

Human Resources Management Demands and Challenges in Small and Medium Scale Enterprises

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ABSTRACT

The pivotal role of employees, and their effective management for small business survival, cannot be overemphasized, as it has been found that newer and smaller enterprises rely more heavily on individual employees' contribution to the success of their organization. This review is exploratory in nature. Its objective is to highlight the special human resource needs of small and medium businesses, and identify challenges to effective HRM in such businesses. Data used were mainly from the secondary sources. Evidence from available literature however indicates that there is a dearth of research on the HRM/Entrepreneurship interface. To this end, the government has been making efforts to nurture entrepreneurial development, by formulating policies and establishing agencies to create an enabling environment for the operation of these businesses. However, many small businesses find it difficult to survive and end up closing shop, after a short while. Findings reveal that business size, priorities, informality, and nature of the entrepreneur, were peculiar challenges that hindered effective HRM in small businesses. The paper concluded by advocating the entrenchment of effective HRM practices in small business operations, as a way of ensuring their survival, thereby facilitating sustainable entrepreneurial development in Nigeria.

***Keywords:** HRM Demands, Challenges, Small and Medium Scale Enterprises, Sustainable Entrepreneurial Development*

INTRODUCTION

In Nigeria today, there is an increasing focus on entrepreneurship as a means of tackling the rising scourge of unemployment, particularly among graduates and school leavers. It is a widely held fact that Human Resource Management (HRM) practices constitute an important driver of success in any business organization (Hayton, 2005). This crucial role of HRM is underscored by Werner, Schuler, and Jackson (2012), by declaring that, even though many factors influence the success of an organization, it is indeed very difficult for an organization to succeed without managing its human resources (HR) effectively. For small businesses, the situation is even more critical, because smaller businesses rely more heavily on individual employee's contributions than their larger counterparts. As noted by Messersmith and Rutherford (2010), each individual within the smaller firm contributes to the firm's bottom line in more direct ways, than in larger organizations. Bau and Dowling (2007) lend further credence to the centrality of HRM, by describing it as an especially important activity for entrepreneurial firms; as such, firms often start their businesses based on the competitive advantage of the intellectual capital of their employees. According to Williamson, Cable, and Howard (2002), building up the right management team and hiring

the first employees for such companies, is often a difficult but very crucial task. Despite the recognition of HRM as a critical factor in the success of both large and small businesses, most of the research in existing literature have concentrated mainly, on large businesses, leaving a wide gap to be filled in terms of empirical research on the interface between HRM practices and entrepreneurship (Gringore, 2008; Bau and Dowling, 2007; Ukenna, Ijeoma, Anionwu and Olise, 2010; Cardon and Stevens, 2004; Rutherford and Tocher, 2009; Messersmith and Rutherford, 2010).

In the light of the important role played by small and medium scale enterprises (SMEs) in developing the economy of a nation, it is imperative that all avenues to ensure their sustainable development are explored. This is even more pertinent in Nigeria today, where the scourge of unemployment is very rife (Mamman, 2008). Evidence from research indicates that most efforts by the Nigerian government to enhance entrepreneurial development (as a means of alleviating unemployment and poverty), have been in the area of providing financial resources and establishing financial agencies for SMEs. This, no doubt, emanates from the conviction that small businesses fail mainly due to inadequacy of financial resources (Ukenna *et al.*, 2010). There is the need, however, to look at other possible determinants of entrepreneurial failure and examine what can be done to mitigate the situation. It is against this backdrop, that this reviews the interface between HRM and entrepreneurship. The objective is to identify the peculiar demands of HRM in SMEs and ascertain the challenges arising there from.

