IRINA PIPERKOVA[1*]
VASIL POPOVSKI[2**]
ELENA DAVITKOVSKA[3***]

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THE IMPACT OF ECONOMIC DOWNTURN ON HUMAN RESOURCE POLICIES IN SMALL BUSINESSES: THE CASE OF NORTH MACEDONIA

Abstract: Globally, businesses struggle to survive amid the rising uncertainty, inflationary pressures and increased costs as well as disrupted supply chains, which deeply affects their performance. Such economic turmoil will inevitably result in cost cutting measures by businesses, thus affecting their human resource policies and practices. This raises issues related to the implications of the economic crisis on the human resource function and the challenges in terms of human resource policies that small businesses face. The main objective of this paper is to assess the immediate effects of the economic downturn on the performance and management activities of small businesses in the Republic of North Macedonia, as well as their response in terms of human resource management policies. The findings reveal that although small businesses consider increased costs of doing business to be their primary concern, most of the surveyed businesses did not and do not anticipate to decrease the pay levels or monetary rewards of their employees, nor do they plan major reductions of employee training and development opportunities. In fact, as a response to the growing inflation, many businesses have increased pay levels of their employees. In terms of staffing policy, the results show that the majority of businesses have already frozen their planned recruitments, but do not plan to implement layoffs. These findings are in line with the studies on firms' human resource policy response conducted during previous economic crisis.

Keywords: *human resource management policies, small businesses, economic crisis*
JEL Classification: M50

[1] * Associate professor, Institute of Economics – Skopje, "Ss. Cyril and Methodius" University, North Macedonia, irina@ek-inst.ukim.edu.mk
[2] ** Professor, Institute of Economics – Skopje, "Ss. Cyril and Methodius" University, North Macedonia, vasil@ek-inst.ukim.edu.mk
[3] *** Professor, Institute of Economics – Skopje, "Ss. Cyril and Methodius" University, North Macedonia, elena@ek-inst.ukim.edu.mk

Introduction

The ongoing economic crisis is probably the most profound one in modern times. Current economic conditions create challenging environment for small businesses which could significantly affect the way they do business and manage their workforce. Globally, businesses struggle to survive amid the rising uncertainty, inflationary pressures and increased costs as well as disrupted supply chains. Such economic turmoil puts great pressure on firms to control their costs of doing business, which in turn would affect their human resource practices.

This raises issues related to the implications of the economic crisis on the human resource function and the challenges in terms of human resource policies that small businesses face. Previous research reveals that during economic downturn, businesses normally respond by implementing short-term cost-cutting measures as freezing recruitment, reducing employee development budgets, pay cuts and reduction of bonuses and even layoffs. These cost-cutting measures however should not be at the expense of a severe loss of motivation and commitment among employees or reduction of their key talent pool. While focusing on short-term strategy to respond to the uncertainty and imposed changes, firms do not take activities to support long-term strategy during challenging times. However, coping with current challenges and reactive cost-cuttings can undermine the future competitiveness of firms. Therefore, the major challenge of human resource management during uncertainty is balancing between short-term strategy, as controlling costs, and the long-term strategy of achieving desired market performance.

1. FIRMS' RESPONSE TO ECONOMIC DOWNTURN IN TERMS OF HR PRACTICES

Previous economic crises have initiated a great deal of debates about the possible effects on human resource management policies and the potential areas for action, as retention of key talent and maintaining employee commitment and productivity. During economic downturn, businesses implement short-term cost-cutting measures mainly by freezing recruitment, reducing employee training and development budgets, pay cuts, reduction of bonuses and even layoffs. Research on the effects of recession on human resource management found that major areas that are primarily affected refer to reductions in

compensation and monetary rewards, training and development opportunities and the staffing levels.

In order to avoid large-scale redundancies during economic downturn, firms implement short-term cost-cutting measures as freezing recruitment, reducing employee training and development budgets, pay and bonus reductions and alike. These types of measures however, could have a significant negative effect on employee performance[4].

