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The Interrelationship between HR, Strategy and Profitability in Service SMEs: Empirical Evidence from the UK Tourism Hospitality and Leisure Sector

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Abstract
We investigate the strategies, HR attributes and their synergies that are associated with superior performance in service SMEs using data from the UK Tourism Hospitality and Leisure (THL) sector. A major advantage of our analysis is that our sample includes information also on very small firms which makes results representative of the industry but also sheds light on a very little investigated area related to the nature of HRM and its link with performance of micro businesses. Our results suggest that high-performing SMEs in the THL sector are managed by more experienced entrepreneurs. Moreover, they employ a combination of technological and know-how firm differentiation strategies together with a highly skilled workforce, and/or a combination of (product) differentiation strategies based on quality of service and personal attention to customers, and a generous compensation package and attention to employees development.

Keywords: Value capture strategies, Human capital, Organisation Commitment to Employees, Profitability
JEL Classifications: J2

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Introduction

The central theme in the field of Strategic Human Resource Management (SHRM) has been the investigation of the mechanisms that describe the link between Human Resource (HR) architecture and organisational performance. The theoretical literature in the field has been mainly based on the Resource Based View (RBV) of the firm which provides a convincing justification of how HR is linked to Sustainable Competitive Advantage (SCA) (Wright et al., 1994; Lado and Wilson, 1994; Boxall, 1996). On the empirical side the focus has been mainly on testing the validity of universalistic ("best practices") versus contingency ("external fit") approaches of the relationship between HR and financial performance (Huselid, 1995; Koch and McGrath, 1996; Wright and Boswell, 2002) with most of the evidence providing support to the "best practice" framework (Becker and Huselid, 2006).

However, many scholars in the field suggest that, despite the lack of empirical support, the "contingency" perspective" should not be dismissed, as it may still provide a "compelling" framework for analysis in the SHRM theory (Huselid, 1995; Becker and Gerhart, 1996; Becker and Huselid, 2006). This is especially true because the vast majority of empirical evidence is produced by studies from the US focusing on samples of large firms in the manufacturing sector (Arthur, 1994; Ichiowski et al., 1997; MacDuffie, 1995; Appelbaum et al, 2000; Youndt et al., 1996), raising doubts on the generality of their results in other settings.

For example, it has long been acknowledged by SHRM scholars that the nature of HRM and its link with organisational performance depends critically on firm size and industry context (Huselid, 1995; Way, 2002; Combs et al., 2006). In general it is expected that HRM can be even more important for the service sector than the manufacturing sector, given the much larger share of production costs accounted for by employment (Rosenthal, Hill and Pecei, 1997; Bartel, 2004, Combs et al., 2006) and there is evidence that smaller firms are not just "scale-down" version of large firms and engage in different HRM practices than larger firms (Huselid, 1995; Storey, 2002).

Although recent studies produce evidence on the HRM-performance link from services and SMEs (Guest et al., 2003; Way, 2002), this area is still viewed by many as surprisingly under-researched (Delery and Dotty, 1996; Huselid, 2003; Heneman and Tanksy, 2003). This is especially true when one considers the importance of services and the small business sector for OECD economies[1] (OECD, 2003).

Perhaps more importantly, the samples analysed by empirical HRM studies of SMEs exclude very small firms (firms with less than 25 employees) (Hoque, 1999; Way, 2002; Bacon and Hoque, 2005). As a result, empirical results may not be representative of the population of SMEs, as in most service industries very small firms account for a significant share of all firms[2] (Hoque, 1999). It is also true that we know next to nothing on whether very small firms engage in any HRM at all or whether they deploy, and what types of, business strategies to capture value in the market (European Commission, 2002).

The purpose of this paper is to shed some light in this little investigated area and in particular to identify those HR factors and value capture strategies, as well as their synergies that are associated with superior performance of SMEs, including very small businesses, in the UK Tourism Hospitality and Leisure (THL) sector.

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[1] The service sector accounts for about 70% to 80% of aggregate production and employment of OECD economies (OECD 2003) and SMEs account for two thirds of total employment and economic activity in OECD countries (OECD, 2002) and for 99% of all firms in Europe and in the UK (Small Business Service, 2003).

[2] In particular for the Hospitality industry which is the focus of our analysis, Hoque (1999) suggests that 81% of establishments within the industry employ fewer than 25 people which makes most findings unrepresentative of the industry as a whole.

Our results provide evidence of zero or negative direct association of strategy and profitability and that the entrepreneur's experience is the only HR factor of THL SMEs that is directly and positively associated with profitability. More importantly we find that synergies of strategy and HR matter for SMEs' performance but the evidence points towards a "good" and "bad" fit of strategy and HR, i.e. that only certain interactions of strategy and HR are associated with higher profitability whereas others have a negative or no association.

The structure of the paper is as follows. In the next section we build on extant theory to develop the hypotheses for empirical investigation. Section three describes our method and in particular includes a description of the survey design, the sample and the operational measures of the dependent and independent variables employed in our analysis. The fourth section discusses the main results and findings. Finally section five presents implications for managerial practice and concluding remarks.

