

Strategic Human Resource Management in SMEs: Exploring the Impact of HR Practices on Innovation and Performance in Chennai's Export-Oriented Enterprises

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Abstract

In the dynamic landscape of modern business, Human Resource Management (HRM) emerges as a pivotal factor for organisations striving to maintain competitiveness amidst turbulent conditions. This study delves into the critical role of HRM practices in fostering innovation and enhancing organisational performance. Employing a comprehensive questionnaire based on a Likert scale, the research captures the perceptions of 126 managers and middle managers from export-oriented small and medium enterprises (SMEs) in Chennai, India. The study's design aims to empirically test a model linking HRM practices to innovation and organisational outcomes. The findings reveal HRM's significant impact on organisational performance and innovation. Notably, innovation is a crucial mediator that can potentially elevate organisational performance. However, a simultaneous testing process yields intriguing insights, indicating that innovation does not always translate into improved performance outcomes. This paradox highlights a critical gap in SMEs' investment in human resources, underscoring the need for more strategic HRM approaches to drive innovation effectively. The study contributes to the existing literature by providing empirical evidence from a unique context, offering valuable implications for HRM practices in SMEs. It suggests a recalibration of HRM strategies to better harness the potential of human capital in driving innovation and achieving superior organisational performance.

Keywords: *Human Resource Management, Innovation, Organizational Performance, Small and Medium Enterprises, Export-Oriented Businesses, Chennai*

Introduction

In the era of globalisation, organisations are continuously challenged to stay competitive amid escalating industrial rivalry. This evolving landscape necessitates a constant pursuit of innovation, integrating diverse knowledge for effective organisational learning. Historical studies have highlighted the critical role of creativity and innovation in an organisation's products, processes, and services, underscoring their contribution to long-term growth and success (Yeh-Yun Lin & Yi-Ching Chen, 2007; Zhou & Shalley, 2008). These elements are vital for organisations to thrive in a competitive and dynamic environment.

An organisation's innovation ability has been linked to maintaining a competitive advantage, enabling a more agile response to environmental changes. A fundamental aspect of fostering such innovation is emphasising the quality of human resources, positioned as a top priority. The practice of human resource management (HRM) plays a pivotal role in this context. Earlier research by Gil-Marques and Moreno-Luzon (2013) and others has demonstrated the significant impact of HRM on innovation, asserting that effective HRM practices contribute positively to organisational innovation.

Further, the role of HRM in enhancing organisational performance has been widely acknowledged in academic literature. Studies like those by Budhwar, Chand, and Katou (2007) have provided strong evidence of HRM's practical function in supporting organisational performance. This is complemented by the assertion that appropriate implementation of HRM strategies is crucial in realising organisational goals.

Despite the acknowledged importance of innovation, research in this area, particularly within the context of small and medium enterprises (SMEs), has been limited. Often, SMEs tend to focus more on conventional operational activities, overlooking the critical role of innovation in enhancing organisational performance. However, HRM plays a crucial role in this context by ensuring the recruitment and development of suitable employees. The dynamic capability theory, as proposed by Teece (2007), suggests that organisations can amalgamate internal and external knowledge to navigate environmental changes effectively.

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Therefore, this study aims to analyse HRM practices in fostering innovation and enhancing organisational performance, focusing on understanding these dynamics within the context of SMEs.

Literature Review

Human Resource Management (HRM) encompasses a series of interconnected activities and functions aimed at effectively managing the workforce of an organisation. This includes attracting, developing, maintaining, and even terminating employment. Critical dimensions of HRM, as identified by earlier studies (Laursen & Foss, 2003; Jiménez-Jiménez & Sanz-Valle, 2005; Shipton et al., 2005; Tan & Nasurdin, 2011), include performance appraisal, career management, reward systems, training, and recruitment. These dimensions enhance employees' innovative behaviour, thereby supporting organisational innovation.

Innovation is viewed as a process of accumulating and managing knowledge in a planned and organised manner. It is more than just implementing changes; it represents a fundamental shift in how an organisation operates and is perceived (Crumpton, 2012). Innovative organisations often find achieving their vision and mission easier, thereby enhancing performance. The general concept of performance is rooted in the idea that organisations are an amalgamation of productive assets, including human, physical, and capital resources, all working towards common goals (Carton & Hofer, 2006).

The impact of HRM on organisational performance has been a subject of extensive research. Studies such as those by Batt (2002) have indicated a significant relationship between HRM practices—particularly regarding salaries and career security—and organisational performance. HR practices contribute to business success, including sales growth, teamwork, and employee participation in decision-making processes.

