

The Impact of Human Resources Practices upon Small Companies Performances

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Abstract

The investigation of the relation between human resources management (HRM) and the company performance was mostly carried out in big companies. The question we have raised is whether the development of an intensive HRM is profitable for small companies. The results of our investigations show that HRM intensity has a strong positive effect upon the productivity, the innovation capacity and small company's profitability.

Key words: *human resources management, small and medium enterprises, high performance work systems*

Introduction

The problems of small enterprises – a family of firms of strong peculiar features and functions – become an intriguing object and subject for scientific debates, for politics and for civil society, as far as the options for the economic policy are concerned. This is due to the growing resources that the small enterprises are controlling and to their role in the overall economic mechanism.

Having appeared after 1990, the entrepreneurial phenomenon manifests in Romania a series of specific features, due to the historic, geographic, economic, social and cultural conditions in which it surfaces. Currently, in Romania there is a unanimously accepted fact that the small and medium-sized enterprises (SMEs) represent a key sector for economic growth. The analysis of the SME's evolution after the year 1989 reveals that they constituted an important factor for the absorption of the unoccupied workforce or for the workforce that had been laid off, and also a flexible vector in the adaptation of the production of goods and services to the volume and structure of the demand on the market. From the data provided by the National Statistics Institute and by the White Book of SMEs results that at present in Romania there are approximately 550,000 SMEs. An important indicator which characterizes SMEs' development is the percentage of the workforce hired in this domain, compared with other domains, indicator which has the value of approximately 63%. The power of a company is also reflected in the number of company employees. The consolidation of this domain as far as the occupied human resources are concerned, due to the yearly growth of employees, also modified the average number of employees per SME, currently reaching the number of 5 employees per enterprise. Although the SMEs have reached an overwhelming percentage in the totality of companies in our country (more than 99,5%), the investigation of the Human Resources Management in these companies is still almost a "white spot" on the research map.

To lead a successful organization means to identify, retain and trigger the adequate employees. The changes occurring in the demographic and economic structure of the Western companies, such as the increased role of knowledge, the aging of the labour force and the decreasing entrance flow of the new labour force contribute to a higher increase in the available human resources management role. This is valid for all organizations regardless of their size.

The HRM concept involves treatment of the employees as resources. As resource type “the human capital” means the organization’s employees introduced in terms of training, experience, judgment, intelligence, relationships, empathy – characteristics that can add economic value to the organization. In other words, it either produces cars or forecasts the weather; an organization needs employees with certain skills, training and specific experience. This approach supports the idea that the employees of the contemporary organizations are not interchangeable parts but the very source of the success or failure of a company. By influencing who is working for the organization and how, the HRM contributes to the basic arguments of the success of an organization: quality, profit and client’s satisfaction. The following diagram demonstrates this relation:

