

Chapter 2: Literature Review

2.0 Introduction

This chapter discusses the relevant literature review and the framework for the research questions and research objectives which are posted in Chapter 1. To explore the past related research topic, the cross-disciplinary review of the literature is needed in order to seek accurate and adequate processes, objects, activities, and person's involvement (Allison, 1996). This study is an exploratory research. The conceptual framework has been modified and it is based on previous research studies conducted in other countries. This framework is applied to the Malaysian context to discuss the relationship of human resource practices and organizational performance of Malaysian SMEs with company's policy on innovation as a mediating factor (Pfeffer, 1994).

Accordingly to Ting (2004), most of Small and Medium Enterprises (SMEs) in Malaysia face challenge such as lack of business strategies, human resource (i.e. people) constraints, limited technology or inability to adopt new technology (Street, 2007), and lack of information on potential markets. With regard to the issue of human resource practices, Pawanchik and Sulaiman (2010) found that the Malaysian SMEs have retained traditional human resource practices and have not increased their current competitive awareness for the new and rapid changing world of globalization. As a result, the SMEs in Malaysia could be leapfrogged by SMEs from other developing countries such as India, Thailand, Vietnam, Laos, and Indonesia.

There are new development theories which can contribute to the human resource practices in pursuing more flexibility and innovation and also to encourage SMEs in developing a creativity culture (Damanpour, 1991). The full utilization of human resources is essential in order to lead and achieve organization goals and sustainability in the competitive world in the long run. According to Chirico and Salvato (2008) sustaining the company's competitive position is not only about adopting to changes in the environment but the speed of change in the competitive environment is also a key

driver of any company to develop and increase the strategic capabilities for better performance.

Armstrong (1988) explained that Human Resource Management (HRM) is an approach of how well organizations manage their resources i.e. people or human capital in all aspects of planning, design and evaluation. Efforts to build better human resources and competency management must be developed by good concepts and structures in business and by being people-orientated. According to McGoldrick and Stewart (1996) emphasizes that the Human Resource Development (HRD) functions to create learning and education atmosphere through training and development programmes in supporting SHRM towards organizational performance. With integrating HRD process, they will aim to match available HRMs' needs to pursue effectively and also to gain the competitive advantages with innovative ways.

Empirical assessment of HRM practices are happening in Malaysian companies (Butler & Lee, 2003). The research by Othman and Teh (2003) observed that the importance and the created value of HR as the competitive advantage has yet to be appreciated in the Malaysian context. According to the studies by Grant and Spender (1996); Grant (1996b), the knowledge, skills and abilities produced by employees are transformation of inputs into outputs which sustain competitive advantage. The human resource practices are correlated with people and organizational performance through strategies to build assets (i.e. human capital) and competitive advantage (Bartlett & Ghoshal, 2002). Also, in a study by Henderson and Clark (1990), the researcher find that knowledge base is an aspect of the company's asset in the long run. As we know, knowledge is defined as "understood information" whereby information is being "translated data" or "organizational facts".

In Malaysia, Haslina (2009) conducted a study which focused on human resource development. Addition, Malaysian Innovation Climate survey report done by Pawanchik and Sulaiman (2010) discussed the point of views on company's practices and process leads innovation way. They found that the main barriers to be solved in terms different of industry sector, company size and age group in the report. However, Rowley and Abdul Rahman (2007) have reported that some organizations began to reassess their corporate philosophy regarding "people or human" to be less of "costs" but as "assets". With this transformation, the innovative and creative ideas are closely associated with human capital through the learning motive, ready for change and to exchange skill and knowledge working towards innovation.

This particular study is very much focus on how the human resource practices can increase organizational performance medicated by the company's policy on innovation. One aspect is to look at the internal factors (i.e. human resource practices) that can influence company's policy on innovation towards organizational performance. In addition, Pfeffer and Veiga (1999) found that seven human resource practices have a significant impact on innovation of organizations. These seven HR practices are employment security; selective hiring; self-managed teams; high compensation contingent; training and development; reduction of status differences and sharing information. However, Boselie et al. (2005) mentioned that the linkage between HR Practices and organizational performance are through training and development; contingent pay; reward schemes; performance management (i.e. appraisal); recruitment and selection which allows in creating a high participation in innovative activities.

2.1 Overview

In 1991 the Malaysian government has already acknowledged that human resource is the most important element for business development and it plays an important role as the backbone of the country. Hence, the government has emphasized Human Resource Development (HRD) in the 6th Malaysian Plan (1991 – 1995) through the introduction of several incentive packages and financial support especially tailored for SMEs. As discussed earlier, SMEs is one source for economic contribution.

Hence, human resource is not only one of the internal resources of any organizational system but it also contributes and enhances innovativeness. Innovation can lead to the development of key capabilities which improves organizational performance (Teece et al., 1997). In most studies, the researchers have mentioned managerial innovativeness as the greatest innovation of top-management to show their willingness to change, commit themselves into a new way and welcome new ideas (Rainey, 1999). This top-management innovation must be done first before product or service innovations and market innovations can be carried out. For example, Japan used to raise investment funds for human capital (Lepak & Snell, 1999), increased manpower and observed respect for intellectual property such as the bottom-up management approach (Mintzberg, 1978) in generating the meaningful innovative inputs from workers and employees.

