The Role of Human Resource Management Practices on Financial Performance in Firms

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Abstract

Human resources are considered the most precious asset of the organization. In order to reach its values the firm must pay a huge importance in human resource management. Good management of human resources helps three fundamental intentions of each enterprise: surviving, increasing and raising their incomes. On the other hand, it offers them an easy confrontation with the market competitors, which is very cruel. Financial performance of firm comprises of financial efficiency and profit. Financial efficiency measures the return on investment and return on equity, whereas profit measures the return on sales and net profit margin. The hypothesis of this seminar paper is that appropriate human resources practices have positive relationship with financial performance of firms. The subject of the paper is analysis of the relation between different human resource practice and the financial performance of the firms. So, the aim of this seminar paper is to choose the best human resource practice visa-vi financial performance of the firms. The methodology of the paper include: descriptive and comparative method, then questionnaire and econometric model to test empirically this relationship, passed through the IBM SPSS v.23.0. For the research is used contemporary literature and publication in the field of HRM practices and financial performance.

Keywords: HRM practices, financial performance, firms.

1. Introduction

Global growth competition of recent time influences SMEs to raise constantly their performances if they want to be confronted with the competitors, to achieve these firms must invest in human resource management. According to Armstrong (2008), human resource management (HRM) is a strategic and coherent access of management the most valuable asset of an organization-people that work there individually or collectively contribute to achieve the objectives of the organization. SMEs that improve their performances and develop competing advantages, must apply an effective system of human resource practice (Zheng *et al*, 2006; Katou, 2012). Practices of human resource consist of formal access used in human management (Armstrong, 2008). Generally speaking, SME follow informal practices of management (Behrends, 2007), they persuade these informal practices of management in order to control the employees, where the formal structures of communication and control do not exist (Willkinson, 1999). The owners and managers of SMEs percept formal human resource management as a road leading to bureaucracy (Katz *et al*., 2000).

According to Marlow (2002), SME ignore the application of formal HRM practice, for the reason that they do not have necessary resources. Informal practices of management; with increase they build formal regulation and policies for SME employees" control (Nguyen and Bryant, 2004; Marlow, 2002). The movement toward a more structured of formal persuades HRM can be seen when an enterprise starts to form a hierarchical structure with an access to split the work and administrative increasing process (Kotey and Slade, 2005). Informal practices of management resources are more developed in small and medium enterprises than big enterprises. According to Wright and McMahan, 1992 it is revealed that management of human resources of SME to be less structured and planned in comparison with big firms that apply more formal practices of human resources. The study made from Kotey and Slade (2005) has showed that small firms that raised the formal adaption of practices of HRM in comparison with previous periods. SME applying the formal management of human resources have a better performance than SME which do not apply the formal management of human (Gibbons and O'Connor 2005). The study of human practices are studied also from Bacon and Hoque (2005), according to them the wide range of practices which are used in SME are depended from the scale of employees" qualification, SME with low employees" qualification have less opportunity to

approve some practices of HRM, whereas SME that have a high percentage of employees" qualification have more opportunity to invest in such practices in order to keep and develop their talents. SME in general do not have specific department to manage human resources and decisions are made usually from the director, owner or firm management (Marlow and Patton, 2002; Fabi *et al*, 2009). Even in some cases where the specialists of HRM are employed again the top of HRM is the owner or director which takes decisions for HR (Kroon *et al*., 2013).

2. Theoretical review about HRM practices and financial performance

Armstrong (2008) showed that the assumption of human resources is that people are key source of organization and the performance of organizations depends especially from people. And that the wide range of appropriate policies and human resources process is developed and applied effectively, HR will substantially influenced in the firm performance. Using human resources practices effectively, the firm can survive from traditional practices not effective nor efficient which disturbs the firm to achieve the objective (Delery and Doty, 1996).The practices of HRM with the focus on employees in firm strategy implementation, influences positively the performance of firm, in the same form as the small enterprises and in the big enterprises (Arthur, 1994; Hayton, 2003).From various empirical studies that have been made has been showed that the application of SME traditional practices of human resource management are useful for all the sizes of enterprises. Selection and formal recruiting (Terpstra & Rozell, 1993), offering trainings for employees (Litz & Stewart, 2000), and using a system of formal evaluation of performance (Gerhart & Milkovich, 1992), are evidenced that have a positive influence in the enterprise performance. According to Kotey and Folker (2007), the practice of HRM in SME consists of a mixture of non-structured training, compensation, recruiting and selection of employees. This assumption is supported even more from the other empirical researches of the authors (Hornsby & Kuratko, 1990; Cardon & Stevens, 2004). Cardon and Stevens (2004) claimed that exactly these are the variables that contribute more in HRM success in small enterprises. The usage of these practices of HRM in SME has improved their performance (Chandler & McEvoy, 2000). Also, the same opinion is shared from these authors (Huselid, 1995; Osman *et al*, 2011) which came to conclusion that HRM practices or the relationship in between the staff, training, development and compensation are related directly with the firm performance. The other authors such as Tocher and Rutherford (2009) showed that the formal practices of HRM are positively related with firm performance. Literatures on strategic HRM even indicate that HRM practices and systems contribute to the creation of a sustained competitive advantage for the firm (Gerhart & Milkovich, 1992; Huselid, 1995; Macduffie, 1995). Mulolli

