

**HUMAN RESOURCE MANAGEMENT PRACTICES
AND FIRM PERFORMANCE: THE MODERATING
ROLES OF STRATEGIES AND ENVIRONMENTAL
UNCERTAINTIES**

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by

NORMALA BINTI DAUD

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DEDICATION

This dissertation is expressly dedicated to the memory of my father, Daud bin Sulaiman who left us with the most precious asset in life, knowledge. I know that he would be the happiest father in the world to know that his daughter has successfully completed her thesis. May Allah place his soul among the righteous; and to my mother, Hajah Mariam Idris, for her continuous blessings and prayers and whose love and guidance throughout my life can never be repaid.

Secondly, I dedicate this dissertation to my family members, my son, Azam, my three wonderful cheerleaders, Aaina, Alyaa and Amirah and especially to my beloved husband, Alias Abdul Jalil. Thank you for your continued encouragement, endless support, love, understanding and sacrifice. You are my life and my inspiration.

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TABLE OF CONTENTS

	PAGE
DEDICATION	ii
ACKNOWLEDGEMENTS	iii
TABLE OF CONTENTS	iv
LIST OF TABLES	x
LIST OF FIGURES	xii
LIST OF APPENDICES	xiii
ABSTRAK	xiv
ABSTRACT	xvi
CHAPTER 1 INTRODUCTION	
1.1 Introduction	1
1.2 Background of Study	1
1.3 Problem Statement	5
1.4 Purpose of Study	6
1.5 Research Objectives	6
1.6 Research Questions	6
1.7 Significance of Study	7
1.8 Scope of Study	7
1.9 Definition of Key Terms	8
1.9.1 Human resource management	8
1.9.2 HRM practices	8
1.9.3 Firm performance	8

1.9.4	Business strategy	8
1.9.5	Environmental uncertainty	9
1.9.6	Manufacturing sector	9
1.9.7	Employees	9
1.10	Organization of Remaining Chapters	9
CHAPTER 2 LITERATURE REVIEW		
2.1	Introduction	11
2.2	The Concept of Human Resource Management	11
2.3	The Importance of HRM as a Source of Competitive Advantage	12
2.4	Single HRM Practices and Firm Performance	14
2.5	Approaches in Studying HRM Practices	16
2.5.1	Universalistic perspectives	18
2.5.2	Contingency perspective	19
2.5.3	Configurational perspective	20
2.6	Relationship between HRM Practices and Firm Performance	20
2.6.1	HRM practices	20
2.6.2	Firm Performance	32
2.7	Organizational Context Variable	35
2.7.1	Business strategy	36
2.7.2	External environment	42
2.8	Gaps in the Literature	45
2.9	Theoretical Framework and Hypothesis	47
2.9.1	Direct relationship between HRM practices and firm performance	48
2.9.1.1	Staffing	49
2.9.1.2	Training and development	49

2.9.1.3 Performance appraisal	50
2.9.1.4 Compensation and benefits	50
2.9.1.5 Employee participation and involvement	51
2.9.1.6 Job security	51
2.9.1.7 Human resource planning	52
2.9.2 Moderating effects of environmental uncertainty	54
2.9.3 Moderating effects of business strategy	57
2.10 Summary	58
CHAPTER 3 RESEARCH METHODOLOGY	
3.1 Introduction	59
3.2 Research Design	59
3.3 Sampling Design	60
3.4 Population and Sample Size	61
3.5 Data Collection Procedure	62
3.6 Variable and Measures	63
3.6.1 HRM practices	64
3.6.2 Environmental uncertainty	65
3.6.3 Business strategy	66
3.6.4 Firm performance	67
3.6.4.1 Profitability	67
3.6.4.2 Growth	68
3.6.4.3 Employee turnover	68
3.6.5 Control variables	70
3.7 Data Collection Procedure	71
3.7.1 Pilot test	71
3.7.2 Administering the survey	72

3.8	Statistical Analysis	72
3.8.1	Validity and reliability	74
3.8.2	Hierarchical regression analysis	75
3.9	Summary	75
CHAPTER 4 DATA ANALYSIS AND RESULTS		
4.1	Introduction	77
4.2	Sample Characteristics	77
4.3	Sample Profile	78
4.3.1	Organizational profile	78
4.3.2	Respondents' profile	81
4.4	Goodness of Measures: Factor Analysis and Reliabilities	82
4.4.1	HRM practices	84
4.4.2	Profitability	86
4.4.3	Environmental uncertainty	86
4.5	Result of Reliability Test	87
4.6	Restatement of Hypothesis	88
4.7	Response Bias Analysis	92
4.8	Descriptive Statistics	93
4.9	Extent of HRM Practices in Manufacturing Firms	95
4.9.1	Differences in extent of HRM practices	95
4.9.1.1	Length of operation	95
4.9.1.2	Size	95
4.9.1.3	Life cycle stage	96
4.9.2	Differences in extent of adoption of strategies by types of industries	98
4.10	Correlation Analysis	100

4.11	Regression Analysis	104
4.11.1	Regression analysis between HRM practices and profitability	104
4.11.2	Regression analysis between HRM practices and growth	106
4.11.3	Regression analysis between HRM practices and voluntary employee turnover	108
4.11.4	Regression analysis between HRM practices and involuntary employee turnover	110
4.11.5	The moderating effect of environmental uncertainty on profitability	111
4.11.6	The moderating effect of environmental uncertainty on growth	115
4.11.7	The moderating effect of environmental uncertainty on voluntary employee turnover	118
4.11.8	The moderating effect of environmental uncertainty on involuntary employee turnover	120
4.11.9	The moderating effect of business strategy on profitability	123
4.11.10	The moderating effect of business strategy on growth	126
4.11.11	The moderating effect of business strategy on voluntary employee turnover	130
4.11.12	The moderating effect of business strategy on involuntary employee turnover	133
4.12	Summary	136

