

Impact of SHRM Practices on Organisational Performance: An Empirical Study on Employees of the Sri Lankan Banking Sector

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Abstract:

Purpose: This research examines the impact of strategic human resource management (SHRM) practices on organisational performance, as mediated by employee retention in the Sri Lankan banking sector.

Design/methodology/approach: Data was collected from 238 employees using a self-administrated questionnaire and analysed using structural equation modelling.

Findings: The results suggest that the three SHRM practices of ability enhancement, skill enhancement and motivation enhancement have significant indirect impact on organisational performance. The relationship between the SHRM practices and organisational performance is also mediated by employee retention.

Practical implications: This study provides SHRM practitioners in the banking sector with a useful guide on which SHRM practices are significant to employee retention and organisational performance and hence, should be given attention.

Originality/value: SHRM theory has been largely developed in traditional functional manufacturing organisations but not in service-oriented organisations. This study fills the gap by examining the causal relationship between the SHRM practices and organisational performance through the mediating effect of employee retention in a service-oriented industry, i.e. the banking sector. A model which bundles the SHRM practices is employed in the study to provide a comprehensive picture of its relationship with employee retention and organisational performance.

Keywords: SHRM practices, organisational performance, employee retention, banking sector.

Paper type: Empirical research

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I. Introduction

Human resources management (HRM) has been recognised as the most important source of competitiveness, since it is the human capital who use organisational assets to create competitiveness and to realise organisational objectives. This explains the considerable number of conceptual and empirical studies which found that strategic human resource management (SHRM) practices influence organisational performance such as increased productivity, higher profitability and lower employee turnover rates (Arthur, 1994; Combs, Liu, Hall and Ketchen, 2006; Knies, Boselie, Gould-Williams and Vandenabeele, 2018; Van De Voorde, Paauwe and Van Veldhoven, 2010).

Despite the consensus, many scholars suggest that more conceptual and empirical work is required (Brewster, 2004; Carden and Stevens, 2004). Today, most of the companies are operating in complex and dynamic environments, where competition is constantly emerging. The traditional sources of competitive advantage can no longer guarantee the sustainability of organisations, creating a need for rapid adaptation. This situation is leading to redefinition of SHRM practices and retention strategies (Antonio, Gregorio and Arleen, 2015; Pfeiffer, 1994; Wernerfelt, 1984).

Most of the studies related to SHRM practices have concentrated on the Western context, with little evidence on organisations in the developing countries such as in the case of the banking industry in Sri Lanka (Abewickrama, 2016; Amin, Hossain and Khatoun, 2013; Salman, Ahmad and Martin, 2014; Shahid, 2017). In addition, the issue of employee retention due to globalisation, competition and the characteristics of millennials has made the relationship between SHRM practices and organisational performance much more complicated as they have been previously thought of. There are research evidences to show that rather than directly influencing organisational performance, SHRM practices have been found to affect employee retention rates in a positive direction (Antonio, Gregorio and Arleen, 2015; Pfeiffer, 1994; Wernerfelt, 1984), pointing to the 'black box' in the SHRM-performance relationship. Many researchers have echoed the need to include mediating variables in the relationship to enhance the clarity of such relationship (Alcazar, Fernandez and Gardey, 2005; Becker and Gerhart, 1996; Katou, 2008).

On this score, employee retention is an especially prevalent issue amongst the junior and supervisory levels of employees in the banking industry in Sri Lanka which calls for effective SHRM practices to motivate and retain them to improve the performance of the banks (Abewickrama, 2016; Dwomoh and Frempong, 2017; Shahid, 2017), suggesting the mediating role of employee retention. However, there is dearth of literature on how SHRM practices are operationalised across the management hierarchy and achievement of organisational performance through clear, consistent and relevant HRM practice. These studies which focused on the upper level rather than junior and supervisory employees who have higher tendency to leave. (Mbugua, waiganjo, & njeru (2014).

