Moderating Role of Competitive Environment between Knowledge Management, Human Capital and SMEs' performance: Emerging Countries' Perspective

Khansa Masood[1]
Mohd Noor B Mohd Shariff[2]
Halim Bin Mad Lazim[3]

Abstract

The importance of small and medium enterprises (SMEs) and their economic contribution is acknowledged globally. Although SMEs in developed economies have become fairly competitive, their counterparts in the emerging economies have struggled in the rapidly evolving external environment. The objective of this study is to present a conceptual framework for SMEs in emerging economies targeted to raise their performance. Literature indicates that the low skill level of human resource and the lack of emphasis on knowledge management are the major factors behind the struggle of SMEs to establish themselves in emerging economies. Earlier studies have discovered a positive impact of knowledge management and human capital in raising SMEs' performance. Literature also indicates that the influence of knowledge and human capital within SMEs' performance varies due to the prevailing competitive conditions. Therefore, this study proposes a conceptual framework to leverage the performance of SMEs in emerging economies and examines how this relationship may vary when it interacts with the competitive environment.

Keywords: access to finance, human capital, knowledge management, SMEs, SMEs' performance

1. Introduction

The role of SMEs in the development of a country's economy and stimulating economic growth is multipronged. SMEs are believed to have a

[1] School of Business management, University Utara Malaysia, Sintok Campus, Malaysia;
[2] School of Business management, University Utara Malaysia, Sintok Campus, Malaysia;
[3] School of Business management, University Utara Malaysia, Sintok Campus, Malaysia
Correspondence concerning this article should be addressed to Khansa Masood, School of Business management, University Utara Malaysia, Sintok Campus, Malaysia. E-mail: khansa.chandio@gmail.com

paramount significance which deserves full-scale support from governments and other economically supporting units in a country. SMEs that lack the financial and other required resources to operate face an adverse impact on their performance and competitiveness which can attenuate the economic growth in a given country (Khan, 2015). Thus, it is essential to determine the underlying challenges and issues SMEs face in today's intensely competitive business environment.

Interestingly, the concept of SMEs differs from country to country across the globe. There is no uniform definition of SMEs, rather they are premised on parameters such as annual turnover, total invested capital, total number of employees and sales volume (Ng & Kee, 2012). SMEs account for over 90% of businesses at the global level (Vashisht, Chaudhary, & Priyanka, 2016). The pivotal place of SMEs in the world economy is affirmed by the enormous contribution they make to employment creation and national income (GDP) in many high performing economies around the world. For example, in the United State of America, SMEs contribute 50% to the total employment and 52% to the country's GDP. The figures from Japan show a similarly significant contribution, 75% contribution to employment creation and 60% contribution to the GDP. SMEs in the European Union also make a sizable contribution of almost 58% to the economy and 67% to employment creation. These figures furnish the evidence of the crucial impetus SMEs provide to the global economy.

SMEs play an important role in providing goods and services that large size enterprises either fail to offer or they deem them insignificant and undesirable (Amwelex, 2013). Especially, the manufacturing process and the nature of trade in textile, skin processing, metal processing, glass and mineral exploration, and wool and food processing units allow them to be dominated by SMEs (Bowen, Morara, & Mureithi, 2009). It is believed that SMEs in emerging economies are strapped due to their small size. However, some find it advantageous, since their small size provides them with flexibility and versatility. Such characteristics may provide a competitive edge in domestic and international markets when competing with rigid and bureaucratically structured large corporations.

Numerous studies have identified the problems of SMEs that include a severe absence of technical and non-technical innovation (Saunila, 2014; Weerawardena, O'Cass, & Julian, 2006), deficient human resource competency (Prajogo, 2016), branding (Hirvonen, Laukkanen, & Reijonen, 2013) and dynamic competitive environment (Gaur, Vasudevan, & Gaur, 2011). A closer look at SMEs in the emerging economies highlights the directly influencing factors such as human and financial knowledge and constraints of market-based resources that potentially affect adversely their high performance. In the same vein, the lack of competence needed to leverage the resources adds to the concerning state of SMEs (Khalique, Shaari, Isa, & Ageel, 2011; Prajogo & Oke, 2016; Qureshi & Herani, 2011).

