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# A human-resource-based theory of the small firm

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## Summary

This report presents a conceptual model as to how personnel management is established within small enterprises.

The model presented in this research report is based on the human-resource-based theory of the firm (Paauwe, 1998), which explains how human resource management policies come into being. On the one hand, this theory emphasises the importance of various stakeholders who form the *dominant coalition* of an organisation. Values and attitudes of the members of this coalition determine the long-term objectives and influence the way personnel management is effected. On the other hand, the theory recognises that the available *room to manoeuvre* for this coalition is limited by product, organisational and social dimensions. In summary: the space available to the dominant coalition to manoeuvre leads to specific approaches to HRM, the outcomes of which to a greater or lesser extent satisfy specific objectives.

In our study we have extended the human-resource-based theory of the firm to include small enterprises, by introducing some stylised facts concerning small enterprises: the dominant position of the employer, the lack of 'classical' management styles and a low degree of specialisation within the production process. We argue that the employer is often the only stakeholder in the dominant coalition. As a result, his/her attitudes have an important impact on the room to manoeuvre. Despite the heterogeneity within the population of small enterprises, it is possible to distinguish some general attitudes shared by most employers: they like to participate in the production process rather than carry out management tasks, and they want to keep full control. Besides the dominant position of the employer, the room to manoeuvre is limited by external factors or influencing dimensions. We mention the fact that small enterprises are less specialised compared to their larger counterparts, and discuss limitations imposed by the process approach to strategy formulation.

These typical SME-features also manifest themselves in the objectives of small enterprises: many employers rate continuity, keeping full control and a good working climate among their most important long-term objectives. The strategy of a firm is determined within the dominant coalition. This includes the (main characteristics of the) personnel management. Due to differences in the dominant coalition (and its room to manoeuvre), personnel management will also differ

between firms: each firm has its own unique approach to HRM. Looked at from the perspective of small enterprises, this raises the following question: if small firms have certain features in common regarding their dominant coalition, do they also share general characteristics of personnel management? And if so, how are these general characteristics related to their long-term objectives?

There is very little known empirical research on this subject. In order to gain new insights in the unique approaches to HRM, we conducted an empirical investigation among 18 small Dutch enterprises. First of all, the results of this investigation were used to examine hypotheses about the relations between the room to manoeuvre and personnel management. The results of the survey were in agreement with the hypotheses. We found, for instance, that most small enterprises do not pursue a growth strategy, as we expected – based on their objective to keep full control.

Next, the investigation was used to elaborate our understanding of the unique SME approaches to HRM. We discussed the fact that small enterprises have a number of general characteristics that determine their room to manoeuvre. In theory, this could result in some general principles personnel management that apply to many small enterprises. Our investigation suggests that this is indeed the case. Despite the uniqueness of enterprises, three general principles of personnel management measures for small enterprises have emerged: a strong accent on team spirit, informal working procedure and firm co-ordination by the employer. These characteristics prove to be strongly related to the long-term objectives of the employer: continuity, creating a good working climate and keeping full control. Future research is needed to confirm these findings.

The existing normative models on HRM are often based on a large-firm blueprint and take the classical approach of strategy formulation. We conclude that this approach is not relevant for small enterprises: personnel policies of small enterprises cannot be judged without paying attention to the characteristics of small firms.

# 1 Introduction

Personnel management (or HRM) has received much attention in recent years<sup>1</sup>. Various conceptual approaches have been developed to study the relationships between personnel management and performance<sup>2</sup>. Empirical investigations of these relationships have also been conducted<sup>3</sup>. However, most of these studies concentrate on large firms, whereas more than 50% of European employment is accounted for by firms with fewer than 50 employees<sup>4</sup>. The present study discusses a conceptual model on how personnel management is established within small enterprises<sup>5</sup>.

Our conceptual model is based on two different strands of literature. On the one hand, there is an abundance of literature on the specific features of small firms and entrepreneurship. Notwithstanding the heterogeneity within this population, small firms share certain characteristics that distinguish them from their larger counterparts. The next chapter discusses three characteristics that are relevant for this study: the dominant position of the employer, the lack of 'classical' management styles and the low degree of specialisation within the production process.

On the other hand, Paauwe (1998) developed a model on how personnel management policies come into being. This model is rooted in the resource-based theory of the firm. Both theories will be presented in chapter three.

In chapter 4 the characteristics of small firms are used to specify Paauwe's model on personnel policies. This results in a human-resource-based theory of the small firm. This theory is still very general, but it is possible to derive some specific hypotheses. These hypotheses have been investigated, using an empirical questionnaire among 18 small Dutch firms. Chapters 5 and 6 describe the set-up and results of this questionnaire.

However, it is not the main purpose of this inquiry to test specific hypotheses, but to generate new ones: new insights into how per-

- 1 In this article we shall use the terms 'personnel management' and 'HRM' interchangeably. We share the view of Fowler (1987) who 'identifies the real difference between HRM and personnel management as 'not what it is, but who is saying it' (Fowler, as quoted by Legge, 1995, p. 75).
- 2 Guest (1997), Legge (1995), Paauwe (1996), Storey (1992).
- 3 Hassink (1996), Huselid (1995), Ichniowski, Shaw and Prenzushi (1997), Koch and McGrath (1996) and Lynch and Black (1995).
- 4 The European Observatory for SMEs (1997).
- 5 This study will also be published as a discussion paper by the Tinbergen Institute, Erasmus University Rotterdam, The Netherlands.

sonnel within small firms is managed. Chapter 7 elaborates the theory developed in chapter 4, based on the insights gained from the inquiry. Chapter 8 concludes with a discussion of the main results from this study.



## **2 Characteristics of small enterprises**

Small firms<sup>1</sup> share certain characteristics that distinguish them from their larger counterparts. Three characteristics relevant to the management of personnel are identified: the dominant position of the employer, the lack of ‘classical’ management styles and the relatively low degree of specialisation of the production process.

### **2.1 The dominant position of the employer**

The employer of a small firm is typically also the owner. Usually, no other (full-time) managers are employed. Combined with a relative lack of contact with the government and unions, this results in a dominant position within the firm. The nature and background of the employer will therefore influence enterprise performance<sup>2</sup>.

The dominant position of the employer is often associated with entrepreneurship. According to Van Dijk and Thurik (1995), entrepreneurship deals with firms with one dominant position – the entrepreneur. According to this description, we could use the term ‘entrepreneur’ instead of ‘employer’. However, the term ‘entrepreneur’ is often associated with a willingness to take risks and a tendency to be innovative (Hall, 1995, p. 67). Since this study does not limit itself to employers with innovative behaviour, the term ‘entrepreneurship’ will not be used.

