

Sustaining growth – the HR dimension

**HR practices and management and
leadership skills of High Growth SMEs**

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ABSTRACT

This research set out to investigate human resource management (HRM) practices and leadership behaviours in UK SMEs that represent a small proportion of firms to have achieved long-term growth. We interviewed 30 senior leaders of such SMEs and found that most leaders espouse key high performance work practices such as selective hiring, employee development, open communication, and, to a varying degree, performance management and employee participation. Through flexible informal practices, SME leaders tap into employee's intrinsic motivation to enhance performance and to develop personal trust and reciprocity. Overall, our research paints a picture of HRM in growth-oriented UK SMEs as a complex phenomenon where a number of formal and informal HR levers interact, guided by a compelling vision, and creating a positive company culture in the process.

CONTENTS

ABSTRACT	3
INTRODUCTION	5
Rationale for the research	5
The focus of the research	5
Research approach and methodology	6
KEY FINDINGS	7
Deliberate informality geared towards employee wellbeing and engagement.....	7
Evolution of HR practices	9
Importance of a robust hiring process.....	10
CONCLUSION.....	13

INTRODUCTION

Rationale for the research

SMEs are a significant driver of the UK economy. In 2014, they represented £1.4 trillion, close to 40% of UK's private sector turnover. However, prior business demographics research conducted by the ERC identified that only a small minority of UK SMEs experience sustainable growth over an extended period of time. Of all newly established firms in 1998 with less than five employees, only 11% survived to 2013. Of these, only 6%, or just fewer than 1,250 firms managed to create significant employment (i.e. grow to 20+ employees). A similar percentage of firms within this cohort has shown a material revenue growth. Similar results held for firms originated in other years. This dynamic provided the rationale for the present study.

The focus of the research

This research set out to investigate what lies behind such a remarkable performance on the part of so few high growth companies. More specifically, we zeroed in on the leadership behaviours and HR management practices of a selection of these paragons of SME growth. Our particular focus was on so called "high performance work systems", a set of HR practices that are intended to align employees' performance with organizational goals through self-regulation rather than sanctions. These practices include selective hiring, training and development, performance appraisals and feedback, clarity of roles and responsibilities, incentivisation, attention to the work-life balance of employees, encouraging team-working, autonomy and employee participation. These practices affect employee's ability, motivation and an opportunity to perform and are often seen as HR "best practices".

In particular, the objective of this research is to address the following questions:

- How do high-growth, established firms attract, retain, motivate and leverage their talent?
- How do HR practices evolve over time in such firms?
- As firms grow, how do they ensure that their emerging middle management / senior employee pool develops the required management and entrepreneurial capabilities?

Research approach and methodology

To shed light on the above questions, we interviewed 30 senior leaders of high growth SMEs. This sample was drawn from among the above-mentioned cohort of firms that were newly established in 1998 and had less than five employees at that time. In addition, an initial interview protocol was piloted on six other firms.

The interviews were typically conducted face-to-face, although some telephone interviews have also been done. The interviews lasted between 35 and 90 minutes, with the vast majority exceeding 1 hour. Additional information from company's websites or that handed over to the interviewer helped to cross-validate and enrich the interview data. The interviews were recorded and professionally transcribed. The transcripts were analysed with the support of qualitative data analysis software.

The sample represents a fairly well balanced distribution of firms across a range of industrial categories including professional services, manufacturing, trade, IT and communication services and other sectors. Two thirds of the interviewees were the original founders of their firms. Three quarters or 25 respondents represented firms of between 11 and 50 employees. This size composition of the firms needs to be borne in mind when considering the research findings.

KEY FINDINGS

Deliberate informality geared towards employee wellbeing and engagement

Past research on HRM in small firms tended to focus on the adoption of formal HRM practices. Its main premise has been that as firms grow, they tend to adopt increasingly formalised procedures and a managerial hierarchy necessary to effectively manage a larger growing firm. It is not surprising, therefore, that formalisation of HRM has traditionally been seen as a sign of firms' ability to support growth.