Research on the effects of an economic downturn on human resource policies in firms reveals similar findings among UK firms[5]. The recession has affected several HR practices in firms as reductions in pay rises, size of bonuses, training and development budgets and the staffing levels. As a response to the challenging economic conditions, firms tend to use flexible and part-time working in order to avoid layoffs. Nevertheless, these measures had negative effects on employees' motivation and engagement. In addition, a survey in more than 30 European countries and more than 15 industries by The Boston Consulting Group (BCG) and the European Association for People Management (EAPM)[6] highlights similar findings with regard to firms' response. The primary actions taken by firms during recession include freezing recruitments and cutting back on bonus payments tied to company performance. The research also points out that firms have given priority to temporary employee layoffs over cutting back on training and/or using early retirement. Reduction on individual and functional training were least effective in the previous recession and had negative impact on employee commitment. In fact, layoffs based on low individual performance were found to be effective in previous crisis and had positive impact on high performers, who were rewarded with job security.

During recession, businesses pay insufficient attention to retaining their talent pools. Some of the previous recessions have resulted in major employee layoffs. Nevertheless, the demographic changes and talent shortage have influenced many firms to continue to recruit new employees amid the economic crisis and seek to maintain their talent pools. Therefore, the issue of pay levels

[4] Moore, S., Grunberg, L., Anderson-Connolly, R. & Greenberg, E., "Physical and mental health effects of surviving layoffs: a longitudinal examination", Institute of Behavioral Science, Working paper PEC 2003-0003, 2003

[5] Clinton, M. & Woollard, S., "From recession to recovery? The state of HR in this challenging economic environment", HR Survey 2010 Report, King's College London University & Speechly Bircham, 2010

[6] Strack, R., Caye, J.M., Thurner, R. & Haen, P., "Creating people advantage in times of crisis: how to address HR challenges in the recession", Boston Consulting Group & European Association for People Management, 2009

and key talent retention are equally important aspects during economic downturn. Namely, pay rates suffer most in times of crisis, while businesses are seeking alternative ways to retain their key talent. At the same time, due to the crisis, firms find themselves overstaffed in comparison to their current scale of production. The actions taken in past recessions, as freezing recruitment and employee layoffs, have left firms with a talent shortage, which had additional implications on their post-crisis performance. So, many companies that focus on their long-term strategy are looking for ways to retain their talent with the capacities necessary for the future post-crisis period.

Broadly speaking, recession has negative impact on employee training, as well. In challenging times, investments in employee training and skill development are the first to feel the consequences of the reactive measures by firms. Indeed, firms are expected to cut training and development budgets over 10% in response to recession[7]. Businesses are generally reluctant to invest in training as they seek to reduce costs and solve acute financial challenges. When revenues shrink, cost-cutting measures are inevitable in firms, hence reflecting on training budgets, among others. However, the last recession proved that employers have recognized the value of employee training and seek to sustain the levels of training investments by balancing the high costs of training and training benefits through alternative methods of delivery of employee training. Firms that have recognized training benefits, and focus on long-term strategy, could change the delivery of training to less expensive alternatives as taking training in-house or introduce e-learning[8]. The reduction in training investments mainly refers to training on soft skills whereas training in job-specific skills, that are core to businesses, has kept the same levels of the pre-recession period. In this context, employers in UK continued to invest in employee training, but primarily in 'training floors' that were essential for their operations[9]. Businesses, however, did seek alternative cost-effective ways to deliver training as in-house training, having regular employees as trainers, group training and increased e-learning. The above could be mainly due to the fact that businesses are obliged to sustain employee training despite the reces-

[7] Noe, R. "Employee training and development", (5th Ed.), New York: McGraw–Hill, 2010

[8] ibid

[9] Felstead, A., Green, F. & Jewson, N. "Training in the Recession: The impact of the 2008-2009 recession on training at work", UK Commission for Employment and Skills, Evidence Report 72, 2013, p. 64

sion in order to comply with legal requirements, meet operational needs and customer demands[10].

A large-scale survey in England[11] reported a reduction in training investments among small and medium-sized enterprises as a result of the costs of training and managers' belief that employees did not need training. Around a quarter of surveyed firms have never provided any training to the employees revealing the differences between small and large firms in training investments. Namely, small firms continuously report lower incidence of employee training as a result of higher training costs per employee[12], absence of HR expertise and/or departments and lack of training budgets[13]. On the other hand, employee training is essentially important to overcome challenges that businesses face, maintain their competitive position and prepare for the post-recessionary period. In addition, during economic downturn major concern of employees has proven to be job security. In this regard, training and development programs can boost employee morale and organizational commitment as employees regard training as firm's investment in them[14]. Research confirms that firms that use more rigorous staffing and training outperform competitors, before and during a recessionary period and recover more quickly than those firms that do not use so rigorous practices[15]. Moreover, these human resource practices enhance both organizational and financial performance of businesses and differentiate the organization from competitors.