Hypotheses Development

Value capture strategies

Profiting from one's 'advantages is a major objective of the firm (Teece, 1986; Brandenburger and Nalebuff, 1995). The ability of a firm to do so will depend on factors such as its market power, for example, enabled through structural and strategic barriers to entry[3], as in Porter (1980) and the ability of a firm to create 'relatively impregnable bases'[4], (as described in Penrose (1959) and the RBV), namely technological and know-how-based bundles of (tacit) knowledge which are hard for rivals to imitate. Relatively Impregnable bases (RIBs) engender differentiation of the firm as a whole vis-à-vis competitors, thus intra-firm-based barriers to entry and firm heterogeneity. In addition to "Bain-type" barriers to entry and RIBs, strategies of value capture discussed in the literature include 'generic strategies' (differentiation, cost leadership and focus) (Porter, 1985) as well as integration, diversification and cooperation strategies (Williamson, 1975; Teece, 1986).

The above strategies have received the lion's share in empirical studies notably in Industrial Organisation (IO) economics, in the transaction costs approach, but also in the RBV-see Williamson (1975), Teece (1986) and Mahoney (2005) for extensive critical surveys. They operate through control/power and/or efficiency (e.g. in RBV, the Chicago-version of IO, e.g. Alchian and Demsetz (1972), and/or transaction costs, e.g. Coase (1937); Williamson (1991).

It is interesting to note that Bain-type barriers include Porter's two generic strategies, i.e. (product differentiation and focus). Integration, cooperation and diversification moreover,

[3] The literature on barriers to entry goes as far back as Bain (1956). Bain identified three main barriers to entry of new firms, which allow incumbents to capture above normal profits, by keeping prices above the competitive levels; absolute cost advantages, economies of scale and product differentiation. His empirical work for US manufacturing firms has shown that the last mentioned (or preference barrier) was the most important. Subsequent literature focused on pricing (e.g. the limit pricing model, Modigliani, 1958), investments in excess capacity (Spence, 1977) product proliferation, and advertising, (Porter, 1980; Scherer and Ross, 1990). The main characteristic of such barriers is that they focus on the industry, not the firm, in contrast to the resource-based view (RBV).

[4] Edith Penrose (1959), one of the founders of the RBV, discussed both Bain-type barriers to entry, but also ' relatively impregnable bases', such as intra-firm technological resource bases, that create a stronghold on which firms can build, and which allow firms to out-compete rivals. Technological -'impregnable bases' can be seen as the dynamic equivalent of non-imitable resources as they can change over time. Hard to imitate intra-firm resources and capabilities, as well as 'impregnable bases', create a firm's 'identity', therefore they can constitute a new genre of barriers to entry, that we term 'firm differentiation'.

are often viewed as barriers to entry (Porter, 1980), and they impact on 'firm differentiation' as they help determine a firm's "identity".

Empirical research based on case studies and statistical analysis of surveys from SMEs suggests that SMEs mainly pursue one of the above value capture strategies depending on their particular characteristics such as the industry in which they operate and the resource constraints they face (Lefebvre and Lefebvre, 1993; Rangone, 1998; Lee, Lin and Tan, 1999).

Based on these arguments we propose our first hypothesis:

H1: *Strategic entry deterrence, RIBs/firm differentiation, generic and integration/cooperation/diversification strategies for value capture will tend to be positively associated to SMEs profitability.*

Human resources

Based on the RBV theory, HR factors can lead to Sustainable Competitive Advantage (SCA) as long as they are valuable, rare inimitable and non-substitutable-VRIN (Barney, 1991). Wright et al. (1994) distinguished between the firm's human capital pool (i.e. the stock of employees' education and skills that exist within a firm at any given point in time (Becker, 1962) and HR practices (those HR tools intended to manage the human capital pool). By employing the concepts of VRIN, they argued that the human capital pool had greater potential to constitute a source of SCA.

Recent research distinguishes between human capital attributes (including education, experience and skills) of employees and of top managers as important determinants of firm outcomes (Finkelstein and Hambrick, 1996; Huselid, 1995; Pennings et al., 1998). This distinction is expected to be even more important in SMEs where the owner/entrepreneur's creative talent is fundamental for business success (Stoner, 1987; Lefebvre and Lefebvre, 1993).

In contrast to Wright et al. (1994), Lado and Wilson (1994) proposed that firm's HR practices could provide a source of SCA. They suggested that HR systems (a combination of individual HR practices) can be unique, causally ambiguous and synergistic in how they enhance firm competencies and thus could be inimitable. This point of view seems well accepted within the current SHRM paradigm (Snell, Youndt and Wright, 1996).

Among HR practices, an organisation's commitment to its employees (OCE) is expected to be fundamental in achieving SCA (Lee and Miller, 1999, Wright and Boswell, 2002). OCE is expected to be particularly important for SMEs in the service industry that are expected to rely on personal relationships between management and employees rather than on other more sophisticated high performance work systems (Huselid, 1995).

An OCE may be reflected in its care for employee wellbeing and satisfaction, in the fairness and compassion of its rewards, and its investment in competence development of employees (Eisenberger, Cotterell, and Marvel, 1987; Eisenberg, Fasolo and Davis-LaMastro, 1990).