While HRM is instrumental in fostering an environment conducive to innovation, it is not guaranteed that all employees will act innovatively. An innovative organisational culture is necessary to nurture and support employee innovation (Coffman, 2015). Such a culture promotes mutual support and knowledge sharing among the workforce. Effective staff placement strategies are also crucial as they help employees feel comfortable and transparent about their roles and expectations, fostering a conducive environment for innovation.

The effectiveness of a well-run Human Resource Management (HRM) model is crucial in influencing organisational performance. Historical research findings consistently show that HRM significantly boosts customer satisfaction and organisational performance. For instance, studies such as those by Vermeeren, Kuiper, Bram, and Vogelaar (2014) and Al-bahhussin and El-grainy (2013) have confirmed this positive correlation. Moreover, research by Chand and Katou (2007) highlighted the significant impact of various HRM programs, including recruitment, selection, work planning, job design, training and development, and payroll systems on organisational performance. Wright, Gardner, Moynihan, Park, Gerhart, and Delery (2000) further reinforced that effective HRM implementation can enhance competitive advantage, thus improving organisational performance.

Hypothesis 1: HRM has a significant effect on organisational performance.

The role of HRM in fostering organisational innovation has also been explored extensively in academic literature. Earlier studies have pointed out that interventions in HRM positively contribute to organisational innovation by increasing employee involvement, leadership, motivation for learning, promoting a learning culture, and developing social capital. Research by Ma Prieto and Pilar Perez-Santana (2014) suggested that HRM practices related to employee placement and selection have significant implications for fostering innovative behaviour. The active participation of employees in organisational processes can enhance their confidence in their tasks, thereby promoting innovation. Past research, including studies by Al Haraisa (2016) and Farouk et al. (2016), has underscored the significant impact of HRM on innovation.

Hypothesis 2: HRM has a significant effect on innovation.

Innovation is increasingly recognised as a fundamental requirement for organisations to sustain competitive advantage. It is vital to winning competitions by creating new ideas, products, and improved processes, often supported by technological advancements (Trott, 2008). Despite its recognised importance, the role of innovation in enhancing organisational performance has been a subject of debate. Generally, innovation is seen as a means to create new values and improve competitiveness. The importance of organisational innovation lies in maintaining effectiveness and achieving long-term success, especially in navigating the challenges of a turbulent external environment.

Innovation is increasingly recognised as a critical factor affecting employee and organisational performance. Several researchers have underscored the essential role of innovation in driving enhanced organisational performance, primarily

through increased effectiveness and efficiency. Studies prior to 2016, like those by Nawab et al. (2015), have highlighted the significant impact of an organisation's ability to innovate on its overall performance. Innovations within an organisation can elevate its competitiveness, leading to improved performance.

The research by Valdez-Juárez, García-Pérez de Lema, and Maldonado-Guzmán (2016) specifically focused on the effect of innovation on the performance of SMEs, suggesting that innovation is crucial for enhancing competitiveness and achieving superior performance. Earlier studies, such as those by Cho and Pucik (2005), have elaborated on how innovation can improve product quality, thus increasing profitability and market value. Similarly, Hua and Wemmerlöv (2006) noted that increased product change intensity due to innovation leads to better marketing performance, positively affecting organisational performance.

On the other side of the spectrum, the successful implementation of innovation behaviour is contingent upon support from innovative employees. The acquisition of such employees largely depends on implementing effective human resource management practices. Earlier research, including studies by Budhwar et al. (2007), has demonstrated the impact of HRM on fostering an environment conducive to innovation, which subsequently influences organisational performance.

Hypothesis 3: Innovation has a significant effect on organisational performance.

Research Methodology

This study focused on small and medium enterprises (SMEs) engaged in export activities across five districts in Bali. The research encompassed 168 top and middle managers from 42 SMEs operating in the export sector. A questionnaire designed to gather comprehensive data formed the core of our data collection method. This questionnaire included eleven distinct indicators, each represented by a series of statements. Respondents were asked to rate these statements on a five-point Likert scale, ranging from 'strongly disagree' (1) to 'strongly agree' (5).

