

## *The relationship between formalization of HRM function and HRM intensity in SMEs: An empirical investigation in Sri Lanka*

### *La relación entre la formalización de la función de recursos humanos y la intensidad de las prácticas de gestión de recursos humanos en las PYMEs: Un estudio empírico en Sri Lanka*

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#### **Abstract**

Human resource management (HRM) intensity is important for any type of business in which human resources play a vital role. However, little is known about HRM intensity in the context of small and medium-sized enterprises (SMEs). The aim of this study is to investigate the relationship between the formalization of HRM function and HRM intensity. The sample of the study consists of medium-sized enterprises operating in Sri Lanka. The results show that although the formalization of HRM function is low, HRM intensity is high. The findings also show that higher levels of formalization lead to a greater intensity in HRM practices.

**Keywords:** HRM formalization; HRM formality; human resource management; HRM intensity

**JEL Classification:** J21; J24; L2; M12; O15

#### **Resumen**

La intensidad de las prácticas de gestión de recursos humanos (GRH) es importante para cualquier tipo de empresa en la que las personas desempeñen un papel vital. Sin embargo, poco se sabe sobre la intensidad de las prácticas de GRH en el contexto de las pequeñas y medianas empresas (PYMEs). El objetivo de este estudio es investigar la relación entre la formalización de la función de recursos humanos y la intensidad de las prácticas de GRH. Sobre la base de una muestra de PYMEs que operan en Sri Lanka, los resultados muestran que, aunque la formalización de la función de recursos humanos es baja, la intensidad de las prácticas de GRH es alta, señalando que un mayor nivel de formalización conlleva una mayor intensidad en las prácticas de GRH.

**Palabras clave:** formalización de recursos humanos; gestión de recursos humanos; GRH; intensidad de las prácticas de GRH

**Clasificación JEL:** J21; J24; L2; M12; O15

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## 1. Introduction

It has been theorized and empirically established that human resource management (HRM) is synonymous with both the adoption of a set of people management practices and a strategic activity that aligns people management practices with the business and its other strategies. When HRM is viewed as a strategic activity, the existence and process of human resource strategy development is important. When HRM is viewed as a set of practices such as employee resourcing, performance management, and rewards, then the existence and use of these practices for attracting, developing, and maintaining (or disposing of) a firm's human resources are important (Lado & Wilson, 1994, p. 701). This study adopted the latter approach.

HRM intensity refers to the extent that a set of HRM practices is used (Sels et al., 2006). According to Kaufmann and Eroglu (1999), HRM practices can be identified as format facilitators, comprised of a wide range of policies and procedures that form the foundation for both an effective and efficient operation at the functional level, as well as the integration of this function into the operation of the total system. Format facilitators are critical for an organization because they make up the management and operational infrastructure for the entire system (Kaufmann & Eroglu, 1999, p. 71). The detailed literature review in the latter part of this paper suggests that HRM intensity leads a firm to experience significant and managerially relevant improvements in terms of better performance, competitive advantage, and the satisfaction of a variety of stakeholders such as employees, trade unions, and governments (Campbell et al., 2012; Lado & Wilson, 1994; Sánchez-Marín et al., 2019; Tocher & Rutherford, 2009). Previous empirical studies that investigated the antecedents of HRM intensity are scarce. In the present study, the formalization of HRM function is considered as an antecedent of HRM intensity. As explained in the section on the literature review, the formalization of HRM function or HRM formality denotes the extent to which the HRM function is systematized and institutionalized (Nguyen & Bryant, 2004; Singh & Vohra, 2009; Štangl Šušnjar et al., 2016). The formalization of HRM function is depicted by indicators such as the existence of a separate function for HRM hosted by an HR expert and the existence of stated policies for managing human resources. The in-depth review of previous studies (i.e., de Kok et al., 2003; Kotey & Slade, 2005; Sheehan, 2014; Štangl Šušnjar et al., 2016), in the next section, provides evidence to suggest that the formalization of HRM function plays an important role in HRM intensity.

Regarding the gap in the current literature, the extant literature shows that the context or circumstances within which an organization operates are important in understanding HRM intensity (Brand & Croonen, 2010; Ogunyomi & Bruning, 2016; Sels et al., 2006; Singh & Vohra, 2009; Way, 2002). For example, Ogunyomi and Bruning (2016) state that "the circumstances of the organization (i.e., whether micro, small, medium or large) at a particular point in time determine the types of strategies, policies, aims, and lists of activities that will be adopted in managing employees" (p. 615). The present study was conducted in the small and medium-sized enterprise (SME) sector. HRM intensity improves the performance and survival of SMEs, and helps to sustain competitiveness (Sels et al., 2006). However, previous studies (e.g., Sels et al., 2006; Way, 2002) provide evidence for differences in HRM intensity not only between large firms and SMEs, but also between small-sized and medium-sized enterprises, with higher HRM intensity in medium-sized enterprises. This may be due to the presence of HRM experts and the implementation of more standardized HRM practices to cater for a considerably larger employee base in medium-sized enterprises compared to small-sized enterprises (Sels et al., 2006). For these reasons, the study investigated 1) the level of formalization of HRM function; 2) the extent of HRM intensity; and 3) whether the formalization of HRM function leads to HRM intensity in medium-sized enterprises operating in Sri Lanka. As detailed in the methodology section, a survey was carried out in medium-sized enterprises operating in Sri Lanka to capture the experiences of line managers and thereby achieve the above-mentioned objectives. A multivariate regression analysis was used for the hypothesis testing.