A probe into the state of SMEs' performance in Pakistan reveals that they have been gravely affected by the lack of government assistance, energy crisis, political turmoil, lack of access to international markets, deficiency of innovation, absence of branding approach, below par quality benchmarks and uncertainty of the business environment (Afraz, Hussain, & Khan, 2014; Khalique et al., 2011; Qureshi & Herani, 2011; Tanvir, Rizvi, & Riaz, 2012). The performance of SMEs in Pakistan has been dismal despite the business potential offered by its market. As compared with countries like India and China, SMEs in Pakistan have attained a much lower threshold of performance than their actual potential (Tanvir et al., 2012), which is evident from only 4.47% growth of SMEs in Pakistan as compared to the 9.1% growth rate attained by Chinese SMEs (Afraz et al., 2014; Khan, 2015). SMEs in Pakistan has also struggled due to the status quo and sluggish economic growth for the last six decades.

The critical nature of SMEs for economic development is undeniable. However, the intensive competitive forces that greatly affect the long-term performance of SMEs in developing countries (Ates, Garengo, Cocca, & Bititci, 2013) demand a close analysis of the market to uncover the underlying factors for the below-par performance of SMEs. SMEs in Pakistan are struggling due to the shortage of valuable resources and competencies that have led them to become virtually dormant or perform negatively (Kazmi, 2017). Therefore, the current study is focused on the variables that can influence the performance of SMEs.

2. Conceptual Framework

Managerial and operational practices, total number of employees, annual turnover, market share, and internal and external environment are the major factors that differentiate SMEs from large enterprises (Pascal & Alain, 2012). Other prominent differences are personalized and modified products and services offered by SMEs that large organizations generally do not. Likewise, in the context of Pakistan, the SMEs policy document viewed SMEs as entities that employ less than 250 people, have the worth of 2.5 million PKR maximum paid-up capital and annual sales of 250 million PKR (SMEDA, 2007).

Based on the issues highlighted above, a conceptual framework is proposed by bringing forward competitive environment as a moderating force that affects the strategic resources and capabilities of SMEs and that can ultimately lead to raising performance, especially in emerging economies.

2.1 Human Capital

Literature on SMEs argues that human capital represents the attributes of Resource-Based Theory (RBT) (Crook, Todd, Combs, Woehr, & Ketchen, 2011; Wright, Dunford, & Snell, 2001). In knowledge-driven economies, knowledge is an "invisible asset" which has earned a growing importance in securing competitive advantage (Grant, 1991; Hitt, Bierman, Shimizu, & Kochhar, 2001), predominantly relying on resources that are rare and hard - to - imitate and are rooted deep in the fabric of organizations (Barney, 1991; Black & Boal, 1994). Factoring in that a large part of organizational knowledge remains with the employees, human capital is an organization-specific asset that often becomes impossible for competing firms to replicate (Coff, 1997; Crook et al., 2011; Grant, 1991, 1996). Moreover, every business situation is unique in nature and their mechanism to solve issues is largely not applicable to other businesses (Kor & Mahoney, 2005; Lado & Wilson, 1994).

Thus, SMEs that are focused on developing their human capital through skills and knowledge enhancement based on innovative ideas are likely to benefit from it and perform better in the marketplace. A firm's ability to repeatedly create unique and innovate solutions and practices is often a result of consistently pressing for latest and diversified creative knowledge. In the same vein, the role of human capital in services business is to create and enhance innovate service solutions by employing critical creative skills and knowledge to test and realign the status quo, that is, the prevailing methods. Hence, previously it has been established that human capital in the services firms positively influences the competitive advantage for these firms (Liao & Chuang, 2004; Skaggs & Youndt, 2004; Susskind, Kacmar, & Borchgrevink, 2003). Nonetheless, some studies have also reported conflicting findings pertaining to human capital and organizational performance (Chan, 2009; Chu, Chan, & Wu, 2011). Based on these arguments, the following proposition can be developed.

