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**How to Build Internal Capabilities for Indonesian Family SMEs'  
Innovativeness**

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Adaptif dengan Kebutuhan Global

TOPIK PENELITIAN UNIT  
Family SMEs (Perusahaan Keluarga UMKM)

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## General Overview of the Research

**Purpose** – The research intended to explore the process of building internal capability (i.e. knowledge) on Indonesian family SMEs. The process focus on building successors' capabilities.

**Design/methodology/approach** –This study used qualitative approach with multiple case studies. In-depth interview conducted to 42 participants from 22 Indonesian family SMEs. Semi-structured interviews were conducted with the predecessor and the successor of the company. Triangulation technique and member checking use in this research to ensure validity. The data were analyzed using content analysis method, visual map strategy, and temporal bracketing.

**Findings** – The findings indicate that Indonesian family SMEs have internal and external innovation resources. The internal resources are internal family and internal company, while external resources are institution (School/college, government, and business association), supply chain network, and internet. A well design and spontaneous of internal capabilities development also found in the process.

**Research Limitation / implication** – This research conducted in service and manufacturing sectors. It needs to explore more on each sectors and details based on service or manufacturing.

**Originality/value** – This paper shows the internal and external innovation capabilities resources and also the development process of internal capabilities for innovation in family SMEs.

**Keywords** – internal capability, family business, family SMEs, innovation,

## Forewords

This research is dedicated to improve the innovation capabilities of Indonesian Family SMEs. Innovation is critical for the sustainable success of family SMEs. Companies, including family SMEs, need competitive advantage to survive in the long term, and innovation is one of the key drivers of sustainable competitive advantage. Meanwhile, based on a study by Boston Consulting Group (2013), 70% of Indonesian family SMEs failed to pass the torch on to the second generation, and only 7% of family SMEs survived into the third generation. This research in line with Universitas Atma Jaya Yogyakarta research focuses on adaptive to global needs.



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## I. Introduction

### 1.1 Research Background

Family SMEs are a significant economic force in the global economy (Llach & Nordqvist, 2010; Cabrera-Suarez, et al., 2001) and also have been believed to be driving force in economics development within a country (Indarti & Langenberg, 2004; Taneja, et al., 2016). Family SMEs can solve social problem such as unemployment, poverty, and criminal activity (Indarti & Langenberg, 2004; Kusuma & Indarti, 2017).

Family SMEs entrepreneurs are unique because they build business that are also family institution (Chrisman, et al., 2003). Family SMEs has desire to keep the business going for multiple generation (Kellermanns, et al., 2012), therefore family SMEs may determine not only the extent of their innovation efforts but also how they attempt to innovate and the results they achieve (Nieto, et al., 2015).

Companies, including family SMEs, need competitive advantage to survive in the long term, and innovation is one of the key drivers of sustainable competitive advantage (Taneja, et al., 2016; Brines, et al., 2013). Innovation also ensure the survival of the family SMEs against competitors (De Massis, et al., 2016). It is important for family SMEs to be continually involved in the process of innovation to survive in the competitive environment (Taneja, et al., 2016).

Innovativeness is an important entrepreneurial capability that Family SMEs can use to achieve competitive advantage (Llach & Nordqvist, 2010). Innovativeness may describe a core concern for family firms in achieving their performance goals (Kraiczy, et al., 2015). The benefits of innovativeness vary depending on the generational ownership dispersion of the family firm (Kellermanns, et al., 2012), hence, the Family SMEs must ensure that the successor has the same knowledge and key skills as the predecessor to maintain and improve the company's performance (Cabrera-Suarez, et al., 2001).

The study of innovation in family SMEs is essential since these firms are governed by a unique set of norms, cultures, and processes that are not found in nonfamily SMEs (Kellermanns, et al., 2012). Innovation management in family SMEs is also inherently interesting because there are strong theoretical reasons to believe that it differs from innovation management in nonfamily SMEs (Chrisman J., et al., 2015).

*Ability* and *willingness* are two key drivers of family governance that theoretically cause the differences in behavior and performance between family and nonfamily SMEs as well as among family SMEs (Chrisman J., et al, 2015). Family SMEs have some particular

advantages over their non-family counterparts with respect to discovering new opportunities through a combination of some of the common family business characteristics such as long-term orientation, low staff turnover, long leader tenure, and family ties that may lead to this advantage (Patel and Fiet, 2011) cited in (Brines, et al., 2013). Familiness also a unique resources of family SMEs that make family SMEs behaving entrepreneurially and innovatively (Brines, et al., 2013; Llach & Nordqvist, 2010; Kellermanns, et al., 2012; Casprini, et al., 2017)

Initial studies regarding innovation in family SMEs found that they were less innovative than non-family SMEs due to their risk averse behavior (Llach & Nordqvist, 2010; Taneja, et al., 2016; Nieto, et al., 2015; Casprini, et al., 2017; Werner, et al., 2017; De Massis, et al., 2015). Risk-taking behavior of the family firm is mostly affected by the organizational context (i.e., family ownership, family management, and family control) (Kraiczy, et al., 2015), and due to the overlapping nature of the family and business, family firms are more apt to be risk adverse (Kellermanns, et al., 2012). The lack of Innovation of family SMEs also occurs from the resource scarcity. Compared to large corporations, family SMEs are generally more resource constrained in their ability to develop and commercialize new products and services. To be innovative and maintain competitive advantage, Family SMEs must overcome resource scarcity by finding ways of deploying and combining existing resources in a value-creating approach (De Massis, et al., 2017).

The predecessor of family SMEs intends to inherit the company to the successor (Chirico, 2008; Kusuma & Indarti, 2017; Varamaki, et al., 2003). Family firms at later generational stages tend to become more professional than family firms at earlier generational stages (Kraiczy, et al., 2015), but the succeeding generations of family firm leaders seem to be more risk averse than the founder generation. As a result, the innovation output continuously decreases from generation to generation. Founder generation acts more innovatively than succeeding generations (Werner, et al., 2017).