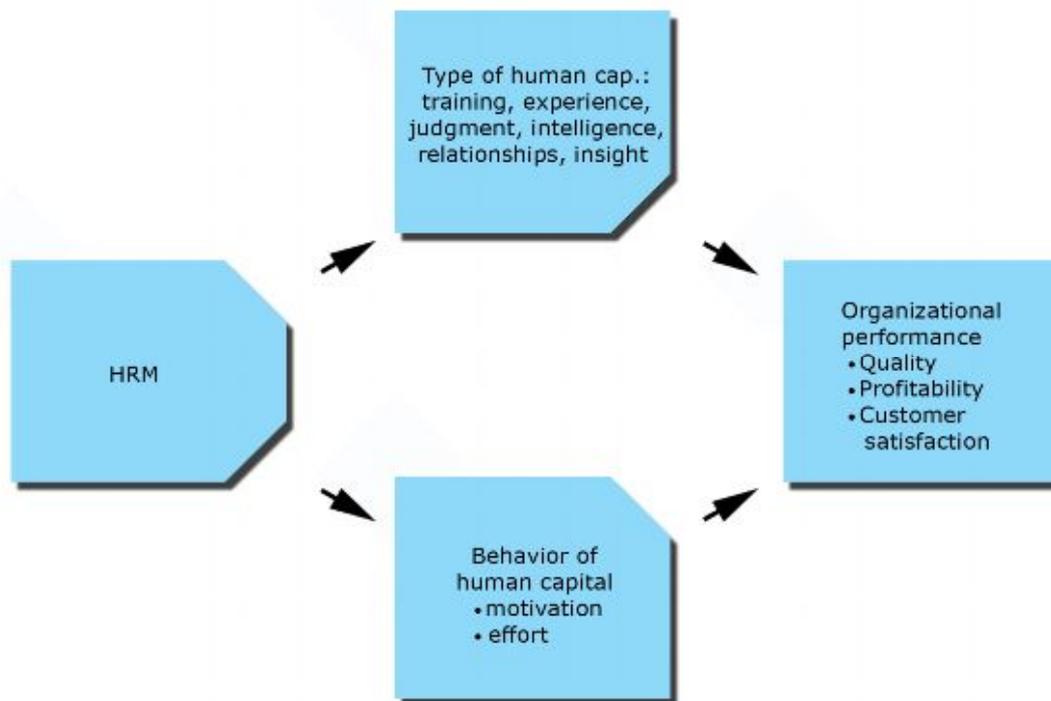


Fig. 1. Impact of human resources management

Source: Noe, R. A., Hollenbeck, J.R., Gerhart, B., Wright, P.M. - *Fundamentals of Human Resource Management*, 2/e, McGraw-Hill, 2007

The serious implementation of HRM in SME is a relatively recent phenomenon, the research in the field still being in an exploring stage. The company size is strictly related to the implementation of HR instruments¹. In general, the small companies are less susceptible to appeal to HRM. This statement does not relate only to the level of individual HRM instruments but also to the level of the configuration of these instruments. Recent researches have correlated some types of systems or configurations of HRM practices with different indicators of the company performance. Small companies usually have a more modest score concerning the

¹ Compeer, N., Smolders, M. - *Scale effects in HRM Research*; *EIM*, Zoetermeer, pag. 7, 2005

HRM formalization². However, we guess that HRM will also matter in small companies, although their possibilities and practices in the field are different from those of the big companies – and even their mentality of becoming aware and measuring the HRM effects upon performance, innovation, increase.

High Performance Work Systems

Some of the systems integrated with HRM practices are called high performance work systems (HPWS^{*}). Such system is made up of different HRM practices in the fields such as: assessment, training, development and improvement of communication and involvement of employees and it targets to obtain a positive answer on their behalf. HPWS literature pleads for the efficient use of a consistent internal HRM practices assembly – which completes each other as the HPWS becomes bigger than the sum of its parties. Many studies dedicated to HRM's impact upon the organisation performances assume that there are synergies and contingences. HPWS contribute to the increase of the skills, to the people's company fidelity and motivation which in their turn contribute to the sensitive increase of the company's performances.

It is not always clear what “high performance” signifies. And it is no wonder that the term was used in such different circumstances that the concept is in danger of losing its signification because it was so much abused. What company would eventually admit that it administers a low performance system?

The only useful answer to this strict term is to carefully define it. The authors of “Manufacturing Advantage”³ offer a wider definition of the concept but also a more focalized one. At the widest level they define “high performance” as a modality to organize the work so that the first line workers should attend the decisions which have an impact upon them and upon the whole organization. Their focalized definition translates the theory into practice. The degree of autonomy that the employees enjoy constitutes for the researchers the first stage of great performance: how much do the workers control their tasks and working methods? Of course, without information and resources, the autonomy is useless. Because of this researchers consider the access of executives to colleagues, managers and specialists to be the second stage towards great performance. The third stage: the existence of an autonomous team at production level. The authors sustain and keep arguing that the impact of high performance practices upon quality and productivity is higher if these practices occur within the frame of a correct HRM approach in the company. In their opinion, human resources practices must include: extensive scanning of new employees; intensive training of first line executives, concern for employees' safety and financial motivations for group performance.