However, in Malaysia there is a long way to go to reach this bottom-up management approach concept. It will be a hard task to ensure intrinsic motivation encourages innovative towards organizational performance to appear as intrinsic motivation which is a key driver of creativity. There is a need for more time and patience for each aspect to be established. However, Pervaiz (1998) has suggested that extrinsic motivation through rewards and evaluations had directly affected innovation in attracting attention from the “experiences” instead of to obey the rules and regulations to perform specific tasks. Moreover, in order to have a greater impact, innovation must be through an

organizational culture in belief, trust, confidence and empowerment system (Vermeulen, 2005).

In order to achieve common objective, a new structure or administrative system and programme need be created and monitored by the organization to encourage employees towards innovative works (Damanpour, 1991). A potential for creating innovation among co-workers or employees could be through HRD fully to facilitate the new knowledge and insights that encourage them to raise questions on the long-held routines of organizational performance (Lopez, Peon & Ordas, 2005).

In addition, a network allows for promoting social interaction or inter-linkage between other parties in gathering trust and information so that knowledge transfer or exchange would allow it to lead to innovation success. However, inter-company networking can facilitate the innovation process instead of leading it to innovation success (Harris, Coles & Dickson, 2000). By fostering communication, interaction among all hierarchical levels to share and acquire knowledge about the formal planning process or status would also lead to innovation (Sadler-Smith et al., 2001).

For this study, the focus will be on the internal organizational factors. Some researchers have argued that SMEs hardly carry out human resource practices. SMEs do not have “proper human resource practices,” instead they practised “part of everyday workflow or work life” as the informal approach to HR practices and innovation policies in organizational performance (Joyce, McNulty, & Woods 1995:19). Smaller SMEs could be different and less sophisticated than larger enterprises (Sadler-Smith, Down & Field, 1999:375). However, the Malaysian Innovation Climate Survey 2009 has shown many smaller companies’ rather than larger organizations use innovative solutions in the collaboration stage. This was because of the larger organizations’ innate reluctance to interchange ideas or collaborate with each other (Pawanchik & Sulaiman, 2010).

The definition of SMEs in Malaysia (i.e. Small and Medium Enterprises) is presented in Table 2.1.1. An effective implementation of Human Resource Practices is a key source of competitive advantage with a positive relationship towards organizational performance (Ordonez de Pablos, 2008; Chew & Basu, 2005; Khandekar & Sharma, 2005). Hence, the Malaysian government stresses on the importance of “Transformation to the New Economic Model, 2009/2010” to ensure that SMEs shall continue with a higher speed to transform their recent business operations in order to remain relevant and competitive as well as to sustain their domestic market and to expand into the global business environment. Also, the National Small and Medium Enterprise Development Council (NSDC) has been allocated RM10 million to Pembangunan Sumber Manusia Berhad (PSMB) to organise and coordinate training and human resource development as basic needs for SMEs in all sectors. The purpose of the action is to increase employees’ competence, attitude and creativity towards innovation (SME Development Masterplan, 2010). Both the organizations and training institutions need to work together to provide a conducive environment for the employees to shape their knowledge, skills and ability towards excelling organizational performance as acknowledged by the Chairman of Malaysia Institute of Management, Dato’ Hj Mohamed Iqbal Rawther.

Organizations could show effects through maximizing the employees’ knowledge, skills, and abilities of employees to obtain the rightly tailored human resource practices (Barney, 1991; Wright et. al, 1994).

2.1.1 Definition of Small and Medium Enterprises (SMEs) in Malaysia

Different countries have different definition for SMEs. In Malaysia, the definition of SMEs is based on two criteria:

- The total sales revenue or turnover by a business on a yearly basis; or
- The number of full-time employees by a business.

Besides, Malaysian SMEs are divided into two sector groups:

- Manufacturing sector: Sales revenue of less than RM25 million or full-time employees of less than 150
- Services and other sectors: Sales revenue of less than RM5 million or full-time employees of less than 50

Also, Malaysian SMEs are categorized into Micro, Small and Medium sizes.

Table 2.1.1 Definition of SMEs in Malaysia:

Total Annual Sales Revenue

Size	Manufacturing (including agro-based) & manufacturing-related services	Primary Agriculture	Services Sector (including ICT)
Micro	Less than RM250,000	Less than RM200,000	Less than RM200,000
Small	From RM250,000 to less than RM10 million	From RM200,000 to less than RM1 million	From RM200,000 to less than RM1 million
Medium	From RM10 million to less than RM25 million	From RM1 million to less than RM5 million	From RM1 million to less than RM5 million

(i) Total Number of Full-Time Employees

Size	Manufacturing (including agro-based) & manufacturing-related services	Primary Agriculture	Services Sector (including ICT)
Micro	Less than 5 employees	Less than 5 employees	Less than 5 employees
Small	From 5 to less than 50 employees	From 5 to less than 20 employees	From 5 to less than 20 employees
Medium	From 50 to less than 150 employees	From 20 to less than 50 employees	From 20 to less than 50 employees

Source: Key Statistics on SMEs**(SME Annual Report (2009/2010) publication of September 2010)**

In addition, according to Lee and Lee (2003) the terms SMEs (Small and Medium-scale Enterprises) and SMIs (Small and Medium Industries) refer to enterprises primarily involved in non-manufacturing industries as retail organizations (i.e. SMEs) and manufacturing (i.e. SMIs)

respectively.

