Journal of Business Venturing 25 (2010) 349–360

Contents lists available at ScienceDirect

Journal of Business Venturing

The adoption of human capital services by small and medium enterprises: A diffusion of innovation perspective

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ARTICLE INFO

Article history:
Received 25 February 2008
Received in revised form 10 November 2008
Accepted 22 December 2008

Keywords:
Small and medium sized enterprises
Human capital programs
Consulting firms

ABSTRACT

While lack of scale economies have traditionally limited the use of human capital programs among small and medium enterprises (SMEs), outsourcing models have recently emerged to provide cost-effective access to these programs. Drawing on the diffusion of innovation literature, we apply the rational accounts model and institutional theory to examine why SMEs differ in their willingness to use newly available human capital programs. We specifically examine the impact of SME size on the adoption of human capital innovations. Using survey and archival data from over 400 SMEs, we found broad support for the integrated approach we propose.

1. Executive summary

Large, complex firms commonly make extensive use of human capital programs—programs designed to affect workforce skill, motivation, and performance. Further, such programs have been found, within a number of different settings, to positively affect organizational performance. Yet, human capital programs in the small business sector have traditionally been viewed as cost-prohibitive, limiting their use. But increasingly, small and medium enterprises (SMEs) are turning to HR outsourcing to provide these services. Given the newness of these services to this sector, we apply a diffusion of innovation perspective to determine why some SMEs adopt the services while others do not. Specifically, we apply the rational accounts and institutional theory perspectives to human capital service adoption among SMEs, with our key questions focused on how this innovation diffuses differently among SMEs.

The rational accounts perspective asserts that the spread of innovation is influenced by adaptive responses by firms to environmental pressures and constraints. We examine these adaptive responses by taking into account the size of the SME, positing that smaller SMEs will not adapt the same way that larger SMEs do. This is based on the ability of the leader within smaller firms to adapt via personal initiative rather than turning to human capital programs to respond to environmental exigencies. The other perspective, institutional theory, emphasizes that the willingness to innovate may be affected by the degree to which decision-makers have observed other firms doing the same, thereby legitimizing the innovation. We argue, however, that SME size will not influence institutional forces affecting firm adoption. Finally, we join the rational accounts and institutional theory perspectives by examining how the rational account factors are moderated by institutional forces.

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0883-9026/$ – see front matter
doi:10.1016/j.jbusvent.2008.12.002

In this research, we examine the rational account factors of strategic emphasis on differentiation, environmental uncertainty, and strategic emphasis on growth and the institutional theory factor of SME leader exposure to HR services. We use survey and archival data on human capital services adoption by over 400 SMEs. We find support for the rational accounts perspective that human capital service adoption differs according to the size of the SME, with smaller SMEs adapting to environmental pressures and constraints differently than larger SMEs. We also find support for the institutional theory perspective that prior exposure to HR programs is positively related to use of human capital services and moderates the relationship between rational account factors and human capital services.

This research extends the literature in the following ways. First, to our knowledge, this is the first study to examine how SME size affects how firms respond to strategic or environmental pressures to invest in human capital. Second, we draw upon and integrate the rational accounts perspective and institutional theory to examine the adoption of innovation relating to human capital. In doing so, we build on the innovation literature by examining whether the impact associated with variables suggested by the rational accounts literature depends on processes associated with institutional theory.

2. Introduction

Human capital programs have been found, within a number of different settings, to positively affect organizational performance (Datta et al., 2005; Youndt et al., 1996; Benson et al., 2006; Cappelli and Neumark, 2001; Huselid et al., 2005). Within the small business sector, however, human capital programs have traditionally been viewed as cost-prohibitive (Klaas et al., 2005a). Thus, despite the very significant human resource challenges faced by many firms in this sector, use of such programs has been limited (Kerr et al., 2007). Increased attention, however, is being given to outsourcing models designed to make it more cost-effective for SMEs to utilize human capital programs (Cook, 1999; Heneman et al., 2000; Klaas, 2003). While use of such models is currently sporadic, some SMEs are innovating by relying on outsourced human capital services (Klaas et al., 2005b).

Because obtaining human capital programs via outsourcing remains a novelty within the small business sector (Hirschman, 2000; Klaas, 2003), the literature on the diffusion of innovation offers a useful framework for understanding why SMEs differ in their willingness to use these programs. One perspective within this literature, the rational accounts model, emphasizes that the spread of innovation is influenced by adaptive responses by firms to environmental pressures and constraints (Kraatz and Zajac, 1996; Wejnert, 2002). Consistent with this model, SME willingness to use human capital services may be influenced by firm characteristics or environmental pressures that affect the need to modify employee skill, motivation, and commitment. Another prominent perspective, institutional theory, emphasizes that the willingness to innovate may be affected by the degree to which decision-makers have observed other prominent or visible firms doing the same (Haunschild and Miner, 1997; Williamson and Cable, 2003; Milkovich and Barringer, 1998). Such contagion processes are thought to occur because innovation adoption often involves substantial risk for the firm and the behavior of other firms can serve to legitimize taking such action.

Within the diffusion of innovation literature, there is support for both the rational accounts perspective and institutional theory (Wejnert, 2002). Further, both perspectives have effectively been used to explain the use of human resource practices and policies within large firms (Osterman, 1994; Batt, 2000). One might expect, therefore, that both perspectives would be relevant in explaining the adoption of innovation in the form of human capital programs by small and medium enterprises. But how does the context of the small and medium enterprise affect how firm leaders react to pressures and demands created by the firm's strategy and environment or to information about prior adoption by other firms? The small and medium enterprise classification includes firms that range from those with a very small number of employees to those with as many as 500. It includes firms where the entire workforce falls within the leader's span of control as well as larger SMEs where there would be a need for hierarchical and coordination mechanisms (Borch et al., 1999). Processes suggested by the diffusion of innovation literature may operate differently in these different types of small and medium enterprises.

For leaders of smaller SMEs, pressures created by the firm's strategy or environment may not necessarily be perceived as affecting the need for employee skill and motivation. Instead, these pressures may be perceived as affecting what is needed in terms of the leader's personal behavior and activities. Because the leader within very small firms typically is personally involved in many organizational processes and directly influences employees throughout the firm (Baron et al., 1996), leaders may perceive changes in personal behavior as a sufficient response. However, in larger SMEs, it is less likely that leaders will see personal responses as being sufficient to address pressures and demands created by their environment or strategy (Baron et al., 1999). These pressures and demands may create a need for change in activities and processes far removed from the leader's sphere of activity. As a result, leaders may be more likely to consider changes in organizational processes and systems, including human capital programs (Burton, 2001). Because of these differences between small and large SMEs, SME size is likely to moderate the impact of factors suggested by the rational accounts perspective.

The impact of factors suggested by the rational accounts perspective is also likely to depend on factors suggested by institutional theory. As is often the case with innovations in management practice, substantial causal ambiguity exists regarding the process by which human capital innovations affect outcomes (Baron et al., 1999; Abrahamson and Fairchild, 1999). Because of this, the effect of variables suggested by the rational accounts perspective is likely to depend on whether the innovation has been legitimized through prior adoption by firms salient to the decision-maker. This moderating effect is expected because prior adoption by other firms is likely to mitigate the impact of uncertainty regarding causal processes on innovation adoption. The willingness to invest in human capital within the small business sector has substantial implications both for the individual organization and society at large (Heneman et al., 2000). By examining why this willingness varies across SMEs, we contribute to our understanding of factors that may facilitate or inhibit investment in human capital in the small business sector.