

## **Impact of High Performance Work Practices on Employee Loyalty and Financial Performance through Mediation of Employee Satisfaction: An Empirical Evidence from the Financial Sector of Pakistan**

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**Abstract:** Since last two decades, in response to changes in the competitive working world of business and management, organizational researchers have focused their attention towards high performance work practices that enhance the employee loyalty and organizational performance via employee satisfaction. In consistent with this stream of research, this study aims to find the impact of three High Performance Work Practices – employee training, appraisal system & empowerment- on employee loyalty and financial performance via mediation effect of employee satisfaction. For this purpose, data was collected from a sample of 400 employees of the financial sector of Pakistan. SPSS 17 has been used for data analysis. Factor analysis and Cronbach's alpha confirmed the validity and reliability of the instrument. Similarly, correlation and regression analysis were applied to find out the relationship among independent variables (employee training, appraisal system and empowerment), mediating variable (employee satisfaction) and dependent variables (employee loyalty and financial performance). The findings show positive and significant relationship among all variables and employee satisfaction partially mediates the relationship between independent variables and dependent variables. Theoretical & managerial implications along with limitations and recommendations for future research have also been discussed in the paper.

**Key words:** HR practices • Training • Appraisal System • Empowerment • Employee Satisfaction • Loyalty • Financial Performance

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### **INTRODUCTION**

Economic growth of a country is driven by a rapid pace of activities nested in a financial sector. In Pakistan, the progress of banking industry can be attributed due to increase in advances, deposits, investment in securities and shares, weighted average rates on advances and deposits during the last two decades. Moreover, as on 31<sup>st</sup> December 2012, number of branch network of 44 public sector commercial, specialized, domestic private and Islamic Pakistani and foreign banks has also been reached to 9,772 branches all over the Pakistan [1]. This high number of branch network of bank branches shows high competition among Pakistani and Foreign Banks. To remain in this competition, banks have to show high organizational performance by generating more profit, cash flow and high return on sale and assets.

Organizational researchers are of the view that satisfied employees are indispensable to profitability and maintaining competitive position in this dynamic environment. Similarly, management concepts - Total Quality Management, Balanced Scorecard, Intangible Assets Navigator, etc. – have highlighted employee satisfaction as a driver of organizational success [2]. According to Edvinsson [3] and Sveiby [4], companies such as the Swedish insurance and financial services company Skandia started to report an Intellectual Capital Supplement in their annual reports which allows for information on the development of intangible assets. The firm's intangible assets reside in the employees and their skills and know-how. In other words, employee satisfaction and loyalty are essential for improving organizational performance [2]. Employee satisfaction plays a vital role in achieving employee loyalty which

ultimately increases firm's profitability. Therefore, it is important to study the factors which foster the employee satisfaction and employee loyalty.

The organizational researchers have highlighted various means to satisfy employees [5, 6, 7, 8, 9, 10, 11]. Many of them focused on High Performance Work Practices (HPWP) such as training, empowerment and rewards as antecedents of employee satisfaction [12, 13]. The theoretical justification of the relationship between HPWP and employee satisfaction is provided by Affect Theory, Equity Theory and Job Characteristics model. According to affect theory, the autonomy (empowerment) in the work increases the satisfaction level of employees [14]. Similarly the equity theory states that when employees are given fair rewards then satisfaction of employees increases [15]. The model of Hackman & Oldham [16] proposed that the aftermath of training i.e. skill variety and task identity are related to employees work outcomes including job satisfaction, motivation and absenteeism.