Researchers found a correlation between high performance practices on one side and low costs on the other side. However, in many cases the true reward of the company came from another place, from product improvement, the reaction time towards the client and other collateral advantages which elevated the company's general level. In fast-moving consumer goods industry, for example, high performance practices have helped companies to rapidly answer the modification requested by the consumer. This leads to higher sales (and higher profits), independent of productivity.

Among the performed studies there are high variations concerning the specific practices included in HPWS and their operational feature in making up a system. Hereafter we present

² Kok, P.M., Hartog, D. - *Is human resource management profitable for small firms?*, EIM, Zoetermeer, pag. 6, 2006

^{*} High Performance Work System

³ Appelbaum, E., Bayley, T., Berg, P., Kalleberg, A. - *Manufacturing Advantage*, Cornell University Press, 2000

some points of view. HPWS researchers tend to choose the practices in the field of employees development, autonomy and attendance at the same time with the existence of a motivation and stimuli system which assures that the supported work is awarded financially and at career opportunity level. Components of such systems can also be considered to be the extremely careful selection and the work environment designed in such a way that the employee can use at maximum the expertise in cooperation with other operators⁴. For example, Batt⁵ stated that such a system usually requires a relatively high training level, suitable relationships between the group members and a well done stimuli system. Similarly, Delany and Huselid⁶ mention the employee's participation, the increase of their responsibility, redesign of team-based system job, extensive training and performance related stimuli – as practices meant to increase the quality of the organization activity.

An HPWS system can be defined as a correlated distinct practices assembly which together “make a selection, develop, keep and motivate the labour force:

1. which possesses superior skills;
2. apply the skills in their work;
3. whose activities related to work are translated into superior company achievements (those indicators upon which the labour force has a direct effect) and it offers to him competitive advantage”⁷.

Pfeffer⁸ presents his high performance work system as being made up of seven *factors*:

1. *Employee's security (safety)*. Considered to be a fundamental factor in ensuring employees' devotion. If the employees are not afraid that they will lose their job, they willingly contribute to the increase of productivity. When the employees feel safe they are able to think and to act with a long term mentality;
2. *Selective employment*. Those responsible for employment have to be liable to employ the right persons at the right place. Pfeffer is the advocate of competence-based employment, strictly related to the job requirements. Only with such employees one can obtain the success of the organisation on the market;
3. *Self-leading teams and decentralization of decision making*. The traditional supervision has to be replaced with the permission of a considerable force labour to accept responsibilities in relation to the company's performances. The employees will easily understand how their work affects others' work. The ideas will be able to circulate and the useless hierarchy layers will be „wiped out”;
4. *Compensation in relation to the performance*. Profit can be also obtained based on high salaries if correct methods are used– percentage out of earning, preferential shares, award of high qualification. When the employees are rightfully awarded they are expected to be loyal;

⁴ Den Hartog, D.N., Verboug, R. M. - High Performance Work Systems, organizational culture and perceived organizational effectiveness, *Human Resources Management Journal*, 14 (1), pag. 55-78, 2004

⁵ Batt, R. - Managing customer service: human resources practices quit rates and sales growth, *Academy of Management Journal* 45(3), pag. 587-598, 2002

⁶ Delaney, T.J., Huselid, A.M. - *The impact of human resource management practices on perceptions of organizational performance*, *Academy of Management Journal*, 39(4), pag. 802-835, 1996

⁷ Way, S.A. - High Performance Work Systems and Intermediate Indicators of Firm Performance Within the US Small Business Sector, *Journal of Management* 28 (6), pag.765-766, 2002

⁸ Pfeffer, J. - *The Human Equation: Building Profits by Putting People First*, Harvard Business School Press, 1998

5. *Training*. The „permanent” employees are more flexible and more ready to accept change, to predict problems and to resolve them, to assume their responsibility for quality products or services;
6. *Reduction of status differences*. To create a more equal job encourages setting up of communication channels. The employees get the feeling of the common aim;
7. *Share of information*. This leads to the increase of employees’ confidence and devotion towards the company. Thus, the employees are able to understand and to notice the multiple target priorities that they aim at.