The study utilised four indicators to assess Human Resource Management (HRM) in developing the questionnaire. These indicators were based on the frameworks established in previous studies by Tan and Nasurdin (2011) and Manafi and Subramaniam (2015). For evaluating innovation, the questionnaire incorporated three indicators, drawing upon the research methodologies used by Lai, Hsu, Lin, Chen, and Lin (2014), Nawab et al. (2015), and Byukusenge, Munene, and Orabia (2016). Additionally, four indicators were used to measure organisational performance, inspired by the works of Sanchez and Marin (2005) and Chong (2008).

Out of the questionnaires distributed, 126 were returned, filled out and deemed valid for analysis. The data gathered from these responses was processed using the WarpPLS analytical tool. Detailed respondent profiles are systematically presented in Table 1 of the study.

Table 1: Demographic Profile of Respondents in Chennai's Export-Oriented SMEs Research

No.	Profile of respondents	Total	Percentage (%)
1	Male	58	46.0
2	Female	68	54.0
3	< 26 years old	20	15.8
4	27-36 years old	64	50.8
5	37-46 years old	30	23.8
6	> 47 years old	12	9.5
7	Senior high school	70	55.5
8	Diploma	25	19.8
9	Bachelor	15	11.9
10	Master	16	12.7
11	6-10 years	76	60.3

12	11-15 years	25	19.8
13	16-20 years	14	11.1
14	21-25 years	11	8.7

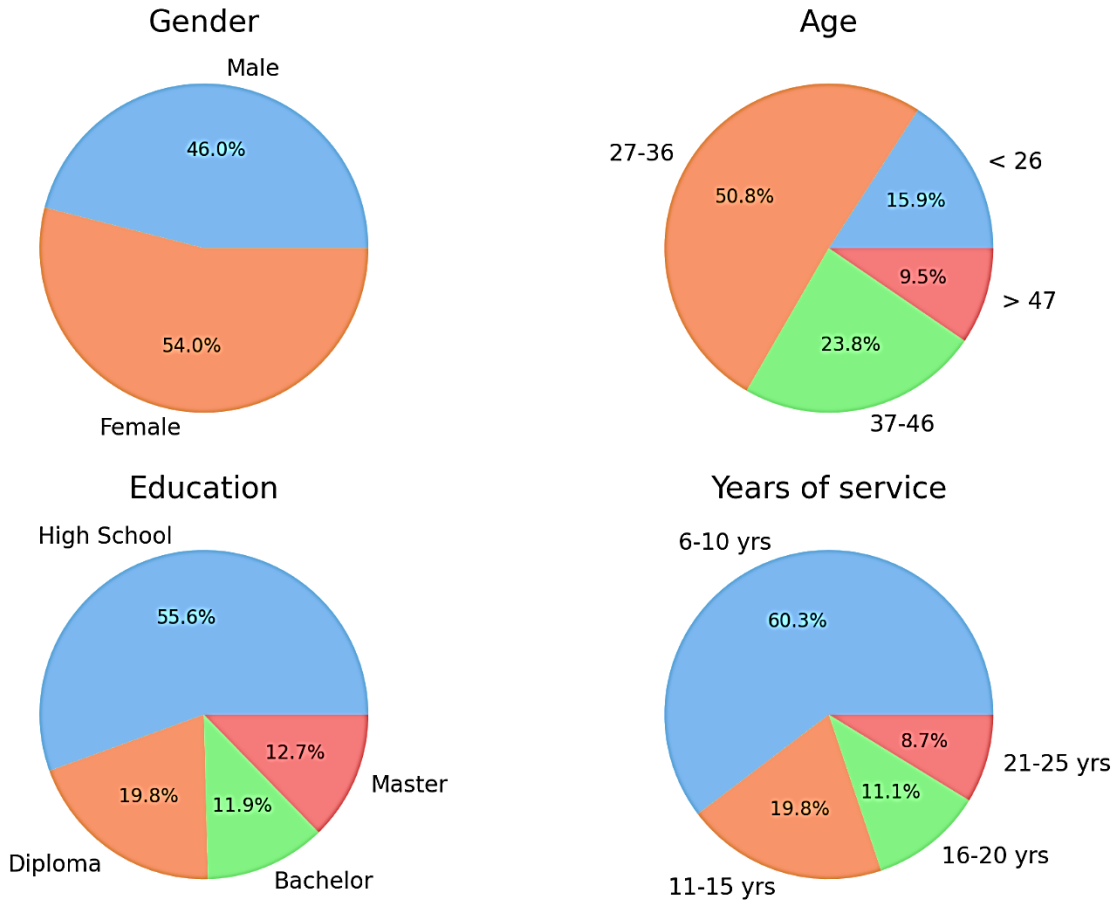


Fig. 1: Demographic Profile of Respondents in Chennai’s Export-Oriented Research

Results

The measurement model's validity was appraised by examining both construct indicators' convergent and discriminant validity alongside the composite reliability for each indicator block.

