

# 1. Optimizing SMEs' Business Performance Through Human

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## Optimizing SMEs' Business Performance Through Human Capital Management

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### Abstract:

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Small medium enterprises (SMEs) provide the basic foundation for Indonesian economic and social development. SMEs employ a large number of the human capital and foster entrepreneurial side of individuals. Based on opportunity approach, SMEs can create high level of human capital and entrepreneurial competencies.

This study aimed at explained the relationship between human capital and entrepreneurial competencies on the SME business performance. Study was conducted on SME's in Central Java, Indonesia. Based on quantitative approach, this research used survey instrument by delivering questionnaire. The Statistical Package for Social Science (SPSS) was used to analyze the data.

The result showed the significant relationship between human capital, entrepreneurial competencies and SMEs performance. This suggests that SME entrepreneurs should give attention to learning activities. This study's findings contribute to SMEs literature and human capital theory.

**Keywords:** entrepreneurial competencies, human capital, SMEs, opportunity approach

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## 1. Introduction

Economic activity in many countries has experienced a significant change. Firstly, it was originally dominated by large companies and now this is a new era for the presence of small and medium enterprises. Acs and Audretsch (1993) describes a mechanism of this change as a form of global competition in the higher level of uncertainty. This thing causes an increasingly fragmented global market. In addition, a fairly massive technological developments provide opportunities for small businesses to have certain specialties and they are more flexible in responding to market needs. Small and medium enterprises then took over the leading role in the social and economic growth of a country. The sensitivity of small businesses is supported by their role in looking at opportunities and enter new markets with a simple strategy utilizing company resources (Wernerfelt, 1984; Havlicek *et al.*, 2013; Epifanova *et al.*, 2015).

From a social aspect, small and medium enterprises can create jobs in large numbers so contribute in solving the problem of unemployment and equal opportunity endeavor. The existence of small and medium enterprises in a country also plays a role in the formation of gross domestic product larger than the large-scale enterprises. It is seen from the experience of developed countries, the small and medium enterprises are the main instrument in the development of the country because they can mobilize and empower the society widely. This condition is consistent with models developed by Shaffer (2002) on the relationship between firm size and growth rate of the economy. The new paradigm in economic growth is also explained in the results of empirical research and Oulton Hart (1996) and Robbins *et al.* (2000) who explains that most of the new jobs are created by small companies.

In Indonesia, the movement of small and medium enterprise development has long been a major concern for the government. Indonesian Central Bureau of Statistics (BPS) data in 2012 showed that the number of small and medium enterprises in Indonesia experienced a growth of 2.41 per cent of the total 56.5 million units and is able to provide employment for 9.16 percent of the total 107.7 million over the previous year. Small and medium enterprises also contribute to the growth of gross domestic product by 59.08 percent. of the total 4.9 trillion so it can be said that small and medium enterprises to be one of the biggest factors in driving economic growth in Indonesia. In 1998, small and medium enterprises have been proven to withstand economic shocks than large firms even able to change orientation to play in the global markets (Berry *et al.*, 2002). The survival of a business can not be separated from the characteristics possessed by entrepreneurs who runs the business. In the context of entrepreneurship, the scope of the discussion on small and medium enterprises to become more widespread in terms of business objectives, risk and growth focus (Darrren *et al.*, 2009).

The traditional view of the small and medium business purpose is limited to the effort of producing, buying and selling of goods and services for profit. In contrast, the concept of entrepreneurship to explain that the purpose of small and medium enterprises covering innovation, sustainability and growth so that the role of entrepreneurship is crucial to the success of a business (Andriyansah and Zahra, 2017; Handayani *et al.*, 2017). But until now, it is seen from the entrepreneurial stage of development, Indonesia is still in the early stages and is based on the necessity-based entrepreneurship (GEM, 2013). Characteristics of this type of entrepreneurial activity tend to have high levels of competence and low human capital. Previously, the data APEC in 2006 also showed that the competitiveness of small and medium enterprises in the lowest ranks compared to other APEC member countries. One factor that influences the low competitiveness is the poor quality of human resources and business management (Anggraeni, 2014; Herman and Anggraeni, 2015).

