HOW DO SMALL BUSINESSES MANAGE THEIR MOST VALUABLE RESOURCE? A STUDY OF HRM PRACTICES IN A SAMPLE OF NEW ZEALAND SMALL BUSINESSES.

John Gilbert
Glyndwr Jones

Department of Strategic Management and Leadership
University of Waikato
Hamilton

ABSTRACT

This paper is part of an on-going study of HRM / ‘people management’ practices of New Zealand small businesses. The primary aim is to provide an understanding of how small businesses manage their human resource. Three main areas of HRM / ‘people management’ practices were explored in the study: i) the extent to which owner managers operate formal HRM policies and procedures, ii) how owner managers deal with an increasingly complex legal environment and iii) how owner-managers deal with ‘people development’ issues. Data was gathered from semi-structured interviews with the owner-managers of 70 businesses employing between 3 - 40 staff. The research suggests that the economic and social significance of a small business can only be understood in terms of its particular context and that the extent to which small businesses operate formal recruitment and selection varies not only with their size but also with the organization’s needs within its environment.

The research found that small businesses rarely operate formal performance management systems but that owner-managers operate informal performance assessment procedures best described as ‘performance by observation’ and the cost of training is generally borne either by the individual employee or by supplier-manufacturers. The majority of owner-managers surveyed considered that they now had to manage within a far more complex legal employment environment.

INTRODUCTION

This paper reports the findings of a continuing study of the Human Resource Management (HRM) or ‘people management’ practices of small enterprises in New Zealand. Owner-managers of small businesses were interviewed about their approach to managing their ‘most valuable’ resource. In particular they were asked how they recruit and select employees, how they evaluate individual performance, what contribution they made to employee training and development and how they coped with an increasingly complex maze of legislative requirements.

The first part of the paper provides a brief comment on definitional problems associated with the concept of a small business followed by an overview of the small business environment in New Zealand and HRM within this context. The second part of the paper discusses the study of small business owner-managers and reports on the findings. The third part of the paper discusses these findings and draws conclusions.

‘Small Business’ - Definitional Problems

There is no precise definition of what constitutes a small business for two main reasons. The first is that there is no single measure of size that would suit the purposes of all those concerned to identify small businesses. Measures could include asset base, sales turnover or number of employees. The second problem is that the threshold for what signifies the upper limit of 'smallness' will reflect the relative scale of the economic context in which the small businesses are being studied. For example, Golhar and Despande, for their comparative study of HRM in large and small Canadian firms, use the U.S. Small Business Administration definition, which defines a small business as one which employs fewer than 500 employees (Golhar and Deshpande 1997). However, this measure would be too large by a factor of ten to be useful as a definition of small business in the much smaller New Zealand economic context. For the purposes of this study of HRM in small businesses in New Zealand, the logical determinant of size is number of employees. Based on Gilbert and Jones assessment, which argued that as over 98% of New Zealand enterprises have fewer than 50 employees, a small business, for the purpose of studying HRM/'people management' practices in this context, is defined as one which employs fewer than 50 people (Gilbert and Jones 1996).

Human Resource Management Within the Small Business Context

Economic and technological changes of the last two decades have stretched beyond breaking point simplistic neo-Human Relations 'be-nice-to-your-employees' approaches to people management practices. This is just as much the case for small as it is for large business, yet there is no compelling evidence of a clearly articulated small business framework for 'people management', as a surrogate for HRM, being developed. Such a framework for small business should not be a scaled down version of HRM practices in large organizations and should address small business needs i) for appropriate systems and procedures, ii) to be able to cope with legal requirements relating to employment and iii) to develop 'people-management' skills. Like large organizations, small businesses have to recruit and select employees, assess and reward performance and provide opportunities for training and development. Small businesses are limited in terms of financial resources and managerial skills for the development and operation of even the simplest of 'people-management' systems and procedures. Even large organizations with extensive HR sections are often dilatory in maintaining up to date versions of such basic requirements as job descriptions and it is not hard to find amongst large organizations either poor or non existent performance management systems. Therefore, if large businesses with all their resources find HR difficult to manage well, it does not make much sense to suggest that small business should embark on an attempt to develop the same elaborate systems and procedures. Small businesses need basic systems and approaches which include:

i) simple but clear job descriptions and person specifications
ii) practical guides to recruitment together with a sound and manageable approach to selection
iii) a basic employment contract which covers the essential requirements of the employment relationship within a small business context
iv) a practical guide to appropriate induction requirements
v) guidelines for the management of job performance within the context of a small business, which provide a framework for the discussion of performance and the identification of development needs
vi) a clear guide to a defensible warning and dismissal procedure.

With regard to the legal aspects of the employment relationship, New Zealand underwent a fundamental change in 1991 with the introduction of the Employment Contract Act. This

legislation altered the nature of the employment relationship from one based on status to one based on a contract 'negotiated' at the enterprise level. Small businesses in New Zealand also have to comply with a raft of additional legislation which impinges on the employment relationship - the Privacy Act 1992, the Human Rights Act 1993 and the Health and Safety in Employment Act 1992. The latter act has proved particularly problematic, transferring responsibility for workplace safety and hazard management from central agencies, such as the Department of Labor, to individual enterprises. The potentially onerous costs of compliance, or more particularly the significant consequences of non-compliance, have resulted in many medium to large organizations creating specialist full-time positions to develop the necessary safety standards. Such responses are beyond the resources of small businesses, for whom the consequences of non-compliance may be relatively more dramatic.

To be effective 'people managers' the owner-managers of small businesses have a need to develop sound 'people-management' skills, which may include inter-personal skills, decision making skills, leadership skills and team management skills. While many small business owner-managers may have good technical and entrepreneurial skills, the tend to have had few opportunities to develop similarly effective 'people skills'.

The findings of the survey described in the following sections provide some indication of the extent to which a small business framework for HRM/'people-management', as described above, has either developed or is in need of development within small businesses in New Zealand.

THE STUDY

Objectives

The study explored three aspects of HRM/'people management' practices in small businesses:

i. The extent to which owner-managers operated formal HRM policies and procedures.
ii. How owner-managers coped with an increasingly complex external environment including legislation in employment relations, health and safety, human rights and privacy.
iii. The approach owner-managers took towards 'people development' including their own development.

Sample and Data Gathering

Data was obtained from two sources:

i. Owner-managers of retail pharmacies, printeries and restaurants.
ii. Owner-managers of small businesses in a variety of industries; manufacturing, professional (legal, consulting), hairdressing, retail, panel beating, transport and building.

Approximately half the sample were owner-managers of pharmacies, printeries and restaurants in one of New Zealand's most populous regions, the Waikato. The second sample was made up of businesses from a range of industries in the greater Auckland region. Businesses in both samples employed from 3 to 40 staff.

Seventy semi-structured interviews of 1 to 2 hours were conducted with owner-managers. The questions deliberately avoided using HRM terms or jargon. For example, no mention was

made of recruitment or selection. Instead respondents were asked to describe what they did when an employee resigned or when, as a result of business expansion, additional staff were needed.

Findings

Section One: The Use of Formal HRM Policies and Procedures

1. Recruitment and selection.

Owner-managers were asked how they went about finding a replacement when an employee resigned or, if they required extra staff as a result of business expansion. The recruitment channel chosen depended on the type and level of the position being filled (skilled, semi-skilled or unskilled), the nature of the business and geographic location. Increasing specialization in the printing industry, for example, meant that owner-managers were likely to seek applicants with higher skill levels, qualifications and relevant experience.

To do this they advertised locally and nationally, using letters of application and requiring a CV. Because of low turnover in the industry, however, recruitment was not a major issue.