While coping to maintain their viability through cost-reduction plans, businesses should also consider long-term plans and strategy in order to be prepared for the post-crisis period. In developed economies, many businesses are aware that in responding to the crisis they have to develop strategies that combine initiatives to reduce costs with measures to improve innovation and

[10] Ibid, p. 88

[11] Green, A.E. & Martinez-Solano, L.E. "Leveraging training skills development in SMEs: An analysis of the West Midlands, England, UK", OECD Local Economic and Employment Development Working Paper Series, 2011, p.27

[12] Stone, I. "*Encouraging small firms to invest in training: learning from overseas*", Praxis, UK Commission for Employment and Skills Iss.5, 2010, p.10

[13] Beraud, D. "SMEs are increasingly interested in the effects of training", *Training and Employment* No.114, 2014, p. 2

[14] Flannery, J. et al. "Experiencing training: the need for a detailed investigation", Working with older people, 9 (1), 2005, p. 13-16

[15] Kim, Y. & Ployhart, R.E. "The effects of staffing and training on firm productivity and profit growth before, during, and after the great recession", Journal of Applied Psychology, Vol.99 No.3, 2014, p.361-389

quality, employee morale and engagement. In this regard, for example, the financial crisis of 2008 has not affected the level of training investments considerably as major reductions in employee training were not reported in developed countries. Companies have given priority to temporary and full-time employee layoffs over cutting back on employee training and using early retirement[16]. This is mainly because the cuts on employee training and development were least effective in the previous recession and had negative impact on employee commitment and consequently productivity. In addition, major layoffs not only disrupt businesses' talent pools, but also diminish the motivation among employees and affect their productivity levels. Therefore, in an effort to avoid major layoffs and maintain their talent pools, businesses insist on short-term cost-cutting measures as reducing employee training or compensation and bonus levels. Costs related to funding development opportunities are always a concern for management, making businesses reluctant to continue to provide development opportunities to their employees in such times.

2. METHODOLOGY

The main objective of this research was to assess the immediate effects of the economic downturn on management activities of small businesses in Republic of North Macedonia and their response in terms of HRM policies. The research was conducted using an online survey questionnaire which was distributed to owners and/or managers of small businesses in different sectors in North Macedonia.

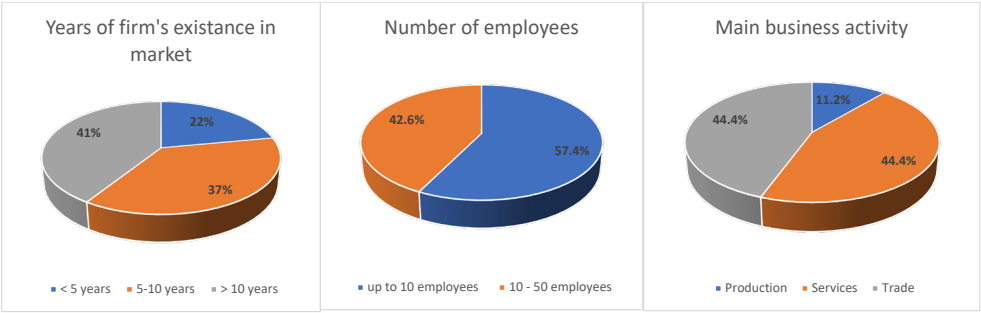
The questionnaire included questions that would determine the negative effects of the current economic conditions on small businesses, as perceived by business owners. In addition, the questionnaire covered aspects pertaining to current human resource policies undertaken by small businesses as a response to the current economic downturn, in particular, recruitment, compensation and employee training and development policies. The research was conducted during February and March 2022. The analyzed sample included 54 small businesses in different industries in North Macedonia.