ENTREPRENEURSHIP AND ECONOMIC VIABILITY

Entrepreneurship is globally recognized as an engine of economic growth and poverty reduction (Kurya and Kurfi, 2010). The Entrepreneurship Centre of the University of Ohio (2003) defines entrepreneurship as a process of identifying, developing, and bringing a vision to life. The vision may be an innovative idea, an opportunity, or simply, a better way of doing something. The end result of this process is the creation of a new venture, formed under conditions of risk and considerable uncertainty. Hisrich and Peters (2002) opine that it is the process of creating something new, with value, by devoting the necessary time and effort, assuming the accompanying financial, psychological and social risks, and receiving the resultant rewards of monetary and personal satisfaction. Entrepreneurship is linked to entrepreneurial opportunities, which are the compelling forces that enable entrepreneurs to introduce or develop new products or services. Dutt and Crossan (2005); Inyang and Enuoh (2009) describe entrepreneurial opportunities as being a set of environmental conditions that lead to the introduction of one or more new products or services in the market place. This is done by an entrepreneur or by an entrepreneurial team. Aina and Salao (2008) have observe it as comprising any purposeful activity that initiates, maintains or develops a profit oriented business interaction with the internal situation of the business and the economic, political and social circumstances surrounding the business. Kurya and Kurfi (2010) summarize the various definitions by seeing entrepreneurship as an economic activity which requires abilities in creativity, innovation, resource gathering, and the capacity and motivation to evolve an economic organization, and a willingness to undertake risk and uncertainty. From the foregoing, it can be deduced that entrepreneurship

entails the establishment of an enterprise, and the risking of capital in mobilizing resources to satisfy society's needs and make a profit. This includes continuous ownership of the enterprise by the entrepreneur, as well as his active involvement in managing it. Entrepreneurs can thus be described as individuals in society who take the lead, as well as the risk, in mobilizing the factors of production (natural resources, human resources and capital) in specific combinations to produce products and services for their communities (Badenhorst *et al.*, 1998). Entrepreneurs innovate and take risks, employ people, provide services through new combination of materials, processes and products, create new products for new markets. Entrepreneurs are found in both large and small businesses, but throughout the world, it has been observed that smaller enterprises (SMEs) constitute the natural habitat of entrepreneurs (Badenhorst *et al.*, 1998).

This concept of SMEs is relative and dynamic; hence there is no universal definition for them. Each country develops its own definition, based on the role that SMEs are expected to perform in that country's development. The programmes of assistance designed by each country to assist SMEs achieve such expected role, is also a factor considered in their definition. Therefore, what is considered a small business in one country may be large in another (Udofia, 2010). In Nigeria, the National Council of Industry in 1992 streamlined various definitions of SMEs using capital investment and employment capacity to categorize the industries. Itemized below are the definitions, which were first revised in 1996 and then 2001 (Udofia, 2010).

1. *Micro/Cottage Enterprise*: Enterprise with up to 10 workers and total cost (including working capital but excluding cost of land) that is not more than N1.5m.
2. *Small Scale Enterprise*: Enterprise with 11-100 workers and total cost (including working capital but excluding cost of land) that is not more than N50m.
3. *Medium Scale Enterprise*: Enterprise with 101-300 workers or a total cost (including working capital but excluding cost of land) that is not more than N200m.
4. *Large Scale Enterprise*: Enterprise with over 300 workers or a total cost (including working capital but excluding cost of land) of over N200m.

In most countries of the world, SMEs have been found to be responsible, for most, if not all of the new job opportunities created during the past two decades (Badenhorst *et al.*, 1998). According to Reynolds, Williams, and Erkkö (2004), over 200 million individuals in China and India are new enterprise owners or managers. Indonesia and Malaysia account for 15 million while sub-Saharan Africa account for about 10 million. It is also estimated that SMEs employ 22.0% of adult population in developing countries (Ukeje, 2003). In Nigeria, SMEs are known to have contributed significantly to economic development, job creation and sustainable livelihood (NIPC, 2003). Owualah (1999), Inyang and Enouh (2009) note that small firms make both social and economic contributions to the nation's development process. The social benefits include transforming and stimulating indigenous industry and technology, job creation, and redistribution of wealth and income. The economic benefits involve utilization of local resources, dispersal and diversification of economic activities, and mobilization of savings (Owualah, 1999). According to Aruwa (2006), SMEs in Nigeria were found to have contributed 90% to total number of industrial

employment and 10-15% to total industrial production, in 2003. Kuratko and Hodgett (2001) also state that SMEs provide employment for 53% of private workforce, account for 47% of sales, and 51% of private sector Gross Domestic Product (GDP). From the foregoing, it is apparent that small businesses contribute, in no small way, to economic development. It is therefore, very imperative that all necessary avenues to guarantee their sustained development are explored. The focus of this paper is on examining the human resource management dimension, and establishing how it can be used as a veritable tool for facilitating sustainable SME development.

