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Linking Human Capital To Firm Performance: The Mediating Role Of Organizational Learning Capability In Nepali Smes

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Abstract

This study examined how human capital would affect the performance of a firm and the effect the presence of organizational learning capacity within the firm could have on the relationship in case of Nepali Small and Medium Enterprise (SMEs). The survey used responses from 246 Owners and Managers of SMEs in Nepal. The analysis used EFA (Exploratory Factor Analysis) to establish/affirm factor structure, model fit, validity and reliability testing was done using CFA (Confirmatory Factor Analysis) while SEM (Structural Equation Modeling) was used to test and validate relationships. Higher levels of human capital in the firm had a positive effect on its overall performance. The study further revealed a partial mediation between human capital and firm performance through organizational learning capability. This showed that an organization's ability to improve human capital would have a sizable effect on its ability to perform. The study also showed that development of human capital and organizational learning capability needed to be carried out in parallel as the partially mediating effect suggested that human capital leads to firms' performance not only through organizational learning capability through other mechanisms as well. This underlines the need for improving the skillsets and knowledge of employees, owners and managers within SMEs to while also continuing to develop mechanisms to more effectively acquire and utilize knowledge while reinforcing learning within their organizations to help them perform better.

1 INTRODUCTION

Akin to other developing nations, Nepal relies heavily on Small and Medium Enterprises (SMEs) to keep its economy moving, with certain estimates putting the proportion of SMEs among businesses at around 90 % (Irwin & Ibrahim, 2020). However, the sector faces a myriad of challenges that range from external to internal. Chief among them has been political instability, with Nepal experiencing significant political transitions in the last 3 decades, with certain stability being experienced in the last one (Baral, 2020). Similarly, infrastructure issues such as unpredictable electricity supply (Timilsina & Steinbuks, 2021) and inadequate transportation networks (Bhagat, 2017) have also presented operational challenges for SMEs in Nepal

In this difficult backdrop, human capital management in SMEs has been challenging, with high emigration rates creating issues with talent retention (Sharma, 2024). This has also meant that the workforce has become largely transient, with key employees leaving from time to time for better opportunities abroad, which has been a problem for many developing countries. Similarly, employee turnover from switching organizations for better pay and growth prospects (Bhattarai, Paudel, & Acharya, 2023) also remains high as in other emerging markets. Nevertheless, barring unforeseen circumstances such as the 2015 earthquake and the COVID-19 pandemic, SMEs in Nepal have continued to perform well, which may be attributed to the strength of the human capital that the organization can retain and onboard.

Another hypothesized reason for this resilience is mechanisms within Nepali SMEs that enable it to acquire, distribute, and effectively utilize knowledge to remain competitive within the marketplace. This organizational learning capacity helps firms to become more dynamic and adapt quickly to changing business conditions, ultimately helping them become more successful (Bhusal, 2023). This effect should be even more pronounced in the case of SMEs which tend to face much broader constraints on the type of resource they command compared to larger firms.

Thus, in this study, there will be an investigation on how human capital influences business performance in Nepali SMEs and whether organizational learning capacity plays a role in mediating this relationship.

2 LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1 Human Capital

Human capital can be referred to as the amalgamation of the knowledge, skills, and competencies of human resources within an organization (Davenport, 1999). Human Capital is an important resource for an organization as postulated in the early works of Schultz (1961) and Becker (1964) which stipulated that improved education levels and adequate training would lead to generation of economic value for the organization. Similarly, Edvinsson et al. (1997) and Sveiby (1997) furthered the discourse by incorporating creativity, adaptability, and intellectual contributions as core elements of human capital.

Barney (1991) in his work on competitive advantage highlighted the idea that human capital as a resource of a firm, if it is unique and difficult to replicate would lead to competitive advantage. For Nepali SMEs, where resources are often constrained, leveraging human capital can a strategic resource which allows an organization with to differentiate itself in a competitive marketplace (Alhassan & Asare, 2016).

