

# A review of the human resource management dilemma for SMEs: case of central Uganda

## Abstract

The increasing interest in human resource practices is driven by the hypothesis that employees and their management are critical to the success of an organization. Small and medium enterprises (SMEs) contribute significantly to several countries' economies in terms of gross domestic product, employment fraction and exports. Human resource management (HRM) on the other hand plays a pivotal role in the growth and survival of SMEs if systematically understood and implemented in these businesses. As such, this paper aims to analyze factors that affect successful HRM and implementation in small and medium enterprises. Our findings demonstrate that SMEs need to make an effort to close the gap between demand and supply of labor for them to be able to compete with larger firms in the market. We conclude that the factors that affect human resource management are mainly due to the internal organization of these businesses and if HRM is properly implemented, it almost guarantees sustainability and competitive advantage of small firms. An "employee retention model" was formulated which can be used by SMEs to guide the retention of employees hence reducing staff turnover.

**Keywords:** human resource management, small and medium enterprises, employee retention, internal organization

Volume 4 Issue 6 - 2020

**Raymonds Mutumba, Elisa Basika, James Menya, Isa Kabenge, Nicholas Kiggundu, Brenda Oshaba**

Department of Agricultural and Biosystems Engineering,  
Makerere University, Uganda

**Correspondence:** Elisa Basika, Department of Agricultural and Biosystems Engineering, Makerere University, P. O. Box 7062, Kampala, Uganda, Tel +256701909944, Email [ebasika21@gmail.com](mailto:ebasika21@gmail.com)

**Received:** December 15, 2020 | **Published:** December 31, 2020

## Introduction

One of the major limitations in performing a thorough analysis of small and medium enterprises (SMEs) data is the absence of a universal description of what constitutes an SME.<sup>1</sup> Because of this, a number of research efforts have been aimed to streamlining several SMEs definitions.<sup>2</sup> Although there isn't yet universally agreed definition of an SME, the number of workers and size of assets are the most common indicators in developing countries.<sup>3</sup> According to McQuaid,<sup>4</sup> there are two main approaches of defining SMEs; Quantitative approach based upon criteria such as employment, capital turnover, asset size and Qualitative approach based on ownership or control of the business. SMEs therefore are of strategic importance in the economy of many countries owing to their significant contribution to employment, national income and innovation.<sup>5</sup> Human resource management (HRM) on the other hand is the management function that employs policies and strategies that aid in the management of individuals in a work place.<sup>6</sup> It is the management activity taken by state owned enterprises and commercial firms to employ, retain and motivate their work teams.<sup>7</sup> HRM includes policies designed to maximize employee commitment, flexibility, quality of work and people management in achieving the desired set goals.<sup>8</sup> The main aim of HRM in is to make an efficient utilization of existing individuals and drive towards having the most skilled and competent workers than the competition.<sup>9</sup> Having an effective HRM can be a major competitive advantage for SMEs because motivated employees are seen as a valuable resource that has a significant influence on the overall performance of a business.<sup>10-12</sup> According to Bacon et al.,<sup>13</sup> SMEs' possibility of survival and productivity may significantly rise if they adopt HRM practices. However, there is a notable lack of interest with regard to HRM in SMEs.<sup>14,15</sup> This paper thus aims to review the HRM dilemma for SMEs. The next chapters further breakdown HRM and SMEs, compare the two and discuss the SLAP model as a tool to analyze HR problems SMEs.

