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THE RELATIONSHIP BETWEEN ENTREPRENEURS KNOWLEDGE AND PERFORMANCE

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Abstract

The purpose of this research is to find out the relationship between entrepreneur knowledge and performance of small medium family-owned business in East Java Indonesia. A total of 381 small medium family-owned businesses in the East Java province of Indonesia are used as research respondents. These respondents were selected using proportional cluster random method to ensure that all of the predetermined areas in East Java were proportionally represented. Confirmatory Factor Analysis (CFA) is used to test the validity of the research variables, whereas Composite (Construct) Reliability is used to test the reliability of the variables. After all variables were declared as valid and reliable, the following step was to perform a multivariate analysis which involved normality, singularity, and outlier tests. After all the multivariate assumptions were fulfilled, a structural model testing was performed using the covarian-based structural model of AMOS. The result of this research suggests that entrepreneur knowledge has a positive and significant influence on performance of SMEs.

Keywords: performance, entrepreneur knowledge, small medium enterprises

INTRODUCTION

The business climate faced by companies nowadays is characterized by the increasing level of complexity, market diversity, and rapid change as the result of information technology development. This condition applies in every size of business, including small medium enterprises (SMEs). SMEs require business owners to cope with product manufacturing and market uncertainty (Heinrichs & Lim, 2008). In such condition, where competition is high and market is uncertain, every company needs a businessman with a strong entrepreneurial orientation and the ability to empower knowledge to create a strategic decision making that is in line with the rapid change in the business environment.

Small medium enterprises have some advantages by its size, such as the flexibility in changing the direction of their business. For example, changing product quality to meet the market’s needs is easier to do because the procedure is simpler and easier to manage. Another advantage is close relationships with customers and suppliers. Since small medium companies only have several customers and suppliers, their relationships become closer and more personal. The other advantage is the development in information technology. IT development affects almost every aspect in life, including business. The development in IT also brings advantages to all business elements, including small and large companies. Since it is easier to access information, businesses are able to accelerate their decision makings. It also brings variety to promotional media or channels. These channels will become even more interactive and less expensive if the marketers are creative with their marketing communication strategies. IT development also simplifies the payment method and communication process within a business. Things become cheaper and more interactive for employees, suppliers, and customers alike. As the field of strategic management expands,
strategy researchers and practitioners show increasing interest in the role of IT in strategy formulation and implementation, and its impact on financial performance (Henderson & Venkatraman, 1993; Powell & Micallef, 1997). On the other hand, SMEs also find some disadvantages such as the limited access to banking institution. Many small medium companies experience difficulties in getting loan from banking institution because they normally do not report their activities in good business reports. This condition makes it difficult for the companies to get the capital to expand their business. This condition affects the ability of SMEs to compete with larger companies because small medium companies have limitation in financial resources. Another obstacle is the difficulty in developing marketing activities that require big amount of resources, such as conducting a market research that requires financial investment to pay researchers or buy research equipments, and also in terms of the time needed to conduct the research.

This condition is in line with the situation in Indonesia, where many small medium companies lack competitiveness due to several reasons, including how the small size of the company leads to difficulties in doing a big project which enables the company to compete with other bigger companies. The working culture often fails to meet the standard, because small companies tend to operate on personal’s style, often the owner’s style, which makes the company very dependent on the owner. Unfortunately, company owners are usually experts in product production but not in management, including marketing. Some small medium companies in Indonesia are experts in production process but they often fail to have marketing sensitivity. They produce products without understanding what the market needs or how to market such products. Another condition involves the lack of time dedication for strategic planning. Many small medium companies run their business in a very natural way. They let things happen naturally without any plan. Each small medium company on average just focuses on daily survival, not the determination of long-term strategy (Hill & Wright, 2000). Another factor that leads to a lack of competitiveness is the fact that the founders of small medium companies tend to act as owners and managers at the same time, causing all the decisions and responsibilities to regulate all functions in small medium companies to be determined by the ability of a single leader (Berthon, Ewing, & Napoli, 2008). This condition shows the critical existence of the owner.

With the existence of small medium company, the increasingly competitive business environment, and the factors that become disadvantages or advantages, one crucial factor which affects the ability of the company to run its business continuously and meet the goals is the people involved in the business. The knowledge of the people within companies will determine the performance of the company (Bontis, Keow, & Richardson, 2000). They concluded that intellectual capital has a significant and substantive correlation with business performance regardless of the industry sector. Knowledge is one factor that affects a person’s competence.