OCE is expected to create useful emotional bonds between an organization and its employees. If employees believe that their organization cares about them and their happiness, treats them with consideration and distributes its rewards accordingly, those employees are far more likely to develop positive affective attachments to their employer (Eisenberger et al., 1987, 1990; Levison, 1965; Smith, Organ and Near, 1983). Strong effective bonds can induce greater efforts from employees-efforts to work harder, to cooperate more willingly, to work more innovatively, and thus to do a better job (Eisenberger et al., 1990). This can lead to greater productivity, more creativity, higher quality work, and better team decisions (Collins and Porras, 1994; Peters, 1994). In fact employees' affective attachments to their organizations have been shown to reduce costly absenteeism, to cut turnover, and to improve

job performance (Mowday et al., 1984; Steers and Porter, 1987). OCE can also create climate of trust that allows firms to dispense with costly and demotivating bureaucratic controls (Barney and Hansen, 1994). Thus, OCE and the effort, initiative and collaboration it fosters can help firms to build SCA.

Based on these arguments we propose our second hypothesis:

H2: The SMEs human capital such as the entrepreneur's education and experience, the education and training of the workforce and HR practices such the SMEs OCE will tend to be positively associated to SMEs profitability.

Synergies of value capture strategies and HR

The strategy literature has called attention to the wide gulf that exists between strategic conception and effective execution (Hamel and Prahalad, 1994; Porter, 1996). Proponents of the RBV argue that positioning strategies such as Porter's (1980) may be worth little without highly qualified human resources to execute or implement them (Barney, 1991; Hall, 1993; Lado and Wilson, 1994; Wernefelt, 1984).

An organisation's human resources may lead to SCA by facilitating the achievement of strategic goals, as these goals require relevant knowledge, skills and experience by employees (Wright et al., 2001). In turn, the pursuit of a dedicated value capture strategy may lead to superior performance via the efficient deployment of the organisation's human capital (Lee and Miller, 1999).

In addition, effective strategy implementation requires a certain set of behaviours and attitudes from employees. Provided that HR practices elicit this set of responses from employees, they can mediate between value capture strategy and SCA (Cappelli and Singh, 1992). As suggested above OCE, which is especially critical for service SMEs, is expected to contribute towards a committed and motivated workforce that in turn is more willing to work in harmony towards the achievement of strategic objectives and to make decisions with care and generosity of spirit (Hart, 1992; Lado and Wilson, 1994; Senge, 1990). Conversely, dedicated value capture strategies may intelligently help focus employee effort and thus leverage the benefits of OCE. A dedicated and coherent strategy can give committed employees useful goals to work towards and important work to do. Firms without a strategy for attaining competitive advantage may end up wasting their employees' best efforts (Lee and Miller, 1999).

Based on these arguments we propose our third hypothesis:

H3: Value capture strategies will tend to be more strongly positively associated with SMEs profitability when the firm has a higher stock of employees' skills and invests in OCE.

Methodology

Research design and sample

The data used in our analysis, was collected through a large scale survey of THL SMEs implemented between September and December 2005 by the Centre for International Business and Management (CIBAM), at the Judge Business School, University of Cambridge, and in close collaboration with trade associations of the THL sector[5]. The THL

[5] This is because the data was collected as part of a project aiming to evaluate the effect of business support programmes for SMEs in the THL offered by the Best Practice Forum (BPF), a strategic alliance of all trade associations in the sector.

sector is a very heterogeneous[6] consisting mainly of micro (very small), small and medium sized businesses.[7]

We adopted the methodology of contacting the firms, mailing the questionnaire and following up, as proposed in the literature (Dillman, 1999). We contacted in total 1328 businesses that participated in business support programmes offered by the Best Practice Forum (BPF), a strategic alliance of the main industry associations in THL.[8] Questionnaire items were identified by a review of the literature on the organisational structure of service SMEs (Lefebvre and Lefebvre, 1993; Rangone, 1998; Lee et al., 1999; Hoque, 1999; Bacon and Hoque, 2005) and by interviews with CEOs of the main trade associations in the sector and several business owners/entrepreneurs that had as main objective to identify the key areas of strategy and HR for THL SMEs.[9]

The questionnaire was kept relatively short (3 pages) and simple, partly because of concerns of a low-response rate and partly because extant literature (Hoque, 1999; Bacon and Hoque, 2005) and discussions with CEOs of the main trade associations in the THL and with business owners, revealed that in contrast to large firms the organisational structure and HR architecture of THL SMEs is quite simple, allowing more focused questions.

The questionnaire included questions on key financial and other performance indicators as sales revenue, total expenditure, advertising expenditures and expenditure on R&D (e.g. expenditure on the development and commercialisation of new products/services, expenditure on the development of new ways of doing business and expenditure on new technology). Information was also requested on business objectives and strategies to achieve these, competencies for the business strategy and management and personnel policy, as well as information on the number of employees and workforce skill decomposition and training provision. Business managers/owners were also asked to provide information on their education and experience as well as on business characteristics, such as ownership status, age of business and on whether the business is a part of larger organisation, as well as the number and type of collaborations and partnerships and reasons led to the establishment of these partnerships.

