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Employee Engagement as a Strategic Capability in SMEs: A Theoretical Perspective on Municipal Enterprises

Zapojenie zamestnancov ako strategická schopnosť v malých a stredných podnikoch: Teoretická perspektíva na mestské podniky

Rabel B. Catayoc ^{a*}

^aMindanao State University – Iligan Institute of Technology (MSU-IIT), Philippines, ORCID: <https://orcid.org/0000-0003-0630-8965>

Abstract: Employee engagement is well-studied in large corporations, yet its theoretical application to small and medium-sized enterprises (SMEs)—particularly those operating in municipal economies—remains underexplored. This paper addresses a gap in the strategic human resource management (SHRM) literature by contextualizing engagement as a strategic capability for municipal SMEs. The primary aim is to develop a conceptual framework that links employee engagement to six SHRM domains within municipal SMEs. Secondary aims include the articulation of mediating and moderating relationships that add depth to engagement theory in resource-constrained environments. This is a theoretical review that synthesizes foundational literature across engagement and HRM domains. Key theories include Herzberg’s Two-Factor Theory, Transformational Leadership Theory, Self-Determination Theory, and Organizational Climate Theory. The framework was developed through thematic integration of peer-reviewed sources relevant to SMEs, engagement, and local governance. The model proposes that employee engagement is driven by six antecedents: work itself, compensation and benefits, work environment, leadership, personal growth, and opportunities to contribute. It introduces two additional propositions: (1) the mediating role of work environment between leadership and engagement, and (2) the moderating role of growth opportunities in the compensation–engagement link. As a conceptual paper, empirical validation is needed. Future studies should test the model using quantitative or mixed methods across varied municipal settings. The framework provides guidance for SME managers and

* Corresponding author: Rabel B. Catayoc

Author's address: Andres Bonifacio Avenue, Tibanga, 9200 Iligan City, Philippines

e-mail: rabel.catayoc@g.msuiit.edu.ph

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municipal policymakers to adopt scalable, low-cost engagement strategies aligned with local economic development goals. This paper advances SME-focused SHRM theory by integrating engagement constructs into a localized, strategic framework. It offers value to researchers, practitioners, and policymakers aiming to strengthen SME resilience and workforce sustainability in municipal economies.

Key words: *Employee Engagement, Strategic Human Resource Management (SHRM), Small and Medium-Sized Enterprises (SMEs), Municipal Economies, Work Environment*

JEL Classification: J45. M54.

Introduction

In the rapidly evolving economic landscape, small and medium-sized enterprises (SMEs) have emerged as critical drivers of employment, innovation, and economic development within municipalities. However, despite their pivotal role in local economies, SMEs often face persistent and complex human resource management (HRM) challenges. Employee engagement, a fundamental HRM construct, has increasingly been recognized as crucial for achieving higher productivity, reducing turnover, and enhancing organizational resilience. However, while employee engagement has been extensively studied in large corporations, its explicit relevance, applicability, and theoretical underpinnings in SMEs—particularly those situated within municipal or local government contexts—remain relatively under-examined in scholarly research.

Municipalities, with unique local governance structures and economic dynamics, present distinctive challenges and opportunities for SMEs. The strategic management of human resources within these local contexts necessitates nuanced understanding and specialized approaches to employee engagement. SMEs operating within municipalities often contend with limited resources, regulatory frameworks, and localized economic pressures, all of which influence their capacity to effectively engage employees. Therefore, a clear, theoretically informed perspective is necessary to guide SMEs in aligning strategic human resource management (SHRM) practices explicitly to foster sustained employee engagement.

While existing literature recognizes employee engagement as vital for organizational performance, few studies explicitly articulate how SME specific contexts, such as municipalities, shape the implementation and effectiveness of engagement strategies. Prior studies have largely focused on broad organizational contexts, predominantly emphasizing

larger firms operating within corporate environments. Consequently, there is a theoretical and practical gap regarding how municipalities influence SMEs' HRM strategies, particularly concerning critical engagement domains such as job design, leadership, compensation, work environments, opportunities for personal growth, and avenues for employee participation.

To explicitly address these gaps, this paper systematically synthesizes existing theoretical insights on employee engagement within SMEs situated in municipal contexts. Drawing explicitly upon a comprehensive review of relevant literature, the paper seeks to offer clear theoretical contributions through the development of a novel conceptual framework. Specifically, the study aims to articulate explicit theoretical propositions linking core SHRM practices—such as work itself, compensation and benefits, work environment, leadership, opportunities for personal growth, and employee contributions—to heightened employee engagement in SMEs operating within municipal structures.

