Human Capital in SMEs Life Cycle Perspective

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Abstract

In tandem with globalization and rapid changes in technology, the role of SMEs in enhancing economy development and employment becomes more crucial despite resource constraints. The emergence of a knowledge economy requires SMEs to be embedded with intellectual capital, namely human capital, structural capital and relational capital in order to compete in the resilient business environment. Given the unique characteristics of SMEs, prior studies revealed that human capital has the strongest influence on SMEs’ performance than the other sub-elements of intellectual capital. The changes in the business environment force firms to alter their strategies in achieving their stated goals. Hence, to align between the changes in the environment and the firm’s structures, systems and processes, the role of human capital must be properly identified and distinguished according to the needs in different life cycle stages. The contributions of human capital in the early stages are found to be more significant than later stages. Therefore, the aims of this conceptual paper are twofold. The paper will highlight the contribution of human capital in business performance, followed by the role of human capital in the different life cycle stages of SMEs.

Keywords: Human capital; SMEs; Life Cycle; Performance

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1. Introduction

The rapid growth of the global knowledge economy requires firms in various industries and sizes to be embedded with intellectual capital in assuring sustainability and competitiveness. In today’s knowledge economy, the influence of human capital, structural capital and relational capital on business performance indicates that the investments in intangible resources gain their importance over tangible resources (Cohen and Kaimenakis, 2007; Clarke et al., 2011). In the context of small and medium-sized enterprises, the transition of the Malaysian economy requires SMEs to become more resilient in facing the challenges despite their shortage in financial and non-financial resources. The small size and fund of SMEs hinder them to highly invest in external resources, therefore the internal knowledge that is embedded in SMEs’ managers and employees must be effectively and efficiently used and managed to continue success (Desouza and Awazu, 2006). Prior studies revealed that human capital is a primary determinant of SMEs performance than structural capital and relational capital (Daou, 2014; Rohana and Abdul Razak, 2009;Tovstiva and Tulugurova, 2007). The quality of SME employees not only contribute to the value enhancement of SMEs, but is also beneficial in developing structural capital through the transformation of employees’ knowledge into process and routines and improving relational capital with stakeholders (St.Pierre and Audette, 2011). Accordingly, the uniqueness of humans that is hard to be substituted and duplicated by other firms provide managers the opportunities to identify and develop the human capital’s potential to achieve the firm’s stated goals (Darcy et al., 2014).

The challenges confronted by SMEs throughout their business life require education, experience and motivation of humans to be engaged in business strategies that will lead to business performance (Pena, 2002). As the business grows, myriad issues and problems occur due to factors such as technological advancement, which requires some changes in strategies, systems and structures (Churchill and Lewis, 1983). Therefore, the role of human capital must be identified and mobilized according to their importance in different business life cycle stages due to its characteristics that are accumulative, continuously created and adaptive to environmental changes (Chang and Hsieh, 2011). Human capital requirement in the start-up stage might have different significance compared to the growth period, thus it must be distinguished properly in order to attain performance in each stage (Chang and Hsieh, 2011; Zalesna, 2012). Hence, the objectives of this paper are twofold. Firstly, the paper aims to highlight the contribution of human capital on the business performance and secondly, to review the importance of human capital in different business life cycle stages in the context of SMEs namely starts up, growth and maturity. The following section presents the literature review on the overview of Malaysian SMEs, human capital and the human capital in different life cycle stages.

2. Literature Review

2.1. Malaysian SMEs: An overview

The roles of SMEs in economic development, growth, export and employment are highly recognized in most countries despite facing challenges and limited resources (Saleh et al., 2008). The definition of SME varies across countries. Meredith (1994) argued that the definition of SMEs must comprise not only the quantitative components such as turnover, assets and staff levels, but qualitative components such as how the business is organized and operated also need to be incorporated. In Malaysia, SMEs are typically defined according to the number of employees and the firm’s annual turnover. Effective from 1st January 2014, the new definition of SME is used where the qualifying threshold for annual turnover and number of employees has been revised in all sectors to adapt with the current economy situation (SMECORP, 2013), as depicted in Table 1.