In addition, almost without exception, SHRM research has relied on evidence from private sector organisations and public sector organisations in isolation. There is an increasing call for the need to address this imbalance by considering SHRM in a public as well as private sector context (Knies, Boselie, Gould-Williams and Vandenabeele, 2018, Ongaro and Van Thiel, 2017), including the banking sector.

The aim of this study is to determine whether SHRM practices are significantly associated with the performance of the banks, and whether employee retention mediates the relationship between the SHRM practices and performance of both the publicly- and privately-owned banks in a developing country such as Sri Lanka. The Central Bank of Sri Lanka (CBSL) reported that the banking industry in Sri Lanka comprises 25 licensed commercial banks, which includes 13 domestic banks and 12 foreign banks, two of which are local public banks (CBSL Annual Report, 2017). Data were collected from the junior and supervisory levels of employees working in these banks in the Western province of the country, where most of the branches of the banks are located. The data were then analysed using structural equation modelling (SEM). By addressing the aforementioned gaps, it is hoped that the study makes incremental contributions to the body of knowledge. From the practical perspective, it is hoped that the findings could serve as a reference on what are the SHRM practices that the banks should concentrate on to retain their employees and to increase the performance of banks. They could also be used as a reference for investors and policy makers to make relative investment and policy decisions.

The rest of the paper is organised as follows. The next section presents the relevant literature, resulted in the development of a research framework and a series of hypotheses to be tested. The methodology and framework adopted in this study is presented next. This is followed by the presentation of the key results, along with discussion on both their theoretical and practical implications. The paper is concluded with limitations and future research directions.

II. Literature Review

2.1 SHRM practices

The resource-based view (RBV) theory states that a firm develops competitive advantage by not only acquiring but also developing, combining, and effectively deploying its physical, human, and organizational resources in ways that add unique value and are difficult for competitors to imitate (Barney, 1991). The central tenets of RBV as suggested by various researchers (e.g. Barney, 1991; Barney & Wright, 1998; Newbert, 2008; Takeuchi et al., 2007; Wright et al., 2001; Wright et al., 1994) are that resources that are valuable, rare, inimitable, and non-substitutable will lead to competitive advantage. Value in this context is defined as resources either by exploiting opportunities or neutralizing threats to the organization, while rarity is defined as a resource that is not currently available to a large number of the organization's current or future competitors (Barney, 1991).

Bowen and Ostroff (2004) introduce the construct of 'strength of the SHRM' and describe the main features of SHRM that result in a strong organisational climate in which individuals share a common interpretation of what behaviours that are expected and rewarded. Amongst the many theories, the AMO (ability-motivation-opportunity) theory is regarded to be at the heart of SHRM that is designated to positively shape discretionary behaviours of employees (Boxall and Purcell, 2003; Lepak et al., 2006; Katou, 2008). The theory explains three SHRM variables of (1) ability enhancement practices; (2) motivation enhancement practices; and (3) opportunity enhancement practices and their associated SHRM practices as summarised in Table 1.

SHRM Practices(IV)	Employee retention (ME)	Organization Performance(D)
1. Recruitment and selection	1. retention & presence	1. Productivity
2. Training and development		2. Efficiency
3. Work design		3. Innovation
4. Performance appraisal		4. Satisfaction
5. Compensation and benefits		5. Quality
6. Promotion		6. Profits
7. Encouragement		
8. Grievances		
9. Job confirmation		
10. Communication		
11. Participation in management		
12. High performance		
13. High commitment		
14. Facilitating teamwork		
15. Communications and involvement		
16. Enhancing quality		
1.0 Developing talent to serve the business in the future.		

2.2 Employee retention

Employees are the most valuable assets of any organization. Their significance to organizations calls for not only the need to attract the best talented employees but also the necessity to retain them for a long term.

