



SELECTING BUSINESS PERFORMANCE INDICATORS: A FIRST STEP TO LINK HRM IMPACT ON BUSINESS PERFORMANCE

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ABSTRACT

Measuring impact of Human Resource Management (HRM) on business performance is a tedious task, especially to decide what type of business performance indicators to be used. The paper presents deposits, advances, return on equity (ROE), return on asset (ROA), net NPA Ratio and business per employee (BPE) as selected financial performance indicators among several, with a supporting evidence, when HRM especially recruitment and selection is used as an independent variable.

KEYWORDS : HRM, HRM Impact, Business Performance Indicators, Recruitment and Selection

INTRODUCTION:

Business performance may be defined as an accomplishment of business objectives against a predetermined set of standard. The standards set can be both qualitative like job satisfaction, turnover rate and quantitative like return on equity (ROE), return on asset (ROA). The paper is centered towards the quantitative measures of performance or financial performance indicators. choosing Indicators of performance when we are dealing with the same set of variables is one thing, example ROE of one company to ROE of another company. Whereas when we are measuring the impact of independent variable like HRM on business performance (dependent variable), selecting the right kind of indicators need lots of precision. A wrong selection of indicators will give misleading results. The research evidences show that human resource management (HRM) does show impact on business performance (Purcell & Kinnie, 2007).

OBJECTIVE OF THE STUDY:

To present a methodology for choosing business performance indicators when linking it to staffing practices and providing justification why a particular indicator was chosen.

LITERATURE REVIEW:

A lot of work is done measuring impact of HRM and its sub components on business performance. Rozell & Terpstra (1993) in their study, the relationship of staffing practices to organization level measures of performance used profit margin, annual growth in profit over five years and annual sales growth as dependent variable for measuring organization performance. Koch & McGrath (1996) in their study human resource management policies do matter improving labour productivity used labour productivity as a dependent variable which is business unit net sales/number of employees. Chanda, Bansal, & Chanda (2010) in their study strategic integration of recruitment practices and its impact on performance in Indian enterprises measured organizational performance on 03 financial performance indicators: market share, sales growth, profit growth and 03 non-financial indicators: employee productivity, employee satisfaction and employee turnover. Bollen, Vergauwen, & Schnieders (2005) work on linking intellectual capital and intellectual property to company performance used future outlook, profit, profit growth, sales growth, return on asset and return on sales as a dependent variable. Liao (2005) in his study, business strategy and performance: The role of human resource management control, used four performance indicators (market

share, profit growth, return on investment, and sales growth). Chang & Huang (2005) in their study, relationship between strategic human resource management and firm performance used profitability during the past three years' profit margin, annual growth in profit over five years, annual sales growth over five years. Whereas, why these indicators were chosen were not chosen were not logically connected. Financial performance indicators have been part of dominant models used in business performance measurement specially in strategy field. Venkatraman & Ramanujam (1986) mentioned about different measurement of performance along with their merits and demerits. Other work done in this field includes (Ichniowski, Shaw, & Prennushi, 1997; Omolo, Oginda, & Oso, 2012) where performance indicators were life span, profits, sales volumes, expansion, market share, employee productivity, turnover rate and employee satisfaction. But justification of why these performance indicators were used was missing.

RESEARCH GAP:

It is evident from the review of literature that the authors have been interested in proving impact of the independent variable on the business performance with little emphasis on why the particular indicator was chosen. The present paper tries to emphasize that a particular methodology should be chosen while selecting performance indicators. The paper concentrate on financial performance indicators.

METHODOLOGY:

The methodology adopted is a five stage process to filter out the financial performance indicators to be linked, when recruitment and selection as an independent variable is chosen

- Stage one: An analysis of financial performance indicators used by the banking system in India.
- Stage two: Reviewing the business flow of banks and finding the key indicators.
- Stage three: Extracting the key indicators from stage one and two on the basis of key ratios and business flow of banks.
- Stage four: Establishing a link between business performance indicators and HRM by measuring their strength of association.

- For our study we have chosen the period of 05 years from 2009-2013. The last updated data from the Reserve Bank of India database as on 1st Dec. 2015.
- Stage five: Giving justification for the selected business performance indicators while linking them to recruitment and selection.

Stage 1: An analysis of financial performance Indicators used by the commercial banks of India.

Commercial banks of India include two categories: public sector banks and private sector banks. A total of 46 commercial banks are working out of which 26 public sector banks and 20 private sectors banks (RBI, A Profile of Banks, 2013). To study the financial performance indicators two core reports were assessed from the RBI database "A Profile of Banks, 2013" and "Report on Trend and Progress 2013".