CHAPTER 5 DISCUSSION AND CONCLUSION

5.1	Introduction	140
5.2	Recapitulation of the Study's Findings	140
5.3	Discussion on Findings	142
5.3.1	What is the extent of HRM practices in Malaysian manufacturing firms?	142
5.3.2	Relationship between HRM practices and profitability	143

5.3.3	Relationship between HRM practices and growth	144
5.3.4	Relationship between HRM practices and voluntary employee turnover	145
5.3.5	Relationship between HRM practices and involuntary employee turnover	146
5.3.6	Moderating effect of environmental uncertainty	146
5.3.6.1	Profitability	146
5.3.6.2	Growth	147
5.3.6.3	Voluntary employee turnover	147
5.3.6.4	Involuntary employee turnover	147
5.3.7	Moderating effect of business strategy	148
5.3.7.1	Profitability	148
5.3.7.2	Growth	148
5.3.7.3	Voluntary employee turnover	149
5.3.7.4	Involuntary employee turnover	149
5.4	Implications of the Study	149
5.5	Limitations of the Study	153
5.6	Suggestions for Future Research	154
5.7	Conclusion	155
	REFERENCES	156
	APPENDICES	170

LIST OF TABLES

Table	Title of Table	Page
Table 2.1	Empirical Studies on Single HRM Practices and Organizational Performance	15
Table 2.2	Selected Empirical Studies on HRM Practices and Firm Performance	24
Table 2.3	Performance Variables used in HRM Practices- Firm Performance Studies	34
Table 3.1	A Summary of Scales used in Questionnaire	64
Table 4.1	Response Rate	78
Table 4.2	Organizational Profile	80
Table 4.3	Respondents' Profile	82
Table 4.4	Factor Analysis on HRM Practices	85
Table 4.5	Factor Analysis on Profitability	86
Table 4.6	Factor Analysis on Environmental Uncertainty	87
Table 4.7	Reliability Coefficients for Variables	88
Table 4.8	Restated Hypotheses	89
Table 4.9	T-test for Different Means of Variables: Early and Late Response	93
Table 4.10	Means and Standard Deviation of Variables	94
Table 4.11	One-Way between group ANOVA with Post-Hoc Tests: A Summary of Differences in Extent of HRM Practices and Length of Operation	96
Table 4.12	One-Way between group ANOVA with Post-Hoc Tests: A Summary of Differences in Extent of HRM Practices and Size	97

Table 4.13	One-Way between group ANOVA with Post-Hoc Tests: A Summary of Differences in Extent of HRM Practices and Life Cycle Stage	98
Table 4.14	A Cross-Tabulation between Industrial Sector and Business Strategy adopted by Firms	100
Table 4.15	Correlations between Variables	103
Table 4.16	A Summary of Multiple Regression Analysis for HRM Practices Relating to Profitability and Growth	106
Table 4.17	A Summary of Multiple Regression Analysis for HRM Practices Relating to Voluntary Employee Turnover and Involuntary Employee Turnover	109
Table 4.18	Hierarchical Regression Results: Profitability and Environmental Uncertainty	113
Table 4.19	Hierarchical Regression Results: Growth and Environmental Uncertainty	117
Table 4.20	Hierarchical Regression Results: Voluntary Employee Turnover and Environmental Uncertainty	120
Table 4.21	Hierarchical Regression Results: Involuntary Employee Turnover and Environmental Uncertainty	122
Table 4.22	Hierarchical Regression Results: Profitability and Business Strategy	125
Table 4.23	Hierarchical Regression Results: Growth and Business Strategy	128
Table 4.24	Hierarchical Regression Results: Voluntary Employee Turnover and Business Strategy	132
Table 4.25	Hierarchical Regression Results: Involuntary Employee Turnover and Business Strategy	135
Table 4.26	Summary of Results	136

LIST OF FIGURES

Figure	Title of Figure	Page
Figure 2.1	Theoretical framework	47
Figure 4.1	The impact of environmental uncertainty on the relationship between human resource planning and practice and profitability	114
Figure 4.2	The impact of environmental uncertainty on the relationship between performance-based practice and profitability	115
Figure 4.3	The impact of business strategy on the relationship between performance-based pay practice and growth	129

LIST OF APPENDICES

Appendix	Title of Appendix	Page
Appendix A	Sample cover letter and questionnaire	170
Appendix B	Organizational Profile	186
Appendix C	Factor Analysis of HRM Practices and Reliabilities	191
Appendix D	Factor Analysis of Profitability and Reliability	197
Appendix E	Factor Analysis of Environmental Uncertainty and Reliability	200
Appendix F	Mean and Standard Deviation of Variables	203
Appendix G	Post-Hoc tests	204
Appendix H	Multiple Regression Analysis – Profitability and Growth	205
Appendix I	Multiple Regression Analysis – Voluntary and Involuntary Turnover	211
Appendix J	Hierarchical Regression Analysis – Environmental Uncertainty	217
Appendix K	Hierarchical Regression Analysis – Business Strategy	226

**AMALAN PENGURUSAN SUMBER MANUSIA DAN PRESTASI FIRMA:
PERANAN STRATEGI DAN KETIDAKPASTIAN PERSEKITARAN SEBAGAI
PENYEDERHANA**