A Family SMEs' successor must have the skills and master the knowledge of the predecessor to have credibility and to be accepted by the company's key stakeholders (Lee, et al., 2003). Accordingly, transferring knowledge internally sets the basis for innovating and improving efficiency (Davenport & Prusak, 1998, cited in Cabrera-Suarez, et al., 2001). Family SMEs successors need to be more realize about innovation strategy. One element of the strategy that they must concieve is internal capabilities. Internal capabilities are the necessary resources that family SMEs must have to be strategically innovative, including people, skills (i.e. knowledge), and technology (Taneja, et al., 2016).



## **1.2 Research Problem**

Innovation is critical for the sustainable success of family SMEs (Brines, et al., 2013; Taneja, et al., 2016; De Massis, et al., 2017). A recent review article indicates that research about family firm innovation management is very much in its early stage and that, unsurprisingly, results are inconsistent (Chrisman et al., 2015). Many studies have explored innovation in family SMEs, but there is a lack on the exploration of the process (or inputs) that influence innovation in family SMEs (Glover, et al., 2016; Roessi, et al., 2010). Continued research around innovation within family SMEs is needed to better understand the influence of specific resources and capabilities that might promote and/or constrain entrepreneurial activities (Brines, et al., 2013). since many family firms can be clasified as SMEs, it seems appropriate to also have a study on innovation in family SMEs (Roessi, et al., 2010).

## **1.3 Research Purpose**

The current study is intended to fill the above mention gap. The current study explores the process of building internal capability (i.e. knowledge) on family SMEs. This study conducted in Indonesia, where the vast majority of SMEs owned by family (Indarti, 2010 cited in Kusuma & Indarti, 2017). Using the Knowledge Based view Theory as frame of this study, the study aims to answer the following question: How do Indonesian Family SMEs build their innovation internal capability (i.e. knowledge)?

## **1.4 Research Urgency**

Earlier studies on business survival, especially in the context of family small and medium enterprises (SMEs), have shown that only a few survive into the next generation (e.g., Varamäki et al., 2003). As an illustration, 30% of family SMEs in the UK survived into the second generation, and only 17% survived into the third (Bridge et al., 2003). A similar pattern applies to the Indonesian context. Based on a study by Boston Consulting Group (2013), 70% of Indonesian family SMEs failed to pass the torch on to the second generation, and only 7% of family SMEs survived into the third generation.

A survey by *SWA Magazine* (2011), a well-known business magazine in Indonesia, listed several weaknesses of family SMEs: potential conflict, lack of planning, lack of management systems and relying only on the family structure. To a great extent, these weaknesses relate to the Innovativeness of Family SMEs. This research focuses on internal capabilities development (i.e. knowledge and skill) for innovativeness in Indonesian family SMEs.

## II. Literature Review

### 2.1 Family SMEs

Family SMEs can be considered as a unique bundling of two influencing system: the family and the business (Habbershon & Williams, 1999; Brines, et al., 2013). The “borders” between family and business are blurred due to the business and family systems interacting and overlapping in unique and dynamic ways over time and across generations (Brines, et al., 2013).

A firm also can be considered as a family firm when the business is owned and managed by a nuclear family (Chua, et al., 1999). However, most of the authors base their criteria in three conditions, ownership (the family has to hold more than 50% of the ownership of the firm), governance (a family is controlling the business) and management (significant proportion of the senior management is drawn from the same family) (Llach & Nordqvist, 2010; Floren, 2002).

According to Floren (2002), the family SMEs applies the business system and the kinship system all at once. The kinship system is oriented to balancing and minimizing the conflict, while business system aims to produce goods or services for profit. In order to survive, it uses the alteration to effectively adapt to the environment. In the family SMEs, these two systems interact and overlap, as well as depend on each other. Family SMEs must be able to balance the two systems ( Kusuma & Indarti, 2017; Ramadani & Hoy, 2015; Floren, 2002). The interaction between the kinship system and the business system generate a unique resource and become the main characteristic of family SMEs called *familiness* (Cabrera-Suarez, et al., 2001; Higginson, 2009; Chirico, 2008). The difference between the kinship system and the business system can be seen in Table 1.

Increasing business competition, in particular against large and modern competitors, put Family SMEs in a vulnerable position (Indarti & Langenberg, 2004). Family SMEs have some hard-to-duplicate capabilities or ‘familiness’ while on the other hand family firms suffer a lack of financial capital due to family ownership and control (Llach & Nordqvist, 2010). Compared to large corporations, SMEs are generally more resource constrained in their ability to develop and commercialize new products and services (De Massis, et al., 2017; Indarti & Langenberg, 2004).

In Indonesia, most Family SMEs operate along traditional lines in production and marketing, and the main problem for family SMEs in developing countries is not their small size but their isolation, which hinders access to markets, as well as to information, finance

and institutional support (Mead & Liedholm, 1998; Swierczek & Ha, 2003, Cited in Indarti & Langenberg, 2004). To be innovative and maintain competitive advantage, family SMEs must overcome resource scarcity by finding ways of deploying and combining existing resources in a value-creating approach (Boyd, 2010; Eddleston, et al., 2008; Sirmon et al., 2011 cited in De Massis, et al., 2017)

**Table 1. The Difference between the Kinship System and the Business System Factors**

<b>Factors</b>	<b>Kinship System</b>	<b>Business System</b>
Relation	Connected by birth	Joined by choice
Duration	The rest of life	Temporarily
Decision	Based on emotion	Based on ratio
Behavior	Unconscious Behavior	Conscious Behavior
Reward	Based on equality	Based on achievement
Orientation	Internal	External
Character	Conservative	Dynamic

Source: Floren (2002)

## **2.2 Internal Capabilities of Family SMEs**

The objective of the entrepreneur is to successfully hand over the firm to the next generation (Werner, et al., 2017; Cabrera-Suarez, et al., 2001; Chirico, 2008). Family SMEs' successor must continuously innovate and be ready to adapt to changes in the marketplace by improving their learning capability to survive and surpass the competition (Taneja, et al., 2016).

One of the most important factors for generating innovations is the knowledge basis of the workforce. It can represent a competitive advantage when the company is able to develop, keep, and exchange the knowledge as it is based at least partially on experience (Cabrera-Suarez, et al., 2001; Werner, et al., 2017; Chirico, 2008). A company successor must have the skills and master the knowledge of the predecessor to have credibility and to be accepted by the company's key stakeholders (Lee, et al., 2003).