However, several authors have questioned these assumptions due to the differences between intended human resource practices and employees' experience [17], because complex organizations have different types of employees who may be managed successfully through diverse sets of HR policies [18, 19] and because of strategic differences between firms in the manufacturing [20] and service sectors [21]. Moreover, despite that most of the researchers pointed out the importance of intervention and mediation of employee related factors such as employee satisfaction, the research on this mediation is fragmented and piecemeal [22]. Therefore, there is strong need to check the validity of the relationship between HPWP and performance and between HPWP and loyalty and via mediation effect of employee satisfaction. The aim of this study is to provide empirical evidence of the relationship between HPWP (training, empowerment and rewards) and employee satisfaction and employee loyalty in the Pakistani context. The specific research questions of this study are as follow:

- Do HPWP leads to employee satisfaction in the financial sector of Pakistan?
- Do HPWP leads to employee loyalty in the financial sector of Pakistan?
- Do HPWP leads to financial performance in the financial sector of Pakistan?
- Do employee satisfaction mediates the relationship between HPWP and employee loyalty in the financial sector of Pakistan?

- Do employee satisfaction mediates the relationship between HPWP and financial performance in the financial sector of Pakistan?

In the following discussion, this paper reviews the literature that leads to a number of research hypotheses. This is immediately followed by a detailed specification of the research methodology. Thereafter, the empirical results are presented and discussed. The final part of the paper presents the discussions on the basis of the research findings, managerial implications, outlines some inherent limitations and offers some directions for future research.

**Literature Review:** In the last two decades, the researchers and practitioners have focused on improving organizational performance through managing the Human Resources efficiently and effectively [23, 24, 25, 26]. HRM focuses on better development and deployment of human resources [27]. Among the various HR practices, employee empowerment, appraisal system and training are most popular. Many studies considered training, empowerment and appraisal system/ rewards as High Performance Work Practices [28, 22, 29]. The employee empowerment concept is grounded on the assumption that employees are the unexploited source of knowledge, initiative and creativity [30]. Empowerment refers to "the freedom and ability to make decisions and commitments" [31]. According to Honold [32], employee empowerment is related with job involvement i.e. higher the job involvement higher is the empowerment. Similarly, fair appraisal system is honoring the efforts of the employees objectively [33, 34].

According to strategic human resource perspective, High Performance Work Practices including empowerment, appraisal system and training influence the organizational and employee performance [35]. However, for better performance, employees should be motivated from high performance work practices [36]. Employees are motivated when they are given authority/ empowerment and when they participate in training programs along with having returns for their efforts. This increased motivation level upturns the satisfaction level of employees and ultimately employee loyalty and better organizational performance [37, 38]. Similarly, the social exchange theory (SET) states that when organization takes care of employees, there are social exchange relationships which promise to improve organizational performance [39]. Employees feel obliged to repay the organization when they receive socio-emotional and economic resources from the organization. Similarly when employees are

empowered, trained and awarded fair rewards, they dedicate their physical, emotional and cognitive resources to perform their jobs well [33].

Researchers also found that empowerment without training does not produce intended results [33]. The employees should acquire technical skills, interpersonal skills and solid knowledge through training to perform their jobs efficiently and effectively [40]. The lack of ongoing training programs leads to lower performance of employees. This relationship is also supported by Combs [41] who found that abilities, skills and knowledge of employees are enhanced through HR practices such as training and empowerment which result into better performance of the employees. Moreover, adequate appraisal system is also necessary to have consistent performance from employees [42].

A major stream of empirical studies found positive relationship among HR practices, employee outcomes and organizational performance. Zhang & Morris [22] found that High-performance work systems increase the level of employee satisfaction which results into better organizational performance. The appraisal fairness provides perceived fairness to the employees, which elicits employee satisfaction and organizational performance [42]. Similarly, training programs increases the job satisfaction and employee loyalty [43]. This is also supported by Koster, Grip & Fouarge [44] found in their study on Dutch employees that perceived support in development programs is positively associated with employee satisfaction and negatively correlated with intention to quit. Also, empirical studies found that empowerment is important determinant to employee satisfaction [45, 46] and firm performance [47].

From above discussion and consistent with social exchange theory and strategic human resource perspective, the following hypotheses have been proposed:

**H1:** HPWP (empowerment, training and rewards) are positively related to financial performance in the financial sector of Pakistan.