[16] Strack, R., Thurner, R., Caye, J.M., Haen, P., Zimmermann, P. & Von der Linden, C., "Creating people advantage: how to tackle the major HR challenges during the crisis and beyond", Boston Consulting Group & European Association for People Management, 2009

3. RESEARCH FINDINGS

Based on the business activities, the analyzed sample included equal percent of firms in the services sector and trade (44.4%), whereas 11% of firms are in production. In addition, most of the firms (41%) operate more than 10 years, whereas 37% are active in the market from 5 to 10 years. Only 22% of firms exist in the market less than 5 years. More than half of the analyzed sample are firms that employ 10-50 employees, while almost 43% employ up to 10 employees (see Figure 1).

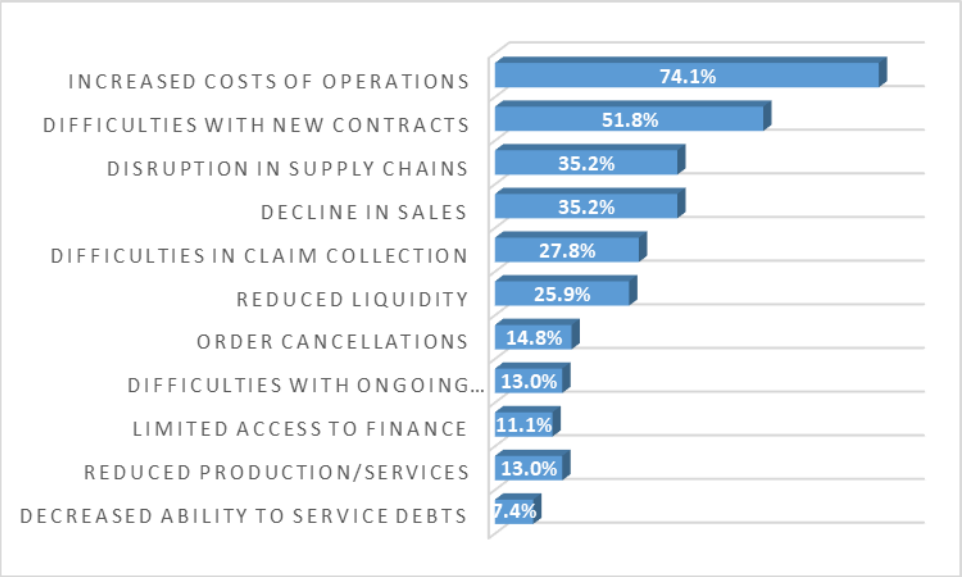
Figure 1. Characteristics of analyzed sample



Source: Authors' findings

Most of the firms (48.2%) consider the ongoing economic crisis to have partial negative impact on their business, while for less than one third of the firms the negative impact is severe. Regarding the business aspects that are mostly affected by the crisis, for a significant share of firms (74%), these refer mainly to increased costs of operations, immediately followed by difficulties with new contracts (51.8%), disrupted supply chains (35.2%) and decline in sales (35.2%). For about one quarter of the analyzed firms, reduced liquidity is also an issue (Figure 2).

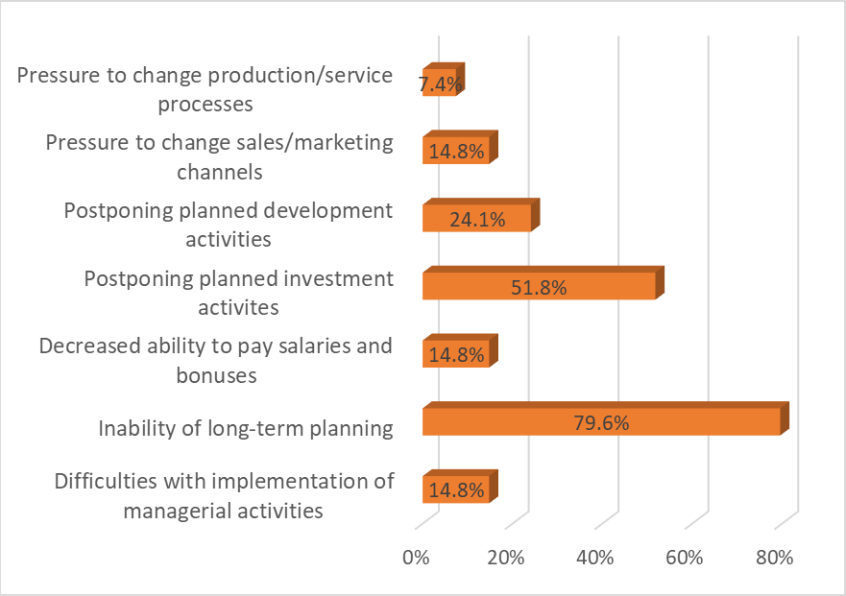
Figure 2. Major negative effects on firms as perceived by small businesses