2.1.2 Contribution of SMEs to the Malaysia's economy

SMIDEC is one of the government agencies that has encouraged an environment for SME development in Malaysia. But it has also been working very closely with other agencies to provide necessary assistance such as monetary and non-monetary incentives for SMEs' development. SMIDEC has also conducted industrial linkage programmes (ILP) and Global Supplier Programmes (GSP) to constantly assist SMEs become industry suppliers in terms of physical and non-physical in order to achieve a position in highly competitive global markets. All of these assistances are structured into broad-based programmes tailored to strengthen SMEs in the areas of knowledge, skills, ability as well as how to retrain and retain the existing human capital pool.

According to the Department of Statistics Malaysia, 86.6% of the total SMEs in Malaysia are in the services sector, i.e. 477,525 out of total of 552,849 SMEs (Malaysia Department of Statistics, 2005). In 2009, SMEs in Malaysia contributed 31.2% to the Malaysia GDP. The SMEs in the service sector is the main contributor, contributing 20.1% to the Malaysia GDP (SME Annual Report, 2009/2010). Hence, the services sector is the key contributor to GDP growth by human resource by providing intangible and tangible products for end-users in Malaysia.

2.1.3 Importance of Human Resource Practices

Through a well employees' skill and organization structure, it has allowed in shaping human capital activities on organizational performance. Also, human resources can be a primary support of a sustainable competitive advantage of an organization and the advantage exists for competitors are incapable of duplicating the same work culture for the benefits and values of a competitive advantage (Huselid et, al., 1995).

Although the concept of human resource practices is wider and multifaceted, several researchers have developed a number of instruments to measure and examine them. Pfeffer (1994) identified 13 HR practices in his earlier studies. In Pfeffer and Veiga (1998), the number was reduced to 7 HR practices which are as follows: (1) job security, (2) selective hiring, (3) self-managed teams or team-working, (4) high compensation contingent on organizational performance, (5) extensive training, (6) reduction of status differences, and (7) sharing information. Also Galia and Legros (2003), Roffe (1999), Michie and Sheehan (1999) as well as Holbrook and Hughes (2003) have all presented evidence to show that good human resource practices have a significant impact on the innovation performance of organizations through strategies such as training and development, sharing skills, extensive recruitment, selection processes, employment security and incentive compensation. These innovative strategies are not only to produce high productivity but also to enhance innovative involvement since they sustain the competitive advantage (Wright et al., 1994).

2.1.4 Definition between the Organizational Innovation and Performance

The implementation of human resource practices through recruiting, training or development programme (Garvin, 1993; Habbershon & Williams, 1999; Paul, 1994), performance evaluation and a good rewarding system have a strong relationship towards organizational performance (Ordonez de Pablos & Lytras, 2008; Collins, 2007; Chew & Basu, 2005; Khandekar & Sharma, 2005). This study focuses on the organizational innovation through the implementation of the company's policies on innovation in seeking facilitate the achievement of the organization's objectives and goals as it is a vital competitive advantage source.

Schumpeter (1934: 65) has defined innovation as "the carrying out of new combinations of resources in terms of technical innovation involving product and services or process innovation as tangible

asset”, whereas non-technical innovation such as intangible asset through services, management or system (Barney, 2001).

Organizational performance can be argued to be the most important construct in any management research (Barney, 2007). There is a wide variety of definitions of organizational performance found in the literature review on efficiency or effectively utilizing its own resources (i.e people) in generating economic outcomes and business success. However, there are two major factors - external environment and internal organizational factors. There is a need to be concerned because they are the determinants of organizational performance (Hansen & Wernerfelt, 1989).

2.2 Approaches in Strategic Human Resource Management: Three Perspective Theories

In today’s fast-changing economy, competition is an issue of human resource management as a strategic and challenging task for an organization on how it fully utilizes the existing human resources (Porter, 1985; Barney, 1991). Hence, an effective HR strategic integration between the business and human resource strategies is the most important formulation (Finnigan, 1998). It is not only human resource management that should help organizations in moving forward their company goals and objectives set by the business strategies, but also there is a need for change or innovative management approaches through integration of human resources such as HR Development, performance evaluation, reward management system and organization work cultures (Solis et al., 2001). However, some scholars have argued that not only HRM should be driven by the top management to involve and support their people at every different level in the organization but also how to play a role or be an example of top management commitment motivating them (Gratton, 1997). Thus, it is also pointed out that the “behavioral perspective” is the most powerful root cause that has shaped people’s work to adopt HR practices (Lado & Wilson, 1994; Wright & McMahan, 1992).