### **2.2 No ‘classical’ management**

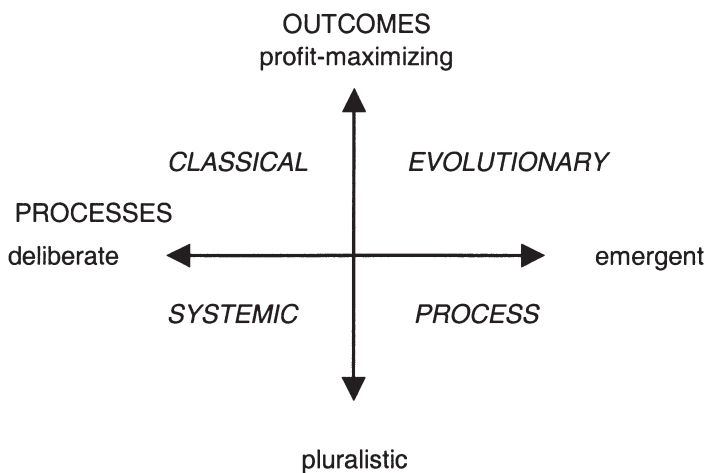
In many publications on HRM it is assumed that strategy is formulated in a rational way, aimed at maximising profits over a certain period of time. HRM or personnel management is determined similarly, as part of the overall strategy. This does not seem to be a realistic description of strategy formulation for small enterprises.

Whittington (1993) distinguishes between four dominant themes within strategy theories. He sets out a typology in which he distinguishes the four approaches along two dimensions of deliberate versus emergent processes of strategy formulation, and profit-maximising versus pluralistic outcomes (figure 1).

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1 Small enterprises are usually defined by the number of employees (for example, less than 50).  
2 For an overview of studies into the relations between characteristics of the employer and the performance of his or her enterprise, see Hall (1995) chapter 6.

figure 1 four approaches to strategy formulation



Source: Whittington (1993).

The classical approach is the standard approach to strategy formulation and can be found in many textbooks. Profitability is seen as the supreme goal, and rational, top-down planning as the means to achieve it. SWOT-analyses<sup>1</sup> and more sophisticated methods, used to analyse markets and organisations, result in fully formulated strategies. The process approach is quite the opposite. It has little faith in the feasibility of rational planning strategies, since ‘... both organisations and markets are often sticky, messy phenomena’ (Whittington, 1993, p. 22). Also, ‘... Knowledge of alternatives and consequences is prey to an individual’s cognitive limitations [and] lack of motivation to conduct comprehensive information searches. ... [the reality of strategy-making is] a ‘bounded rationality’ resulting in satisfying behaviours, acceptable to the ‘dominant coalitions’ (Legge, p. 100).

Of these four approaches, the process approach seems most relevant for small enterprises. This is due to the fact that various features of small enterprises point to pluralistic goals of the manager/employer and the emergent style of strategy formulation. Two of such features will now be discussed.

**Profit maximisation is not the only goal**

The employer of a small enterprise is often the (sole) owner of the firm. As an owner, continuity of the firm and profit maximisation are

<sup>1</sup> SWOT stands for Strengths, Weaknesses, Opportunities and Threats.

likely to be the most important goals. But the employer also participates in the enterprise's labour force. His or her labour can be seen as a consumable commodity, of which he/she wants to maximise the utility. Or, in plain English: the employer wants to enjoy working (Lee, 1995; Pfeffer, 1994; WRRa, 1987).

### **No full-time managers**

In general, employers of small firms have neither the time, the knowledge nor the inclination to spend much time developing and monitoring explicit long-term strategic plans.

The lack of time is due to the fact that most employers are occupied with day-to-day problems. This is a consequence of their participation in the actual production process (Tillaart and Warmerdam, 1997). Often, management and operational activities are hard to separate (WRRa, 1987).

The lack of knowledge is the consequence of a lack of formal management education. Also, the possibilities to gain management skills by co-operating with other managing employees are very limited. As a result, employers are often not able to use classical management tools properly (Lee, 1995). More specifically, they lack the knowledge of personnel management that can be found within larger enterprises.

## **2.3 Production process less specialised**

Due to the limited number of employees, functions are less specialised compared to larger firms. Employees have to (be able to) perform various tasks. These tasks are less formalised, as is the communication between employees and employer (Bacon e.a., 1996; Wagner, 1997).



## **3 Human capital as a resource**

To study the relevance of these characteristics for personnel policy, a theory of the firm is needed that allows for the dominant position of the employer and the process approach to strategy formulation. The human-resource-based theory of the firm meets these demands. This theory, developed by Paauwe (1998), is based on the resource-based theory of the firm. Both theories will be discussed in this chapter.

### **3.1 The resource-based theory of the firm**

The core of the resource-based theory of the firm lies in a fundamental heterogeneity in the production processes of firms. Given certain inputs, each firm will apply these inputs in a different way, resulting in different outputs or products. As a consequence, sustained competitive advantage will result for those firms whose production process proves to be most efficient and whose outputs best meet demand. Inputs are usually divided in three categories: physical resources, organisational resources and human resources.

Two mechanisms prevent this sustained competitive advantage from diminishing rapidly: path dependence and routines. The mechanism of path dependence refers to the fact that the assets for many firms, are the result of sustained investments over time (for example: firm-specific human capital). Routines stand for 'repetitive patterns of behaviour within an organisation' (Koch and McGrath, 1996, p. 336). Often the employees involved will not be fully aware of the routine actions they perform each day; this makes it very difficult to imitate such routines. As a result, the specific operational knowledge involved in these routines is very immobile.

### **3.2 The human-resource-based theory of the firm<sup>1</sup>**

Within the resource-based theory of the firm, human capital is one of the major resources. Paauwe (1998) has formulated a conceptual model on how available human resources are utilised: which factors influence this utilisation, and what are the outcomes? His human-resource-based theory of the firm (figure 2) combines the resource-based theory with a stakeholder view of the firm.

On the one hand it recognises the importance of the various stakeholders and the relations between them. These stakeholders form the

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<sup>1</sup> This section is based on Paauwe (1996).

