

# HOW HRM PRACTICES RELATE TO FIRM PERFORMANCE - A MODEL PROPOSED

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## ABSTRACT

*This study examined the Relation of Human Resource Management (HRM) practices (selection, training, compensation, and appraisal) with the Firm performance (operational performance and financial performance) of selected firms in Almaty, Kazakhstan. Survey results from sampled respondents indicated that HR Practices were significantly related to operational performance of the firms. Further analysis also indicates that operational performance was significantly related to firms' financial performance. Implications are discussed and a model is proposed for understanding the relation between firm Performance and HRM practices.*

**Key Words:** HRM Practices, Operational Performance, Financial Performance.

## INTRODUCTION

The Increasingly competitive global economy is pushing firms to exploit all of their available resources as means of achieving desired firm performance. Recently human resources of the firms have been recognized as an important source of achieving firm performance. Such recognition by many have resulted in growing conceptual and empirical research works directed at understanding the relation between human resource management and firm performance.

The seminal work in this area was produced by Huselid (1995) who examined the relationship between HR practices and corporate turnover, profitability, and market value. He surveyed Senior HR executives in a sample of 968 publicly traded corporations in the United States regarding the percentage of employees who were covered by a set of HR practices he considered representative of a High Performance Work System (HPWS). After controlling for a number of variables, he found that his HR index was significantly related to the gross rate of return on assets (a measure of profitability) and Tobin's Q (the ratio of the market value of a firm to its book value). This study provided the foundation for much of the research that followed.

MacDuffie (1995) found that the HR practice "bundles" he measured were related to quality and productivity on auto assembly lines.

Youndt, Snell, Dean and Lepak (1996) found that human capital enhancing HR practices were related to operational performance among a sample of manufacturing plants.

Delery and Doty (1996) examined the relationship between HR practices and profitability in a sample of banks in the U.S. In testing universalistic, contingency, and configurationally approaches to HR, they found that in general, HR practices were positively related to profitability.

Brian Becker & Barry Gerhart (1996) proposed an answer to 'how HR practices influence firm performance'? They said in simplest terms HR practices must either improve efficiency or contribute to revenue growth. Where efficiency is the organization ability to accomplish its goals, achieve competitive advantage, satisfy all of its strategic constituencies.

Carl F. Fey (2000) examined the relationship of HRM and performance of 101 foreign-owned subsidiaries in Russia. The study's results provide support for the assertion that investment in HRM practices can substantially help a firm perform better.

Although a number of studies have found a positive relation between HRM practices and different measures of organizational performance, empirical evidence to support that proposition is still scattered. Increasingly, assertions about the virtues of the practices are being transformed into testable propositions and in the last decade an innovative body of literature based on empirical measurement has provided more evidence. This paper is an attempt to further verify the basic question 'Are HRM practices related to performance of a firm'? This study also proposes model showing 'How HRM practices relate to firm performance?'

## THE THEORY

HRM practices are essentially the levers by which a pool of human capital can be developed. Through selection practices the firm seeks to identify individuals that possess relevant skills and abilities. Organizations also invest in the continuing skill development of its human capital pool through

administering a variety of training aimed at increasing and maintaining each individual's job related skills and providing development opportunities for individuals which broaden their skill base. Compensation systems are often used to attract individuals who possess the highest levels of skills. Finally, performance appraisal systems promote skill development through identifying specific skill needs of individuals.

A firm's human resources impact firm performance through exhibiting discretionary behavior (e.g., activities, decision-making, etc.) that provides value to the firm. Much of the writing in the strategic human resource management literature has focused on employee behavior, rather than on employee skills, as the mediator in the relationship between a firm's strategy and its performance e.g., Schuler (1992). Thus, high performing firms must possess workforce members who are motivated to engage in discretionary behavior directed toward achieving organizationally relevant goals. Again, HR practices are the means through which firms seek to motivate employees to engage in discretionary behavior that contributes to the achievement of the firm's goals. Firms can seek to distinguish applicants who are likely to be conscientious workers and who will be unlikely to engage in counterproductive behavior that impedes organizational performance. Similarly, training programs allow the firm to both communicate to employee's proper behaviours, and to socialize employees into the norms and culture of the firm. Appraisal systems identify the extent to which individuals are engaging in both functional and dysfunctional behaviours. Through tying rewards to appraisal systems, firms are able to encourage the employees to exhibit those functional behaviours while refraining from the dysfunctional ones, and thus, to act in the interest of the firm.

Thus HRM practices that consist of an emphasis on selection, training, appraisal, and compensation are positively related to the skills, morale, productivity, and efficiency of the workforce.