A successful organization does not easily isolate their human resource programmes. Through management trust, high motivation and individual commitment, these will generate an unexpected high performance as well as management returns (Guest, 1997). Some studies have found that most organizations believe HR rather than financial or technological resources allow them to gain a sustainable competitive advantage (Gratton, 1997; Wright et al., 1994). A study by Schuler and Jackson (1987) has shown a strong linkage between competitive strategy, HR practice and performance. However, Porter (1985) has proved that business can develop a sustainable competitiveness by two strategies: Cost leadership strategy and differentiation strategy. According to Schuler and Jackson (1987), these strategies have enabled organizations to gain a competitive advantage through product and service innovation, quality enhancement and cost reduction. In these strategies, costs are reduced through minimal training cost, cutting staff numbers, minimum rewards for employees' outputs and predictable behaviours.

However, according to Storey's theories (1989), "soft strategic HRM" encourage human relations aspects of people management, stressing continuous development, communication, involvement, employment security, the quality of working life and work-life balance. Moreover, Wright, McMahan and McWilliams (1994) have stated that HR can be a part of the criteria for achieving a sustainable competitive advantage. Other researchers have stated that employees must be managed more effectively to improve organizational performance (Armstrong, 1995; Guest, 1991; Legge, 1995). In addition, Delery and Doty (1996) has demonstrated the importance of managing the HR of organizations effectively through the Strategic Human Resource Management (SHRM) theory. The SHRM literature articulates on the individual relationships among the three important perspectives: the Universalistic, Contingency and Configurational perspectives.

2.2.1 Universalistic Perspective

Recently there has been discussion about what are the optimum ways to ensure human resource practices that can be used as the main factor through the company's policy on innovation to lead it to organizational success. Jackson, Schuler and Rivero (1989) found that it is essential for organizational HR systems to consist of individual capabilities to acquire, develop, motivate and retain employees towards organizational effectiveness with a behavioural approach. Human resources have contributed to organizational performance to gain a competitive advantage through the majority of work from human resource practices which have adopted the resource-based view of the company and human capital enhancement (Barney, 1991; Delery, 1998). This is called the "Universalistic or Best-Practice Approach".

The research study by Zhu (2010) encourages organizations to adopt the universalistic approach when it asserts that certain independent-dependent variable relationships could exist across the whole population of organizations under study. Similarly, the research work by Pfeffer (1998) was influential in identifying HR practices that contribute towards achieving a sustainable competitive advantage. This model proposes that HR strategy and practices will perform effective results when integrated with the overall business activities of the organization based on the national culture which had influenced employees' behaviour more than the company culture (Hofstede, 1994).

Most studies on the Universalistic approaches were conducted in the U.S; there are few studies carried out in the United Kingdom and Europe (Guest & Hoque, 1994; Hoque, 1999) and in Asia (Huang, 2001; Huang & Cullen, 2001; Khatri, 2000; Mak & Akhtar, 2003; Wan, Kok & Ong, 2002). Ng and Molukin (2009) studied the universalistic perspective of HR practices in the Malaysia context. They found a significant relationship between the variables such as training, resulted-oriented appraisals, employment security, employee participation, job descriptions, profit sharing and

other internal practices, and organizational performance.

The “Universalistic or best-practice approach” is an applicable and useable approach which can be adopted by companies to improve their organizational performance. Researchers such as Osterman (1994), Pfeffer (1994) and Huselid (1995) have argued that this model has the perspective to allow organizations to produce superior performance across all types of organizations. Also, the organizational performance is being measured through financial performance such as profits or gains, market share and sales revenue levels (Paauwe, 2004:53). Through communication, teamwork and the utilization of individual talents as part of the soft strategy approach, it is more flexible than the contingency model (Beardwell, Holden & Claydon, 2004).

2.2.2 Contingency Perspective

Apart from the Universalistic or best-practice approach, the contingency perspective approach can be used to investigate the relationships between the HR systems and organizational performance. This model is more specific with the congruence of fit between various strategies or policies (i.e. company’s policy on innovation) and between the HR practices and organizational performance to be adopted by an organization through HR practices with performance evaluation, participation and internal career opportunities on how to attract and retain human capital (Delery, 1998). It reviews internally the so-called “Defender” strategy (Miles and Snow, 1984; Sonnenfeld & Peiperl, 1988).

Elsewhere, that relationship between the individual independent HR practices variables and the dependent organizational performance variable will be affected or modified by other variables such as the mediator variable (i.e. company’s policy on innovation) or strategy (Delery & Doty, 1996: 807) involving high innovation and bright future opportunities, which is the so-called “Prospector” Strategy. On an international scale, it is used to design the different business systems and the cultures of different countries are required. It shows an impact on both specific combination and outcomes of

HR practices (Whitley, 1992). Other factors also allow the significance of contingency such as the industry sector, company size, company age, degree of unionization, capital intensity, geographical location, local demographics and infrastructure of technology (Boselie et al., 2005).

However, some empirical studies have shown that the company is a major variable influencing the HRM practices (Ng & Maki, 1993; Wagar, 1998).