This paper makes several contributions to the literature. First, it is built on the arguments of the resource-based view of the firm, the dynamic capabilities perspective, and the ability, motivation and opportunity (AMO) model. The resource-based view of the firm argues that firms must acquire and utilize valuable, scarce, and inimitable resources (Barney, 1991). Human resource is identified as having distinct capabilities that are more difficult to imitate and substitute compared to other resources, and is the glue that binds other resources together (Barney, 1991). Consequently, human resource is a potential source of significant competitive advantage. The dynamic capabilities perspective argues that human resource is capable of learning, creating, adopting, and changing in response to a continuously and rapidly changing environment (Teece et al., 1997). If properly managed, human resource propels the long-term survival and growth of the organization. The AMO model argues that if a firm recruits and selects quality human resources, motivates them to use their discretionary efforts, and provides opportunities for engagement, it will experience high organizational performance (Appelbaum & Kamal, 2000). The basic premise of these three theoretical frameworks is the potential of HRM intensity for better performance in organizations of all sizes (Sheehan, 2014). However, SMEs experience limitations in the availability of resources such as financial, expertise, and staff functionaries, and resource limitations give SMEs fewer options compared to their larger counterparts when making choices for organizational survival and growth. Limitations in the resource availability of SMEs emphasize the need for an increasingly strategic focus on a more efficient and effective utilization of available

resources (Sheehan, 2014). This also applies to the human resources of SMEs. Some scholars argue that the three above-mentioned theoretical frameworks (resource-based view, dynamic capabilities, and AMO) are of even greater significance for SMEs than for their larger counterparts since SMEs “often have to do more with fewer resources in order to remain competitive” (Sheehan, 2014, p. 547). By identifying the formalization of HRM function as an antecedent of HRM intensity, the present study contributes to the extant literature on HRM intensity for the better management of human resources.

Second, although some progress has been made in the research on SMEs in other parts of the world, research on Sri Lanka, South Asia, and on developing Asian countries is very limited in the mainstream literature. Hence, more context-dependent empirical studies have been called for to better understand the practice of HRM in SMEs (see Štangl Šušnjar et al., 2016; Wickramasinghe & Mahmood, 2017). As presented in the *sample* section, although less than 1% of firms operating in Sri Lanka are medium-sized, they employ more than 13% of the total workforce (Department of Census and Statistics, 2015). Previous research in the context of Sri Lanka suggests that the difficulties SMEs face in utilizing human resources effectively are due to issues in HRM practices such as human resource planning and performance measurement (Wickramasinghe & Mahmood, 2017; Wijetunge, 2014). By investigating the formalization of HRM function and HRM intensity in Sri Lanka, the study aims to address this research gap. It is expected that academics, practitioners, and policymakers in SME-related fields may be interested in better understanding the practice of HRM in the present study context.

The paper proceeds as follows. First, the literature related to the present study is reviewed. This is followed by a description of the methodology. The findings are then presented and discussed. In the last section, the conclusions are presented together with the contributions to the existing literature and the implications for practice.

## 2. Literature review

### 2.1 Formalization of HRM function in SMEs

The formalization of HRM function denotes the degree to which HRM function is systemized and institutionalized. Indicators of the formalization of HRM function include “the extent to which a stated policy is in place, regular and written-up procedures exist, and a specialist designs and executes the HR systems” (Singh & Vohra, 2009, p. 95; also see Nguyen & Bryant, 2004; Štangl Šušnjar et al., 2016). Formalization of HRM function could lead an organization to develop appropriate HRM structures to effectively manage human resources, which could ultimately result in favourable organizational outcomes (Dekker et al., 2013; Li & Rees, 2021; Lozano-Reina & Sánchez Marín, 2019; Sánchez-Marín et al., 2019).

Concerning the formalization of HRM in SMEs, previous studies such as Štangl Šušnjar et al. (2016) and Çetinel et al. (2008) show that SMEs with a dedicated HRM department/unit are very rare. Line managers (such as chief executive/owner-managers or other department managers) are responsible for managing human resources in SMEs when neither an HRM department nor an HR manager is present (Çetinel et al., 2008; Štangl Šušnjar et al., 2016). Even in SMEs with an HR manager, Štangl Šušnjar et al. (2016) showed that decisions regarding training and financial rewards were usually taken by the line managers. However, Singh and Vohra (2009) showed an inverse relationship between the extent of involvement of the owner-manager in managing human resources and the existence of a formal policy for HRM; de Kok et al. (2003) showed that the presence of an HRM department/unit or HR manager is related to the existence of more formal HRM practices. Furthermore, SMEs with HRM policies and practices perform at higher levels (Chandler & Mcevoy, 2000), and the chances of SMEs maintaining higher retention rates increase with the presence of HR managers (Heneman & Berkley, 1999).