According to Sveiby, 1997 as stated by Hunt (2003), knowledge is capacity to act. Meaning to say by having knowledge someone will be able to act properly. The higher the knowledge owned by someone, the higher the capacity of his/her action. In other word, having knowledge is giving someone a chance to perform powerfully. In organization context, knowledge can be particularly critical for the firm’s survival and development (Omerzel & Antoncˇicˇ, 2008). Therefore in this study the relationship between entrepreneurs knowledge and company performance will be tested.

LITERATURE REVIEW

Performance

According to Man, Lau and Chan (2002), the demographic condition, psychological state, and behavioral characteristics of an entrepreneur are often considered as the factors that influence the performance of small medium companies, along with managerial and technical skills. It is also strengthen by Covin and Slevin, (1988), they argue that the existence of specific personal factors within the leaders that enable them to be more effective in improving their company’s performance. Company performance refers to a company’s achievement in a certain period of time (Matic, 2012). In the field of entrepreneurship, there are a number of different views on how to measure performance. Based on the study conducted by Davis, Bell, Payne, & Kreiser, (2010) there are 8 dimensions commonly used in a company performance measurement for small and medium companies, namely efficiency, growth, profit, size, liquidity, success or failure, market share, and leverage. Out of the eight, three of the most commonly used dimensions are efficiency, growth, and profit. This fact is in line with a research result which suggests that the most commonly used performance dimensions in small medium companies are profitability, sales growth, Return
on Investment (ROI), and Return on Equity (ROE). The same research also suggests that 75% of the data used to measure company performance comes from primary data obtained from interviews or surveys, while 29% comes from secondary data and 6% comes from both. This condition describes the difficulty of acquiring information on financial performance in the forms of reports or archives in small and medium companies. It also explains why the majority (75%) of performance measurements in small medium company is based on survey approach. Survey-based approach means that company performance measurement is obtained from the company’s top management, either owner or manager (Wiklund & Shepherd, 2005); (Keh, Nguyen, & Ng, 2007); (Davis, Bell, Payne, & Kreiser, 2010). Therefore, it can be said that survey-based approach actually measures the perception of the company's top management on the company’s performance. There are many ideas surrounding the most suitable type of performance measurement for a company. The most common approach is financial approach, which measures a company’s performance using financial perspective. Although a finance-based performance measurement is good, it does not sufficiently describe the company’s actual condition (Murphy, Trailer, & Hill, 1996). As a result, many studies with a focus on company performance encourage the use of multi-dimensional approach in performance measurement by combining financial and non-financial dimensions (Murphy, Trailer, & Hill, 1996); (Neely, Marr, Roos, & Pike, 2003). Likewise, this research will also use both financial aspect and non-financial aspect in measuring company performance by adapting the performance measurement conducted by another research (Keh, Nguyen, & Ng, 2007). Performance of small medium family-owned business will be measured by two dimensions they are; financial and non-financial performances. Financial performance is company's performance in financial aspect; based on the company’s profitability, sales growth, market share and overall performance, compare to competitors. While non-financial performance is company’s performance in non-financial aspect; based on the company ability to achieve start-up goals; to provide secure job to employees; and obtain satisfaction regarding company’s performance compares to competitors.

**Entrepreneurs Knowledge**

Knowledge is defined as a fluid mix of framed experience, values, contextual information, and expert insight that provides a framework for evaluating and incorporating new experiences and information (Davenport & Prusak, 2000 in Awad and Ghaziri, 2004). People use knowledge to minimize the uncertainties in life (Beijerse, 1999). According to Mincer (1974) in Lopes (2012), a man’s knowledge is formed in his early school years and experiences. Barker III and Mueller (2002) support this statement by saying that a person’s knowledge depends on his education and experiences. The learning perspective suggests that the more knowledge a person has, the more capable that person is in making associations and solving problems effectively and accurately (Cohen & Levinthal, 1990; Eisenhardt & Martin, 2000). Knowledge is more than just possessing or discovering information, because it also contains the element of capacity, which involves self-confidence capacity and the capacity to act based on the information possessed. Therefore, Beijerse, (1999) considers knowledge as information plus, since knowledge consists of information, self-confidence, and action capability. Based on the explanation, four dimensions of entrepreneurial knowledge be used in this research are entrepreneur’s last education, functional knowledge related to business management, skills, and self-confidence.