## Small and medium enterprises distinctive characteristics

To this day, there is no universally accepted definition of small and medium enterprises since the definition varies depending on the industry and country.<sup>16</sup> Barrett<sup>17</sup> defines a small firm as one as having less than 20 employees in the service industry or not more than 100 in manufacturing, though several other studies define small firms as those operating with less than 100 people.<sup>18-20</sup> In Uganda, SMEs are defined basing on both the number of employees and the annual turnover of the business. Ministry of Finance, Planning and Economic Development defines a small business as one that employing a between 5-50 people with an annual revenue turnover of a maximum of Ugx 360M and total assets of a maximum of Ugx 360M. The ministry as well defines a medium business as one employing between 50-100 people with an annual revenue turnover of more than Ugx360M and total assets of more than Ugx 360M.<sup>21</sup> A small firm is also defined by Hashim and Abdullah<sup>22</sup> as employing between 5-19 workers whereas a medium firm employs between 20-199 employees. According to this description therefore, firms with 5-199 employees can be called as SMEs and this is the SME definition that is going to be considered throughout this paper. These enterprises play a pivotal social and economic role in all industries. Mallett and Wapshott<sup>23</sup> argue that smaller firms are not scaled down versions of larger firms. This is mostly because employment relationships in small organizations are approached in environments of greater social and spatial proximity between managers and workers than we find in larger firms. The development of relationships and practices is neither linear nor smooth but more improvisatory, often renegotiating towards the best task of fit. In the sense of diversity, personalities in a small firm largely govern the behavior of the organization<sup>24</sup> because of the locked-in-vicinity characteristics of the work environment. The second important feature that stands out when identifying SMEs is flexibility.<sup>25</sup> Internal flexibility is the company's ability to implement

ideas and redirect resources with ease as need arises.<sup>26</sup> The small size, independence and personal involvement all aid in reducing bureaucracy and creating the SMEs' known reputation of being able to instantly respond to shifting circumstances.<sup>25</sup> External flexibility on the other hand is the ability to influence the firm's operating environment. The small scale therefore almost automatically implies a hindrance when influencing the external environment.<sup>27</sup> These two fundamental characteristics facilitate small firms to readily change their environment by altering their strategic niche whenever the owner deems it necessary. Compared to larger organizations, SMEs leave little to no room for politics and power plays when making pivotal decisions.<sup>28</sup> The diverse human resource needs and practices between small and large organizations are usually determined by the business models represented by these firms.<sup>29</sup>

Organizational structure of SMEs

An organizational structure is the categorized arrangement of levels of authority, duties, rights and communications of an organization. It evaluates how distinctive roles and responsibilities are defined, as well as company communication of personnel best fit for those kinds of tasks. Lunenburg<sup>30</sup> defines the organizational structure as the formal arrangement between individuals and groups regarding the allocation of authority, tasks and responsibilities within the firm. This is best illustrated by an organizational chart and describes how information flows through the different levels of management. An organizational structure solely depends on the company's objectives and strategy.<sup>31</sup> Regardless of the industry, a certain type of structure will automatically emerges as soon as a company hires one or more employees.<sup>32</sup> A dimensional notion of an organizational structure by Schein (1971) approaches organization in three dimensions as; (1) The hierarchical element which comparatively demonstrates certain rank division, (2) The functional dimension which distributes the labor requirements within the organization and (3) The inclusion dimension

which represents the current position of an employee regarding the overall organization of the firm.<sup>33</sup>

Human resource management in SMEs

Until recently, HRM had been seen as irrelevant for smaller entities and there is limited direct research about the HRM practices and policies in SMEs.<sup>34</sup> On the other hand, several studies have covered HRM practices in larger firms which might arguably imply that researchers deem HRM in SMEs unimportant. It can therefore be stated that HRM is mostly informal in SMEs compared to the more formal employment practices in large corporate entities.<sup>35</sup> A survey conducted by the Confederation of Indian Industries indicated that 20% of medium and 80% of small sized businesses have no Human Resource departments. This therefore implies that the increasing attention on human resource management in small and medium enterprises is a comparatively recent phenomenon.<sup>5</sup> HRM practices in small firms are largely understood as informal and improvised.<sup>36,37</sup> Heneman et al.,<sup>38</sup> explain that SMEs may be confronted with time constraints or may lack awareness of the importance of HR practices to business performance. Newman & Sheikh<sup>39</sup> studied the HR factors in Chinese small firms and found strong relationships between firm age and size with the adoption of best HR policies. Wu et al.,<sup>40</sup> also examined SMEs in UK from the HR perspective and realized that the requirement of highly skilled workers is rather greater in SMEs than in other firms. This is because human capital directly affects globalization of business hence HRM is fundamental throughout the growth process of SMEs.<sup>41</sup> Julien<sup>42</sup> provided a detailed overview of surveys done on a several HRM related topics in SMEs illustrated in Table 1. The study concluded that HRM practices exist and are applied in small businesses too, even though they are generally informal and extremely diverse thus resisting generalization. This diversity is affected by several factors for example company location; where legal factors are at play that largely employment policies of all firms.