Family SMEs need resources, skills, and proficient leaders who care about innovation to use their innovation capabilities (Taneja, et al., 2016; De Massis, et al., 2017). Innovation capability describes the actions that can be taken to improve the successful implementation of innovation strategies and activities in a firm. Innovation capabilities allows SMEs to integrate, build, and reconfigure internal and external competences to address rapidly changing competitive environments (Taneja, et al., 2016). This study focus on internal capabilities, especially on knowledge and skill.

The knowledge based theory identifies knowledge as the most fundamental asset of the firm that all other resources depend on (Grant, 1996; Spender, 1995; Chirico, 2008). In Family SMEs context, successor need to acquire knowledge from the previous generations

but also add new knowledge gained through education and personal experience within and outside the family SMEs (Cabrera-Suarez, et al., 2001). Assimilating knowledge from outside the firm requires “learning” or “absorptive” capacity (Cohen & Levinthal, 1990). Family firms need to invest in absorptive capacity in order to extract the benefit from innovation (Feranita, et al., 2017).

Knowledge is defined here as the integration of information, ideas, experience, intuition, skill and lessons learned that creates added value for a firm (Dana, et al., 2005). The literature clearly distinguishes between pure knowledge and skill. Pure knowledge regarding the information and understanding of fundamental principles acquired through education, hence, skill is the ability to apply the accumulated pure knowledge through the experience gained (Chirico, 2008). Skill is the ability to carry out a particular task or activity, especially because it has been practices. Pure knowledge is the information behind that skill (Chirico, 2008; Nonaka & Takeuchi, 1995).

The knowledge takes two forms, tacit and explicit, raises a dilemma for companies, referred to as the paradox of tacit and explicit knowledge. These dilemmas have lead to idiosyncratic knowledge, or the combination of tacit and explicit knowledge (Jassimuddin, et al., 2005). The majority of knowledge in family SMEs is idiosyncratic (Cabrera-Suarez, et al., 2001; Lee, et al., 2003). Key knowledge which transferred from predecessor to successor in Family SMEs summarized in Table 2.

**TABLE 2. KEY KNOWLEDGE OF FAMILY SMEs**

<b>Transferred Knowledge</b>	<b>Description</b>
Knowledge of the product	Product composition Quality standard Process of product making
Knowledge of company management	Financial management Employee engagement Business risk Company partners Competitors and business environment Trend and business cycle
Technical knowledge	Negotiation and make a deal Consumer handling
Philosophical knowledge	Professionalism: work ethic, discipline, commitment Honesty Religion values Intuition (identified threats and seize the opportunities).

Source : Indarti & Kusuma, 2016

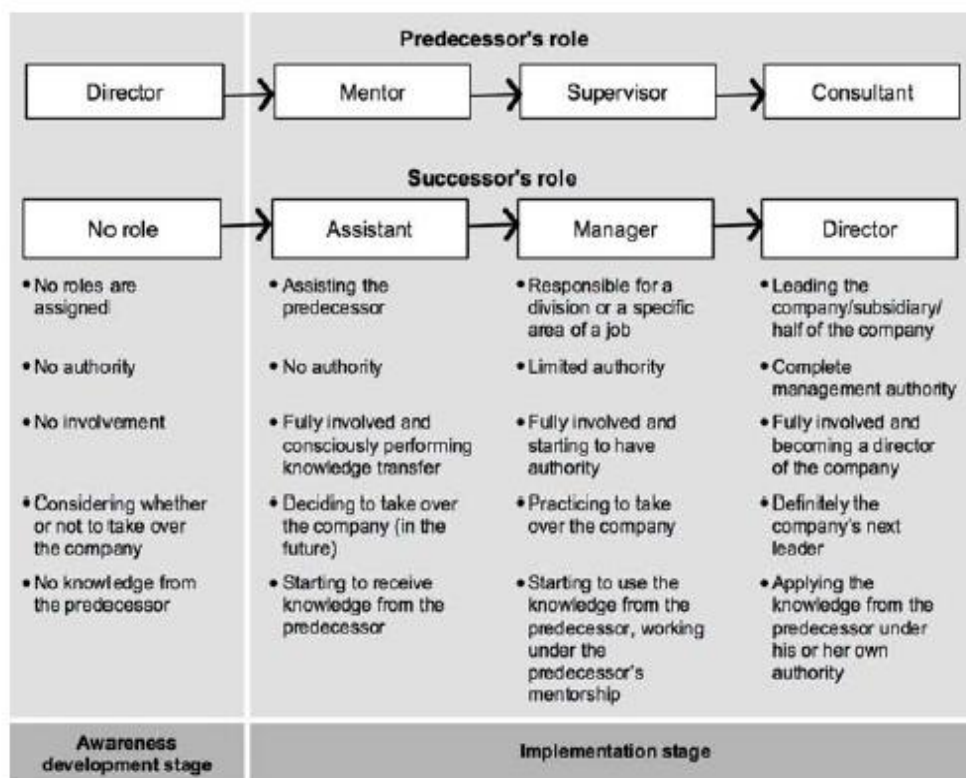
In family SMEs, the predecessors have a great desire to transfer their knowledge and have the willingness to teach their successors everything they know about the company (Trevinyo-Rodriguez & Tapias, 2006). Knowledge transfer is the key to the sustainability of a family SMEs after the transfer of responsibility from one generation to the next (Cabrera-

Suarez, et al., 2001). Knowledge transfer in family SMEs is done slowly and in stages. The transfer begins with conveying simple practical know-how before moving on to more complex and abstract knowledge ( Kusuma & Indarti, 2017).

The learning process stages are based on the successor’s level of understanding. The knowledge transferred by the predecessor to the successor begins simply and then becomes more complicated over time ( Kusuma & Indarti, 2017; Chirico, 2008). From a knowledge-based view, this process includes know-how gained through education, training, and experience as well as the ability and motivation to share and exchange one’s knowledge within the firm and to absorb new knowledge from colleagues (Cohen & Levinthal, 1990). In the family SME context, the predecessor has rich tacit knowledge due to the accumulation of knowledge and experience (Chirico, 2008) Learning from experience should be transferred to the next generation so that the successor has the same level of capabilities with the predecessor (Trevinyo-Rodriguez & Tapies, 2006).