However, researchers increasingly recognise that (i) in the SME context, formal and informal HRM practices co-exist and should both be considered when assessing growth and performance implications of HRM. Furthermore, (i) the incidence of formal HRM policies and procedures among SMEs is higher than previously thought, but that (ii) formal written policies, if they exist, may not be utilized unless problems arise. At the same time, important gaps in our understanding of the role of informal HRM practices in supporting SME growth remain.

We found that high growth SMEs in our sample embraced a varied range of informal practices that impact key HR outcomes. Many such practices demonstrate care for the wellbeing of employees and concern for creating a positive working environment as well as a financially sustainable enterprise. This care for the employees as a cornerstone of the approach to HR has been aptly exemplified by one MD of a wholesale trade firm:

“My policy on human resources generally is to solve my employees’ problems. So, this is the way I run my business. So if my employee has an issue with their husband's tax return – our employees are mainly female – I give them my accountant to sort it out. If they want to borrow a van to move to a new house, if they want to store goods, if they need a home office, they can sort it out. [...] I'll do all of that and this is how I see my way of engendering loyalty about work. And people don't leave.

You know, we're a popular place to work and I'm sure it's part of that."

Informal practices of this nature are intended to create greater employee engagement and reciprocity in terms of employees' additional effort. An additional, or be it, more flexibly applied, effort may be crucial to ensuring SMEs' agility and its ability to secure sustainable financial performance. There is evidence of some firms in the sample enjoying a high degree of commitment from their employees, particularly in case of peaks of demand:

"It's more – [it is] when the job is done, people go home. So, nobody goes home early. So, if we have to stay till 10 o'clock, everybody stays till 10 o'clock. There's no 'I need to go at six'. So it's very team work environment."

In the majority of cases, HR practices have been found to be consistent with the best practice advice related to fostering employee engagement. At least according to the interviewees, there is a concerted effort to instil positive working environment through merit-based promotions, socialisation, providing constructive feedback, celebrating successes, etc.

Some practices are forward looking even beyond the SME context. For instance, one firm was gearing up to put in place a holiday-time market. Aside from advantages for the employees, such practices would enable a firm to manage peaks and troughs in demand, thus contributing to financial sustainability.

Progressive HR practices provide a sense of purpose and meaning to the employees and create and reinforce an appealing company culture. Corporate culture tends to affect the implementation of HR practices. There is some evidence that some initiatives intended to create more inclusive and close-knit working environment are particularly effective when implemented from bottom-up.

Evolution of HR practices

We have been able to trace some clear patterns in the evolution of HR practices in the sample firms. As expected, initially, HR tasks tended to be seen as interference with the day-to-day management of the firm, stretching already-thin managerial capacity. Then, as firms add employees, HR becomes a relatively low-level administrative task, finally emerging as an integral part of the company's strategy.

A typical state of HRM in an early-stage SME have been described as follows:

"I think it is very typical of entrepreneurial types of organisations. They are so busy trying to create a business that actually there is no particular will actually to look at how you can get more out of people, have you got the right people etc., and also you don't have much management as such in those kinds of organisations. It tends to be pretty flat there".

A leader of a larger SME where HRM has become more strategic has summarised this transformation and the meaning of strategic HRM as follows:

"...And HR really at that time was more what you call "personnel" a little around the hiring. [...] Gradually it became more strategic, I suppose. The first strategic thing we started doing was around performance management of people. So trying to get the best out of people. And after that we've done lots of different things. [...] So it is working out whether we've got the right people who can take us forward, whether we've got people that we can improve their skills, do you have to have new skills and if so what are they and how do you get the right people".