2.2 Human Capital and Firm Performance

The mechanisms through which human capital affects firm performance have been widely discussed in strategic management research. Studies have shown that employee centric outcomes ranging from innovation, up to the satisfaction of customers, as well as good financial performance itself are a result of enhancement of human capital within firms through the cultivation as well as retention of skilled and motivated employees who tend to outperform their peers. (Haar & O'Kane, 2023; Park & Shaw, 2013; Widyana et al., 2021).

It has also been found that well-developed human capital with firms leads to an advancement in technology-related outcomes while also leading to gains in productivity within firms (Benhabib & Spiegel, 1994; Pérez & de Pablos, 2003). Another study from Lafuente and Rabetino (2011) also established a linkage between human capital and profitability for a business.

2.3 Organizational Learning Capability

Organizational Learning Capability is the capacity of a firm to acquire, absorb and effectively utilize knowledge. It consists of mechanisms which support the acquisition of knowledge, as well as its proper integration within an organizational setting (Jerez-Gómez et al., 2005). The organizational learning capability of an organization helps it become dynamic and sustainable in a volatile business environment. An organization's ability to strengthen its organizational learning capability depends on whether it can convert individual-level expertise into collective organizational knowledge.

2.4 Organizational Learning Capability and Firm Performance

Pranowo et al. (2022) states that firms with strong learning capability do well in turbulent or resource-constrained environments. Organizational learning Capability improves firm performance by effectively collecting, synthesizing, and utilizing knowledge (Goh & Richards, 1997). Organizational learning capability has been shown to improve strategic thinking and decision making which has led to operational effectiveness in firms (Herawati et al., 2018; Sendawula et al., 2021).

2.5 Theoretical Framework

2.5.1 Resource-Based View (RBV)

According to the Resource-Based View (RBV), a firm can achieve competitive advantage by using its internal resources. RBV originated in the works of Penrose (1959) and was elaborated by Barney (1991). Since RBV assumes a firm is comprised of a set of resources, Human Capital becomes a vital resource that can be harnessed for continued firm performance. From this perspective, the ingredients of human capital should be proprietary in nature and difficult to imitate by competitors. Hence, the capacity of a firm to develop specialized knowledge, know-how and skills will be critical. This view is supported by the fact that human capital has positively affected long-term success for firms in cases where other resources were not easily available (Rauch et al., 2005; Unger et al., 2011).

2.6 Research Hypotheses

The following hypotheses based on the findings of the literature reviewed have been proposed:

H1: Human capital positively influences the performance of firms among Nepali SMEs.

H2: Organizational learning capability plays a significant mediating role in the relationship between human capital and firm performance in Nepali SMEs.

3 METHODOLOGY

3.1 Research Design

This study used various tools and techniques to examine the correlations between Human Capital, Organizational Learning Capability and Firm Performance within organizational settings. A total of 285 participants were selected from a diverse range of industries, encompassing SME owners and managers, ensuring a wide spectrum of organizational insights and perspectives. A structured 15-item questionnaire, with 5 items per construct was used to gather data on human capital (independent variable), organizational learning capability (mediating variable), and firm performance (dependent variable) using a five-point Likert scale (Strongly Disagree to Strongly Agree). After the data quality check, 246 valid data sets were found to be valid for analysis.

The human capital construct was operationalized using the themes from Jardon & Martos (2012) and used employees proactivity, risk assessment at the decision making, creative power, knowledge sharing, and commitment to training and education. The organizational learning capacity construct derived from (Jerez-Gomez et al., 2005) considered leadership support for continuous learning, cross-functional cooperation, openness to innovation, and knowledge retention and dissemination mechanisms. Firm Performance construct was conceptualized based on the items suggested by Bontis (1998), which assessed firm performance from various stakeholder perspectives (revenue growth, human capital receipt, market standing, profitability) compared to industry rivals.

Using structural equation modelling, we evaluated the hypotheses regarding both direct and indirect effects among study variables.