**H2:** HPWP (empowerment, training and rewards) are positively related to employee loyalty in the financial sector of Pakistan.

**H3:** HPWP (empowerment, training and rewards) are positively related to employee satisfaction in the financial sector of Pakistan.

**H4:** Employee satisfaction mediates the relationship between HPWP and financial performance in the financial sector of Pakistan.

**H5:** Employee satisfaction mediates the relationship between HPWP and employee loyalty in the financial sector of Pakistan.

**Theoretical Framework:** On the basis of above hypotheses, the theoretical Framework has been proposed in figure 1.

**Data Collection and Measurement Scales**

**Methodology:** Population of this study consists of employees of banking sector of Pakistan. The sample of the study includes all the conventional and Islamic banks, foreign and local banks and government owned and private banks operating in the Pakistan. Data were collected from eight big cities of Pakistan (Lahore, Islamabad, Faisalabad, Karachi, Quetta, Peshawar, Multan and D. G. Khan) by visiting and mailing respondents in January to March, 2013). Questionnaire, adopted from multiple studies, is used as tool for data collection. It is consisted of total 24 items to measure perceptual constructs and along with some demographic information. Total 350 questionnaires were distributed to the employees of financial sector and 320 were returned out of 350 with 91.4% response rate. 20 questionnaires were rejected due to incomplete information. Therefore actual response rate came to be 85.7%. This survey was applied to different level employees i.e. branch managers, cashiers, tellers, credit officers, trade managers, relationship officers.

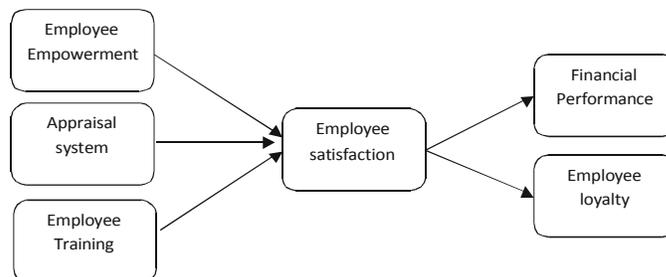


Fig. 1: Research Framework

SPSS 17 is used in this study to analyze the collected data from employees of financial sector of Pakistan. Factor analysis and reliability analysis (Chronbach's alpha) are used to test the validity and reliability of the questionnaire measures. Similarly, correlation and regression analysis are run to find the relationship between the variables.

**Measurement:** Multiple items, adopted from different studies, have been used to measure the perceptual constructs of this study. Employee training, empowerment, appraisal system, employee satisfaction and employee loyalty have been measured with 4-items each by following Jun, Cai, & Shin [47], where all the measures have acceptable and reliable value of composite reliability i.e. training (0.757), empowerment (0.731), appraisal system (0.709), employee satisfaction (0.795) and employee loyalty (0.798). And similarly by following Yee, Yeung, & Cheng (48), financial performance is measured with four items.

#### Data Analysis

**Factor Analysis:** *Factor analysis of independent variables:* Table 1 shows three factor solution of independent variables in shape of employee training (4 items), appraisal system (4 items) and employee empowerment (4 items) which together explained 64.58% of total variance. Kaiser-Meyer-Olkin Measure of Sampling Adequacy (KMO) is 0.798 that is acceptable and significant.

**Factor Analysis of Mediating Variable:** Table 2 shows one factor solution of employee satisfaction in shape of 4 items which explained 62.796% of total variance. Employee satisfaction has a significant and acceptable KMO that is 0.748, as KMO greater than 0.50 is generally deemed to be significant and acceptable.

**Factor Analysis of Dependent Variable:** Table 3 shows two factors solution of employee loyalty and financial performance in shape of employee loyalty (4items) and financial performance (4items), explained 60.79% of total variance. Factor solution of dependent variables has significant and acceptable KMO that is 0.769.