On the knowledge transfer proses, the predecessor’s and successor’s roles gradually change. The successor’s roles and responsibilities increase with the decrease of the predecessor’s roles and responsibilities (Kusuma & Indarti, 2017). The role adjustment illustrated on figure 1.

Figure 1. Role adjustment on knowledge transfer process in Family SMEs



Source: Kusuma & Indarti, 2017

### **2.3 Innovation in Family SMEs**

Innovation is capability that allows SMEs to integrate, build, and reconfigure internal and external competences to address rapidly changing competitive environments (Saunila & Ukko, 2014). Innovation is an improvement anywhere in the business; not only in products, services, and processes, but also in leadership, HR, communication, organization, marketing, and any other activities (Csath, 2012 cited in Taneja, et al., 2016).

Innovativeness is an important entrepreneurial capability that family-run firms can use to achieve competitive advantage (Llach & Nordqvist, 2010). The social capital created by the notion of “familiness” is a key contributor to family SMEs behaving entrepreneurially and innovatively (Cabrera-Suarez, et al., 2001; Brines, et al., 2013; Lee, et al., 2003).

Family SMEs tend to have flexible innovation cultures with low resistance to change, low risk aversion, and high tolerance for ambiguity (Taneja, et al., 2016). The characteristics of family firms may influence their decisions on innovation strategies (Nieto, et al. 2015). In small and medium-sized family firms, where decision-making is often centralized and the firms' size are rather small, it is the CEO's disposition and resulting behavior that most strongly influence innovation in family SMEs (Kraiczy, et al., 2015).

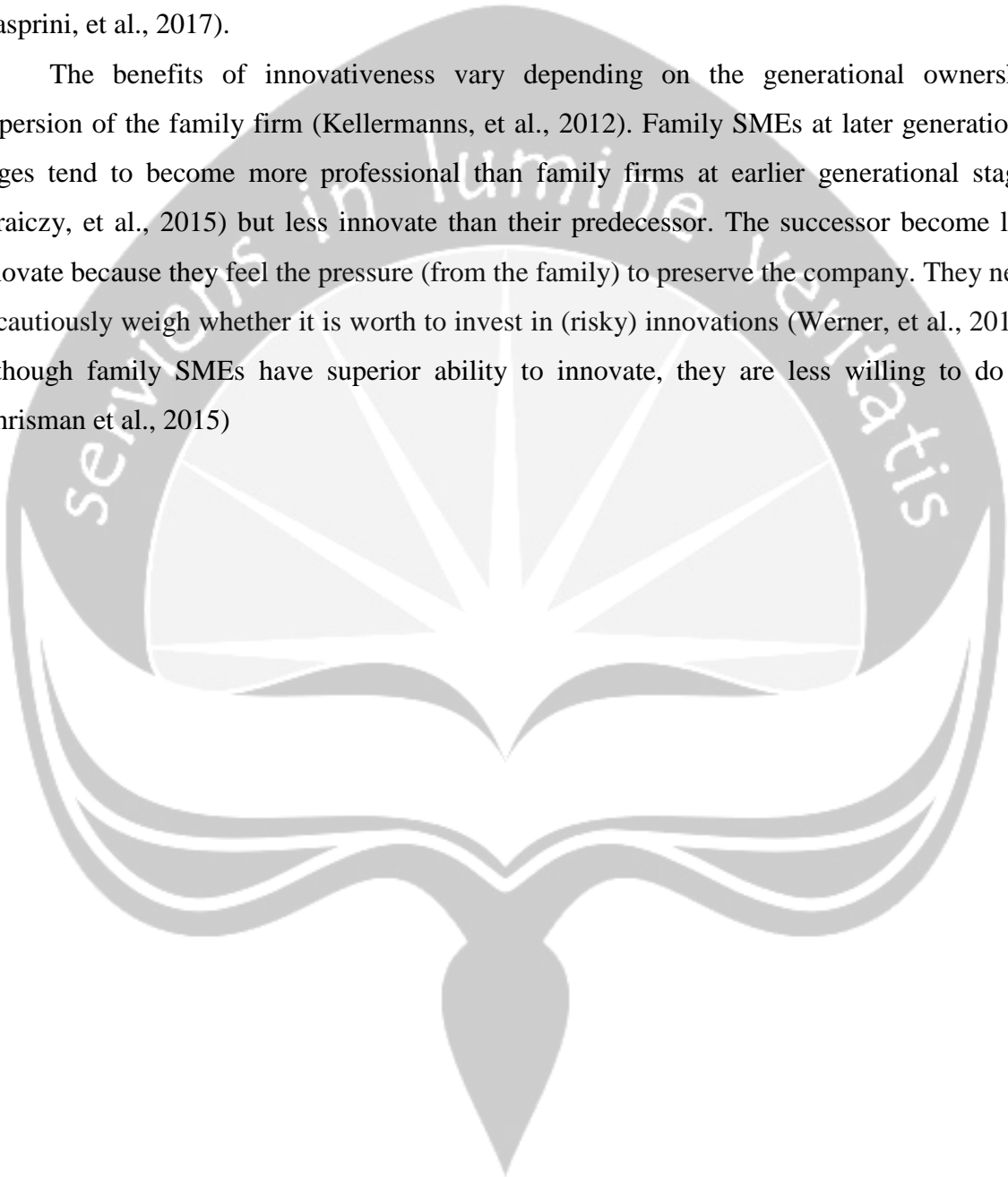
Innovation in family SMEs are more informal and risk averse rather than non-family SMEs (De Massis, et al., 2015). Family SMEs also invest less in R&D due to higher risk aversion and resource constraints (Nieto, et al., 2015). Non-family firms are more likely to use formal monitoring and control mechanism that oppress innovation activities, whereas in small family firms, open channels of communication, informal decision making, and flexibility in processes are prevalent and lead to a more innovation-friendly atmosphere (Craig & Dibrell, 2006).

