

# EFFECTS OF HUMAN RESOURCE MANAGEMENT PRACTICES ON FINANCIAL PERFORMANCE OF BANKS

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## Abstract

Human Resource Management (HRM) practices are being increasingly considered as major contributory factors in financial performance of organizations. This research study highlights the importance of HRM practices with impact on financial performance of banks (FPB) operating in Nigeria. The major objective of the study is to find out the relationship between 'HRM Practices' and the 'Financial Performance of Banks'. As a sample, 24 scheduled banks were contacted, of which 38 responded. The HRM practices selected for the research study were selection, training, performance appraisal system, compensation system and employee participation. Empirical evidence was calculated through stepwise regression analysis, Pearson correlation and descriptive statistics to support theoretical models that link HRM practices with financial performance of banks. The study concluded that all tested variables have a positive relation and impact on financial performance of banks but the major contributory practices are selection, training, compensation and employee participation.

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**Key Words:** HRM practices, selection system, career planning system, employees participation, financial performance of the banks

## Introduction

The study of human resource management practices as a determinant of organizational performance has gain currency in the last two decades especially in the banking industry. However, the results from the researchers are either inconclusive or controversial (Qureshi et al., 2007).

This sector performs momentous functions in the present day world for overall economic development of countries. Nigeria started banking operations in 1958 with the establishment of Central Bank and recorded an earth-shattering growth in the third quarter of the 20th century, but a sudden nationalization decision of banks in the seventies proved not to be a good decision. In the nineties, there was a paradigm shift in deregulation, privatization and restructuring in the banking industry. After this shift, the country now has a well-developed banking network, consisting of different institutions including a Central Bank and many commercial banks (DFID, 2006). One thing about that particular period was the recruitment of fresh officers in banking industry through well-organized policies (Akhtar, 2007). In this research, we will investigate the banking sector performance in the last three years. During these years, hiring of officers was done under the application human resource management practices.

Human resource management is linked with all the managerial functions involved in planning for recruiting, selecting, developing, utilizing, rewarding, and maximizing the potential of the human resources in an organization (Franklin and Byrd, 1995). Human resources management (HRM) is defined as the policies and practices needed to carry out the "people" or human resource aspect of a management position, including selection, job definition, training, performance appraisal, compensation, career planning and encouraging employee participation in decision making. From another point of view, HRM is defined as a process for the development of abilities and the attitude of the individuals, leading to personal growth and self actualization which enables the individual to contribute towards organizational objectives. Much of the debate has been around the meaning of HRM, yet there is no universally accepted definition of HRM. Some definitions interchange HRM with personnel management. Personnel management characteristically focused on a range of activities centered to the supply and development of labour to meet the immediate and short term needs of the organization. Under personnel management, the activities of recruitment, selection, rewards, development, training, compensation and the others are viewed as separate individual functions. HRM aims to integrate all of the personnel functions into a cohesive strategy. Personnel management is largely something that managers do to the subordinates, whereas HRM takes the entire organization as a focal point for analysis. Success in today's competitive market depends less on advantages associated with economies of scale, technology, patents and access to capital and more on innovation, speed and adaptability. Competitive advantages and organizational performance are largely derived from organizational human resources and high involvement of human resource management practices. Although in most of the developing

countries, the main impediment of organizational growth and profitability is the lethargic use of professional HRM practices but struggle is going on to find out best ways to utilize these practices optimally. Nigeria is very much focused on banking growth for the last few decades. As a result, different banks are performing a momentous role in the economic development of the country. Despite their economic importance, different banks suffer from a variety of structural and institutional weaknesses, which has constrained their ability to take full advantage of the rapidly advancing process of globalization and HRM practices. This research is an attempt to explore the relationship of (HRM) practices and financial performance of banks (FBP) operating in Nigeria. In this research, different HRM practices will be discussed.

### **Literature Review**

This study is conducted based on universalistic perspective, indicating that fixed set of best practices can create surplus value in various business frameworks (Delery and Doty, 1996). Justifying our choice for the universalistic perspective, the Harvard model by Beer et al. (1984) guided the initial process of domain identification. In this study, the most relevant HRM domains (e.g. selection, training, job description, performance appraisal system, compensation system, career planning system and employee participation) followed by universalistic perspective are selected for research. In the field of human resource management and behavioral sciences, plenty of examples and discussions are highlighting that there is an uplifting connection between effective HRM practices and organizational performance (Deepak et al, 2003; Sels et al., 2003; Singh, 2004).