Table 1 General distinction in Human resource management practices between small and large firms<sup>42</sup>

(What should be the heading here!)	Higher in large firms	Higher in small firms
Formality	<ul style="list-style-type: none"><li>manpower need planning</li><li>Introduction of new staff</li><li>appraisal and evaluation</li><li>training</li><li>tests</li></ul>	How come this cell is empty?
frequency of use	<ul style="list-style-type: none"><li>HRM training</li><li>external recruitments assistance</li></ul>	<ul style="list-style-type: none"><li>evaluation</li><li>Internal referrals</li><li>References</li><li>use of job try-outs</li></ul>
Employee benefits	<ul style="list-style-type: none"><li>wages and fringe benefits</li></ul>	<ul style="list-style-type: none"><li>satisfaction</li></ul>
work environment	<ul style="list-style-type: none"><li>participatory management</li></ul>	<ul style="list-style-type: none"><li>informal, personal atmosphere</li><li>open communication</li></ul>

Relationship between recruitment and SMEs performance

Hull<sup>43</sup> states that one of the most vital and challenging decisions faced by business owners is recruiting employees. Hiring the right employees is paramount for business, as they are likely to be more productive and propel the organization forward.<sup>44</sup> Fasbender & Wang<sup>45</sup>

also emphasize that recruiting great employees is fundamental to the success of any business because hiring employees that cannot meet the demands of the business will eventually cost the organization in terms of the extra investment required to motivate them. The fact that smaller firms have fewer employees makes it more difficult for them to build an independent internal labor market with both demand and supply forces at play. SMEs are also less likely to use recognized channels of

recruitment than larger firms which would explain the lower presence of personnel specialists in smaller firms.<sup>46</sup> The fact that generally SMEs are less likely to employ formal recruitment procedures creates a gap for discrimination in recruitment which affects an optimum recruitment decision that would be made.<sup>47</sup> Because of the necessity to import new skills into the firm, a management study by DeVaro<sup>48</sup> showed that larger firms are more likely to give preference to internal applicants when filling vacancies than smaller firms. SMEs are also less likely to adopt modern methods of recruiting which is why potential candidates will have less information about the available job opportunities across the board. Omolo et al.,<sup>6</sup> reviewed the relationship between selection and performance of SMEs in Kisumu Municipality Kenya and found a correlation between the two. From the study, it was established that recruitment and selection are significant determinants of the performance of the SMEs in Kisumu Municipality. The adjusted *R square* statistic indicated that recruitment habits accounts for 40.8% of the variation in the performance of the SMEs. Whereas this means that it is possible to increase the performance of SMEs in Kisumu city by about 40.8% through effective recruitment criteria, it also implies that SME performance can be lowered by the same magnitude if the poor recruitment habits are allowed to prevail. These findings fit well with the views of Acikgoz<sup>49</sup> who describe recruitment as the process of selecting and attracting competent people for a task which implies that if done well, it is capable of enhancing growth of the organization. Selection and recruitment is therefore a major part of an

organization's resourcing strategy as it build the team required for an organization to survive and succeed through the short to long term.

### The strategic labor allocation process model (SLAP-model)

The major assumption of the model by Bax (1998) is that the central objective of HR managers is to establish a balance between the demand and supply of labor. This means that every production process demands a certain number of specific tasks for people to accomplish formulating the qualitative and quantitative dimensions of the demand for labor within that organization. On the supply side, the HR manager needs a specific number of people with the required skills to perform the tasks at hand.<sup>50</sup> To meet the demands of the tasks, the manager can use people already employed by the organization or can hire more people.<sup>51</sup> This means that modern HR managers are constantly engaged in managing processes of labor allocation within the company which makes the SLAP-model (Figure 1) relevant in SMEs. Several factors determine the degree of play to manipulate the dimensions that form the supply and demand side of the process hence HRM is tasked to deal with constraints produced by external organizations. Next to these factors, one can also identify the economic, socio-cultural and technological variables which affect the labor allocation process inside the firm yet all these factors cannot be controlled by the individual firm.<sup>52</sup>