ABSTRAK

Sejak kebelakangan ini banyak penyelidikan telah dijalankan dalam bidang pengurusan sumber manusia dan kaitannya dengan prestasi firma. Kajian terdahulu mendapati banyak bukti positif terhadap perkaitan statistik diantara amalan pengurusan sumber manusia dan peningkatan prestasi firma. Tujuan kajian ini adalah untuk menyiasat perhubungan diantara amalan pengurusan sumber manusia dan prestasi firma dengan strategi perniagaan dan ketidakpastian persekitaran bertindak sebagai penyederhana. Kajian ini menyiasat perhubungan diantara amalan pengurusan sumber manusia, ketidakpastian persekitaran, strategi perniagaan dan prestasi firma. Kajian menghipotesiskan bahawa amalan pengurusan sumber manusia dapat mempengaruhi keuntungan dan pertumbuhan secara positif dan mempengaruhi pemberhentian pekerja secara negatif. Data dikumpul melalui soal selidik yang di hantar melalui pos kepada pengurus sumber manusia firma pembuatan di Malaysia. Sebanyak 162 respons yang boleh digunakan diperolehi untuk tujuan analisis. Penemuan dari ujian hirarkikal yang digunakan untuk menguji perhubungan diantara angkubah mendapati bahawa (1) perancangan sumber manusia mempunyai kaitan dengan keuntungan dan pertumbuhan; (2) upah berasaskan prestasi mempunyai kaitan dengan keuntungan dan pertumbuhan; (3) pembangunan kemahiran mempunyai kaitan dengan pemberhentian pekerja tanpa sukarela; (4) ketidakpastian persekitaran sebagai penyederhana mempengaruhi perhubungan diantara perancangan sumber manusia, upah yang berasaskan prestasi dan keuntungan; dan (5) strategi perniagaan sebagai penyederhana mempengaruhi hubungan diantara upah yang berasaskan prestasi dan

pertumbuhan. Hasil dari kajian ini boleh menjadi satu asas cadangan yang berguna kepada pengurus di Malaysia dalam mengalakkan amalan pengurusan sumber manusia dan kepada pekerja yang begitu prihatin untuk mengekalkan kelebihan bersaing mereka untuk kejayaan jangka panjang sesebuah organisasi.

**HUMAN RESOURCE MANAGEMENT PRACTICES AND FIRM PERFORMANCE:
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ABSTRACT

Over the last decade, much research has been conducted in the field of human resource management (HRM) and its associations with firm performance. Prior studies have found substantial positive evidence for statistical associations between HRM practices and improved firm performance. The purpose of this study is to investigate the relationships between HRM practices and firm performance with business strategy and environmental uncertainty as moderators. This study examines the relationships among HRM practices, environmental uncertainty, business strategy and firm performance. It was hypothesized that HRM practices could positively influenced profitability and growth and negatively influenced employee turnover. Data were collected using mail questionnaire sent to human resource managers in manufacturing firms in Malaysia. A total of 162 useable responses were obtained and used for the purpose of analysis. Results of hierarchical regression used to test the relationships among the variables indicated that (1) human resource planning has a relationship with profitability and growth; (2) performance-based pay has a relationship with profitability and growth; (3) skills development has a relationship with involuntary employee turnover; (4) environmental uncertainty as a moderator influence the relationship between human resource planning, performance-based pay and profitability; and (5) business strategy as a moderator influences the relationship between performance-based pay and growth. The findings can form the basis for useful recommendations for Malaysian managers in encouraging the practice of human resource management and for employees who are

concerned with maintaining their competitive advantage for long-term organizational success.

CHAPTER 1

INTRODUCTION

1.1 Introduction

This chapter describes a brief background of the research. It explores the problem statement, objectives of the study, research questions of the study, scope of the study and the significance of the study. Definition of key terms and outline of the thesis is also provided at the end of the chapter.

1.2 Background of Study

The increasing pressures from the rapid changes that are occurring in the business environment have led to a variety of responses among industrial organizations. Globalization of production and markets, the rate of technological innovation and fluctuation in consumer demand are among the factors that have increased the dynamism of the competitive environment to which organizations must respond.

For Malaysian firms to survive in a global economy in the new millennium, they need to exploit all the available resources as a means of achieving competitive advantage. One resource recently recognized as providing a source of competitive advantage is the human resources of the firm and it is widely accepted that people in organizations are an important source of competitive advantage for firms (Pfeffer, 1994). Many scholars have reiterated that the increasing interest in human resources is due to the assumptions that employees and the way they are managed are critical to the success of a firm (Kamoche, 1996; Lado & Wilson, 1994; Mueller, 1996; Wright, McMahan & McWilliams, 1994). Since firm performance is considered as one of the major organizational goals, much of the recent human resource management (HRM)

research has been directed at understanding the relationship between HRM practices and firm performance.

An effective and competitive human resource is the key to the strength of organizations in facing the challenges of business today. The importance of having a competitive human resource is synonymous with the success of today's organizations. An efficient and effective human resource will produce quality, productive individuals that will eventually minimize the problems that are related to human resource such as job dissatisfaction, absenteeism, or turnover of employees.

What is human resource management? Human resource management is a system, a philosophy, policy and practices that can influence individuals that work in an organization. HRM activities include staffing, training and development, performance appraisal compensation management, safety and health and industrial relations. According to Huang (2000), HRM practices is one area that influences employees' intention to leave, levels of job satisfaction, and organizational commitment. Since the concept of HRM became popular in the early 1980s, there have been increasing academic interest in the concept as well as research in the area. Early models of HRM (Beer, Spector, Lawrence, Miles, & Walton, 1984; Fombrun, Tichy & Devanna, 1984; Guest, 1989) were largely conceptual and not based on substantial empirical evidence for their validity. The 1990s saw a substantial amount of empirical research carried out to find evidence on the link between HRM practices and performance. In recent years much of the research in the 1990s did in fact found statistical evidence for an association between HRM practices and performance (e.g. Arthur, 1994; Huselid, 1995; Ichniowski, Shaw & Prennushi, 1997). Researchers also have shown an increasing interest in the concept of HRM practices and in the link between HRM practices and organizational performance.

A significant body of previous research has reported positive associations between HRP practices and organizational performance. These studies focus on the impact of several specific HRM practices, such as compensation (Gerhart & Trevor, 1996, Gomez-Mejia, 1992), training (Bartel, 1994) or performance management systems (McDonald & Smith, 1995). Other studies report the positive impact of HRM practices on organizational performance (Arthur, 1994; Bawa, 2000; Becker & Huselid, 1998a; Berg, 1999; Berg, Appelbaum, Bailey & Kalleberg, 1996; Delaney & Huselid, 1996; Delery & Doty, 1996; Fey & Bjorkman, 2001; Fey, Bjorkman & Pavlovskaya, 2000; Gelade & Ivery, 2003; Guest & Hoque, 1994; Huang, 2000; Huselid, 1995; Huselid & Becker, 1996; Ichniowski et al., 1997; Ichniowski & Shaw, 1999; Jayaram, Droge & Vickery, 1999; Khatri, 2000; Lahteenmaki, Storey & Vanhala, 1998; MacDuffie, 1995; Paul & Anantharaman, 2003; Ramsay, Scholarios & Harley, 2000; Sels, DeWinne, Maes, Faems, DelMotte & Forrier, 2003; Wood & de Menezes, 1998; Wright, McCormick, Sherman & McMahon, 1999; Youndt, Snell, Dean & Lepak, 1996).