Several interesting observations are important in the context of the evolution of HRM in SMEs. One relates to the importance of high quality recruitment for the success of SMEs, both initially and further along their growth trajectory. Accordingly, firms try to develop a well-thought-out hiring process early on, learning from experience if problems arise. Another

important point to bear in mind in this respect is the the incidence of carefully considered, albeit not as yet formalised HR practices since the very early stages of the company. Among the latest practices to become adopted and formalised were (i) more structured performance appraisals to complement the “real time” feedback practiced from the early days of the firms, (ii) more formal information sharing in the form of strategy and performance updates and other relevant news and (iii) greater employee participation in decision making when appropriate. There has been diversity in the level and the extent of adoption of these practices across the firms in the sample.

At the current stage of companies’ growth and development, the importance of senior management’s unifying vision, accompanied by the development of the managerial team and positive company culture become particularly evident. These findings will be dealt in greater detail in the Role of Leadership section.

Importance of a robust hiring process

Within SMEs, hiring can have significant implications both of the company’s financial position and on its managerial capacity:

“I don’t like to recruit too early because that can create as many problems as it solves. You’ve got to do it very, very carefully. You’ve got to make sure you don’t overload people and sometimes some people will, they will work really, really hard and they won’t notice when they need help until too late. Because when you take someone else on it’s more work initially before it gets better. So part of my job is looking for that.”

Significant hires are taken with great care and foresight. One SME leader described his sense making at the time of the first senior hire in the following way:

“And we got to be really careful if we’re truly pushing the boat out in term of spending this money and we got to grow the work into them. And not

only is there 50% chance of failure in terms of who you recruit but actually if we don't bring the work in to cover what they're doing then in six months, we're either went out of cash or will have to let them go."

Cultural fit has been deemed important when making hiring decisions, as exemplified by a statement by one MD of a professional services firm:

"You know, we are a small business so that family culture is important and making sure that every employee feels part of that family. It's been actually critical and we've had occasions in the past where we've had people that didn't culturally. You know, they didn't last very long. And I think that having a strong family culture has been definitely one of the reasons why we have had a good retention rate at our company. [...] When we hire someone, we want them to kind of get into that culture very quickly."

Aside of senior level attention to hiring, most interviewed firms had evolved a relatively sophisticated, formal multi-step hiring process, often involving multiple rounds of interviews, behaviour-based interviewing, performance assignments, on-the-job try-outs, among others.

"It is very expensive getting the wrong person. It wastes a lot of time, and a lot of opportunities actually [...] So I think it's worth making sure that this process is as good as you can achieve even if it costs a bit of money to do it upfront."

At times, there was a clear tension between the importance of careful hiring and a lack of talent pool, felt most acutely in manufacturing. A leader of a high-tech manufacturing SME described the problem as follows:

"The reason we're not growing it at the moment is a lack of human resource-there is simply not the engineers around [...] So, it's finding people with those skills that experience, that knowledge, to join the business. [...] And that's the difficulty we have as a company in going forward, that skills are just not available. [...] If someone comes along with the right skills, we would probably snap them up. But I can say

we've been looking for years, really.”

The role of leadership – vision, culture and team development

It is hard to underestimate the importance of the senior leadership in the development of SMEs. Research suggests that in the early years of organizations, founders' values shape the company culture and influence the choices these organisations make with respect to HRM practices. Throughout the life of organisations, their leaders set out the overall vision and are instrumental in making it alive by linking it to employees' roles and contributions.

“So you create a vision of where you want to be, share this vision with people in the organisation and get them to buy into that vision. So that is around what's in it for them, why should we do it, what's the reason, why should we try and grow instead of staying the same.