Proposition 1: Human capital has a positive impact on SMEs' performance.

2.2 Knowledge Management

Perhaps, the most recognized and widely discussed contribution to the conceptualization of knowledge management came from Nonaka and Takeuchi (1995), who postulated that employee experience and creative experience are the two prerequisites needed to gain competitive advantage through knowledge management. They conceptualized that knowledge is of two types, tacit knowledge and explicit knowledge. Explicit knowledge is accessible through words, numbers, and codes that are shared and communicated among people. On the contrary, tacit knowledge is a built-in characteristic in the minds of individuals which results from personal experiences.

Knowledge management earned recognition as a life-long tool to raise organizational performance and has been practised by organizations since 1990 (Al-Hakim & Hassan, 2011). The current age, being the age of knowledge, has further enhanced the reliance of organizations on knowledge and to treat it as a resource for managing information and to compete for survival in the market (Liao & Wu, 2009). It is also well-acknowledged as a strategic resource which leads to gaining competitive advantage for businesses. Essentially, knowledge management is potentially leveraged to enhance customer perception and customer attraction (Davood & Morteza, 2012). The importance of knowledge management becomes more obvious keeping in view how organizing information leads to guiding, maintaining and enhancing a firm's revenue (Shehu & Mahmood, 2014). Thus, it has been argued to be an efficient organizational asset, since knowledge management effectively contributes to value addition and in dealing with unforeseen occurrences (Davenport & Prusak, 1998).

Numerous studies have reported a positive impact of knowledge management on firms' performance. For instance, customers' loyalty, satisfaction and efficient decision making were found to be the consequences of effective knowledge management (Alavi, Kayworth, & Leidner, 2005). Similarly, Wang, Lee, Wu, Chang, and Wei (2012) undertook a study and emphasized the primary effect of organizational information embedded in various processes, branches, units, and employees on organizational performance (Safa, Shakir, & Boon, 2006). The role of organizational knowledge and how it is created, organized and put to work reaches deep into the success of organizations (Ahmadi & Ahmadi, 2011). Moreover, knowledge management is also essential in enhancing the sustainable competitiveness of SMEs (Egbu, Hari, & Renukappa, 2005).

However, a few studies have also found contradictory evidence in the context of positive influence of knowledge management on firms' performance (Darroch, 2005). Hence, this study proposes to further evaluate how knowledge management affects SMEs, specifically in emerging economies. Based on these arguments, the following proposition can be developed.

Proposition 2: Knowledge management has a positive influence on SMEs' performance.

Prior studies have recognized that business environment is one of the main forces that affect firms' strategic competence and choices (Barney, 2001; Ketokivi, 2006; Sousa & Voss, 2009). Human capital is fairly dependent on its fit with the overall business environment which highlights the role competitive environment plays in establishing the relationship between human capital and firms' performance. Therefore, it is important to understand that organizational capabilities are not only the consequences of human capital but the alignment of organizational capabilities with the external business environment is always a part of this process. The overlying role of environment has also been viewed as the contingency factor in organizational performance because the external environment functions as the constraint that firms must consider when drawing strategic actions and reaping benefits from them (Dess & Beard, 1984).

Therefore, the earlier discussed conflicting findings in relation to human capital, knowledge management and SMEs' performance demand further comprehensive studies to examine the relationship between the abovementioned determinants and SMEs' performance. Thus, to address the inconsistent results of the earlier studies, it is appropriate to introduce a moderating variable that potentially influences the relationship between knowledge management, human capital and SMEs' performance, following the recommendations from Baron and Kenny (1986).