2.2.3 Configurational Perspective

The configurational perspective is a study based more on the holistic principle of inquiry. It concerns about how the pattern of multiple independent variables are related to a dependent variable bundling together with strategies, structures, cultures and processes in order to maximize organizational performance (Meyer, Tsui & Hinings, 1993; Miller & Friesen, 1984). However, Arthur (1994) has stated in his research findings that using the commitment systems of human resource practices has shown higher productivity and lower turnover compared with the control system.

Although the HR practices are seen affecting not only individually of the organizational performance, it has closely interrelated elements internally consistent in a bundle or system of HR practices (MacDuffie, 1995), from the view which focuses more on the patterns of HR practices that together form an internally consistent whole (i.e. commitment or control system) where it allows a correlation between those patterns and organizational performance (Doty & Glick, 1994). Consistency in achieving the “synergistic” approach within internal fits between the HR practices and the HR system is to ensure that the system must be congruent with other organization culture towards organizational performance (Paauwe, 2004: 54).

The most recent and existing studies in Europe have explored the linkage between HR practices and organizational performance. The successful U.S HR practices models were carried out in the Malaysian setting of the subsidiaries of MNCs (i.e. Multinational Corporations). MNCs attempt this

configurational approach which generates high returns in organizational performance, regardless of the location of their subsidiaries (Gooderham & Nordhaug, 2003). This indirectly can raise problems for the environmental fit owing to operating in multiple businesses in multiple countries by aligning their internal HR practices.

2.3 Strategic Human Resource Management (SHRM) as a Source of Competitive Advantage

Several scholars have argued that it is impossible for the best HR practices to be adapted across industries (Huselid, 1995; Pfeffer, 1994). The Universalistic or best practice approach has received more empirical support than the contingency approach (Huselid, 1995). Thus, this researcher has adapted the Universalistic or best practice approach for this research study.

There are scholars from different disciplines who have presented various conceptual frameworks regarding human resource practices and organizational performance. The “Universalistic or Best Practice” approach is often associated with both these variables. It is also called the high performance work system (HPWS). In the 1980s, the Japanese management practices have encouraged companies to adopt and to create lean and agile manufacturing systems (McCurry & McIvor, 2002). The characteristics of these systems were linked with four core HR practices which cover employee development; flexible job design in terms of employee participation and teamwork; incentive-based payment systems and investment in recruitment and selection (Boxall & Purcell, 2003; Boseline et al., 2005). Human resource management is the main contributor to lead employees in improving organizational performance towards innovation and to be more sustainable competitive business strategies (Barney, 1991). All these compositions of human resources theory are based on employees’ valuable knowledge, skills and abilities to foster the better performance.

Also, Barney (1991) has continuously expanded on this research topic to determine the effects of HR practices. The study for Pfeffer (1998) has identified “seven practices” of successful organizations.

These seven practices were reduced from his earlier research study list of sixteen by combining several practices (i) Employment security; (ii) Selective hiring; (iii) Self-managed teams/team-working; (iv) High compensation contingent on organizational performance; (v) Extensive training; (vi) Reduction of status differences and (vii) sharing information. Under the Universalistic or best practice approach it has been found that it allowed organizations to lead consistently to a higher organizational performance. His research findings and results have shown that human resource practices have a positive relationship and significant influence towards organizational performance.

An alternative group of researchers have claimed that the “contingency perspective” is more effective to gain organizational performance than the Universalistic or best practice perspective (Butler, Ferris & Napier, 1991; Dyer, 1985; Fombrum et al., 1984; Golden & Ramanujam, 1985; Gomez-Mejia & Balkin, 1992; Lengnick-Hall & Lengnick-Hall, 1988; Milkovich, 1988; Schuler & Jackson, 1987a). In order to be effective, the contingency theorists have attempted to show that the HR practices are consistent and can relate to the different strategic positions toward organizational performance (Balkin & Gomez-Mejia, 1987; Begin, 1993; Gomez-Mejia & Balkin, 1992; Schuler & Jackson, 1987a).

The strong links between HR practices and company performance have been based on two approaches: the universalistic (i.e. best practice) and the contingency (i.e. best fit practice). Pfeffer (1994) has identified a set of HR practices in the universalistic approach to improve organizational performance. This approach is suitable for all types of organizations and all employees. On the other hand, the second approach – the contingency (i.e. best fit) approach has argued that the performance can be maximized when the company adopted HR policies are consistent with the business strategy of the company (Schuler & Jackson, 1987; Miles & Snow, 1984). However, some literature on HRM practices has no consensus on which HRM practices can be considered appropriate or to be used for long-term business operations where the HRM practices have a significant impact through

employees' attitudes and behaviors that are significantly based on the premise of social exchange (Blau, 1964) and the norm of reciprocity (Gouldner, 1960).