We consider that at SME level important *specific factors* interfere, additional factors on which the company’s performance depends, as follows:

1. *Versatility*: multi-qualified labour force, able to resolve many types of tasks and to efficiently work at different levels;
2. *Employee’s attitude towards the stakeholders*. The chances that these ones get directly into contact especially with the beneficiary-client of the product or service are much higher; the company’s staff is directly close to the company’s image, rather than the external „signs”;
3. *Involvement in operational decisions of a highest part of the staff*: this leads to a better communication and to an easier acceptance of tasks to be fulfilled;
4. *Entrepreneur*. His training level, his mentality and vision upon the business, the will for development, the skills, and the competences are conditioned elements;
5. *Appeal to consulting services for specialized problems*. Some fields are too complex and too specialized, the time consumption and energy to cover them are too high and the effective solution is to appeal to consulting companies.

However, we consider that HWPS by itself is not enough for assuring the global level competition. The companies that face global competition need macroeconomic policies (at their home) which support the reduction of unemployment, a global financial system which promotes stable financial flows and development agencies which implement higher living standards and the expansion of the internal markets in the countries that are economically less developed.

Is HRM Profitable for Small Companies?

Few things are relatively understood concerning the needs and practices of small companies – related to HR. In particular, the impact of human resources practices upon the small companies has not been studied so much. This field of interest is a sort of „*terra incognita*”⁹. Since it was noticed that for big companies the HRM impact upon the performance is a positive one a much higher number of authors have underlined the need for similar researches for SME. The existent researches focus upon the managers’ perception on the importance and/or the success of HR practices¹⁰. The main conclusions suggest that the enterprisers /managers acknowledge the necessity of HR practices for reaching the objectives. However, translating the theory into practice can cause many problems. Many authors have studied the connection between HRM and performance empirically.

⁹ Kok, P.M., Hartog, D. - *Is human resource management profitable for small firms?*, EIM, Zoetermeer, pag.11, 2006

¹⁰ Heneman, R. L., Tansky, J. W, Camp, S. M. - Human resource management practices in small and medium-sized enterprises: unanswered question and future research perspectives, *Entrepreneurship - Theory and Practice*, Fall, 25(1), 11-26, 2000

De Kok¹¹ examines the impact of training upon the production on a sample of Dutch companies with 40-5000 employees. He studies the impact of training upon the series production and the added value and he displays a model in which training is measured according to the training volume per employee (the time spent for the program preparing and management) and to the size of the company. His results confirm the presence of the moderation effect (mediation) of the training effect per employee but it is not correlated with the size of the company: the small companies tend to ensure a more reduced training volume as compared to the big companies, which reduces the impact upon the production and the added value. Even if the training may have a positive effect upon performances, for smaller companies this effect can not be enough in order to cover the training costs.

Cardon¹² suggests that small and/or new companies might face problems in recruiting the employees because they lack the resources and the stature. Williamson¹³ also reaches the conclusion that without candidates having heard about the company, about its practices or its members, it is difficult for small companies to find the necessary employees. In a survey upon 120 German companies with 1-50 employees, Rauch et al.¹⁴ found a significant positive impact of the human resources development upon the small companies' benefits.