et al. (2015) using the human practices help SME to improve their firm performance. As a result, it is important that a firm adopt HRM practices that make use of its employees.

- *Recruiting and Selecting*

According to Cassell *et al*. (2002), recruiting and selecting are the practices of human resources which are used more than any other practice in SME. Recruiting and selecting refer the selection of staff, Wright *et al*. (2005), points out that the staff selection includes structured interviews and official tests of the candidates through the process of employment. Tocher and Rutherford (2009), claimed that the SME in general have a traditional access with the process of recruiting. The traditional method of recruiting includes: describing the places of work, deciding the duties, duties and responsibilities for the employees. Generally, the traditional method starts with recruiting process, through continuing with the selection of employees, their training and in the end employees "performance evaluation (Tocher and Rutherford, 2009). In comparison with the SME big organizations have more problems in recruiting of clever staff, because they use more attractive channel of employees, such as commercials in newspaper and walking, in comparison with big recruiting agencies (Bacon and Hoque, 2005). Barret and Mayson (2007) have stated that the mostly used method of recruitment in SME is the word of mouth, which is an option with low cost of withdrawal of candidates.

- *Training and Development*

Training and development refers to the amount of formal training given to employees. Organizations can provide extensive formal training or rely on acquiring skills through selection and socialization. Training is targeted on skill development, whether technical, clinical or soft skills such as team working, leadership and interviewing (Delery and Doty 1996). According to Harel and Tzafrir (1999), training can influence performance in two ways: first, training improves relevant skills and abilities; and second, training increases employees' satisfaction with their current job and workplace. Training can consist of on-job training, off-job training, formal training, skill training, cross-functional training, team training, literacy training and so on (Gomer-Mejia, Balkin and Cardy 2004). Hill and Stewart (1999), claimed that a lot of SME do not have disposition for training but even if there is, there is only reactive and informal with short term leading exclusively in problem solution that are related with the place of work and not with the human development. As well as some authors like Kotey and Folker (2007) pointed out that training of employees in SME is informal, not planned, with minimum dispositions and oriented in a short-term period. On the other hand, formal offer of trainings for employees is a problem for small firms as it costs (Mayson and Barrett,

2006). According to Johnston et.al, (2003), the potential of SME is effectively achieved only if abilities and competencies of employees are developed appropriately. Whereas, Chandler and McEvory (2000), stated that regular trainings of employees has appositive effect on the individual productivity of an employee. The improvement of individual productivity will result in improvement of performance and organization rise (Wright, *et al.*, 2005).

- *Compensation and Rewarding*

Compensation and rewarding is any kind of payment, monetary reward or not monetary. Compensation or incentive is contingent on performance (e.g., individual or group incentive pay). One of the primary means organizations use to enhance employee motivation is providing performance-contingent incentive compensation to align employee and shareholder interests (Delaney and Huselid 1996). According to Gomer-Mejia *et al.* (2004), there are three kinds of compensation plan: first is base-compensation (fixed pay to employees). Second is pay incentives (bonuses and profit sharing). Third is indirect compensation (health insurance, vacation, unemployment compensation). Normally, compensation is based on two categories: financial incentives and non-financial incentives. Development of an employment plan is so important for small firms as well as for big firms (Dessler, 2003). Compensation as a practice of management of human resources is an important part to contribute in the success of a firm (Collins and Smith, 2006). Mayson and Barret (2006) point out that SME to use informal routine of compensation and no coordinated to reward the employees. According to Cardon and Stevens (2004), compensation of SME is different, they are concentrated more in non-financial rewards such as education profits and recreative objects. Whereas, Islami (2015) stated that rewarding of employees should be made based on their individual performance. Islami Xh. and Islami V. (2019) suggested that applying performance appraisal in the correct way and for appropriate goals, improves job satisfaction, employees' satisfaction, motivation to employees, and as a result the quality of working life. The usage of this technique pushes the employees to make continuous attempted to realize with success the duties with the purpose to raise their personal performance which is rewarded financially or non-financially such as promotion. Islami *et al* (2018), arguments that employees are more productive when they know that they will be rewarded from the company based on the work that they do in organization. Compensation of SME causes a lot of costs, for this reason its application is rare (Wright *et al.*, 2005). But, despite that a formal evaluation of performance that results in compensation might have increased the performance of a firm (Sun, Aryee and Law, 2007).