Table 1- Variables and Survey Questions

Variable	Survey Questions
Human Capital	Managers and employees in our organization demonstrate a proactive and positive attitude toward their roles and responsibilities.
	Our employees and managers can evaluate risks effectively when making decisions.
	Our organization has the human capacity to innovate in processes, products, or market approaches.
	Employees in our organization can effectively share and transfer their experiences and knowledge with others.
	Our organization invests in regular training and development programs for both managers and employees**.**
Organizational Learning Capacity	Our organization's leadership encourages employees to participate actively in decision-making and continuous improvement efforts.
	Leadership supports ongoing employee learning and the adoption of innovative practices during organizational changes.
	Different departments within our organization work together effectively to achieve common goals.
	Employees are encouraged to share new ideas, and the organization is open to suggestions from both internal and external sources.
	Our organization has established systems and cultures that support open communication, teamwork, and knowledge sharing.

Variable	Survey Questions
Firm Performance	Compared to our competitors, our company has demonstrated strong growth in sales.
	Our organization has experienced a steady increase in employment over recent years.
	We maintain or expand our market share more effectively than our key competitors.
	Our gross profit levels are consistently strong in comparison to other firms in the industry.
	Our net profit margins are healthy and competitive within our sector.

3.2 Data Analysis

We conducted our analysis using specialized statistical analysis software (SPSS and AMOS) in sequential steps. First, EFA was performed to discover the patterns that exist between constructs. Then, the reliability, validity, and goodness of fit of the determined constructs were evaluated by the Measurement Model and Structural Model using Confirmatory Factor Analysis (CFA). Following the two-step process proposed by Anderson & Gerbing (1988), to conduct goodness of fit testing, reliability and validity testing, and hypothesis testing.

To ascertain the fit of the proposed model, various indicators such as chi-square (x2), chi square to degree of freedom ratio (x2/df), Tucker-Lewis Index (TLI), Comparative Fit Index (CFI), Root Mean Square Error of Approximation (RMSEA), and Standardized Root Mean Squared Residual (SRMR) were used. Principal Component Analysis with Varimax Rotation was used during Exploratory Factor Analysis. The analysis established a factor loading threshold of 0.70 (Hair Jr. et al., 2019); also, scale communalities were considered for adequate variance explanation. All communality values exceeded the recommended 0.50 minimum threshold.

The dataset set was confirmed to be fit for factor analysis by the significance of the correlation matrix with statistically significant results ($\chi 2$ (66) = 1430.611, $p < 0.001$) for Bartlett's Test of Sphericity and a Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy of 0.880, exceeding the minimum requirement of 0.80 and further validating the data's suitability for factor analysis.

Three factors were extracted in our analysis, accounting for 68.73 %of the total variance. The rotated component matrix showed high item loadings onto their designated theoretical constructs: Human Capital (HC), Organizational Learning Capability (OLC), and Firm Performance (FP).

Table 2-KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.880
Bartlett's Test of Sphericity	Approx. Chi-Square	1430.611
	df	66
	Sig.	.000

Table 3-Rotated Component Matrix

	Component		
	HC	**OLC**	**FP**
HC1	.843		
HC2	.736		

HC4	.743		
HC5	.825		
OLC1		.727	
OLC2		.755	
OLC3		.749	
OLC4		.792	
OLC5		.785	
FP1			.797
FP2			.746
FP3			.833

Internal reliability was evaluated, giving alpha coefficients between 0.840 and 0.904, which were all above the cutoff value of 0.7. Items such as HC3, HC4, FP4, and FP5 were removed for factor loadings<0.7.

Measurement Model Evaluation

Confirmatory Factor Analysis (CFA) was conducted to evaluate the measurement model for model fit, convergent validity, discriminant validity, and construct reliability by incorporating the three latent constructs: Human Capital (HC), Organizational Learning Capability (OLC), and Firm Performance (FP).