The theoretical contributions of this paper are explicitly twofold. First, by synthesizing existing scholarship within an explicitly municipal SME context, the paper advances theoretical understanding of the unique factors shaping employee engagement strategies in smaller, locally governed enterprises. Second, the proposed conceptual framework offers clear theoretical pathways, testable propositions, and practical guidelines to assist SME owners, HR practitioners, and municipal policymakers in strategically managing human resources to enhance engagement explicitly.

Practically, this theoretical perspective provides municipal SME leaders with explicit insights and recommendations grounded in robust theoretical foundations. Municipal decision-makers can leverage these insights to inform local policy development, capacity-building initiatives, and resource allocation, ultimately fostering thriving and resilient local SME sectors.

In the sections that follow, the paper explicitly presents a structured thematic synthesis of relevant theoretical literature on HRM and employee engagement strategies in SMEs. Subsequently, an explicit conceptual framework, clearly developed from identified themes and theoretical foundations, is introduced. This is followed by explicit theoretical discussions, implications, and clearly articulated recommendations designed specifically to guide future research and practical HRM implementation within municipal SMEs.

1 Theoretical foundations

Understanding employee engagement within the unique operational contexts of municipal SMEs requires anchoring the discussion in both classical and emerging theoretical frameworks in human resource management (HRM). This section laid the foundation for the conceptual

exploration of engagement strategies by examining how established HRM theories—such as Strategic Human Resource Management (SHRM), the Resource-Based View (RBV), and relevant psychological motivation theories—apply to the specific realities of small and medium-sized enterprises operating in municipalities. Given the limitations in formal HR infrastructure and constrained resources common in SMEs, especially those embedded in local economies, theoretical adaptation is essential. This section is structured into two main parts: (1) a review of Human Resource Management in SMEs, emphasizing its strategic relevance in local development and enterprise resilience, and (2) a synthesis of six thematic domains of employee engagement derived from the literature—namely, work itself, compensation and benefits, work environment, leadership, opportunities for personal growth, and opportunities to contribute. Together, these foundations serve as the analytical scaffolding for the conceptual framework presented in the succeeding section.

1.1 Human Resource Management in SMEs

Small and medium-sized enterprises (SMEs) are essential actors in the socio-economic landscape of municipalities. They contribute significantly to local employment, promote entrepreneurship, and support inclusive economic development. However, despite their importance, SMEs often operate under conditions of resource scarcity, informal management structures, and limited access to capital, technology, and professional human resources (Heneman & Tansky, 2006; Drumm, 1994). These challenges are especially pronounced in municipal contexts, where SMEs typically serve niche markets, rely on community-based networks, and are subject to localized policy environments.

Human Resource Management (HRM) in SMEs, particularly within municipalities, is often viewed as an auxiliary function rather than a strategic one (Machado, 2013). Many SME owner-managers consider HR tasks such as recruitment, performance evaluation, and compensation administration to be intuitive or secondary to the core business (Woodhams & Lupton, 2006). However, growing evidence contradicts this perception. Strategic Human Resource Management (SHRM) scholars argue that even in small firms, aligning HR practices with organizational goals yields significant performance benefits (Brewster & Harris, 1999; Wright & McMahan, 1992).

Studies have demonstrated that SMEs implementing strategic HRM—particularly in the areas of employee engagement, development, and retention—experience higher levels of productivity, innovation, and competitive resilience (Trunk Širca et al., 2013; Bhatt & Reddy, 2011). The Resource-Based View (RBV) (Barney, 1991) supports this, emphasizing that human

capital—when effectively harnessed—constitutes a sustainable competitive advantage. SMEs that can attract, retain, and engage competent employees through context-sensitive HRM are more likely to survive and thrive even amid competitive municipal economies.

Furthermore, municipal-level SMEs are influenced by local government programs, regulatory compliance mandates, and the availability of workforce support systems. The ASEAN Strategic Action Plan for SME Development (2016–2025) explicitly includes “*human capital development*” as a core objective, underscoring the policy-level recognition that people management in SMEs is pivotal to regional growth (ASEAN Secretariat, 2015). As such, SMEs must move beyond the view that HRM is only for large firms and instead develop strategies that leverage local talent and foster high employee engagement.

In summary, HRM in SMEs operating in municipalities is not merely a set of administrative tasks—it is a strategic function with clear implications for workforce performance, organizational success, and local economic resilience. The following sub-sections detail key engagement strategies emerging from this HRM foundation.

1.2 Employee Engagement Strategies in SMEs

Employee engagement is defined as the degree to which employees are emotionally, cognitively, and behaviourally invested in their work roles and the organization (Kahn, 1990). In SMEs, engagement is particularly critical because employee performance often has a direct and visible impact on business success. Given SMEs’ smaller workforce and closer employee-manager interactions, HR practices that promote engagement are both highly impactful and practically achievable—even in resource-constrained municipal settings.