Qureshi et al. (2007) explored the positive effect of selection ( $r = 0.53$ ), performance appraisal ( $r = 0.55$ ), training ( $r = 0.61$ ), compensation system ( $r = 0.39$ ) and employee participation ( $r = 0.46$ ) with organizational performance. Out of these practices, only selection ( $b = 0.27, 0.30$ ), training ( $b = 0.31, 0.28$ ) and employee participation ( $b = 0.19, 0.26$ ) had positive impacts on organizational performance and market performance of the organization. This indicated that an increase of 1 unit in selection will increase firm performance by 0.27 and firm market performance by 0.30; secondly, an increase of 1 unit in training will increase firm performance by 0.31 and firm market performance by 0.28. Finally, an increase of 1 unit in employee participation will increase firm performance by 0.19 and firm market performance by 0.26. Supporting these findings, Singh (2004) found that there is a positive relationship amongst several HR practices like selection ( $r = 0.32$ ), performance appraisal ( $r = 0.32$ ), training ( $r = 0.32$ ), compensation system ( $r = 0.32$ ) and employee

participation ( $r = 0.32$ ) with firm performance. Out of these practices, only training ( $b = 0.37, 0.39$ ) and compensation system ( $b = 0.41, 0.43$ ) had positive impacts on firm performance and market performance of the firm. This indicated that an increase of 1 unit in training will increase firm performances by 0.37 and firm market performance by 0.39; secondly, an increase of 1 unit in compensation will increase firm performance by 0.41 and 0.43 in a firm's market performance. On the other hand, two practices namely, job definition ( $b = -0.21$ ) and career planning system ( $b = -0.15$ ) have a negative and insignificant impact on firm performance. Deepak et al. (2003) concluded that organizational performance and competitiveness can be enhanced by utilizing high performance work system. Through Universalistic and contingency approach using regression (189 at 95% level of confidence) analysis, it is identified that relative use of HR practices displays stronger association with organizational performance. Supporting the same arguments, Arthur (1994) found that steel mills that use an HRM 'Commitment System' have higher productivity levels than those that do not. HPW system has significant positive effects on organization productivity. Huselid (1995), in his study of 968 US companies, identified a positive link between HRM practices and firm performance. One standard deviation increase in HRM practices increases firm performance by 25%. Wan et al. (2002) examined the relationship between HRM practices and firm performance. HRM practices were creating positive effect on organizational performance. Results calculated through regression suggested that effective implementation of key HRM practices increases organizational performance. On the other hand, companies interested in enhancing HR performance may emphasize the need for empowerment and training. Few studies, however, did not find clear effects of HRM practices on productivity (Delaney et al., 1989). Kelley (1996) found that HRM practices do not affect performance of organizations; Batt (2002) found that HRM practices do not pay off in small organizations that operate in local markets. Cappelli and Newmark (2001) identified that human resource management practices may raise productivity slightly, but they also raise labor costs. Huselid (1995) evaluated that HRM practices are statistically significant and having positive effect on corporate financial performance of the organization. Numerous researchers found the relationship between corporate financial performance and HRM practices. Flamholtz (1985) and Cascio (1991) concluded that financial returns associated with investments in progressive HRM practices are generally substantial. Schmidt et al. (1979) explored that increasing one unit of employee performance is equivalent to 40% of salary increase. Each of these studies has emphasized on the impact of human resource

management practices on organizational performance. Research on relationship and impact of HRM practices with financial performance of the banks is much more limited in the world and in Nigeria nothing has been done so far in this regard. This research study in the context of financial performance of banks with relation to HRM practices will be first of its nature.