So you create that vision, you have a culture that gives permission to people to do things and you have a very clear strategy with a number of milestones in that strategy and a number of things that you need to do. And I think if people understand that and if you have the right people then you can do that. That links back into HR and the fact that you have to have the right people with the right skills and right attitude etc. etc. which is why HR is that the core of strategy, it has to be. You can't achieve any of these things without people, well, we can't anyway. “

An important HR-related lever of growth relates to senior team development. This is an area where leadership decisions and behaviours are particularly crucial. Internal promotion is seen as an effective avenue for creating a strong management team. The most salient benefits of internal promotions can be grouped into two broad categories – the existing employee's knowledge of the business, its culture and its ways of working, and a motivational effect of internal promotions on these employees and their peers. The latter was voiced in the context of the belief in the benefits of, and indeed the responsibility of senior leadership for employee

development.

With reference to specific practices preceding internal promotion, senior leaders spoke of engaging and encouraging coaching and mentoring by senior- and middle management employees so as to facilitate the internal promotion process. Several firms also pursued more formal management and leadership skills training to develop relevant capabilities of employees to be or recently promoted. Occasionally, interviewees described ways of legitimizing internal promotions, e.g. through setting developmental tasks to specific employees earmarked for promotion in the future.

Overall, the interviews paint a picture of HRM in high growth SMEs as a complex phenomenon where a number of formal and informal HR levers interact, guided by a compelling vision, and creating a positive company culture in the process.

CONCLUSION

In this study, we have set out to investigate the nature of HR practices within high growth SMEs. Early research into HRM practices and performance relationship firmly established the benefits of formalized HRM systems. However, high growth SMEs tend to rely heavily on informal HRM practices, which either complement or substitute the formal ones. While most of the existing research has focused on the formal best practices, informal HRM practices as a method of garnering commitment, motivation and a sense of culture are much less researched. Hence, the focus of this study.

We have found that virtually all leaders of the high growth SMEs we interviewed embrace key high performance work practices (“HPWS”) such as selective hiring, the need for training and development of the employees, appropriate job design, communication, compensation, and a varying degree of performance management and employee participation. SME leaders show interest in tapping into employee’s intrinsic motivation to enhance their performance or potentially to develop a close bond with

employees based on direct personal trust and reciprocity. Whether it is to ease the task of managing their employees or out of genuine concern for their wellbeing and developing the sense of purpose in their work, most of the SME leaders we have interviewed do recognize the importance of creating an open and positive company culture.

The effectiveness of the informal HR practices rests on an understanding of employees' preferences and their primary motivational levers, be it flexible working, opportunity to develop relationships through social activities or endeavouring to resolve employee's difficulties. Some of these measures are relatively unique even in a flexible and informal SME setting and could potentially contribute to the employees' perception that the firm over-fulfils its side of the obligations to the employees (its "psychological contract"). The psychological contract is subject to changes in the context of firm growth given that individuals' roles change and new employees tend to be recruited, potentially altering existing understandings.

Uniformly, the case study companies devoted significant attention to hiring right employees. Most firms provide feedback to employees through near real-time communications and regular performance reviews, although the latter are not always seen as effective in the context of interviewees' business or indeed, in the context of specific categories of employees. Performance reviews are one of the last key HPWSs to get formalized. Although most firms realize the importance of training and development, in practice, given the contingencies of running a business, approach to training is somewhat ad hoc. In contrast, coaching is considered a very effective mechanism for improving employee's capabilities. Recognising employees' strengths and leveraging them can considerably enhance the pathway to growth.

We also found that internal promotion is espoused as a preferred avenue for building up the management team, with some interviewees expressing it as a preference to develop, nurture and motivate their employees. However, SME leaders also recognise the need to hire externally, when

required skills cannot be found within the company.

In contexts where the company relies on technical or other rare or specialized skills, firms experience significant skill shortages. This creates problems for high growth SMEs that, despite the use of several adaptive mechanisms, hinders production and firm growth.

In conclusion, HPWS provide an interesting lens for a qualitative analysis of HR practices in SME. In particular, using HPWS as a starting point, enabled us to delve into less well researched areas of informal practices that are designed to enhance employee's intrinsic motivation and engagement by generating positive discretionary behaviours.



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