CHAPTER 1
INTRODUCTION

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CHAPTER 1

Introduction

1.1 Context of the Study

For quite some time now, the language of competency-based human resources management (HRM) has dominated human resources (HR) thinking and practices. Business organisations are being increasingly forced to operate under higher degrees of uncertainty in a constantly changing environment, which would require greater professionalism and adaptability in delivery of goods and services. This has influenced HR management to focus more on competencies for recruitment, training, succession planning, appraisals and promotions (Gupta, 2011). In the current market scenario of higher human resource overheads, there is an urgent necessity of hiring competent manpower for corresponding positions. Concurrently, the call for greater competitiveness and acknowledgement of the considered benefits of acquiring good quality workforce have obliged enterprises to be more competency focused. The idea of ‘competency management’ captured the imagination of HR professionals as a means to more efficiently use worker skills in the place of work. It started as a technique to align HR processes (like recruitment, assessment and training) to work needs and organizational policy (Green, 1999). Most HR experts have been professing competency management as an efficient method to use employee skills in the workplace. The awareness of competency has attained this level of importance because it is fundamentally about performance.

What are competencies? Competencies are defined by Boyatzis, (1982) “as the capacities that exist within a person and which predict superior performance”. Spencer and Spencer, (1993) have formally defined a competency “as an underlying characteristic of an individual that is causally related to criterion-referenced effective

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and/or superior performance in a job or situation”. Dessler (2008)\(^5\) has defined competencies as “demonstrable characteristics of a person that enable performance of a job”. They are usually seen to “encompass a person’s knowledge, skills, attitudes and behaviours which predict competent performance in a certain job” (Ley & Albert 2003)\(^6\).

Whiddett & Hollyforde (2004)\(^7\) define competencies as “the behaviours that individuals demonstrate when undertaking job relevant tasks effectively within a given organisational context”. Rankin (2004)\(^8\) describes competencies as “definitions of expected performance that, taken as a whole, should provide users with the complete picture of the most valuable behaviours, values and tasks required for their organisation’s success”. Ramakrishna, R. (2011)\(^9\) defines ‘‘competency’ as something that describes ‘how’ a job might be done excellently, whereas a ‘competence’ only describes ‘what’ has to be done’. “Any underlying characteristic required for performing a given task, activity, or role successfully can be considered as competency. It includes the following forms: Knowledge, Attitude, Skill and other characteristics of an individual like Motives, Values, Self Concept etc.” (Rao, T.V. 2011)\(^10\).

A critical analysis of the above definitions reveals the basic features of competency as indicated in Figure 1.1 below.

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Figure 1.1: Features of Competency

Emanates from professional life

Certified

Demonstrated

Learned

Associated to whole role

Defined proficiency

Defined in a context

Ability to perform

(Source: Gupta, B.L. 2011, Competency Framework for Human Resources Management, Concept Publishing Company Pvt Ltd, New Delhi, p.7)

Kujansivu, P. & Lonnqvist, A. (2005)11, in their thesis have reported “It seems intuitively clear that certain factors related to intellectual capital (IC) should affect organizations’ productivity and profitability, for example, increasing employees’ competencies should lead to improved productivity”. In general, it has been approximated that an outlay in ‘Intellectual Capital’ would generate two times as much reimbursement to a firm when compared to a comparable outlay in a physical asset (Abernetby et.al. 2003)12. Enterprises utilize competencies primarily because their incorporation in development and evaluation processes are improving the output of employees, and also because they offer a way to communicate company values so that their needs can be integrated in HR practices and be easily accepted by all employees. (Becker, 1999)13 stated that tasks performed by workers in any firm could

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be further refined into numerous distinct sub-tasks, and increasingly focusing on a narrower set of the latter would raise the productivity of a specialist above that of a jack-of-all-trades.