The survey achieved an relatively high response rate (32%), compared to the average response rate for SMEs in this sector (Dillman, 1999), with 430 businesses returning the survey questionnaire. The information collected was of very good quality as the vast majority of managers provided detailed answers to all questions.

Table 1 presents some important statistics such as number of employees, turnover and profit margin for SMEs responding in the survey, for all contacted businesses and for all UK SMEs in THL.[10] The average firm in our sample is quite small with around 50 employees.[11]A simple comparison of the main statistics between respondents and all firms included in the

[6] Businesses receiving BPF support include hotels, attractions, other service accommodation and self-catering accommodation providers, restaurants, caravan/home sales, pubs/bars, businesses in catering service, health clubs and leisure centres, businesses organising conferences and events, recruitment, cottage letting and travel agencies.

[7] As micro businesses are defined those with less than 10 employees.

[8] CEOs of all trade associations of the UK THL sector were initially contacted and were kindly requested to send a signed notification letter that was sent to businesses, explaining the purpose and the usefulness of the research for the sector, and requesting their help and collaboration. At the second stage a survey questionnaire was addressed to the owner/entrepreneur/manager of the business.

[9] We also conducted interviews with owners/managers of several businesses that participated in the survey to test initial versions of the questionnaire.

[10] Data on all UK THL SMEs was obtained by FAME (Financial Analysis Made Easy) database in 2005, an economy-wide database that covers all registered firms in the UK.

[11] However, note that 70% of businesses are small, i.e. employing less than 50 employees of which 30% are micro businesses employing less than 10 employees.

survey as presented in table 1 does not seem to suggest a problem with non-response bias. However, comparing SMEs responding in the survey with all UK SMEs in THL seem to suggest that responding firms are on average smaller in size[12] and less profitable than the population of THL SMEs. This raises concerns for sample selection, which we try to address in our analysis that follows[13].

Measures

Dependent variables

We use the price-cost margin (PCM) as an index of firm profitability. This is specified as sales revenue minus total expenditure divided by sales revenue. The PCM represents the proportional difference between unit price and the marginal cost of output. A high PCM reflects a firm's ability to increase price over costs and/or to reduce average costs. The former situation might reflect a firm's monopoly power or differentiation/RIB posture, whereas the latter might reflect the firm's cost efficiency (Spanos et al., 2004). The PCM is the most common index of profitability in strategic management and it is extensively employed in the IO literature (Collins and Preston, 1969; Cowling and Waterson, 1976; Cubbin and Geroski, 1987; Uri, 1988; Gisser, 1991).

Independent variables

Our main independent variables include two aspects of human resources, (the human capital pool of the organisation distinguishing between entrepreneurial human capital and employees' human capital and the organisation's commitment to employees) as well as three types of value appropriation strategies, namely a proxy for RBV-based RIBs, two major generic strategies of Porter-differentiation and cost leadership-(these are also Bain-type barriers to entry), and integration/cooperation/diversification strategies as in Williamson (1975), Teece (1986) and others. We also constructed the interactions between employees' human capital and OCE with the three types of value appropriation strategies[14].

Factor analysis was used to identify structure within the strategy-related and HR-related subsets of the data. In particular, we used the information provided on the level and the number of educational/professional degrees/qualifications of the entrepreneur to construct a composite measure of manager's education. A confirmatory factor analysis (orthogonal, Varimax) was run to determine whether these items loaded on the factor labelled as entrepreneur's education (see Table 2). Similarly, we used information on the years of general managerial experience of the owner/entrepreneur of the SME, and on the years of experience in the THL sector to produce factor scores that measure the underlying latent construct of entrepreneur's experience. As indicated by Table 2, the items related to entrepreneur's education are negatively and strongly correlated with the items linked to

[12] The size disparity between BPF businesses and the population of THL SMEs from FAME is mainly due to the presence of large firms (firms with more than 250 employees) in the latter. The difference in size also explains differences in profitability as larger firms are also more profitable (Manning, 2003).

[13] As noted by Berk (1983), sample selection bias, in principle, exists for any and all data sets (but is minimized, he notes, in randomized experiments). The significant question is, therefore, "whether the bias is small enough to be safely ignored". The sample selection problem is also pointed out by Huselid (1995) and Becker and Huselid (2006) to be a major source of bias in empirical studies of the relationship between HR and firm performance. These authors also express their surprise that researchers do not address it "despite the well-developed literature devoted to the statistical correction of selection bias" (pp. 640).

[14] We do not include interactions of manager's human capital with value capture strategies because the intensity of pursuing a value capture strategy reflects manager's education and experience. As suggested by Azhdar, Farhad and Nada Korak (2006) managerial human capital attributes, such as education and experience, are formed prior to the choice of strategy and thus are fundamental determinants of this choice.

entrepreneur's experience, suggesting that higher managerial experience is associated with fewer and lower educational qualifications. The factor loadings for these items further suggest that entrepreneur's education and experience are linked to two separate latent constructs, represented by factor 1 and factor 2 respectively.

The employees' human capital was measured by a single indicator, the ratio of qualified/trained employees to the total number of employees in the business, calculated as the weighted sum of managerial employees with a degree/professional qualification and the number of non-managerial employees received formal training, to the total number of employees[15].