- *Financial Performance*

According to Armstrong (2009), the concept of performance includes two things the one that has to be reached and the one reached. He further claimed that the performance of firm can be evaluated in different manners, but mostly used methods in a lot of studies are key indicators of a performance (KPI) that includes financial indicators and the second manners have to be with the evaluation "who" which is supported with the qualitative data in abilities of evaluation or effective organization. A number of previous studies examined the impacts of HRM practices on different kinds of firm performance, such as on productivity (Chen, Liaw and Lee, 2003), on efficiency and employee turnover (Huselid 1995), on financial performance (Huselid, Jackson and Schuler, 1997), on customer satisfaction (Koys, 2003), on turnover, absenteeism, productivity and quality (Richard and Johnson, 2001). This opinion is shared from the authors Wright *et al* (2005) that pointed out that there are two methods to evaluate the performance of a firm. The first method is the organizational result, whereas the other function of measures like productivity and quality are used to evaluate the employee's performance and the second method is financial or countable result, which is an evaluation of a real financial performance. Measurement from financial results is costs, incomes and profitability (Wright *et al.*, 2005). Islami *et al*. (2020) measured firm performance using financial and market criteria, including such as: return on investment (ROI), market share, profit margin on sales, the growth of ROI, the growth of sales, the growth of market share, and overall competitive position. In firm evaluation performance in SME, the method of financial indicator is selected in a lot of studies (Simpson, Padmore and Newman, 2012). The same method of measuring firm performance were used by several authors (e.g. see Islami, Mulolli and Skenderi, 2015; Islami, Islami, Topuzovska and Mulloli, 2019; Islami, Mulolli and Mustafa 2018). This evaluation method is acceptable even for us and we will apply the same method to evaluate SME performances. This evaluation method is acceptable even for us and we will apply the same method to evaluate SME performances.

3. Research hypothesis

In order to find and analyze the relation between different human resource practice and the financial performance of the firms a hypothesis must be tested:
H0: Human resources practices on financial performance of the firms have the correlation coefficient zero; there is no association, (p=0)
H1: Human resources practices on financial performance of the firms do not have correlation coefficient zero; a nonzero correlation could exist, ($\rho \neq 0$).

4. Methodological approach

To realize this study, a methodology consisting from a combination of primary and secondary data has been used. The article has been prepared using the analysis of secondary resources (scientific publications and articles from specialized databases, such as Science Direct, Emerald and Pro Quest) and primary resources in the form

of results of the quantitative survey conducted in a sample firms that operate their activity in the Republic of Kosovo**.** For the empirical analysis of the study, the data were gathered from a self-administered questionnaire. The participants were randomly chosen. To measure the impact in between variables in this study SPSS v. 23 programs has been used.

A.   Data Collection

From 60 questionnaires in total distributed to 60 firms, we have only 53 well-filled o (so the scale of responses was 88.33%). Even though 57 filled questionnaires were returned, 4 of them lacked in data and cannot be entered in the further analysis, therefore only 53 questionnaires with full data were analyzed. Table 1, presents general data for responding firms. The questionnaire has been conducted in the way that the respondents to take their opinion of the relationship of human practices on financial performance of firms of R. Kosovo. The scale used in the questionnaire is based in a scale of five Likert -scale. Likert scale (1- absolutely don't agree, 2- Don't agree, 3-Neural, 4- Agree, 5- Absolutely agree).