SME development is crucial since it is expected to be an integral component of Malaysia’s plan to achieve sustainable economic growth and a developed country status by the year 2020. The achievement of Malaysian SMEs can be seen from their high contributions in total output, gross domestic product (GDP), value added, as well as employment. The 2011 Economic Census by the Department of Statistics Malaysia reported that SMEs constitute 97.3% of total firms in Malaysia for the year 2010 with 90% of the establishments in the service sector, 5.9% in the manufacturing sector and the remainders operate in the construction, agriculture and mining and quarrying sectors.
Table 1. Definition of SMEs by size and sector of operation

<table>
<thead>
<tr>
<th>Size / Sector</th>
<th>Manufacturing</th>
<th>Services and other sectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro</td>
<td>Sales turnover is less than RM300,000 OR full time employees is less than 5</td>
<td>Sales turnover is less than RM300,000 OR full time employees is less than 5</td>
</tr>
<tr>
<td>Small</td>
<td>Sales turnover from RM300,000 to less than RM15m OR full-time employees from 5 to less than 75</td>
<td>Sales turnover from RM300,000 to less than RM3m OR full-time employees from 5 to less than 30</td>
</tr>
<tr>
<td>Medium</td>
<td>Sales turnover from RM15 million to not exceeding RM50m OR full-time employees from 75 to not exceeding 200</td>
<td>Sales turnover from RM3 million to not exceeding RM20Mm OR full-time employees from 30 to not exceeding 75</td>
</tr>
</tbody>
</table>

As a major player in the economy, SMEs are urged to become more resilient and competent to face the challenges in today’s knowledge economy. The failure of SMEs to adopt with globalization and rapid changes in technologies might lead them to cease the business within the first five years of operation (Wong et al., 2013). Prior studies summarizes that the failure of SMEs are due to a few factors, which include lack of skilled and experienced human resources (Jeen et al., 2006; Saleh et al., 2006), lack of access to financial resources (Saleh et al., 2006; Zairani and Zaimah, 2013), lack of access to information and communication technology and lack of productivity (Saleh et al., 2006).

To show their concern and commitment towards enhancing the development of SMEs, the Malaysian government has provided a number of financial and non-financial support programmes, which involves a huge amount of funds and cooperation from various agencies. Recently, the government has launched the SMEs Masterplan 2012-2020 with the aim to provide SMEs with comprehensive approaches and strategies to assist the country in achieving a high-income nation status by the year 2020 (SMECORP, 2010). The focus areas of the framework includes innovation and technologies, human capital development, access to finance, access to market, legal and regulatory environment and infrastructure. With the target to achieve 41% of GDP, 62% of employment and 25% of exports contribution by the year 2020, the enhancement of human capital has become one of the important aspects in the national economy development agendas.

2.2. Human capital

Human capital refers to the knowledge, skill and experience of employees (Roos, 1998). Bontis et al. (2000) argues that human capital is mainly based on individual abilities, knowledge, know-how, talent, education skills and experience of employees in the firms. As an intangible resource to the firms, human capital is a crucial element in the transformation process of information to valuable knowledge that will enhance firm performance. Mayo (2001) categorized human capital into three categories, namely capability and potential, motivation and commitment and innovation and learning. Capability and potential refers to the educational level, professional skills, experience, attitudes, personal networks, values, and the ability of current employees to evolve within the organization. Motivation and commitment refers to whether employees align their own interests with those of the firm, while innovation and learning shows the degree to which employees are open to change.

A number of prior researches have highlighted the importance of human capital in assisting firms in various industries to attain business performance. Human capital provides firms with direct influence on the business performance or indirect effects through relational, structural, innovation or process capital (Mention and Bontis, 2013). The direct influences of human capital on large business and financial sector’s performances have been proven in several studies, including Alipour (2012); Amrizah and Rashidah (2009); Dewi Fariha and Saudah (2012) and Kamukama (2013). For indirect effects of human capital, Bontis et al. (2000) found that human capital affects large firms’ performances through customer capital in both service and non-service industries, while the impact of human
capital on structural capital is more significant in nonservice industries. In another study, Wang and Chang (2005) found that human capital indirectly affects business performance through innovation capital and process capital.