One of the dimensions which form knowledge is education. As stated by Barker III and Mueller (2002), one’s knowledge is shaped by his education and experience. Based on this understanding, many companies assign their employees to follow trainings and pursue higher education in order to increase the employees’ knowledge (Sitzmann, Ely, Brown, & Bauer, 2010). The second dimension is functional knowledge which associated with business management knowledge. It has similarity with explicit knowledge in terms of being classified as documented knowledge. An example of explicit knowledge in an organization is how employees understand certain job procedures. Then the third dimension is skill. Skill is defined as an entrepreneur's abilities to manage the business. It is associated with the person's tacit knowledge, because it indicates the person’s ability to do certain tasks. Wooliscroft, Relich, Caganova, Cambal and Sujanova (2013) define tacit knowledge as "a very personal understanding." Every employee in the same company may experience similar or the exact same incident, and yet, they may interpret it differently. Self-confidence is the last dimension which describes a condition which encourages someone to courageously take an action (Benabou & Tirole, 1999). Therefore, without self-confidence someone is not able to take action although he/she has knowledge. A person with high level of self-confidence will have a strong opinion on something; and therefore, other people’s opinion will not affect them that much.
In this research entrepreneur knowledge (EK) refers to the level of knowledge possessed by the company's management, based on their most recent formal education, their knowledge about management which named as functional knowledge; their skills in managing business and doing business which called as skill and the last is self-confidence the respondents' confidence toward the successfulness of their business.

CONCEPTUAL FRAMEWORK

Figure 1: The Relationship between Variables

RESEARCH METHODOLOGY

Sampling Design

The population of this research is small medium companies in East Java, specifically from 6 areas which are determined as economic back bone of East Java. Registered as small medium companies in Department Cooperatives and Small Medium Enterprises of East Java from 5 areas (Gresik, Mojokerto, Surabaya, Sidoarjo and Lamongan), Company is fully owned by the family and perceived themselves as family business and company is a categorized in small and medium company under the criteria of Constitution Number 9, 1995 published by Indonesian’s government. Based on the criteria, the total amount of companies registered in Department Cooperatives and Small Medium Enterprises of East Java is 63,319 companies in the selected area. According to Krejcie and Morgan (1970), the amount of sample size from the population 63,319 is 381 respondents with 5% margin of error. The sampling technique in the research uses proportional cluster random sampling. The reason for this selection is to facilitate the sampling and provide assurance that each area selected of population in East Java is represented proportionally. The data in this research are primary data which contain the respondent's perception about the company's performance and also entrepreneur's knowledge. The data are compiled using questionnaire. The questionnaires were distributed to respondents by surveyors and the surveyors waited for respondents filled out the questionnaire.

Research Procedure

This research uses a quantitative approach to answer the research questions. Explanatory method is used as an approach to examine the causal relation between the variable in the study by means of hypothesis test. There is one hypothesis in this research it is Entrepreneurs knowledge is positively related to performance. The scale of measurement used to measure the respondents’ perceptions of indicator variables and arranged in a statement list format (questionnaire). The scale measurements used is 5-point Likert Scale marked with the numbers 1 to 5. The measurement of each variable is described in Table 1 below.
Table 1: The Measurement of Variables

<table>
<thead>
<tr>
<th>Number</th>
<th>Variable</th>
<th>Number of Item</th>
<th>References</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Performance</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Financial</td>
<td>4</td>
<td>Keh, Nguyen, &amp; Ng (2007).</td>
</tr>
<tr>
<td></td>
<td>• Non-Financial</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td>7</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Entrepreneurs Knowledge Orientation</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Education</td>
<td>3</td>
<td>Omerzel &amp; Antoncˇicˇ (2008)</td>
</tr>
<tr>
<td></td>
<td>• Functional Knowledge</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Skill</td>
<td>9</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Self-confidence</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td>40</td>
<td></td>
</tr>
</tbody>
</table>

**Total Item in Questionaire is 40 Items**

Source: Keh, Nguyen, & Ng (2007); Omerzel & Antoncˇicˇ (2008)

The data analysis with Structural Equation Model (SEM) using AMOS. Before, it is conducted content and construct validity. The content validity in this research is confirmed, because the measurement of the variables is done thoroughly. It means that the measurement indicator for each research variable is taken from the variable's concept by referring to the basic theory. In addition, the questionnaire used in this research is adapted from others previous researches, and had been tested for validity and reliability in different contexts many times. The product moment correlation coefficient tests the construct validity of the items.

