Employee Retention Practices For Human Capital and its Effectiveness on Financial Performance in Banking Industry

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Abstract

In this article, an attempt is made to assess the employee retention practices for human capital and impact of employee retention practices on financial performance in Banking industry in India based on the views of the bank employees. The study has covered 525 randomly selected employees of public and private sector banks in Chennai metropolitan city of India. The questionnaire instrument with 10 statement for measuring employee retention practices and 22 financial ratios for measuring the financial performance is used to for data collection. The internal consistency of collected data is tested by Cronbach's alpha coefficient. The ratios with high correlation are grouped under common factor using principle component factor analysis. The effectiveness of employee retention practices for human capital on financial performance is evaluated by canonical correlation analysis. The results of the analysis have exposed the fact that PAS in SAIL is effective. It is further exposed that the areas where PAS tend to effect are communication, work assessment, productivity and employee competence.

Key Words: Employee Retention Practices, Human Capital, Financial Performance, Cronbach's alpha coefficient, Principle Component Method of Factor Analysis, Eigenvalue, Varimax Rotation, Canonical Correlation Analysis.

Introduction

In the present competitive industrial world, particularly in the world of service industry like banks where human resource plays a crucial role, Human Resource Management for improving human capital acquires more importance. In Banks, human resource management practices if adopted appropriately, not only increasing the resources of the employees (human capital) through skill development but also help improving their overall performance through employee retention. Moreover, improved performance of bank through enhanced capabilities of its employees leads to the improved social image of the bank as well as satisfying social needs of employees in turn discouraging employee turnover. So the employees are to be given a chance to develop their capabilities like skills and knowledge through various means like career planning and growth, training, works itself which leads to better performance of the job and in turn better performance of the banks. Therefore, employee retention in banks is an important aspect of human resource management (HRM) and improvement in employee retention is essential to reduce HRM practices cost and achieve overall growth of the banks. However, there are no available research works on linking the human capital and employee retention practices with financial performance of banks. Hence, a focus is made in this article as an endeavor to fill these gaps.

Review of Literature

According to Abbasi (2000) employees are seen as major contributors to organizations' competitive advantage and to maintain such competitive advantage, employee turnover should be discouraged, i.e., organizations should take various measures to retain the employees. They pointed out the fact that employee turnover can have a negative impact on organization's performance [1].

The banking industry is considered as crucial in an economy of any country and any poor performance of the industry may diversely effect on the economy of the country as a whole. As stated by Amediku (2008), employee turnover in the banking industry has a lot of cost implications to the industry. This is because training cost, cost associated with exit interview, cost of replacing new employees and cost of gossip of the turnover which involves employee saying negative things about the company cannot be overlooked. Therefore, efforts should be made to mitigate these costs by retaining employees in the organization [2].

Cascio (2006) pointed out that employee retention is an important function of HRM. Retaining function comprises the activities of (i) rewarding employees for performing their job effectively; (ii) ensuring harmonious working relation between employees and managers; and (iii) maintaining a safe healthy work environment. He further suggested that fair treatment of employees, open communication, face-to-face resolution of conflict, promotion of teamwork, respect for the dignity of each individual, and pay increases based on merit are essential to retain employees [3].

Huselid (1995) stated that organizations embarking on talent management need to review their current HR practices. The 'war for talent' has focussed on acquiring and retaining the best employees in an organization. Human resources play a significant role in reaching organizational effectiveness and performance [4].

Aswathappa (2008) stated that to survive in this competitive scenario employees at managerial level in any organizations are being pressurized to improve quality, increase productivity, cut down waste and eliminated inefficiency. He has made an attempt to understand human resource in its proper prospective which are covered include nature of human resource management, employee hiring, employee motivation, employee maintenances and industrial relations [5].

Deshmukh (2013) concluded that selection, training, compensation and employee participation have a high positive effect on the financial performance of the banks. In the banking sector, it was found that compensation is also a major factor towards banking performance. He further concluded that HR practices, training and compensation system had positive impacts on perceived firm and market performances of the firm. On the other hand, two practices namely job definition and career planning system have a negative and insignificant impact on perceived firm performance [6].

The reviews have led to the clear understanding of the employee retention practices for discouraging employee turnover in order to increase the overall performance of an organization. It is understood from the reviews that employee retention practices are likely to influence the financial performance in banking industry.