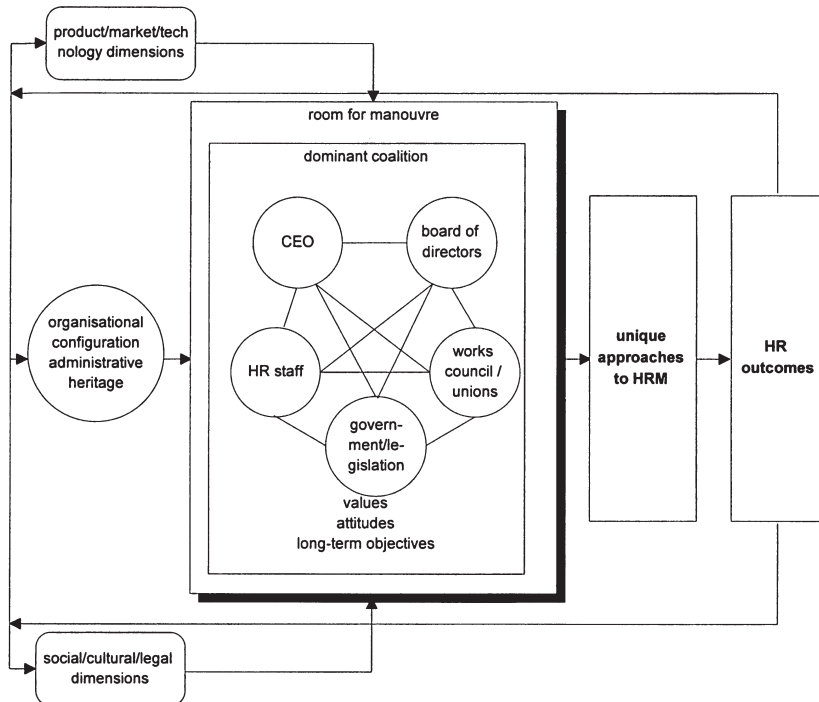
*dominant coalition*. The values and attitudes of the members of this coalition are some of the factors that influence the management of the human resources.

On the other hand it acknowledges that the available resources and the mechanisms of path dependence and routines limit the room to manoeuvre for this coalition. These effects are grouped around three different *dimensions*.

Within each firm the dominant coalition (explicitly or implicitly) decides on how to manage its human resources. This leads to firm-specific *approaches to HRM*, the *outcomes* of which satisfy specific objectives to a greater or lesser extent.

The remainder of this chapter elaborates on these four elements that make up the human-resource-based theory of the firm.

figure 2 the human-resource-based theory of the firm



Source: based on Pauwe (1998).

## **Dimensions affecting the room to manoeuvre**

### *Product/market and technology dimensions*

Each firm serves one or more product/market combinations, using an appropriate production technology. The product/market combinations impose certain demands regarding efficiency, effectiveness, quality and flexibility; these demands represent the economic rationality of national and international competition and determine, to a large degree, the (HRM) strategy of a firm.

The technology that is used also has a direct impact on personnel management. For example, the appropriate technologies will to a large extent determine the educational type and level required of employees. And the extent to which the technologies used are generally accepted influences the relative importance of general versus firm-specific human capital.

### *Social, cultural and legal dimensions*

Values and norms of parties involved in the actual decision-making process (the dominant coalition) are embedded in a social, cultural and legal context. This context affects the levels of fairness and legitimacy the dominant coalition strives after. *Fairness* refers to a 'fair' arrangement in the agreed exchange between the individual as an employee and the organisation as employer. Elements in this exchange are not only time, money and labour, but also information and know-how. *Legitimacy* is a collective manifestation of fairness; the parties involved are interest groups (unions, government through legislation) rather than individuals.

### *Organisational configuration and administrative heritage*

The resource-based theory of the firm stresses the importance of routines and path-dependence as causes for the heterogeneity among firms. These mechanisms are at the core of the organisational configuration and administrative heritage.

The organisational configuration can be influenced by other firms and organisations. For example, a firm can co-operate intensively with its major suppliers and adapt its organisation to facilitate a close collaboration. Sustained competitive advantages can be the result of the routinised actions between the firm and its supplier.

### **Dominant coalition and room to manoeuvre**

The stakeholders involved in the process of strategy formulation form the dominant coalition of a firm<sup>1</sup>. In general, the dominant coalition will include the CEO, board of directors, personnel staff and the works council or trade union representatives. Also external stakeholders, such as the government, can participate in this coalition.

The dimensions discussed above impose limits on the room to manoeuvre for the dominant coalition. For example, national legislation and collective labour agreements can impose lower limits on wage costs per employee. But they can also represent changes in the room to manoeuvre. For instance, the technology that is available to a firm changes continuously, thanks to world-wide R&D activities. Changes in technology can cause certain routines to become superfluous, and new routines to emerge. Thus, changes in one dimension (technology) can result in adjustments in another (organisational configuration), through its impact on (decisions made by) the dominant coalition.

### **Unique approaches to human resource management**

The influencing dimensions determine, to a large extent, the room to manoeuvre for the dominant coalition. Nevertheless, there is still ample scope to develop a unique strategy, including the personnel management. This strategy depends on the goals, norms and values of the different stakeholders in the dominant coalition, their relative bargaining power and the interaction between them.

### **Human resource outcomes and long-term objectives**

All activities, including activities regarding personnel management, aim to achieve certain objectives or outcomes. These outcomes should in turn contribute to long-term objectives such as the effectiveness of the organisation, individual and social well-being.

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<sup>1</sup> Strategy is about the major moves a firm does or does not make. Therefore, all firms are involved in strategy, no matter which approach to strategy formulation is deemed appropriate.



## 4 A human-resource-based theory of the small firm

The human-resource-based theory of the firm can be elaborated for specific subsamples of firms. We shall do so for small enterprises, based on the characteristics described in chapter 2.

The topic of this study is how personnel management is formed, not how effective it is. Therefore, we shall concentrate on the dominant coalition, its room to manoeuvre and the impact of influencing dimensions. The relations between these elements and personnel management will be specified by formulating specific hypotheses. These hypotheses are the result of investigation, using a poll that was held among 18 small Dutch firms. Some of these hypotheses concentrate on differences between the populations of small and large firms, but also differences within the population of small firms are examined<sup>1</sup>.

### 4.1 Influencing dimensions

Since the characteristics described in chapter 2 do not relate to the product/market and technology dimensions, these dimensions will not be discussed. In this section only the organisational configuration and the legal dimension will be dealt with.

#### Organisational configuration

##### *Small firms are less specialised*

Compared with large firms, the positions within small firms are less specialised. Employees have to (be able to) perform various tasks. And for certain tasks there will be no specific position because of a relatively low demand for these services and the relatively high fixed costs of employing personnel. An example of such a position is that of a personnel officer. This is formalised in the first hypothesis.