Several authors have conducted studies on the influence of human capital on SMEs performance. Cohen and Kaminenakis (2007) demonstrates that human capital has huge impacts on organization capital and customer capital, where the investments in human capital will probably lead to the efficiency and effectiveness of other elements of the intellectual capital. Daou (2014) and Tovstiga and Tulugurova (2007) conclude that human capital directly influences SMEs performance, therefore the management are encouraged to put more effort in providing training to employees. The retention of knowledgeable and skilled employees is important for SMEs in achieving superior performance (Daou, 2014). Overall, the transition of a traditional economy to a knowledge economy that heavily relies on employees’ capabilities and competencies, witnesses the important contribution of human capital in SMEs. However, the lacuna of previous literatures of human capital has been on its mobilization and contribution in the different stages of business life cycles. The following sections will highlight the way in which human capital roles have to be differentiated according to different cycles.

2.3. Organizational life cycle stages

Changes in the business environment force managers to face different crises and challenges. These changes of business environments are also known as stages of the business life cycle. The organizational systems, structures and processes must fit to the changes in environment in ensuring better resource allocation and business performance (Chang and Hsieh, 2011). Kiriri (2004) argued that the capabilities of the firms to face issues and challenges at any stage depends on how successful the firms confront the issues in the prior stages. Hanks et al. (1993) defines life cycle stages as a “unique configuration of variables related to organization context and structure.” Prior researches proposed several life cycle models with no consensus in the number of stages. For example, Churchill and Lewis (1983); Greiner (1972) and Miller and Friesen (1984) divided the stages into five stages, Kazanjian (1988) proposed four stages of life cycle, while Adizes (1989) suggested a model up to 10 stages. In general, each model discusses the characteristics, problems and strategies that arise in each stage.

2.4. Human capital in business life cycle stages

Despite the different numbers and names of the stages in the organizational life cycle model, the characteristics and issues discussed in each model are almost similar (Kiriri, 2004). It is very important to note that each business life cycle not only require different roles of human capital, but it also needs us to identify who should play the roles. The human capital roles could take place at the level of owner, managers or employees depending on the stages of business, as depicted in Table 2. The first stage of the life cycle is known as creativity (Greiner, 1972), birth (Miller and Friesen, 1984), existence (Churchill and Lewis, 1983), conception and development (Kazanjian, 1988) and entrepreneurial (Quinn and Cameron, 1983). In this stage, firms are characterized with limited financial resources (Kazanjian, 1988), developing new products or services, obtaining customers (Churchill and Lewis, 1983; Kazanjian, 1988), building relationships with external stakeholders, especially customers (Quinn and Cameron, 1983), and highly depend on the “owner’s role in business affairs and employees’ supervision” (Churchill and Lewis, 1983). The role of the owner is very crucial at this stage since he /she is the only responsible person who started the business, hence the owner must possess good elements of human capital in ensuring the business is capable to move to the next stages.

Pena (2002) argued that the start-up period requires the owner’s experience, level of education and high motivation for survival and growth. It is crucial for owners or managers to possess human capital attributes in order to attract potential customers and marketing strategies due to their new entry in the markets. The owner’s prior experience in business related fields provides him/her with advantages in developing relationships with other external parties such as suppliers, potential business partners, government and financial institutions. In the aspect of motivation, the owner who quits his former job, use his own savings to be invested in the new venture and devote his time and energy, has a high level of motivation in ensuring the survivability and growth of the business (Pena, 2002). The knowledge and leadership style of the owner is important in creating a better communication environment with employees, which
simultaneously develops a positive culture and high achievement of the SME (Zalesna, 2012). The lack of formal systems in the existence stage witnesses the informal communication system and organizational structure of the SMEs, where the employees rely on the owner’s instruction as the only source in carrying out their tasks (Churchill and Lewis, 1983). Therefore, it is critical for the owner to equip himself with educational qualification, past experience and managerial skills.