The summary of the most frequently used financial performance indicators are categorized into three categories:

1. Profitability Indicators:

a. Return on Asset (ROA): ROA is calculated by dividing a company's annual earnings or Net Income by its total assets and is expressed as a percentage. ROA is indicator of how profitable a company is relative to its total assets, and gives an idea as to how competent the organization management is at using its assets to generate its earnings. The ROA figure gives investors an idea of how effectively the company is converting the money it has to invest into net income. When ROA is compared between companies it is advised to compare it against a company's previous ROA numbers or the ROA of a similar company. The higher the ROA number, the better it is.

b. Return on Equity (ROE): In simple terms ROE is a measure of profitability which explains how much profit a company generates with the money shareholders have invested. It is expressed as the amount of Net Income returned as a percentage of shareholder's equity. The ROE like ROA when used for comparison, it is advised to compare it against a company's previous ROE or of a similar company and/or in the same industry. It is also known as "Return on Net Worth" (RONW).

c. Operating Expenses (OE): An operating expense can be explained as an expense a business puts in its normal business operations. Calculating a point of controlling expenses, is one of the typical responsibility the management has to determine, such that the firm's ability to compete with its competitors does not get affected due to it. When profit cannot be raised by normal measures; firms do attempt to cut their operating expenses example, laying off employees, compromising on product quality to maintain their competitiveness in the market.

d. Net Interest Margin (NIM): The NIM measures the difference between interest paid and interest received, adjusted relative to the amount of interest-generating assets.

e. Spread (Difference between Return and Cost of Funds): The spread is the difference between the return earned as charged to borrowers and cost of funds which is the interest rate paid by financial institutions for the funds they invest in their business. The cost of funds is an important input cost, as the lower cost will generate better return. Cost of funds is determined by the interest rate paid to depositors on financial products like saving account, time deposits.

2. Efficiency Indicators: Empirically, there are two ways of measuring efficiency of the banking sector:

(a) Standard accounting measures of productivity/profitability.

1. Cost-to-Income ratio (CI): which shows costs incurred to mobilize one unit of revenue/ income by the banking sector reflecting cost

efficiency. The lower the ratio, the more efficient are the operations of the banking sector.

2. Net Interest Margin (NIM): as explained above, the lower the ratio, the more efficient are the operations of the banking sector and

3. Return on assets (ROA): which reflects the efficiency with which banks deploy their assets. The higher the ratio, the more efficient are the operations of the banking sector.

(b) Data Envelopment Analysis (DEA: It uses Deposits, Borrowings, Operating Expenses, Loans and Investment): The DEA follows an input-oriented model that captures the extent of reduction in costs that is essential for achieving a given level of output. Here, the DEA is based on an "intermediation" approach. Under this approach, banks are regarded as financial intermediaries that use a certain set of inputs to create a set of outputs.

© *Other Variables:* Other than these variables two variables which has been mark of efficiency are business per employee and profit per employee (A Profile of Banks, 2013; A Report on Trend and Progress 2013).

3. Soundness Indicators: It includes

a. Capital Adequacy Ratios: such as Capital to Risk (Weighted) Assets Ratio (CRAR), is the ratio of a bank's capital to its risk and is expressed as a percentage of a bank's risk weighted credit exposures. It is a ratio of International standards and is used to protect depositors and promote the stability and efficiency of financial systems around the world. Two types of capital are measured: Tier-I capital e.g. Ordinary share capital, which can absorb losses without a bank being required to cease trading, and Tier-II capital, which can absorb losses in the event of a winding-up and so provides a lesser degree of protection to depositors. The reason why minimum capital adequacy ratios are critical is to make sure that banks have enough cushion to absorb a reasonable amount of losses before they become insolvent and consequently lose depositors' funds.

b. Non-Performing Asset Ratio: The *Net NPA ratio* shows banks recovery of assets to its total assets, given as loan or advances. An NPA are those assets for which interest is overdue for more than 90 days (or 3 months). *NPA ratio = Net non-performing assets / Loans given.*

Profitability is about gains whereas efficiency is about using inputs to create best possible of outputs. Profitability indicators can best be used when we are taking about profitability whereas efficiency indicators are best used when we want to make inter and intra comparisons between Banks (RBI, 2008). Other than these basic indicators we have few more indicators of performance (RBI, Profile of Banks, 2013)

1. Deposits: Bank deposits consist of money placed into a banking institution for safekeeping in accounts of banks such as saving and current accounts.

2. Advances: Total output cash given as loan or advances.

3. COF: As explained above cost of funds and net interest spread are conceptually the most basic way banks make money. Banks make money through the interest rates they charge on loans as well as debt securities they own and other equity products that consumers, companies and large-scale institutions need.

4. Wages as % of total expenses: Wages as percentage to total expenses is computed as the ratio (in %) of payment to and provisions for employees to total expenses.

5. Net NPA Ratio: Bank soundness indicator (Report of Trend and Progress in India, 2013).

STAGE II- Reviewing the business flow of Banks in India and selecting the key Indicators.

