right level of sophistication in personnel management to achieve competitive advantage with better overall results.

## **7.2. Societal Relevance**

Scientific literature in economics and business has been continuously pointing out the factual importance of the SME sector due to its tremendous impact on business growth and employment generation in both developed and developing economies across the world. SMEs play critical role in every economy as their success affects the well being of the economy and society at large due to their leading share in employment and economic growth. SMEs are considered as driving force for economic development with enough contribution to exports in a rapidly changing scenario of national and international business operations. Expectations concerning SMEs have been increasing across the world due to their flexible nature of business operations, which helps better adaptability of changing economic environment, to serve the customers better through tailor made products at a time when standardized and globalize items create less value, to ever changing expectations of the strong emerging consumers.

Governments recently affirmed the importance of SMEs and their potential for economic growth, employment and income generation, for better economic outcomes for the well-being of public at large especially in transitional economies like Pakistan, where government inducements for SME's can have large effects in densely populated low income groups. It is unfortunate that Pakistani SMEs alongside some other developing nations are still struggling with the initial problems of getting started. Up until now, efforts from various stakeholders have been presumed as inadequate in rescuing this promising sector from the traditional hitches of ineffective and unproductive management styles shackled by strong cultural, institutional and legislative norms. It is believed that in any economy's success this dynamic sector put some role and value in real terms and on the other hand, this sector's success depends on individual entrepreneur's success. Organizational resources and their utilization determine the path to progress and ultimate success that every entrepreneur strives for. It is our belief that well-crafted studies within SMEs and surveys of employer practices across SMEs

will be valuable additions to the strategic human resource management literature that is becoming so popular in the mainstream journals (Heneman et al, 2002).

It is widely accepted that key resource in business are the employees which make an organization dynamic by providing the basis for a competitive edge in today's fast paced and highly challenging local and international business environment. The challenge that confronts owner-managers is the effective management of this resource to achieve a competitive advantage. Scientific efforts alongside stakeholder activities, in the shape of continuous empirical studies can make discernible contribution to lower management worries that may have a direct impact on business and society in general. Investigation of HRM system will provide valuable findings for this sector's better performance. This single study on HRM sophistication and SME performance may not bridge the tough gap that SME management has to overcome for improved performance, however enough to reach on some findings SMEs desperately requiring among contemporary research in this sector. This will allow us to fulfill, our responsibility as scholars to design carefully thought-out integrative studies that explore what we do not yet know about managing non-founder employees in entrepreneurial ventures (Cardon and Stevens 2004). This study will answer various questions raised by the academics for future research on HRM and firm performance especially in the context of SMEs. Summing up, we will disseminate our knowledge and findings to all the participating firms, including other stakeholders and policy formulating bodies. Results and recommendation of this study will be published in related scientific journals.

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## 9. APPENDIX

### Appendix 1: Subscales for HRM Sophistication

HRM sophistication will be measured using a single overall scale. In addition, separate scales will be used to measure the formality of specific categories of HRM practices leading to HRM sophistication (e.g. De Kok et al., 2002). Based on some previous related studies, this appendix provides some information on the HRM sophistication subscales that would be used in this study. The HRM subscales will be defined using these items in the questionnaire. Each of these items is measured on a 3-point scale (no, for some vacancies/jobs, for all vacancies/jobs) (see, De Kok et al, 2003). On the basis of some previous studies (e.g. De Kok et al, 2003; Desislava 2005; Hornsby and Kuratko 1990), we have just given an intended list of items to define each subscales. This list is not finalized yet, as mentioned earlier; we intend to conduct some interview prior to the finalization of model variable and questions in the questionnaire. The purpose for such interviews is to identify context specific HRM practices (relevant to Pakistani SMEs).