Table 2. Latent Variable Coefficients

Coefficients	HRM	Innovation	Organisational Performance
R-square	–	0.403	0.227
Composite Reliability	0.861	0.651	0.926
Cronbach’s Alpha	0.774	0.662	0.886
Average Variance Extracted	0.605	0.593	0.760
Variance Inflation Factors (VIFs)	1.353	1.350	1.202
Q-square	–	0.385	0.230

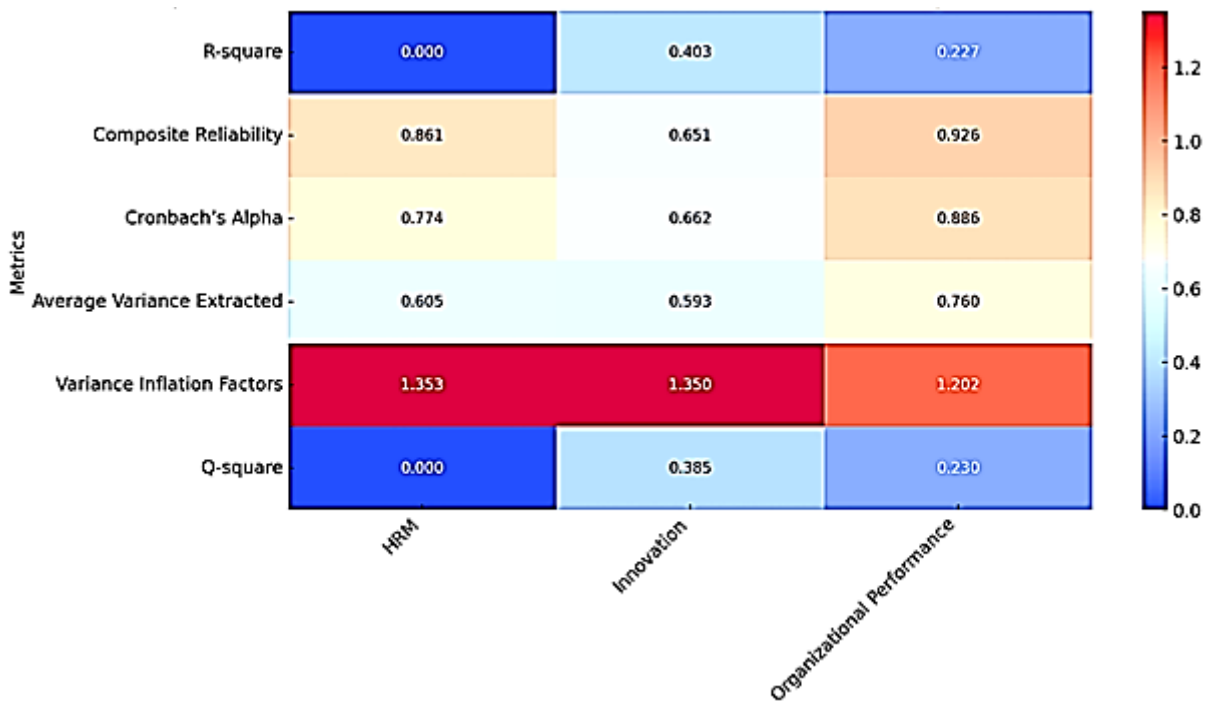


Fig. 2. Latent Variable Coefficients for HRM, Innovation, and Organizational Performance

The R-square value indicates the proportion of variance in the dependent variables explained by the predictors. For organisational performance, an R-square of 0.227 suggests that 22.7% of the variance is explained by HRM and innovation, with the remaining 77.3% attributed to other factors outside the research model and errors. The composite reliability and Cronbach's alpha values, above 0.70 and 0.60 respectively, confirm the instruments' reliability.

The Average Variance Extracted (AVE) values exceeding 0.50 indicate strong convergent validity. Additionally, the Variance Inflation Factors (VIFs) values below 3.3 suggest the absence of significant collinearity problems. The Q-square values above zero (0.385 and 0.230) demonstrate good predictive validity of the model.