Hypothesis 1:

Firms with fewer than 50 employees do not employ persons solely for (tasks related to) personnel management.

<sup>1</sup> Most of these hypotheses were the subject of previous research. The main reason for incorporating them in this chapter is to illustrate how they fit in the human-resource-based theory of the small firm.

Specialisation requires co-ordination, as indicated in transaction cost theory. Being small and less specialised, small firms offer considerable opportunity for informal co-ordination and knowledge-sharing. According to Nooteboom (1993, p. 291), ‘... large firms [have] more explicit rules and procedures associated with the need to communicate more widely and therefore more formally’. Small firms are confronted with this need for formalised co-ordination to a much smaller extent.

The lack of explicit rules and procedures associated with small firms should manifest itself in the management of human resources. Generally speaking, this implies that HRM processes are less formalised within smaller firms. This assumption is translated into specific hypotheses for two such processes. The first process concerns the use of written job descriptions.

Hypothesis 2:

Small firms make less use of written job descriptions than large firms.

This is not only due to the relatively informal nature of HRM within small firms. Small firms also have a less specialised production process, which requires a relatively high level of flexibility from most employees. This makes it difficult to write down all the tasks that an employee is expected to perform. And the lack of a personnel officer does not help either.

The second process is that of job evaluations.

Hypothesis 3:

The percentage of small firms that carries out structured job evaluations will be lower than for large firms.

Job evaluations are considered structured if they satisfy the following criteria:

- every employee is evaluated
- evaluations take place at least once a year
- formally recorded guidelines are used.

### *Process approach to strategy formulation*

The process approach to strategy formulation stresses the importance of 'bounded rationality'. If a strategic decision must be made, firms do not endeavour to pick the most promising one during a rational search for all possible policy options. Instead, '... knowledge of alternatives and consequences is prey to individual cognitive limitations, such as ... lack of resources and motivation to conduct comprehensive information searches' (Legge, 1995, p. 100).

Regarding personnel management, small firms are clearly hampered by cognitive limitations. First of all, we hypothesise that small firms do not employ a personnel officer (or a comparable position). This means that it is very likely that no specific 'theoretical' knowledge on personnel management is available within the firm. Secondly, as a consequence of having relatively few employees, decisions regarding personnel management have to be made less often. This implies that small firms have less experience and routine in the relevant activities (Nooteboom, 1993; WRRa, 1987).

### **The legal dimension**

The legal dimension is clearly related to firm size. In many countries there is legislation regarding the influence of employees and unions on the policy of an enterprise. These rules depend partially on firm size. For instance, in larger firms works councils have more rights regarding the formulation of firm policy than in small firms.

Legislation not only differs between size classes, but also between sectors. In the Netherlands, many firms are subject to collective labour agreements that apply to a specific sector. These agreements cover more than just wages. For example, the collective labour agreement for small firms in the metal products industry imposes specific demands concerning the use of written job descriptions. This calls for an amendment to the second hypothesis, which stresses the heterogeneity within the population of small firms:

#### Hypothesis 2a:

Within sectors that are subject to collective labour agreements that hold for all firms, the percentage of small firms using written job descriptions is higher than for small firms from other sectors.

## **4.2 The dominant coalition and its room to manoeuvre**

The influencing factors limit the room to manoeuvre for the dominant coalition of a firm. The personnel management decided upon will depend on the specific dominant coalition, and on the goals this coalition sets for personnel management<sup>1</sup>.

### **4.2.1 The employer**

The five different stakeholders depicted in figure 1 are not relevant for a small enterprise. The CEO (chief executive officer), board of directors and HR staff are replaced by the employer. If there is a works council<sup>2</sup> it will have very few rights. The employer will often be the only stakeholder in the dominant coalition.

Because of the dominant position of the employer, decisions can be made very rapidly. According to the process approach to strategy, '... strategy is the product of political compromise, not profit-maximising calculation. The combination of political bargaining and bounded rationality strongly favours strategic conservatism' (Whittington, 1993, p. 24). As they often do not need to compromise, small firms have a clear advantage over larger firms.

The dominant position of the employer also has a disadvantage. Very often no specific knowledge of (or interest in) personnel management will exist within the dominant coalition. If strategy is indeed the product of political compromise, and there is no one to 'promote' personnel management, then it will receive little attention. This idea is confirmed by empirical research: only if the employer of a small firm has taken a formal training in personnel management, will he/she regard personnel management as being important for the long-term objectives (Benmore and Palmer, 1998, p. 4).

Because of the dominant position of the employer, the values, attitudes and long term objectives of the dominant coalition are mainly those of the employer. These will now be discussed.

### **Values and attitudes of the employer**

Despite the heterogeneity within the population of small firms, it is possible to distinguish some general attitudes that are shared by

- 1 All firms are assumed to have personnel management. Any employer with employees must make decisions (be it consciously or not) regarding hiring new personnel, firing employees, job reviews, salaries, etc.
- 2 According to a study by Klandermans and Visser (1995), the percentage of Dutch private firms with an active works council is an increasing function of the size class. This percentage ranges from 7% for firms with 1-9 employees and 18% for firms with 10-34 employees to over 90% of the firms with more than 500 employees (p. 165).

most employers. The relative importance attached to each of these attitudes has an important impact on the room to manoeuvre<sup>1</sup>.

#### *Participating in the production process*

Labour is more than just another production factor: it is also a commodity from which people derive a certain utility. Research has shown that for most small-firm employers, maximising profit is less important than enjoying day-to-day activities, qualities of personal relations within the firm and the respect that can be earned (WRRb, 1987, p. 7; EIM, 1986, p. 6).

Most employers devote relatively little time to factual company management, particularly (the preparation of) strategic decisions. Not only because it would take relatively little time to manage a small firm, but also because management is not their favourite activity<sup>2</sup>.

#### *Keeping full control*

Firm size is related to the level of control by the employer. From a certain point onwards, each employer will have to delegate an ever-growing proportion of the management tasks to one or various subordinates.

Greiner has elaborated this relation into an organisational growth-and-development model. According to Greiner<sup>3</sup> characteristics of a firm's management are connected to its development stage. Following the theory on organisational development, the first stage of firm growth is creativity (pioneer stage). The employer is characterised by a bond with the product and his or her craftsmanship. The employer is much less concerned with company management. The less time this takes, the better. When the enterprise grows, this type of management will no longer be sufficient. The employer will no longer be able to run the firm single-handed. To prevent a leadership crisis, management tasks must be delegated and management itself be formalised.