The hospitality industry, on the other hand, experiences high turnover and relies on casual, part-time, often low-skilled employees. Consequently, recruitment occupied more of the owner-manager's time. The nature of the business meant that restaurateurs relied on 'word-of- mouth' and 'walk-ins' for front of house staff, but used conventional avenues such as local advertising when seeking specialized staff, for example, a chef. The skill requirements of the position were a major factor in the recruitment decision. Attracting a qualified pharmacist to a rural town meant that the owner-manager had to use the services of a specialist recruitment agency or resort to national advertising, both of which were expensive options.

The approach to recruitment was influenced not only by the skill requirements of the position and the nature of the business but also by geographic location. A small business in a rural town could rely on 'community networking' rather than advertising whereas this would not work for a similar sized business in the same industry in the greater Auckland region.

Across the sample, the selection process was generally informal regardless of industry, nature of business, geographic location, skill level or size of organization. Only a minority of owner-managers had developed and used a formal job description at the recruitment stage and these tended to operate the larger businesses in the sample (30 - 40 employees) or to have had formal management training.

The degree of formality at the interview stage depended largely on the nature of the position being filled, for example, skilled or unskilled. When filling an unskilled position, the process was highly informal with the owner-manager taking a 'satisfying' approach. For skilled positions, the unstructured, one-on-one interview was the most common selection technique used, involving the owner-manager, frequently assisted by a spouse or partner. Pre-selection involved sifting through letters of application (often hand written) before deciding who should attend the interview. No formal criteria was likely to be used. The interview itself tended to be driven by a series of unwritten questions rather than a systematically developed interview schedule, resulting in a conversational style of interview.

Considerable importance was placed on selecting an employee with the ‘right attitude’ and ‘personality’ with these often being ranked ahead of qualifications, skill or experience. With the ‘right attitude’ it was believed there was a better chance of getting the behavior required in the business even though no formal selection tools were used to assess either attitude or personality. Assessment of a potential employee’s attitude and personality was based on the owner-manager’s intuition and experience.

When the selection decision was made, an employment offer followed in the form of an employment contract. Little negotiation took place about the terms or conditions of the contract with this being seen as implicit in the interview.

2. Induction

Formal induction was rarely practiced. A new employee was usually shown around the business, introduced to fellow workers and left to ‘learn-on-the-job’. A number of businesses operated a ‘buddy’ system, but this depended on the size of the enterprise and the previous work experience of the new employee.

3. Employee performance

Although the management of performance occupies a central place in contemporary HRM literature, few businesses in the study operated any formal performance appraisal procedures.

Rather, they operated what could best be described as ‘appraisal by observation’, assessing employee performance ‘every six minutes rather than every six months’. Being in the thick of the action, owner-managers considered themselves well placed to appraise employee performance supported by whatever data was available, such as point-of-sale returns or customer feedback. When a problem surfaced, such as errors or poor workmanship, owner-managers would intervene, taking the employee aside to discuss the problem.. ‘On-the-job’ training might take place but if this was not effective, the employee’s continued employment with the business might be re-considered.

A number of owner-managers in ‘larger’ small businesses indicated dissatisfaction with this ‘after-the-fact’ approach to managing employee performance, suggesting that should the business expand further, it was an area that would need attention and the development of a formal system of managing performance.

4. Training

All owner-managers claimed that training, of some form, took place with the type of training depending on the nature of the business. It was, however, predominantly ‘on-the-job’. Some organizations in the study had developed ‘innovative’ approaches to training. For example, the ‘strategic’ direction taken by the owner-manager of a pharmacy - whether the ‘core’ business was traditional dispensing or retailing - determined the type of ‘in-house training undertaken. Pharmacies with an 80:20 split in favor of retailing rather than traditional pharmaceutical dispensing - a clear development in the industry - relied on manufacturers and cosmetic houses to conduct their training. Retailers operating a Lotto agency made use of the training programs operated by the Lotto organization such as financial management, customer service and inter-personal skill development.

Owner-managers were often ambivalent about training viewing it as a cost to be borne by the employee rather than by the business. For courses or programs undertaken at a polytechnic, an owner-manager might contribute to the cost or reimburse the fees on the successful completion of the course. Training was, however, often seen as ‘personal development’, increasing an employee’s marketability and therefore, a cost that she or he should bear.