Family SMEs should have incentives to innovate as innovation creates wealth and opens new business opportunities (Nieto, et al., 2015). Compared to large corporations, Family SMEs are generally more resource constrained in their ability to innovate. They must overcome resource scarcity by finding ways of deploying and combining existing resources in a value-creating approach (De Massis, et al., 2017). Resource constraint and market uncertainties limit SMEs ability to invest on R&D to experiment with new product development, hence, it is advantageous for SMEs to connect to local networks in their community because it helps them to get the benefit from the community to enhance their innovativeness (Taneja, et al., 2016).

Innovation occurs primarily through new combinations of resources, ideas, and technologies. However, a fertile innovation environment requires a constant inflow of

knowledge from other places (Fey & Birkinshaw, 2005). Concerning the type of innovation output, family firms are more likely to achieve incremental than radical innovations and are less inclined to assimilate external knowledge than their non-family counterparts (Werner, et al., 2017). Family SMEs tend to prefer using internal knowledge, thus adopting a more closed approach to innovation, unless specific knowledge management practices are adopted (Casprini, et al., 2017).

The benefits of innovativeness vary depending on the generational ownership dispersion of the family firm (Kellermanns, et al., 2012). Family SMEs at later generational stages tend to become more professional than family firms at earlier generational stages (Kraiczy, et al., 2015) but less innovate than their predecessor. The successor become less innovate because they feel the pressure (from the family) to preserve the company. They need to cautiously weigh whether it is worth to invest in (risky) innovations (Werner, et al., 2017). Although family SMEs have superior ability to innovate, they are less willing to do so (Chrisman et al., 2015)



### III. Research Method

#### 3.1. Research Framework

##### 3.1.1. Research Roadmap

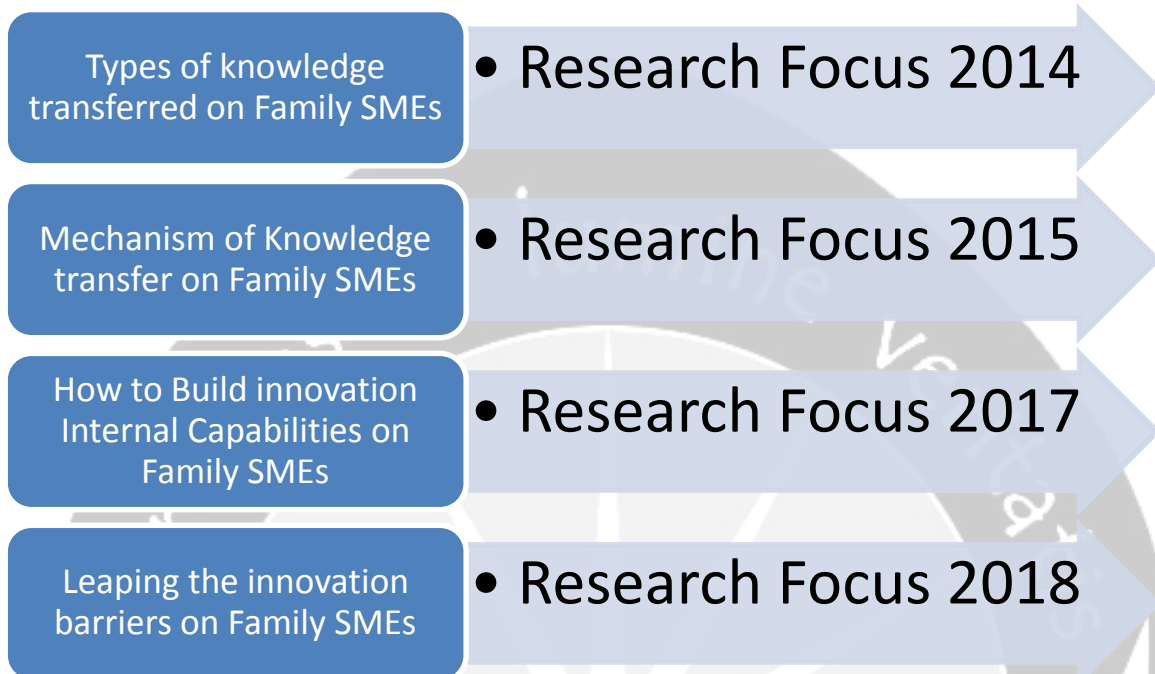


Figure 2. Research Roadmap

##### 3.1.2. Research phases

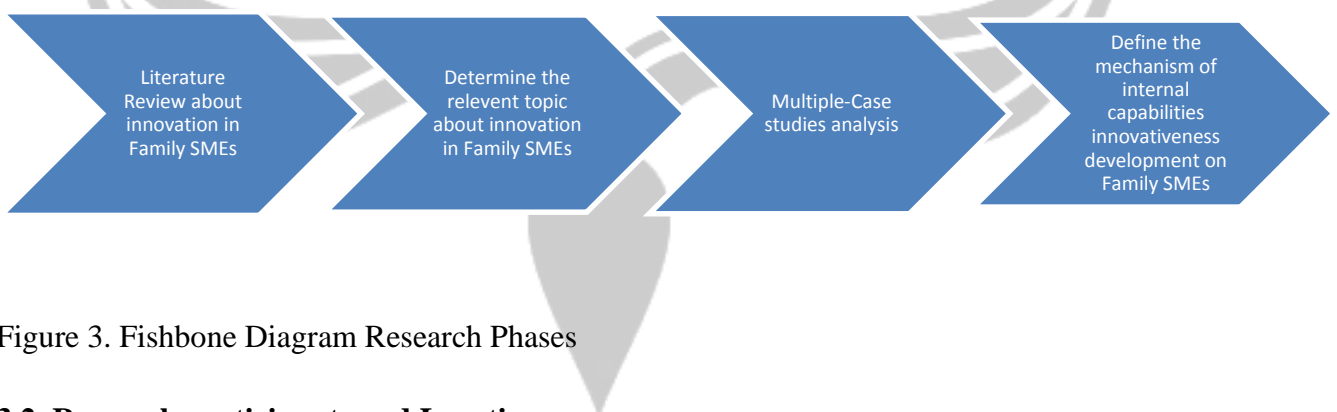


Figure 3. Fishbone Diagram Research Phases

#### 3.2. Research participants and Location

This research participants are Family SMEs' owner (both predecessor and successor). The research will conducted in Yogyakarta, West java (Cirebon), Central java (Solo), and East java (Surabaya).