The literature also provides evidence to suggest that the degree of formalization of HRM in SMEs is determined by several contingency factors (Çetinel et al., 2008; de Kok et al., 2003; Li & Rees, 2021; Singh & Vohra, 2009; Urbano & Yordanova, 2008). The number of employees engaged in the enterprise (Çetinel et al., 2008; Singh & Vohra, 2009; Urbano & Yordanova, 2008), its involvement in export trade (de Kok et al., 2003), and whether it is managed by non-family counterparts (de Kok et al., 2003; Molina-García et al., 2020; Sánchez-Marín et al., 2019) were all found to influence the degree of formalization of HRM as well as how SMEs are managed in general. For example, SMEs that are managed by non-family counterparts and are involved in export trade have more formalized practices than other SMEs (de Kok et al., 2003). Furthermore, SMEs that operate as franchise units or are owned by a larger firm have more formalized practices than other SMEs (de Kok et al., 2003; Urbano & Yordanova, 2008). In addition, the degree of formalization increases with the increase in employee strength, where the level of formalization is greater in medium-sized enterprises compared to small-sized enterprises (Çetinel et al., 2008; Singh & Vohra, 2009).

## 2.2 HRM practices and intensity of practices in SMEs

Human resource management practices include those practices carried out by an organization that aid in managing its people. According to Lado and Wilson (1994), HRM practices serve the purposes of attracting, developing, and maintaining (or disposing of) an organization's human resources. When drawing on the resource-based view of the firm, the dynamic capabilities perspective, or human capital theory, the focus is on the practices that enhance employees' capabilities, i.e., their knowledge, skills, and abilities (see Appelbaum & Kamal, 2000; Barney, 1991). When drawing on the AMO model, the focus is on ability-, motivation-, and opportunity-enhancing practices (Jiang et al., 2012). Lepak et al. (2006) suggested conceptualizing HRM practices into one of these three primary areas. Accordingly, typical ability-enhancing practices include recruitment, selection, and training; typical motivation-enhancing practices include performance-based pay and job security; typical opportunity-enhancing practices include work teams and employee involvement (Jiang et al., 2012; Lepak et al., 2006). However, as there is no single agreed list of HRM practices (Sánchez-Marín et al., 2019), they cannot be grouped into distinct categories (Kellner et al., 2019). For example, previous research has classified performance appraisal as being an ability-enhancing practice (e.g., Sarikwal & Gupta, 2013), a motivation-enhancing practice (e.g., Tian et al., 2016), and an opportunity-enhancing practice (e.g., Raidén et al., 2006). Therefore, Kellner et al. (2019) argue that a prescriptive course of action to group practices into distinct categories of ability-enhancing, motivation-enhancing, and opportunity-enhancing remains elusive. When considering the popularity of applying HRM practices, Boselie et al. (2005) identified "training and development", "compensation and performance management", and "recruitment and selection" as being the top three practices in order of popularity. In the context of SMEs, the literature implies the importance of operationalizing HRM practices in a way that is SME-friendly (i.e., Sels et al., 2006; Štangl Šušnjar et al., 2016). HRM practices in operation and the extent of HRM intensity in an SME reflect the operational needs of the enterprise and the rational concerns in running the business (Barrett & Mayson, 2007; Ogunyomi & Bruning, 2016). Most HRM practices used by SMEs address the attraction, motivation, and retention of employees (Barrett & Mayson, 2007; Cassell et al., 2002; Sels et al., 2006; Štangl Šušnjar et al., 2016). Attraction practices such as planning for human resources and staffing (recruitment, selection, and hiring), motivation practices such as performance measurement, and retention practices such as training are identified as being the main sources of SME performance (Appelbaum & Kamal, 2000; Brand & Croonen, 2010; Ogunyomi & Bruning, 2016; Štangl Šušnjar et al., 2016). Accordingly, the present study investigated three HRM practices commonly used by SMEs, namely planning for workforce needs and staffing (recruitment, selection, and orientation), performance measurement, and training.

Most of the previous studies that investigated HRM intensity limited themselves to listing the HRM practices present and used descriptive techniques to present their findings (e.g., Nguyen & Bryant, 2004; Sels et al., 2006; Singh & Vohra, 2009; Štangl Šušnjar et al., 2016). However, a few studies went beyond merely investigating the presence of HRM practices to investigate the extent of HRM intensity (e.g., Brand & Croonen, 2010; Çetinel et al., 2008; Marescaux et al., 2012). These studies emphasized the importance of implementing HRM practices in view of the employees' capabilities and expectations, as well as the interests of the organization. This is in line with the arguments of Edgar and Geare (2005) who stated that the way HRM practices are used is more important than their mere presence. The literature further suggests that significant differences exist between larger firms and SMEs with respect to *how* HRM practices are adopted, and not with respect to *what* HRM practices are adopted (Nguyen & Bryant, 2004, p. 601), and this involves the extent of HRM intensity. However, multiple previous studies demonstrated that HRM intensity in SMEs is less professional and less intensive in nature compared to their larger counterparts (Brand & Croonen, 2010; de Kok et al., 2003; Kotey & Slade, 2005; Sels et al., 2006).