The following six dimensions of engagement strategy are synthesized from literature and represent strategic HRM domains that influence employee engagement in SMEs:

Work Itself. The design and intrinsic characteristics of a job significantly affect employee engagement. According to Herzberg’s Two-Factor Theory (1959), motivators such as the nature of the work, responsibility, and recognition drive satisfaction and engagement. This is complemented by the Job Characteristics Model (Hackman & Oldham, 1976), which posits that jobs high in autonomy, task identity, skill variety, and feedback foster internal motivation and meaningfulness. In SMEs, especially within municipal settings, roles tend to be multi-faceted due to lean staffing structures. Employees often perform a wide range of functions, allowing for skill use and autonomy (Armstrong & Taylor, 2014). When employees are involved in meaningful work with visible outcomes, they tend to identify more strongly with organizational goals, increasing cognitive and emotional engagement (Robertson-Smith & Markwick, 2009).

The emotional dimension of engagement is also impacted by how jobs are structured. Employees who receive constructive feedback and are recognized for contributions report higher job satisfaction (Lickman, 1993; Tontini & Jaime, 2010). Conversely, monotonous tasks and unclear re-sponsibilities lead to boredom, frustration, and disengagement (Dasgupta et al., 2014). A high degree of task significance and feedback creates a virtuous cycle that reinforces employee performance and psychological commitment.

Compensation and Benefits (CompBen). Compensation is a foundational element of engagement strategy, particularly in resource-limited SMEs where employee expectations must be carefully managed. Compensation influences employees' sense of fairness, self-worth, and motivation—elements central to Equity Theory (Adams, 1965) and Expectancy Theory (Vroom, 1964). Even when SMEs cannot match corporate salary scales, strategic compensation practices—such as performance bonuses, flexible work arrangements, and non-monetary incentives—can increase perceived value and fairness (Bhatt & Reddy, 2011; Madhani, 2012). In the Philippine SME context, adherence to national labour standards plays a significant role. Republic Act No. 9178 (BMBE Law) allows for exemption from minimum wage requirements but mandates the provision of social protection benefits such as SSS, PhilHealth, and PAG-IBIG. This legal framework creates both obligations and opportunities: SMEs that comply build trust and legitimacy, while those that exceed the minimum can use compensation strategically as an engagement tool (Nyantakyi, 2016; Hicks, 1963). Maslow's Hierarchy of Needs (1954) also supports the role of compensation in fulfilling physiological and safety needs, which must be satisfied before higher-order engagement can occur. Milikić & Janićijević (2009) argue that both monetary and non-monetary rewards (e.g., recognition, professional development) play a complementary role in engaging employees. Compensation strategies that are transparent, equitable, and performance-linked contribute to employee retention and commitment.

Work Environment (WorkEnvi). The work environment encompasses the psychological, social, and physical conditions in which employees operate. SMEs that cultivate a positive, inclusive, and psychologically safe environment tend to experience higher levels of employee engagement (Daley, 2012). Organizational Climate Theory suggests that shared perceptions of support, fairness, and innovation influence motivation and discretionary effort (Gordon & Jack, 2010). A conducive work environment in SMEs includes open communication, healthy interpersonal relationships, and low levels of job-related stress. Studies have shown that such environments not only improve job satisfaction but also stimulate creativity and innovation (Fillis, 2005; Allen, 2015). For SMEs that cannot afford formal R&D structures, an engaging work environment serves as a substitute innovation mechanism. Kelloway et al. (2001)

highlight that work environments that encourage collaboration and problem-solving enhance employee self-efficacy and engagement. In municipalities, local SMEs must also respond to community expectations and labour norms, which influence perceptions of legitimacy and ethical conduct. SMEs that align their internal environment with external social expectations benefit from stronger employee and customer loyalty (Ministerråd, 2005; Kongtip et al., 2008).

Leadership. Leadership significantly shapes employee engagement in SMEs. In most small firms, the founder or owner-manager directly influences organizational values, workplace culture, and employee motivation. According to Transformational Leadership Theory (Bass, 1985), leaders who inspire, support, and challenge employees foster higher levels of commitment and creativity. Such leadership is characterized by individualized consideration, intellectual stimulation, and visionary communication. Research confirms that transformational and strategic leadership styles are associated with higher engagement, particularly in SMEs where proximity to leadership increases the impact of behaviour modelling (Obiwuru et al., 2011; Muenjohn & McMurray, 2016). Leaders who involve employees in goal setting, recognize contributions, and encourage autonomy promote emotional and psychological investment in the organization. In addition, Strategic Leadership Theory (Boal & Hooijberg, 2001) emphasizes aligning people systems with strategy. In municipal SMEs, this alignment is critical for navigating community dynamics, complying with local policies, and leveraging limited resources. Leaders who demonstrate strategic vision and personal integrity are more likely to sustain employee engagement over time (Posner & Kouzes, 2012; Matzler et al., 2008).