In order to effectively investigate whether human resources are capable of contributing to competitive advantage, it is pragmatic to examine HRM practices in as many settings as possible. Most of the studies in HRM practices and organizational performance have been conducted in the West, on the domestic operations of US firms, with a smaller number of studies carried out in the UK and Europe (e.g. Guest & Hoque, 1994; Hoque, 1999), and Asia (e.g. Huang, 2000; Huang & Cullen, 2001; Khatri, 2000; Mak & Akhtar, 2003; Wan, Kok & Ong, 2002). There is a dearth of empirical studies in HRM practices conducted in Malaysia. One important attempt to study HRM practices was conducted in the plantation sector, specifically the oil palm plantation estates (Bawa, 2000).

In this new millennium, the role of human resources remains important if not vital to organizations. In spite of this evidence, many organizations are slow in adopting those practices that were found to contribute to organizational success. This situation is found not only in the plantation sector (Bawa, 2000), but also in manufacturing sector in Malaysia.

The decision to study the manufacturing sector is due to several reasons; firstly, the manufacturing sector is expected to remain a strong contributor to the sustained recovery and growth of the Malaysian economy (MIDA, 2000). The manufacturing sector is expected to pick up and grow at a better rate after the Asian financial crises in 1997 that has left many Asian economies crippled.

Secondly, the manufacturing sector remains the largest source of employment opportunities, accounting for 27 percent of total employment or 2.455 million persons (Economic Report 2000/2001). The growing demand for labor in the sector, growing at 9.0 percent per annum during the period, coupled with industrial restructuring towards higher value-added products and activities, resulted in labor shortages not only at the production level but also at the skilled and semi-skilled levels (Eight Malaysian Plan, 2001-2005). Based on the continued favorable economic outlook, employment is expected to grow better during 2001-2005, with the creation of about 1.2 million additional jobs.

Given the importance of employees to the Malaysian economic growth and a lack of systematic study in HRM practices in manufacturing sector, it is crucial that immediate action is taken to examine the relationship between HRM practices and firm performance.

1.3 Problem Statement

This study arises from the need to manage the human resources of the firms more effectively. The rapid growth of manufacturing firms, increase in environmental variability and degree of competition, acute shortage of labor and the corresponding increase in labor turnover and costs of employee replacement have forced firms to aggressively compete for employees. These industry issues and problems demand that firms continually assess its internal processes and capabilities if it is to remain competitive. It is known that HRM can positively affect organizational performance. Numerous studies have shown a positive relationship between HRM practices and organizational performance. However, previous studies in Malaysia are quite limited in investigating this phenomenon. The first limitation is that in Malaysia, besides the two studies done by Bawa (2000) and Hung (2001) on HRM practices, little empirical research has been done to date. Bawa (2000) investigated the relationship between HRM practices in the plantation sector. On the other hand, Hung (2001) examined the relationship between fairness of HRM practices, leader-member exchange on organizational commitment in the manufacturing companies. Secondly, despite the abundant of studies in the West which revealed the positive effects of HRM practices on a firm's performance (e.g., Ahmad & Schroeder, 2003; Bae & Lawler, 2000; Batt, 2002; Delery & Doty, 1996; Guthrie, 2001; Hoque, 1999; Jayaram, Droge & Vickery, 1999; Wright, Gardner & Moynihan, 2003), so far there is no consistent agreement on how to measure HRM practices and what to measure with regards to organizational performance (Becker & Gerhart, 1996; Dyer & Reeves, 1995; Wright & Gardner, 2003). Lastly, very few of these studies (Arthur, 1992; Khatri, 2000; Sanz-Valle, Sabater-Sanchez & Aragon-Sanchez, 1999) have considered business strategies and environmental uncertainty as moderators in one study. Besides examining the relationship between HRM practices and firm performance, the possible moderating

effect of business strategy and environmental uncertainty on these relationships is also examined. This study examines (a) the relationships between HRM practices and firm performance, (b) the moderating effect of environmental uncertainty on the relationship between HRM practices and firm performance, and (c) the moderating effect of business strategy on the relationship between HRM practices and firm performance.

1.4 Purpose of Study

The purpose of this study is to investigate the relationship between HRM practices and firm performance and the moderating effect of environmental uncertainty and business strategy in the manufacturing sector in Malaysia.

1.5 Research Objectives

Specifically, this study is intended to achieve the following objectives:

- a. To identify and examine the extent of HRM practices in the Malaysian manufacturing firms.
- b. To investigate the impact of HRM practices on the firm's performance.
- c. To examine the moderating effects of environmental uncertainty and business strategy on the relationship between HRM practices and firm performance.

1.6 Research Questions

This study is conducted to address the gap in the literature. It offered three important questions that had not been previously investigated in other studies and in the manufacturing setting in Malaysia.

- a. What is the extent of HRM practices in Malaysian manufacturing sector?
- b. Do HRM practices affect firm performance?

- c. Do environmental uncertainty and business strategies moderate the relationship between HRM practices and firm performance?

1.7 Significance of the Study

This research and its findings are considered important to provide insight into the various HRM practices needed to successfully perform in the manufacturing sector in Malaysia. In terms of theoretical significance, this study proposes to fill the gap in the body of knowledge in the practices of HRM in Malaysian manufacturing firms by addressing these issues: first, the present study intends to investigate the role of HRM practices associated with firm performance, namely profitability, growth and employee turnover. Secondly, this study is to investigate whether business strategy and environmental uncertainty moderate the relationship between HRM practices and firm performance. Lastly, this study intends to further the previous research in HRM practices using the contingency approach. Relevant to the issues above, this study intends to generate a new framework for further research pertaining to HRM practices-firm performance relationships.