Employee retention is a process in which the employees are encouraged to remain within the organization for the maximum period of time or until the completion of the project. Employee retention is important for the organizations as well

as the employees. If the employees feel disappointed with the current employer or the job, they switch over to the next job. It is the responsibility of the employer to retain their best and top talented employees. If they don't, they would be left with no good employees. A good employer should know how to attract and retain its employees on board (Nor, 2018)

However, one drawback of the models presented literature is that they focus on the two end-points of the SHRM-performance relationship. At one end is HRM strategy and at the other end is organization performance. But what happens between these two endpoints? Exactly how do HR practices influence organization performance? The mechanism, which remains unknown, is often referred as the black box (Boselie et al., 2005). Accordingly, the aim of this study is to elaborate on the effect of SHRM practices outcome on organizational performance in Sri Lankan banking sector. This study examines which strategic human resource management (SHRM) practices that stimulate employee retention. Effective SHRM practices can reduce employee turnover and increase retention within an organization context.

Employee retention behaviour as an important attribute of SHRM outcome is a key variable in the study of HRM (katou & budhva, 2008). Compared to western countries, Sri Lanka is undergoing the critical period of economic transformation as well as various external threats from economic globalization, increased competition and technology revolution. Therefore, employee retention is considered as one of the prime factors when banks make decisions (Zhang, 2005)

2.3 Bank performance

In this study, bank performance is operationalised based on: (1) customer satisfaction of the bank; (2) service innovation; (3) quality of service; (4) operational efficiency; (5) level of productivity; and (6) profitability based on the measures developed by Katou (2008).

2.4 SHRM practices and bank performance

Dharmasiri (2016) cites Dave Ulrich that effective human resource (HR) professionals can help the collective HR practices to reach the tipping point of their high impact on business performance by focusing on few but centrally important HR practices. This suggests that the identification of the important components of SHRM practices for organisational performance would help to better theorise the nature and impact of SHRM-performance relationship.

2.5 SHRM practices and employee retention

From the contingency perspective, the literature suggests that the set of SHRM practices of an organisation will be effective if it is consistent with its retention strategies (Aldamoe, Yazam and Ahmid, 2012). With the acknowledgement that profit and goodwill are generated through employees who are the backbone of the banks, investment in SHRM practices such as recruitment, induction, orientation, socialisation, training and development can minimise the turnover rate, as well as the cost of selection and recruitment.

This research fills the knowledge gap of which SHRM practices (ability enhancement, motivation enhancement, or opportunity enhancement) are the most influential as the employee retention strategy for the Sri Lankan banking sector.

2.6 Retention and bank performance

Employee retention has proven to be one key challenge for the banking sector in Sri Lanka to achieve its business objectives. From the contingency perspective, SHRM practices are followed by retention strategies in determining organisational performance (Aldamoe, Yazam and Ahmid, 2012).

2.7 Retention as a mediator between SHRM practices and bank performance

The intermediate linkages and processes, through which SHRM practices affect organisational performance, have challenged researchers to define and examine their rationale that opens the 'black box' between SHRM practices and organisational performance (Chuang and Liao, 2010). This in turn leads to organisational performance at the collective level. According to their argument, the contribution of SHRM practices to organisational performance is determined not only by the choice of SHRM but also by features and the synergistic effects of the SHRM practices. Since there is no consensus or consistent evidence illustrating what constitutes these HRM systems or bundles that are associated with high firm performance, the HR department needs to create SHRM practices that are perceived as distinct, consistent and unambiguous by employees. If SHRM practices possess these features, it will create a strong SHRM which facilitates the strong relationships between employee retention and individual performance, which ultimately contributes to better organisational performance.