Section Two: Small Business and the Employment Context

The New Zealand economy has undergone major change since 1984, affecting organizations large and small. Respondents were asked how the following recent legislation had influenced their approach to managing staff:

i. The introduction of the Employment Contracts Act 1991
ii. Safety and hazard management requirements of the Health and Safety In Employment Act 1992
iii. The Industry Training Act 1992
iv. Human rights provisions included in the Human Rights Act 1993
v. Individual privacy requirements laid down in the Privacy Act 1993.

The Employment Contracts Act 1991 fundamentally changed the nature of the employment relationship, replacing a centralized bargaining system based on national awards with a system based on legally-binding individual or collective contracts.

The consequences of the Act were profound. Owner-managers were responsible for negotiating legally binding employment contracts with their employees but, unlike their counterparts in large organizations, lacked resources such as consultants to draw upon.

The predicted chaos did not happen and seven years on, few owner-managers considered the Act to be an issue. Most used standard, pro-forma contracts developed by professional or trade associations or, employer groups such as the Employers and Manufacturers Associations. Managing within a legal, contractual context has become a norm for small business.

A number of owner-managers had experienced problems with the operation of the Act, having had Personal Grievance cases taken against them by employees. Many of these cases ended at the Employment Tribunal. These businesses tended to have higher levels of staff turnover and employed casual or part-time employees.

The Health and Safety in Employment Act 1992 presented small businesses with their greatest challenge. The Act transferred responsibility for safety and hazard management from the Department of Labor to individual employers and employees. All businesses in the study indicated that the legislation had affected them, requiring them to identify hazards in the workplace and develop appropriate procedures. This involved considerable effort and money in developing systems and procedures to comply with the Act. Unlike large organizations, small businesses were in no position to employ someone to do this for them.

Owner-managers showed limited understanding of the other major pieces of legislation. The Industry Training Act 1992 was considered to have little or no relevance to them. Knowledge of the Human Rights Act 1993 was scant even though it has important implications for small businesses - for example, avoiding discrimination in the workplace. Even more surprising was

the lack of concern about the Privacy Act 1993, which protects individual privacy – for example, when gathering information at the recruitment stage. In a number of cases the HRM/'people management' practices in the study breached a number of these Acts.

Section Three: Small Business and 'People Development'

The mainstream HRM literature argues that human capital is the source of potential competitive advantage, capital that is capable of growth and development. Implicit in this view is the role of the manager as developer and 'shaper' of the organization's human resource.

The owner-manager's view of his or her employee as a source of competitive advantage depended largely on the nature of the business and the employee's position in it. For example, recruiting an unskilled employee in a manufacturing business was often a 'hit or miss' process with the decision seen as unlikely to have a significant effect on the business. When recruiting a skilled or professional employee, however, the potential value to the business was considered significant, requiring not only the 'right' decision at the recruitment stage, but also requiring that the employee be 'maintained' in order to ensure that she or he stayed with the business. This might mean supporting training through the completion of professional or technical examinations.

The owner-manager's approach to his or her own professional or management development depended on factors such as age and the competitive nature of the industry. Owner-managers frequently mentioned the increasingly competitive nature of business in New Zealand and of the need to be effective and efficient. This included being current with developments taking place in the industry. For smaller businesses, however, even when the owner-manager recognised the value of 'taking time out' to assess changes taking place in the industry or to develop his or her own knowledge through attending a course or seminar, it was often difficult to do with no one available to provide cover. Larger businesses in the study were better able to do this with a partner or supervisor covering for the manager.

Of a number of managers who had set out to develop their managerial skills and knowledge through attending courses and seminars, most tended to be younger and entrepreneurial by inclination. They were also more likely to have used this knowledge to develop more formalized systems and procedures in their businesses.