Objectives of the Study

1. To assess the major components of financial performance in Banking industry in India.

2. To find out the effectiveness of employee retention practices for human capital on financial performance in Banking industry in India.

Methodology

The present research work is solely based on primary data. The sample for the study comprises of 525 employees across three different categories of employees at managerial levels (Manager, Manager Grade I and Manager Grade II). The respondents (bank employees) for the sample are selected using simple random sampling technique. To measure the employee retention practices, 10 statements with scale values ranging from 1 to 5 for 'strongly disagree' to 'strongly agree' (2, 3 & 4 for 'disagree', 'neutral' and 'agree' in between) are included in the questionnaire instrument.

The sample employees' perception of financial performance of their banks is obtained by including 22 financial ratios in the questionnaire. As measurement of respondents' opinion has been in the 5-point scale, the opinion of entire sample is considered to be 'strongly disagree', 'disagree', 'neither agree nor disagree'(neutral), 'agree', and 'strongly agree' if the obtained mean value to 5 (score for 'strongly agree') is 0 – 20 per cent, 21 – 40 per cent, 41 – 60 per cent, 61 – 80 per cent and 81 – 100 per cent respectively.

In order to ascertain the internal consistency of the data collected from the sample employees, Cronbach's alpha coefficient is used. According to George and Mallery (2003), the internal consistency items in a measurement scale is "excellent", "good", "acceptable" if alpha coefficient is " >0.90", "> 0.80", "> 0.70" respectively.

After the validity check, the data on financial performance are subjected to principle component method of factor analysis in order to groups the ratios that are highly correlated with each other under common factor to avoid multi-collinearity problem in the canonical correlation analysis, which is used to find out the effectiveness of employee retention practices on financial performance in Banking industry.

Results and Discussion

Table I provides the results of descriptive statistics along with Cronbach's alpha coefficient identifying the internal consistency of items for employee retention practices in banking industry. As provided in the table, the item to total correlation for all 10 items is more than 0.30, the minimum required value for internal consistency.

Table I: Descriptive Statistics and Reliability Coefficient for Items in the Scale Measuring Employee Retention Practices

Scale Items	Mean	SD	% Mean	Item to Total Correlation	Alpha If Deleted
Employees are shared with mission, vision and values of the Bank	4.01	0.67	80.15	0.3157	0.8616
Bank equip the employees with competencies	4.22	0.74	84.38	0.5783	0.8423
Employees are set with clear performance standards	4.20	0.79	84.00	0.5444	0.8451
Employees are recognized and rewarded for best performance	4.11	0.87	82.29	0.6927	0.8312
Promotions are given without delay when they are due	4.10	0.82	81.94	0.6284	0.8376
Employees are treated equally regardless of their job status	4.12	0.87	82.32	0.6320	0.8372
Provide a safe and healthy workplace	4.22	0.68	84.34	0.5180	0.8473
Provide a clean, comfortable environment	4.18	0.70	83.70	0.4040	0.8557
Include employees in decision-making	4.19	0.73	83.89	0.5810	0.8422
Allow employees some discretion over timing of overtime	4.25	0.94	84.95	0.7029	0.8299
Overall Cronbach's alpha					0.8570

Further, the Cronbach's alpha coefficient for all other items if item under consideration is deleted (alpha if deleted) is less than overall Cronbach's alpha coefficient of 0.8570 in respect of all items except for the first one. For first item, alpha if deleted value is 0.8616, but the difference is very trivial when compared to overall coefficient. Moreover, the item to total correlation is more than 0.30 for the first item. Hence this item is retained in the measurement scale. Therefore, from the overall Cronbach's alpha value, it is evident that the data pertaining to employee retention practices are internally consistent and valid for further analysis.

From the mean values and corresponding percentage of obtained mean value to 5 (score for strongly agree) which is 80.15 per cent for first items and ranging from 81.94 per cent to 84.95 per cent for the remaining 9 items, it is understood that the respondents have agreed that they are shared with mission, vision and value of the bank and the respondents have strongly agreed that the bank allow the employees some discretion over timing of overtime, equip the employees with competencies, provide a safe and healthy workplace and set with clear performance standards. The bank also include employees in decision making, provide a clean and comfortable environment, treating every employees equally regardless of their job status, recognizing / rewarding them for best.