## METHODOLOGY

Following three indicators were used in this study:

**1. Human Resource Management (independent variable):** A seven point Likert type of scale was used to measure the HRM practices; this scale was adapted from Snell and Dean (1992). The scale measured four human resource variable viz. selective staffing, comprehensive training, developmental performance appraisal and equitable reward system. The scale contains 32 items covering 4 dimensions. With 7 items coming under selective staffing. 9 items coming under comprehensive training. 8 items coming under developmental performance appraisal and 8 items coming under equitable reward system. As shown in table 1. Every item has seven point response category. A seven point rating scale that ranged from 1=(very low response) to 7 = (very high) was used with the item statement.

Table 1 Scale Measuring Human Resource Management Practices

Dimension	No. of Items
<b>Selective Staffing</b>	<b>7</b>
<b>Comprehensive Training</b>	<b>9</b>
<b>Developmental Performance Appraisal</b>	<b>8</b>
<b>Equitable Reward System</b>	<b>8</b>

**2. Financial Performance Scale (dependent variable):** Financial performance was measured with three items adapted from Terpstra & Rozelle (2003). The questionnaire consists of three items covering three dimensions. The distributions of items are shown in table 2. Every item has eight point response category that ranged from 1=(very low response) to 8 = (very high) was used with the item statement.

Table 2 Scale Measuring Financial Performance of Firms

Dimension	No. of item
Profit Margin	1
Average Annual Profit Growth	1
Average Annual Sales Growth	1

**3. Operational performance Scale (dependent variable):** The operational performance scale was specially developed for this study. A final questionnaire was then prepared, based upon the outcome of item judgment. As shown in table 3 the format of the final draft of questionnaire consisted of 20 items belonging to 7 dimensions. Every item has seven point response category. A seven point rating scale that ranged from 1=(strongly disagree) to 7 = (strongly agree) was used with the item statement.

Table 3 Scale Measuring Operational Performance of Firms

No	Variable	Item
1	Quality	3
2	Speed	2
3	Employee morale	4
4	Employee productivity	3
5	Employee skills	3
6	Innovativeness	3
7	Efficiency	2

A sample was collected from both types of industries namely service industry and manufacturing industry's located in Almaty, Kazakhstan. Stratified random sampling was used to collect 400 samples from different firms viz. 5 banks, 6 trading, 4 construction and 4 food and beverages industries. Table 4 shows biographical information of the sample respondents. The sample includes operations managers, human resources managers or employment coordinators and supervisors of both domestic and multinational manufacture and service industries.

Table 4 Biographical Information of Sample Respondents

<b>Manufacturing Industry</b>	<b>Multinational</b>	<b>Domestic</b>
Managers	37	36
Supervisors	63	64
<b>Service Industry</b>		
Managers	49	53
Supervisors	51	47
<b>Total</b>	<b>400</b>	

## FINDINGS

Surveys were conducted in each of above mentioned organizations. The respondents were asked to indicate the extent to which their company used a variety of selection, training, appraisal, and compensation practices for managing employees. In addition, the survey asked both the manager and supervisors to assess the quality, speed, productivity, innovativeness, efficiency, skills and morale of the employees as well as to indicate the financial performance of the company. Data was then subjected to statistical analyses; the following correlation between HRM Practices, Operational Performance and Financial Performance was established .as shown in table 5.

Table – 5 Correlations

		Financial performance	Operational performance	HRM practices
Financial performance	<b>Correlation</b>	<b>1</b>	<b>.200**</b>	<b>.029</b>
	<b>Significance</b>	<b>-</b>	<b>.000</b>	<b>.558</b>
	<b>N</b>	<b>400</b>	<b>398</b>	<b>400</b>
Operational performance	<b>Correlation</b>	<b>.200**</b>	<b>1</b>	<b>.911**</b>
	<b>Significance</b>	<b>.000</b>	<b>-</b>	<b>.000</b>
	<b>N</b>	<b>398</b>	<b>398</b>	<b>398</b>
HRM practices	<b>Correlation</b>	<b>.029</b>	<b>.911**</b>	<b>1</b>
	<b>Significance</b>	<b>.558</b>	<b>.000</b>	<b>-</b>
	<b>N</b>	<b>400</b>	<b>398</b>	<b>400</b>

**\*\*.** Correlation is significant at 0.01 level (2-tailed)

From the above analysis two hypotheses were measured the results are as follows:

1. "HRM practices are correlated with operational performance".