B.   Descriptive Data of Respondent Firms

In Table 1, are presented data of contributors (firms' representatives) concerning descriptive data such as: gender, education, age, and their position in firm and their activity in the enterprise

Table 1: Demographic characteristic of the sample

| Demographic variable	Count N=53	(percentage)
Gender		
Male	31	(58.4%)
Female	22	(41.5%)
Age		
20–25 years	5	(9.4%)
26–30 years	13	(24.5%)
31–35 years	17	(32.1%)
36–40 years	8	(15.1%)
41–45 years	6	(11.4%)
46–50 years	3	(5.7%)
Over 50	1	(1.8%)
Work experience		
2 years	8	(15.1%)
3–5 years	15	(28.3%)
6–10 years	21	(39.6%)
11–15 years	9	(17%)
Education		
Intermediate	12	(22.6%)
Bachelors	24	(45.3%)
Masters	17	(32.1%)
Position in Firm		
Owner	4	(7.5%)
Director	11	(20.8%)
Manager	17	(32.1%)
Human resource staff	13	(24.5%)
Employees	8	(15.1%)

Source: Author

5.   Empirical findings

In order to realize this research, the descriptive data and correlation measurement in between variables that were used in the study are presented statistically.

5.1 Descriptive statistics

Descriptive data are presented in Chart 1, 2, 3 and in table 2, in which are presented minimum, maximum, mean, and standard deviation, for all study variables. In order to do the analysis of the gathered data, the variables are: "recruitment and selection" (which consists as an average of five questions of the questionnaire), "training and development" (which consists as an average of four questions of the questionnaire) as well as "compensation and rewarding" (which consists of an average of five questions of the questionnaire).
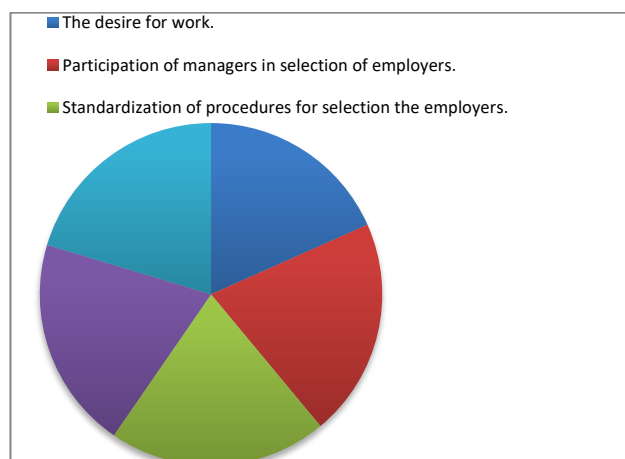
Chart 1: Impact of Recruitment and selection on firm performance (n=53) [Source: authors]

*Liker scale is used 1- strongly disagree till 5- strongly agree

Based on descriptive analysis we concluded that Recruitment and selection have impact on firm performance whereas the results show that participation of managers in selection and standardization of procedures for selection the employers had the most impact on firm performance with an average of 3.6
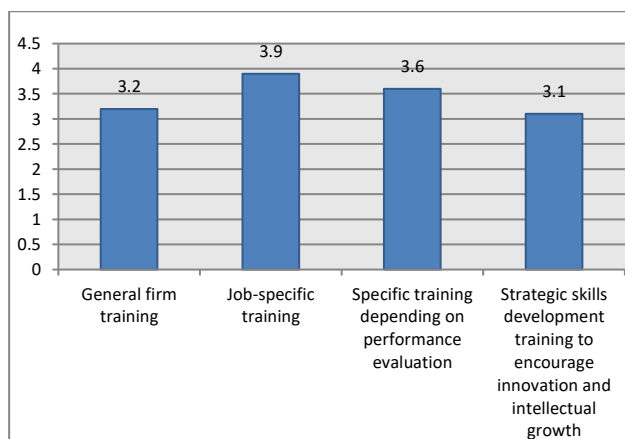
Chart 2: Impact of training and development on firm performance (n=53)[Source: authors]