Following Lee and Miller (1999), the OCE measure was assessed using 5-point Likert scale items, but also metric variables, like the average hourly wage of non-managerial employees in the business and staff turnover. As already discussed, OCE is mainly reflected in investments in competence development of the employees, in the care for employee wellbeing and satisfaction and in the fairness, compassion and generosity of a firm's rewards (Eisenberger, Cotterell, and Marvel, 1987; Eisenberger, Fasolo and Davis-LaMastro, 1990; Organ, 1990). Factor analysis confirmed this conceptual structure of OCE by identifying three separate latent constructs associated with OCE, and in particular a human resources development related OCE dimension (factor 3), an employee wellbeing OCE dimension (factor 4), and a compensation related OCE dimension (factor 5)[16].

The same approach was used to assess the dedication by which a firm pursued each of the value capture strategies. The results of factor analysis of strategy-related items presented in table 3 seem to confirm the a priori expectations about the structure in strategy-related data. In particular, factor 1 is labelled as RIB strategy, because it is characterized by high R&D expenditure, advertising expenditure and expenditure on business support, indicators that are likely to relate to firm differentiation as a whole, and correspond to the definition of RIB strategies discussed in the hypotheses development section. Factor 2, is labelled as (product) differentiation and based on factor loadings presented in table 3, high scores of this factor correspond to differentiation based on pricing and innovation whereas low scores are linked to differentiation based on quality of service and personal attention to customers. Factor 3 is labelled as cost-reduction/leadership, because higher score values of this factor are associated with businesses in which the manager considers cost control as one out of three main means to achieve business objectives, considers cost-reduction over time very important for business success and has established cooperation with other stakeholders with the primary purpose to reduce costs.

Finally, factor 4 is a composite measure of the extent to which the business pursues a cooperation/diversification strategy. Higher score values of this factor are associated with more intensive cooperation and networking activities, as measured by the number of memberships of the entrepreneur/owner in professional associations and the number of cooperations with other stakeholders (customers, suppliers, government, etc.) and more

[15] In his seminal work, *Investment in Human Capital: A Theoretical Analysis*, Becker (1962) included in his concept of human capital activities such as formal education and off-the-job training (general human capital) and on-the-job training (specific human capital).

[16] Note that some of the items heavily loaded on OCE1 and OCE3 are indirectly linked with these constructs. For example clear communication of HR may indicate the presence of (formal or informal) communication systems which are linked to staff development (Way, 2002). Moreover, the impact of the minimum wage and staff turnover are expected to reflect many unobserved aspects of compensation in the organisation. In particular there is evidence that the share of employees paid below the forthcoming minimum wage rate is a strong indicator of whether the organisation is a high or low-paying (Draca et al., 2008) and that staff turnover in the small business sector strongly reflects the level of compensation (Storey, 2002) and the opportunities for wage progression (Holtman and Idson, 1991).

intensive product diversification as measured by the number of different products/services offered by the business.

Analysis and Results

Table 4 presents Pearson correlations of the dependent and independent variables and Table 5 presents estimation results of several specifications of the profitability/price-cost margin (PCM) model. The first column of Table 5 reports linear regression results whereas in column two are reported estimates produced by Heckman's (Heckman, 1979) two-step method (Heckit) that addresses sample selection bias that may result from the fact that SMEs participating in BPF business support programmes are systematically different in profitability, strategy and HR architecture from other THL SMEs (Heckman, 1979).[17] Linear regression results are very similar to the Heckit and the inverse Mill's ratio is insignificant suggesting that sample selection is not a major concern for our analysis and thus one can proceed with OLS rather than Heckit estimation of the model[18].

We follow a general to specific model selection strategy (Hendry, 1987, 1995) by starting with a general specification and gradually omitting all variables with strongly insignificant estimated coefficients to derive the most parsimonious model representing the data, as that presented in column (4) of Table 5.

Results presented in column (4) seem to suggest no direct association of value capture strategies and profitability except of the case of RIB which is negatively correlated to price-cost margins. This finding may be consistent with the view that in the absence of complementary resources, the pursuit of a dedicated value capture strategy is not sufficient for successful strategy implementation and thus may have no effect on profits or even a negative effect. This can be the case when the strategy contributes more to costs than to revenues.[19]

We also find that out of all HR factors only entrepreneur's experience has a direct and strong positive association with financial performance. This result seems to support the

[17] We implemented Heckman's two-step method by estimating a probit model where the independent variable is binary taking the value 1 if the firm is participating in BPF business support programmes and 0 otherwise and as independent variables were included variables that are likely to be associated with the decision of a business to participate in business support programmes as size, industry, ownership type and region. The sample used in the first stage is a mixed sample that includes all businesses participating in BPF programmes but also all THL SMEs from FAME that do not receive business support from the BPF. In the second stage we run a linear regression of the PCM model in the BPF sample only, including also as an independent variable a selection bias control (the inverse Mill's ratio) estimated by the first stage (Wooldridge, 2002; Cameron and Trivedi, 2005).

