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Effect of Human Capital on Productivity and Efficiency in the Banking Sector: An Exploratory Study of Sri Lanka and New Zealand

Ahesha Perera
Senior Lecturer
Department of Commerce & Financial Management
University of Kelaniya, Sri Lanka
Email: aheshasp@gmail.com

Abstract

The performance of world class manufacturing companies is not only based on equipment, material, and processes but also human capital. Thus, this research contributes and extends the existing knowledge on human capital to provide a comprehensive understanding by exploring following questions: “How do human capital effect on productivity and efficiency?” and ”How do human capital and its role on productivity and efficiency in the banking sector in Sri Lanka differ from that in New Zealand?”. This research employed a qualitative case study as a research approach. Data is collected, via conducting in-depth interviews, and gathering information from available secondary sources from 10 banks in two nations, Sri Lanka and New Zealand. Data analysis is done through content analysis which resulted in a comprehensive understanding of the relationship between HC and the productivity and efficiency in the banking sector in a developing country, Sri Lanka and a developed country, New Zealand. This study revealed that HC has the potential to enhance overall productivity and efficiency in thebanking sector in both contexts. Comparative analysis suggests that although some differences existed, views on the importance of having HC to enhance productivity and efficiency in these two countries were consistent.

Keywords: Human capital, efficiency and productivity, banking sector, Sri Lanka, New Zealand.

Introduction

Workforce and talent are the driving forces behind innovation that leads sustained competitive advantage (Verma and Dewe, 2008, Gamerschiag and Moeller, 2011, Memon et al., 2009, Rastogi, 2000). In this setting, human capital is a key component for anycorporation. Manufacturing based companies function with tangible resources such as materials, processes, and equipment; however, the cornerstone is human capital (Brandt et al., 2013). More importantly, the success behind world class manufacturers is their human capital (Brandt et al., 2013). 'Nike' benchmarked as the most innovative company in 2013, for example, came from talented people; and not from physical assets. Indeed, the live asset, human capital, enhances overall productivity and performance of organizations.

The concept; human capital began in the 1960s with scholars like Adam Smith, Irvin Fisher and Shultz. Initially, it was discussed within the arena of society. Human capital was not a well- known concept for organizations until the 1980s. This was when discussions began about intangibles, intellectual capital, knowledge management, and organizations. Initially, the literature focused on intellectual capital and then moved to its subcomponents of structural capital, customer capital and human capital (Bontis and Fitz-enz, 2002, Kym and Moon, 2006, Schnieders et al., 2005). Among these three, human capital identified as the most important subcomponent of intellectual capital (Cuganesan et al., 2007, Rastogi, 2000).

A number of studies of intellectual capital were carried out including a human capital focus on different nations and industries (Tovistiga and Tulugurova, 2009, Abeysekera, 2008a, Abeysekera, 2007, Cuganesan et al., 2007, Abeysekera, 2006, Cuganesan, 2006, Abeysekera and Guthrie, 2004, Courchene, 2002, Brennan, 2001, Subbarao and Zeghal, 1997). These studies revealed that different nations and different industries follow different practices about human capital in order to achieve amyriad of advantages such as competitive advantage, enhance productivity, enhance performance, etc.

Despite the magnitude of practices in human capital around the world, there have been few studies on human capital and its importance in enhancing productivity and efficiency. Especially, no studies focus on the relationship between the extent of human capital and productivity and efficiency in the banking sector in Sri Lanka and/or New Zealand. Therefore, this study aims to achieve an objective, "*How is human capital in the banks in two nations, Sri Lanka and New Zealand, theeffect on productivity and efficiency*?". In this setting, this study examines the following research questions:

1. How do human capital effect on productivity and efficiency?

2. How do HC and its roleon productivity and efficiency in the banking sector in Sri Lanka differ from that in New Zealand?.

Human Capital

Various definitions of human capital have been given in the literature(Tovistiga and Tulugurova, 2009, Berkowitz, 2001, Bontis, 1998, Schnieders et al., 2005). However, alittle consistency is found among these definitions. Brooking (1996)defined human capital as employees and their skills, experience and competencies. Brooking's definition was expanded by Australian Society of CPA (ASCPA) and the Society of Management Accountants Canada (CMA) in 1999 and International Federation of Accountants (IFAC) in 1998 (as cited in Abeysekera and Guthrie, 2004). This study uses Brooking's 1996 definition with a modification regard to knowledge, training, and values(Abeysekera and Guthrie, 2005, Guthrie and Petty, 2000, Shaikh, 2004). Accordingly, human capital is defined as employees' skills, knowledge, experience, and values.