Section Four: Discussion

1. 'Small business': a misnomer

The small business literature invariably attempts to define *what* constitutes a 'small business'. How many employees does a 'small business employ? Is there a cut-off point between 'small' and 'medium' sized businesses? While this might be necessary for research purposes, it fails to capture the *nature* and *value* of a 'small business' within its particular context. For example, a pharmacy employing eight full-time and four part-time staff in a rural town is not a 'small' business at all but is a relatively 'large' enterprise within the context of its 'rural town' location. It will be a major employer and generator of income and a significant contributor to local advertising, transportation, cleaning services, etc. Its failure would have a major impact on the local community whereas a pharmacy of similar size in a large urban setting would make a proportionately smaller contribution and in the event of failure may go un-noticed.

The term ‘small business’ belies the nature of the contribution such an enterprise makes in its particular context. In reality there are ‘small’, ‘medium’ and ‘large’ small businesses dependent upon their setting.

2. The use of formal HRM/’people management’ systems and procedures.

Few businesses in the study operated formal HRM systems or procedures. Recruitment and selection was predominantly informal, relying on the owner-manager’s intuition and experience for making the ‘right’ decision. Induction was treated in much the same way. Although employee performance was considered critical to the success of the business, owner-managers relied on informal and subjective methods of assessment. Few had established formal criteria, relying instead on observation or surrogate indicators such as sales figures.

Training was informal, carried out ‘on the job’ to meet short term needs and frequently was viewed as a cost to be minimized. Rarely was the effectiveness of training evaluated. Where owner managers had instituted formal HRM procedures they were, more often than not, responding to external pressures rather than as a proactive move. In one case, the owner-manager of a small manufacturing business had been forced to invest time and money into developing ISO 9000 accreditation in order to continue supplying a major customer. Small businesses often developed formal employment-related procedures to comply with legislation, for example, health and safety requirements.

For organizations employing up to 20 staff, the lack of formal procedures was not a problem. With a small number of employees the owner-manager could keep ‘in touch’ and literally observe individual behavior. It was when the business expanded, with a concomitant increase in the number of employees, that this reliance on a ‘hands-on’ approach tended to break down.

With increased size came increased complexity and the need for more systematic ways of managing. This manifested itself in the development and use of formal job descriptions, structure at interviews, more objective performance criteria and an increase in the use of written policies and procedures.

3. The relationship between the use of formal HR systems and procedures and management training and development.

Where formal HRM systems and procedures were evident, they were related not only to relatively larger size and greater complexity of the business, but also to the owner-manager’s exposure to formal management training. A number of owner-managers in the study had undertaken management training programs offered by universities, polytechnics, professional associations or the New Zealand Institute of Management. This experience led them to re-consider their organizational systems (or lack of them) and the need to develop appropriate frameworks. In some cases, particularly where the business was expanding, this had led the owner-manager to re-consider his or her role, moving from ‘hands-on’ involvement to a more ‘professional’ managerial role. This involved planning the longer term ‘strategic’ direction of the business, marketing, identifying sources of competitive advantage, researching industry developments overseas and the effective management of staff. Managers who had pursued managerial rather than further technical or professional training, were often younger and entrepreneurial in inclination.

Exposure to academic management knowledge invariably led to a questioning of the way

things were done in the business, including the limitations of informal methods, particularly in terms of consistency, validity, reliability and legal defensibility. In an era of legally binding contracts, exposure to HRM knowledge raised doubts about how legally defensible some currently employed methods might be - for example, dismissal based on poor performance.

CONCLUSION

Little evidence was found of ‘hard’ HRM policies and procedures among businesses in the sample. Instead, most relied on informal, subjective, sometimes ad hoc practices for managing their employees. This informality, however, worked for the majority of businesses due mainly to the small number of employees. When the number of employees increased, the effectiveness of these practices came under pressure, leading to a more formalized approach.

Establishing effective HRM/’people management’ systems and procedures for small businesses does not mean borrowing, holus-bolus, from those found in large organizations. For example, rather than ‘downsize’ conventional performance appraisal models, it requires the development of systems that fit with the nature of small business. In the matter of HRM, small businesses simply are not large businesses ‘writ small’.

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