The success of small and medium businesses is largely determined by the role of entrepreneur. Research Gill (1985), Dobbs and Hamilton (2007) and Gimeno (2007) concluded that entrepreneurs who have a higher education, management experience have a greater expectation on business performance than entrepreneurs who have lower education levels and lack of management experience. Although the results of other studies mention that there was no correlation between the success of business and management experience as fieldwork conducted by Birley and Westhead (1990), Siegel *et al.* (1993) and Sinha (1996). It is necessary for the better understanding of the importance of human capital and entrepreneurial competence in driving the success of small and medium enterprises. Study aims to analyze the relationship between human capital and competence on the success of small and medium enterprises.

## 2. Literature Review

### 2.1 Small and Medium Enterprises in Indonesia

Each state has a somewhat different definition of the small and medium enterprises. In Indonesia, the understanding of small and medium enterprises refer to Act No. 20 of 2008, namely the activity of several people in a small to medium-sized scale with maximum total assets of 740,000 U.S. dollars, including land and buildings owned by Indonesian citizens. This business is owned by an independent company and is not part of a big company either directly or indirectly. Business presence status can be incorporated or unincorporated.

### 2.2 Entrepreneurship and Business Management

The high competitiveness of small and medium enterprises is determined by entrepreneurial competence and good business management. This supports the model developed by Man *et al.* (2000) about the connections between

entrepreneurial characteristics and long-term business performance. Entrepreneurial expertise includes insights into the business and the external environment (Tambunan, 2008). Competitiveness and success of small and medium enterprises is determined by the innovation made by entrepreneurs. This can happen if the entrepreneur have knowledge of good business so that he is able to creatively respond to market demands. Hebert and Link (1998) gives an extensive explanation of the role of entrepreneurship in the economy. According to him, an entrepreneur understands well that there is always a risk in conditions of uncertainty so that it will attempt to allocate resources as efficiently as possible to achieve higher productivity and greater income (Drucker, 1993). Entrepreneurship is also interpreted as an innovator for his activities related to the efforts to introduce the product , quality standards , methods , new markets and resources (Schumpeter, 1934). Entrepreneur also refers someone who is capable of capturing opportunities using a variety of information to gain advantage through the marketing process. In this case study is an essential part of running the marketing process (Kirzner , 1978; Breckova and Havlicek, 2013).

### 2.3 The concept of Human Capital

The view that capital is a tangible investment is no longer appropriate, because of the skills and knowledge of the human capital can be an important investment (Schultz, 1961) . Ont context of human capital, we assume that the capital has a significant impact on the entrepreneurship. Entrepreneurship theory Schultz (1975) explains that the market mechanism does not automatically be in equilibrium but it is determined by the activity of the various parties to efficiently respond disequilibrium conditions by considering the costs and benefits as well as adapting all the time. This is called innovation. On the context of human capital, we assume that the capital has a significant impact on the entrepreneurship. Thus, entrepreneurship is the ability to adjust or reallocate various resources to respond effectively to changing market conditions increasingly competitive (Burns and Stalker, 1961). Thus, entrepreneurship is the ability to adjust or re- allocate various resources they have to respond effectively to changing market conditions. Based on this theory, entrepreneurial ability can be regarded as a form of human capital is the ability gained through experience, training and education.

### 2.4 Entrepreneurial Competence Concept

Chandler and Ganssen (1992) argued that the most important aspect in the role of an entrepreneur is the ability to recognize and take advantage of existing opportunities. This capability also includes the activities of finding and developing new opportunities. Furthermore McLelland (1987 ) explained that an entrepreneur should think of efficiency. It is a focus on high quality work and be able to monitor the course of business. Being the owner of a business also requires a vision and a clear view to formulate and implement strategies to achieve business objectives (Lau *et al.*, 2000). In developing the business, entrepreneurs also need to have the ability to