Human Capital Theory

Human Capital Theory refers to the positive correlation between investment in HC and economic return. In his 1961 paper, 'Investment in HC,' Shultz elaborates on the relationship between education and the productivity of employees. Shultz first identified the type of expenditures incurred for HC and then what expenditure contributes to increasing productivity. According to Shultz, expenses incurred for HC are categorised as consumption and investment (Schultz, 1961, Sweetland, 1996). Expenditure for consumption is usually provided for acquiring 'full day's work' from the workforce, for example, food and shelter (Schultz, 1961, Becker, 1962), but expenses for investment yield a long-term return, for example, schooling, on the job training and medical care. Schultz (1961) argued that people with no schooling and poor health are unskilled and perform at a lower rate. Therefore, productivity depends on investment in HC. In particular, Shultz emphasises the way investment in HC has to be done. Accordingly, among different ways of improving human capabilities such as health facilities, on the job training, formal education, study programs for adults, and migration of individuals and families to adjust to changing job opportunities, Shultz identified the most appropriate dimension for improving capabilities as 'education'(Schultz, 1961). Shultz's perspective of HC can conclude that 'the knowledge and skills that people acquire through education are forms of capital, and investment on this capital yield returns (Schultz, 1961).
After Schultz's work, Becker (1962) applied the idea of human capital in economics. Here, Becker's Human Capital Theory is based on both schoolings and on the job training (Sweetland, 1996, Becker and Tomes, 1994). Becker's

approach in 1964 contributed to the development of Human Capital Theory, introducing a money rate of return on investment in education and training (Becker, 1962). Also, Becker in his work in 1964 argues that employers prefer to invest in training to acquire firm-specific skills rather than general skills (Swart, 2006, Kessler and Lulfesmann, 2002, Kriechel and Pfann, 2005). Firm-specific HC is used within the specific job or firm, and general HC used in across jobs, firms and industries (Kriechel and Pfann, 2005). As Swart (2006) states, general HC is developed from outside the boundaries of the organisation. Accordingly, this kind of knowledge is easily transferable across the firm. Levels of formal education, years of experience, etc. are some indicators that can be used to measure general HC (Swart, 2006, Kriechel and Pfann, 2005). On the other hand, specific HC is developed within the organisation and cannot be easily transferable to any other firms or industries (Swart, 2006). The knowledge of specific HC is considered unique to an organisation. As Kriechel & Pfann (2005) states, working in a job for a longer period and gaining specific education qualifications accumulate specific HC. According to Becker (1964), employers prefer to invest in firm-specific skills rather than generic skills, because such skills cannot be transferable and result in higher productivity (Kessler and Lulfesmann, 2002).

Justification to Select Banking Sector

Scholars argue that human capital is pivotal to any sector (Wickramasinghe and Fonseka, 2012). Specifically, the service sector is considered an ideal pool to study human capital because the service sector performance depends on humans (Joshi et al., 2010). Thus, this study selected the banking sector, which is a key sector in the service sector(Mavridis, 2004).

Justification to Select New Zealand

New Zealand was chosen as a comparable country to Sri Lanka for two reasons. First, with reference to the human capital level, New Zealand ranks in one of the highest positions. The second reason for using New Zealand as a comparison is that New Zealand and Sri Lanka are categorised in the same region of Asia and the Pacific. Specifically, in the Asia and the Pacific region, Singapore is ranked in first place in the Human Capital Index and New Zealand in second place (World Economic Forum, 2013). There is a comparative study in the field of human capital between Singapore and Sri Lanka (Abeysekera, 2008b), but no studies have been found in between New Zealand and Sri Lanka.

Method

The study adopted the interpretivist paradigm (qualitative method). Both primary and secondary data were used for this study. Primary data was collected via semi-structured in-depth interviews. Particularly, 21 in-depth interviews were conducted with six banks in Sri Lanka and four banks in New Zealand. Secondary data was collected from both published and unpublished sources including annual reports, media publications, website publications and case studies. Data analysis is done through content analysis with the support of NVivo software. When analysing the data, six banks in Sri Lanka named as bank A, B, C, D, E, and F and four banks in New Zealand as G, H, J and K.