### 3.3. Research Method

This study required the participants to share their experiences and understandings related to the study context. The participants were required to describe the condition (setting) in which they were connected to the study problem as well (Creswell, 2010). Based on that issue and also the opinions from McCollom (1990) in Chirico (2008), this study used a qualitative approach with various case studies. Each case was examined independently, and the results were compared based on the characteristics of the study (Yin, 2009).

Family SMEs were selected using theoretical sampling by considering the following characteristics: age of successor (younger or older); gender of predecessor and successor (different or the same); and number of successors (one or more). We used purposive sampling procedure to see participants in this study. The criteria to select the participant: 1) the family SMEs were already run by the next generation and 2) the successor was involved in the daily operation of the family SMEs. Data were collected by means of in-depth interview and observation.

The data collection was done by personal in-depth interviews with the owner of the family SMEs. The Family SMEs details are described in Table 3. The interviews were conducted with the predecessor and/or successor. To increase the validity, the data was also supported by the company's documents, archives recorded, direct observation, participant observation, and physical artifacts (Yin, 2009).

Semi-structured interviews were conducted with the predecessor and the successor of the company. Each session was conducted in two stages. The first stage was done by providing an open question without informing the participants about the purpose of the study, so that it does not affect them. The second stage was done in the structured questions in which those are related to the transfer of knowledge between generations that occurs in the company. The data collection was over when the data obtained was saturated. Saturation in data collection happens when there is no new information. The indicator of saturation occurs when there is replication or repetition in the information obtained from different informants (Creswell, 2010).

To ensure validity and credibility, this study used triangulation technique and member checking (Yin 2009; Creswell 2010). Triangulation includes source triangulation (the participants were predecessors and successors; primary and secondary data); method triangulation (observation and indepth interview), and time triangulation (the studyers interacted intensely with the family SMEs in a determined time frame). Member checking was done by sending back interview transcripts to the participants to ensure data congruity

with the participants' perspectives. This process also ensured that there was no bias in the study (Yin 2009; Cresswell 2010). The data were analyzed using content analysis method, visual map strategy, and temporal bracketing (Langley, 1999).

**Table 3. Participant Profiles**

No	Firm	Year of establishment	Sectors	Generation
1	KFS	1981	Photography	2
2	BRJ	1981	Food Production	3
3	ECH	2000	Construction	2
4	CVA	2000	Construction	2
5	CVM	1978	Offset	2
6	EPP	1995	Tailoring	2
7	KBI	1978	Tailoring	2
8	AMN	1990	Hotel	3
9	CRF	1990	Offset	2
10	TGC	1985	Catering	2
11	ADM	1985	Restaurant, Music store	3
12	PLJ	1997	Interior Design	2
13	APS	2000	Sanitation	2
14	BNM	1997	Sanitation	2
15	BBS	1990	Construction	2
16	BPP	2004	Food Production	2
17	PAR	1980	Fashion	4
18	NMK	1990	Fashion	3
19	TBD	1965	Grocery	4
20	LSS	1974	Offset	3
21	SBA	2000	Grocery	2
22	RPA	2000	Hospital	2

## IV. Data Analysis and Discussion

Internal capabilities development is crucial for Family SMEs. This process is central and crucial to the existence of Family SMEs (Taneja *et al.*, 2016). Innovation capabilities development needs involvement of the owner of the Family SMEs. This study reveals that the involvement of predecessor and successor of Family SMEs are crucial. The predecessor is one of the capabilities source, and the successor is the new energy for company innovativeness.

In line with Chirico (2008), this study found that there are knowledge accumulation on Family SMEs, and the new generation add new knowledge and offer new innovation for the family SMEs. This study found internal and external sources of innovativeness, including predecessor's experience.

### 4.1. Innovativeness Sources

#### 4.1.1. Internal Sources

##### a. Internal Family

The owner of Family SMEs plays important role on firm's innovation. Predecessor and successor determine how the firm will innovate. The main resources of the knowledge came from founder (predecessor). Second generation of BRJ confirmed this: "This company built by my mother, all of the food products that we produce are based on her recipee". The 3<sup>rd</sup> generation of BRJ add: "We make the basic product based on my grandmother recipee, but now we make new variance of those products".

The knowledge from the predecessor is not only about the product, but also about process. They innovate incrementally in line with their daily process. They found new method when they do their job. They learn from their mistake and also from trial and error process. They use Learning by doing method to build their knowledge. The second generation of KBI confirmed this: "My father has his own method to sew the clothes. He has special formula to make a fit and comfortable clothing model that he got from his experiences as a tailor." Predecessor of KBI confirmed this statement: "I made my own method to tailor the clothes. I got it from my experiences on tailoring for more than 30 years."

Indonesian Family SMEs also get the innovation capabilities from relatives. Family members outside the nuclear family also play important role on Family SMEs innovation.

Owner of ECH said: “I learnt about this business from my uncle. He also gave me his network, so i can develope my own network.”

#### b. Internal Company

Indonesian family SMEs also get their innovation capabilities (knowledge) from the employees. The firms which already established for several generation have employees whose age are older than the successor. These employees have experinces and also valuable tacit knowledge that build for many years. The successor of LSS told his experience: “I also learn from senior employees at my company. They have valuable experiences that help me to solve the problem creatively. I can not find their way to solve the problem at school or anywhere else.”

Innovation capabilities also arise from combination between pure knowledge which the owner got from formal education and employees experiences. ECH owner confirm this. He said:”I studied architecture at university, but in daily operation, I also need my employees’ experiences. They know how to build the house technically, but they don’t understand the concept comprehensively. Hence, my knowledge is a combination of my knowledge from college, my employees experiences, and my own experiences from learning by doing.”

Research and development department also become one of Indonesian Family SMEs alternative to develope their innovation capabilities. Family SMEs which have R&D department are the companies that have sufficient resources. They hire competent employee for R&D, but the control of the R&D still on the owner’s hand. The owner involve in the R&D operation, and they keep the knowledge from R&D result. The owner of BPP explain this: “We have R&D department. My daughter is the head of R&D department.” The APS sucessor also explain:”My father controls the R&D department.”