build relationships both internally and externally, to communicate effectively and persuasively (Bird, 1995). Entrepreneurial success is often characterized as individuals who are good and have a positive work attitude (Anggraeni *et al.*, 2017). He was able to be totally committed, dedicated and acted proactive in taking responsibility (Chandler and Jansen, 1992). Another important aspect is the ability to think analytically and willing to learn so that they can make decisions and solve problems effectively under conditions of uncertainty. Competence is useful in the short- term decision-making that seeks to resolve problems within a relatively narrow so intuitive abilities needed in this condition. Man *et al.* (2002 ) and then give the construct of the self-employment competency includes six aspects: competence to recognize and benefit from the opportunities, the ability to manage, strategic capabilities, the ability to establish relationships, ability to commit and conceptual abilities.

## 2.5 Business Success

Mostly great business success of small and medium enterprises focused on profitability, return on investment, turnover and product quality. Mann and Kehoe (1994) and Santos (2007) provide a model of a more comprehensive performance measurement includes operational performance and strategic performance. Dimensional measurement is divided into market performance, the performance of the process, the performance of human resources and customer relationship performance (Andriyansah *et al.*, 2017; Suharto and Sulistiyono, 2015; Sulaiman *et al.*, 2017).

## 2.6 The Impact of Human Capital on Business Performance

Various studi<sup>1</sup> show a positive effect anatra human capital and business performance. The results of the study Bruderl *et al.* (1992) concluded that entrepreneurs who have experience working with the same industry with the type of industry that he would run to apply the knowledge, experience and relationship with external parties that may affect the business success. The results of the study Cooper (1994) proves the opinion that the experience of working in the same industry with businesses is run by entrepreneurial impact on business performance. Based on the above results, hypothesis can be formulated as follows:

*H1: There is a positive relationship between human capital and business performance.*

## 2.7 The Impact of Entrepreneurial Business on Competence Performance

Various studies describe the relationship between entrepreneurial competencies and business performance. Research was conducted by Sony and Faith (2005) concluded that there is positive between entrepreneurial competencies and business performance. The results of the study support the conclusion Baum (2001) who

found that the ability of entrepreneurial influence on business performance from the aspects of growth. Based on the above results, the hypothesis is formulated as follows:

*H2: There is a positive relationship between entrepreneurial competencies and business success.*

### 3. Research Method

This study uses a quantitative approach with a survey method for data collection on small and medium enterprises in the region of Banyumas. The sampling method was purposive sampling with sampling based on certain criteria. This study involved small and medium business owners as respondents. The criteria of selected small and medium enterprises in this study were having employees in operations and has run it for 5 year. This study aims to analyze the influence of human capital and entrepreneurial competencies to business success in small and medium enterprises. Conceptual model in this study consisted of two independent variables, human capital and entrepreneurial competencies and the dependent variable is the success of the business. There are seven dimensions in the human capital variable. They are the level of education, business management training, work experience, experience in the family business, managerial experience and experience as a business owner. Measurement of human capital in this study using a scale developed by Isaksen (2006).