The details on the types of business the banking companies can get in is clearly interpreted under Section 5 (interpretation) and Section 6 (form and business in which banking companies may engage) of the Banking Regulation Act 1949. Sec 5 (b) mentions the definition of word banking:

"Banking" means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise. Sec 5 (c) says "banking company" means any company which transacts the business of banking in India.

The business of banking companies can be elaborated by the fig.1 below.

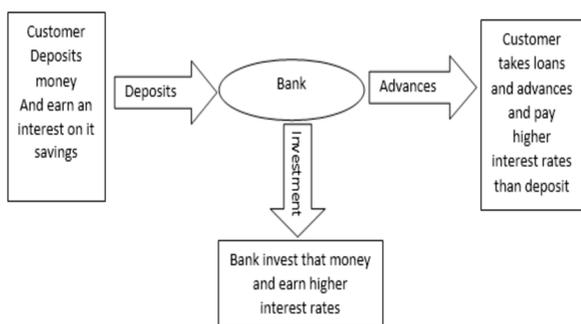


Fig.1: Business flow of Commercial Banks

It's very much clear from the figure that the main source of business for banking companies are deposits and advances. As bank deposits will increase so as the corpus will be increase which can be later for income generation through distribution as advances/loans to customers at a much higher rate than the rate given to customers on their deposits. From here we can say that the continuous increase in deposits is a mark of their business performance. To increase the amount of deposits bank can perform two tasks.

- a) Inform customers to increase their amount of money deposited with bank. For example, the money deposits in banks is more secure than depositing into share market.
- b) Increase the number of customers through opening of current accounts and saving accounts.

Whereas for increasing advances because of which banks perform actual earnings, the most important thing to be considered is its NPA ratio. The lower it is the more profitable the bank will be. From this indicator banks can regular monitor its performance of advances.

STAGE III- Extracting the key indicators from stage one and two on the basis of key ratios and business flow of banks.

The eight indicators short listed are ROA, ROE, NET NPA Ratio, Deposits, Advance, Business per Employee(BPE), NIM, CRAR. Banks statistics on this data as mentioned in Table I. and Table II. below will help us to understand the trend on these data.

Table I. Group Wise Business performance of Public Sector Banks

Public Sector Banks					
	(Amount in ` million)				
Items	Bank Group-wise Aggregates				
	2008-09	2009-10	2010-11	2011-12	2012-13
No. of employees	731524	739646	755102	774329	801659
Return on Assets	1.03	0.97	0.96	0.88	0.78
Return on Equity	17.94	17.47	16.90	15.33	13.24
Net NPA ratio	0.94	1.10	1.09	1.53	2.02
Deposits	31127471	36920194	43724487	50020134	57456972
Advances	22592117	27010187	33044329	38773075	44727740
Business per employee	73.44	86.43	101.67	114.68	127.47
Net Interest Margin	2.35	2.29	2.77	2.76	2.57
CRAR	13.49	13.27	13.08	13.23	12.38

(Source: A profile of Banks 2008-2013, RBI)

Table II. Group Wise Business performance of Private Sector Banks

Private Sector Banks					
	(Amount in ` million)				
Items	Bank Group-wise Aggregates				
	2008-09	2009-10	2010-11	2011-12	2012-13
No. of employees	193578	188332	217953	248284	269941
Return on Assets	1.13	1.28	1.43	1.53	1.63
Return on Equity	11.38	11.94	13.70	15.25	16.47
Net NPA ratio	1.29	1.04	0.56	0.46	0.52
Deposits	7363776	8228007	10027588	11745874	13958355
Advances	5753276	6324409	7975440	9664030	11432486

Business per employee	67.76	77.27	82.60	86.23	94.06
Net Interest Margin	2.86	2.90	3.10	3.09	3.22
CRAR	15.23	17.43	16.46	16.21	16.84

(Source: A profile of Banks 2008-2013, RBI)

STAGE- IV Establishing a link between business performance indicators and HRM by measuring their strength of association.

The business performance is the outcome of the efforts done by the human resources of the organization holding all the other variables constant. The relationship is visible by measuring the strength of association between these two variables by taking an initial assumption.

H0: There is no relationship between business performance indicators and the change in the size of number of employee.

H1: The selected business performance indicators are strongly correlated with the change in the size of number of employees.

The correlation statistics is mentioned in Table III, which shows relationship between the performance indicators and number of employees in public and private sector banks.

