HUMAN RESOURCE PRACTICES AND ORGANIZATIONAL PERFORMANCE. INCENTIVES AS MODERATOR

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Abstract

It has become clear that firm performance has important implications for employees and organizations as confirmed by past researchers. This study examines human resource practices and the impact of incentives on manufacturing companies in the Malaysia context. Three types of human resource practices namely, performance appraisal, training, and information technology have been chosen as the focus of this research with the presence of incentives as moderator on organizational performance. This is imperative in order to ensure the successful management of employees and also to improve productivity and achievements of an organization. The research uses a sample of eighty-five firms in Sarawak, Malaysia, voluntarily participated in this study. The results have indicated that the two components of human resource (HR) practices namely, training and information technology have direct impact on organizational performance. It was found that incentive is positively related to organizational performance but did not moderate the relationship between both HR practices and organizational performance. Implications of the findings, potential limitations of the study, and directions for future research are suggested.

Keywords: *HR practices, organizational performance, incentives, training, performance appraisal, information technology*

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1. INTRODUCTION

Organizations are now evolving toward structures in which rank means responsibility but not authority, and where the supervisor's job is not to command, but to persuade (Drucker (1999). Blickle (2003) contended that, in order to be effective, it is critical for managers to influence their subordinates, peers, and superiors to assist and support their proposals, plans, and to motivate them to carry out with their decisions. Previous researchers on managerial performance such as Kanter (1982) and Pavett and Lau (1983) pointed out that an important component of successful management is the ability to influence others. There is a growing body of work on HR practices and organizational performance (e.g., Li, Zhao, & Liu, 2006; Sanchez, Jimenez, Carnicer, & Perez, 2007; Lin & Chen, 2007) which showed an important linkage between HR practices and organizational performance. In addition to that, Brower, Schoorman, and Tan (2000) stated that effective managers do not work in isolation from their subordinates, instead they would prefer to work with their subordinates, and the nature of the relationship between the manager and subordinate has been acknowledged as complex, interactive, and exist reciprocity in the dyad.

Despite the enormous breadth of the literature on the relevance of HR practices to organizational behavior in general, and to an understanding of organizational performance in particular, research studies of HR practices, incentives, and organizational performance are not well integrated. Having said that, a better understanding of these effects will offer insights into positively influencing organizational performance such as sales revenue, profitability, net asset return on investment (ROI), and market share. In addition, most prior researches focused on cases in Western countries, while very few researches on HR practices have focused on emerging economies such as Malaysia, hence, it will be interesting to see the much different research results on HR practices on organizational performance due to the huge differences in the market environment and the management practices between Western counties and Malaysia.

The major concern of this research is to determine whether HR practices and organizational performance are significantly linked in the manufacturing companies situated in Malaysia. Although HR practices and organizational performance have been widely studied, their distinct relationship has received limited empirical scrutiny, especially in the case of small and medium industries (SMIs). To fully understand, explain, and predict organizational performance, it is imperative to investigate how incentives operate as a moderator on organizational performance. The endeavor to embrace incentives between HR practices on organizational performance was undertaken because it was deemed that more precise conclusions concerning the effective use of HR practices could be revealed, which would be of more value, theoretically, and empirically. Hence, this research attempts to answer the following questions:

(i) Do HR practices directly predict organizational performance?

(ii) Does incentives significantly moderate the relationship of HR practices and organizational performance?

2. THEORETICAL BACKGROUND

2.1. FIRMS PERFORMANCE

Firm performance has been researched in the past extensively. Some of the financial indicators which determine firm performance are like productivity, profitability, turnover etc (Nickell, 1995; Estrin & Rosevear, 1999). Past researchers such as Noe, Hollenbeck, Gerhart and Wright (2000) contended that human resource management (HRM) is known as the central business concern, that shapes the behavior, attitudes, and performance of the employees, hence, HR practices are important tools for organizational performance. Hom and Griffeth, (1995) posited that when employees are not committed to their firms, this would lead to reduction in productivity, poor service quality provided, lost business opportunities, and subsequently increased administrative burden to the companies. Ramsey, Scholario, and Harley (2000) who have conducted a research to investigate the link between HR and productivity found that HR practices have in fact improved the performance of the companies. Other researchers who have conducted similar researches are Arthur (1994) and MacDuffe (1995). This is further supported by Horgan and Mohalu (2006), Bashir and Khattak (2008) that some selected HR practices are associated with better employee performance. However, the influence of HR practices is found to have affected firm performance when it involved and allowed employees to contribute on organizational outcomes (Wright, McCormick, Sherman, & McMahan, 1999).