### 2.2.1 Planning for workforce needs and staffing

Having an adequate workforce supply to perform the required work is of fundamental concern to SMEs. Workforce planning helps to obtain the right number and quality of employees with the appropriate attributes wherever and whenever they are needed. However, Çetinel et al. (2008) provided evidence to suggest that SMEs often have poor workforce planning and only recognise personnel requirements when a person resigns, which could have negative consequences for the staffing process. Hence, paying inadequate attention to the number and quality of employees and to the employee resourcing process could be central to several subsequent issues in managing employees in SMEs. Job descriptions identify job roles, clarify the tasks to be performed, and minimize errors in the staffing process. According to Kotey and Slade (2005), jobs are not always clearly defined in smaller firms compared to larger ones; job descriptions in smaller firms are vague because of not incorporating the changes that have taken place over time, leading to employees creating their own jobs. Similar evidence was also provided by Çetinel et al. (2008) and Priyanath (2010). Appropriate staffing practices involve recruitment, selection, and orientation, and these practices are usually less formal in SMEs. For example, the smaller the size of the enterprise, the greater the reliance on informal sources of potential employees through word-of-mouth recruiting (Çetinel et al., 2008; Štangl Šušnjar et al., 2016). However, the number of formal practices such as job vacancy advertising and conducting formal job interviews increases with enterprise growth to adequately respond to the firm's needs (Carlson et al., 2006; Çetinel et al.,

2008; Priyanath, 2010; Štangl Šušnjar et al., 2016). Building on the literature reviewed above, the following hypothesis is proposed:

**H1:** *Formalization of HRM function positively affects the intensity of workforce planning and staffing practices.*

### 2.2.2 Performance measurement

The evaluation of past performance against set standards, the identification of gaps between past performance and expectations, the provision of feedback on performance, and the establishment of corrective actions to address gaps or rewards are vital in the performance appraisal process. Kotey and Sheridan (2004) suggest that SMEs are in a better position to observe and correct employees' performance on the spot due to the smaller size of the enterprises. However, studies such as Cassell et al. (2002) and Çetinel et al. (2008) showed that formal performance appraisals are rare in SMEs. However, Carlson et al. (2006) showed that employee performance appraisals are more common in faster-growing SMEs. Some studies showed that as firm size increases, employee performance appraisals become more extensive (e.g., Hornsby & Kuratko, 1990). However, SMEs often use performance measurements to monitor and control worker outcomes rather than to identify development needs (Barrett & Mayson, 2007). Furthermore, Hongmin and Yanbing (2011) state that when there are issues in the performance appraisal system, employees are more likely to seek employment elsewhere, especially those with higher skills. Building on the literature reviewed above, the following hypothesis is proposed:

**H2:** *Formalization of HRM function positively affects the intensity of performance appraisal practices.*

### 2.2.3 Training

The literature emphasizes the importance of employee training for SMEs (Carlson et al., 2006; Cassell et al., 2002; Çetinel et al., 2008; Hongmin & Yanbing, 2011; Sheehan, 2014; Štangl Šušnjar et al., 2016). When it comes to the provision of training, the orientation of new employees is identified as a specific form of training where employees learn their job roles alongside other workers within the enterprise. Re-training is also important for SMEs. Although SMEs mainly rely on the prior skills, knowledge, and experience of their employees rather than the provision of training to suit the enterprise concerned (Greenidge et al., 2012), faster-growing SMEs provide more training opportunities for employees (Carlson et al., 2006). According to Çetinel et al. (2008), many SMEs identify training needs based on quality issues in final outcomes (products/services and customer complaints) or from employee performance appraisal information. Skill-based training involves the learning of discrete skills needed to perform specific or limited/selected job tasks compared to the acquisition of a broader set of skills that makes an employee more versatile and flexible (Hongmin & Yanbing, 2011). MacMahon and Murphy (1999) suggest that employees with highly specialized skills are less appropriate for SMEs since these enterprises need employees with a more flexible range of skills. On-the-job training is identified as the predominant method of training in SMEs in addition to orientation training (Kotey & Slade, 2005). These training sessions in SMEs were tailored for previously identified needs, which makes the training effort both focused and targeted (Cassell et al., 2002). Furthermore, hands-on enterprise-specific training can create an internal labour market that holds down the value of an employee to other firms (Arthur & Hendry, 1990). The existence of a training policy, training plan, and training budget are also identified as important for SMEs (Wickramasinghe & Mahmood, 2017). Building on the literature reviewed above, the following hypothesis is proposed:

**H3:** *Formalization of HRM function positively affects the intensity of training practices.*

## 3. Methodology

### 3.1 Sample and data collection procedure

The study was conducted in medium-sized enterprises in Sri Lanka. Following the guidelines of the United Nations Industrial Development Organization (UNIDO) (2004), enterprises with a number of employees ranging from 50 to 249 were considered as medium-sized enterprises. In the Sri Lankan context, irrespective of the size of the enterprise, all businesses operating in the country adhere to government-stipulated labour laws and standards. In addition, some SMEs even provide food, accommodation, and year-end bonuses, and operate schemes for employee recognition, such as Employee of the Month awards, with the intention of attracting and retaining employees in Sri Lanka (Wickramasinghe & Mahmood, 2017, p. 403). Contingency theory (Delery & Doty, 1996) provides the theoretical underpinning to the notion that HRM intensity in SMEs could be influenced by various contingencies, such as the location and age of the business. For example, most of the medium-sized and large enterprises were identified as operating in urban areas of Sri Lanka, unlike the micro enterprises (Department of Census and Statistics, 2015). Moreover, the number of years the business has been in operation is important for SMEs when adopting standard business practices in Sri Lanka, where enterprises which have been operating for seven years or more have more strategic planning compared to

enterprises which have been operating for less than seven years (Wijetunge, 2014). Furthermore, the literature suggests that family-owned businesses do not generally have business plans and apply less formalized practices, and remarkable differences exist in the way HRM is applied compared to non-family businesses (Reid et al., 2002; de Kok et al., 2003, p. 6). In addition, SMEs engaged in export trade, with franchise agreements, or SMEs that cooperate with larger firms in business operations show remarkable differences in managing human resources compared to their respective counterparts (de Kok et al., 2003; Urbano & Yordanova, 2008). Therefore, the following criteria were used in the study to identify medium-sized enterprises:

1. The total number of employees should be between 50 and 249 to be considered a medium-sized enterprise.
2. The enterprise must have been operating for more than seven years.
3. A dedicated department/unit is in place to manage employee-related matters.
4. The human resources department/unit should be headed by a dedicated person (identified as the HR manager, personnel officer, or HR/personnel executive).
5. The HR department/unit must have been in operation for more than five years.
6. The enterprise should not be a family-owned business.
7. The enterprise should be engaged in export trade.

The sample was composed of medium-sized enterprises operating in the western province, the main business hub of the country, using convenient and snowball sampling methods. The study was designed to capture the experiences of line managers (non-HR managers). Hence, potential respondents were line managers in lower (supervisor) to middle-level managerial job positions, with subordinates reporting to them. In addition, potential respondents were considered as those who had at least three years' experience in the present workplace since their capacity to make an accurate assessment of HRM intensity is important. For each enterprise, a maximum of half of the individuals who fulfilled the sample selection criteria were invited to participate in the survey. Participation was voluntary and anonymous. The survey was distributed across 30 medium-sized enterprises and a total of 181 responses was received.

### 3.2 Measures

The formalization of HRM function was measured on a six-item scale developed for the study. This scale intended to capture whether the respondents agreed with the level of formalization, and the items were measured on a five-point Likert scale that ranged from *strongly agree* (5) to *strongly disagree* (1), as shown in Table 1. HRM intensity was measured on a ten-item scale developed for the study. This scale intended to capture the actual level of use rather than the respondents' feelings, such as satisfaction or importance. Hence, the items were measured on a three-point Likert scale that ranged from *highly used* (3), to *used to some extent* (2), and *not used at all* (1), as shown in Table 2. All Likert-scales (such as three-, five-, seven-, and nine-point scales) are recognized as valid and reliable depending on what is being measured (see Brown, 2010; Jacoby & Matell, 1971; Vagias, 2006). The item measures developed for the present study were pre-tested with a sample of appropriate personnel to ensure content and face validity. The item measures of internal consistency reliability, factor structure, convergent validity, discriminant validity, and construct reliability were ensured during the data analysis, as described in the next section. Regarding the control variables, as described in the section on the sample, the study controlled for seven contingency variables at the sample selection stage.

### 3.3 Method of data analysis

Factor analysis was performed on the two scales, i.e., the formalization of HRM function and HRM intensity, for appropriate internal consistency reliability, factor structure, convergent validity, discriminant validity, and construct reliability (CR) to identify any issues with multicollinearity and response bias. Convergent validity was measured using the average variance extracted (AVE) and discriminant validity was measured using the square root of AVE. As detailed in the *results* section, the factor analysis for the formalization of HRM function yielded one factor (the independent variable) and the factor analysis for HRM intensity yielded three factors (the dependent variables). The intention of the study was to test the effect of the independent variable on all three dependent variables instead of running three separate models using a simple regression analysis. Hence, a multivariate general linear model was used for testing the hypotheses, and the results were interpreted accordingly (IBM SPSS Statistics, 2020). As already explained in the *sample* and *measures* sections, the study controlled for seven contingency variables at the sample selection stage, and none were controlled for at the data analysis stage.