Scholars such as Agarwala (2003), Guzzo and Noonan (1994), and Whitener (2001) have argued that between the employer's HR practices and the employees' psychological contract, the latter has affected directly employees' level of commitment to employer ultimately. To consistently focus on the self-developmental aspects of the employees, the organization must be concerned with the employees' well-being and work initiatives through rightly tailored HRM practices. Folger and Cropanzano (1998) as well as Konovsky and Cropanzano (1991) have discovered that through fair performance appraisal, it has positively been associated with employees' perceptions and commitment. Similarly, some empirical studies have shown that the role of training can produce beneficial individual employees to contribute commitment (Lam, Lo & Chan, 2002; Saks, 1996; Tsaur & Lin, 2004). Besides, the dynamic global environment has resulted in human resources to be more challenging for the company to manage in order to be competitive.

Hence, the implementation of SHRM not only allows for the beneficial and supportive tool to achieve the overall business strategies towards desirable outcomes but also it is essential to develop and integrate its processes, structures and activities to fit into the strategic management (Miles & Snow, 1984).

In contrast, research studies in the United Kingdom (Guest & Peccei, 1994; Mc Nabb & Whitfield, 1997) and in the Netherlands (Boselie et al., 2001) have found that adopting a contingency approach rather than using the universalistic approach to explore the relationship between HRM and organizational performance is more effective. They have pointed out that the companies would undertake the contingency or "situationally-based" approach with the organizations' adoption in dealing with any different situation. It is considered as a much more useful approach in order to matching processes, structures and activities to the varying business needs of the organization (Stace

and Dunphy, 1993).

Also, Boxall and Purcell (2000) have concluded that most companies have created HR strategies to suit situationally-based or environmental contingencies as their “best-fit” model. These companies adapt certain contingencies in the business environment such as by varying social issues, industry size and other organizational factors including company age, degree of unionization, capital intensity, geographical locations, local demographics and technologies (Boselie et al., 2005). Guest (1999b) has also emphasized the potential importance of this approach in terms of personal characteristics such as age, gender, education level and position in the organization. However, it does not fully invalidate the all “best practice” or “Universalistic” thinking.

However, Paauwe (1998) has argued that the contingency factors were not only affected by the range of choices of both management and the organization as a complexity body but has found that the majority of the 16 best HR practices identified by Pfeffer (1994) had all been in place in almost every Dutch company since the 1970’s. Leaders of management who possess organization competencies have become HR innovators to overcome those institutional obstacles and in contrast to laggards who thought that the institutional mechanisms are a restraint and threat (Mirvis, 1997).

2.3.1 The benefits and weaknesses of Universalistic Approach

The universalistic approach is emphasizes enhancement of employees’ knowledge, skills and abilities. Generally, companies adopt a set of HR practices such as recruitment and selective hiring; performance evaluation; training and development programmes benefits for employees’ needs. Besides, to create the desired behavior, companies consistently encourage employees to contribute more ideas and to participate through specially tailored intrinsic and extrinsic motivation system.

However, there are some weaknesses for Universalistic approach. For example, it is a challenge to adapt a set of HR practices across industries sectors and the results might not be desired due to

different culture and work environment factors. Further, Boxall (1996) and Wright et al. (1994) found that HR practices per se cannot be a source of sustainable competitive advantage. Rather, the human resources themselves are the source of sustainable competitive advantage.

2.3.2 The benefits and weaknesses of Contingency approach

The recent studies show that the contingency approach could assist companies to be more competitive in the global market. That is also called “situationally-based” approach which allows companies to adopt HR practices and policies according to business strategy in different situations. Also, in matching processes, structures and activities are varied according to the business needs of the organization (Stace and Dunphy, 1993) in order to reduce unnecessary operational costs.

However, there are some of weaknesses for contingency approach such as the company might overlook for employee’s interest and needs. This approach only emphasizes on the alignment of the competitive strategies which may overlook the imbalance of incentive compensation.

From the comparison of both approaches, the universalistic approach allows company to create a successful business strategy with the best HR practices at the initial stage. Hence, the researcher decided to use the universalistic approach as reference and guidance to determine the relationship between human resource practices and organizational performance, mediated by the company’s policy on innovation in SMEs in Klang Valley.

2.4 Concepts and Variables

2.4.1 Human Resource Practices (Independent Variables)

The concept of this study is to determine the linkage between HR practices towards innovation and organizational performance results. The strategic human resource management (SHRM) refers to the combination of the practices, policies and systems internally that influence directly employees' behaviour, attitudes and organizational performance (De Cieri et al., 2008) and its business objectives (Baird & Meshoulam, 1988; Delery & Doty, 1996; Huselid et al., 1997; Jackson & Schuler, 1995). In addition, Wright et al., (1996) argued that the HR practices are organizational activities which directly influence HRM towards the business objectives and organizational goals. Hence, the researcher has identified three dimensions of best HR practices as the independent variables; the company's policy on innovation as the mediator variable and organizational performance as dependent variable.