Furthermore, the analysis of correlations among latent variables, crucial for assessing discriminant validity, revealed that the square root of AVE was higher than the correlation coefficients of the latent variables (p -value < 0.001). This indicates that the model satisfies the criteria for discriminant validity. Also, the cross-loading indicator values were above 0.5, reinforcing the model's convergent validity.

Table 3. Correlations among Latent Variables

No.	Variables	HRM Practice	Innovation	Organisational Performance
1	HRM practices	(0.780)	0.475	0.355
2	Innovation	0.475	(0.762)	0.352
3	Organisational performance	0.355	0.352	(0.872)

P-values for Correlations

No.	Variables	HRM Practice	Innovation	Organisational Performance
1	HR practices	1.000	< 0.001	< 0.001
2	Innovation	< 0.001	1.000	< 0.001
3	Organisational performance	< 0.001	< 0.001	1.000

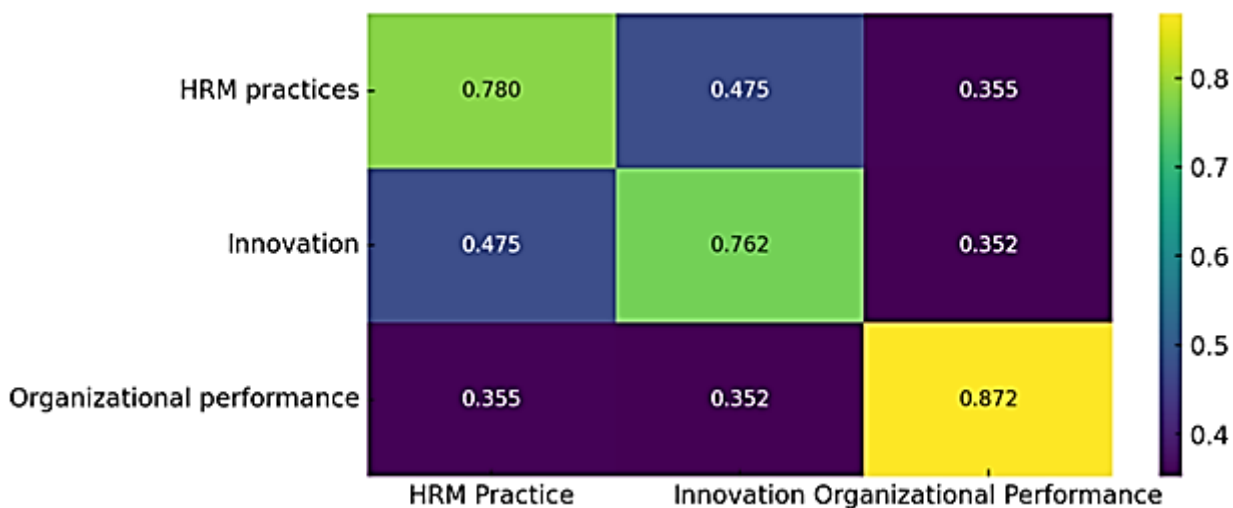


Fig. 3. Correlations among Latent Variables

Table 4. Outer Model's Measurement Analysis

Construct	Item Code	Cross Loading	Type (SE)	p-value
HRM practices	Compensation	0.860	Reflect	< 0.001
	Training	0.898	Reflect	< 0.001
	Performance assessment	0.602	Reflect	< 0.001
	Participation	0.718	Reflect	< 0.001
Innovation	Product innovation	0.530	Reflect	< 0.001
	Process innovation	0.870	Reflect	< 0.001
	Market innovation	0.960	Reflect	< 0.001
Organisational Performance	Sales growth	0.980	Reflect	< 0.001
	Competitive position	0.976	Reflect	< 0.001
	Profit growth	0.652	Reflect	< 0.001
	Employee growth	0.840	Reflect	< 0.001