1.2 Rationale and Significance of Study

How are competencies used by enterprises? Which competencies enable higher profits? These are significant issues of debate for all business personnel and especially all HR practitioners. While this issue has been widely examined in the situation of large business establishments, relatively few experts have investigated its impact in the situation of small businesses, which contribute to the wellbeing of all countries both in terms of productivity, and more significantly for employment opportunities. “HR management research literature generally focuses on large firms” (Carroll et al., 1999)\(^ {14}\), and their results are not likely to be valid for small firms (Tanova and Nadiri, 2005)\(^ {15}\). Williamson, (2000)\(^ {16}\) revealed that “on reviewing all HR management research related articles published in three academic journals, only seven of the 207 articles that address recruitment and selection issues used small firms in their sample”. The paucity of HR studies in small businesses is brought out by the frequent calls for more research in this region, which have been articulated in recent years (Hornsby and Kuratko, 2003\(^ {17}\); Katz et al., 2000\(^ {18}\)). Irrespective of where one examines, in literature reviews (e.g. Good, 1998)\(^ {19}\), in experiential research (Heneman & Berkley, 1999)\(^ {20}\), and in surveys (e.g., Hornsby & Kuratko, 1990)\(^ {21}\), researchers are complaining against the absence of available data about human resource activities in


small businesses. In particular, Tansky and Heneman (2003, p. 302)\(^{22}\) have encouraged HRM researchers to focus on the area of SMEs. Hence, there is an urgent requirement to complete this perceptible gap in knowledge about small businesses.

Since small businesses are generally more labour intensive than larger firms (Flanagan and Deshpande, 1996)\(^{23}\), good HR management practices are especially significant for “developing and sustaining their competitive advantage” (Duberley and Walley, 1995\(^{24}\); Lado and Wilson, 1994\(^{25}\)). Since each employee in a small business constitutes a significant proportion of the workforce due to its comparatively small scale of operations, HR decisions in such organizations become more relevant (Brand and Bax, 2002)\(^{26}\). Overell, (1996)\(^{27}\) predicted that the future of economies all over the world is likely to be dominated by small businesses for employment generation and modern style of operations. Moreover, small enterprises can be a crucial hub of innovation and also rejuvenate the economy (Storey, 1994)\(^{28}\).

Micro, Small and Medium Enterprises (MSMEs) in India too have been contributing considerably towards economic growth and employment generation. The MSME sector in India is “employing over 60 million people, accounts for 8% of the Gross Domestic Product (GDP), 45% of its manufacture output and 43% of its export, and has grown at a healthy rate of 10% in recent years” (Singh, M. 2014)\(^{29}\). However, this sector is primarily grappling with two main challenges – financial and HR related (Thakur, A.K. 2012)\(^{30}\). For sustained growth and global competitiveness, they need to harness their human resources more effectively especially in terms of skilled


manpower. Their current infrastructure is sub-optimally utilized. However, since MSMEs are extremely labour intensive, enjoy higher growth rate than larger enterprises and are more evenly distributed all over the country, they play a very important role for achieving the “national objectives of growth with equity and inclusion”31.

Varghese, S. (2010)32 has observed that business management and human capital practices followed by the millions of MSME units across India continue to be unprofessional primarily because they are largely family enterprises and do not apply modern management techniques and are ignorant about important issues like competency-based management. A CII-Deloitte Report (2008)33 on fast-growing SME clusters in Gujarat identified a number of key challenges which included the following:

i. Lack of systematic approach to strategy formulation, business planning and decision making.

ii. Inadequate marketing expertise to penetrate new geographies and customer segments.

iii. Absence of structured trade information.

iv. Lack of awareness of business/expansion opportunities.

v. Inadequate exposure to international environment.

vi. Inability to deal with competition.

vii. Inability to attract and retain right talent.

viii. Concerns on business succession.

ix. Low productivity compared to competitors.

x. Lack of knowledge and information on improved techniques.

xi. Lack of modern management practices.