Table III. Correlations Statistics Between Number of Employees and Business Performance Indicators

	Deposits	Advances	NIM	ROE	ROA	CRAR	NPA Ratio	BPE	
Employee Public sector banks	Pearson Correlation	.986**	.987**	.544	-.993**	-.986**	-.891*	.975**	.976**
	Sig. (2-tailed)	.002	.002	.343	.001	.002	.043	.005	.004
	N (2008-2013)	5	5	5	5	5	5	5	5
Employee Private sector banks	Pearson Correlation	.982**	.989**	.927*	.986**	.933*	.124	-.832	.907*
	Sig. (2-tailed)	.003	.001	.023	.002	.021	.843	.080	.034
	N (2008-2013)	5	5	5	5	5	5	5	5
**. Correlation is significant at the 0.01 level (2-tailed).									
*. Correlation is significant at the 0.05 level (2-tailed).									

It is evident from the table above that most of the selected performance indicators show a strength of association with the number of employees of the banks. An analysis of the indicators shows that a high correlation exists between the Number of Employees of the banks and their financial performance indicators for the Deposits, Advances, ROE, ROA, Net NPA ratio, BPE both for private and public sector banks. Were as NIM for public sector banks and CRAR for private sector banks does not show significant statistics at p value .05 and below.

The final list of business performance indicators which have shown significant relationship with the number of employee, both for public and private sector banks during the said period are: Deposits, Advances, ROA, ROE, Net NPA ratio, BPE.

Stage V: Linking recruitment and selection to business performance indicators:

1. **Deposits:** In case of deposits which is an input to banks and main source of income generation. As blood is to human beings so is the deposits to the banks. The increase in deposits means more funds to be disbursed as loans and advances. The sales staff make sure that the current and saving accounts are open and people should save their money in it. Deposits should always be chosen as a dependent variable when measuring recruitment and selection impact on business performance.

2. **Advances:** In case of advances which is an output to banks and main source of income generation. Everything has to be taken care of. The corpus of money generated through deposits are used for income generation in line with the banking principles. The customers are charged interest rates which are much higher than deposits rates which are one of the sources of income for banks. The sales staff make sure that the loans are distributed in ratio much higher than deposit. So that higher income can be generated. The administrative and sales staff make sure that the advances given are into safe hands and there is no scope for bad debt. In case of advances HRM skills are to be used at their best. Therefore, advances should also be chosen when linking recruitment and selection

impact on business performance.

3. **ROE and ROA:** Together they provide a clearer representation of a company's performance. On the off chance that ROA is sound and obligation levels are sensible, a solid ROE is a strong sign that organization is returning well for its shareholders. ROE is unquestionably an "indication" that management is giving shareholders more for their cash whereas on the other hand, if ROA is low or the company is carrying a lot of debt, a high ROE can give investors a false impression about the company's fortunes. It is recommended to use ROE and ROA as a performance indicator only when whole HRM as a function is chosen as an independent variable, as ROE and ROA are the factors which depends on many factors including recruitment and selection therefore should be taken as an independent variable with lots of evidences behind.

4. **Net NPA ratio:** Net NPA ratio is the amount of bad debt. converted out of loan distributed. Linking recruitment and selection to Net NPA Ratio is somewhat dicey. The valid reason behind it is that the advances distributed, especially for the government sector banks, are related to loan given to the priority sector specially to farmer as agriculture loans. The best an employee recruited can do the verification process in the advance distribution. But conversion of advances to bad loans if related to fraudulent may be related to the verification process of loaning team, but those related to governments interventions may not be directly related to it, as the government channels banks to provide loans to the agriculture sector. The inability of the farmer to return loan due to non-production of farm product make him unable to pay which then convert to bad debt. The human resource skills can help banks to stop assets to become bad debt (rebelloe, 2016). The Net NPA ratio should be chosen as a performance indicator in lieu of advances.

5. **BPE:** Business per employee is a ratio that is calculated as company's revenue divided by the current number of employees. This ratio is most useful when comparing it against other companies in the same industry. Ideally, a company wants the highest revenue per employee possible, because it indicates higher productivity and effective use of the firm's resources. Business per employee is

affected by a company's employee turnover rate, and turnover is defined as the percentage of the total workforce that leaves voluntarily each year and must be replaced. Turnover is different from employee attrition, which refers to workers who retire or whose jobs are eliminated. Until the replacement is ready to work in the position, other employees must take on the work and company productivity declines. If employees are satisfied with their jobs, they are less likely to leave. BPE should always be chosen as an as a dependent variable for HRM specially recruitment and selection as it includes the sales or profit divided by number of employees.

CONCLUSION:

Selecting the business performance indicators using the five stage filtration process is one of the way that is being suggested to find out the right kind of indicators measuring business performance when it is linked to an independent variable. Other approaches which can be used in relation to it is CAMEL approach which uses a scoring system to find out the financial performance. Qualitative analysis of these variables shows that's deposits, advances, BPE and Net NPA ratio sounds more directly linked to recruitment and selection than ROA, ROE. These indicators should be tested in the model when HRM or specifically recruitment and selection is taken as independent variable.

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