In the growth stage, the firm’s priorities are to achieve high volumes of production, sales and profit as well as to penetrate a wider market (Churchill and Lewis, 1983; Miller and Friesen, 1984). As customers start to accept the products or services offered, firms should focus on innovation and have bigger access to the markets in order to gain rapid growth (Miller and Friesen, 1984). To deal with mass production and sales, formal and proper systems are introduced such as budget and costing (Churchill and Lewis, 1983) and productivity and efficiency measurement (Quinn and Cameron). At this stage, the delegation of tasks to departmental managers witnesses formal and frequent communication from the top management to other lower levels (Greiner, 1972). Therefore, in the context of human capital, the management team must be equipped with skills such as finance management and operations management skills to ensure efficiency in the allocation of limited resources and strategic planning to ensure the firm’s development (Hove and Tarisai, 2013). However, Greiner (1972) argued that the formal organizational structure minimizes the opportunity of lower level employees in applying their knowledge, experience and expertise into practice due to the limited job scopes.

The maturity period focuses on the organizational stability and efficiency in both production and operational divisions (Quinn and Cameron, 1983). Churchill and Lewis (1983) suggested that this stage requires firms to be cautious in managing their wealth transferred from the growth period and to retain the entrepreneurial spirit. However, the role of human capital in the maturity stage is not as critical as the start-up and growth stages. The employees in the maturity stages are adequate and well-experienced (Churchill and Lewis, 1983), therefore the delegation of tasks are minimized to avoid any controlling and coordination problems among experienced managers (Greiner, 1972).

Table 2. Level and roles of human capital in different life cycle stages

<table>
<thead>
<tr>
<th>Business life cycle</th>
<th>Critical level of human capital</th>
<th>Human capital roles</th>
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<tbody>
<tr>
<td>Existence</td>
<td>Owner</td>
<td>To create a viable business, to attract potential customers, to build relationship with external stakeholders, to instruct and supervise employees.</td>
</tr>
<tr>
<td>Growth</td>
<td>Owner and managers</td>
<td>To achieve high number of production, sales and profit, to penetrate wider market, to handle formal systems and structures, to ensure the efficiency in resources allocation and strategic planning.</td>
</tr>
<tr>
<td>Maturity</td>
<td>Managers and employees</td>
<td>To ensure the well-maintained wealth, to control and coordinate departments.</td>
</tr>
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</table>

Overall, human capital plays an important role in enhancing business performance in all stages of the business life cycle stages. However, Chang and Hsieh (2011) and Liang and Lin (2008) suggested that human capital has a different weight of importance in different life cycle stages. Chang and Hsieh (2011) found that human capital at owner level is more important in the start-up and growth stages than the maturity stage. Meanwhile, managers need to take a significant part in the growth stages by co-operating with the owners and leading the strategy of business. In the maturity stage, managers and employees can run the business without the significant presence of the owner, as control and coordination are already established. Therefore, considering the crucial role of human capital in supporting the
limited physical resources of SMEs, it is important for SMEs to identify and distinguish human capital according to their importance in each stage towards achieving better performance.

3. Conclusion

In conclusion, the vital role of human capital in directly and indirectly improving SMEs’ performance is undeniable. The limitation in physical resources such as lands and machineries becomes challenges for SMEs in competing with their larger counterparts. In today’s knowledge economy, SMEs must rely on workforce with human capital attributes such as education, experience, motivation, talent and skills to attain superior performance. The capabilities of human capital in transforming information into valuable knowledge through other elements such as structural capital indicate that human capital is the main root of firms’ investments. However, the SME’s short lifespan requires the segregating of the roles of intellectual capital into different life cycle stages to suit the needs of each stage. Different stages of business life cycle require SMEs to operate within different systems, strategies and structures. Therefore, as the most important asset, SMEs need to distinguish human capital according to its role in different business life cycle stages to reap the fullest potential of human capital. Hence, the investments in human capital provide SMEs with advantages in value creations and performance superiority.

References