It is said that HR practices do not influence directly the company performance but only through a variable interim causal chain¹⁵. The basic idea is that the performance can be differentiated on hierarchical levels, the net result of a level causing the performance of the next level. In spite of some evident inconsistency in the specialized literature – concerning the number of hierarchical levels or the used criteria –the generated models suggest that HR practices have the biggest influence upon the employees' motivation, knowledge, skills, competences¹⁶. In its turn, a change in these components influences productivity. It goes without saying that the variation of the productivity influences the company's performance. De Kok and Den Hartog¹⁷ undertook a survey on a sample of 800 small companies from Netherlands which proved a positive correlation between HPWS and the innovation capacity (which is so crucial for small companies). Furthermore, they also found a positive correlation between HPWS and work productivity, which has a positive effect upon the organisation profitability. This suggests that HPWS is able to increase the small company's ability to select, develop and motivate a labour force able to produce superior results.

Sels *et al.*¹⁸ carried out a survey on a sample of 416 Belgian companies which had between 10 and 100 employees, following the HRM impact upon the productivity and financial performances of small companies. As we have mentioned before, the company performances

¹¹ Kok, M.P. - The impact of firm-provided training on production, *International Business Journal* 20(3), pag.271, 2002

¹² Cardon, M.S. - Contingent labour as an enabler of entrepreneurial growth, *Human Resources Management*, 42(4), pag.357-373, 2003

¹³ Williamson, I. O. - Employer legitimacy and recruitment success in small businesses, *Entrepreneurship - Theory and Practice*, Fall, pag.27, 2001

¹⁴ Rauch, A., Fres, M. - Effects of human capital and long term human resources development and utilization on employment growth of small-scale businesses: a causal analysis, *Entrepreneurship: theory and practice* 29(6), pag.681-689, 2005

¹⁵ Becker, B., Gerhart, B. - The impact of human resource management on organizational performance: progress and prospects, *Academy of Management Journal* 39(4), pag.779-801, 1996

¹⁶ Delery, J., Shaw, J. - The strategic management of people in work organizations: Review, synthesis, and extension; *Research in Personnel and Human Resources Management*, Vol. 20, Oxford, 2001

¹⁷ Kok, P.M., Hartog, D. - *Is human resource management profitable for small firms?*, EIM, Zoetermeer, 2006

¹⁸ Sels, L., De Winne, S., Delmotte, J., Maes, J., Faems, D., Forrier, A. - *Linking HRM and Small Business Performance: An Examination of the Impact of HRM Intensity on the Productivity and Financial Performance of Small Businesses*, *Small Business Economics*, 26, pag.83-101, 2006

can be differentiated on hierarchical levels. The authors of the survey opted for *three levels*, namely:

1. behaviour variable (staff voluntary fluctuation);
2. employees performance (labour productivity);
3. company performance (financial results).

We will approach them in order:

1. Staff fluctuation in SME. Most specialists agree that one of the biggest problems is to keep its employees¹⁹. Small companies have evident difficulties as compared to big companies concerning the type of work conditions ensured by them. A high fluctuation also implies high costs (for replacement and additional hours etc.) and it can lead to (temporary)²⁰ productivity decrease. The research in the field suggests counteracting modalities such as: level of salary, career opportunities and training, participation of employees.
2. Work productivity in SME. The work productivity is a central concept in the theory of human capital²¹. In particular, in Western countries, work and capital productivity is considered to be the main vector of economy. Since it is known the fact that big companies have easier access to capital and technology, the human capital becomes very important for small companies in their fight for survival and in the competition with big companies. According to the human capital theory we can assume that HRM can influence the productivity by changing the competences of the employees and of the motivation levels which can lead to a faster and better performance of the operations related to the business flow.²²
3. Financial performance in SME. We can assume that not any kind of company has the ambition to grow.²³ Given the high risk of failure of small companies, surviving is their main concern. Although the utility of a dynamic pursuit is acknowledged, a static approach is preferred, such as the profitability instead of increase, for small companies.