**Correlation and Reliability Analysis:** As the purpose of this study is to find the relationship between independent variables (three dimensions of Human Resource practices i.e. training, appraisal system and employee

empowerment), mediating variable (employee satisfaction) and dependent variables (financial performance and employee loyalty, therefore correlation analysis is used to find the relationship among the study variables. The results are shown in Table 4. The results show that independent variables (training, appraisal system and empowerment), mediating variable (employee satisfaction) and dependent variables (financial performance and employee loyalty) are significantly & positively correlated with each other. The mean, standard deviation (S.D) and cronbach's alpha values are also given in the Table 4. It shows that each study variable is highly rated, as mean value of each variable is greater than three. Moreover, all the perceptual variables are having reliable and acceptable values of cronbach's alpha i.e. employee satisfaction ( $\alpha= .799$ ), training ( $\alpha= .777$ ), employee empowerment ( $\alpha= .843$ ), employee loyalty ( $\alpha= .744$ ), appraisal system ( $\alpha= .784$ ) and financial performance ( $\alpha= .797$ ).

**Regression Analysis:** Regression analysis has been carried out with the help of SPSS 17 to investigate the impact of three dimensions of Human Resource Practices, namely employee empowerment, appraisal system and training on financial performance and employee loyalty. The impact of employee empowerment, appraisal system and training on employee loyalty is shown in Table 5 and the impact of employee empowerment, appraisal system and training on financial performance is shown in regression Table 6. Regression model in regression Table 5 and Table 6 confirms that in total all the three dimensions of human resource (training, appraisal system and empowerment) stimulates employee loyalty ( $R^2=0.496$ ;  $F=36.403$ ;  $P<0.01$ ) and financial performance ( $R^2=0.537$ ;  $F=10.771$ ;  $P<0.01$ ). In other words, employee empowerment, appraisal system and training altogether explained 49.6%, & 53.7% of total variance of employee loyalty and financial performance respectively. Moreover standardized coefficient  $\beta$  and T values also depict positive and significant impact of employee training on employee loyalty and financial performance. Hence, H1, H2 and H3 are supported.

**Mediation Analysis:** Mediation analysis has been used to see the impact of independent variables (employee training, appraisal system and empowerment) on dependent variables (employee loyalty and financial performance) in the presence of mediator (employee satisfaction). Method suggested by Baron and Kenny [49] has been used to find out the effect of mediator.

Table 1: Factor analysis of “Independent Variables”

	Component		
	Empowerment	Appraisal	Training
KMO=0.798 Variance Explained= 64.58			
I am encouraged to develop new ways to provide better products and services	.849		
I am provided with substantial autonomy and responsibility	.833		
I am not punished for quality improvement ideas that are unsuccessful	.777		
I am provided with sufficient information to arrive at good quality suggestions	.753		
Part of my job performance evaluation is based on how well I work with teams		.849	
I am regularly given feedback on my job performance		.782	
Quality of my work is an important factor in evaluating my job performance		.726	
performance is evaluated on the basis of customer feedback of quality		.658	
I am trained in quality improvement skills			.830
Much of the training at our facility emphasizes product and service quality			.757
I have received sufficient training at this firm to do my job effectively			.756
I am trained in group-discussion and communication techniques			.713

Table 2: Factor analysis of “Mediating Variable”

	Component
	Employee Satisfaction
KMO=0.748 Variance Explained= 62.79%	
This is the best organization for me to work for	.871
I would recommend this company to a friend if he/she were looking for a job	.794
I feel personal satisfaction when I do my job well	.788
I am proud to tell people that I am part of this company	.708

Table 3: Factor analysis "Dependent Variable"

	Component	
	Financial Performance	Employee Loyalty
KMO=0.769 Variance Explained= 60.788%		
Return of sales	.815	
Return on investment	.802	
Return on assets	.761	
Overall profitability	.666	
I plan to make this company my own career		.858
Put in a great deal of effort beyond what is expected		.785
I care about the fate of this company		.638
I feel a lot of loyalty to this organization		.629