The impact of HR practices on organizational performance were noted in past researches where HR practices were linked to lower employee turnover (Huselid, 1995), better employees' organizational commitment (Wright, Gardner, & Moynihan, 2005), and improved on the work skills and behaviors of the workers (Wright, Gardner, Moynihan, & Allen, 2005). It was noted that most of the research on HR practices mainly revolved around developed countries. It is interesting to investigate the impact of HR practices on employee performance since developing countries are not fully comparable to the situation in Western parts of the world (Tessema & Soeters, 2006).

2.2. INCENTIVES

Miller and Whitford (2007) argued that the role of incentives has expanded considerably in view of the fact that it has been studied rigorously in principal-agency theory. Past researchers (e.g., Prasnikar, Ferligoj, Cirman, & Valentincic,

1999) have found that there is a strong relationship between management incentive and risk-taking which would subsequently lead to better firm performance. The role of incentives on behavior has been well documented in the literatures. Incentives come in the form of monetary rewards or other types of incentive-based remuneration such as stock option, share ownership, rewards, and bonuses. Employees' performance is substantially better under incentive plans which are substantiated by supportive innovative work practices (Ichniowski, Shaw & Prennushi, 1997).The conceptual model of this study is based on agency theory which explained that the risk-neutral principals would prefer their agent to maximize the firm returns (Baysinger & Butler, 1985). Hence, this study grounds the conceptual model with agency theory in order to better understand whether incentive would serve as a moderator in affecting firm performance. On the other hand, Armstrong (2001) linked incentives to the achievement of previously set targets which are designed to motivate people to be more productive to achieve high level of firm performance. Ian, Jim and Will (2004) concurred that incentives should be incorporated to organization strategies as seen as a technique which organization can apply in order to achieve higher productivity in accordance with goals.

2.3. EMPLOYEE TRAINING

Past researchers have found evidence on the impact of training on productivity and where employees and employers were able to share the benefits from training (Conti, 2005; Dearden, Lorraine, Reed & van Reenen, 2006; Ballot, Gerard, Fakhfakh, & Taymaz, 2006). On the other hand, Lynch and Black (1995) whose research focused on the generality of training to organizational performance revealed that only off-the job (general) training improves on the performance whereas on the job training does not. This is further concurred by Barrett and O'Connell (2001) that general training has positive impact on firm performance whereas firm-specific training does not. On the other hand, Nankervis, Compton and McCarthy (1999) were of the opinion that effective training would not only equip employee with most of the knowledge and skills needed to accomplish jobs, it would also help to achieve overall organization objectives by contributing to the satisfaction and productivity of employee. Past researchers such as Drummond (2000) revealed that training provides adequate criteria to an individual to perform better in a given task and subsequently contributes to the firm performance (Rothwell, Sullivan & McLean, 1995). However, Drucker (1999) commented that training is an expensive way of attempting to enhance human productivity.

2.4. INFORMATION TECHNOLOGY

Technological innovation was found to have strong impact and influence on firm performance (Nohria & Gulati, 1996; Lin & Chen, 2007). As stated by Hassan (2007), globalization and technological advancement are moving organizations to develop new business strategy and future directions. According to

Pratali (2003), technological innovation helps to improve the competitiveness of the companies and subsequently increase company value. Hitt, Hoskisson, and Kim (1997) further elucidated that the technology capabilities of the firms has vital influence on long-term performance of the firms. In addition, Dave and Wayne (2005) concluded that human resources regularly find new application of technology to improve their efficiency and their effectiveness in an effort to influence firm performance. Some scholars commented that innovation has mixed result. Some said that innovation leads to long-term growth for the companies (Leifer, O'Connor, & Rice, 2001; Li, Zhao, & Liu, 2007), while others commented that innovation will result in resource inefficiencies (Foster, 1986).