However, not all employers are willing to give up their control over the firm. Many employers have difficulties delegating, because of their orientation on independence, craftsmanship and freedom (WRRb, 1987, p. 22).

- 1 Existing literature on firm typologies can very likely be used to characterise the room to manoeuvre for different types of firms or employers. Such an analysis is however beyond the scope of this study.
- 2 Within the classical approach to strategy formulation this aversion would be irrelevant: even if an employer does not like to manage, his or her drive to maximise profits will ensure that an optimal amount of time is devoted to management activities. But according to the process approach, this lack of motivation becomes very important: it means that little time will be devoted to explicit and conscious strategy formulation. And because of imperfect market conditions, firms that do not operate in a profit-maximising way do not necessarily go bankrupt.
- 3 As discussed in Keuning and Epping (1987), pp. 250-258.

The importance an employer attaches to keeping full control has a direct impact on the room to manoeuvre: employers who want to keep full control will (from a certain point onwards) not pursue growth strategies. Keeping full control is thus not only a characteristic of the employer's attitude, but can also be a long term objective.

### **Long term objectives of the employer**

The human-resource-based theory of the firm stresses the heterogeneity of firms. This heterogeneity not only manifests itself in various strategies to reach certain objectives, but also in various objectives. Despite this heterogeneity it is possible to identify three objectives that most small firms find important to some extent:

- continuity
- a good working climate
- keeping full control.

#### *Continuity*

The first two objectives are especially relevant for employers who want to participate in the production process rather than manage that process from a relative distance. Often, maximising profits is deemed less important than enjoying day-to-day activities. Within the framework of the human-resource-based theory of a small firm, it is assumed that the financial objective of these employers is not to obtain maximum profit, but enough profit to ensure the continuity of their firm.

#### *A good working climate*

That employers want to enjoy their work is a safe assumption; this probably holds for every member of the labour force. However, achieving this objective can have different consequences for employers of small firms and large firms. Small firm employers often obtain their satisfaction primarily from participating in the production process, and not from managing it. We assume that this satisfaction depends to a large extent on the (working) relations between the employer and the employees who regularly work together. For a small firm, this will include almost every employee. This implies that a good working climate, as it is experienced by the employer, can be a long-term objective in itself.

#### *Keeping full control*

As discussed in the previous section, the wish to keep full control over the firm can become an objective in itself. If keeping full control is indeed an important long-term objective for many employers, then it may be expected that many small firms will not show a sustained growth in the number of employees, after a certain threshold

level has been reached. This is in accordance with previous empirical research<sup>1</sup>. This leads us to formulate:

Hypothesis 4:

A majority of small firms does not pursue strategies aimed to increase the number of employees.

This hypothesis has one serious drawback: even if it is found to be true, no conclusions can be drawn as to the causes of this behaviour. According to our model, this behaviour is explained by many employers wanting to keep full control over their firm.

A different argument can be used to arrive at this fourth hypothesis: firms want to maximise profit, and due to various circumstances<sup>2</sup> maximum profit can be obtained with the current number of employees. It is however beyond the scope of the current research to test for these alternative explanations empirically.

### **Objectives differ between firms**

It is important to note that the objectives that have been identified in this section are not equally relevant for all employers. The relative importance that is attached to each of these objectives will be different for each employer. And for some employers none of these objectives are relevant. For example, employers for whom managing their firm is more rewarding than participating in the production process. Or employers who derive the most personal satisfaction from the growth process of their firm, and who are willing to release their complete control in order to stimulate this growth process. Their firms will typically not remain small. The point that we want to make here is that only a minority of the employers can be stereotyped this way.

### **4.2.2 The employees**

In the human-resource-based theory, individual employees are not present in the dominant coalition. They can be represented by a works council or union representatives. However, many small firms do not have a formal works council. It is also very unlikely that union representatives are part of the dominant coalition.

1 According to a Dutch study, a majority of small enterprises do not show any structural growth, even if measured over a longer period (WRRb, 1987, p. 19).

2 For example the size of the product/market combination the firm operates in, the availability of capital and labour and the (perceived) costs of hiring extra personnel.

Does that mean that employees have no means of exerting influence within the dominant coalition? No. We hypothesise that in small firms, individual employees can become part of the dominant coalition. Not because of formal rights or their position, but because the employer attaches importance to good employee relationships in their own right.

### **4.2.3 Outside stakeholders: associated organisations**

Each firm has relations with other firms and organisations. These outside stakeholders can even directly influence the process of strategy formulation of some firms. Examples of such outside stakeholders are franchisors and buying groups. For the purpose of this study, these outside stakeholders are labelled 'associated organisations'. These associated organisations are part of the dominant coalition of the firm.

#### **Associated organisations and the room to manoeuvre**

Associated organisations influence or even control certain aspects of the management of the firm. Examples are purchasing, marketing, pricing, and also personnel management. Certain conditions are imposed on the management of the firm, implying a limitation of the room to manoeuvre.

But, on the other hand, these associated organisations can provide individual firms with means they would otherwise have no access to. This access relates not only to capital and labour, but also to knowledge. This leads to an expansion of the possibilities for that firm; an expansion of the room to manoeuvre.

#### **Associated organisations and the unique approach to HRM**

Being large organisations themselves, associated organisations are more specialised and formalised. As part of this specialisation they employ personnel officers or have a specific HRM department.

The associated organisations have both a disposition towards a more formalised style of personnel management and the knowledge to introduce such a style in their associated firms. We therefore expect that the presence of associated organisations will result in a more formalised management style. As specific examples we examine the policies regarding job descriptions and firm provided training. This leads us to formulate the last hypothesis of this chapter:



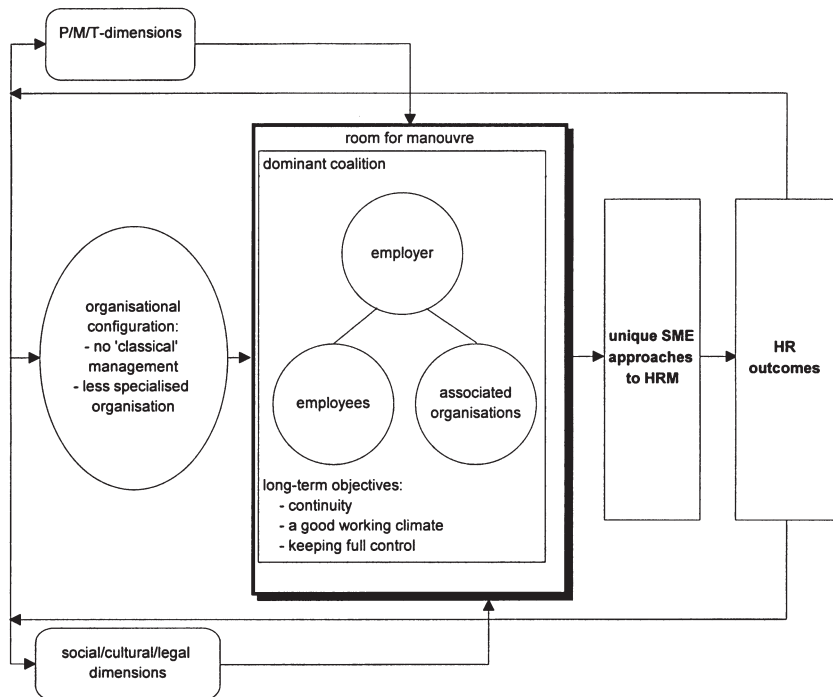
Hypothesis 5:

Small firms with associated organisations provide relatively more often training courses than small firms without associated organisations.

### 4.3 Unique approaches to human resource management

Thus far the first two elements of the human-resource-based theory of the firm have been specified for small firms: the influencing dimensions and the dominant coalition. The formulated hypotheses link these elements with the unique SME approaches to HRM. The resulting theoretical framework is depicted in figure 3.

figure 3 the human-resource-based theory of a small firm



The next step would be further examination of the unique SME approaches to HRM. Is it possible to define these unique approach-

es? Do small firms share general characteristics of personnel management, which are not to be found with larger firms?

There is very little known empirical research on this subject. The majority of SME-focused studies on personnel management appear to concentrate on enterprises with 100 or more employees (Duberly and Walley, 1995; Poutsma, 1993), and hardly consider the characteristics of small enterprises. Moreover, these studies are based on the large-firm HRM blueprint for SME staff policy (Desphande and Golhar, 1994).

At this moment we shall not specify the remaining elements of our theoretical framework; our understanding of the kind of measures that small enterprises take is still insufficient. Therefore, we have undertaken explorative research bridge this gap. This will be the subject of chapter 7. But first, we shall turn to the hypotheses derived in this chapter.

## **5 Empirical study**

### **No formal testing**

To investigate the personnel management practices amongst small firms, we conducted interviews with employers. Based on these interviews, we can elaborate the human-resource-based theory of the small firm. Chapter 7 will present a general hypothesis of the unique approaches to HRM within small firms, and the connections with the long-term objectives of the employer.

In the previous chapter, various hypotheses were formulated. Due to the nature of the empirical research, it is not possible to formally test these hypotheses. Testing these hypotheses would require a large scale survey including both small and large firms. Such a survey is, however, less suited for generating new insights regarding personnel management practices in small firms. We have chosen to concentrate on the latter topic. Therefore the hypotheses are translated into more general questions that can be answered for our sample of small firms. These questions, and their answers, are the subject of the next chapter.

This chapter discusses the set-up of the interview sessions used in the next two chapters.

### **Interviews**

The information was gathered by means of semi-structural interviews. In the summer of 1997, interviews were held with 18 employers who had 10 to 50 employees. To ensure sufficient variety as to age, education level of employers and character of the working process, the conversations were held in various sectors, i.e. in metal processing, food, automation and cleaning services. In addition, firms older than five years were selected to prevent firms without a crystallised staff-policy profile being represented.

For the interviews we developed a checklist, based on a classification by 'flow measures, controlling and development', (Fisscher, 1988). Flow measures relate to influx, internal mobility and labour turnover, controlling pertains to the composition of internal work procedures (for instance delegating, managing) and development relates to the maximum utilisation of human capital (for example training, career development).

This classification covers all aspects of personnel management. In this way, we could ensure that all subjects of personnel management would be discussed in the interview, even if some subjects were not very important according to the employers. To serve the objective of our study, we also had to identify why employers did not pay much attention to some aspects of personnel management.

### The sample

In table 1, summary statistics for the survey are presented. Originally, 20 firms were interviewed. However, two of the interviewed firms were dropped from the sample, because they did not meet the requirements; one firm was not independent, the other was too large.

table 1 summary statistics

sector	firms	with associated organisations	employees*	
			mean	range
cleaning services	4	1	19,8	10-37
metal processing	6	1	15,3	10-25
automation	3	0	19	12-25
retail (food)	5	4	22,8	10-41
total	18	6	19	10-41

\* Excluding owners.

The firms from the metal processing and food retail sector were subject to collective labour agreements.

## 6 Results

In this chapter, the hypotheses as formulated in chapter 4 are translated into new hypotheses that may be tested based on the empirical study.

### Hypothesis 1: personnel department within small firms

Since small enterprises are less specialised, we expect that almost none of the surveyed enterprises employ persons solely for (tasks related to) personnel management<sup>1</sup>.

This hypothesis is supported by the study, as none of the enterprises surveyed employ staff specifically engaged in HRM.

table 2 hypothesis 1: personnel department within small firms

HRM staff?	number of enterprises	percentage
no	18	100
yes	0	0
total	18	100

It is safe to assume that all firms with a certain number of workers have a personnel department. If on the other hand (very) small firms have no personnel department (officer), then a certain size class can be identified for which some, but not all firms have a personnel department. If one is interested in when and why firms decide to install a personnel department, one should focus on this size class. Table 2 suggests that the lower boundary for this size class is above 50 employees.

### Hypotheses 2 and 2A: job descriptions and collective labour agreements

We expect that the majority of small enterprises do not have any job descriptions (hypothesis 2), unless they belong to a sector where collective labour agreements link salary scales to job descriptions (hypothesis 2A).

The findings of the study (table 3) support this hypothesis: 11 of the 18 enterprises surveyed do not have any job descriptions, and 6 of the *remaining* 7 enterprises that do work with job descriptions

<sup>1</sup> Since our study defines small enterprises as those with 10-50 employees, we use this definition when referring to the term small in our hypotheses.

follow the job descriptions as stipulated by collective labour agreements. They mainly adopt job descriptions to rank employees according to salary scales, while self-styled job descriptions are adopted by 1 enterprise only. Remarkably, a major customer of the latter enterprise had stipulated a total-quality-assurance plan that included detailed job descriptions.

table 3 hypotheses 2 and 2A: job descriptions and collective labour agreements

job description available?	number of enterprises	percentage
yes; stipulated by collective labour agreement	6	33
yes; not stipulated by collective labour agreement	1	6
no	11	61
total	18	100

### Hypothesis 3: use of structural performance assessments

We expect that the majority of enterprises surveyed do not effect performance assessment in a structural face-to-face manner.