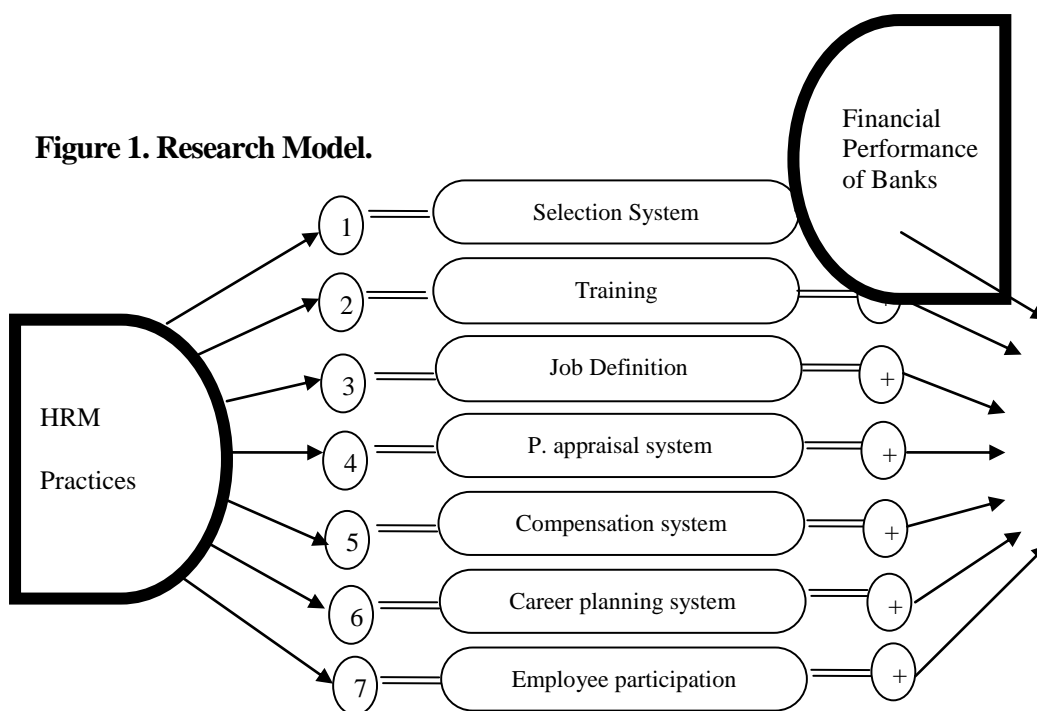
### **Purpose Of Research Study**

In the banking industry, there is one common slogan that "all our stakeholders are important" but clients are at the top. Clients can be satisfied when they will entertain desired services with all protocols. This is possible when employees of the banks are fully committed and involved in their professional working. They will be involved when banks utilize human resource management practices at the apex and altitude of sublimity. Many banks are now investing in human resource management but few banks still ignore this area. This assumption needs to be carefully tested. This research study addresses this assumption directly and therefore the focus of the research borders around whether human resource management practices make a difference in the financial performance of banks or not. If so, which practices appear to be more performance contributory? In a nutshell, the major objectives of this study are to explore the relationship between HRM practices and financial performance of banks and finding impact intensity of HRM practices on the financial performance of banks functioning in Nigeria.

### **Research Design**

"Convenience sampling" technique, a form of non-probability sampling, is used for data selection. This technique is used to make research process faster by obtaining a large number of completed questionnaires quickly and economically from the banks. All operating banks in Nigeria were selected for the study. A list of these operating schedule banks was taken from their websites and other necessary information like addresses and phone numbers of different banks were taken from the websites of respective banks, after which questionnaires were posted to them. Following the tradition of social sciences, we used the questionnaire for primary data collection. This questionnaire was designed on a five point-Likert scale with options; 5 for strongly agree, 4 for agree, 3 for indifferent, 2 for disagree and 1 for strongly disagree. For data collection, human resource managers of 24 schedule banks of Nigeria were mailed questionnaires. After one week, respondents were given 1<sup>st</sup> reminder through email and telephone calls. A 2<sup>nd</sup> reminder was given three days after the first one, while respondents

started responding. However, the process of data collection took 36 days. Aggregately, we collected 38 participants' responses, so the response rate was 82.6%, which is many times better than previous researches by Singh (2004) and Qureshi (2007). Human resource managers from different banks were contacted for information collection regarding perceived financial performance of the banks and human resource management practices. These managers were appealed to answer all the questions to the best of their knowledge. There was another manager in the bank, any person from the HRM department at the managerial level can fill the questionnaire. After data collection, we coded it in Excel 2007 and SPSS 17.0. Statistical tool. Stepwise regression analysis, correlation and descriptive statistics were used to strengthen the results with numerical evidences



**Figure 1. Research model**

### Description of the instruments

The questionnaire included life of the bank, number of employees, years of education of employees, experience of HR manager with this bank and in the banking industry and HRM practices. Out of these items, only HR practices were considered for analyses. Perceived financial performance of the banks in the last three years including increase in sales market share and share price and net profit growth are selected as dependent variables. Statistical tools used were multiple stepwise regression analysis and correlation based on the methodology adopted by Deepak et al. (2003), Singh (2004) and Qureshi (2007) for finding organizational performance.