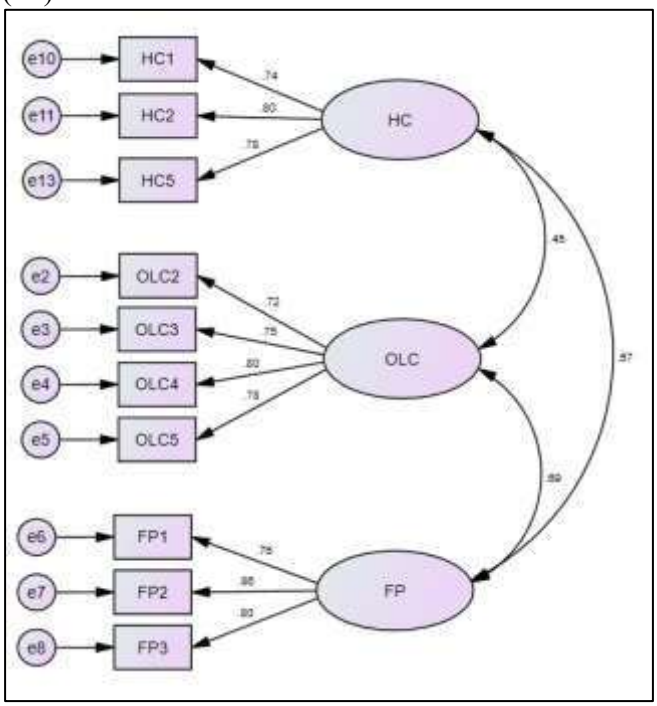

Figure 1-Measurement Model

Looking at the fit indices, the measurement model showed an acceptable fit for the data with x2/df equal to 1.747, CFI equal to 0.979, TLI equal to 0.971, SRMR equal to 0.039, RMSEA equal to 0.055, and Pclose equal to 0.339, all crossing the recommended thresholds for adequacy of fit (Hu & Bentler, 1998). OLC1 was removed from the measurement model during CFA as its standardized factor loading onto its construct was below the acceptable threshold of 0.7.

Table 4-Goodness of Fit Indices (Measurement Model)

Measure	Estimate	Threshold
X2/DF	1.747	Between 1 and 3
CFI	0.979	>0.95
TLI	0.971	>0.95
SRMR	0.039	<0.08
RMSEA	0.041	<0.06
PClose	0.339	>0.05

For construct validity, the reported values of Composite Reliability (CR) (0.817-0.813, all above the criteria of 0.70) (Sideridis et al., 2018) and Average Variance Extracted (AVE) (0.582-0.732, more than the minimum of 0.50) (Bagozzi & Yi, 1988) validated the same. The discriminant validity was supported based on accepted guidelines, where the square root of AVE values was greater than inter-construct correlations, Fornell-Larcker (1981), and AVE for each construct exceeded its Maximum Shared Variance (MSV).

Table 5-Table 6-Reliability and Validity Assessment

	OLC	FP	HC
CR	0.847	0.853	0.818
AVE	0.58	0.659	0.6
MSV	0.478	0.478	0.328
MaxR(H)	0.85	0.861	0.821
OLC	0.762	0.692***	0.453***
FP		0.812	0.573***
HC			0.775

Structural Model Evaluation

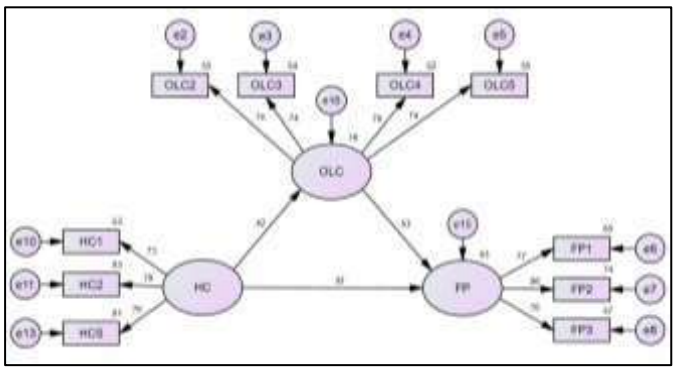

Figure 2-Structural Model

Looking at the fit indices, the structural model showed an acceptable fit for the data with x2/df equal to 1.260, CFI equal to 0.988, TLI equal to 0.982, SRMR equal to 0.042, RMSEA equal to 0.0461 and Pclose equal to 0.617, all crossing the recommended thresholds for adequacy of fit (Hu & Bentler, 1998).