Opportunities for Personal Growth. Opportunities for growth, learning, and development are essential drivers of sustained engagement. Employees who feel their skills are being developed and that their career trajectory is supported are more likely to remain committed (Černe et al., 2012; Renkema, 2006). Self-Determination Theory (Deci & Ryan, 1985) assumes that fulfilment of psychological needs for competence, autonomy, and relatedness enhances intrinsic motivation and performance. In SMEs, formal training programs may be limited; however, on-the-job learning, mentoring, job rotation, and involvement in new projects can serve as effective growth mechanisms. A culture that values continuous learning—encouraged by leadership and supported by practice—fosters loyalty and discretionary effort (Nguyen & Mohamed, 2011; Aminu & Shariff, 2014). In contrast, cultures of favouritism or nepotism (ascriptive cultures) discourage merit-based advancement and undermine engagement. Csath (2012) notes that such environments lead to disillusionment, reduced innovation, and disengagement. SMEs committed to equitable and transparent development opportunities benefit from increased employee capability and retention.

Opportunities to Contribute. The ability to contribute ideas, participate in decisions, and express concerns fosters a sense of ownership and belonging. Theories of employee voice (Morrison, 2011) and participative management (Likert, 1961) argue that organizations that involve employees in shaping work processes build stronger psychological contracts. In SMEs, communication structures are typically flatter, enabling more direct feedback loops. Employees working in such environments are more likely to engage proactively and align their goals with those of the enterprise (Forth et al., 2013; Woolfson et al., 2008). Participation also enhances problem-solving, innovation, and morale. SMEs that empower their workforce through regular consultations, suggestion systems, and feedback mechanisms create inclusive cultures that improve performance and reduce voluntary turnover (Bae et al., 2011; Oeij et al., 2014). These practices are especially relevant in municipalities, where SMEs often rely on informal labor markets and community ties to build business resilience.

2 Conceptual Framework and Development

Employee engagement is a multidimensional construct influenced by an array of strategic human resource management (SHRM) practices. Drawing on the theoretical synthesis presented in Section 2.3 (Fig. 1), this framework proposes a conceptual model that positions six SHRM domains as antecedents of employee engagement within the context of municipal SMEs. The framework addresses a critical gap in the HRM literature by integrating both foundational and context-specific engagement factors into a unified theoretical perspective, offering practical pathways for future empirical testing.

2.1 Framework Constructs and Theoretical Basis

This conceptual framework comprises seven constructs—six independent variables representing SHRM domains and one dependent variable representing employee engagement. Each construct is grounded in a specific body of HRM theory and adapted to the SME-municipal context.

1. *Work Itself.* This construct refers to the intrinsic characteristics of the job, such as autonomy, task identity, significance, and feedback. It is grounded in Herzberg's Two-Factor Theory (1959) and the Job Characteristics Model (Hackman & Oldham, 1976), both of which suggest that well-designed jobs enhance intrinsic motivation and engagement.
2. *Compensation and Benefits.* This domain encompasses both monetary and non-monetary rewards, perceived fairness of pay structures, and the alignment between effort and reward.

It draws from Equity Theory (Adams, 1965) and Expectancy Theory (Vroom, 1964), which posit that perceived fairness and motivation are directly related to engagement outcomes.

3. *Work Environment*. Refers to the physical, psychological, and social conditions in which employees work. According to Organizational Climate Theory (James & Jones, 1974), a supportive work environment increases trust, safety, and morale—all of which are antecedents of engagement.
4. *Leadership*. This includes transformational, participative, and strategic leadership behaviours. Transformational Leadership Theory (Bass, 1985) suggests that leaders who inspire, support, and develop employees are instrumental in building engagement through emotional and cognitive alignment.
5. *Opportunities for Personal Growth*. Reflects the presence of learning, mentoring, career advancement, and professional development within the organization. This is supported by Self-Determination Theory (Deci & Ryan, 1985), which links autonomy, competence, and relatedness to intrinsic motivation and engagement.
6. *Opportunities to Contribute*. Captures employee involvement in decision-making, suggestion systems, and opportunities to influence workplace policies. Employee Voice Theory (Morrison, 2011) and Participative Management Theory (Likert, 1961) both posit that when employees feel their input is valued, their sense of ownership and engagement increases.
7. *Employee Engagement*. Defined as the extent to which employees are emotionally, cognitively, and behaviourally committed to their organization and its objectives (Kahn, 1990). It is the primary dependent variable in this framework and serves as the outcome of effective SHRM.

2.2 Theoretical Propositions with Integration Justification

Based on the relationships among the above constructs, I propose the following eight theoretical propositions. Each is clearly grounded in the literature and theory reviewed in Section 1. Building on Herzberg's Two-Factor Theory and the Job Characteristics Model (Hackman & Oldham, 1976), job design elements such as autonomy, feedback, and task significance are believed to foster psychological ownership and intrinsic motivation. These elements enable employees to find meaning in their work and apply their skills effectively—conditions repeatedly associated with higher levels of engagement.