The report commented that “most of these challenges can be addressed by a knowledge and performance focused organizational culture. However, with the highly limited time the MSME entrepreneur himself/herself has for any knowledge investment, thanks to limited delegation, non-stop fire-fighting on daily operational issues and lack of competent personnel internally, these challenges persist till they impact the profitability of the enterprise”. A large number of these difficulties faced by the entrepreneurs were caused by their failure to adopt best practices in business management and human capital management. This fact was also clearly evidenced when as part of the CII Deloitte survey, the SMEs were asked to list down in terms of priority, their most preferred "Strategic Decision" and their most "Critical Challenge". Most of the SMEs surveyed identified several business management and human capital challenges including "Attracting and Retaining Right Talent" (major hurdle) in implementing primary strategic decisions like "Quality Improvement" and "Enhancing Productivity" to realize most favored growth objectives in the area of Revenue Growth and Cost Efficiency.

“A Task Force (TF) under the chairmanship of Principal Secretary to the Prime Minister had been constituted to address issues affecting the prospects of Indian MSME sector” (PM’s TF Report, 2010)\textsuperscript{34}. The Report pointed out that Indian MSMEs have been traditionally besieged by a number of problems. These are primarily related to problems of credit availability and cost, inadequate infrastructure facilities, low technology levels and most importantly by the lack of skilled manpower. India does have a vast pool of human resources, but those with the right skill-set are ominously lacking. This problem is further aggravated by the problem of high turnover rate. Government institutions like District Industries Centres (DICs) at the state level which have been primarily involved in regulating the industry, have not been very successful in tiding over this deficiency.

In mid-2013, the Indian Government announced rules for establishment of National Investment Manufacturing Zones (NIMZs) in order to resuscitate India’s


sagging economy (Kumar, 2013). It invoked a number of benefits to boost manufacturing with special emphasis on SMEs. India’s National manufacturing policy has envisaged creating 100 million more jobs in the next 10 years, for which the only solution is by making India’s MSME sector robust and healthy. National Skill Development Corporation (NSDC) was set up in 2008 with the purpose of providing skills to 500 million Indians by 2020 through a Public Private Partnership (PPP) model, which has hardly taken off till date.

Survey of existing literature indicates a surprising lack of well documented scientific studies on the effect of employee competencies on the financial performance of small businesses in India. Maharashtra Industrial Development Centre (MIDC) in Pimpri Chinchwad Municipal Committee (PCMC) area in Pune offers an excellent opportunity for conducting a study on this neglected but significant gap in our body of research on Indian MSMEs. Results of this research would provide valuable input to the MSME industry in India and help it to become more competitive in facing global challenges of the 21st century.

1.3 Background Information on Indian MSMEs

The latest census of the MSME sector in India was conducted during the 4th All India Census of MSMEs launched by the “Office of the Development Commissioner (MSME) in May 2008 with 2006-07 as reference year”. This was the first census in India that covered the Medium Enterprises and the Service Sector Enterprises as well, as a result of the promulgation of MSMED Act 2006 which expanded the scope of this sector from the erstwhile Small Scale Industries (SSIs) to “Micro, Small and Medium Enterprises (MSMEs) with inclusion of both industrial and service sectors”. According to Government of India MSME Annual Report (2012-13), the total number of enterprises in MSME Sector in 2006–07 as per the 4th All India Census was estimated to be “about 36.2 million which provided employment to an estimated 80.5 million persons. Of the 36.2 million MSMEs, only 1.5 million were in the registered segment while the remaining 34.7 million (96%) were in the

informal or unorganised segment. The projected estimates for 2011-12 in this Report are 44.8 million enterprises employing about 101.2 million persons. This MSME sector accounts for 45% of total industrial output, 40% of exports and contribute more than 8% of our GDP. 94% of Indian MSMEs are proprietorships and partnerships. 94.9% of MSMEs in the registered segment are Micro enterprises, 4.9% are Small enterprises and only 0.2% are Medium enterprises.”

1.3.1 Definition of MSMEs in India

The most commonly used method of classifying MSMEs globally is the number of employees. In India, Small-scale industries (SSI) were first defined in 1950, when “in addition to a limit on investment in fixed assets, there was also an employment stipulation, which was deleted in 1960. In 1966, the limit on investment in fixed assets was changed to a limit on investment in plant and machinery (original value) only.” The definition of “small enterprise” (small-scale industry, initially) has undergone many changes during its journey through the various policy statements on industry/small industry. The chief criterion that defines an establishment as “small” and as “business” or “industry”, is investment in plant and machinery (Kondaiah, 2007). According to the terms of the MSMED Act, 2006 Indian MSMEs are classified in two Classes:

“Manufacturing Enterprises: The enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the first schedule to the Industries (Development and Regulation) Act, 1951 or employing plant and machinery in the process of value addition to the final product having a distinct name or character or use. The Manufacturing Enterprises are defined in terms of investment in Plant & Machinery.