As 22 various financial ratios are used to get the respondents' views on the financial performance of their banks and inter-correlations among the ratios are highly likely, principle component factor analysis is used to simplify the ratios into minimum number of common factors. For meaningful interpretation of factors varimax method is used for factor rotation.

Table II shows the eigenvalues of factors underlying the 22 financial ratios. As per the table, the eigenvalue is above one for first five factors (for factors to be valid, eigenvalue should be more than one), in turn indicating that there are five major components underlying financial performance in banking industry. The characteristics of each one of five valid factors is identified using factor loadings.

Table II: Eigenvalue of Common Factors Underlying Financial Performance Measures

Factor	Before Varimax Rotation			After Varimax Rotation		
	Eigenvalue	% Total Variance	Cumulative % of Total Variane	Eigenvalue	% Total Variance	Cumulative % of Total Variane
1	6.340	28.82	28.82	4.256	19.34	19.34
2	2.225	10.11	38.93	2.395	10.89	30.23
3	1.831	8.32	47.25	2.165	9.84	40.07
4	1.541	7.01	54.26	2.395	10.88	50.96
5	1.292	5.87	60.13	2.018	9.17	60.13
6	0.871	3.96	64.09			
7	0.793	3.61	67.69			
8	0.761	3.46	71.15			
9	0.718	3.26	74.41			
10	0.641	2.92	77.33			
11	0.575	2.61	79.94			
12	0.560	2.54	82.49			
13	0.547	2.49	84.97			
14	0.505	2.29	87.27			
15	0.456	2.07	89.34			
16	0.413	1.88	91.22			
17	0.398	1.81	93.02			
18	0.355	1.61	94.64			
19	0.347	1.58	96.21			
20	0.308	1.40	97.61			
21	0.290	1.32	98.93			
22	0.235	1.07	100.00			

Table III exhibits the factor loadings, eigenvalues, cumulative percentage of explained variance along with Cronbach's alpha coefficients for items loaded with every factor. The table also includes the factor labels. As seen from the table, based on the loadings of items (ratios), the first factor posses the most of qualities of profitability and earning quality, second factor has essence of financial leverage and third factor explains most of the qualities of management efficiency. While fourth factor is highly loaded with financial ratios pertaining to asset quality, the fifth and final valid factor is contributed by the liquidity ratios.

Table II: Item's Loadings with Extracted Factors Representing Financial Performance

Measurement Items	Factor Loadings	Eigenvalue	Cronbach's Alpha	Cumulative % of Explained Variance	Factor Label
Return on Equity (ROE)	0.766	4.255	0.872	19.3	Profitability & Earning Quality
Return on Capital Employed	0.753				
Return on Assets (ROA)	0.751				
Net Profit to Total Assets	0.741				
Interest Spread	0.703				
Interest Income to Total Income	0.660				
Operating Profit to Working Fund	0.553				
Debt – Equity Ratio	0.707	2.395	0.730	30.2	Financial Leverage
Advances to Total Assets	0.585				
Capital Adequacy Ratio (CAR)	0.576				
Non-Interest Income to Total Income	0.538				
Return on Net Worth	0.745	2.166	0.704	40.1	Management Efficiency
Profit per Employee	0.696				
Business per Employee	0.692				
Total Advances to Total Deposits	0.689				
Gross NPA to Total Advances	0.777	2.395	0.754	51.0	Asset Quality
Total Investments to Total Assets	0.752				
Net NPA to Net Advances	0.750				
Net NPA to Total Assets	0.570				
Current Assets to Short-term Deposits	0.815	2.018	0.668	60.1	Liquidity
Current Assets Ratio	0.757				
Quick Assets Ratio	0.652				
Overall Cronbach's alpha			0.878		

The Crombach's alpha coefficient is 0.872, 0.730, 0.704, 0.754 and 0.668 for first, second, third, fourth and fifth factors respectively. This suggests that there is internal consistency among the items under each factor. Further, the cumulative proportion (percentage) of explained variance of all five common factors is more than 50 per cent (60.1%), suggesting a sound construct validity of the data. Hence, based on this picture, the five factors are labeled as "profitability & earning quality", "financial leverage", "management efficiency", "asset quality" and "liquidity" for identification with further analysis.

Table IV reports the canonical correlation functions between factors underlying financial performance and items measuring employee retention practices for human capital in banking industry.