## 4.2. External Sources

#### a. Institution

School or college is an option for Indonesian Family SMEs to develop their innovation capabilities. Company invest their money on education especially for the successor. They choose education that relevant and support the company sustainability. KFS sucesor confirmed this. He said “My parents asked me to study abroad and learn about photography.” Predecessor of PAR also confirmed this by saying “I asked my first daughter to study about business, and her younger sister went to fashion design college.”

Government is an important part on Indonesian Family SMEs innovativeness development. Indonesia Family SMEs had been facilitated by the government in term of technology improvement. The owner of BNM explain this: “I used to make my product manually, I change my production process after I joined government program on sanitation technology.”

It is advantageous for SMEs to connect to local networks in their community because it helps them to get the benefit from the community to enhance their innovativeness (Taneja, et al., 2016). Business associations help the Indonesian family SMEs to enhance their knowledge to support innovation. It is a common to share their knowledge to the other company on the association. It explained by APS owner. He said “I learnt about this business from my friend on association. He shared his experiences, He already work in this field for 25 years.”

#### b. Supply Chain Network

Innovation environment requires a constant inflow of knowledge from other places (Fey & Birkinshaw, 2005). Supply Chain Network need to be integrated, hence it encourages each part to enhance their capabilities. It explained by SBA owner that said his company must improved their accounting system and also warehousing system in term of integration to their supplier.

Company also get input for their innovation from their retailer or customers. Idea for new product design arise from customer request. It explained by ECH owner. He said: “Sometimes I got new idea for designing a house from my customers.”

#### c. Internet

Participants on this research already familiar with the internet. Internet has been an alternative for Indonesia family SMEs to get information to enhance their capabilities. Even the predecessor did not familiar with the internet, the next generation use this technology. It said by ADM successor. He said:” I always use internet to get idea for new recipee. I combine the informaton on internet and my prior knowledge on cooking to make innovative product for my restaurant.”.

### **4.3. Internal Capabilities Development Process**

#### **4.3.1. Knowledge Accumulation and Absorptive Capacity**

Inline with Chirico research (2008), this research found the knowledge accumulation on Indonesia Family SMEs. The knowledges that owned by predecessor (i.e. founder) are in the form of tacit knowledges. The owner learn from daily process. Most of the participants said that they got the knowledge based on their learning by doing experiences. These experiences transferred to the successors and become their basic capabilities. It explained by KBI successor, he said “I learnt from my father. He has his own method to do tailoring. We can not find his method on any books.

The successor obtained his/her knowledge from the predecessor by verbal explanation, example, and chance to practicing their knowledge. Time required in this process depend on successor ability to understand the knowledge. Absorptive capacity (Cohen & Levinthal, 1990) also plays a role in this process. Sucessor of CVA said “I need years to understand my father’s method.”

#### **4.3.2. *Designing internal capabilities platform***

On the planning level in Indonesia Family SMEs, this research found that there are two types of internal capabilities development design. First type is a well design internal capabilities development, and the second is a spontaneous internal capabilities development design.

A well design internal capabilities development has a systematic scheme and a clear time schedule, otherwise a spontaneous internal capabilities development design does not have scheme and clear time schedule.

For the family SMEs, owner’s disposition and resulting behavior that most strongly influence innovation (Kraiczy, et al., 2015). The owner’s role, in this case is the predecessor, determine the form of design. The factors such as the owner’s orientation, the owner’s expectation, and also their pride to be an entrepreneur influence the internal capabilities development design. The design will give impact to the innovation process at Indonesian Family SMEs.

The owner’s orientation based on their awareness of the importance of innovation. The owner of KFS explained “I know that the innovation is important to our company, hence, i made a plan for my successor. I sent him to study abroad. I think international exposure will give us benefit.” In the other hand, NMK owner said “I am too busy to think about that (internal capabilities development).” The owner that aware about the importance of

innovation will develop a scheme and make a plan especially for the successor. In contrast, an owner who is too busy with daily company operation would not prepare the internal capabilities development for successor.

Family SMEs always related to the involvement of owner's family members, especially children as successor. Innovation in Indonesia Family SMEs influenced by the owner expectation to their children. The owner who expect their children to be an entrepreneur will develop a clear scheme for internal capabilities development, especially for preparing their successor. It was explained by BPP owner "I want her (successor) to be an entrepreneur, therefore I already arrange her a learning plan in the company. She must be able to handle the company." In the other hand, the owner who do not expect their children to take the company's torch, do not make any plan to their successor, even they prefer their children will get a better job at the bigger company or to be a government employee. It said by the BNM owner "This sludge removal business is not prestigious for our society. I want my children have a better job than this. So i do not prepare them to lead this company in the future. I also run this company as it is. I only think how to survive until my children have their own job."

The prideness to be an entrepreneur also give impact on the decision to design of internal capabilities or not. It said by The PAR owner "I proud to be an entrepreneur, hence, I want this company sustained. I develop R&D department even it costs much. My daughter should mastering the knowledge, therefore I ask her to lead the R&D department."

#### *4.3.3. Process of internal capabilities development*

The company which has a well design of internal capabilities development plan the scheme carefully. It has clear activities and also time schedule. The CFS owner strengthen this by his statement "I change my company production technology. Therefore, I develop the steps with a clear time schedule to integrate the new system in my company."

A well design of internal capabilities also take a part on the successor preparation to be the next leader. Predecessors have a clear and systematic method to prepare the successor. They know how and when to start the process for their successor. The ADM owner explained this "My father has a clear track for me. He developed a process so i can get the capabilities to manage this company. My first involvement was when I studied at elementary school. I started from a simple tasks and the complexity increased proportionally."

A spontaneous internal capabilities, in contrast, does not have systematic scheme. It flows naturally without any planning. Therefore, the company with a spontaneous design

does not have clear activities and time schedule. The owner of NMK explained this. She said “I never think about planning to make a new product or have a R&D department. I get new idea from my interaction with customers on my daily routine.”

A spontaneous design also impacting the successor preparation. The successors of the companies with a spontaneous internal capabilities design do not have a clear path to develop their internal capabilities. The owner of ABR explained this “My mother persists with her traditional business concept. She never think about internal capabilities. Hence, I do not have a clear scheme about that.”