2.4 Research hypotheses

From the aforementioned literature, it can be observed that previous research focusing on the link between SHRM practices and organisational performance can be grouped into two categories: (1) research on the direct relationship between SHRM practices and firm performance (Arthur, 1992, 1994; Huselid, 1995; MacDuffie, 1995; Osterman, 1994); and (2) research on the internal mechanisms (i.e. mediators) through which the relationship between SHRM and organisational performance takes place (Batt, 2002). This study adopts the two categories, in which research of such a nature is still relatively limited (e.g. Appelbaum et al., 2000; Nishii, Lepak and Schneider, 2007), including the context of the developing world. The following hypotheses were developed to be tested:

H1: SHRM practices significantly impact on organisational performance in the banking sector in Sri Lanka.

H2: SHRM practices are significantly associated with employee retention in the banking sector in Sri Lanka.

H3: Employee retention significantly impacts on performance of the banking sector in Sri Lanka.

H4: Employee retention significantly moderates the relationship between the SHRM practices and performance of the banking sector in Sri Lanka.

III. Methodology

3.1 Sample

According to Lanka Business Online (www.lankabusinesonline.com), the banking industry is densely concentrated in the Western province of Sri Lanka, with nearly 40% of the branches of licensed commercial banks located in this area. In addition, in terms of banking density (the number of bank branches per 100,000 persons), it stands at 11.9 in the Western province against a range of 5.3 to 8.4 in other provinces, making this province an appropriate setting for the study to be conducted.

A total of 390 questionnaires were distributed to junior executives, managers and senior managers positioned in the branches of the licensed commercial banks in the Western province using the stratified sampling method. With 342 questionnaires returned, only 328 were found to be valid, yielding a response rate of 85.5%. As shown in Table 2, the majority of respondents were female with age of 31 and older. Their age corresponded with their years of experience, where the majority of them have worked for five or more years in their respective banks. Most of them hoped to remain working in the same bank for 15 or more years, followed by those between 11 and 15 years. Many of them are executives, followed by managers and junior executives, with only one response from a branch manager responsible for HR functions. In addition to the data reported in Table 2, 55.9% of them are working for privately-owned banks, with the remaining with publicly-owned banks.

Table 2: Profiles of Respondents

Age	Percent	Experience	Percent
21 – 25	4	Less than 5 years	9
26 – 30	9	5 – 10 years	26
31 – 35	27	11 – 15 years	20
36 – 40	21	15 years or more	45
41 – 45	14		
46 – 50	11	Hope to Remain	
50 and above	14	Less than 5 years	16
		5 – 10 years	26
		11 – 15 years	17
		15 years or more	41
Gender			
Male	49		
Female	51		
Designation			
HR Managers			3
Branch managers responsible for HR functions			1
Non-managerial employees			8
Chief Managers			10
Managers			24
Executives			36
Junior Executives			18

3.2 Questionnaire

The survey questionnaire constitutes four parts. The first part comprises questions on the demographic characteristics of respondents such as age, gender, years of working experience, how much longer they intend to work in the same bank and their designation. The second part of the questionnaire consists of items measuring SHRM practices, i.e. ability enhancement practices (13 items), motivation enhancement practices (15 items) and opportunity enhancement practices (14 items). The third part comprises six items measuring retention behaviour. The questions in the second and third part were scored using 5-point Likert scale of 1 (strongly disagree) to 5 (strongly agree). The fourth part of the questionnaire consists six items measuring organisational performance, scored on a 5-point Likert scale of 1 (very poor) to 5 (very good).

3.3 Data analysis methods

The data collected were analysed using the Statistical Package for Social Science (SPSS) and SEM using the AMOS version 23.0 software. Factor analysis (FA) used in order to further examine the measurement items used in the present study. According to the Tabachnick and Fidell (2007, p.26) factor analysis is best way to understand the underlying structure about particular theory and its variables in analysis. Usually two techniques of factor analysis was used to discover the variable of interest from the set of coherent subsets that are relatively independent from each other: exploratory factor analysis (EFA), and confirmatory factor analysis (CFA) (Hair et al., 2006; Tabachnick & Fidell, 2007). The SEM is a statistical methodology that takes a confirmatory (i.e., hypothesis-testing) approach to the analysis of a structural theory bearing on some phenomenon (Barbera, 2010). It covers two important aspects: (a) the casual process represents series of structural equation; and (b) these relationships can be modeled pictorially.