Service Enterprises: The enterprises engaged in providing or rendering of services and are defined in terms of investment in equipment.”

The limits for investment in plant and machinery / equipment for manufacturing / service enterprises, as notified in the MSMED Act are as shown in Table 1.1 below:

**Table 1.1 Definition of Enterprise Types by Investment limit (Rs. Lakh)**

*(One Million = 10 lakh) (Now, One $ = Rs. 60 approximately)*

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<th>Type of Enterprise</th>
<th>Manufacturing</th>
<th>Service</th>
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<td>Micro</td>
<td>Up to 25.00</td>
<td>Up to 10.00</td>
</tr>
<tr>
<td>Small</td>
<td>More than 25.00 but less than 500.00</td>
<td>More than 10.00 but less than 200.00</td>
</tr>
<tr>
<td>Medium</td>
<td>More than 500.00 but less than 1000.00</td>
<td>More than 200.00 but less than 500.00</td>
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### 1.4 Types of Competencies

Various experts have identified a large variety of competency classifications and the competencies in each type. The 2003/4 Competency and Emotional Intelligence Survey (2004)\(^{40}\) established “that the 49 competency frameworks reviewed had a total of 553 competency headings.” However, they discovered that this variation was primarily due to the varying nature of the business and the purpose for which competencies were being framed. They also found that many of these overlapped. The Survey also found “that 95% of respondents used behavioural competencies and 66% used technical / functional competencies. They further noted that a large number of organisations covered the whole workforce with a single set or framework of values-based organisational core competencies”. Bersin (2007)\(^{41}\) analysed the role of competencies in “high-profit and high-growth companies”. He found that “competency–based performance management varies widely by industry,

market maturity and phase of growth. Growth–oriented organizations focus on strategic competencies to drive leadership behaviour, while organizations in lower-growth markets focus on general management behaviours. High-performance organizations value competencies that build organizational capabilities while lower-performing organizations focus on competencies that build individual capabilities.”

(a) **Value-based Organisational Competencies** A number of establishments like PepsiCo and General Electric adopt a few values-based organisational competencies, which are applicable to all employees. These competencies characterize the organisation’s fundamental core values which remain unchanged under normal circumstances, and represent the brand of the company. These also indicate the type of employee behaviour cherished by the company, and are normally adopted in their performance appraisal systems. Some of the value-based competencies common in a number of firms are ‘quality consciousness’, ‘customer focus’, ‘team spirit’ and ‘innovativeness’.

(b) **Leadership Competencies** These are a set of competencies generally applicable to employees with a certain potential or after having reached a certain level in the organisation. They represent the managerial and leadership traits required to sustain the company’s organisational culture. A large number of companies have earmarked capabilities, such as ‘decision making’, ‘strategic thinking’, ‘planning and organising’, ‘problem-solving’ and ‘communication’ as leadership competencies.

(c) **Functional Competencies** These are individual competencies, generally technical in nature, like functional skills applicable at individual employee or workgroup level for specific job functions. For example in a furniture manufacturing business it could be a carpenter’s technical skills.