[18] Based on Heckman (1979) sample selection can be a source of model misspecification and thus a threat to the internal validity of econometric estimates when unobserved factors leading to sample selection are also correlated with the dependent variable. In our case sample selection does not seem to be a problem probably because as also presented in table 1 the fundamental difference between BPF (participating) businesses and the population of SMEs (non-participating) is size which is observed and included as a control in the OLS estimation of the PCM model.

[19] Strictly speaking the negative association between RIB and profitability implies that firms that adopt an such a strategy have on average lower profitability but the direction of causality may run either way. However, one could interpret results as running from strategy to profitability if strategy and profitability are not simultaneously determined and in particular if strategy is determined prior to profitability which can be the case when strategy adjusts slower than profitability to an exogenous shock (Guest et al., 2003; Wright et al., 2005). This seems like a plausible assumption given that while profits are expected to change instantaneously in the face of a shock, strategy may be fixed in the short run as it is tied to fixed assets, such as physical capital and equipment (Youndt et al., 1996). The same argument can be used to support also the argument that HR practices such OCE are determined prior to profitability. Overall this argument rules out simultaneity bias problems in our analysis (Becker and Huselid, 2006).

importance of the entrepreneur/owner for SMEs stemming from the concentrated decision-making power as stressed in the strategy and entrepreneurship literature (Vesper, 1980, Dunkelberg et al., 1987; Finkelstein and Hambrick, 1996). Moreover, a potential interpretation of the lack of direct correlation between employees' human capital and OCE with profitability may be the lack of complementary resources, as for example a dedicated value capture strategy that would assist in effectively deploying human capital and HR practices to boost performance.

Moving to the associations/correlations between interactions/complementarities of value capture strategies and HR factors with performance we find all kind of associations i.e. positive, negative and zero. Positive associations of interactions of strategy and HR with profitability are consistent with the "contingency"/external fit approach in SHRM (Huselid, 1995; Becker and Huselid, 2006) but the presence of negative and zero associations seem to suggest that one should distinguish between "good", "bad" and "no" fit (complementarities) between strategy and HR for profitability.

In particular, we find that profit margins of firms pursuing a dedicated RIB strategy are higher the larger is the human capital stock of the firm. This is consistent with the idea that the successful implementation of a strategy based on technological and know-how- based assets, requires that employees possess sufficient skills and knowledge to implement it (Hitt et al., 2001). Conversely, human capital can only be effectively deployed when the firm adopts a strategy that makes full and efficient use of the human capital and does not waste employees' specific skills.

Our results show a negative association of the interactions of (product) differentiation strategy with the HR development dimension of OCE (OCE1) and with the compensation aspect of OCE (OCE3). Given that higher values of the differentiation strategy indicator are associated with differentiation based on pricing and innovation and low values with differentiation based on quality of service and personal attention to customers, this result implies that firms that combine investment in HR development and a more generous compensation package with quality of service and attention to customer exhibit better financial performance[20]. Additionally, this finding suggests that profit margins of firms that combine more attention to OCE1 and OCE3 with differentiation based on pricing and innovation tend to be lower. Overall, this seems quite plausible and intuitive to the extent that personal attention to customers and quality of service may hinge largely on the motivation, dedication and commitment of the workforce, which can be elicited via a positive attitude towards employees' training[21] and development and generous compensation. This is in contrast to innovation and pricing that may also require among others, investment in market knowledge, R&D and marketing (Porter, 1985).

Another result seems to suggest that a combination of commitment to employees' well-being (OCE2) with a RIB strategy is negatively associated with profitability. This finding may suggest that investing in employees' well-being as a means to implement successfully a knowledge-based strategic differentiation of the firm as a whole, may not pay-off and in particular may contribute more to costs than to revenues. This may be because although overall employees' satisfaction may lead to higher effort and motivation (Bartel et al., 2004) this may not be sufficient for executing a strategy based on technological and knowledge- based bundles, that requires specific expertise from employees.

[20] This result is in line with Hoque (1999) who finds that hotels pursuing a strategy based on an ethos of service quality coupled with a high number of HRM practices are performing best.

[21] Note that OCE1 is weakly correlated with the share of qualified/trained employees in the firm, which suggests that these two variables measure different aspects of HR, which can further explain the difference in their complementarities with value capture strategies.

All in all, our results support the argument that high-performing SMEs in the THL sector are on average managed by more experienced managers/entrepreneurs and employ a combination of technological and know-how firm differentiation strategies together with a highly skilled workforce, and/or a combination of (product) differentiation strategies based on quality of service and personal attention to customers, with a generous compensation package and attention to employees development.

Conclusions and Implications for Managerial Practice

The primary aim of this study was to identify value capture strategies, HR factors and their synergies that are associated with superior financial performance of medium, small and micro businesses in the service sector and in particular the UK Tourism, Hospitality and Leisure (THL) industry. This remains a surprisingly under-researched area in the SHRM field, considering especially the heavy reliance of service SMEs on employees' and thus the key role of HR in these businesses, as well as the importance of SMEs and the service sector in today's economies.