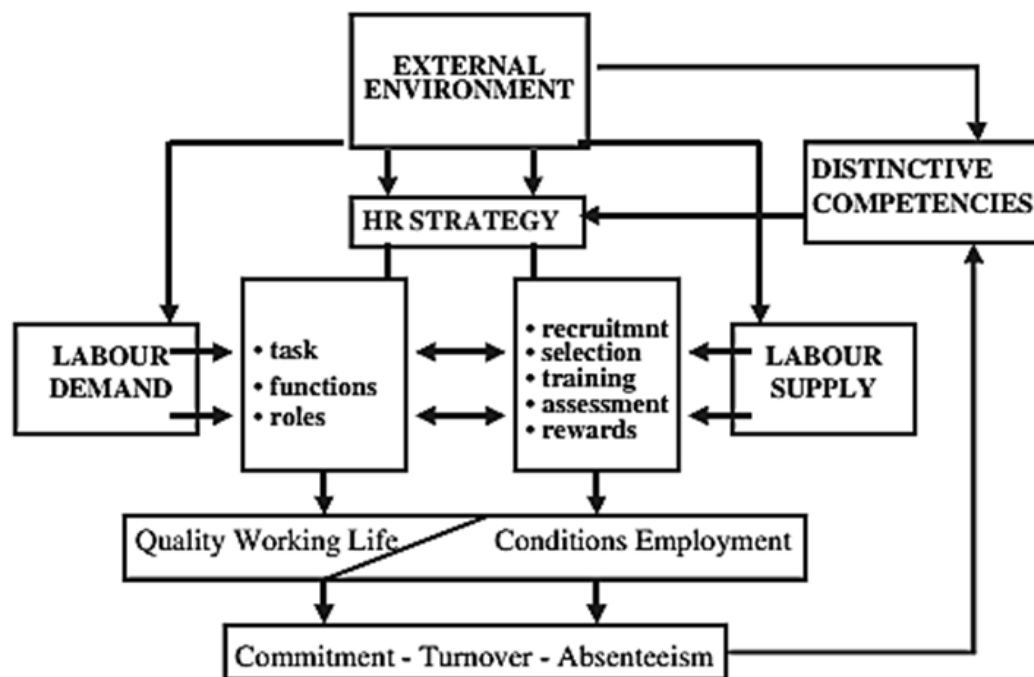


Figure 1 The strategic labour allocation process model (SLAP).<sup>50</sup>

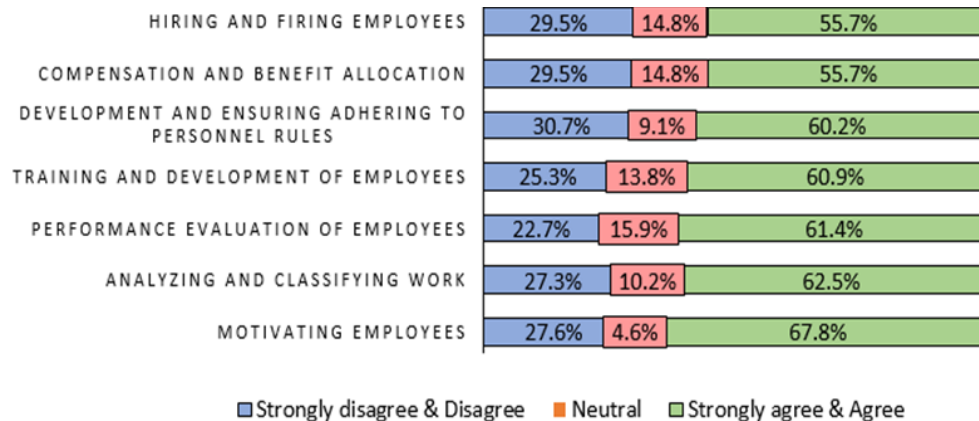
According to the logic of the SLAP-model, although rather contrary to concepts of personnel management, the fit between demand and supply is not solely achieved by manipulating the supply side of the labor market. This is because recruitment, training, selection and rewarding are only one side of the story meaning, the HR management should also attempt to redesign the production process to close the gap between demand and supply.<sup>53</sup> The model further builds on the 'bundling hypothesis' by MacDuffie (1995) which states that HR practices affect performance, not individually, but as interrelated elements in an internally consistent HR bundle or system.<sup>54</sup>