### 1.5 Research Problem

Besides other issues like availability of capital and infrastructural requirements, the performance of MSMEs in India is seriously affected due to lack of competent manpower as brought out in the PMs Task Force Report on MSMEs in Jan 2010. Interaction with MSMEs in MIDC PCMC Area has also highlighted this being one of their prime concerns. One recurring aspect that emerged during the researcher’s interaction with the MSME owners and experts was that while they were
able to tackle with persistent problems like those mentioned in the PM’s TF report earlier, the emergence of relentless global competition with exacting standards in the last decade had reduced their comfortable financial margins of earlier period and made it very difficult to derive profits from their existing pattern of operations. They were looking for financially viable solutions to this dilemma. HR initiatives offered a low-cost option to overcome this situation. Traditionally, HR has been a comparatively neglected domain in MSMEs except for personality based intervention by the owner manager at a personal level. One obvious route for HR intervention could be enhanced compensation to attract better work-force, but this option did not find favour with the MSME owners, apprehensive about its cost effectiveness. However, one more HR area in which the MSMEs expressed considerable interest was the enhancement of employee competencies, as the multi-national corporations (MNCs) have adopted as routine business practice, which they believed could drive their financial performance in terms of improving their return-on-investment (ROI) or profitability. The research problem for this study is as follows:

“Would higher level of employee competencies enhance financial performance of MSMEs, and if so, which ones and to what extent?”

1.6 Aim of Study

The Aim of this study is to determine whether higher employee competency levels enhance financial performance of MSMEs, and if so, which ones and to what extent.

1.7 Objectives of the Study

The Aim is the basis for following objectives of the study:

i. To identify all possible employee competencies that could enhance financial performance of MSMEs.

ii. To categorise these competencies under the three employee competency factors of ‘core’, ‘functional’ and ‘leadership’ categories.

iii. To find out to what extent these employee competency factors and their constituent competencies enhance financial performance of MSMEs.

iv. To suggest measures for enhancing financial performance of MSMEs through better utilization of employee competency factors.
1.8 Scope of the Study

The study aims at identifying employee competencies that could enhance the financial performance of MSMEs. According to the MSME Annual Report 2012-13, there were about 2 million registered MSMEs in India. However, other reports have suggested that there are over 36 million MSMEs in India, most of the Micro-enterprises being non-registered. Maharashtra state is one of the leading industrialised states with Pune region being its foremost industrial district with the largest concentration of MSMEs in the state. The MSME cluster in MIDC Bhosari, PCMC area of Pune with 2266 registered MSMEs was selected as it provided a representative population for the study.

Ideally, this type of research problem could be investigated by adopting an experimental or case study research strategy. However, after discussion with a few MSME owners, industry experts and government authorities in the District Industries Centre (DIC), it became evident that the survey questionnaire method would be the most appropriate and pragmatic approach for this study. Although this would make the study dependent on the information provided by the owner managers of the MSMEs which would be based on their subjective experience and judgement, rather than on hard financial data obtained from objective sources, this was the best option for conducting a meaningful study.

There are a large number of employee competencies all of which would not be relevant for this study. Accordingly, the aim was to focus on the most significant ones for MSMEs which could be suitably explained to the owner managers in simple language for obtaining a meaningful response.

Financial performance of MSMEs like any other enterprise is evidently dependent on a number of other factors or variables including its market share, competitive pricing, merchandise, size of business, positioning, and experience in business. The researcher attempted to ignore all other extraneous factors and focused only on employee competencies as independent variables. Financial performance also could be measured either by profitability (return on investments) or growth in revenue. Profitability was the term most MSME owners inherently considered as an indicator of financial performance. Accordingly, the researcher adopted this term as the dependent variable, so that a simple relationship could be effectively established in the research findings.
1.9 **Organisation of the Report**

The following chapter scheme has been followed in the study report:

Chapter 1: Presents all relevant sections of an introductory chapter.

Chapter 2: Summarises the survey of related literature pertaining to the area under investigation.

Chapter 3: Brief information on the MSME industry details of MIDC PCMC area.

Chapter 4: Covers the research methodology involving hypothesis formulation, research design, sample selection, questionnaire design, pilot study and statistical tools and techniques used for data analysis.

Chapter 5: Presents the details of data analysis, hypothesis testing and relevant observations on the results.

Chapter 6: Summarises the study in retrospect offering a brief summary of the procedure, major findings, recommendations and conclusion.

The report is supported by an exhaustive bibliography and reference list, and detailed annexures which elaborate on certain details of data collected, limitations of study, scope for further study, impact of the research and managerial implications, and elements related to the study.