STRATEGIC IMPORTANCE OF HUMAN RESOURCE MANAGEMENT

Managing Human Resources (HR) effectively is critical to the success of all organizations whether large or small. The more effectively a firm manages its human resources, the more successful the firm is likely to be (Werner, Schuler and Jackson, 2012). HR management ensures that human talents are used effectively and efficiently to accomplish organizational goals (Mathis and Jackson, 2008). The overall purpose of HRM is to ensure that the organization is able to achieve success through people (Armstrong, 2006). Arthur (1994); Huselid (1995); Way (2002) and Hayton (2005) have established direct association between proper HR management and positive firm level outcomes in firms of all sizes, including new ventures. HRM activities include the formal HR policies developed by an organization, as well as the actual ways these policies are implemented in the daily practice of supervisors and managers. Werner, Schuler and Jackson (2012) identify the many HR policies and practices that organizations need to understand and create. These are:

- HR planning for alignment and change
- Job analysis and competency modeling
- Recruiting and retaining qualified employees
- Selecting employees to fit the job and the organization
- Training and developing a competitive workforce
- Conducting performance management
- Developing an approach to total compensation
- Using performance-based pay to achieve strategic objectives
- Providing benefits and services
- Promoting safety, health, and well being in the workplace
- Understanding unionization and collective bargaining

According to Subramony (2009), when all these HR activities are systematically understood and integrated, it creates a human resources management system that works together to get the best results for an organization. Perry (1993), Huselid (1995) and Terpstra and Olson (1993) confirm this by stating that the effectiveness of a firm, and its ability to create a sustainable competitive advantage (Prahalad, 1983; Pfeffer, 1994) can hinge on whether HRM practices are properly thought out and successfully implemented (Bhatti, Syed, Shah and Shaikh, 2012). Flanagan and Despande (1996) also argue that the human potential in an organization is generally much more difficult for competitors to duplicate, than its plant, equipment or even products. Consequently, the nature and well being of a company's employees can become its main strength in carving out a profitable

existence in the industry. Gringore (2008) describes HRM as that which involves treatment of employees as resources, that is, as human capital whose training, experience, judgment, intelligence, relationships, and empathy, add economic value to the organization. Thus, employees in contemporary organizations, whether large or small are not interchangeable parts, but the very source of the success or failure of the organization. By influencing who is working for the organization and how, HRM contributes to the basic determinants of the success of an organization which are quality, profit and client satisfaction (Gringore, 2008).

The Role of HRM in SMEs: Attention to the serious implementation of HRM in SMEs is a relatively recent phenomenon, and research in the field is still in an exploratory stage. Phelps (2007) observes that in spite of claims that entrepreneurship is the key to developing and sustaining a prosperous economy, relatively little has been investigated with regard to the managerial values that help new ventures become successful. Nevertheless, the influence of HRM on SME effectiveness can neither be overlooked, nor overemphasized. Marlow and Patton (1993) point out that HRM practices can be particularly important for small firms, even as research indicates that inadequate and inefficient management of employees in small firms result in low productivity and high turnover rates (Mathis and Jackson, 1991). McEvoy (1984) also fingers poor employee management as one of the leading causes of small firm failures.

Dessler (2011) also argues that small firms face some peculiar risks, hence they need all the advantages they can get, and for them, effective HRM is a competitive necessity. Brand and Bax (2002) support this by noting that human resources take a crucial part in raising and sustaining the competitive advantage of small firms. Dessler (2011) also adds that the presence of certain HR policies is also an important condition for getting and keeping big customers by small firms. This is because big customers check for compliance with international quality standards, which includes presence of certain HR policies such as training and performance management activities. Nevertheless, managing HR in small businesses is different from that of large businesses. According to Dessler (2011), four factors are reasons for the variances. These are size, priorities, informality, and nature of the entrepreneur.