IV. Results

4.1 Measurement model

The 42 items representing the three first-order SHRM constructs were subject to confirmatory factor analysis (CFA) as a required step for testing the relationship of the manifest items with their respective latent constructs (Hair et al., 2010). The results indicated that all the values were within the acceptable ranges except for the standard errors. In addition, the analysis was also conducted with SHRM being measured as a second-order construct. The overall Cronbach's alpha was 0.872, indicating a good reliability.

The measurement model was tested in two stages. In the first stage, all measurement models were investigated individually with the latent constructs of ability enhancement practices, motivation enhancement practices, opportunity enhancement practices, employee retention and organisational performance. In the second stage, all measurement models were analysed as one model. If the measurement model fit indices (GFI, AGFI, CFI TLI and RMSEA) are deemed as not fit with the recommended values, then the measurement model would be reanalysed (Hair et al., 2010; Kline, 2005).

The fit indices indicated a poor fit (AGFI, GFI, CFI, TLI and GFI < 0.9; RMSEA > 0.08) in the initial measurement model for overall structure. The modification indices showed that the final model can be improved by allowing correlation of the items PE4 and PE5, PE6 and PE5, SHO9 and SHO8, SHM10 and SHM9, SHM10 and SHM8, SHM7 and SHM5, SHM5 and SHM3, SHA11 and SHA10, as well as RT3 and RT2.

Since the results of factor analysis showed that the factor weights of the items were higher than 0.5, the continuous analysis of the fit of the overall model primarily evaluated the extreme values indicated by the modification indices and demonstrated the connection path (co-variance). The connection paths fulfilled basic requirement that the regression arrows should be drawn between errors connected to the same factor (Gaskin, 2012) after the continuous repetitive confirmation processed through the applicable fit of the final overall measurement model for the framework. The final measurement model fit indices are presented in Table 3 where all fit indices achieved the recommended levels.

Table 2: Results of the Final Measurement Model

Fit indices	Accepted value	Results
Chi square/df	<3	2.049
AGFI	>0.9	0.759
GFI	>0.9	0.792
CFI	>0.9	0.874
TLI	>0.9	0.858
RMSEA	<0.08	0.066
P-value	>0.000	0.005

The co-variances of the final measurement model are presented in Table 4. The assessment for unidimensionality of the final measurement model, as well as the further development of the final measurement model examining the co-variances of the final measurement model demonstrated that there were strong and positive relationships between employee retention and bank performance, as well as between SHRM practices and employee retention and between SHRM practices and bank performance. All the co-variances in the final measurement model have high loadings (0.5) and are statistically significant (p < 0.05). In the next stage, all measurement models were tested together to check the model fitness, as well as to address the issues with regard to validity and reliability.

Table 4: Co-Variates of the Final Measurement Model

			Estimate	S.E.	C.R.	P	Correlation
RT	<-->	PE	0.320	0.051	5.957	***	0.714
SHRM	<-->	PE	0.271	0.046	5.958	***	0.678
SHRM	<-->	RT	0.314	0.059	5.522	***	0.718

4.2 Convergent validity

Convergent validity refers to the amount of shared variation amongst items of the same constructs. It also refers to the amount of correlation amongst the items of a construct. Convergent validity of the construct can be assessed using average variance extracted (AVE), item loadings and composite reliabilities of the construct. The AVE is the percentage of variation explained by the items in a construct. The threshold value of AVE is above 0.50. Since the values of AVE for all the constructs were more than 0.50 (Table 5), all the constructs have adequate convergent validity. In addition, the threshold value of the composite reliability should be above 0.70 (Gaskin, 2012). Table 4 also shows that all the constructs have sufficient reliability, ranging from 0.810 to 0.961. Therefore, the current study does not violate the convergent validity of the constructs.