This hypothesis is supported by our study (table 4), as more than three-quarters of the enterprises surveyed do not effect structural face-to-face performance assessments: performance assessment mainly takes place on the workflow.

table 4 hypothesis 3: use of structural performance assessments

face-to-face staff-performance assessment?	number of enterprises	percentage
yes	4	22
no	14	78
total	18	100

### Hypothesis 4: pursuing growth strategies

The majority of the small enterprises surveyed is expected to have no strategies aimed at increasing the number of employees.

As expected, only a tiny minority of the enterprises surveyed pursue a strategy focused on business expansion (table 5). Besides, remarkably, 3 enterprises were even found to maintain a shrinking strategy, as staff problems encountered outweigh (expected) entrepreneurial revenues.

table 5 hypothesis 4: pursuing growth strategies

growth strategy?	number of enterprises	percentage
yes	3	17
no	15	83
total	18	100

### Hypothesis 5: firm-provided training

Regarding firm-provided training, our final hypothesis states a positive influence of associated organisations: enterprises linked to an associated organisation are more likely to provide training than other enterprises.

Indeed, 4 of the 6 enterprises linked to an associated organisation were found to provide training courses for their employees. This share is higher than that among enterprises not linked to an associated organisation (17%) (table 6).

table 6 hypothesis 5: firm provided training

training schedule?	no associated organisation		associated organisation		total	
yes	2	(17%)	4	(67%)	6	(33%)
no	10	(83%)	2	(33%)	12	(67%)
total	12	(100%)	6	(100%)	18	(100%)

### Conclusion

All hypotheses as formulated in chapter 4 are supported by our empirical study.

Once more, we emphasise that the sample survey is too small to arrive at conclusions that are significant and well-founded in a formal, statistical sense; this cannot be expected from an inquiry among 18 employers. But at this stage, this is less relevant. Very little research has been done on personnel management in small firms, either theoretical or empirical. Explorative empirical research, as described in this chapter and the next one, is needed to develop more detailed theories. And the results discussed in this chapter demonstrate the ability of the human-resource-based theory of the small firm to explain both similarities and dissimilarities between small firms.





## **7 Unique SME approaches to HRM: an explorative study**

In chapter 4 we looked at the first two elements of the human-resource-based theory of the firm. Various hypotheses regarding the organisational configuration and the dominant coalition were investigated, using interviews. This chapter focuses on the third element of the theory: the unique SME approaches to human resource management.

According to the human-resource-based theory of the small firm, each firm has its own unique approach to HRM. The results from the previous chapter already indicate that despite this uniqueness, it is possible to identify differences between small and large firms, and between groups of small firms. In this chapter we go one step further: we argue that there are three general principles of these unique SME approaches to HRM which are shared by many small firms. These principles are found to be strongly related to the long term objectives of the employer: continuity, creating a good working climate and keeping full control.

The next section gives a short description of these three general principles. After that, each principle will be discussed in more detail.

### **7.1 Three general principles**

Based on the results of the interviews, we identified the following general principles:

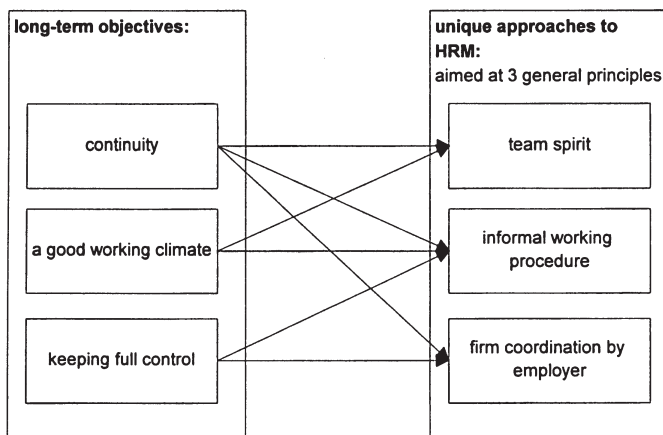
- accent on team spirit  
Accent on team spirit means emphasis on good relations within the team, including the employer himself.
- informal working procedure  
The informal working procedure relates to the lack of instruments and the absence of procedures, and links to a flexible working method.
- firm co-ordination by the employer  
The central position from which the employer controls the firm is characteristic of the firm co-ordination by the employer.

The connections with the long-term objectives of the employer are depicted in figure 4.

The next three sections focus on these general principles and their interrelationships with the long-term objectives. For each principle we shall discuss how it influences the following aspects of personnel management<sup>1</sup>:

1. recruitment & selection
2. managing/delegating
3. internal communication.

figure 4



## 7.2 Accent on team spirit

### Interrelationship between objectives and accent on team spirit

According to the employers interviewed, the accent on team spirit results in a good working climate, in which employees will be more motivated and will feel part of the firm. As a result, employees will be willing to make an extra effort when necessary, to replace absent colleagues and help each other out. The informal way of communicating also requires that employees are willing to share information with each other, which requires a good working climate.

Thus, by providing a good working climate the accent on team spirit will benefit the continuity of the firm. Some employers stated that the good working climate can lead to employees not wanting to search for another job, even if they can earn more money or have better career prospects in larger companies.

<sup>1</sup> A more detailed discussion of these principles can be found in EIM (1997).

Employers pay attention to team spirit for their own well-being as well. In contrast to employers in larger companies, the former work with most of their employees all day long. The good working climate (as stimulated by the accent on team spirit) is factually both an instrumental characteristic and a goal in itself.

### **Recruitment & selection**

Small firms pay less attention to a specific type of education than large firms do. This is due to the fact that small enterprises are generally less specialised than larger enterprises. Employees have to be able to perform multiple tasks. Whether or not an applicant has received training applied to one specific task is less relevant if she/he is not expected to perform that task all of the time.

Creating and maintaining a good working climate is a major long-term objective of the employer. It is therefore relatively more important for small firms to establish whether or not an applicant will get along with the employer and employees. In combination with a tendency to spend as little time and money on recruitment procedures as possible<sup>1</sup> this leads to the high popularity of using personal connections (both colleagues and employees) to recruit new employees.

### **Managing/delegating**

In many small enterprises, the informal hierarchy characterises the structures. The solidity of relationships in this structure is an important issue.