*Liker scale is used 1- strongly disagree till 5- strongly agree

From the Chart 2 we can see that: training and development has a positive impact on firm performance. Whereas the results of the questionnaire show that job-specific training has the greatest impact on achieving high firm performance with a mean of 3.9.
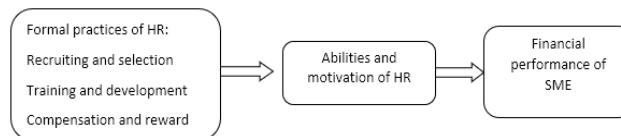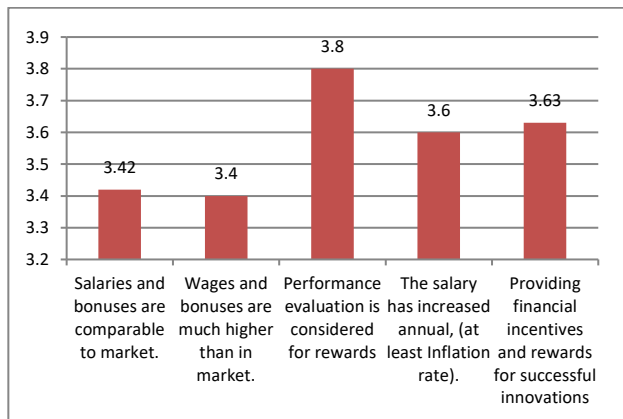

Chart 3: Impact of Compensation and reward on firm performance (n=53)[Source: authors]

*Liker scale is used 1- strongly disagree till 5- strongly agree

From the Chart 3 we can see that: Compensation and reward has a positive impact on firm performance. Which performance evaluation with 3.8 mean has the most impact on firm performance.

To sum up, the descriptive data analysis was used as an average of all questions for each variable; the results for practices of human resources which include recruitment and selection, training and development, compensation and reward to studied firms are presented in table 2.

Table 2: Descriptive Statistics of variables (n= 53)

Practices of human resources in firms	Mean	Standard deviation	Minimum	Maximum
Recruitment and selection	3.49	.891	2	5
Training and development	3.45	.911	2	5
Compensation and reward	3.57	.866	2	5

Source: authors

Results from the table showed that the average of using the practice of human resources in studied firms vary from 3.49 to 3.57, which mean that these practices are used from the most firms with the purpose of improving their performance. "Compensation and reward" are methods that are mostly used as the practices of human resources in studied firms (Mean = 3.57, Sd = .866). Compensation and reward are effective methods, which start the rotation success of the firm if the employee realize bonus like raising the incomes or personal satisfaction they will be more motivated for work and will improve their individual performance as the results of these firms which have the employees clever and motivated for work, the performance will be better.

Figure 1: Conceptual Model

Starting from the concept of individual performance of Vroom (1964) which claimed that motivation for work is depended from the level of abilities of employees and the relationship of the abilities for performance. He further continues to say that the effect of the abilities and motivation in performance are not added, but are effectively interactive. So, Vroom has stated that people have necessity for abilities and motivation in order to increase the firm performance, and in case that if the abilities or motivation is zero there will not be effective performance, Performance = (Ability Motivation).

In order to analyze in more details the data and to test hypotheses in section three of the study it is used the correlation analysis. The statistical software IBM SPSS is used for analysis correlation.

5.2 Correlation Analysis

In table 3 & 4, is presented the correlation matrix for variables that are taken in order to measure the scale of relation in between variables in this testing. It is presented the connection in between Recruiting and selection, Training and development, Compensation and reward. According to results presented on the table it is shown that the relation in between independent variable is within the allowed borders (+,- 0.7) (Hair et. al.,1998). In (table 3) is presented what is meant with numbers that show the correlation presented in lines of Pearson Correlation of table 4.

Table 3: Description of Matrix correlation

Value of "r"	Condition	Strength of relationship
1.00	r is one	It is a perfect relationship between the two variable
0.50	r is greater than 0.00 but less than 1.00	It is a positive relationship between the two Variables
0.00	r is zero	There is no relationship between the two variables
-0.50	r is between 0.00 and -1.00	It is a negative relationship between two variables.
-1.00	r is negative one	It is a perfect negative relationship between the to variables.