Building on extant theory and/or the particular characteristics of SMEs, and the idiosyncrasies of the service industry, we suggested that four types of value capture strategies, (entry deterrence, RIB, generic strategies and integration/cooperation/diversification strategies), employees' and entrepreneur's human capital as well as the Organization's Commitment to its Employees (OCE) and their synergies/complementarities are expected theoretically to be most important predictors of SMEs profitability.

Our analysis suggests that pursuing a RIB strategy (as proxied in our analysis) is negatively associated with profitability and this negative association becomes stronger the more committed is the firm to improve aspects of employees' well-being (OCE2). The relationship between RIB strategy and profitability turns positive only when the RIB strategy is complemented by larger stock of employees' human capital. Moreover, we find that entrepreneur's experience is a strong positive covariate of profit margins. Also our results suggest that paying more attention to staff development and having a generous compensation policy are positively correlated with profits, when the firm adopts at the same time a (product) differentiation strategy based on personal attention to customer and quality of service. However, both attention to staff development and a generous compensation package are negatively correlated with performance when the firm pursues simultaneously product differentiation based on pricing and innovation.

Our results add new evidence on important current debates on the RBV and the role of strategy and HR in achieving SCA. They also have important implications for managerial practice. In particular, it is not necessarily true that profits will be higher and may be even lower when managers/entrepreneurs engage more actively in the sole pursuit of a dedicated value capture strategy or have in place HR practices to elicit required behaviour by employees. What seems to be a significant predictor of profitability is the external fit, i.e. the combination/complementarity of value capture strategies and HR factors such as human capital and HR practices. Moreover, our results suggest that there is "good" and "bad" fit of strategy and HR as some combinations of strategy and HR are associated with higher and some with lower profitability. An immediate implication of this is that one needs to investigate what factors determine whether the strategy and HR are successfully "matched" to contribute towards the achievement of SCA.

A major advantage of our paper is that our sample includes very small and micro businesses which have been excluded from samples analysed by other empirical studies in the HRM literature largely because of the lack of data .Given that very small firms comprise a significant share of all firms in the THL industry, our results are representative of the industry as a whole and provide a picture of the nature of HRM and its link with business performance for micro firms which has been missing in the literature. However, a limitation related to the inclusion of micro firms in the sample is the lack of detailed information on HR architecture (all aspects of HR practices and systems) and business strategy which further limits our proxies for value capture strategies and HR factors.

Another limitation of our analysis is that although we deal with some of the threats to internal validity, that is a prerequisite for causal inference (sample selection bias), our analysis may still mask other omitted factors that may explain the observed associations. This is why we are cautious and interpret the results as statistical associations and not as causal effects running from strategy and HR to profitability. However, we believe that our exercise is fruitful and informative in that knowing what patterns and correlations are in the data does restrict the set of possible conceptual frameworks to those that can explain that correlations. It is also important to remember that there is little quantitative evidence of the type we present on the SHRM of service SMEs. Clearly more evidence is needed to fill such an important vacuum, but we feel our research opens new avenues for us, and may hopefully motivate others to work on this important and underexplored area.

Table 1: Main Descriptive Statistics of the BPF Sample, the BPF Population and the UK THL SMEs Population

	BPF Sample	BPF Population	THL SMEs Population
Number of Employees	52	54	63
Turnover/Sales Revenue	2172	2033	3180
Profit Margin	0.3	0.23	0.54
Number of Firms	430	1328	7771

Notes: Turnover/Sales revenue is measured in £000.

Table 2: Varimax Rotation of Human Resources Items

Item	Factor 1	Factor 2	Factor 3	Factor 4	Factor 5
Factor 1: Manager's experience					
Years of general managerial experience	0.9	-0.56	-0.01	0.009	-0.016
Years of managerial experience in the THL	0.9	-0.48	0.06	-0.048	0.089
Factor 2: Manager's Education					
Level of degree/professional qualifications	-0.6	0.91	0.02	0.004	0.022
Number of degrees/professional qualifications	-0.57	0.89	-0.01	-0.01	0.02
Factor 3: OCE 1					
Human resources key for business strategy	0.17	-0.027	0.64	0.07	0.1
Importance of clear communication of HR policy	0.16	-0.19	0.63	0.24	0.15
Importance of human resources for business success	0.03	-0.11	0.77	0.23	0.14
Importance of education/training of employees for HR	0.21	-0.08	0.88	0.11	-0.01
Cooperation with other stakeholders for staff development	0.08	-0.06	0.91	-0.07	0.16
Factor 4: OCE 2					
Importance of workers' satisfaction for HR	-0.02	-0.22	0.18	0.78	0.001
Importance of a good work environment for HR	0.13	-0.26	0.37	0.77	-0.27
Factor 5: OCE 3					
Average wage	0.09	-0.081	0.11	-0.021	-0.76
Impact of Minimum Wage	-0.079	-0.037	-0.06	-0.012	0.88
Staff turnover	-0.002	-0.022	0.03	-0.15	0.76
Eigen Value	5.866	4.06	1.4	1.19	0.966
% of Variance	41.9	29	10	8.5	6.9