Findings

Sri Lanka

While recognising the importance of HC in enhancing efficiency and productivity, three banks (A, C, and D) in the sample in Sri Lanka identified different strategies for enhancing them and these included improving employee wellness (health) and the recruitment of internal employees for vacancies. In terms of enhancing productivity and efficiency through improving employee wellness, Bank C stated that:

> *We think that people have to be physically fit. Then, that will improve his or her health and, at the same time, productivity, efficiency et cetera.*

As Bank C noted, they organised different programmes to stimulate the wellness of employees, for example, a wellness programme called "Lose to Win" was conducted by the bank with the intention of reducing employees' weight. Employees from different departments participated in this competition and worked towards reducing their weight in consultation with doctors. Employees who did not participate in the competition also enjoyed the programme by supporting employees who participated. Finally, the employee team who lost the most weight was rewarded for their efforts. As Bank C remarked, this programme contributes to improve physical fitness as well as mental fitness:

> *These kinds of strategies help people to be healthier and active. Teamwork improves and finally they increase involvement in company matters very actively. We in the HR team also take part, so HR was also a team. It is a really surprising thing to see how [much] people enjoy this programme. During that period we saw a kind of special motivation and unity among staff. Doctors came here and gave advice and lessons, [provided] different exercise programmes, help(ed) with dieting et cetera.*

> *Finally, we rewarded to winning team. We all really enjoyed it.*

By conducting these programmes the bank expected to enhance not only the physical fitness and happiness of employees through providing a new, positive life experience but also to improve the motivation of employees to work. With enhanced motivation, employees work harder and more efficiently, which improves the overall level of productivity. This view was in line with Human Capital Theory (Schultz, 1961), which explained that organisations tended to develop their HC through investing in them owing to their ability to enhance productivity. Such investment includes expenses incurred for employee education, health and training (Becker, 1964, Flamholts and Lacey, 1981, Marginson, 1989, Schultz, 1961).

Further, internal recruitment was also mentioned as a mechanism to enhance efficiency and productivity. Banks A and D expressed a different approach for this purpose, that is, they redesigned the recruitment procedure in such a way as to reduce time and costs. As Respondent in Bank D states, the redesign was:

> *Because we need to take one who knows our culture, our values, and our procedures of the bank. The most suitable one comes from inside not from outside. We don't have time to waste recruiting one from outside and teaching him what our culture, procedures, and values are. It takes time. Otherwise, it is a waste of time and the money.*

As stated in the comment above, the bank preferred not to recruit employees externally due to the associated high costs. External recruitment incurs substantial expenses related to advertisements, hiring, inductions, training, and development. The bank is of the opinion that if they recruited employees internally, it would help to reduce these expenses. They believed the costs they incur to develop external candidates were a waste of money and time, thereby, reducing efficiency and productivity. In summary, bank D believed that they could enhance efficiency and productivity by reducing or eliminating expense. For this reason, the bank has set their recruitment policy to recruit internal candidates to fill vacancies. Bank A also agreed with this view stating that:

> *Through internal recruitment, we expect to enhance cost efficiency* (Bank A)

In supporting the banks' (A and D) views, Lepak and Snell (1999) stated that an organisation's decisions, about whether to invest in HC, depended on the possibility of exceeding the enhancement of productivity over investment costs. If costs associated with the investment exceeded the expected improvement in productivity and efficiency, then rational organisations would not invest in HC.

However, the view that internal recruitment enhanced productivity and efficiency contradicted Human Capital Theory (Schultz, 1961). Human Capital Theory was associated with the enhancement of productivity through investing in HC (Becker, 1964, Flamholts and Lacey, 1981, Marginson, 1989, Schultz, 1961). Yet, in this study, Banks A and D attempted to enhance productivity and efficiency not through investing in HC but through eliminating such investment costs.

New Zealand

When the researcher inquired about why HC is important, Bank K promptly stated that *"because, for efficiency."* The reason was that it was necessary for banks to accomplish their objectives such as achieving planned competencies, going to the global market, and to be benchmarked.