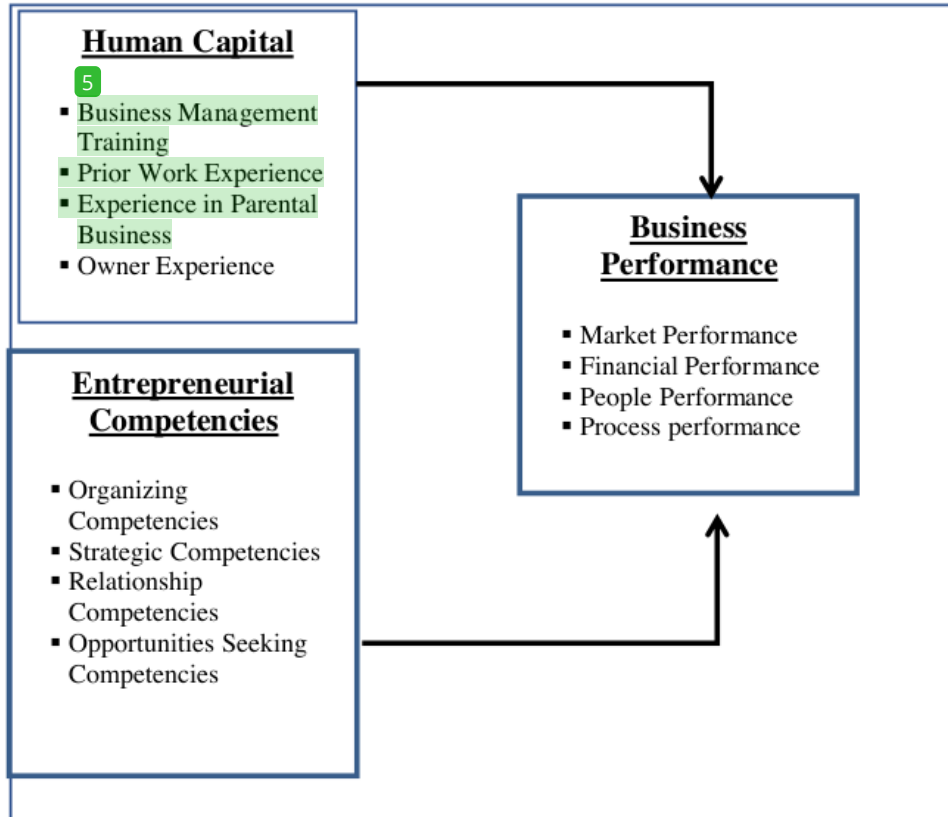
Constructs covers six dimensions of entrepreneurial competencies are competencies to recognize and benefit from the opportunities, the ability to manage, strategic ability, the ability to establish relationships, ability to commit and conceptual abilities. In this study, the writer used measurement of managerial competence, using a measurement scale developed by Man (2000) Next, construct a business success are described in 5 dimensions of marketing performance, supplier performance, process performance, the performance of human resources, customer relations and performance developed by Dawes (1999). Analysis of the data in this study include descriptive statistics, the mean, standard deviation, correlation, test validity, reliability testing and testing hypothesis using multiple regression analysis considering that the focus of research examines the effect of two independent variables on the dependent variable.

### 4. Results and Discussion

Questionnaires were given to the respondents of small and medium business owners in the area Banyumas 160 numbered copies. The number of questionnaires were returned as much as 148 copies. After the screening to see the completeness of data, the number of questionnaires that can be used for data processing as many as 145 copies. Based on the analysis of data, most of the respondents are engaged in the service (0.38) the number of employees between 11-15 people (0.26) and by

succession to establish his own business (0.36). The majority of respondents are male (0.63) and aged between 31 and 40 years (0.43). Table below shows a summary of the results of the data analysis.

**Figure 1. Research Model**



**Table 1. Sample Characteristics**

Demographics Characteristics		Number of Response	Percent
Gender	Male	93	0.63
	Female	55	0.37
Way of Becoming Business Owner	Startup	23	0.16
	Succession	54	0.36
	Take Over	21	0.14
	Joining as Other	50	0.38
Type of Business	Service	56	0.38
	Retail	43	0.29
	Craft	49	0.33
Age	>20	9	0.06
	21-30	32	0.21



Number of Employees	31-40	64	0.43
	40-50	27	0.16
	<50	16	0.11
	1-5	17	0.11
	6-10	21	0.14
	11-15	39	0.26
	16-20	51	0.34
	>20	20	0.14

Conformance testing research instrument with a variable that will be measured using the test validity. Based on the statistical results, there is one item that does not meet the standards validity, so it is not included in the subsequent analysis steps. After the reliability test and analysis results show that the overall construct reliability eligible. This study used a test of internal consistency using Cronbach alpha coefficients with coefficient 0.6 refers to the opinion of Nunnaly (1978).