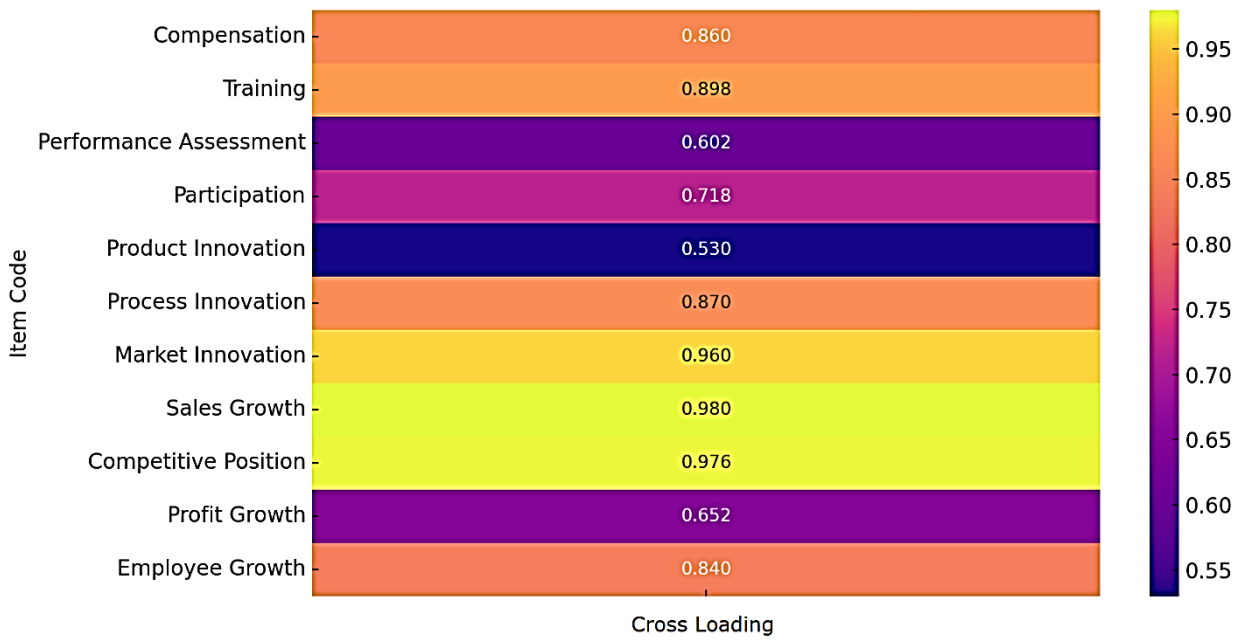


Fig. 4. Outer Model Measurement Analysis

Direct and Indirect Influence Hypothesis Test Results

The hypothesis testing involving direct and indirect influences among variables was conducted using WarpPLS. This analysis focused on the path coefficient direct effects among latent variables and the calculation of variance accounted for (VAF) in mediation testing.