Nonetheless, past researchers (McLaughlin & Harris, 1997) found out that technology account on business is minimal as many firms which incorporated technology to do transaction work, surprisingly, has a relatively low impact on performance. As stated by Mumford (2000), if firms emphasize too much on outcomes, they will tend to develop low-level technological innovation in order to avoid high uncertainty.

2.5. PERFORMANCE APPRAISAL

Comprehensive performance appraisal system forms the basic yardstick for assessing an individual's performance, highlight potential for future career advancement, most importantly, to improve the performance (Mullins, 2002). Lecky (1999) defined performance appraisal system as a benchmark which is set against specific task performance, define and evaluate current performance. It requires the input and output such as remuneration, pay rise, level of expectation, promotion and managerial planning. In addition, it is a merit rating which should be beneficial to both parties and must be constantly reviewed to suit the requirement. The system explicitly mentioned the individual's needs and thus has far reaching effect of improving productivity. Dave and Wayne (2005) argued that performance appraisal is an instrument whereby an individual was retaliated by the assessment due to certain personal dissatisfaction, and it has adversely affected future performance. Nonetheless, study by Hassan (2007) has discovered that in Malaysia, the focus on employee development has yet to be the centre stage in organizations.

3. METHODOLOGY

3.1. SAMPLE

With an aim to generalize on firms in Sarawak, the population of the present study consists of manufacturing companies located in Sarawak, Malaysia. Currently, the manufacturing sector is considered as one of the cornerstone of

Malaysia's economic diversification strategy. The researcher has selected large scale manufacturing companies in Sarawak using convenient sampling. Two hundred sets of questionnaires were distributed to executives working at manufacturing companies in Sarawak, however only 85 copies of questionnaires were usable for analysis.

3.2. MEASURES

The questionnaire used in this study consists of three parts. Section 1 required the respondents to rate a total of 20 items on the four components of HRM namely, training, incentives, information technology, and performance appraisal which were extracted from past researches such as Snell and Lau (1994), Kuratko, Hornsby, and Naffziger (1997), and Zahra, Neubaum, and Huse (2000). Incentive questions such as incentive increases individual material fortune, incentive increases opportunity to gain economic interest in the firm were asked.

On the other hand, Section 2 contained 5 items of questions pertaining to firm performance based on the research of Daily and Johnson (1997). For example, questions such as firm performance is associated with increasing rate of sales revenue, firm performance is measured by increasing rate of profit, firm performance is related to increasing rate of market shares were asked. The respondents were asked to describe on a 7-point Likert scale with: 7 = strongly agree, 6 = agree, 5 = slightly agree, 4 = neutral, 3 = slightly disagree, 2 = disagree, and 1 = strongly disagree. In addition, personal and demographic data relating to age, gender, race, length of employment, academic qualification, monthly gross salary, job position, and industry sector were also collected.

4. FINDINGS

As shown in Table 1, it contains items regarding the demographic of the respondents such as gender, age, education background, working experiences, monthly gross salary, etc. Table 1 displays the characteristics of the 85 respondents in the survey. In terms of gender, respondents were fairly evenly distributed with 40 male respondents (47.1%) and 45 female respondents (52.9%). Of the 85 respondents, the vast majority were Chinese (49 or 57.6%), followed by Malays (20 or 23.5%), and others (16 or 18.8%). Of the total sample, 21 (24.7%) respondents were engaged in the industrial sector, while 17 (20%) were from the consumer sector, 9 (10.6%) were in construction sector, and the rest numbering 29 (34.1%) and 9 (10.6%) worked in the trading or services and others, respectively. In addition, 48 (56.4%) of them were concentrated in lower level management and below, while 37 (43.6%) were from middle level of management and above.

The Cronbach's coefficients alphas for HRM factors ranged from .75 to .92, respectively, which is clearly acceptable (Nunally, 1978). Whereas standard deviations of the variables were either close to or exceeded 1.0, indicating that the study variables were discriminatory. The firm performance retained all the 5 items which accounted for its Cronbach's coefficients alpha of .83. Generally, the values indicated good internal consistency estimate of reliability of the grouped items for both factors. The findings of the reliability analysis are summarized in Table 2.