1. P1: Job design characterized by autonomy, feedback, and task significance positively influences employee engagement in SMEs within municipal contexts. Building on

Herzberg's Two-Factor Theory and the Job Characteristics Model (Hackman & Oldham, 1976), job design elements such as autonomy, feedback, and task significance are believed to foster psychological ownership and intrinsic motivation. These elements enable employees to find meaning in their work and apply their skills effectively—conditions repeatedly associated with higher levels of engagement.

2. P2: Perceived fairness and strategic administration of compensation and benefits positively influence employee engagement. According to Equity Theory (Adams, 1965) and Expectancy Theory (Vroom, 1964), employees are more motivated and engaged when they perceive that rewards are fair, attainable, and aligned with their effort. In the SME context—where resource limitations often create disparities in compensation—strategically administered benefits and transparent reward systems become critical to sustaining employee morale and discretionary effort.
3. P3: A supportive, inclusive, and psychologically safe work environment positively influences employee engagement. Organizational Climate Theory (James & Jones, 1974) posits that the social and psychological environment of a workplace influences employees' willingness to invest effort and remain committed. A supportive and psychologically safe environment fosters trust, reduces anxiety, and encourages collaboration. In SMEs—where close-knit teams and informality are prevalent—these climate factors are amplified, making workplace atmosphere a vital engagement determinant.
4. P4: Transformational and strategic leadership behaviours positively influence employee engagement in municipal SMEs. Transformational Leadership Theory (Bass, 1985) argues that leaders who articulate a clear vision, inspire trust, and support employee development are key drivers of engagement. Particularly in SMEs, where leaders often work in close proximity to their teams, leadership behaviour directly affects motivation, organizational identification, and job satisfaction. Strategic leadership aligned with local community values further reinforces engagement by connecting employee work to broader municipal goals.
5. P5: Access to personal and professional development opportunities positively influences employee engagement. Self-Determination Theory (Deci & Ryan, 1985) highlights that autonomy, competence, and relatedness are central to intrinsic motivation. In SMEs, providing access to training, mentoring, and developmental tasks—despite limited resources—helps employees see pathways for growth. These opportunities reinforce their sense of purpose and potential, fostering sustained engagement and reducing turnover intentions.

6. P6: Opportunities to participate in decision-making and voice opinions positively influence employee engagement. Empirical studies in leadership and engagement (e.g., Kelloway et al., 2001) have demonstrated that leadership indirectly influences engagement through the shaping of the organizational environment. Leaders who model inclusive, ethical, and communicative behaviours foster a culture of psychological safety, cooperation, and respect—conditions that mediate the translation of leadership into sustained employee commitment.
7. P7: The positive relationship between leadership and employee engagement is mediated by the quality of the work environment. Participative Management Theory (Likert, 1961) and Employee Voice Theory (Morrison, 2011) suggest that when employees are involved in decision-making and their ideas are taken seriously, they experience greater psychological ownership and loyalty to the organization. For SMEs in municipal settings, creating spaces for employee input—even informally—cultivates a culture of inclusion and shared responsibility.
8. P8: The relationship between compensation and engagement is moderated by perceived opportunities for growth. In SMEs where financial resources are limited, compensation alone may not suffice in retaining talent. However, if employees perceive clear growth pathways—such as promotion opportunities, skill development, or increased responsibilities—their engagement remains high even when monetary rewards are modest. This aligns with moderation logic in HRM literature, where the strength of one variable's influence is shaped by another.

2.3 Conceptual Framework Diagram

This conceptual framework models the multi-dimensional drivers of employee engagement within Small and Medium-Sized Enterprises (SMEs), particularly those operating in municipal or local economies. It is theoretically grounded in Strategic Human Resource Management (SHRM) and the Resource Based View (RBV) and integrates classical psychological and organizational behaviour theories to explain how internal HR mechanisms drive engagement outcomes.

The framework outlines six core HRM domains with direct paths to the outcome variable: Employee Engagement. Each represents a strategic lever available to SME leaders and HR practitioners.

1. *Work Itself* – Encompassing job design attributes like autonomy, task significance, and feedback (Herzberg; Hackman & Oldham), this domain is foundational to intrinsic motivation and psychological meaningfulness.
2. *Compensation & Benefits* – Includes both financial and non-financial reward systems. Rooted in Equity Theory and Expectancy Theory, it reflects employees perceived fairness and anticipated effort-reward payoff.
3. *Work Environment* – Refers to the emotional, psychological, and social climate, particularly around collaboration, safety, and support. The Organizational Climate Theory supports its link to sustained engagement.
4. *Leadership* – Focuses on transformational and strategic leadership behaviours (Bass; Boal & Hooijberg), which shape organizational culture and drive team-level morale, commitment, and direction.
5. *Personal Growth* – Includes learning, mentoring, and internal mobility. Grounded in Self-Determination Theory, this domain addresses the innate need for competence and continuous development.
6. *Opportunities to Contribute* – Captures mechanisms for employee voice and participation in decision-making, fostering ownership and alignment with organizational goals.