> *If we are planning to achieve the competency and planning necessary to go out to the global market and if we want to benchmark, especially globally, then we have to know what we have. What kind of people we have and what their skills are and what values they bring to the company.* (Bank K)

A similar view was provided by Bank G reporting that the financial sector remained a challenge so therefore, the banks had to enhance their efficiency and productivity in order to strengthen their financial position.

> *While we continue to build the business, the financial services environment remains challenging and has required us to maintain a focus on strengthening our financial position, while at the same time improving efficiency and productivity.* (Annual Report, Bank G, p. 8)

Thus, from the perspective of Banks K and G, enhancing efficiency and productivity is vital to them. In terms of how banks enhance efficiency and productivity, similarly to the Sri Lankan findings, Banks G and J identified different HC attributes in achieving this, which included innovativeness and diversity. Bank G reported that diversity enhances productivity.

> *We believe diversity, flexibility and inclusiveness are vital to improving the quality and productivity of our workforce.* (Annual Report, Bank G, p. 17)

Diversity was a significant attribute of HC for the sample banks in New Zealand. All banks in the sample recognised that their employees comprised a mix of personnel of different genders, nationalities, cultures, ages, and with differing perceptions. As banks in the sample further noted, diversified employees contributed to the bank in many ways due to their potential to think differently. The banks interviewed seemed to engage with employees to motivate different thoughts and perspectives because this resulted in innovative solutions to problems, which improved the business process. Bank J noted that:

> *… through an initiative called [name of bank and programme] we have a program that empowers our people to make continuous improvements to their day-to-day activities – we are proactively working towards improving our customers' experience and our internal productivity.* (Annual Report, Bank J, p.17)
> *Technology and innovation are key priorities for the Board; we recognise that they pursue sustainable efficiency and productivity improvements.* (Bank J)

Thus, banks in the sample remained committed to managing the diversity and innovativeness of HC in order to pursue sustainable productivity improvements and business efficiency. The linkage between HC and efficiency and productivity accord with previous findings (Apergis et al., 2009, Sharma, 2014).

The findings presented with regard to the two countries are compared in the following section.

Comparison of the importance of Human Capital on Efficiency and Productivity between Sri Lanka and New Zealand

Enhancing productivity and efficiency via human capital was recognised as important by the sample banks in both countries; however, the way they achieved them was quite different. The New Zealand sample banks mentioned that employee diversity and innovative ideas enhanced efficiency and productivity while Sri Lankan sample banks specified it could be achieved through investment in improving employees' physical and mental fitness and internal recruitment. The latter mechanism of Sri Lanka was internal recruitment, which was absent from the New Zealand context and contradicted Human Capital Theory. However, in supporting the banks' views, Lepak and Snell (1999) stated that organisations' decisions about whether they invested in human capital or not, depend on the possibility of exceeding enhanced productivity over investment costs. Thus, rational organisations would not invest in human capital if the costs associated with the investment exceeded the expected improvement from productivity and efficiency.

Contribution

Banks in both Sri Lanka and New Zealand appeared to have a common view that human capital is important to the banking business owing to its wider role in enhancing productivity and efficiency. Such similarity between Sri Lanka and New Zealand has not been addressed by any previous study in the field of human capital. Further, though there are similarities in terms of the role of human capital between sample banks in Sri Lanka and New Zealand, the following difference was also found. The New Zealand sample banks noted that employee diversity and innovative ideas enhanced efficiency and productivity, while the Sri Lankan sample banks specified these could be achieved through investment in improving employees' physical and mental fitness and internal recruitment. Such differences between Sri Lanka and New Zealand has not been addressed by any previous study in the field of human capital.

Limitations of the Research

The qualitative case study method was adopted and focused solely on the banking sector. At the time the interviews were conducted, there was a total of 34 banks in Sri Lanka and 21 in New Zealand. Although the study invited all banks to participate only six banks from Sri Lanka and four from New Zealand agreed to take part. The sample size is, therefore, small. The small sample size meant that we must be careful not to generalise. As Adler and Adler (2012) note, the purpose of qualitative research is to generate a subjective understanding of how and why people perceive, reflect, role-take, interpret, and interact. In other words, qualitative research findings are theoretically valuable even though they may have fewer subjects than quantitative methods (Adler and Adler, 2012). In order to counter this limitation, the researcher decided to collect data not only from depth interviews but also secondary resources.

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