From a practical perspective, the findings of this study will be useful to top management and HRM managers and practitioners to design their HRM practices within a strategic condition at the micro or macro organizational level in order to improve firm performance.

1.8 Scope of Study

This study concentrates on the manufacturing sector of Malaysia only. The justifications are based on the significant contribution made by this sector to the nation's economy in terms of gross domestic products (GDP) and employment as compared to other sectors in Malaysia. HRM practices are limited to practices that are prevalent in

Malaysian manufacturing firms while the contingencies to HRM practices-performance relationship are limited to business strategy and environmental uncertainty only.

1.9 Definition of Key Terms

1.9.1 Human resource management

Refers to a distinctive approach to employment management which seeks to obtain competitive advantage through the deployment of a highly committed and skilled workforce, using an array of techniques (Storey, 1995).

1.9.2 HRM practices

Refers to organizational activities directed at managing the pool of human resources and ensuring that the resources is employed towards the fulfillment of organizational goals (Schuler & Jackson, 1987; Schuler & MacMillan, 1984; Wright & Snell, 1991).

1.9.3 Firm performance

For the purpose of this study, firm performance refers to profitability, growth and employee turnover.

1.9.4 Business strategy

Business strategy is defined as the fundamental pattern of present and planned resource deployment and environmental interactions that indicates how the organization will achieve its objectives.

1.9.5 Environment uncertainty

Environmental uncertainty refers to a condition which decision-makers do not have sufficient information about environmental factors, and they have difficulty in predicting changes in environmental factors (Daft, 2001).

1.9.6 Manufacturing sector

Manufacturing sector refers to the mechanical or chemical transformation of inorganic or organic substances into new products whether the work is performed by power driven machine or by hand, whether it is done in the factory, and whether the products are sold at wholesale or retail (MIDA, 2000).

1.9.7 Employees

Employees refer to a pool of human resources under the firm's control in a direct employment relationship. For the purpose of this study, employees (workers) refer to non-managerial employees who are below the management levels of the organization.

1.10 Organization of Remaining Chapters

This thesis is divided into five chapters. The first chapter provides an overview of the background of the study, the problem statement, objectives of the study, research questions, significance of the study and lastly, scope of the study. Chapter two reviews the concept of HRM, the resource-based view theory and the literature on HRM practices and firm performance relationships. At the end of Chapter two the research framework and hypotheses are presented. Chapter three describes the research methodology and design employed in gathering and analyzing the data. Chapter four reports the findings of the study. The profiles of the respondent, goodness of measures,

descriptive statistics and the result of hypotheses testing are presented. Chapter five presents the discussion and recapitulation of the whole study, provides interpretation and conclusions related to the research hypotheses, and discusses the implications of these results for future research.

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

This chapter is devoted to the literature on human resource management (HRM) practices. This chapter begins with a review on the concept of HRM, the importance of HRM, and the resource-based view of the firm. An overview of previous studies on the researches that has been done in human resource management practices is also discussed. Finally, a theoretical framework and hypotheses are presented to show the relationships between the study variables.

2.2 The Concept of Human Resource Management

The term “human resource management” has been commonly used for the last ten to fifteen years. Prior to that, the field was generally known as “personnel management”. Dessler (1991) had made no differentiation between personnel management and HRM and saw that the latter as a modern expanded version of traditional personnel management due to technological change in the work environment and a shift in societal values. Torrington and Hall (1998) explained the differences between personnel management and HRM by mentioning that personnel management is considered as workforce-centered while HRM as resource-centered. Guest (1987) conception of HRM is not as an alternate to personnel management but as a particular form of personnel management which stressed the strategic issues of employee commitment, flexibility, quality and integration.

Since there is no universal agreement on the meaning of HRM, many definitions have been offered. Armstrong (1995) defined HRM as “a strategic and coherent approach to the management of organization’s most valued assets – the employees who individually and collectively contribute to the achievement of the objectives of the business.” Beer et al. (1984) viewed HRM as involving all management decisions that affect the relationship between the organization and employees – its human resources. Storey (1995) considered HRM as a distinctive approach to employment management which seek to obtain competitive advantage through the deployment of a highly committed and skilled workforce, using an array of techniques. While others have defined HRM as being concerned with the need to achieve congruency among the various HRM policies and practices so that they become mutually supportive, rather than conflicting (Milliman, Von Glinow & Nathan, 1991; Schuler & Jackson, 1987).

2.3 The Importance of HR as a Source of Competitive Advantage

In recent years, human resources have been recognized as an important source of sustained competitive advantage. Much of the human resources and theoretical and empirical work has been grounded in the resource-based view (RBV) of the firm (Barney, 1986, 1991, 1995). This theory maintains that in order to develop a sustainable competitive advantage, organization must create resource in a manner that is rare, non-imitable, and non-substitutable. Barney (1986, 1991, 1995), Pfeffer (1994), Snell, Youndt and Wright (1996) and Wright and McMahan (1992), have argued that because the resources that have historically provided organizations with competitive advantage are easily and rapidly imitated, the human resources of the organization may be an extremely important source of sustained competitive advantage.

The RBV of the firm is a theoretical paradigm originating in the field of strategic management. The RBV assumes that resources and attributes of the firm are more important to sustained competitive advantage than industry structure and competitors' actions (Barney, 1997).

Resources have been defined as “the tangible and intangible assets a firm uses to choose and implement its strategies” (Barney, 2001). This broad definition includes human, organizational, financial and physical resources. Barney (1991) and Teece, Pisano and Shuen (1997) have outlined a framework for determining if a resource can be considered a source of sustained competitive advantage. The key elements of this framework require resources to be valuable, rare, inimitable and non-substitutable. Technology, natural resources and economies of scale can create value, RBV argued that these sources of value are increasingly available to almost anyone anywhere and they are easy to copy, whilst human resources which is defined as “the pool of employees under the firm’s control in a direct employment relationship” (Wright & McMahan, 1992) can provide the firm with a source of competitive advantage with respect to its competitors.