Table 3 illustrates the intercorrelations among the subscales obtained using Pearson correlation to determine whether the subscales were independent measure of the same concept. Generally, the values indicating intercorrelations among the predictor variables were low, ranging from .29 to .46 ($p<.01$), thus indicating the independence of the scales used for measuring the predictors. In addition to that, a number of the predictor variables were noted to be significantly correlated to the criterion variables ranging from .35 to .52, which were considered as low intercorrelation values.

A 3-step hierarchical multiple regression analysis was carried out to test the direct and moderating effects of HR practices, incentives, and organizational performance. The purpose of hierarchical regression is to get information regarding the form or the pattern of the relationship between the variables. Table 4 presents the results of the analyses. As noted in Table 4, step 1 and step 2 were found to be significant ($p<.01$). Hence the direct effects of the predictors significantly explained 31% and 40% of the variability in organizational performance. Hence, the analysis revealed that two dimensions of HR practices namely, information technology, employees training, and incentives were significantly predicting organizational performance at at .29 ($p<.01$), .30 ($p<.01$), and .35 ($p<.01$), respectively.

This study suggested an interesting pattern of relationships between HR practices and organizational performance. Factors such as information technology, employees' training, and incentives were found to have contributed positively towards organizational performance. On the other hand, incentives were not found to have moderated the relationship between HRM and organizational performance. This was rather unexpected. In other words, if the organization established a good HR system, organizational performance can be increased without the need to incorporate incentives.

This analysis helps us to shed light on the impact of HR practices on organizational performance. Previous researches assert that firms possessing HRM capability are more likely to increase the organizational performance; nonetheless, this study reveals that the direct relationship between HR practices and organizational performance was not moderated by incentives provided by the companies. Hence, this research contributes to existing HRM studies in its focus on HRM and incentives capabilities.

5. DISCUSSION AND CONCLUSION

This paper attempts to analyze the impact of HR practices by focusing on the relationship between three of HR indicators on organizational performance, with the presence of incentives as moderator, in manufacturing companies in Malaysia, which is a developing Asian country.

Boxall (1995) contended that HR practices vary in different societal contexts and none best practice can be applied universally. Thus, it is suggested that organization should define the desired performance outcome as HR practices are different according to the performance measures (Khatri, 2000).

It is interesting to note that information technology, employees training, and incentives showed a strong and significant relationship with organizational performance. This could be due to the fact that in most developing countries, the employees are not as highly paid as those workers in developed counties, thus the workers are more concerned with HR practices which could subsequently increase their earnings (Bashir & Khattak, 2008). Hence, incentives given to the employees are found to directly affect the organizational performance rather than moderating the relationship between HR practices and performance.

Considering the fact that information technology, employees training, and incentives are directly affecting the organizational performance, these practices are important indicators which must be linked with performance to have better organizational performance. On the other hand, information technology is also found to be instrumental in achieving better firm performance. As commented by Dave and Wayne (2005), information technology plays an important role in many global firms. In the same vein, Sorge et al. (1995) had discovered unbreakable link between information technology and firm performance. They concluded that the advent of technology has indeed helping many of the firm to turnaround in the aspect of performance. As stated by Preece (2000) and concurred by other researchers (e.g., Abernathy & Utterback, 1978; Foster, 1986; Hill & Rothaermel, 2003) information technology increases effectiveness and outputs by cutting short transaction time for tasks. The result was also supported by Mullins (2002) that training is the key element in influencing the performance of a firm.

On the other hand, as stated by Bloor (2008) employees do not respond simply to financial incentives as other kinds of non-financial incentives such as trust, duty, reputation within peer groups and communities etc. are equally important. This could probably due to the fact that 'high powered' incentives such as from market transactions, and 'low powered' incentives found in bureaucratic setting (Frant, 1996) which could have contributed to this result. In the same vein, incentives was not found to moderate the relationship between HR practices and organizational behavior. This is most likely due to the fact that the willingness to perform and achieve better organizational performance is influenced by conformity to collectivity-oriented behavior, which is common in Asian countries. In addition, this finding is further supported by past researchers (e.g., Costigan, Insinga, Berman, Kranas, & Kureshov, 2007) in a cross-cultural study that employees' affect-based trust behavior is associated with employees' enterprising behavior; hence incentives offered by the companies do not moderate the relationship between HR practices and their level of performance in the companies.