Source: Authors' findings

As for the negative effects on managerial activities, the main challenge to firms is the inability of long-term planning and postponing investment activities (see Figure 3). Indeed, almost 80% of the firms point to the inability of long-term planning as a major negative effect of the ongoing economic crisis, whereas more than half have postponed their planned investment activities. For one quarter of firms this refers to their development activities as well.

Figure 3. Major negative effects on managerial activities of businesses

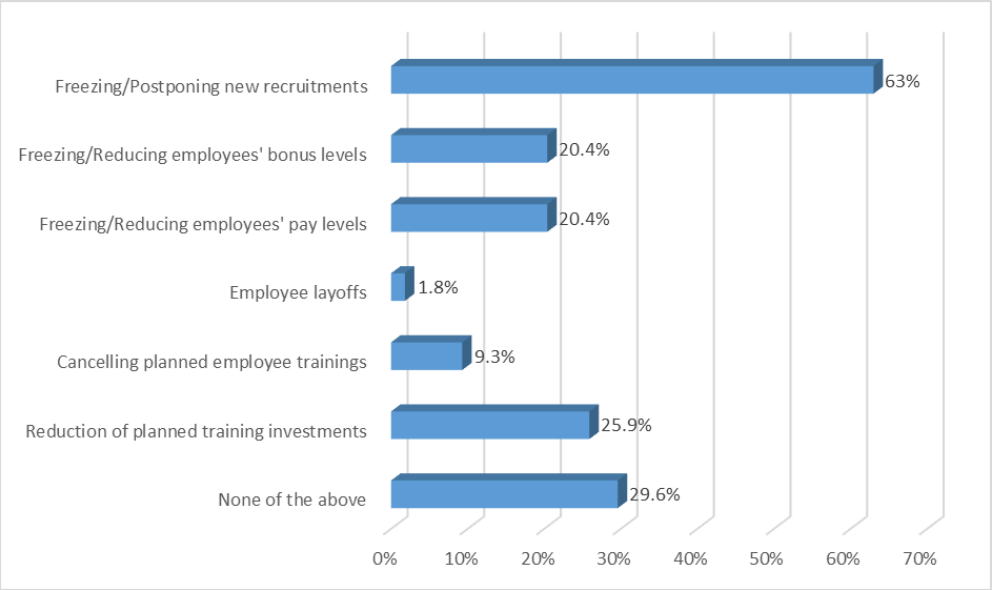


Source: Authors' findings

In terms of the negative consequences on human resource policies, the ongoing economic crisis has affected firms' recruitment, employee development and compensation policies. In particular, more than half of the firms (63%) have either frozen or postponed planned recruitments (Figure 4), while about 25% of firms have reduced their planned training investments as a response to the increased uncertainty. Additionally, about 20% of firms have reported that, as a result of the current conditions, employees' pay and/or bonus levels were affected.

The findings reveal that firms do not undertake cost-cutting measures at the expense of their talent pools. Indeed, for an insignificant percent of firms this crisis has already led to employee layoffs. Moreover, the findings show that for about one third of the firms the current economic downturn does not affect their human resource policies and these firms have neither frozen recruitments nor have reduced their training budgets or employee pay/bonus levels.