(i) Incentive Compensation

Past research studies on the relationship between SHRM and organizational performance have found that incentive compensation has a positive effect on many organizational performances (Delery & Doty, 1996; Fey, Bjorkmen & Pavlovskaya, 2000; Pfeffer, 1998; Huselid, 1995). A study by Lowe et al. (2002) on monetary and non-monetary compensation practices has shown that appreciation of work contributed by employees as one the best practices by employers. Both types of compensation practices are strongly tied with the performance outcomes and act directly as a motivation tool to enhance their behaviour in participating in the tipping-point jobs (Gerhart and Milkovich, 1990). Employees become more involved in challenges or difficult tasks given by management in achieving the desired organizational performance and outcomes. Through a formal grievance procedure, it protects employees from arbitrary treatment. These allow measures by the management to motivate

them to work harder and contribute more. Their expectations on their efforts and contributions are to be fairly rewarded and compensated (Ichniowski, 1986; Ichniowski et al., 1994). Every customer's satisfaction will be translated into organization profit and good reputation. Hence, Wilson (1995) has found that a well-designed fair reward system is essential to satisfy employees' satisfaction who are front liners to deal with customers.

(ii) Training

Adam Smith (1776) has mentioned skills and training as an economic prosperity factor. To grow further with this application, it was essentially perceived to increase productivity (Paul, 1989). Hence, training and development programmes are not only an essential instrument for an organization to increase their specific knowledge and skills of employees but also to let the organization improve its current status in terms of quality, quantity products or services with comprehensive training and development activities (Delaney & Huselid, 1996; Koch & Mc Grath, 1996). In addition, the World Bank (2008) has stated that the "education and training" has to be one of the parameters in the knowledge economy index.

Nevertheless, most Malaysian companies have perceived training to be costly and unnecessary for their employees more than just the basic skills required. However, on-the-job training is provided to perform daily and conceptual scope of work is thought to be good enough (Yong, 1996; cited by Chew & Basu, 2005). Moreover, to continue investing in knowledge, skills and abilities for employees is necessary (Wright et al., 1994). Managers must realize that employees are an asset and training is not an extra expense or burden of development. It is the core to improving the competitive advantage (Scherkenbach, 1986). There is a case-study evidence of a "soft" indicator to prove that there is a positive relationship between training and improved organizational climate (Cannon, 1995) and learning culture (Mabey & Mallory, 1994). Indirectly, the perception of employees and trust on this subject is fair and reasonable. They will deliver what they have been promised in terms of

organizational commitment, job satisfaction and effort.

SMEs in Malaysia do not seem to engage aggressively in training and development programmes and also have constraints in access to technology as well as a lack of market information. These are shown to be the key challenges for growth or survival of an organization (Harvie & Lee, 2002).

(iii) Selection Hiring

Recruitment or selective hiring activities should not only focus on individual capabilities to create or share knowledge, value and cultural fit but also needed for necessary skills through social background and character references as well as matching the candidates' knowledge, skills and attitudes (KSAs) to the job specifications and position requirements (DiBella et al., 1996 & Williams, 2001). This indirectly allows the organization to reduce subsequent turnover and leads to better company performance (Goodman & Svyantek, 1999) as well as to maintain a competitive edge in small and entrepreneurial companies (Heneman, Tanksy & Camp, 2000).

(iv) Performance Evaluation

Performance evaluation is defined as a process by a company to measure and evaluate an individual employee's work behaviour and performance (Moen, 1989; 62; Johnson, 1995; 278). An accurate performance appraisal is requested as an instrument tool and is administrated on a mid-year or year-end basis. Managers hold the important task of coaching and counselling employees in order to ensure that the employees perform well in their workplace. Also, they need to find work recognition and fair performance appraisal to be implemented (Mondy, 2010; Cassell et al., 2001). It is an opportunity to let management review the employees' past performance as well as to develop plans for the future as their yearly objective needed to be achieved in order to increase the positive pressure through employees' motivation, high commitment and high productivity (Jassim & Gaber, 1998).

(v) Organization of Work

According to Yahya and Goh (2002), companies must have a working environment where their employees work together closely to accomplish a purpose and to achieve the organization objective. A healthy system in stirring the employees to pursue great performance can be encouraged through cohesive norms representing their beliefs and ideas (Lim & Klein, 2006). Furthermore, it has been elaborated by van den Akker (2005) that the components of the spider web model are important factors to imitate in order to influence the quality of work which is contributed by employees towards innovation.

(vi) Sharing Information

Howells (2002) has emphasized that the acquisition of knowledge, skills and abilities through cooperation and active communication among employees are the main contributors in building trust and understanding for innovation. Therefore, working as teams to share information or knowledge among employees has shown that it is a good communication tool to produce unexpected and effective outcomes (McGill & Slocum, 1993; Lei et al., 1999). To provide employees with appropriate communication tools, techniques and systems through meeting, reviews, updates and reporting structure can be effective channels to deliver information. Interactions between departments in order to exchange opinions and experiences as well as to discourage employees to misuse resources for their own benefits through the setting up of group or team incentive schemes in order to pursue effectively organizational objectives (Pil & MacDuffie, 1996). Moreover, Morishimo's research (1991) has found a positive association between information sharing and organizational performance. It has allowed for increasing productivity and profitability. With this information-sharing activity, it not only leads to organization to have more transparency with its employees but it also enhances employees' commitment and subsequently reduces turnover (Ahmad & Schroeder, 2003). Hence, through consistency in sharing organizational information regarding

financial and non-financial performance, business strategy and operational measurement, employees have been treated as part of the organization members and that as a result they feel that they are trusted (Pfeffer, 1998).