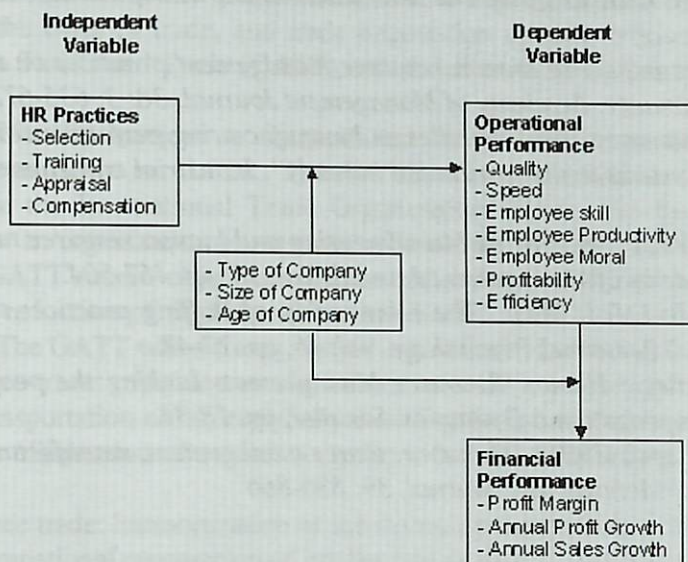
The hypothesis is accepted on grounds of obtained significant 'P' value. The obtained 'P' value is significant at 0.01, level of significance. The correlation value is 0 .911 which suggests that there is a direct relationship between HRM practices and operational performance. This means that the better the HRM practices the better the operational performance of the firm will be.

## 2. “Operational performance variables are correlated with financial performance”.

The hypothesis is accepted on grounds of obtained significant ‘P’ value. The obtained ‘P’ value is significant at 0.01, level of significance. The correlation value is 0.200, which suggests that there is a direct relationship between operational performance and financial performance. This means that the better the operational performance of the firm the better its financial performance will be.

This result is consistent with Delery and Doty (1996); Dyer and Reeves (1995); Snell & Dean (1992) and many others who investigated the relationship between various human resource management practices and with performance indicators found a number of relationships to be positive and significant.

## CONCLUSION- THE MODEL PROPOSED



**Figure 1- The Model Proposed**

In conclusion it can be said the independent variable HRM practices impact the dependent variable operational performance, which in turn impacts financial performance of the firm. The findings conceptualize the research question which relates HRM practices to organizational performance.

Figure 1 shows the model of the relationship between HRM practices, operational performance and financial performance used in this study. The independent variable HRM practices impact the dependent variable operational performance, which in turn impacts financial performance of the firm. The model suggests that this impact will vary depending upon type of firm, size of the firm and age of the firm.

The above model shows how HRM practices relate to the firm’s financial performance? HRM has indirect relation with financial performance. HRM practices such as selection, training, compensation, participation, influence firm’s resources such as human capital of the firm or employee behavior. It results into creation of a skilled, motivated and empowered workforce that enhances operational performance. This improvement in operational performance can then lead to higher financial performance. Possible measures for operational measures are quality level of firm’s goods and services, the skill of the employee, production speed, and productivity of the workforce and on time delivery etc. Possible measures for financial performance are annual profit growth, annual sales growth etc.

Thus this study verifies the HRM and firm performance relationship and further explains how HRM practices impact financial performance of a firm. The study suggests it is important to pay attention not only to financial outcomes but also to intermediate operational criteria that indicate how financial results are achieved. Further this study proposes that, operational and financial performance variables are not the only determinants of organizational performance; other variables such as marketing and sales performance must also be tested. This type of study should be repeated with larger samples and in other industries.

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## THE ROLE OF INTERNATIONAL INSTITUTIONS IN THE GLOBALIZATION OF THE WORLD ECONOMY

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### 1. Introduction

For the last several decades many countries across the globe have established close contacts. Multinational corporations manufacture products in many countries and sell them to consumers around the world. Money, technology and raw materials move more rapidly across national borders. Along with products and finances, ideas and cultures circulate more freely. As a result, laws, economies, and social movements are being formed at the international level.

According to capitalist economic theory, a completely liberalized global market is the most efficient way to foster growth, because each country specializes in producing the goods and services in which it has a comparative advantage. Yet, in practice, cutting trade barriers and opening markets do not necessarily generate development. Rich countries and large corporations dominate the global marketplace and create very unequal relations of power and information. As a result, trade is inherently unequal and poor countries seldom experience rising well-being but increasing unemployment, poverty, and income inequality.

An additional problem is that free trade is not equally free. Agricultural subsidies and other trade barriers in the US and the EU prevent poor countries from gaining access to the most important markets. Meanwhile, poor countries open up their own markets to US and EU exports.

From another point of view, international trade is an important factor for the development of poor countries and their integration into the global economy. Rich governments' promotion of these ideals has led them to develop an array of new trade agreements and international institutions. These bilateral, multilateral, and regional treaties strongly affect people at all levels of the economy by regulating pricing, tariffs, export levels, and methods of production. Though it seems that trade agreements bring sustainable development and