Figure 4. Impact of the economic downturn on human resource practices

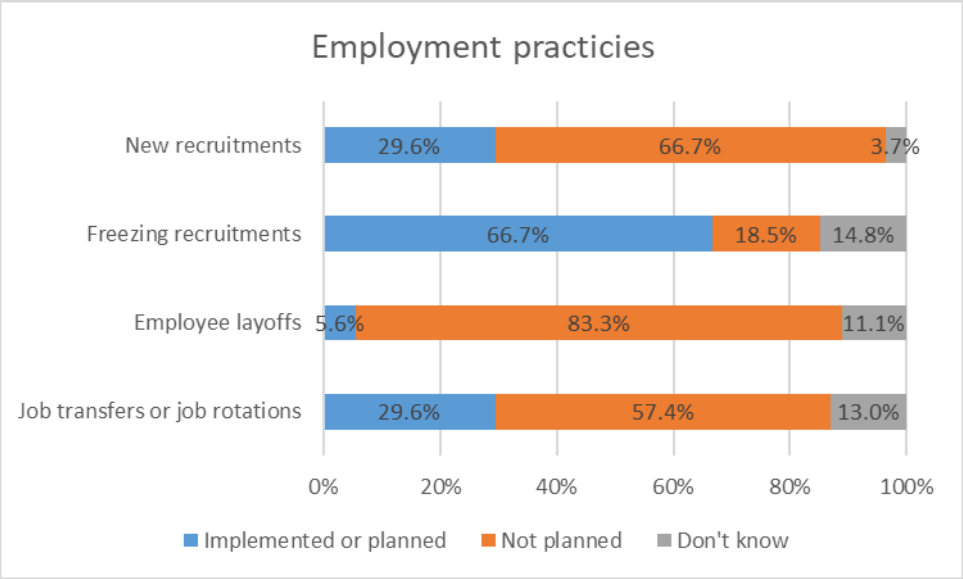


Source: Authors' findings

In fact, about 30% of firms implemented or plan new recruitments while more than half of the firms have already frozen or plan to freeze new recruitments (see Figure 5). Freezing new recruitments is usually the first step that firms undertake during economic crisis, which is in line with our findings.

The analysis also revealed that firms strive to preserve their talent pools and are reluctant to make employees redundant. Hence, it is not surprising that more than 80% of businesses do not plan to lay off employees. Also, a significant number of firms do not plan to implement job transfers or job rotations.

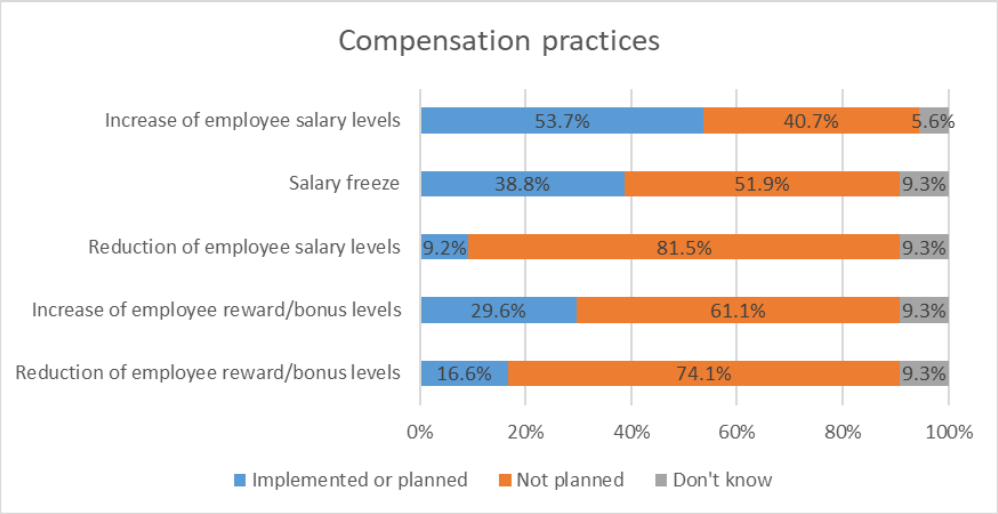
Figure 5. Employment practices of small businesses



Source: Authors' findings

Regarding compensation practices, it is interesting to note that more than half of the analyzed firms have increased or plan to increase salary levels, whereas 39% have or plan to freeze it. Based on these findings, it can be concluded that businesses strive to maintain employee levels of motivation, engagement and subsequently employee productivity, by increasing levels of employee salary as a response to the rising costs of living. In this regard, reduction of salary levels is implemented only in less than 2% of firms, while 7% plan to reduce these levels should the crisis continue (Figure 6). Nevertheless, most of the firms do not plan to implement any changes in their reward policies, that is, do not plan to either increase or decrease employee bonus levels (61% and 74% of firms, respectively).