### Variables

In this research study, perceived financial performance of the bank is considered as the dependent variable and human resource management practices (selection, training, job description, performance appraisal system, compensation system career planning system and employee participation) as independent variables. The research model is given in Figure 1. Aggregately, 8 variables are considered for analysis out of which 7 are independent variables, and 1 is dependent. Variables were selected from studies conducted, by Beer et al. (1984); Delery and Doty, (1996); Singh (2004) and Qureshi (2007).

## Research Model

### Equations for stepwise regression analysis

$$2. y = a + \beta(x_2) + \varepsilon$$

$$3. y = a + \beta(x_3) + \varepsilon$$

$$4. y = a + \beta(x_4) + \varepsilon$$

$$5. y = a + \beta(x_5) + \varepsilon$$

$$6. y = a + \beta(x_6) + e$$

$$7. y = a + \beta(x_7) + e$$

Where  $X_1 = S$  = selection system;  $X_2 = T$  - Training;  $X_T = JD$  = job description;  $X_4 = PA$  = performance appraisal system;  $X_5 = CS$  = compensation system;  $X_6 = CP$  = career planning system;  $X_7 = E?$  = employees participation;  $X_8 = FPB$  = financial performance of the banks.

## Hypotheses

On the basis of research literature b> Beer et al. (1984), Wan et al. (2002), Alberto (2002, 2003), Sels et al. (2005). Singh et al. (2004) and Qureshi (2007), I developed the following eight Hypotheses for this research study.

- H1: There is a positive/significant relationship between effective HRM practices and the financial performance of the banks.
- H2: Comprehensive and transparent selection system positively affects the financial performance of the banks.
- H3: Training positively affects the financial performance of the banks.
- H4: Job description positively affects the financial performance of the banks.
- H5: Performance appraisal positively affects the financial performance of the banks.
- H6: Compensation system positively affects the financial performance of the banks.
- H7: Career planning system positively affects the financial performance of the banks.
- H8: Employee participation positively affects the financial performance of the banks.

## Multicollinearity

In this correlation,  $r$  is greater than 0.80 or tolerance value is closer to zero or Eigen values are not approximately of the same size or variance inflation factor (VIF) is having a high value e.g. +10 in some cases where multicollinearity exists.

Table 2 shows that all correlation values are lesser than 0.80, and Table 1 indicates that tolerance levels for all the variables are greater than 0.40, VIF value is not more than 2.50,



and Eigen values are approximately same, for there is no huge difference amongst them. All these things are indicative of the fact that there is no problem of multicollinearity.

### Research Findings

Pearson correlation is used for finding the degree of relationship between several variables; generally, two variables are correlated when they tend to simultaneously vary in same direction. If both variables tend to increase or decrease together, the correlation is said to be direct or positive. When one variable tends to increase and the other variable decreases, the correlation is said to be negative or inverse.

**Table 1.** Collinearity statistics.

Variables	Tolerance	VIF	Eigen values
Selection	0.64	1.55	0.01
Training	0.46	2.17	0.01
Job description	0.63	1.58	0.01
Performance appraisal	0.40	2.47	0.01
Compensation	0.40	2.50	0.01
Career planning	0.55	1.81	0.00
Employee participation	0.54	1.84	0.00

**Table 2.** Correlations of variables.

Variables	FPB	S	T	JD	PA	C	CP	EP
Financial performance of bank (FPB)	1							
Selection (S)	0.50	1						
Training (T)	0.61	0.51	1					
Job description (JD)	0.26	0.14	0.28	1				
Performance appraisal (PA)	0.56	0.55	0.68	0.24	1			
Compensation (C)	0.50	0.24	0.37	0.50	0.51	1		
Career planning (CP)	0.46	0.35	0.45	0.15	0.46	0.57	1	
Employees participation (EP)	0.50	0.15	0.39	0.55	0.37	0.58	0.26	1