DATA ANALYSIS

By conducted the data analysis, it is found that the correlation coefficient between the score of an indicator with the total score of all indicators is greater than 0.250. The result of calculation confirms that each of the indicators in the performance variable is considered valid. Cronbach Alpha coefficients are used in Reliability testing to (Sekaran & Bougie, 2010). In addition, based on the calculation the Cronbach Alpha value is proven to be higher than 0.60 (0.779). It means that the research instrument is reliable. The hypothesis test uses covariance-based Structural Equation Model (SEM) with the help of AMOS (Analysis of Moment Structure) software. The selection of this analytical model is based on the fact that there is more than one variable in this research and that a structural equation consists of a variable formation (latent) and variables studied (observer). After testing all the data by using AMOS, it is also generated the result of validity and reliability test by applying the confirmatory factor analysis to the research variables, which include Performance and Entrepreneurs Knowledge. Performance (PE) is considered as an endogenous latent variable. It is measured by two indicators; PE1 (0.915) and PE2 (0.513). It is also applied to entrepreneurs knowledge, that entrepreneurs knowledge (EK) is considered as an exogenous latent variable. It is measured by four indicators; EK1 (0.568), EK2 (0.694), EK3 (0.703) and EK4 (0.608). Composite (construct) reliability with a minimum cutoff value of 0.6 is used to test the reliability. The CR value of performance is of 0.693 and it is considered reliable. CR value of EK is 0.739 and confirmed reliable.

Entrepreneurs Knowledge is positively related to the performance of small medium enterprises. This hypothesis is CONFIRMED because test results suggest that Entrepreneurs knowledge gives positive and significant influence on performance. This can be seen from the path coefficient, which has a positive value of 0.152 and a C.R. value of 2.007, and also the probability significance (p) of 0.045, which is smaller than the predetermined significance standard ($\alpha$) of 0.05. This means that entrepreneurs knowledge has a positive and direct influence on performance by 0.152. In other words, for every increase in EK, there will be a 0.152 increase in PE. This finding is consistent with study of Mangistae (2006), which found that the probability of business survival increases with the number of years of schooling (in the context of this study, it equals to level of education) and numbers of years of business experience (equals to skill). Furthermore, Hunt (2000) added that the skill and knowledge of individual employees can be leveraged to increase the ability to efficiently and/or effectively produce market offering and enhance firm performance. The
The conclusion of this study is also supported by the studies of Myers, Griffith, Daugherty, & Lusch (2004); Wiklund & Shepherd (2003), Chen, Cheng & Hwang (2005).

**THE RESULT OF THE DATA ANALYSIS**

*Figure 2*

**CONCLUSION AND DISCUSSION**

This finding is also consistent with the study of Wang (2010), which claims that family business owners or managers need to have technical and managerial skills, because their positions and authorities allow them to trigger and initiate company movement using entrepreneurial ways to increase the current competitive advantage of their companies. These technical and managerial skills are the same as one of the indicators in this study, which is skill and functional knowledge. This is also in line with the statement by Clifton & Badal (2014) that non-personality variables such as skills, knowledge, and experience along with a host of external factors play a role in determining business success and must be taken into consideration when theorizing on business creation and success.

The outcome of this study also indicates that the knowledge owned by an entrepreneur affects the company's ability to create strategies that will improve the company's performance. This statement is in line with the study of Soininen, Puumalainen, Sjogren, & Syrja (2013), which states that the values, characteristics, attitude, and behavior of an entrepreneur affect the strategies of SMEs on corporate level. Therefore, the findings of this study suggest that a company that has high level of knowledge will experience the improvement in company performance.

This provides a new understanding and/or confirms the current belief that the knowledge of owners and managers have significant influence on the performance of a company. The leadership theories on the characteristics of a company leader are confirmed in a way that the leader's knowledge affects the performance of the company. This study also confirms that the indicators which reflect a person's knowledge are education level, skill and functional knowledge, and confidence in using the knowledge. To increase the sustainability of SEMs, it becomes increasingly important for company founders or owners to prepare their successors in terms of knowledge through formal education and business involvement that will allow them to get the necessary skills, experience, and confidence, as suggested by the knowledge indicator in this study. As stated by Pounder (2015) lack of family business-specific management and entrepreneurship education has created a challenge in the management of family businesses both for family and nonfamily members.

By asking the future successors to take formal education, the owners of family business can reap two benefits. In terms of family aspect, the family will have a child with good education. Meanwhile, in terms of business aspect, the family will have a future successor who will be able to initiate the performance of the company. Wang (2010) suggests that company owners or managers must have technical and managerial skills, because their positions and authorities allow them to initiate and run the company using entrepreneurial approach to increase the company's competitive advantage. By sending their children to formal schools, company owners have bigger opportunity to turn their children into successful business leaders. McPherson (2010) supports this idea by claiming that entrepreneurs who have information and education have wider access to business resources, support, and inputs.
The study found that the entrepreneurs knowledge positively and significantly influence performance of small medium enterprises in East Java Indonesia. This finding confirmed and strengthen the existing and previous research that entrepreneur knowledge has a positive and significance influence toward performance specifically in the context of small medium enterprises. This findings add the empirical evidence to encourage small medium enterprises to encourage its member to enrich the knowledge by attending both formal education and informal education.

REFERENCES


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