Figure 6. Compensation practices of small businesses

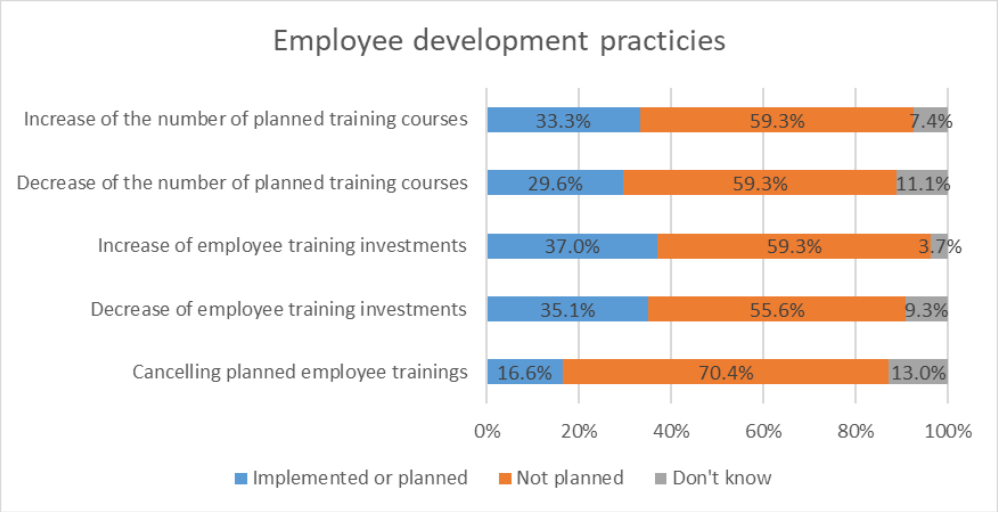


Source: Authors' findings

The analysis of employee development practices shows that about half of the firms also do not plan any changes regarding employee training courses and training investments (see Figure 7). In particular, almost 60% of firms shall neither increase or decrease employee training courses or training investments. Also, a significant number of firms shall not postpone or cancel planned training activities for their employees. It is relevant to note that one quarter of firms even plan to increase employee training courses and training investments amid the economic crisis (33% and 37% of firms, respectively).

The previous economic crisis, as mentioned earlier in this paper, has also not affected the level of training investments considerably, mainly because the cuts on employee training and development were least effective in previous recessions and had negative impact on employee commitment and consequently productivity.

Figure 7. Employee development practices of small businesses



Source: Authors' findings

Based on the results of the survey, firms, so far, have responded to the economic crisis mainly by freezing new recruitments, as a first step undertaken by firms during economic downturn. Even more, as a response to the rising costs of living, a significant number of firms have increased employee pay levels, in an effort to maintain employee's commitment and engagement. Small businesses in North Macedonia also strive to maintain their talent pools by avoiding major layoffs and major reductions of employee training and development opportunities.

Conclusion

During recession, firms undertake cost-cutting measures mainly focused on freezing recruitment, reducing employee training investments, pay cuts, reduction of bonuses and even layoffs. However, previous research revealed that many of these measures undermine employee engagement and subsequently their productivity. In addition, the surging inflation and rising costs of living impose expectations for higher salaries among employees. With this in mind, firms face a twofold challenge, increase salaries and employee training investments and thereby operating expenses to maintain and/or improve employee motivation and engagement, or reduce/maintain the same pay levels and training investments so as to reduce firm's costs. Hence, the major challenge of

businesses during economic downturn is balancing between short-term and long-term goals. While coping with ongoing challenges through cost-cuttings, firms should also take into account their long-term strategy in order to be prepared for the post-crisis period. In recent years, employers acknowledge that in responding to the crisis they have to develop strategies that combine initiatives to reduce costs with measures to improve or maintain their competitive position by focusing on innovation, quality and employee engagement and productivity.

Although small businesses consider increased costs of doing business to be their primary concern, most of the surveyed businesses did not and do not anticipate to decrease the pay levels or monetary rewards of their employees, nor do they plan major reductions of employee training and development opportunities. In fact, as a response to the growing inflation, many businesses have increased pay levels of their employees. In terms of staffing policy, the results show that the majority of businesses have already frozen their planned recruitments, but do not plan to implement layoffs. These findings are in line with the studies on firms' human resource policy response conducted during previous economic downturns.

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