Table 5: Results of Convergent Validity Analysis

Constructs	AVE	CR
SHRM	0.943	0.711
Employee retention	0.810	0.760
Organisational performance	0.961	0.762

4.3 Discriminant validity

Table 6 shows the squared inter-construct correlation of each variable. The results showed that all of the constructs have adequate discriminant validity as the square root of average variance extracted was greater than the inter-construct correlation of each variable and that the values of inter-construct were less than 0.85.

Table 6: Results of Discriminant Validity Analysis

Construct	SHRM	RT	PE
SHRM	0.843		
Employee retention	0.823	0.707	
Organisational performance	0.664	0.838	0.842

4.4 Hypotheses testing

The final estimated model, with standardised path coefficients, is presented in Figure 1. Figure 1 indicates that the results showed a significant model fit [chi-square for this model was $\chi^2=294.121$, $df=177$, $CMIN/DF=1.662$ (it must be <3), $RMR=0.050$ (it must be near to 0), $GFI=0.901$ (less than 1 shows a good fit), $AGFI=0.871$ (close to 1 shows a perfect fit), $TLI=0.933$ (near to 1), $CFI=0.944$ (near to 1 to show a perfect fit) and $RMSEA=0.053$]. Thus, all the fitness statistics indicated an excellent fit to the overall model.

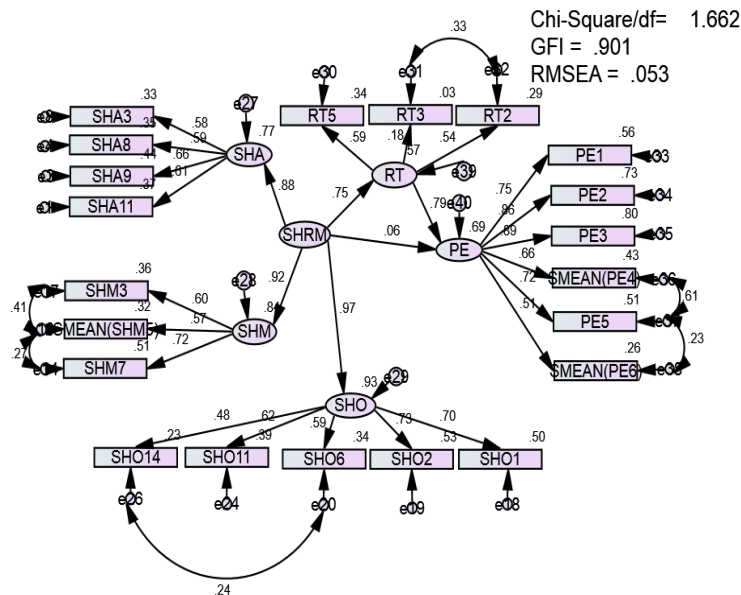


Figure 1: Results of Structural Equation Modelling

The first hypothesis states that SHRM practices significantly impact on organisational performance of the banking sector in Sri Lanka. Table 7 shows that the path of $SHRM \rightarrow$ organisational performance has a p-value of 0.810, which was more than 0.05. Thus, H1 was not accepted. SHRM practices have no significant impact on organisational performance.

Table 7: Results of Hypothesis Testing

			Estimate	S.E.	C.R.	P	Label
RT	<---	SHRM	.692	.121	5.728	***	Significant
PE	<---	SHRM	.055	.227	.241	.810	Not significant
PE	<---	RT	.813	.316	2.574	.010	Significant

The second hypothesis indicates that SHRM practices are significantly associated with employee retention behaviour in the banking sector in Sri Lanka.

As shown in Table 7, the path coefficient of strategic human resource management practices-and employee retention in the proposed final model is positive and significant ($\beta = .827$, $p < .05$). Thus, H2 is supported by the data.