Interestingly, the findings have demonstrated that employee training and performance appraisal correlate with better firm performance. This is not surprising as past literatures on the wage effects of general and specific training have shown conflicting results (Lynch, 1992; Lowenstein & Spletzer, 1999; Budria & Pereira, 2007).

The study has proven strong positive correlation values for HRM determinants such as information technology, training, and incentives with organizational performance exist. This denotes that, employees value incentives and information technology training more importantly than appraisals given by the companies. These findings were consistent with previous research results that allowance of self-growth and independence in the workplace can enhance performances of companies (Dudeck & Hall, 1991; Gruber, 1996; Mumford, 2000).

The upshot for management development efforts is that managers in some functional areas should be educated on the many different types of HR practices that would actually work best with their employees over the long haul, such as organize workshops and training sessions for managers and supervisors.

6. LIMITATION AND FUTURE RESEARCH

While this study makes a number of contributions, it also has a number of limitations. The major limitations of this study revolve around sampling issues as the small sample size reported here may have affected the current results. Even though the findings might have indicated certain results, these findings cannot be construed as an independent model to ensure performance of the companies. Nonetheless, this model has provided insight into possible reasons for organizational performance. In addition to that, the study focused on perceptions of organizational performance and HR practices as reported by the employees. Hence, it is subject to common source and common method bias. Future research should include other workplace dimensions such as organizational politics and managerial practices which could have affected the organization performance. Furthermore, the research has not included other moderator effect of contextual variables such as the relationship between the supervisors and subordinates on firm performance which could be an important factor since the relationship between the supervisors and subordinates can improve the organizational performance.

Comparative studies across professions, cultures, and industries are needed in order to truly understand the many constructs included in this study. Clearly, a longitudinal approach would have placed the researcher in a better position to draw causal conclusions. Therefore, only conclusions or discussions of the general relationships between the variables of interest could be drawn.

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Demographic Characteristics		Frequency	Percentage
Age	<20	3	3.5
	21-30	20	23.5
	31-40	39	45.9
	41-50	14	16.5
	Above 50	9	10.6
Gender	Male	40	47.1
	Female	45	52.9
Race	Malay	20	23.5
	Chinese	49	57.6
	Indian	0	0
	Others	16	18.8
Supervisor Gender	Male	50	58.8
	Female	35	41.2
Year with present organization	<10	36	42.4
	11 to 20	27	31.8
	21 to 30	15	17.6
	31 to 40	7	8.2
Position in the company	Clerical	28	32.9
	Lower level of management	20	23.5
	Middle level of management	26	30.6
	Top level of management	5	5.9
	Others	6	7.1
Sector	Consumer products	17	20
	Industrial products	21	24.7
	Construction	9	10.6
	Trading or services	29	34.1
	Others	9	10.6

Table 1. *Demographic Profile of the Respondents*

Variables	Cronbach's alpha
HRM factors	
Employee training	.75
Incentives	.78
Information technology	.86
Performance appraisal	.92
Firm performance	.83

Note. N = 85

***Table 2**: Results of Reliability Analysis*

Variables	1	2	3	4	5
Incentive	1.00				
Information technology	.31**	1.00			
Training	.44**	.34**	1.00		
Performance appraisal	.20*	.46**	.29**	1.00	
Firm performance	.52**	.45**	.44**	.35**	1.00

Note. *N* = 85 *p<.05, **p<.01.

***Table 3**: Pearson Correlations for HRM and Firm Performance Measures*

Variables	Std Beta Step 1	Std Beta Step 2	Std Beta Step 3
Model Variables			
Information Technology	.29**	.23*	1.55*
Training	.30**	-.17	-.38
Performance Appraisal	.13	.13	-.92
Moderating Variable			
Incentives		.35**	.43
Interaction Terms			
Inc*Information Technology			-1.72
Inc*training			.70
Inc*performance appraisal			1.20
R^2	.31	.40	.42
Adj R^2	.29	.38	.38
R^2 Change	.31	.10	.02
F Value	15.15**	16.16**	1.13

***p< 0.01, *p< 0.05*

***Table 4**: Hierarchical regression results using incentives as a moderator in the relationship between HRM factors and firm performance*