2.3 Competitive Environment as a Moderator

Competitive environment is explained as the propensity of competition that a firm faces when operating in an external environment (Matusik & Hill, 1998). In other words, it is the extent of rivalry that firms counter from various competitors in an industry (Miller, 1987). It is also viewed as the intensified pressure to increase efficiency and lower price margins to better compete in the industry (Matusik & Hill, 1998) and it puts constraints on firms to exercise internal practices towards lean management and drawing competitive profit margins (Zahra, 1996). As competition intensifies, the pressure on cost cutting and lean management practices leads firms to transform themselves while simultaneously ensuing similar reactions from other players of the industry.

Big challenges exist for SMEs amidst the growing competitive environment due to their generic approach of employing inadequate competence and resources to respond to the emerging external competitive forces (Bamford, Dean, & McDougall, 1999). The more intense and complex the competition is, the higher is the need for firms to respond to emerging challenges. Cohen and Levin (1989) also reported that manufacturing firms are greatly affected by the competitive environment to outperform competitors. Hence, firms must invest resources to improve operations and become impregnable for their rivals and develop the competence to consistently deliver innovative products at a lower cost (Ren, 2009).

The introduction of competitive environment as a moderator is in line with the contingency theory that states there should be a fit between strategic resources and environment to cast a positive impact on performance (Hambrick, 1982; Venkatraman & Prescott, 1990). Similarly, Resource-based Theory (RBT), which is intrinsically linked to the contingency approach, advocates the use of strategic resources and capabilities which are rare, valuable, inimitable and non-substitutable (Barney, 1991) to build competitive advantage (Prajogo, 2016).

The business environment of an organization determines the strategic choices it makes (Barney, 2001; Ketokivi, 2006; Miller & Friesen, 1982; Sousa & Voss, 2009). Competitive environment is believed to be an important contingency factor which affects different innovation strategies while delivering business performance (Prajogo, 2016). Particularly, it is believed to strengthen the relationship between process innovation and business performance. It has been stated that competitive environment compels the firms to introduce innovative products and services to protect their market share (Damanpour & Gopalakrishnan, 2001).

Earlier studies have also identified the moderating effect of competitive environment which supports the notion that a hostile and competitive environment appears to strongly moderate corporate entrepreneurship and financial performance (Zahra & Covin, 1995). Another study has examined the influence of external environmental concerns on SMEs' performance (Tang & Tang, 2014). Similarly, the role of external environmental factors, specifically competitive intensity, is also identified as a moderator between market orientation and business performance (Jabeen, Aliyu, & Mahmood, 2016). Likewise, competitive intensity has been identified by recent studies as an important factor that moderates the relationship between organizational resources and performance (Leonidou, Christodoulides, Kyrgidou, & Palihawadana, 2017).

Still another study has identified the moderating role of competitive environment between service innovation advantage and business performance in a way that it weakens the relationship between them (Prajogo & Oke, 2016). This finding is in line with the existing literature that states that hostile environment can decrease profit and market share among the pioneers of innovation (Ali, 1994; Buzzell & Gale, 1987).

It has been stated that business performance cannot be studied as a function of internal capabilities only, rather it should be considered a fit between internal capabilities and external business environment including competitive environment (Prajogo & Oke, 2016). Therefore, substantial evidence exists for competitive environment acting as a moderating force between various organizational resources and capabilities and the performance of firms. Human capital is also taken as a similar strategic capability which is crucial for performance. This leads us to propose a positive moderating role of competitive environment between human capital and SMEs' performance.

Proposition 3a: Competitive environment moderates between human capital and SMEs' performance.

Competitive intensity is believed to influence the relationship between knowledge management and the performance of multinational corporation's subsidiaries (Cui, Griffith, & Cavusgil, 2005). It has been recommended also to study the variables that link knowledge management and business performance due to their ability to attain competitive advantage (Heisig, Suraj, Kianto, Kemboi, Arrau, & Easa, 2016). Based on these arguments, the following proposition can be developed.

Proposition 3b: Competitive environment moderates between knowledge management and SMEs' performance.