**Table 3.** Descriptive statistics

<b>Descriptive statistics</b>								
	<b>FPB</b>	<b>S</b>	<b>T</b>	<b>JD</b>	<b>PA</b>	<b>C</b>	<b>CP</b>	<b>EP</b>
Mean	4.14	4.29	4.03	4.03	4.11	3.78	4.08	4.00
Standard deviation	0.51	0.48	0.42	0.49	0.42	0.54	0.35	0.55
Range	1.75	1.75	1.67	2.00	1.83	2.20	1.57	2.50
Minimum	3.25	3.25	3.17	3.00	3.00	2.80	3.29	2.50
Maximum	5.00	5.00	4.83	5.00	4.83	5.00	4.86	5.00
Sum	157.5	163.0	153.2	153.3	156.3	143.8	155.0	152.0
Count	38	38	38	38	38	38	38	38

Correlation between different variables are shown in Table 2 and descriptive statistics comprising standard deviation, mean, median, mode, minimum, maximum values and ranges are shown in Table 3. There is a positive correlation of 0.50 between financial performance of banks (FPB) and selection system; the mean of selection is 4.29 and standard deviation is 0.48, indicating that most of the HR managers are satisfied with the selection system prevailing in different organizations of Nigeria. This high correlation indicates that whenever there is a highly scientific and rigorous selection system where line managers and HR managers both part: c:r ate in selection, valid and standardized tests are used for the selection of those Who have desired knowledge, skills and attitudes. As a result, the performance of banks goes up. A correlation of 0.61 between training and financial performance of banks indicates that training will be beneficial when conducted after "training needs analysis". Training conducted in this fashion will ultimately increase the efficiency of banking performance. Performance appraisal with FPB shows a 0.56 correlation value, highlighting that performance of those employees will be good. Employing through standardized procedures with the right calibre and the combined opinions of different concerned managers and employees further indicates that when there is a transparent performance evaluation system in the organization, financial performance of the banks move in a positive direction.

**Table 4.** Financial performance of banks by selection.

<b>Selection</b>	<b>Adjusted R<sup>2</sup></b>	<b>Standardized beta</b>	<b>t-value</b>
	0.24	0.52	5.47

Individual regression analysis.

**Table 5.** Financial performance of banks by training.

<b>Training</b>	<b>Adjusted R</b>	<b>Standardized beta</b>	<b>t-value</b>
	0.41	0.59	6.34

Individual regression analysis.

**Table 6.** Financial performance of banks by job description.

<b>Job description</b>	<b>Adjusted R</b>	<b>Standardized beta</b>	<b>t-value</b>
	0.42	0.486	4.34

Individual regression analysis

**Table 7.** Effect of performance appraisal on the financial performance of banks.

<b>Performance appraisal</b>	<b>Adjusted R<sup>2</sup></b>	<b>Standardized beta</b>	<b>t-value</b>
	0.42	0.552	5.43

Individual regression analysis.

Correlation (0.50) between compensar.cn and FPB indicates that compensation based on performance in relation to payment methodology moves banking performance in a positive direction. Employee participation shows a 0.50 correlation with FPB, indicating that when banks allow employee participation for targets development and decision making, FPB moves up. The significant association between the performance appraisal system and training (0.68) indicates that when performance evaluation is calculated and weak areas are identified through "training needs analysis", then organized trainings increase the performance of employees, which ultimately increases the performance of banks.

Mean values for different variables indicate that overall HR managers are satisfied from human resource management practices under practice in the banks. Examples include mean of financial performance of the banks (4.14), selection (4.29), training (4.03), job description (4.03), performance appraisal (4.11), career planning (4.08) and employee participation (4.00) with standard deviation of 0.51, 0.48, 0.42, 0.49, 0.42, 0.35 and 0.55, respectively, indicating

that almost all the opinions of all the participants are the same. Compensation mean (3.78) with standard deviation of 0.54 indicates that managers and employees are not highly satisfied from the payment system.

### Regression

For finding the contribution of independent variables towards dependent variable, multiple regression analysis is used. In this analysis, initially, one variable selection is considered then other variables were tested, one after the other. Tables 4, 5, 6, 7, 8, 9 and 10 bestow the regression outcomes for Nigeria listed banks. Table 4 shows individual regression. In this model, 24% variability is explained in the financial performance of banks by 'Selection', with a coefficient value of 0.52, indicating that increasing one unit of selection will increase FPB by 0.52. Hence, Ho<sub>2</sub> is empirically accepted that is, that there is a positive relationship between FPB and selection (S). Table 5 shows individual regression analysis of FPB and training. In this model, 41% variability is explained in the financial performance of banks by 'Training,' with a coefficient value of 0.59, indicating that increasing 1 unit of selection will increase FPB by 0.59.