The first of these criteria is the value added to the company’s production processes, the contribution made by each employee having its effect on the results obtained by the organization as a whole. Also, since employees are not all the same, their characteristics are in limited supply in the market. In addition, these human resources are difficult to imitate. Since it is not easy to identify the exact source of the competitive advantage and reproduce the basic conditions necessary for it to occur. Finally, this human resources is not easily replaced; though short-term substitutes may be found, it is unlikely that they will result in a sustainable competitive advantage like the one provided by human resources.

Barney (1991) argued that organizations may not obtain the maximum utility from their employees because the employees are not contributing to their fullest potential. It was argued that organizations, through the effects of their HRM practices could maximize the knowledge, skills, and abilities of employees. The focus of the overall body of research, then, is to examine the contributions of HRM policies and practices to the performance of the organizations.

2.4 Single HRM Practices and Firm Performance

A number of researchers examining the relationship between HRM and firm performance have taken a micro approach, investigating single HRM practices such as staffing, training, goal-setting, compensation, and so forth, and the effects of those practices on organizational level outcomes (See Table 2.1).

Russell, Terborg and Powers (1985) examined the relationship between training, organizational support, and performance of organizations in a sample of sixty-two retail stores. Their study utilized both archival data information obtained from a company-developed attitude survey. The findings provided evidence that both training and organizational support was positively and significantly related to store performance.

In a study conducted by Balkin and Gomez-Mejia (1987) on compensation, they found that incentive-based reward systems were more effective in growth stage and in high-tech companies. Jackson, Schuler and Rivero (1989) examined the variation in performance appraisal, compensation, and training and development programs within different strategic setting. Results obtained from survey responses for 267 firms showed firms utilizing an innovation strategy as a means of differentiation versus other firms were: a) less likely to use incentive compensation; b) more likely to offer employment security; c) likely to provide more total hours of training, and d) more likely to offer employees training related to both skills needed currently and skills needed in the future.

Table 2.1
Empirical Studies on Single HRM Practices and Organizational Performance

Researcher	HRM Practices	Dependent variable	Finding
Russell, Terborg & Powers (1985)	Training, organizational support	Store performance	Training was positively correlated with store performance.
Balkin, Gomez-Mejia (1987)	Compensation	-	Incentive-based reward systems were more effective in growth stage & high-tech companies.
Jackson, Schuler & Rivero (1989)	Appraisal, compensation, training, employment security	-	Significant association between firms pursuing high and low innovation strategy and HR practices.
Gerhart & Milkovich (1990)	Contingent pay and base pay	Firm financial performance	Positive relationship between contingent pay and financial performance of firms.
Terpstra & Rozell (1993)	Staffing practices	Annual profit, profit growth, sales growth & overall performance	Positive, significant effect of extensive staffing practices on annual profit, profit growth, and overall performance.
Bartel (1994)	Employee training	Labor productivity	Formal employee training eliminates productivity gap.

Gerhart and Milkovich (1990) examined the effects of both contingent pay and base pay on firm performance. They also studied the determinants of pay mix in an effort to discern the extent to which pay mix decisions vary after controlling for employees investments in human capital, personal characteristics, and job characteristics. They found support for variation in pay mix even after controlling for

these factors. They also found significant relationships between pay mix and industry, firm size, and firm financial performance.

Terpstra and Rozell (1993) also examined the effects of extensive staffing practices, with firm performance as their dependent variable. The staffing practices they investigated were (1) follow-up studies on recruitment sources, (2) validation studies on selection instruments, (3) structured/standardized interviews, (4) cognitive or mental ability tests and (5) biological information blanks or weighted application blanks. It was found that the extent of use of these staffing practices varied by industry and organizational size. Performance measures examined in the study were annual profit, profit growth, sales growth and overall performance. The results of the study demonstrated a positive and significant effect of extensive staffing practices on annual profit, profit growth and overall performance.

Bartel (1994) also utilized training as an independent variable, and labor productivity as her dependent variable. She found that the implementation of formal employee training programs was positively and significantly related to labor productivity gains.

The studies cited above provide examples of the growing interests in the effects of specific HRM practices on organizational outcomes. However, HRM policies and practices do not exist in organizations in isolation. Consequently, a growing body of work has turned toward examination of these systems of HRM practices in an effort to determine the true impact of HRM on organizational performance.

2.5 Approaches in Studying HRM Practices

In contrast to the various empirical works on the individual HRM practices-firm performance relationship, the relationship between HRM practices and organizational performance has been the subject of significant empirical examination. Jackson,

Schuler and Rivero (1989) examined the effects of HRM systems on organizational financial performance through a behavioral approach. They found that it is essential for organizational viability that HRM systems provide the capabilities for firms to acquire, develop, motivate and retain employees who will enhance organizational effectiveness.

In explaining the significance of human resources to firm performance, the majority of work in HRM has adopted the resource-based view of the firm (Barney, 1991, Delery, 1998). According to this view an organization can gain a competitive advantage from the human resources it possesses. However, the organization does not actually gain a competitive advantage from the HRM policies, per se, but from the human resources that the organization attracts and retains (Delery, 1998). These theoretical arguments point to the performance potential of a universal approach to HR focus on capital enhancement. However, apart from the theoretical arguments, there were also empirical evidences supporting a positive relationship between universal approach to HRM practices and firm performance.

Arthur (1994) adopted a contingency approach to this intra-industry examination of the HRM practices of thirty U.S. steel minimills. In addition to the impact of HRM practices on firm performance, the contingency approach is concern with the congruence or fit between various policies and practices adopted by organizations. Arthur employed an empirical taxonomy identifying two types of HRM systems (i.e. control and commitment) to test the extent to which the specific combination of practices utilized by organizations could predict differences in organizational performance. His findings indicate that minimills using the commitment systems of HRM had higher productivity, lower scrap rates, and lower turnover than those minimills using control systems.