All six are shown as individually and collectively contributing to Employee Engagement (emotional, cognitive, and behavioural dimensions per Kahn, 1990).

Mediating Effect

Work Environment as a Mediator between Leadership and Engagement. Leadership does not only influence engagement directly—it also shapes the work environment, which in turn facilitates or inhibits engagement. This mediating pathway suggests that effective leadership improves environmental factors such as psychological safety and collaboration, which subsequently enhance engagement. This aligns with research from Kelloway et al. (2001), asserting that leaders create the climate that enables discretionary effort.

Moderating Effect

Personal Growth as a Moderator between Compensation & Benefits and Engagement. This interaction suggests that the effect of compensation on engagement is stronger when opportunities for personal growth are present. When employees perceive chances to develop and grow within the SME—even if pay is modest—they are more likely to respond positively

to compensation systems. This moderation reflects conditional engagement and highlights that monetary incentives alone may not suffice without development pathways.

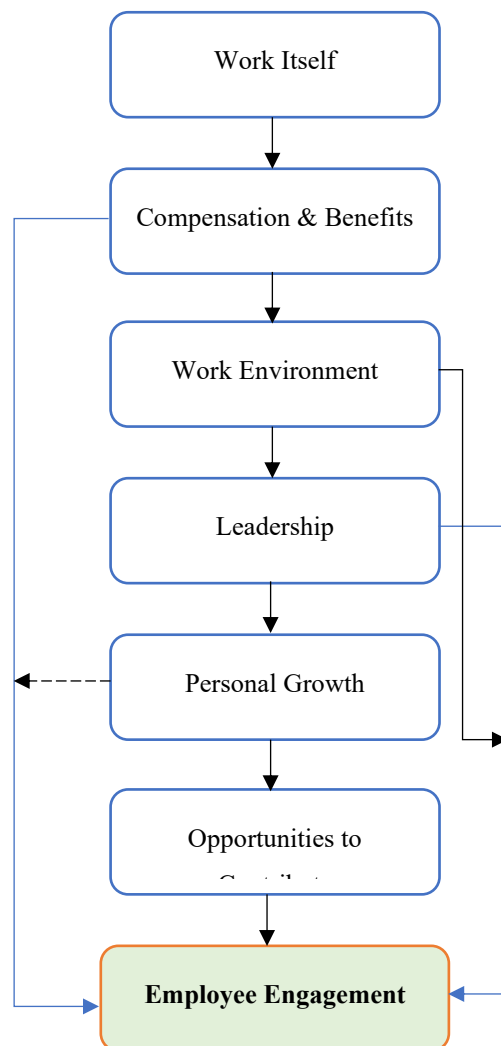


Figure 1 Conceptual Framework: SHRM-Based Employee Engagement Model in Municipal SMEs

3 Summary and Contribution Framework

This conceptual framework makes four core theoretical contributions:

1. Integration of HRM and Engagement Theories in the SME Context. While most engagement models stem from large-firm studies, this framework contextualizes SHRM for small, resource-constrained firms in municipal settings.
2. Multidimensional Perspective on Engagement Drivers. By integrating six distinct SHRM domains, the framework captures the complexity of engagement and its antecedents.
3. Novel Propositions Linking Moderation and Mediation Effects. The inclusion of P7 and P8 introduces nuanced relationships, inviting empirical testing using mediation/moderation models.

4. **Practical Relevance for Policymakers and Entrepreneurs.** By aligning HRM strategies with employee engagement outcomes, the framework informs both firm-level strategy and local policy design in support of SME development.

This model lays the groundwork for future empirical validation through structural equation modeling (SEM), case studies, narratology, or mixed methods research across varied municipal economies.

4 Discussion

This study proposed an integrated conceptual framework for understanding and enhancing employee engagement in small and medium-sized enterprises (SMEs) operating in municipal settings. The model draws on established human resource management (HRM) and organizational behaviour theories, extending them through a context-sensitive synthesis of six strategic HRM dimensions: work itself, compensation and benefits, work environment, leadership, opportunities for personal growth, and opportunities to contribute. The proposed relationships provide a comprehensive basis for both theoretical advancement and practical intervention. This section discusses the implications of the model in three dimensions: theoretical contribution, practical application, and future research opportunities..