Table IV: Canonical Correlation Functions between Employee Retention Practices and Financial Performance Dimensions

Canonical Function	Canonical R	Canonical R^2 (Eigenvalue)	Chi-Square	df	p-Value	Wilks Lambda
0	0.5977	0.3572	268.81	50	0.0000	0.5940
1	0.1736	0.0302	40.75	36	0.2695	0.9241
2	0.1651	0.0273	24.95	24	0.4084	0.9528
3	0.1310	0.0172	10.69	14	0.7103	0.9795
4	0.0582	0.0034	1.75	6	0.9411	0.9966

Source: Primary Data

Out of five functions produced by the analysis, only the first one with canonical correlation of 0.5977 is significant statistically (Wilks' Lamda = 0.5940, Chi-square = 268.81, $p < 0.01$). As there is at least one statistically significant canonical correlation function, it is certain that the employee retention practice for human capital has notable influence on the financial performance in banking industry.

As per Table V, in which loadings of variance in the dependent (Criterion set) and independent set (Predictor set) along with percentage of variance extracted and redundancy values with first significant canonical functions are reported, in the first pair of canonical variates, financial performance set has extracted 39.63 per cent of the variance from its five variables (five dimensions) and employment retention set extracted set has extracted 40.97 per cent of the variance from its variables. The redundancy index has shown that the financial performance set has extracted 14.16 per cent of the variance from the measurement variables of employee retention while employee retention set has extracted 14.64 per cent of the variance from variables in the financial performance set. That is, shared variance between first canonical variates of criterion and predictor set is found to be substantial, in turn establishing the relationship between employee retention (for increasing the resources of human capital) and financial performance.

Table V: Canonical Loadings of Employee Retention Measurement Variables and Dimensions of Financial Performance

Variables	**First Canonical Function**
CRITERION VARIABLES	
Financial Performance Measures	
Profitability & Earning Quality	0.9047
Financial Leverage	0.8137
Management Efficiency	0.4741
Asset Quality	0.3791
Liquidity	0.3636
Percent of Variance extracted	**39.63**
Redundancy Index	**14.16**
PREDICTOR VARIABLES	
Employee Retention Practice Measurement Variables	
Employees are shared with mission, vision and values of the Bank	0.2259
Bank equip the employees with competencies	0.5479
Employees are set with clear performance standards	0.6227
Employees are recognized and rewarded for best performance	0.8081
Promotions are given without delay when they are due	0.6774
Employees are treated equally regardless of their job status	0.6842
Provide a safe and healthy workplace	0.5361
Provide a clean, comfortable environment	0.4131
Include employees in decision-making	0.7379
Allow employees some discretion over timing of overtime	0.8806
Percent of Variance extracted	**40.97**
Redundancy Index	**14.64**

Source: Primary Data

Note: Canonical loadings of 0.5 & above are considered.

From the observation of canonical loadings of the variables in criterion (dependent) set, it is apparent that the profitability and earning quality followed by financial leverage is the strong predictor of financial performance of the banks. From the canonical loadings of the variables in the predictor (independent) set, it is understood that allowing employees some discretion over timing of overtime followed by recognizing and rewarding the employees for best performance contribute more to the employee retention. The banks' retention practices such as including employees in decision making, treating equally regardless of their job status, giving promotions without delay when they are due, setting clear performance standards, equipping the employees with competencies and providing a safe and healthy workplace have also contributed substantially to the employee retention in banking industry.

As far as the effect of employee retention (preserving human capital) on financial performance is concerned, it is emerged from the results of the analysis that profitability & financial quality as well as financial leverage tend to increase when the degree of allowing the employees some discretion over time of overtime followed by recognizing and rewarding the employee for best performance and including employees in decision making is higher in banking industry.

Conclusion

This article is focused on exploring the effectiveness of employee retention practices for preserving human capital on financial performance in banking industry. The data for employee retention and financial performance were found to be internally consistent. From the descriptive analysis, it is understood that employee retention practices were better in banking industry. It is found that the financial performance in banking industry was determined by following five major aspects viz., profitability & earning quality, financial leverage, management efficiency, asset quality and liquidity. Regarding effectiveness of employee retention on financial performance, it is concluded from inferences of the canonical correlation analysis results that profitability & financial quality as well as financial leverage tend to increase when the degree of allowing the employees some discretion over time of overtime followed by recognizing and rewarding the employee for best performance and including employees in decision making is more in banking industry.

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