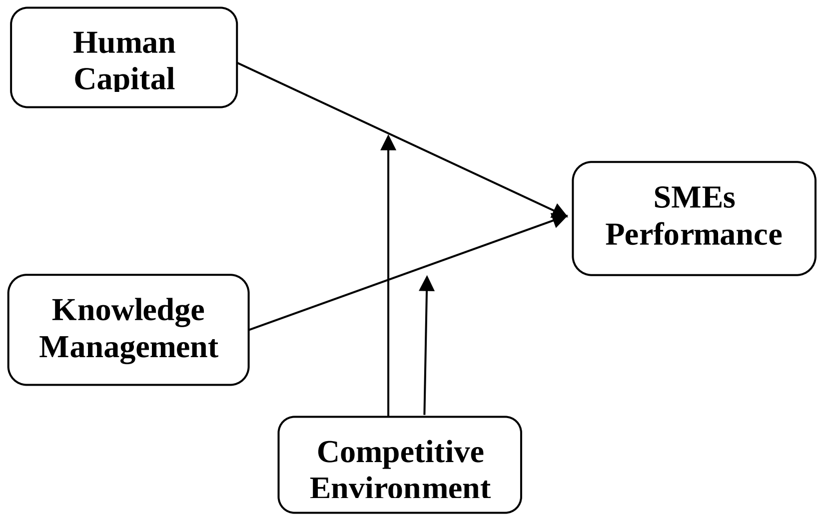

Figure 1. Proposed Framework

3. Conclusion and Discussion

With the advent of globalization, businesses have entered a new era of competition that never ceases to evolve. The challenges this growing competition brings along include rapid technological advancements, customer demand, and compliance with the rules of the World Trade Organization (WTO) and evolving quality standards. In such a rapidly changing competitive environment, firms need to be better equipped to overcome the surmounting business challenges (Gaur et al., 2011; Prajogo & Oke, 2016). Specifically, SMEs require the highest level of resources and competencies to capture the opportunities and avoid threats in their immediate and distant environment. Resources such as human capital and the highest degree of knowledge are believed to allow them to effectively compete against rival firms (Hafeez, Shariff, & Lazim, 2012; Khalique, Bontis, Shaari, & Isa, 2015; Khalique et al., 2011; Prajogo & Oke, 2016).

SMEs in the emerging countries need more concentrated efforts to realize and measure the impact, positive or negative, competitive environment may have on their performance. Since emerging countries have historically faced challenges such as rising cost of doing business, political instability, absence of export-friendly policies and overdependence on low-cost workers; not employing the highly skilled human resource can potentially worsen the competitive pressure on SMEs. The proposed framework of this study highlights the same phenomenon and emphasizes that SMEs benefit from the skilled workforce to shed the mounting competitive pressure. Therefore, this study proposes the relationship between resources, that is, human capital and knowledge management to perform effectively in the face of competition. This study adds to the literature of human capital and its influence on business performance by considering the moderating role of competitive environment. Also, this study is the first to contribute to the understanding of the factors affecting the performance of SMEs in Pakistan to the best of this author's knowledge.

This study also guides future researchers to consider the interacting effects that may change the nature and intensity of various factors that contribute to the successful performance of SMEs. For instance, external competitive pressures also subsume political stability which is pertinent to emerging economies like India, Pakistan, Thailand and the Philippines, where businesses have suffered during the various political movements. Nonetheless, these factors have remained understudied within the context of SMEs' performance in emerging economies. Another area that may be studied in future, with the focus on developing economies, is the hardship that SMEs face in acquiring finances. Since one of the major differences between SMEs and large organizations is the financial muscle that large organizations have. SMEs in the emerging economies invariably struggle to have access to substantial finances. Even if a small percentage of SMEs secure their finances, the cost of such a facility may be exorbitant, raising the operating cost of SMEs instead of helping them become lean. Moreover, the processes and criteria to acquire finances from the financial institutes in the developing countries appear to be too stringent for SMEs to prosper and compete with SMEs in the developed countries in the current era of globalization. Therefore, this study recommends further efforts to explore the various aspects of accessing finance that may have a moderating effect in shaping the performance of SMEs in the emerging economies.

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