## 4. Results

The results of the factor analysis for the formalization of HRM function is shown in Table 1. The factor analysis yielded one factor, which explained 55% of the variance.

**Table 1.** Formalization of HRM function

Item	Formalization
Overall, the HRM unit/department plays an important role in archiving the objectives of my organization	.806
The HRM personnel understand how the HRM unit/department can add value to my organization	.781
The HRM unit/department regulates uniform human resource procedures throughout my organization	.709
The HR personnel in my organization acts professionally when making decisions related to human resources in my organization	.773
The HRM unit/department regulates uniform human resource policies throughout my organization	.704
The HRM personnel is actively involved in making decisions related to human resources in my organization	.667
Eigenvalue	3.299
% of variance	54.99
Cronbach's Alpha	.832
Average variance extracted	.550
Construct reliability	.880

Table 2 shows the results of the factor analysis for HRM intensity. The analysis yielded three factors, namely performance appraisal, training, and workforce planning and staffing. These three factors explained 66% of the total variance. The results of the correlation analysis together with the means and standard deviations are shown in Table 3.

**Table 2.** HRM intensity

Item	Performance appraisal	Training	Workforce planning and staffing
Performance appraisal mechanism allows to identify employees' current performance	.717		
Performance appraisal mechanism allows to identify employees' development needs	.737		
Performance targets are jointly agreed upon between the supervisor (or organization) and the employee concerned	.797		
Performance appraisal feedback is given on time to employees	.816		
Formal orientation to the organization is a major training event for new employees		.639	
Training needs are evaluated before approving training requests		.915	
Training requests are evaluated on time		.862	
The job role of vacant positions is fully understood before commencing the employee resourcing process			.799
The personnel supply within the organization is fully understood before commencing the resourcing process to fill the vacancies			.708
Potential candidates are subjected to interviews/tests (whichever is more appropriate) before the selection is made			.693
Eigenvalue	2.609	2.140	1.899
% of variance	26.09	21.40	18.99
Cronbach's Alpha	.812	.798	.679
Average variance extracted	.890	.663	.540
Construct reliability	.851	.852	.778

**Table 3.** Correlation

Variable	Mean	SD	1	2	3	4
1 Formalization of HRM function	2.68	.79	.74			
2 Workforce planning and staffing	2.65	.83	.479**	.73		
3 Performance appraisal	2.75	.88	.542**	.446**	.94	
4 Training	2.32	.97	.487**	.408**	.370**	.81

Note: \*\*p < 0.01; square root of AVE on diagonal entries

Table 4 shows the parameter estimates of the multivariate general linear model. The partial eta squared value of 0.229 (p < 0.001) suggests that the formalization of HRM function accounts for 23% of the variation of the intensity of workforce planning and staffing practices, which supports H1. The partial eta squared value of 0.294 (p < 0.001) suggests that the formalization of HRM function accounts for 29% of the variation of the intensity of performance appraisal practices, which supports H2. The partial eta squared value of 0.237 (p < 0.001) suggests that the formalization of HRM function accounts for 24% of the variation of the intensity of training practices, which supports H3. Table 5 shows the results of the between-subjects error sum-of-squares and cross-products (SSCP) matrix depicting the cross effects of the intensity of the three practices. The results

of the multivariate tests for the overall model, i.e., the effect of formalization of HRM function on the three dependent variables are shown in Table 6. The results suggest that the overall model is significant (Wilks' Lambda = 0.423, Pillai's Trace = 0.577, Partial Eta Squared = 0.423,  $p < 0.001$ ). The partial eta squared value for the overall model indicates that 42% (0.423) of variation of HRM intensity of the three practices is accounted for by the formalization of HRM function.

**Table 4.** Parameter estimates

Dependent variable	B	t	Sig.	Partial Eta Squared
Workforce planning and staffing	.503	6.769	.000	.229
Performance appraisal	.605	8.012	.000	.294
Training	.594	6.922	.000	.237

**Table 5.** Between-subjects SSCP Matrix

Formalization of HRM function	Workforce planning and staffing	Performance appraisal	Training
Workforce planning and staffing	24.953	30.018	29.468
Performance appraisal	30.018	36.112	35.450
Training	29.468	35.450	34.800

Note: Based on Type III Sum of Squares

**Table 6.** Results of multivariate tests

Test	Value	F	Sig.	Partial Eta Squared
Pillai's Trace	.423	37.089	.000	.423
Wilks' Lambda	.577	37.089	.000	.423