Huselid (1995) examined the effects of the use of thirteen HRM practices on firm performance. Two measures of HRM practices were identified. The first of these were

designated “employee skills and organizational structures”; with practices enhancing skills, abilities, and role performance, and the second was labeled “employee motivation”, with practices targeted at evaluating and reinforcing desired employee behaviors. His findings indicated when these two measures were regressed on productivity individually, both measures were positive and significant, but when they were entered simultaneously, only the motivation measure remained significant.

Most of the foregoing studies have as their goal to verify the relationship between HRM practices and organizational performance. However, different approaches to these examinations have emerged. The following section provides a critical review of the various approaches taken in the area of HRM, and the assumptions made under each approach.

Previous research in HRM has used one of the following three ways to examine the effectiveness of HRM practices on firm performance: universalistic, contingency or configurational approach (Delery & Doty, 1996).

2.5.1 Universalistic perspective

Universalistic perspective is the simplest form of theoretical model in the HRM literature. Universalistic perspective seeks for “best practices”. Researches in the universalistic perspective are micro analytical in nature and posit that some HRM practices are always better than others are and that all organizations should adopt these practices.

Huselid (1995) work reflected the “universalistic” approach to HRM. This perspective assumes that there are certain “best” HRM practices that contribute to increased financial performance regardless of the strategic goals of organizations. Further, a universalistic approach to HRM research assumes that HRM practices contribute to worker motivation (and thereby increased productivity) as well as increased

efficiency (Ichniowski, Kochan, Levine, Olson & Strauss, 1996). While other authors concurred with these assumptions (Osterman, 1994; Pfeffer, 1994), different studies have utilized various assortments of these HRM practices, and there has been little work that provides a definitive description as to which HRM practices should be included in a “best practice” system. Huselid (1995), for instance, utilized thirteen HRM practices. Pfeffer (1994) however, advocated the use of sixteen management practices to achieve higher productivity and profits. In another work, Delery and Doty (1996) identified seven practices that are consistently considered to be strategic in nature. Practices identified were internal career opportunities, formal training system, appraisal measures, profit sharing, employment security, voice mechanism and job definition.

2.5.2 Contingency perspective

Contingency theorists posit that an organization needs to adapt specific HRM practices for different firm strategies. A number of researchers, however, have argued that contingency perspective is the more appropriate approach to HRM (Butler, Ferris & Napier, 1991; Dyer, 1985; Jackson & Schuler, 1995; Lengnick-Hall & Lengnick-Hall, 1988; Schuler, 1989; Schuler & Jackson, 1987). The contingency theorists argue that, in order to be effective, an organization’s HRM practices must be consistent with other aspects of the organization.

The contingency approach differs from the universalistic perspective in that these studies have attempted to link variations of HRM practices to specific organizational strategies (Hoque, 2000; Khatri, 2000; Youndt, Snell, Dean & Lepak, 1996). Schuler (Schuler & Jackson, 1987; Schuler, 1989) argued that HRM practices which are not synergistic and consistent with organizational strategy and, which conflict with other HRM practices are confounding in effect and create ambiguity which can inhibit both individual and organizational performance.

2.5.3 Configurational perspective

The configurational perspective is concerned with how patterns of multiple, planned human resource deployment and activities achieve the organization's goals. A closely related body of work calls for a configurational approach to HRM, and argues that it is the pattern of HRM practices that contribute to the attainment of organizational goals (Wright & McMahan, 1992). According to the configurational perspective, in order to be effective, an organization must develop its HRM system that achieves both horizontal and vertical fit. Horizontal fit refers to the internal consistency of the organization's HRM practices, and vertical fit refers to the congruence of the HRM system with other organizational characteristics, such as firm's strategy (Delery & Doty, 1996).

2.6 Relationship between HRM Practices and Firm Performance

In contrast to various empirical works on the single HRM practices-firm performance relationships, much of the recent research has been directed at understanding the relationships between HRM practices and firm performance.

2.6.1 HRM Practices

Previous empirical research on the relationship between HRM practices and firm performance have focused on single HRM practices (Balkin, Gomez-Mejia, 1987; Bartel, 1994; Gerhart & Milkovich, 1990; Jackson, Schuler & Rivero, 1989; Russell, Terborg, & Powers, 1985; Terpstra & Rozell, 1993). Table 2.2 demonstrated a summary of some of the HRM practices studies that were conducted by various researchers. In a study by Arthur (1994), using an empirical taxonomy of HRM practices, he found that steel minimills with commitment HRM systems had higher productivity, lower scrap rates and lower employee turnover than steel minimills with control HRM systems. Similarly,

Huselid (1995) using a national sample found that HRM practices had an economically and statistically significant effect on turnover, productivity, and corporate financial performance. Youndt et al. (1996) conducted a research in ninety-seven manufacturing plants and found that the human-capital-enhancing HRM systems had a positive main effect on employee productivity and a positive and significant effect on customer alignment and equipment utilization.

Hoque (1999) explored HRM practices and a range of outcome variables from a sample of 209 hotels. The outcome measures were of two types: “human resource outcomes” and “performance outcomes”. He found that, amongst the quality enhancers, commitment, job satisfaction, quality of work, quality of service and financial performance, as perceived by the respondent, were all strongly related to the use of HRM practices. Khatri (2000) using a sample of 200 of the largest companies in Singapore, found that HRM practices have a stronger direct effect on profitability than sales growth and non-financial measures. In fact, the significant relationship between HRM practices and profits is encouraging and is in agreement with findings from other studies (Gerhart & Milkovich, 1990; Huselid, 1995).

Similarly, in a study on long-term incentives plan, Leonard (1990) found that organizations having long-term incentives plan for their executives had greater increase in return on equity over a four-year period than did other organizations. Workers’ participation ensures organizational effectiveness as well. Empirical studies (Delery & Doty, 1996; Huselid, 1995) have showed that linking employee participation results in greater productivity, satisfaction and reduction in turnover.