Size: The small size of SMEs make it rather uncommon for them to have dedicated HR departments. This is not to say that small businesses do not have human resource tasks which they must attend to, such as recruitment, selection, training, compensation, and so on, but most often, it is the owner or his/her assistant that does the HR work. Cardon and Stevens (2004) attributed this to scarcity of financial resources in small firms, which tends to make them reluctant to engage in practices that they regard as costly. Hornsby and Kuratko (1990); Bacon, Ackers, Storey and Coates (1996) reveal a consequence of this line of action (or inaction) by observing that smaller entrepreneurial firms usually have key confronts with HRM, for the reason that the small size of the firm, does not guarantee appointment of professional HR practitioners.

Priorities: The shortage of the entrepreneur's resources in terms of time, money, people, and expertise, compel him/her to focus more on the finance, production, and marketing aspects of his operations, with HR being of diminished importance.

Informality: Due to their small size and areas of focus, that is to say, priority, small businesses tend to handle HR matters informally. Such informality is, however, not just due to lack of resources, but also a matter of survival. It is important for small businesses to be able to react quickly to changes in competitive conditions. Hence, they keep issues like compensation, appraisals and working conditions flexible.

Nature of the Entrepreneur: Mamman (2008) enumerates among others, two distinguishing features of entrepreneurs, which are very pertinent in this context. The first is that entrepreneurs are risk bearing and second, entrepreneurs take personal responsibility for all decisions (and outcomes of such decisions) in the business. Consequently, entrepreneurs tend to be controlling and want to impose their stamp and personal management style on internal matters of the business, including HRM activities.

DEMANDS AND CHALLENGES OF HRM IN SMES

In an exploratory study of successful entrepreneurial firms, Longenecker, Ariss and Eesly (2008), identify HRM demands and challenges faced by these firms. These demands and challenges may be regarded as logical consequences of the peculiar characteristics of SMEs. These include: (i) Hiring Quality People, (ii) Generating Immediate Performance and Productivity, (iii) Maintaining flexibility and (iv) Overall Cost Containment.

Hiring Quality People: Attracting a large pool of high quality job candidates when positions need to be filled is often a challenge for entrepreneurial firms. Reasons for this include the fact that such organizations may not be well known and the youth can raise questions as to their long term viability, in the minds of potential candidates. Furthermore, such companies are usually unwilling to spend a lot of money on full blown recruitment efforts because of the costs associated with such endeavours. Small businesses are also usually unable to offer attractive compensation packages as those of larger, more established firms. Hence, they are left with a restricted recruitment pool, which limits their ability to select the best people. Longenecker, Ariss and Eesley (2008) findings have reveal that successful entrepreneurs overcome this challenge by employing non-traditional recruiting channels such as personal and professional networks, trade associations, universities, and employee-based 'word of mouth' practices to build acceptable candidate pools.

Regarding the issue of compensation, entrepreneurs can overcome this by placing more emphasis on the non-monetary benefits of working in an organization. These include building an entrepreneurial culture, developing a good team environment, operating open door policy, affording potential of growth to employees and so on. Messersmith and Rutherford (2010) note that perceptions of trust, collaboration, and communication, can serve as alternative means for growing ventures to compete for and retain talent. Bau and Dowling (2007) also confirm that reward and incentive systems of entrepreneurial firms place a higher emphasis on non-financial rewards and incentives than on sophisticated financial incentives. Another challenge associated with difficulty in hiring quality people is the inability to exercise enough speed in the hiring process, when the need arises. Sudden emergence of a new business opportunity or loss of a good member of staff may bring up the need to swiftly hire capable staff. Since there is absence of any formal recruitment

process that the entrepreneur can fall back on, the urgency of the need may cause firms to hire someone who is only minimally qualified, or who may not possess the appropriate personality for the job. This, of course, can create a host of long term organizational problems. To overcome this challenge, there is the need for entrepreneurial organizations to have the discipline to develop recruitment and selection systems capable of moving quickly, while still seeking high quality personnel.