## 5. Discussion of findings and implications

This empirical research investigated HRM intensity in the SME sector using a sample of medium-sized enterprises in Sri Lanka. The specific objectives were to evaluate the level of formalization of HRM function and HRM intensity, and whether the formalization of HRM function leads to HRM intensity in SMEs. Concerning the first objective, i.e., the level of formalization of HRM function, formalization denotes the extent to which HRM function is systemized and institutionalized. It was found that the formalization of HRM function is not at a satisfactory level; a mean value of 2.68 on a five-point Likert scale does not suggest an appreciable level of formalization of the HRM function. Previous research, such as Štangl Šušnjar et al. (2016), also showed that the formalization of HRM in SMEs is not at a satisfactory level. Although the present study targeted the specific category of SMEs, the findings generally support the observations of previous research on the formalization of HRM function (e.g., Sheehan, 2014; Singh & Vohra, 2009; Štangl Šušnjar et al., 2016). The second objective of the study was to investigate HRM intensity. Workforce planning and staffing, performance appraisal, and training practices were investigated in the study. The mean values suggest that these three practices were used to some extent (workforce planning and staffing = 2.65, performance appraisal = 2.75, and training = 2.32 on a three-point Likert scale). The mere presence of HRM as well as poorly designed and implemented HRM practices do not drive favourable outcomes (Edgar & Geare, 2005). Therefore, the third objective of the study was to investigate whether the formalization of HRM function leads to HRM intensity. The results show that, indeed, the formalization of HRM function leads to HRM intensity. Specifically, the formalization of HRM function accounts for 23% of the variation of the intensity of workforce planning and staffing, 29% of the variation of the intensity of performance appraisal, and 24% of the variation of the intensity of training, i.e., the findings support the proposition that the formalization of HRM function leads to greater HRM intensity. The results of the study contribute to the literature on SMEs and provide much needed information for academics, researchers, practitioners, and policymakers.

Regarding the contribution of the study to the extant literature, SMEs represent the most numerous and important category of organizations of any nation and SMEs that are growing or growth-oriented are vital for the progress of a nation. Still, relatively little is known and understood about people management in SMEs. The extant literature identifies HRM as one of the most important management activities in SMEs (e.g., Li & Rees, 2021; Sánchez-Marín et al., 2019; Štangl Šušnjar et al., 2016; Wickramasinghe & Mahmood, 2017). However, not much research on HRM in SMEs is widely available, i.e., studies on HRM practices remain a phenomenon of larger firms. When it comes to managing SMEs, on the one hand, it is possible to argue that these should be managed following essentially the same principles that apply to larger firms but on a much smaller scale. On the other hand, it is possible to argue that SMEs are not smaller versions of larger firms. SMEs need special attention due to the conditions they face, especially the poverty of resources such as financial and staff functionaries, which impact on their very existence. As Wickramasinghe and Mahmood (2017) showed, SMEs operating in Sri Lanka must operate with a less reliable, less educated, and less skilled

workforce due to difficulties in offering stable employment and career prospects when attracting employees from the external labour market, and a lack of employee training leads to difficulties in creating an internal labour market compared to large firms. In addition, when employees feel that they are not treated as they deserve through performance appraisal and the provision of skill development opportunities, they seek employment elsewhere. Even worse is that those who leave tend to be the employees who perform best in the workplace. Therefore, by studying medium-sized enterprises, the investigation focused on a type of SME that has been neglected in the HRM research.

In connection to the above points, one of the main limitations of previous studies on HRM practices in SMEs was that all types of such enterprises, i.e., micro-, small-, and medium-sized firms, were investigated together. The present study argues that the different types of SMEs cannot be put into the same basket when investigating HRM practices. This is in line with the arguments of recent research such as Li and Rees (2021) and Sánchez-Marín et al. (2019). Therefore, medium-sized enterprises cannot be equated to either large firms or micro- and small-sized enterprises. Therefore, the present study was limited to medium-sized enterprises and makes an important contribution to the research on SMEs.

Furthermore, most of the research on HRM intensity in SMEs is still exploratory in design and descriptive in analysis (e.g., Štangel Šušnjar et al., 2016). In this context, the present study was designed to confirm whether the formalization of HRM function leads to HRM intensity in SMEs. In doing so, the study developed measures suitable for SMEs to assess the formalization of HRM function. In addition, the study assessed the intensity of three HRM practices by developing measures suitable for SMEs, and found that although the formalization of HRM is at a low level, HRM intensity is high. In addition, the study shows that higher formalization leads to greater HRM intensity. The findings of the present study empirically support the claims made by Brand and Croonen (2010), i.e., the formalization of HRM function is a prerequisite for the effective and efficient practice of HRM.

The findings have several implications for practice. First, the small scale of an enterprise results in a lack of specific resources such as staff functionaries. The findings of a recent study by Li and Rees (2021) showed that a larger number of employees as well as the presence of an HRM department in SMEs lead to a greater level of formalization of HRM. The sample of the present study was confined to medium-sized enterprises with an HRM department headed by a dedicated person. The findings show that the formalization of HRM function leads to higher HRM intensity. Hence, the findings imply that medium-sized enterprises need to have HRM policies and procedures due to the number of employees; these enterprises cannot wait for acute HR issues to arise. Furthermore, the cost of setting up and maintaining an HR department/unit can be spread over the number of employees of the enterprise. Therefore, the formalization of HRM function should not be considered as an alternative option.