**Table 2.** *Validity and Reliability Test*

Construct	Alpha Coefficient	Indicator	Corrected Total	Item-Correlation
Human Capital	0.782	Business Management Training	0.629	
		Prior Work Experience	0.602	
		Experience in Parental Business	0.543	
		Owner Experience	0.576	
		Organizing Competencies	0.426	
		Strategic Competencies	0.537	
		Relationship Competencies	0.446	
Entrepreneurial Competencies	0.769	Opportunity Competencies	0.405	
		Market Performance	0.564	
		Financial Performance	0.611	
Business Performance	0.775	People Performance	0.577	
		Process Performance	0.583	

Table 3 shows the summary results of testing the validity and reliability. Further testing of hypotheses used multiple regression analysis with significance testing simultaneous and significant test of individual parameters . Based on the ANOVA table is known that the probability is below the 0.05 figure so that it can be said that

the variables of human capital and entrepreneurial competencies affect the success of business.

**Table 3.** Hypothesis Testing

Construct		$\beta$	Sig.	Result
Entrepreneur Human Capital -> Business Performance		0,553	0.000	Accepted
Entrepreneurial Competencies-> Business Performance	Business	0,417	0.037	Accepted

Further tests of significance of individual parameters shows that human capital variables significantly influence the business performance of entrepreneurial competencies while variable does not affect the performance of the business as much probability is above 0.05. The analysis showed that the hypothesis 1 is suspected that the significant effect of human capital on business performance is acceptable while hypothesis two who suspect that entrepreneurial competence affect business performance declined.

The results showed that the human capital are possessed by an entrepreneur, play an important role in determining the success of the business performance of small and medium enterprises. The level of education and training management are very important in shaping expectations and encouragement to develop business insights, especially for the entrepreneurs with business education background. Furthermore, management training have been followed by entrepreneurs, is very helpful in the process of building the business goals effectively in both the short and long term. Management training is essential in guiding entrepreneurs to allocate resources effectively, to improve productivity and sustain a business. Working experience in similar work settings make the effort to form a better knowledge about the goods or services that are being marketed, so that could generate goods and services more quickly and effectively (Handayani *et al.*, 2017). Working experience also allows entrepreneurs to access network resources and potential customers for business success. Knowledge is tacit, inherent in entrepreneurship prior to running his own business, have working experience in a similar type of business.

Managerial experience helps entrepreneurs to manage resources better. In addition, entrepreneurs who had previously run a business, whether owned individually or with a partner, have better knowledge about the issue that may be encountered and used to dealing with risks under conditions of uncertainty. The accumulation of such knowledge can be used to reflect before making a business decision. Experienced entrepreneurs who set up a business, have better sensitivity regarding the consequences of any decisions taken. Testing the hypothesis suggests that simultaneous human capital and managerial competence significantly influence business performance. However, the partial testing, only constructs that affect

human capital on business performance of entrepreneurial competency whereas no significant effect on business performance. This proves that the entrepreneurial competencies will only affect the performance of the business if it is supported by other variables. In this study, the performance of the business can not be explained from the construct of entrepreneurial competence but along with the construct of human capital.

## 5. Conclusion

This study aims to examine the effect of human capital and entrepreneurial competence of the success of the business. Dimensions of human capital that are used in this study include level of education, experience and training. This study also aims to examine the effect of entrepreneurial competencies to business performance by using the dimensions of competence to recognize and benefit from the opportunities, the ability to manage, strategic ability, the ability to establish relationships, ability to commit and conceptual abilities. The test results showed that simultaneous human capital and entrepreneurial competencies significantly influence business success despite the partial test, entrepreneurial competence does not affect the performance of the business. This study contributes in explaining entrepreneurial characteristics that affect business performance in particular, human capital and entrepreneurial competencies. An entrepreneur needs to improve the ability to invest in education and training, both formal and informal and gain more experience dealing with managerial aspects. In this case, the role of academics is necessary to design appropriate training to the needs of entrepreneurs for sustainability and competitiveness of businesses.

This study was limited to testing the construct of human capital and entrepreneurial competencies as the characteristics of an entrepreneur in achieving business performance. Future research needs to analyze the characteristics or behaviors of the special and unique nature entrepreneurs to be a determinant factor of business success. Future research needs to more specifically analyze the aspects that are considered important by an entrepreneur in the business of training and education, both formal and informal. To that end, future research will need to use different research approaches.

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