Employee turnover is often separated into categories of voluntary turnover, which is considered controllable, and involuntary (e.g. due to retirement or death), which is considered uncontrollable. Voluntary turnover and involuntary turnover of employees seemed to be influenced by different sets of factors. According to Shaw, Delery, Jenkins

and Gupta (1998), voluntary turnover of employees is affected by factors such as dissatisfaction with current job and availability of alternative jobs, while involuntary turnover is influenced by staffing practices such as recruitment and selection processes and employee monitoring. Along the same line, Pitt and Ramaseshan (1995) found that individuals who displayed a higher tendency to leave their jobs were those who perceived that their job previews that they received during the interview process were not realistic.

In another study by Villanova, Bernedin, Johnson and Dahmus (1994), they found that firms that were able to assess if individuals were compatible for the jobs they applied for, were more able at reducing employee turnover. In other studies related to compensation, Trevor, Gerhart and Boudreau (1997) found that salary growth had a pronounced effect on turnover, that is high salary growth significantly reduced turnover for high performing employees. Similarly, William and Livingstone (1994) found that a negative performance-turnover relationship was stronger in organizations using performance-contingent reward systems. Employees who were compensated more for their high levels of performance were less likely to leave. Park, Ofori-Dankwa and Bishop (1994) also found that turnover is negatively associated with levels of pay, especially when pay was determined by individual incentives programs. As such, the higher the levels of pay, the lower the levels of employee turnover. Batt (2001) study show that turnover rates are lower and sales growth is higher in firms that emphasise high skills, employee participation in decision-making and in teams, and HR incentives such as high relative pay and employment security. Guthrie (2001) surveyed corporations in New Zealand and found that their HRM practices were related to employee turnover and profitability.

The literature highlighted that there were no consensus on which HRM practices should be used in a study. Dyer and Reeves (1995) include a table which compares the

HRM practices included in some of the leading empirical studies in HRM. Table 2.2 highlights HRM practices measured in key HRM research based on various researchers.

As can be readily seen from Table 2.2, there are widespread differences across various studies about which specific HRM practices “matter” for performance. Most studies of the HRM-performance relationship aggregate individual practices into multi-component scales (e.g. Huselid, 1995; Way, 2002), or some would group organizations on the basis of their HRM profile (e.g. Ichniowsky et al., 1997; Wood & de Menezes, 1998), in order to test for the relationships. Researchers like Huselid (1995), Ichniowski et al. (1997), Ramsay, Scholarios and Harley (2000) and Khatri (2000) use comprehensive and detailed lists including up to 24 practices (Ramsay et al., 2000). However, it must be borne in mind that the specific components of HRM practices vary a great deal across studies and measures of HRM are generally of unknown reliability. This finding indicates that HRM researchers need to devote more efforts on examining what should be included in measuring HRM practices influencing organizational performance.

Despite this lack of consistency in the approach to study the concept, there is higher agreement as to the inclusion of some of the practices. Practices such as teamwork, self-managed and self-directed teams, flexibility in terms of job design, sophisticated selection, formal training programs, quality or problem-solving teams, formal programs for participation and involvement, autonomy in decision making, formal performance appraisals, internal promotion opportunities, performance related and incentive pay, high pay, profit sharing and share options, attitude surveys and employment security are seen by empirical researchers more frequently as HRM practices.

Table 2.2
Selected Empirical Studies on HRM Practices and Firm Performance

Study	Sample	HRM dimensions and illustrative components	HRM measure type & source	Dependent variable measures
Arthur (1994)	30 US mini steel mills	Two contrasting types of HRM system; control and commitment (low & high respectively on decentralization, participation, training & skill)	Questionnaire; single-source; HR managers	Self-report: productivity & scrap rate; same respondent as for independent variables
Guest & Hoque (1994)	119 UK Greenfield mainly manufacturing companies	Four a priori types 2X2 – whether or not claim HRM strategy & use more or less than half of 22 HRM practices (e.g., selection, job design)	Questionnaire; single source; principal HR manager or senior line manager	Self report: productivity & quality; same respondent as for independent variables
Huselid (1995)	968 US companies with 100+ staff; heterogeneous sample	Two scales: skill & structures (e.g. communications, QWL, training, grievance procedures); & motivation (e.g. performance appraisals, promotion on merit)	Questionnaire; single-source; mailed to senior HRM professional	Objective: productivity, Tobin's Q & GRATE for subsequent year
MacDuffie (1995)	62 car assembly plants, world-wide	Two scales: work systems (participation, teams, quality role) & HRM policies (selection, performance-related pay, training). Also a use of buffers (lean production) scale	Questionnaire; "a contact person, often the plant manager"; sections completed by different people; later visits/telephone checks	Objective: productivity (labor hours per vehicle) adjusted for vehicle size & number of welds; quality from independent market checks

Table 2.2....continued

Study	Sample	HRM dimensions and illustrative components	HRM measure type & source	Dependent variable measures
Delaney & Huselid (1996)	590 for profit & non-profit US firms, heterogeneous	Five scales: staffing selectivity, training, incentive pay, decentralization, internal promotion	Telephone survey; single-source (multiple respondents in a few cases)	Self –report: organizational & market performance; same respondent as for independent variables.
Delery & Doty (1996)	216 US banks (down to 101 in some analyses)	Seven scales: internal promotion, training, appraisal, profit-sharing, security, participation, job specification; & 2 strategy measures	Questionnaire; single-source; senior HR manager (+ strategy from president)	Objective: return on assets (ROA), return on equity (ROE)
Huselid, Jackson, & Schuler (1997)	293 US firms: heterogeneous (e.g. manufacturing, finance, misc.)	Two scales: strategic HRM (teamwork, empowerment) & technical HRM (recruitment, training). Ratings are not of reported use, but of perceived effectiveness.	Questionnaire; single-source; executives in HR (92%) & line (8%) positions (Effectiveness of HR practices, not use per se)	Objective: productivity, GRATE & Tobin's Q