Source: Amit Saini *et al* (2015)

According to Cohen, J. (1988) the correlation strength can be assessed by these general guidelines:

- .1 < | r | < .3 … small / weak correlation
- .3 < | r | < .5 … medium / moderate correlation
- .5 < | r | ……… large / strong correlation

Table 4: Correlation Matrix (n= 53)

Variables	Correlations	Recruiting and selection	Training and development	Compensation and reward
Recruiting and selection	Pearson Correlation Sig. (2-tailed) N	1 53	.543** .000 53	.595** .000 53
Training and development	Pearson Correlation Sig. (2-tailed) N	.543** .000 53	1 53	.614** .000 53
Compensation and reward	Pearson Correlation Sig. (2-tailed) N	.595** .000 53	.614** .000 53	1 53

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

Discussions and conclusion

The aim of the study is to identify the relationship of human resources practices on financial performance of the firms. In order to find the relationship in between variables of the study three variables are built (each variable presents a possible variable of human resources practices on financial performance). Both propose are made in the form of hypotheses: H_0 and H_1 (see section three). With correlation analysis relationship in between independent variables is strong. As it can be seen in table 3, H_0 is refused, where is shown that variables which are human resources practices on financial performance of the organization, do not have correlation coefficient zero ($H_0\downarrow$). Whereas H_1 is accepted, from table 4 is showed that human resources practices on financial performance of the organization, correlation coefficient is not zero; a nonzero correlation could exist ($H_1\uparrow$). In continuity of the analysis are presented only the cells of (table 4) that have the correlation coefficient ($.5 < |r| \leq 1$) strong correlation and significant in level (0.01), as the same logic of analysis is valuable even for other cells that present the relationship in between variables but are not included in this part of discussion. We can see that the Pearson correlation coefficient for variables "Recruiting and selection" and "Training and development" is 543, which is significant ($p < 0.01$ for a two-tailed test), based on 53 complete observations. Based on the results, we can state the following: variable "Recruiting and selection" and variable "Training and development" have a statistically significant linear relationship ($p < 0.01$), the direction of the relationship is positive, meaning that these variables tend to increase together (i.e., greater "Recruiting and selection" is associated with greater "Training and development"), and the magnitude, or strength, of the association is approximately strong correlation ($.5 < |r| \leq 1$). Managers' perception of responding firms is that if the chose the right persons in the early phase or recruiting and selecting the training and development will be easier and their will have better result understanding their work on the firm. It can be seen that the Pearson correlation coefficient for variables "Recruiting and selection" and "Compensation and reward" is .595, which is significant ($p < 0.01$ for a two-tailed test), based on 53 complete observations. Based on the results, we can state the

following: variable "Recruiting and selection" and variable "Compensation and reward" have a statistically significant linear relationship ($p < 0.01$); the direction of the relationship is positive; meaning that these variables tend to increase together (i.e., greater "Recruiting and selection" is associated with greater "Compensation and reward"); and the magnitude, or strength, of the association is approximately strong correlation ($.5 < |r| \leq 1$). Also we can see that the Pearson correlation coefficient for variables "Training and development" and "Compensation and reward" is .614, which is significant ($p < 0.01$ for a two-tailed test), based on 53 complete observations. Based on the results, we can state the following: variable "Training and development" and variable "Compensation and reward" have a statistically significant linear relationship ($p < 0.01$); the direction of the relationship is positive; meaning that these variables tend to increase together (i.e., greater "Training and development" is associated with greater "Compensation and reward"); and the magnitude, or strength, of the association is approximately strong correlation ($.5 < |r| \leq 1$). Based on the result the formal practices of recruitment and selection influence that firms to increase human abilities through selecting the adequate people, whereas the formal practice of training and development influences the improvement of the firms abilities through development and improvement of human abilities of the firm formal practices of compensation and rewards raise the motivation of human resources in firm and as a result of a huge ability and motivation of people the firm performance will be increased. Based on this the study hypotheses have been built and based on findings and empirical analysis of the study resulted that hypothesis zero is refused ($H_0\downarrow$) whereas alternative hypothesis is accepted ($H_1\uparrow$). In this study it was dealt with resource management to use the practices of human resource and their impact in financial performance on firms that works in Kosovo. Using the human practices help firms to improve their performance from the study resulted that "compensation and reward" is the most profitable practice of firms, which increases more the performance. But even the other two practices that were the objectives of the study showed positive influence in firm performance, therefore it came to conclusion that using formal practices raises firm's financial performance. In generate the

evaluation of participation has been high, it is known that as high to be the evaluation more important are the participants in this study, practice evaluation "compensation and reward" results with the average (M= 3.57 and DS= 0.866), "recruitment and selection" (M= 3.49 and DS= 0.891), as well as "training and development" (M= 3.45 and DS= 0.911), this showed that the three variables are important for the improvement of performance of firms. Besides that, this can be the object of study for further researches.

If firm's managers use the appropriate practices in certain moments, this offers the enterprise to realize its intention and to proceed to be confronted with competitors or even to pass them in positive aspect.

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