4.1 Theoretical Implications

The proposed conceptual model offers several important theoretical contributions to the fields of HRM, organizational behaviour, and SME development.

1. *Contextualizing HRM and Engagement Theories for SMEs.* Mainstream HRM theories—such as Strategic HRM, the Resource Based View (RBV), and employee engagement literature—have traditionally been validated in large organizations with formal HR departments and abundant resources. This model adapts these theories for SMEs by identifying how engagement can be strategically cultivated even in informal, resource-constrained, and locally embedded environments such as municipalities. It demonstrates that the same strategic logic of aligning HR practices with organizational objectives (Wright & McMahan, 1992) applies to SMEs, albeit through more flexible, relational, and contextually grounded mechanisms.
2. *Advancing Engagement Theory through SHRM Integration.* Most engagement literature isolates drivers such as leadership, job satisfaction, or psychological safety without integrating them into a strategic HRM framework. This model positions engagement as the result of intentional, interconnected HRM practices, thereby strengthening its theoretical

foundation. It brings engagement theory closer to the SHRM paradigm, offering a systems perspective that links practices to outcomes via mediating and moderating mechanisms (e.g., leadership–engagement through work environment; compensation–engagement moderated by growth opportunities).

3. *Expanding Construct Relationships*. The inclusion of mediating and moderating propositions (P7 and P8) adds complexity to existing theories by acknowledging that SHRM variables do not operate in isolation. For example, transformational leadership impacts engagement directly, but also indirectly by shaping the work environment. Similarly, while compensation is a known engagement driver, its efficacy in SMEs depends on whether growth opportunities are present. These theoretical extensions encourage future scholars to consider conditional effects in HRM research rather than assuming linear, direct relationships.
4. *Elevating Municipal-Level Analysis*. By focusing on SMEs embedded in municipal economies, the framework bridges the gap between micro-level HRM theory and meso-level economic development. The model implies that engagement strategies in SMEs may also contribute to community-level goals such as employment stability, social cohesion, and inclusive development. This multilevel insight positions employee engagement as both an organizational and a developmental concern.

4.2 Practical Implications

The framework provides actionable insights for SME owners, HR practitioners, and municipal policymakers. Each proposition yields a set of practical recommendations that can be implemented even in low-resource settings.

1. For SME Owners and Managers

- a. **Prioritize meaningful job design.** SMEs should structure jobs with autonomy, task variety, and regular feedback. Even when job roles are broad, aligning tasks with employee strengths enhances engagement and reduces burnout.
- b. **Use strategic compensation.** While financial constraints may limit salaries, SMEs can offer flexible benefits, recognition programs, and performance-linked incentives. Transparency in reward systems builds trust and motivates discretionary effort.
- c. **Foster a positive work environment.** Creating a culture of psychological safety, collaboration, and fairness does not require major investment. Open communication, conflict resolution mechanisms, and supportive supervision are low-cost, high-impact strategies.

- d. Lead with purpose and empathy. Owner-managers should adopt transformational leadership behaviours—setting a compelling vision, involving employees in decisions, and recognizing their contributions. Leadership development, even informally, can enhance workplace morale.
- e. Provide growth opportunities. Mentoring, cross-training, and involvement in new projects can substitute for formal training programs. Employees are more likely to stay in organizations where they see a future.
- f. Encourage participation and voice. SMEs should hold regular feedback sessions, idea-sharing meetings, or team huddles to allow employees to contribute insights. Participation increases ownership and engagement.

2. *For HR Practitioners in SMEs*

- a. Develop integrated HR policies even if informally documented.
- b. Map engagement strategies to business goals—e.g., link customer satisfaction metrics to team-based rewards.
- c. Monitor employee engagement through pulse surveys or informal interviews to capture issues early and adjust practices accordingly.

3. *For Municipal Policymakers and Development Agencies.* Municipal governments and local development bodies can use this framework to design programs that strengthen SME HR capabilities.

- a. Provide subsidized HRM training for SME managers, focusing on job design, leadership, and engagement practices.
- b. Establish HR support centres within local business development offices, offering templates and consulting services.
- c. Include employee engagement metrics in local business accreditation, support grants, or incentives.
- d. Create networks or hubs for SME leaders to share people management practices and innovations.

Such interventions align workforce development with broader goals of local economic stability, reducing employee turnover, increasing labour productivity, and strengthening the local tax base.

4.3 Future Research Directions

The conceptual framework invites empirical testing and refinement across different methodological approaches and contexts.