The authors of the above-mentioned survey started from the idea that they can appreciate the financial performances of some SME with the help of the forecast models of bankruptcy (Figure 2). These models assume that at least four parameters have to be supervised in order to obtain a stable level of financial standing: percentage of the work cost in added value, profitability, liquidity, and solvency. The added value is used to cover the production domestic factors cost: the salaries, the amortisation and the financial capital cost. The higher the added value salaries percentage is, the less money remains to pay the financiers and to protect the financial standing

¹⁹ Hornsby, J., Kuratko, D.K. - Human Resource Management in Small Firms: Critical Issues for the 1990s, *Journal of Small Business Management*, 1990, and Golhar, D.Y., Deshpande, S.P., *HRM practices of large and small Canadian firms*, „Journal of Small Business Management”, Vol. 35, pag. 30-38, 1997

²⁰ Guthrie, J.P. - High-involvement work practices, turnover, and productivity; Evidence from New Zealand, *Academy of Management Journal* 1 (44), pag.180-190, 2001

²¹ Becker, G. - *Human Capital*. New York: National Bureau of Economic Research, 1964 (citation by Sels, L., De Winne, S., Delmotte, J., Maes, J., Faems, D., Forrier, A. - *Linking HRM and Small Business Performance: An Examination of the Impact of HRM Intensity on the Productivity and Financial Performance of Small Businesses*, *Small Business Economics*, 26, pag.83-101, 2006)

²² Koch, M.J., McGrath, R.G. - Improving labour productivity: human resource management policies do matter, *Strategic Management Journal*, 7, pag.335-354, 1996

²³ Heneman, R.L., Tansky, J.W., Camp, S.M. - Human resource management practices in small and medium-sized enterprises: unanswered question and future research perspectives, *Entrepreneurship - Theory and Practice*, Fall, 25(1), pag. 11-26, 2000

on the future (through reserves). Profitability reflects the financial performance in a tighter sense, in particular the ability to return an investment. Liquidity refers to the capacity to cover the short term loans. A company will have serious problems if it does not have funds to cover a short term loan. In the case of small companies which fight for survival, liquidity is a very important factor of financial stability. Solvency refers to the short term financial power of the company and it gives us information on the extent to which the organisation is equipped in order to face risk.

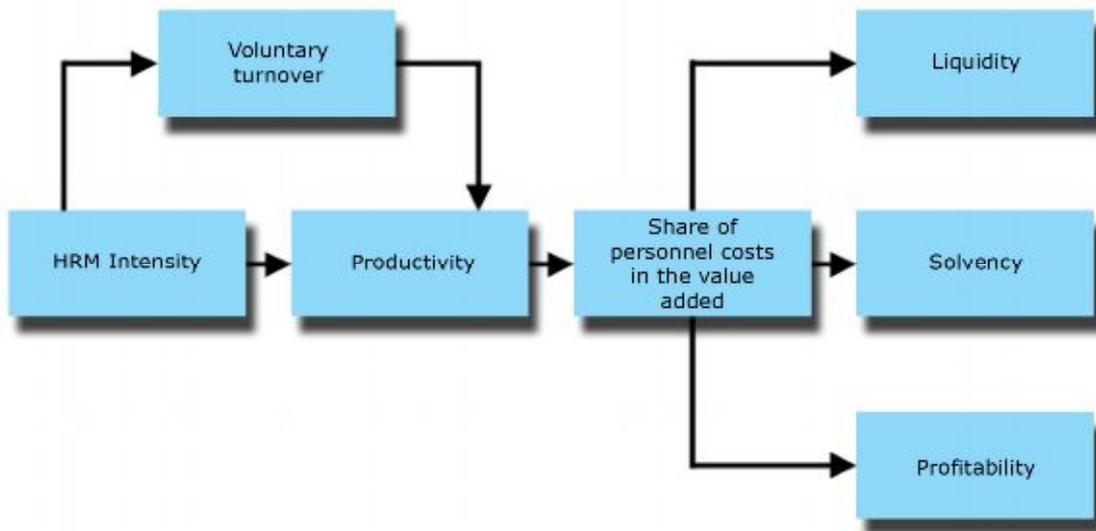


Fig. 2. HRM and the financial performances of the company

HRM intensity and productivity.