Second, an important question related to HRM intensity is how profitable intensive HRM is for SMEs. The three practices of workforce planning and staffing, performance appraisal, and training are important for SMEs. The findings of the study imply that the intensity of these three practices allows medium-sized enterprises to be more transparent in their engagement with employees, as they have a relatively large workforce compared to micro- and small-sized enterprises. Specifically, the findings suggest that the intensity of workforce planning and staffing may lead to obtaining the required workforce on time and becoming attractive for potential employees. Enterprises may experience the beneficial consequences of having clearer job descriptions (such as a better understanding of the requirements of the enterprise in the recruitment and selection process) and being more focused in providing orientation training. The findings suggest that with the intensity of performance appraisal practices, performance assessment can be standardized; an attempt can be made to separate the appraisal of performance from the assessment of potential. This may result in beneficial consequences for the enterprise such as improvements in and maintenance of current performance as well as focused expectations for the future performance of employees. The findings also suggest that training practices contribute to continual growth in workforce capabilities. Therefore, a greater intensity of training practices can address the specific skill needs of the business that may not be transferable, and yet satisfy the skill needs of the enterprise and create an impression on employees of their value to the enterprise. Moreover, the existing employees may become happier due to more standardized and transparent training practices.

Overall, when building on the findings of the present study, on the one hand, HRM intensity may result in a more effective use of the workforce and create a better perception of the enterprise, which in turn leads to attracting, motivating, and retaining the workforce in order to survive and remain competitive. On the other hand, when the number of employees at medium-sized enterprises increases, they may experience an internal need for bureaucracy with the development of identifiable HR strategies, formal policies and procedures, and documentation procedures. This could result in higher levels of HRM intensity for a more effective management of the growing workforce. However, more future research is needed in this line to make informed assessments.

## 6. Conclusion

Although SMEs are the main generators of economic performance, the providers of employment for most of a country's workforce, and the sector with the highest potential for economic recovery and development, they have been underrepresented in the HRM literature. The present study was designed to evaluate the level of formalization of HRM function and HRM intensity, as well as the association between the formalization of HRM function and HRM intensity. The formalization of HRM denotes whether HRM function is systemized and institutionalized, whereas HRM intensity denotes the extent of use of a set of HR practices. The study investigated three practices, which were identified as being the most common and important for SMEs for attracting, motivating, and retaining employees. These three practices were workforce planning and staffing, performance appraisal, and training. The results showed that the enterprises analysed have a relatively low formalization of HRM function. However, HRM intensity is high. The findings show that higher levels of formalization lead to greater levels of HRM intensity. Overall, the study addresses an important gap in the extant SME literature and provides valuable information for researchers and practitioners.

## 7. Limitations of the study and recommendations for future research

The extent to which HRM practices are used can be related to the adoption of certain practices as well as the integration and alignment with the organization and other organizational strategies. The present study adopted the former approach and substantiated the intensity of three HRM practices. On the one hand, although both adoption and integration are important, the adoption of practices examines individual practices in isolation. This approach is commonly found in the literature on SMEs. On the other hand, the integration of HRM with organizational strategies allows to evaluate the process of incorporating HR decision-making at the strategic level in SMEs. Therefore, the evaluation of business strategies and HR strategy, as well as the level of strategic orientation of SMEs are also important in HRM intensity. However, this type of evaluation requires more qualitative investigations, which opens avenues for future research.

Concerning the formalization of HRM function, the majority of the responses denoted that formalization is not extensive, i.e., there exist gaps in the systemization and institutionalization of the function. In addition, regarding HRM intensity, most of the responses ranged between *highly used* and *used to some extent*. This suggests that some gaps exist in the intensity of HRM practices even when HR departments/units exist and dedicated personnel are available to handle the management of human resources. Therefore, in-depth qualitative data will be able to explain the context in detail.

Furthermore, the present study was limited to investigating the intensity of three HRM practices. On the one hand, it is difficult to find a single agreed list of HRM practices (see Kellner et al., 2019; Sánchez-Marín et al., 2019). On the other hand, the importance of HRM practices could be context dependent (see Li & Rees, 2021). Regarding the former, Boselie et al. (2005) identified 26 different HRM practices, whereas Fobrum et al. (1984) identified four. Regarding the latter, although the literature suggests that some HRM practices are more important for SMEs, there is no agreement on which are the most important (see Cassell et al., 2002; Li & Rees, 2021; Sels et al., 2006; Sheehan, 2014; Štangel Šušnjar et al., 2016). Therefore, researchers could expand the list of HRM practices taken into consideration when designing future research studies.

Furthermore, a wide spectrum of external and internal contingencies could prevail in a given context (see Boselie et al., 2005; Li & Rees, 2021; Raidén et al., 2006). Although the study controlled for seven contingency variables at the sample selection stage, none were controlled for at the data analysis stage. Future research could decide which variables are to be controlled for at the sample selection stage, which are to be controlled for at the data analysis stage, and which are to be included as moderators. For instance, based on the findings of the present study, it would be useful to collect and analyse as possible moderators the number of years of experience of the HR personnel as well as their specific skills in the HR domain.

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