1. *Quantitative Hypothesis Testing.* Future studies should validate the eight propositions through empirical testing using structural equation modelling (SEM), path analysis, or hierarchical regression. Recommended hypotheses include:
 - a. H1: Job autonomy, feedback, and task identity are positively associated with employee engagement.
 - b. H2: Perceived fairness of compensation positively predicts employee engagement.
 - c. H3: A positive work environment mediates the relationship between leadership style and employee engagement.
 - d. H4: Opportunities for personal growth moderate the relationship between compensation and engagement.
2. *Survey Instrument Development.* Researchers may develop or adapt validated instruments for each construct. For example:
 - a. Work design: Job Diagnostic Survey (Hackman & Oldham, 1976)
 - b. Leadership: Multifactor Leadership Questionnaire (Bass & Avolio, 1995)
 - c. Engagement: Utrecht Work Engagement Scale (UWES)
 - d. Growth and voice opportunities: Custom scales contextualized for SMEsPilot testing in municipal SMEs will help ensure the reliability and validity of the instruments in localized contexts.
3. *Mixed Methods Studies.* Combining surveys with interviews or focus groups can reveal nuanced insights. For instance:
 - a. How do SME leaders interpret “engagement” in their daily practice?
 - b. What constraints do they face in implementing engagement strategies?
 - c. How do employees in rural vs. urban municipalities differ in their engagement expectations?Mixed methods approach also allow for exploration of sector-specific dynamics (e.g., tourism, agriculture, tech) within municipal economies.
4. *Comparative and Longitudinal Designs.* Comparative research across municipalities or between formal and informal SMEs can reveal structural and contextual moderators. Longitudinal studies would help identify whether engagement strategies sustain performance over time, particularly as firms scale or transition leadership. A possible title of a study could be “An integrative literature review of employee engagement and innovative behaviour: Revisiting the JD-Rmodel“ (Kwon, Kim, 2020).

This discussion reinforces the significance of integrating HRM theory with practical, scalable strategies for employee engagement in municipal SMEs. The conceptual model

developed in this study not only advances academic understanding of engagement antecedents in low-resource organizational settings but also provides a practical blueprint for enterprise resilience and inclusive local development. Future research that tests, refines, and localizes this framework will deepen its utility and further bridge the theory-practice gap in human resource management for development.

5 Conclusion

This theoretical paper developed a strategic, context-specific conceptual framework for understanding employee engagement in small and medium-sized enterprises (SMEs) situated within municipal economies. Drawing from key HRM and organizational behaviour theories—such as Herzberg’s Two-Factor Theory, the Job Characteristics Model, Transformational Leadership Theory, and Self-Determination Theory—this study identified six core strategic HRM domains that significantly influence employee engagement: the work itself, compensation and benefits, work environment, leadership, opportunities for personal growth, and opportunities to contribute.

At the centre of the model is the proposition that employee engagement is not merely a byproduct of isolated HR practices but a cumulative outcome of interrelated strategic decisions across these domains. Theoretical relationships were also extended through two higher-order propositions: (1) the mediating role of work environment in the leadership–engagement link, and (2) the moderating role of growth opportunities in the compensation–engagement relationship. These insights advance both engagement theory and SME-focused SHRM research by introducing a systems-thinking approach to people management in localized, resource-constrained business settings.

Practically, this framework holds significant implications for SME owner-managers. By treating engagement as a strategic lever rather than a passive outcome, they can foster resilient and high-performing teams—even without the scale or resources of large firms. Simple yet intentional practices—such as job enrichment, flexible rewards, collaborative environments, inclusive leadership, and mentoring—can yield significant engagement dividends. The relational nature of SMEs, particularly in municipalities, makes them well-suited to applying these principles, as decision-making is more agile and workplace culture is directly shaped by leadership behaviour.

For municipalities and local development agencies, this framework offers a roadmap for supporting SME growth not only through financial and infrastructural assistance but also through human capital development. Municipal governments can incentivize SMEs to adopt

HRM best practices, integrate en-gagement metrics into business accreditation programs, and provide training on leadership, compensa-tion planning, and workforce development. These institutional mechanisms strengthen not only indi-vidual firms but also the broader socio-economic fabric of municipalities—fostering employment sta-bility, social inclusion, and community resilience.

The theoretical model presented also opens new avenues for academic research. By synthesizing en-gagement literature into an integrative SHRM framework tailored to SMEs, this study provides a foun-dation for future empirical validation through structural equation modelling, comparative case stud-ies, or longitudinal tracking. The model's multidimensionality makes it adaptable to various sectors and geographic contexts, enabling localized research designs that respect the heterogeneity of SMEs.

In closing, the proposed framework repositions employee engagement as a strategic capability that can be designed, influenced, and sustained—even in the informal, resource-limited environments of municipal SMEs. By understanding and intentionally cultivating engagement through targeted HRM practices, SMEs can improve retention, productivity, and organizational resilience. Municipalities, in turn, benefit from more stable and motivated workforces that contribute to local development. The full potential of this framework lies in its application—not just as a model to be tested, but as a guide to be used in practice and policy to build people-cantered, sustainable local economies.

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