Table 3: Varimax Rotated Factor Matrix of Strategy Items

Item	Factor 1	Factor 2	Factor 3	Factor 4
Factor 1: Impregnable base				
R&D expenditure	0.84	0.036	0.02	0.11
Advertising expenditure	0.71	0.09	-0.12	0.02
Expenditure on business support	0.6	-0.034	-0.049	0.19
Factor 2: Differentiation				
Pricing	0.087	-0.79	0.32	-0.22
Quality	0.029	0.8	-0.48	-0.04
Personal attention	-0.006	0.81	-0.33	-0.01
Innovation	0.052	-0.85	0.36	0.07
Factor 3: Cost Leadership				
Cost control key for strategy	-0.03	0.46	0.81	-0.15
Importance of reducing costs for business success	-0.07	0.27	0.73	-0.23
Cooperation with other stakeholders to reduce costs of business	0.05	0.48	0.78	0.12
Factor 4: Cooperation/Diversification				
Number of memberships in professional associations	-0.18	-0.06	-0.28	0.77
Number of cooperations with other stakeholders	-0.04	0.07	-0.07	0.85
Number of activities/products	-0.002	-0.006	-0.04	0.79
Eigen Value	5.265	3.068	2.041	1.144
% of variance explained	40.5	23.6	15.7	8.8

Table 4: Pearson Correlation Matrix

	1	2	3	4	5	6	7	8	9	10	11	12
1. PCM	1.00											
2. Size	0.05	1.00										
3. Imp. base	-0.17	-0.25	1.00									
4. Differentiation	0.11	0.12	-0.03	1.00								
5. Cost leadership	0.12	-0.11	-0.06	-0.39	1.00							
6.Coop/divers	0.01	0.32	-0.01	0.05	-0.06	1.00						
7. Manager's education	-0.02	0.06	0.05	0.08	-0.11	0.17	1.00					
8. Manager's experience	0.13	0.12	-0.01	-0.06	0.1	0.13	-0.11	1.00				
9. Proportion of skilled/trained employees	0.08	0.13	-0.05	0.09	-0.07	0.08	0.1	-0.01	1.00			
10. OCE 1	0.01	0.2	-0.03	-0.01	0.08	0.28	0.02	0.06	0.18	1.00		
11.OCE 2	-0.03	-0.08	-0.04	-0.09	0.04	-0.04	-0.02	-0.07	0.05	0.36	1.00	
12. OCE 3	0.02	-0.16	0.04	-0.3	0.27	-0.06	0.04	0.07	-0.01	0.07	0.08	1.00

Notes: Correlations of 0.2 or more are significant at beyond the 0.05 level under a two-tailed test.

Table 5: OLS and Heckit Estimates of the PCM Model

	(1) OLS	(2) Heckit	(3) OLS	(4) OLS
Strategy				
Impregnable Base	-0.43**	-0.42**	-0.42**	-0.53***
Differentiation	0.11	0.1	0.18	
Cost leadership	-0.2	-0.21		
Cooperation/diversification	0.07	0.05		
HR				
Entrepreneur's education	0.08	0.07		
Entrepreneur's experience	0.31**	0.31***	0.3***	0.27***
Proportion of skilled/trained employees (PSE)	0.16	0.17	0.19	
OCE 1 (HR development)	0.01	0.01	0.009	
OCE 2 (wellbeing)	-0.13	-0.14	-0.13	
OCE 3 (compensation)	-0.09	-0.09	-0.06	
Interactions				
PSEx Impregnable base	0.55**	0.55**	0.57**	0.61***
PSEx Differentiation	0.31	0.3	0.29	
PSEx Cost leadership	0.001	0.006		
PSExCooperation/diversification	-0.17	-0.17		
OCE1x Impregnable base	0.22	0.24	0.23	
OCE1x Differentiation	-0.81**	-0.81**	-0.84**	-0.64**
OCE1x Cost leadership	-0.16	-0.16		
OCE1xCooperation/diversification	0.23	0.24		
OCE2x Impregnable base	-0.77**	-0.78**	-0.81**	-0.76**
OCE2x Differentiation	0.42	0.43	0.41	
OCE2x Cost leadership	-0.041	-0.045		
OCE2xCooperation/diversification	-0.22	-0.22		

OCE3x Impregnable base	-0.58*	-0.59**	-0.56*	
OCE3x Differentiation	-0.47	-0.47	-0.55**	-0.6**
OCE3x Cost leadership	0.15	0.17		
OCE3xCooperation/diversification	-0.004	0.018		
Other controls				
Size (log employees)	-0.21	-0.21	-0.18	-0.17
Part of large organisation	Yes	Yes	No	No
Industry dummies	Yes	Yes	Yes	Yes
Location dummies	Yes	Yes	Yes	Yes
R^2	0.16		0.15	0.13
Inverse Mills ratio		-0.1		
No. of observations	430	2267	430	430
Censored Obs.		1857		
Uncensored Obs.		430		

Notes: *p-value<0.1, **p-value<0.05, ***p-value<0.01.Hotels are the reference industry. For the Heckit model the participation equation includes as independent variables, size (log of employees), industry dummies, regional dummies and ownership dummies. Calculations of p-values in (2) are based on Heckman corrected standard errors. (3) excludes all variables with strongly insignificant coefficients in (1) and (2), and (4) excludes all variables with strongly insignificant coefficients in (3).

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