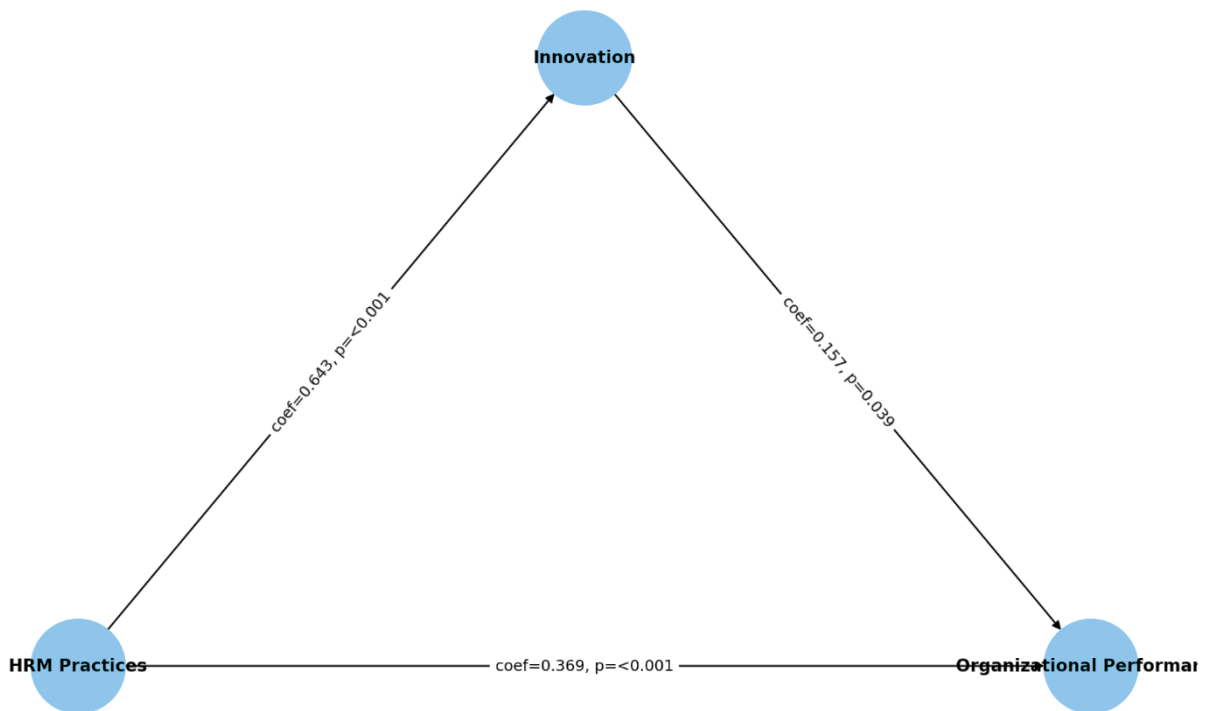


Fig. 5. WarpPLS Analysis Diagram

Results from Table 5:

- **HRM's Effect on Innovation:** The path coefficient was 0.643 with a p-value of < 0.001, indicating a highly significant positive effect. This result supports the hypothesis that HRM significantly influences innovation.

- **HRM's Effect on Organisational Performance:** The path coefficient here was revised to 0.369, with a p-value of < 0.001, again highlighting a highly significant impact. This supports the hypothesis of HRM's significant effect on organisational performance.
- **Innovation's Effect on Organisational Performance:** The path coefficient was 0.157 with a p-value of 0.039, indicating a significant effect. This confirms the hypothesis that innovation significantly affects organisational performance.
- **Indirect Effect of HRM on Organizational Performance through Innovation:** The VAF value is 22.63%, indicating the mediation role of innovation in the HRM and organisational performance relationship is partial (according to Hair, Hult, Ringle, & Sarstedt, 2013).

Effect Size (f2) Testing:

Following Cohen's (1998) criteria for effect sizes, the revised average effect size (f2) is 0.212. This places the relationship among latent variables in the research model within the medium effect size category. Such an outcome suggests that further expansion of the research model could yield more comprehensive analytical results.

Table 5. Path Coefficient Direct Effect and Variance

Relationship Among Variables	Path Coefficients	p-values	Effect Size	SE	Remarks
HRM → Innovation	0.643	< 0.001	0.405	0.078	Highly significant
HRM → Organisational Performance	0.369	< 0.001	0.172	0.084	Highly significant
Innovation → Organisational Performance	0.157	0.039	0.060	0.088	Significant

Mediation Effect Using Variance Accounted For (VAF)

Relationship	Indirect Effect Calculation	VAF Calculation	Total Effect	Remarks
HRM → Innovation → Organizational Performance	Indirect effect: 0.643 x 0.157 = 0.100851	VAF = 0.100851 / 0.469851 = 21.46%	Total effect: 0.100851 + 0.369 = 0.469851	Partial mediation

Discussion

Human Resource Management (HRM) has garnered significant attention in human resource studies, particularly regarding its impact on enhancing organisational performance. The findings of this study corroborate the view that HRM positively influences organisational performance. HRM is a critical tool for management to shape the skills, attitudes, and behaviours of individuals in the workplace (Yu, 2013). It is perceived as a set of interrelated activities to attract, develop, and maintain an organisation's human resources (Florén et al., 2016).

Effective implementation of HRM practices, such as recruitment, training, performance assessment, and compensation systems, has been identified as a catalyst for fostering organisational innovation (Budhwar et al., 2007; Chang et al., 2011). The capacity for innovation within an organisation is often predicted by the efforts made to share experiences and ideas, a critical component of HRM's impact (Mumford, Bedell-Avers, & Hunter, 2008; Nevalainen & Maijala, 2012; Wang & Noe, 2010).

Innovation requires not just the generation but also the transformation and exploitation of existing knowledge within an organisation (Lawson & Samson, 2001). Knowledge sharing, an outcome influenced by HRM, plays a vital role in this process. The adoption of HRM in organisational practices has been shown to provide opportunities for acquiring the right employees, thereby facilitating the implementation of innovation (Lu et al., 2015).

HRM activities also contribute to employee satisfaction by ensuring fair training opportunities, consistent performance assessments, and equitable compensation. This, in turn, fosters a just and supportive work environment conducive to innovation. Employees in such environments are more likely to share knowledge, further driving the organisation's innovative capacity.

Furthermore, the results of this study indicate that HRM enhances organisational competitiveness, subsequently improving performance. Implementing HRM improves employee capabilities and encourages innovative behaviour, thus impacting organisational performance (Cho, Woods, Jang, & Erdem, 2006; Lambooj, Sanders, & Koster, 2006).