### The role of human resources in SMEs

A competent employee is arguably the most important asset for any organization. It is thus in the best interest of any company irrespective of the size to critically focus on internal human resource development and management.<sup>55</sup> The main objective of HR is to create and maintain an efficient workforce that is able to achieve company objectives.<sup>56</sup> A number of reviews have both theoretically and empirically addressed the relationship between human resource management and firm performance which speaks more about the realized significance

of the relationship.<sup>57</sup> Effective HRM has also been found to raise productivity of employees performing at their peak hours. This reduces reducing costs in the case of employees working from home leading to employee fulfillment which in turn almost certainly guarantees firm performance backed by work commitment and trust.<sup>58</sup> Also, businesses with successful HRM processes are likely to have lower employee turnover rates hence better skills development internally.<sup>59</sup> According to Coyle et al.,<sup>7</sup> the effective management of employees

is the single most complex yet most important task that managers face. A study by Hung et al.<sup>11</sup> that looked at descriptive analysis on which specific areas of HRM are important to South African SMEs was carried out, this revealed more insight about the relationship. Participants selected their level of agreement or disagreement with the importance of several HR management tasks. The levels of agreement were reduced to a three-point scale due to an inadequate sample size. The study results are represented in the bar illustration in Figure 2.



**Figure 2** Levels of agreement with the importance of HR management tasks.<sup>11</sup>

According to Figure 2, 55.7% of the respondents strongly agree or agree that all of the listed HR management tasks were important for a business. During initial growth stages, SMEs are more vulnerable as they encounter many difficulties due to lack of both financial and human capital resources. Most SMEs initially focus on the financial and marketing aspects of their business since they seem like the obvious starters but a later stage however, HR becomes a major concern.<sup>60</sup> Ngibe & Lekhanya<sup>61</sup> estimates that up to 63% of South African SMEs do not make it past the second year of trading. This makes HRM a key aspect in the survival of SMEs in South Africa and can be generalized for the business economy in general.

## Factors that affect successful human resource management in SMEs

Basing on case studies of small business owners, Mazzarol<sup>62</sup> developed a theoretical model of the HRM process for growing SMEs. This presented policies and practices as directly shaped by the firm's structure, work environment and the owner-manager characteristics within the firm. The three factors were further influenced by the external market conditions within the firm's operating sector. Mohammad<sup>63</sup> studied the factors affecting HRM practices in a sample of Palestinian organizations and the factors investigated were the number of employees, profitability and operating sector. Findings revealed that larger firms use more formal HR practices than small firms do. Also, studies revealed that nongovernmental organizations were more involved in the implementation of HRM practices than private and public organizations regardless of their size. The study by Bayo & Merino<sup>64</sup> provided evidence about variations in HRM practices according to firm size. They found that the presence of a HR department is another important factor that influences the variations in HRM practices in SMEs and partly an also determined by firm size. HRM practices is seen through existence of a HRM department and HR manager.<sup>65</sup> A conceptual model proposed by Kok & Uhlaner<sup>66</sup> showed how organization contextual variables may influence the formalization of HRM practices in SMEs using insights from resource based view of the firm, behavioral perspective and transaction cost

economics. Company size, growth strategy and collective labor organization were viewed as indirectly influencing the formalization of HRM in SMEs. Whereas a considerable number of studies indicate that firm size has a positive significant influence on HR practices,<sup>63,67</sup> other studies however show that organization size has a limited effect on HR practices.<sup>68</sup> Other external environmental factors include activities of competitors, government regulations, type of industry and sector were also found to affect HRM practices in SMEs. Arthur & Hendry<sup>27</sup> suggested a model of how prime factors identified may affect HRM in smaller firms. Basing on the model, adoption of human resource management practices was influenced by firm size, ownership type, legal regulation, and financial resources.