It is assumed that HRM intensity can affect productivity directly, modifying the competences and the motivation levels. We can offer some examples of HR practices impact on productivity. The training was probably the most examined from this point of view. A second example is the retribution system. By offering salaries and benefits we can improve productivity by attracting a superior level of the labour force.²⁴ Furthermore, “the payment based on results” was considered a good mechanism to guide employees in the desired direction. On the other side, the use of some performing selection techniques can help identify high productivity employees and find the right person at the right place. As concerns the career options, small companies can speculate the flexibility of widening the opportunities for horizontal mobility. Eventually, the relation between the financial participations and productivity proved to be positively strong. The share of profit should be encouraged, as an important price for harmonising the employees, management and shareholders interests, leading to a high productivity in a complex frame, which involves the organisational culture, the company spirit, the cooperation within the group and the main financial mechanisms.

Furthermore, it is assumed that the HRM can indirectly influence productivity by reducing the fluctuation of employees.²⁵ Research has indicated that some HR practices can reduce fluctuation– which in its turn has a positive effect upon productivity. Training can increase

²⁴ Shaw *et al.*, 1998, citation by Sels, L., De Winne, S., Delmotte, J., Maes, J., Faems, D., Forrier, A. - *Linking HRM and Small Business Performance: An Examination of the Impact of HRM Intensity on the Productivity and Financial Performance of Small Businesses*, Small Business Economics, 26, pag.83-101, 2006)

²⁵ Guthrie, J.P. - High-involvement work practices, turnover, and productivity; Evidence from New Zealand, *Academy of Management Journal* 1 (44), pag.180-190, 2001

employees' satisfaction. Payment according to results functions as a valuable recognising system which decreases staff fluctuation at the level of the best ones. The perspective of this career can have a motivational effect – a necessary condition being the consistent application of some transparent selection criteria.

Productivity and financial performances.

Productivity is an important transmission belt between the HRM intensity and the financial performances. In modelling the connection between productivity and financial performance (liquidity, solvency and profitability) the labour cost percentage in added value plays a central role. The other parameters remaining constant, the aforementioned percentage decreases at the same time with the productivity increase.

The results of investigations upon the Belgian companies sample (hereinabove mentioned) show that HRM intensity has a strong positive effect on productivity, which directly influences the staff cost/added value ratio. However, the effect is not so strong as to compensate for the high costs of the HRM intensity increase.

On the other side, the overall effect of HRM intensity upon the profitability is very strong. This effect can be explained through the HRM positive effect upon some operational performances more difficult to measure, such as: the decrease of internal conflicts number, a better quality and an atmosphere favourable to innovation. One last important observation is the fact that the positive impact of HRM intensity upon profitability does not have a place to the detriment of solvency or liquidity.

We agree that this model remains incomplete because of the productivity of the operational performances which can be influenced through HRM. Other operational results include, for example, the rhythm of the innovation the quality of obtained products or services, the client's satisfaction, the improvement of the delivery time etc. The social climate or the number of work conflicts is also not included. The effect upon the profitability represents a combination of factors which are also produced through operational performances results which are not quantifiable.

Conclusions

HRM and HPWS are associated with higher work productivity, higher profits and an increase innovation capacity. This suggests that the HRM can increase the ability of small companies to select, develop and motivate a labour force capable to produce superior results. This thing is relevant for researchers but also for the millions of small company owners. In conclusion, it is worth the investment!

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Impactul practicilor de resurse umane asupra performanțelor firmelor mici

Rezumat

Investigarea legăturii dintre managementul resurselor umane (MRU) și performanța firmei a fost realizată cu precădere în firmele mari. Întrebarea pe care ne-am pus-o este dacă dezvoltarea unui MRU intensiv este profitabil pentru firmele mici. Rezultatele investigațiilor noastre arată că intensitatea MRU are un puternic efect pozitiv asupra productivității, capacității de inovare și profitabilității firmelor mici.