Findings from Table 5 in this study reveal that HRM has a direct and significant effect on innovation, with a path coefficient of 0.643, a p-value of <0.001, and an effect size of 0.405. The effect of HRM on organisational performance is also notable, with a path coefficient of 0.369 and a p-value of <0.001. The influence of innovation on organisational performance is significant, with a path coefficient of 0.157 and a p-value of 0.039. The mediation analysis using variance accounted for (VAF) shows an indirect effect of $0.643 \times 0.157 = 0.100851$ and a VAF of 21.46%, indicating a partial mediation effect.

However, this study's findings reveal that innovation's impact on organisational performance is relatively weak. Innovation is traditionally seen as a catalyst for producing novel products and processes (Yeh-Yun Lin & Yi-Ching Chen, 2007; Zhou & Shalley, 2007) and administrative management (Clark, 2010). This innovative capacity contributes additional value to organisational output and is vital for adapting to changing environments (Lawson & Samson, 2001).

The creation of innovation requires significant investment in human resources (Valdez-Juárez et al., 2016), a domain where SMEs often face challenges, potentially hampering the development of an innovative climate. The innovation development process involves management's ability to stimulate employees to transform their valuable experiences into organisational assets, contributing to knowledge creation (Mathuramaytha, 2012).

Contrary to expectations, this study found that innovation does not mediate the effect of HRM on organisational performance. While HRM contributes to both improving organisational performance (Silvia et al., 2016; Do et al., 2016) and fostering innovation (Nieves & Quintana, 2018; Okoe et al., 2018), innovation in SMEs, as identified in this study, does not significantly enhance organisational performance. This outcome contrasts with some studies (Yeh-Yun Lin & Yi-Ching Chen, 2007; El-Kassar & Singh, 2019; Chen, 2017), which suggest that innovation plays a critical role in countering competitive pressures and securing competitive advantages and better performance.

Limitations of the Study

This study highlights that while innovation may not yet be considered a central element in enhancing the performance of SMEs, it remains a critical factor for success in competitive and dynamic environments. Innovation is still a vital driver for organisations to triumph in competitive scenarios. Prior research has emphasised that innovation can be bolstered through creativity, voice, and knowledge sharing. Additionally, innovation development is often contingent on the support of innovative leaders who foster an innovative culture (Coffman, 2015). The current quantitative research suggests a potential area for future exploration using a mixed-methods approach (combining quantitative and qualitative methodologies). Such an approach would offer a more nuanced understanding of the effects of innovation on organisational performance. Furthermore, the impact of innovation on the performance of SMEs warrants ongoing examination, especially given the strategic importance of innovation in the 21st century. One significant challenge for SMEs in harnessing innovation lies in the limited investment in human resources. This constraint can impede the effective implementation of innovative strategies and processes. Future studies should consider exploring this aspect in greater depth, particularly examining how SMEs can overcome these investment limitations to foster a more innovative and competitive business environment.

Conclusion

This study contributes to the growing understanding of how specific HRM configurations influence outcomes at both organisational and employee levels, focusing on SMEs in Indonesia. In Indonesia, where SMEs are pivotal in driving economic growth, there is a notable gap in guiding frameworks that specifically address the role of innovation as a central focus. The HRM framework explored in this study offers a distinct model for developing innovation within Indonesian SMEs, highlighting unique management approaches that differ from Western practices. The objective of this study, which was to explore the connections among HRM, innovation, and business performance, has been successfully met. However, given the limited research in this area, particularly in Indonesia, the findings should be viewed as initial insights rather than definitive conclusions. This study serves as a starting point, suggesting that implementing HRM in recruitment, training, performance assessment, participation, and reward systems can enhance organisational performance and drive innovation. The study underscores the crucial role of HRM in fostering an environment conducive to innovation, which

can lead to improved organisational performance. However, it also reveals that innovation's impact on performance in SMEs may not be as straightforward as traditionally perceived. This highlights the need for SMEs to invest in human resources to overcome barriers to innovation strategically. Future research could expand upon these findings by employing a mixed-methods approach to provide a deeper understanding of the intricacies of HRM, innovation, and performance within SMEs. Additionally, considering SMEs' unique challenges in Indonesia, further studies could explore how these businesses can effectively leverage HRM to enhance their competitive edge in a rapidly evolving global market. While this study sheds light on the significant interplay between HRM, innovation, and performance in Indonesian SMEs, it also opens avenues for further research to deepen and broaden our understanding of these critical relationships.

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