The third hypothesis states that employee retention behaviour significantly impacts on organisational performance of the banking sector in Sri Lanka. Table 7 shows that the path retention \rightarrow performance showed a p-value of 0.010, which was less than 0.05. hence, H3 was accepted. Employee retention behaviour significantly impacts on bank performance.

The fourth hypothesis states that employee retention significantly moderates the relationship between the SHRM practices and performance of the banking sector in Sri Lanka. In interpreting the analysis, employee retention was influenced by SHRM practices, giving a positive high standardisation coefficient but a low standardised coefficient on bank performance. The dependent variable of the structural model (direct effect), SHRM (path coefficient= 0.06) and retention (path coefficient= 0.79) were loaded onto the organisational performance factor. The employee retention indicator (direct effect) and SHRM (path coefficient= 0.75) was loaded onto the employee retention factor. On the other hand, the indirect effect of independent variable through employee retention (0.59) was loaded onto the organisational performance factor. Table 8 shows the comparisons between direct and indirect effects and the ratio effects. When the indirect effect with the direct effect were compared, the retention factor was high in direct effect but the SHRM variable showed a high indirect effect. However, after standardisation of the direct effect and indirect effect coefficients, the ratio amongst the standardisation synthesis effect was up to 90.8%. Since there is a difference when the ratio is around 90% (Atsuko and Muta, 2006), it can be implied that the indirect effect influenced the organisational performance function. Thus, H4 was accepted. Employee retention is a significant mediator in the relationship between SHRM practices and organisational performance.

Table 8: Direct and Indirect Coefficients

Standardised coefficients	SHRM	RT
Direct effect	.06(9.19%)	.79(57.14%)
Indirect effect	.5925(90.8%)	.5925(42.85%)
Total effect	.6525(100%)	1.3825(100%)

Bold font indicates high values of standardization coefficients.

V. Discussion and Implications

In this study, a hypothetical model of cause and effect, which schematises influential factors for organisational performance, was developed. Specifically, the crucial factor in the SHRM-performance relationship is how SHRM practices shape discretionary behaviour, i.e. the choices people often make about the way their work is done, which are neither expected nor required, and therefore cannot officially rewarded or punished by the organisation for their presence or absence, which is translated into improved organisational performance (Katou, 2008; Purcel et al. 2003;). However, authors such as Gardner, Moynihan, Park and Wright (2001) and Purcell and Hutchinson (2007) argue that in the HRM-performance causal chain, it is not HRM outcomes that affect organisational performance, but may exist a serial causation from employee behaviour such as retention which finally affects organisational performance. This study has provided verification that employee retention behaviour simultaneously affects organisational performance (Pauwe and Richardson, 1997). Thus, in order to improve organisational performance, the levels of retention behaviour should be improved by introducing SHRM using ability enhancement, i.e. specific training for employees in the bank and modified the way their work is done.

The operational model in this study advocates that SHRM practices directly and positively influenced retention behaviour of employees in the banking industry, retention behaviour directly and positively influenced organisational performance and SHRM indirectly significantly and positively affects to improve organisational performance.

This study has a number of clear implications for both managers and decision makers. Realising that retention strategies and SHRM practices are not mutually independent, banks should develop and continue effective SHRM practices with respect to the retention strategies they follow. To achieve this, banks should have HRM departments and representation of these departments at the board level (Pauwe and Richardson, 1997).

VI. Conclusion and Future Research Directions

The study has made some important contributions. It tests theoretical assumptions in the context of a developing economy and provides support for the perspective that indirect relationship between SHRM practices and organisational performance exists, especially with employee retention acting as a mediator.

The conclusions above, nonetheless, should be treated with caution. This study did not focus on the effects of moderating factors such as demographics. Since there might be single responses from each banking institution, respondent bias is likely to occur. In addition, testing on the moderating effects of business strategies (cost, innovation and quality) may also yield interesting results.

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