(vii) Job Security

When informal and formal programmes are applied to employment security or to build job security for employees, these programmes will bring about employees' high commitment, pride and trust. Thus, the company can create and maintain a long-running sustainable competitive advantage which business competitors find it hard to reproduce that same level of job security for their own employees. Kline and Peter (1991) have defined commitment as the high participation by employees and a personal obligation to work and contribute it. Moreover, the use of job security as HR practices helps to retain the most valued and talented employees as well as creating trust and pride in the individual's workplace thus leading to more cooperation (Pfeffer, 1998).

(viii) Social Activities & Sports

In Asia, it is impossible to work independently and employees are expected to work as a group or team in developing empathetic relationships with other co-workers or peers to achieve organization objectives and tasks. This could be advised through inspiring words or leadership in order to motivate and encourage them to build a strong sense of team spirit by using a lot of "WE" statements to describe the relevant subjects to the project and sharing happiness as well as success togetherness. Managers need to use social activities and sports to achieve this strong sense of team spirit. In Malaysia the work culture is more based on relationships orientation and it emphasizes on collectivism and working as a group rather than as an individual (Ahmad & Seet, 2009; Asma, 1996).

2.4.2 Company's Policy on Innovation (Mediator Variable)

Most of us are familiar today with the word "Innovation". It comes from the Latin root 'nova' meaning 'new'. It allows organizations to pursue a "new" approach or SHRM for change through thinking, processes and mindset. A combination of HR practices lead and create value-added outcomes for the organization (Barney, 1991; Wright et al., 1994).

McMahan (1999) suggested that high organizational performance may be achieved if the HR practices which are formulated by senior management are integrated through a pattern of planned action (Wright & Roche, 1999). Senior management could be effective if there is among others, high commitment and capability to manage innovation (Becker, 2001). A study by Budhwar (2001) has found that the improved HR practices enhance employee relations and business values in driving towards innovation. But, some of the empirical evidence regards flexibility is disappointing probably due to the fact that small companies often do not fully use their flexibility potential (Volberda, 1998; Levy & Powell, 1998; Young & Francis, 1993).

SMEs that practised internal flexibility have shown the ability to adapt the organization policy (Ansoff, 1965). The management of organizational changes and co-ordination mechanisms of the organization towards innovation (Watson, 1986) as well as for the HR policies as a tool for business strategy were highlighted by Beer, 1984; Truss & Gratton, 1994; Ulrich, 1997; Dyer & Holders, 1988; Boxall, 1999; Guest, 1987; Lengenick-Hall & Lengenick-Hall, 1990; Schuler et al., 1993. Hence, it is crucial to implement the right human resource policies and practices to achieve organizational performance (Mosadeghrad et al., 2008). Moreover, innovation policies play the role as a platform of intellectual property in developing knowledge transfer or creativity and innovative processes in the companies. This could not only be developed with an absorptive capacity whereby human capital is gathered from their knowledge and solutions by the bottom-up practices rather than by top-down instructions but it is also recognized that operational activities are necessary for human capital to

identify, acquire and transform the knowledge required towards innovation.

2.4.3 Organizational Performance (Dependent Variable)

The management should trust their employees and delegate responsibilities and challenging assignments to them. In return they will respond by high motivation, commitment and performance (Guest, 1997). There is a clear link between the performance and intrinsic or extrinsic supports designed to enhance the competitive advantage in the long run. A proper performance measurement in empirical literature is often recognized as the “balance” between financial and non-financial measures for the overall company performance which is indicated as innovation evaluation (Chiesa, Coughlan & Voss, 1996; Griffin & Page, 1993; Hudson, Smart & Bourne, 2001; Kanji & Sá, 2002; Kaplan & Norton, 1996a; 1996b; Verhaeghe & Kfir, 2002). However, in a majority of USA-based empirical studies adopting and focusing on productivity or financial performance indicators such as returns on investment (ROI); returns on asset (ROA) and returns of equity (ROE) as shareholders perspective were important (Huselid, 1997).

2.5 Conclusion

This chapter discusses the development of the conceptual framework for this research study. The way to integrating variables of a company is that it should continuously retrain, develop and retain their employees and thus this would not only increase their market value which affects employees' commitment and motivation productivity but also may reduce their intensity to quit from the company (Vlachos, 2008).

Apart from the internal factors, awareness of external factors from financial and non-financial advice or guidelines from the government sector is essential in assisting SMEs to gain a more sustainable competitive advantage (Humphreys et al., 2005). Besides, five hypotheses will be used in this study as the basis of the data analysis. These will be presented in Chapter 3 which covers a process of gathering, developing and implementing the research methodology to determine the relationship between the proven HR practices and organizational performance, mediated by the company's policy on innovation. There is also consistency to maintain the HRM and HRD with HR managerial skills in SMEs to facilitate efforts towards environmental change and consequently the sustainable competitive advantage.