Table 4: Correlation, Mean, S.D and Reliability

	Mean	SD	α	Empowerment	Training	Appraisal	Satisfaction	Loyalty	Perf.
Empowerment	4.11	.65	.84	1	.449	.347	.540	.671	.487
Training	4.08	.67	.77		1	.386	.494	.426	.628
Appraisal	3.91	.69	.78			1	.522	.389	.584
Satisfaction	4.11	.58	.79				1	.614	.719
Loyalty	4.05	.62	.74					1	.426
Performance	4.02	.69	.79						1

Table 5: Regression Analysis: Employee Loyalty as dependent

Dependent		B	T	Sig.
Employee loyalty	Empowerment	.304	6.714	.000
	Training	.340	7.333	.000
	Appraisal	.150	3.665	.000

Table 6: Regression analysis: Financial Performance as dependent

Dependent		B	T	Sig.
Financial performance	Empowerment	.301	6.508	.000
	Training	.245	5.371	.000
	Appraisal	.143	2.754	.004

Table 7: Regression Analysis between HRM practices and Employee Satisfaction

Dependent		B	T	Sig.
Employee Satisfaction	Empowerment	.135	3.287	.000
	Training	.246	5.452	.000
	Appraisal	.156	2.951	.002

Table 8: Regression Analysis, Employee Satisfaction as a Mediator Variable

Model	Dependent		$\beta$	T	Sig.
1	Employee loyalty	Empowerment	.304	6.714	.000
		Training	.340	7.333	.000
		Appraisal	.150	3.665	.000
2	Employee loyalty	Empowerment	.239	5.322	.000
		Training	.289	6.401	.000
		Appraisal	.158	2.797	.003
		Satisfaction	.138	3.381	.000
3	Financial performance	Empowerment	.301	6.508	.000
		Training	.245	5.371	.000
		Appraisal	.143	2.754	.004
4	Financial performance	Empowerment	.238	5.321	.000
		Training	.209	4.513	.000
		Appraisal	.138	2.127	.038
		Satisfaction	.250	5.547	.000

Method follows three steps. In first step regression was performed between independent variables (employee training, appraisal system and empowerment) and mediating variable (employee satisfaction). In second step regression was performed between independent variables (employee training, appraisal system and empowerment) and dependent variables (employee loyalty and financial performance). In third step, regression was performed between independent variable (training, appraisal system and empowerment) and dependent variables (employee loyalty and financial performance) in the presence of mediator variable (employee satisfaction).

In first step, all the independent variables are positively related to employee satisfaction i.e. empowerment ( $\beta=0.135, t=3.287, p<0.01$ ), appraisal system ( $\beta=0.156, t=2.951, p<0.01$ ) and training ( $\beta=0.246, t=5.452, p<0.01$ ). Similarly in second step, all the HRM dimensions are positively related to employee loyalty and financial performance. Finally in third step, in the presence of employee satisfaction the relationship between HRM dimensions and employee loyalty and relationship between HRM dimensions and financial performance becomes weaker in the presence of employee satisfaction but relationships are still significant. Therefore the

employee satisfaction partially mediates the relationship between independent variables (training, empowerment and appraisal system) and dependent variables (employee loyalty and financial performance). Therefore H4 and H5 are partially supported.

## DISCUSSION AND CONCLUSION

The current paper has examined the relationships among HPWP (training, appraisal and empowerment), employee satisfaction, employee loyalty and financial performance. Firstly, it has been seen by the results that positive and supportive link exists among three HR practices (training, appraisal system and empowerment), employee satisfaction, loyalty and financial performance. Secondly, the study has investigated the impact of employee outcomes on financial performance. The results indicated that employee satisfaction significantly ( $p<0.05$ ) predicts financial performance. Thirdly, the study has tested the mediating effect of employee satisfaction between the of HPWP and employee loyalty and between HPWP and financial performance. It is found that the employee satisfaction partially mediates the relationships between HPWP and employee loyalty and between HPWP and financial performance.