Generating Immediate Performance and Productivity: This is the second major demand of HRM in small businesses. The challenges inherent here include difficulty in taking time to properly orient and train personnel, coaching and providing feedback for new employees, and developing workforce/management talent. In SMEs, organizing expanded training and orientation of new employees is often considered to be too time consuming to undertake. Unfortunately, new employees often come to the organization with different motivations, expectations and experiences. Without orientation and training, they can end up being very ineffective performers. Proper training and orientation of employees is thus recommended, as this helps them to become more productive in a shorter period, than when they are simply thrown into the job without any orientation. Also training and performance feedback should not be limited to only when employees underperform, but should be an ongoing activity for increased performance and productivity. Ongoing training with skill enhancement opens up opportunities for personal growth and career advancement for employees. This enhances employees loyalty, commitment and performance, which in turn lead to high firm performance and competitive advantage for the business (Ukenna, Ijeoma, Anionwu and Olise, 2010).

Maintaining flexibility: Although flexibility is a major attraction in entrepreneurship, as the business grows, accompanying HRM challenges also arise. One of such challenges is the absence of clearly defined job responsibilities. Overlapping responsibilities and lack of job clarity leads to confusion and frustration, decreased accountability and inconsistent outcomes. To overcome this, small firms need to continuously review their job descriptions/responsibilities and make periodic adjustments to maintain optimal focus and efficiency, while instilling a corporate culture of entrepreneurial adaptability. Other challenges associated with the entrepreneur's drive to maintain flexibility include, ability, demonstrated commitment to the workforce and maintaining fairness in salary and rewards. The entrepreneur can leverage on the small size of the firm to demonstrate commitment to the employees, by getting familiar with their strengths, weaknesses, needs, family situations, and so on. Constant communication about status of the business, and treating employees as partners, can also, instill commitment on the employees. Wages and other rewards should also be managed in ways that will demonstrate fairness, equity and recognition for high performance.

Overall Cost Containment: The challenges associated with this demand include ability to put in place attractive wages and benefits, and appropriate and effective administrative structure. Most often, small businesses do not have the level of financial means to pay high salaries to their workers. But they can make up for this by ensuring that the work environment is conducive and of high quality. This can be achieved through creation of pleasant corporate

culture, getting workers involved, and obtaining their cooperation in important HR functions such as recruitment, training of new employees, and in compensation matters. This helps to minimize overheads and prevents bloated bureaucracy, as experienced in larger firms.

CONCLUSION

Entrepreneurship is widely recognized as the key to developing and sustaining a prosperous economy (Phelps, 2007) and the contribution of SMEs to economic development of a nation cannot be over emphasized (Ukenna, Ijeoma, Anionwu and Olise, 2010). There is also no doubt that managing human resources effectively is one of the most important functions for achieving organizational success. HRM is especially important for entrepreneurs, who often start their business based on the competitive advantage of the intellectual capital of their employees (Bau and Dowling, 2007). However, available evidence from literature reveals that there is still a relative paucity of research on the interface between entrepreneurship and HRM (Heneman, Tansky, and Camp, 2000). Using the work of Longenecker, Ariss and Eesley (2008) as a springboard, this work sheds more light on the peculiar human resource demands of SMEs and the challenges arising there from. Some characteristics of SMEs such as size, priorities, informality and nature of the entrepreneur, were found to have triggered the peculiar demands and challenges of HRM in SMEs. These challenges included, among others, difficulty in hiring high quality personnel, poor ability to generate immediate high employee performance and productivity, and inability to pay competitive salaries and incentives. All these factors, contribute in no small measure, to the high mortality of small businesses.

It can thus be concluded that, even though the pivotal role of HRM in organizational success (particularly small businesses), is not in doubt, SMEs still need to do a lot in terms of putting in place effective human resource management practices in the running of their businesses. Rather than being a disadvantage, the 'small' size of small businesses, can, in fact be a factor which they can leverage upon, in terms of HR practices, to gain competitive advantage in the market. This will assist considerably, in boosting the chances for long term survival of SMES, thereby facilitating their sustainability, and enhancing their contribution to the nation's economic development.

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