Table 9.1 HRM Subscales

HRM Subscale	Items	
<b>HRM Department</b>	Written HR policies Full time HR manager	
<b>Recruitment</b>	Newspaper Magazines Agency Private Employment Agency Referral by employees Referral from other sources Walk-ins Open house Internet	
<b>Selection</b>	Reference Checks Interviews Aptitude Tests	
<b>Training</b>	On-The-Job Formal training budget Apprenticeships Coaching Seminars Computer-Aided Instruction Recent introduction of formal training programs external training	
<b>Compensation</b>	Market Rate Performance pay Job Requirements Experience/Seniority Minimum Wage Group incentive programs Individual incentive programs	

	Commissions Bonuses Profit Sharing additional financial benefits, other than pensions (for example, insurance and savings arrangements) Benefits Health Insurance Life Insurance Disability Pension	
<b>Performance Appraisal</b>	Rating Scales Narrative Essay Goal Setting appraisal conducted by line manager	

(Based on: Hornsby and Kuratko, 1990; De Kok et al., 2003; Desislava 2005)

## Appendix 2: Macro institutions, national values and their impact on HRM in Pakistan

Table 9.2

Macro institutions	National values	HRM (in practice)	Attitude in organizations
Social Religion: Localized and overshadowed		Limited impact	
Indian origin	In-group life  Strong dependence Need, respect for Authority	Gap between policy And practice Little autonomy, little Communication, formal And hierarchical Structure	Frustration Desire to establish Systems, which offer Greater autonomy and frequent communication
British	Dominance of an elite class	Dominance of elite classes	Frustration
American	Management education		Perception that American management is progressive
<i>Political /economic</i> Uncertainty	Culture of broken Promises  Poor development record	Gap between policy and practice, culture of broken Promises  Little training	Lack of trust, pessimism, de-motivation and dissatisfaction

Source: Khilji (2003)



## Appendix: 3 Time Plan

The main activities, objectives and the time schedule that will be observed during this research are given in the table 9.2.

Table 9.3 Research Plan

Time Period	Activities	Objectives
April 2007– March 2008	<ul style="list-style-type: none"> <li>§ Literature review</li> <li>§ Finalizing theoretical frame work</li> <li>§ Refining the conceptual model</li> <li>§ Composition of the research questionnaire</li> <li>§ Development and improvements in the questionnaire and semi-structured interviews for conducting pilot study</li> <li>§ Translation of the questionnaire in Pakistani language (Urdu)</li> <li>§ Conducting pilot study (protocol interviews) of 5 - 10 % firms in Pakistan</li> <li>§ Studying research methodologies</li> <li>§ Development of the research design</li> <li>§ Writing the research methodology chapter</li> <li>§ Analysis of the protocol study</li> <li>§ Refinement and finalization of the conceptual model</li> <li>§ Starting for the preparation of first paper for any conference or relevant HRM Journal</li> </ul>	<ol style="list-style-type: none"> <li>1. To have sufficient topical literature review (In depth knowledge of subject)</li> <li>2. To have knowledge of research methodologies</li> <li>3. To finalize the detailed research proposal</li> <li>4. To conduct the Pilot study</li> </ol>
April 2008 – March 2009	<ul style="list-style-type: none"> <li>§ Completing the research methodology chapter</li> <li>§ Definitions and operationalization of study variables for revised questionnaire</li> <li>§ Final revision in the study questionnaire</li> <li>§ Translation of final questionnaire in Pakistani language (Urdu)</li> <li>§ Finalizing main questionnaire for the quantitative survey</li> <li>§ Distribution of the questionnaires for main study</li> <li>§ Writing literature review chapter</li> <li>§ Follow up of distributed questionnaires</li> </ul>	<ol style="list-style-type: none"> <li>1. Finalization of research questionnaire and distribution</li> <li>2. Completing research methodology chapter</li> </ol>
April 2009 –	<ul style="list-style-type: none"> <li>§ Compilation of data obtained from</li> </ul>	

March 2010	<ul style="list-style-type: none"> <li>questionnaire</li> <li>§ Data analysis using statistical software</li> <li>§ Preparation of second conference paper using quantitative data</li> </ul>	<ol style="list-style-type: none"> <li>1. Data Collection, compilation and analysis</li> <li>2. Preparation and presentation of at least one conference paper</li> </ol>
April 2010 – March 2011	<ul style="list-style-type: none"> <li>§ Preparation of third paper for conference and/or any relevant international HRM and SME journal</li> <li>§ Presentation of findings and results at participating firms</li> <li>§ Writing PhD dissertation and defense</li> </ul>	<ol style="list-style-type: none"> <li>1. Preparation and presentation of second paper</li> <li>2. Dissertation writing and defense</li> </ol>