These findings prove the validity of strategic human resource perspective and social exchange theory in the financial sector of Pakistan. According to strategic human resource perspective, human resource practices such as training, empowerment and appraisal systems increases the performance and are crucial for sustaining competitive advantage [35]. SHRM is a major research field that focuses on the impact of HRM practices on firm performance. SHRM perspective by relying on a resource-based view of the firm considers employees and HRM practices as the critical assets of a firm which boost the firm performance. Moreover, this perspective proposes that effective management of stock of employee skills not physical capital may be the ultimate determinant of organizational performance. Therefore, the findings of this study confirm this SHRM notion by endorsing that effective management of human capital has greater potential to constitute a source of sustainable competitive advantage when human capital or HRM practices such as empowerment, appraisal system and training lead to firm performance [36, 50, 51].

Similarly, according to social exchange theory, if organization demonstrates in some way that it cares about, or extend favors to employees, then employees feel obligated to the organization [52]. The findings of the study suggest that organizations should engage in 'high' exchange relationships in terms of employee empowerment, employee training & fair appraisals systems for positive employee outcomes such as employee satisfaction that become the main vehicle to boost employee loyalty and financial performance [53].

Moreover, the results of this research offer supportive empirical findings to HRM field that is still suffering from mixed findings of the HRM-performance linkage and is criticized for its inability to achieve and sustain both employee well-being and performance [54]. Specifically, the findings empirically endorsed that HRM practices positively and significantly affected both employee outcomes in terms of employee satisfaction and employee loyalty and organizational performance in term of financial performance. These findings are in consistent with the findings of recent study of Zhang & Morris [22], hence further endorsing step-based effect of the HRM-performance relationship [55] and the causal order of this relationship [56, 57]. Finally, as the findings of this study proved that employee satisfaction partially mediates the relationship between HRM practices and employee loyalty and performance, therefore, both

predictors of performance and mediators in HRM-performance connection have to give much more attention seriously [22].

**Theoretical and Managerial Implications:** Many previous researches have been conducted to determine the effect of HR practices on employee satisfaction and performance, but the focus of most of them was conducted in the developed countries. A little attention has been given to the developing countries; especially in Pakistan, the link between High Performance Work Practices was ambiguous. This study contributes to literature by providing empirical evidence from the financial sector of Pakistan that exhibits supportive and significant linkage between HR practices (training, appraisal system and empowerment), employee satisfaction, loyalty and financial performance. Also, this study validates the Ability, Motivation and Opportunity (AMO) theory in Pakistan which states that positive employee attitude results into organizational performance [58].

The present study also contributes practically by concluding that training, appraisal system and empowerment provides a strong base for dynamic organizations to improve their employee loyalty and financial performance by enhancing the satisfaction level of the employees. This can further promote their abilities and competency as well as other strategic priorities to gain competitive advantage. Findings of this study show that employee satisfaction of employees is pivotal for organizations and managers should provide training, appraisal/rewards and empowerment to the employees in order to increase the level of employee satisfaction.

**Limitations and Recommendations for Future Research:**

The limitations of this study would become focus for future research. It is a cross sectional study where all data were collected at a particular time, so variables and analysis is restricted to that particular time. Therefore, longitudinal studies should be conducted in future. Also, this study is limited to only financial sector of Pakistan; further studies may focus on other sectors of Pakistan and other geographical locations. Another limitation of study is that this study did not consider the impact of size, as proposed in the study of Kerr, Way and Thacker [59], so, there is need of comparative study on the basis of size. Finally, this study considered

only three HR practices (training, appraisal system and empowerment), the future studies may consider other dimensions of HR practices included teamwork, two-way communication, human development, selection and recruitment, employment security, internal career/promotion opportunities, single status and harmonization, quality/involvement, job design and financial flexibility as highlighted by Guest and Conway [55].

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