Table 7-Goodness of Fit Indices (Structural Model)

Measure	Estimate	Threshold
CMIN/DF	1.260	Between 1 and 3
CFI	0.988	>0.95
TLI	0.982	>0.95
SRMR	0.042	<0.08
RMSEA	0.041	<0.06
PClose	0.621	>0.05

Hypothesis Testing

The direct influence of Human Capital (HC) on Firm Performance (FP) was evaluated to verify the first hypothesis (H1). The findings established a significant positive association (Standardized β= 0.321, p= 0.000), which shows that human capital directly contributes to firm performance in SMEs in Nepal.

Table 8-Hypothesis Testing (Direct Effect)

Hypothesis	H1: HC significantly impacts FP.
Path	HC → FP
Standardized Estimate (β)	0.321
Unstandardized Estimate	0.297
SE	0.086
CR	3.448
p-value	0.000
Decision	Supported

To examine the second hypothesis (H2), the mediating role of organizational learning capability was evaluated using bootstrapping techniques (5,000 resamples, 95 %confidence intervals). The results showed a significant positive indirect impact (Estimate = 0.226, 95 %CI [0.079, 0.381], p<0.005). With the direct and mediated effects of human capital, with both direct and indirect paths achieving significance, it has also been shown that there is partial mediation brought forth by organizational learning capacity in the relationship between Human Capital and Firm Performance.

Table 9-Mediation Analysis

Hypothesis	H2: OLC mediates the relationship between HC and FP
Path	HC → OLC → FP
Direct Effect	0.297 (0.000)
Indirect Effect	0.209
Lower Bound (95 %CI)	0.079

Upper Bound (95 %CI)	0.381
Significance (p-value)	0.001
Decision	Partial Mediation Supported

4 CONCLUSION

The results found that human capital and firm performance are positively related. The study also revealed that the mediating role of organizational learning capability in this relationship is partial. This interlinkage between human capital and firm performance is supported by other studies which identified human capital as an asset in improving organizational performance (Ahmad & Pantamee, 2020; Chika & Chike, 2021).

Likewise, the partial mediating effect that organizational learning capability indicates that the better a firm can acquire, assimilate, and use new knowledge, the effect of its human capital on its performance will become better.

The mediating role of organizational learning capability is likely to have been realized due to the innovation culture, which encourages flexibility and enhances organizational competition in general (Bibi et al., 2020). Organizational learning has similar effects on performance in organizations where employees can learn how to reflect and reinvent their processes and product offerings (Rehman et al., 2019).

Given these findings, SMEs in Nepal should invest more on their human capital, this can be done through training programs, mentorships and other strategic initiatives which will empower their employees. Similarly, having a learning culture will help the organization improve its learning capability as people will tend to collaborate and share knowledge. These sorts of environments will help SMEs become more dynamic and perform well in a changing market scenario (Kokkaew et al., 2022).

Setting learning-oriented objectives can be a tool to help employees and improve firm performance. This can be done by incorporating learning-oriented objectives in various HR Lifecycle stages such employee recruitment, employee training, and performance management. Firm performance can also be ensured by making sure that its employees have the required skills and knowledge to perform well in their assigned responsibilities and can adapt to the changing business environment (Patwary & Fauzan, 2020). Simialrly, firms can become more competitive through a continuous learning culture which helps them adapt their offerings and strategies effectively (Santos-Vijande et al., 2012).

In terms of future direction, industry specific research would aid in generating specific suggestions for specific industries, and a longitudinal study would help us understand about cause effect in this relationship and what channels mediation would take. Simialrly, adding other mediating and moderating variables such as market conditions and government policies can help establish new phenomena and validate other linkages.

In conclusion, this study has a firm's ability to attract, retain and enhance its human capital significantly impacts its performance. Also, the firm's ability to learn will determine the strength of that effect. Thus, Nepali SMEs with strong human capital, and good learning culture can perform well. In this way Nepali SMEs can ensure they remain competitive and become successful in the long run even if they have to continue operating in a volatile and turbulent business environment.

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