**Table 8.** Financial performance of banks by compensation.

Compensation	Adjusted R <sup>2</sup>	Standard beta	t-value
	0.49	0.68	3.43

Individual regression analysis.

**Table 9.** Effect of career planning on FBP.

Compensation	Adjusted R <sup>2</sup>	Standard beta	t-value
	0.49	0.472	4.56

Individual regression analysis.

**Table 10.** Effect of employee participation on FBP.

Compensation	Adjusted R <sup>2</sup>	Standard beta	t-value
	0.53	0.386	2.61

Individual regression analysis.

Hence, Ho<sub>3</sub> is accepted that there is a positive relationship between FPB and training (T). Table

6 shows individual regression analysis of FPB and job description. In this model, 42% variability is explained in the financial performance of banks by 'job description' with a coefficient value of 0.486, indicating that increasing 1 unit of selection will increase FPB. Hence,  $H_{o4}$  is accepted that there is a positive relationship between FPB and job description. In Table 7, performance evaluation the 4th variable was included, which creates a positive impact but the results are not too attractive thus  $H_{o5}$  is accepted. In Table 8, compensation model (48%) variability is explained in the financial performance of banks by 'Compensation', with a coefficient value of 0.68, indicating that increasing 1 unit of selection will increase FPB. Hence,  $H_{o6}$  is empirically accepted that there is a positive relationship between FPB and compensation (C). Table 9 shows that career planning has a positive impact on FPB but results are not strongly significant. However,  $H_{o7}$  is accepted because there is a positive relationship. Table 10 indicates that employee participation has a positive impact with a coefficient value of .386, which means that increasing 1 unit of employee participation will increase FPB. The research study has proven all hypotheses to be true: selection, training, job definition, performance appraisal, compensation, career planning and employee participation; all these variables have a positive impact on FPB. Hence  $H_{o1}$  is also accepted that HRM practice has a positive impact on FP, but selection, training, compensation and employee participation are major contributory factors in the financial performance of the banks.

This research explored that banks will experience fast growing financial performance when;

1. Banks involved in perfect selection process on the basis of merit were candidates having required attitude, skills and knowledge (ASK).
2. Banks investing heavily on training but after comprehensive "training needs analysis" considered opinions from trainees and supervisors.
3. Banks where payments are made on due date and salaries are according to expectations of employees.
4. Banks providing opportunity to employee for participation in different professional matters with appropriate appreciation and acknowledgement.

### **Practical implication for banks**

From the findings of this research, it can be derived that selection, training, compensation and employee participation are challenging practices in the banking sector of Nigeria. It is suggested that banks operating in Nigeria should give due consideration to selection, training, compensation and employee participation in order to achieve better financial performance. In

order to formulate their policies, this study can be of benefit to officials with more emphasis on HR strategies. This issue is of great magnitude because a developing country like Nigeria will have to operate with emphasis on very high productivity in order to combat the challenges of today's global village. The government needs to appreciate the need for human resource management, to have a strategic perception and to communicate this need to banking business owner for better financial performance.

## Conclusion

Four independent variables namely selection, training, compensation and employee participation have a high positive effect on the financial performance of banks. This research study explored the same results produced by Qureshi et al. (2007). It concluded that human resource management practices, namely selection ( $b = 0.27$ ), training ( $b = 0.31$ ), performance appraisal system ( $b = 0.05$ ) and employee participation ( $b = 0.190$ ) have a positive impact on organizational performance. In the banking sector, we found that compensation is also a major factor towards banking performance. Singh (2004) concluded HR practices, training ( $b = 0.37, 0.39$ ) and compensation system ( $b = 0.41, 0.43$ ) had positive impacts on perceived firm and market performances of the firm. On the other hand, two practices namely job definition ( $b = -0.21$ ) and career planning system ( $b = -0.15$ ) have a negative and insignificant impact on perceived firm performance. The study identified selection, training, compensation and employee participation as major factors for high financial performance of banks; therefore banks' interest in high performance must focus on these variables as an obligation.

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