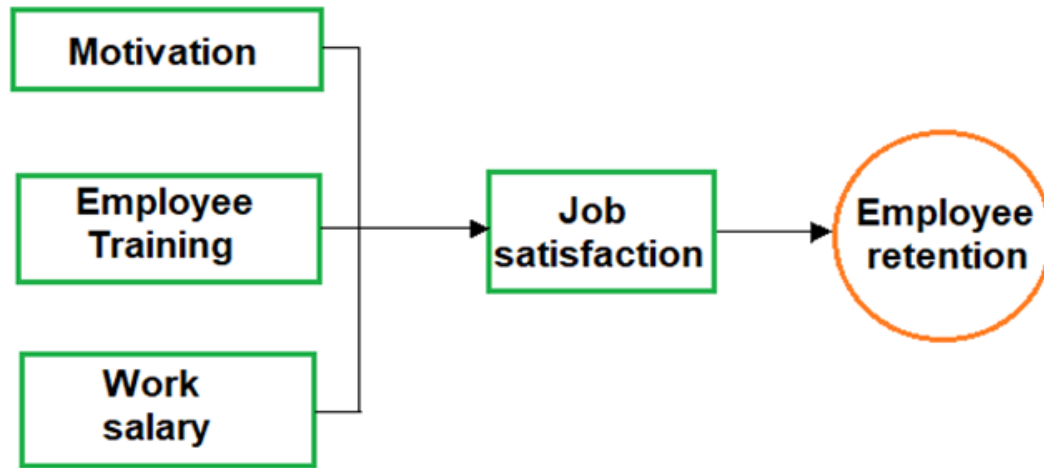
## Analysis of literature

One of the major challenges faced by SMEs in Uganda is the high staff turnover. Coupled with an insufficient internal labor market, this becomes a major hindrance for the survival of SMEs in the short and medium run. It can be hypothesized that motivation of employees stems from their underlying relationship with a firm's owners. This means that beyond creating just a formal bond, a small firm manager is required to build a deeper relationship with an employee that would make them feel like they are a part of the business. This encourages personal management throughout the firm even in cases where the owner isn't around to supervise operations. Employee motivation can be verbal in form of a complement or an extra pay as a token of appreciation for a job well done. Even though isolated formal training program may be costly in terms of time and money, on job trainings in small firms have proven to be very effective in getting new employees up to speed.<sup>69</sup> A case study done by Choi & Dickson<sup>70</sup> revealed that a company was able to reduce the overall annual turnover rate significantly from 89.6% in 2002 to 56.7% in 2003 through management training programs. This means that through on job employee training, the company successfully retained almost 40% of the employees it would have lost based on the 2002 trend. It can therefore be argued that organizations that invest in employee training are more likely to have lower employee turnover and higher



productivity compared to those that do not. On a larger scale, salary is arguably the most important determinant of employee retention in small firms. This can be either a good or constant pay but, in most cases, an employee in Uganda will strongly consider the amount of salary received above other factors before moving to another. When

a well-motivated employee is trained and given a satisfactory salary, it is very likely that that worker will stay on the job for a longer time compared to one that is not. This tri-factor thus becomes the basis of the *Employee Retention model* illustrated in Figure 3.



**Figure 3** Illustration of the Employee Retention model.

The model can mathematically be represented as  $ER = f(K_1, K_2, K_3)$ .

Where  $ER$  = Employee retention,  $K_1$  = Motivation,  $K_2$  = Employee training and  $K_3$  = salary. According to the model, employee retention comes from job satisfaction which is a function of motivation, training and work salary. The model can also be used to predict employee turnover by monitoring the balance between the three factors over different employees. Since compromising on any of the three factors increases the probability of losing a worker, this model can therefore be used by SMEs to retain employees by ensuring a stable balance across the three factors. A small fabrication company MECPOWERS Agri (U) Ltd in Namanve industrial Park Uganda with 13 employees was significantly affected by staff turnover in the past year at a rate of 38.5%. This could strongly be attributed to the fact that the company is still in the initial growing stage hence not financially prioritizing employee trainings and staff motivation. The Employee Retention model in this case would be applied from three directions; scheduling motivation activities for staff, carrying out employee trainings and establishing a satisfactory salary scale for all employees. Prioritizing these three factors would possibly be a means to reducing the staff turnover rate through improving the employee retention.

## Conclusion

The effect of recruitment, performance appraisals, compensation and training contribute individually and collectively to the performance of the SMEs. The study emphasizes that managers and owners are big players in the survival of SMEs since decision making entirely lies on their shoulders. By understanding the supply and demand dynamics of labor within an organization, small firms are able to both attract and retain competent workers which improve their productivity and competitiveness. The results of this review drove us to the recommendation that SMEs must encourage and invest in HRM for a sustainable growth. For as long as most managers believe that people management is just common sense, SMEs will continue to die within the first year as is the trend until the importance of HRM is fully conceptualized.

## Acknowledgments

None.

## Conflicts of interest

Authors declare that there is no conflict of interest.

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