In case of mutual conflicts within the team, the employer will do all he can to solve the problem. He will avoid damaging the team spirit.

### **Internal communication**

Given the teamwork structure, official meetings are considered redundant. Everybody works together intensively. Normally, just a few words suffice to clarify matters. To save time, working conferences are held during (lunch)breaks or on the workfloor.

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<sup>1</sup> This will be elaborated in the next section.

## **7.3 Informal working procedure**

### **Interrelationship between objectives and informal working procedure**

According to employers, a formalised working process has a rigid effect on doing business. The employer wants to be flexible; many believe that their continuity would be endangered if they were to lose their flexibility. The informal character of the working process makes it possible to take decisions quickly. If all agreements were recorded officially, this would lead to inflexibility.

Besides this ‘rational’ argument stressing the advantages of informal working procedures, many employers also have personal preferences for informal procedures. Often employers do not want to spend more time on formal management than is strictly necessary. Rather than carrying out administrative tasks, they prefer to ‘indulge’ in their profession.

Employers have also indicated a major disadvantage of more formalised working procedures. In small enterprises it is too time-consuming to work according to official procedures. Overhead costs are high in relation to operating profits. For example, the cost of developing an introduction programme for new employees costs relatively too much given that it concerns a few persons only.

### **Recruitment & selection**

When recruiting new staff, an employer opts for the least formal recruitment process. Drafting task descriptions and advertisements, reading letters and conducting interviews with candidates are considered barriers by an employer. Besides, staff recruitment by small enterprises is mainly effected on cost-efficiency grounds.

Therefore, informal and inexpensive recruitment methods are standard procedure. Within small enterprises, the via-via recruitment method proves a popular measure. Being inexpensive, this method demands relatively little of an entrepreneur’s time (provided the method produces one candidate only, which is mostly the case here), as he has to conduct one interview only.

### **Managing/delegating**

Usually, SME firms are delineated as ‘horizontal’ organisations with few hierarchical levels. In most cases, the entrepreneur is the all-determining figure. Mutual staff relations and various hierarchical

shades do however illustrate the often subtle differences which are not rooted in any official classification of positions but rather, in such matters, as seniority and social skills. Also in view of the fact that entrepreneurs are likely to describe their enterprise as one large family, it is not surprising that the hierarchical structure is based on other than formal grounds. It is for instance remarkable that entrepreneurs often maintain a 'second man' who acts as some kind of substitute manager on the one hand, and as a staff representative on the other. Factually, this second man assumes the role of intermediary between the entrepreneur and other staff members, without any formal task description.

### **Internal communication**

Generally, staff control is effected on the workforce or during (lunch)breaks. Entrepreneurs are of the opinion that staff meetings attended by all employees could result in employees demanding more formalised communication structures, which they want to prevent from happening. Besides, too much (precious) time would be consumed.

## **7.4 Firm co-ordination by the employer**

### **Interrelationship between objectives and firm co-ordination by the employer**

The principle of firm co-ordination strongly depends on the objective to keep full control. In order to have an overview of the entire working process: the employer will want to have a strong influence in the total organisation; the employer often acts as the sole decision-maker. Delegating part of the co-ordinating activities could lead to a loss of control.

The objective of continuity is also seen as an important reason for a firm co-ordination. Various arguments can be made here. First of all, the employer is often personally responsible for acquiring most of the orders. He will therefore feel strongly responsible for the results, and hence wants to co-ordinate all orders. Another often heard argument is that the employer often feels (s)he is the only one available within the firm with the necessary capabilities. This does not, however, necessarily have to be the case. Finally, it should not be ignored that the employer's income relies on company operating profits; this can be an extra stimulant to retain control of the entire working process.

### **Recruitment & selection**

Although the employer usually states he does not want to spend too much of his time on recruitment and selection, he seldom delegates this task. Whether or not a candidate is hired is completely up to the employer. This is remarkable, considering the importance of 'being a team member' as a selection criterion.

### **Managing/delegating**

As mentioned above, the employer feels a strong responsibility for the results. This makes it difficult for him to delegate. Although the employer demands a high degree of autonomy from his employees, he does not give them the authority they need to perform their duties in accordance with their own views. The employer is unwilling to give up full control.

### **Internal communication**

Internal communication is an illustration of the key position of the employer. In small enterprises communication is usually top-down. Particularly if it concerns fundamental decisions the employer will not consult his employees in the decision-making process.

In some cases the employer will present the company's year results to his employees. Usually, however, it is not customary for employees to make critical comments about the company's policy. Again communication is one-way.

## 8 Discussion

In this paper a human resource-based theory of the small firm has been specified, to gain insight in the way smaller enterprises effect personnel management.

This theory is of a descriptive nature: instead of asking what the optimal type of HRM should look like, it focuses on explaining the practices of personnel management. It is assumed that differences between firms are the result of differences in the dominant coalition and its room to manoeuvre, the latter being determined by influencing dimensions such as the production technology used and the organisational configuration.

This line of reasoning can be inverted: firms that share specific characteristics regarding their dominant coalition and room to manoeuvre can be expected to behave similar as to how they manage their personnel.

It is possible to identify such characteristics that are closely linked to firm size. In particular the dominant position of the employer, the 'process' way in which firm strategy is formulated and the organisation of the production process (less specialised) are features that are common to many small firms. The theory presented in this paper has looked into the relevance of these features for the actual personnel management within smaller enterprises.

We find that, contrary to large enterprises, the employer is often the sole stakeholder in a small enterprise. Therefore, the objectives of personnel management are in line with the targets of the employer. Besides the continuity of the enterprise, an employer aims at a good working climate and keeping full control. The relative importance of these long-term objectives characterises the dominant coalition of the enterprise. The actual operationalisation of personnel management is further determined (limited) by the room to manoeuvre. Various general characteristics of small enterprises, for example the fact that the production process is less specialised, cause this room to manoeuvre to differ between small and large firms. Hence, smaller firms can be expected to have a different type of personnel management than large firms.

Based on our conclusion that the major part of personnel management in smaller enterprises is determined by the general characteris-

tics of these enterprises, we are of the opinion that personnel management cannot be judged by existing models on HRM. This is due to the fact that most of these normative models are (implicitly or explicitly) based on large enterprises and take the classical approach to strategy formulation (Legge, 1995). As we have explained, this approach is not relevant for small enterprises.

Any assessment of personnel management as practised by smaller enterprises should consider the specific characteristics and background of small enterprises. An assessment based on a blueprint of 'adequate HRM-policy' in large enterprises would produce an inaccurate image.



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