Initiator of the innovation also influenced by these designs. In the company which has a well design, the innovation arise from a systematic process. The decision to innovate come from the consensus between predecessor, successor, and also employees. The KFS owner explained this “When we want to make a change or an improvement, we always have a discussion process. The decision should based on data, so we need employees input at this point.” On the other hand, Initiator of the innovation at the company with a spontaneous design are the owner. In some case, the successors are the initiator. The CVM owner explained “I got this company with an old system and also an obsolete technology. I change the system and also the technology. It was not easy because i had to convince my father to change it all.” This statement also illustrate that in some cases, successor is a risk taker and more innovate rather than the predecessor. It is contrast with the research by Werner *et al* (2017) that found the successor be more risk averse than the founder.

## **V. Conclusion**

Indonesia Family SMEs have two source of innovation. They get the innovation from internal and external sources. Internal sources are internal family and internal company. External sources are institution (School/college, government, and business association), supply chain network, and internet.

Predecessor’s experiences and knowledge become the basic of the internal capabilities for the successor. Therefore, knowledge accumulation and absorptive capacity take a part in the development process.

This research also found two types of internal capabilities development design. These designs are a well design and spontaneous of internal capabilities development. The details of the designs can be seen at table 4. The research also found that in some cases, successor is the initiator of the company innovation. It shows that in some cases, successor are more risk taker and more innovate than their predecessor.



**Tabel 4. Details of Internal Capabilities Development Design on Family SMEs**

<b>Internal Capabilities Development</b>		
<b>Factors</b>	<b>Well designed</b>	<b>Spontaneous</b>
Components	Have systematic scheme, clear activities, and clear time schedule	Flow naturally, does not have scheme, spontan
Owner's orientation	The owner (predecessor) aware the importance of internal capabilities development for the company and the successor	The owner (predecessor) too busy with the daily operation, hence, they neglect the internal capabilities development to their successor.
Owner's expectation	The owner expect the successor will continue their company	The owner (predecessor) expect that the successor will get a better job rather than continue their company.
Prideness to be an entrepreneur	The owner proud to be an entrepreneur, therefore they develop innovation in the company	The owner does not proud to be an entrepreneur, hence, they manage the company without long term planning.
Impact to the successor	Successor has a clear path to develop their capabilities	Successor does not have a clear path to develop their capabilities.
Initiator of Innovation	Predecessor play a significant role to develop innovation	Successor become an initiation of Family SMEs innovation

## **VI. Limitation and Future Research**

This research conducted in service and manufacturing sectors. It needs to explore more on each sectors and details based on service or manufacturing. In the future, exploring the internal capabilities development design and the impact of the design to the Family SMEs innovativeness will be interesting. The future research also can explore the role of supply chain network and business associations to the Indonesia family SMEs' innovativeness.

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# ATTACHMENTS

1. Submission Letter
2. Research Article
3. Researcher Profile



## ATTACHMENT 1. SUBMISSION LETTER

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## ATTACHMENT 2. RESEARCH ARTICLE

# How to Build Internal Capabilities for Innovativeness in Indonesian Family SMEs

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### **Abstract**

**Purpose** – The research intended to explore the process of building internal capability (i.e. knowledge) on Indonesian family SMEs. The process focus on building successors' capabilities.

**Design/methodology/approach** – This study used qualitative approach with multiple case studies. In-depth interview conducted to 42 participants from 22 Indonesian family SMEs. Semi-structured interviews were conducted with the predecessor and the successor of the company. Triangulation technique and member checking use in this research to ensure validity. The data were analyzed using content analysis method, visual map strategy, and temporal bracketing.

**Findings** – The findings indicate that Indonesian family SMEs have internal and external innovation resources. The internal resources are internal family and internal company, while external resources are institution (School/college, government, and business association), supply chain network, and internet. A well design and spontaneous of internal capabilities development also found in the process.

**Research Limitation / implication** – This research conducted in service and manufacturing sectors. It needs to explore more on each sectors and details based on service or manufacturing.

**Originality/value** – This paper shows the internal and external innovation capabilities resources and also the development process of internal capabilities for innovation in family SMEs.

**Keywords** – internal capability, family business, family SMEs, innovation,

**Article classification** – Research Paper

## **I. Introduction**

Family SMEs are a significant economic force in the global economy (Llach and Nordqvist, 2010; Cabrera-Suarez *et al.*, 2001) and also have been believed to be driving force in economics development within a country (Indarti and Langenberg, 2004; Taneja *et al.*, 2016). Family SMEs can solve social problem such as unemployment, poverty, and criminal activity (Indarti and Langenberg, 2004; Kusuma and Indarti, 2017).



Family SMEs entrepreneurs are unique because they build business that are also family institution (Chrisman *et al.*, 2003). Family SMEs has desire to keep the business going for multiple generation (Kellermanns *et al.*, 2012), therefore family SMEs may determine not only the extent of their innovation efforts but also how they attempt to innovate and the results they achieve (Nieto *et al.*, 2015).

Companies, including family SMEs, need competitive advantage to survive in the long term, and innovation is one of the key drivers of sustainable competitive advantage (Taneja *et al.*, 2016; Brines *et al.*, 2013). Innovation also ensure the survival of the family SMEs against competitors (De Massis *et al.*, 2016). It is important for family SMEs to be continually involved in the process of innovation to survive in the competitive environment (Taneja *et al.*, 2016).

Innovativeness is an important entrepreneurial capability that Family SMEs can use to achieve competitive advantage (Llach and Nordqvist, 2010). Innovativeness may describe a core concern for family firms in achieving their performance goals (Kraiczy *et al.*, 2015). The benefits of innovativeness vary depending on the generational ownership dispersion of the family firm (Kellermanns *et al.*, 2012), hence, the Family SMEs must ensure that the successor has the same knowledge and key skills as the predecessor to maintain and improve the company's performance (Cabrera-Suarez *et al.*, 2001).

The study of innovation in family SMEs is essential since these firms are governed by a unique set of norms, cultures, and processes that are not found in nonfamily SMEs (Kellermanns *et al.*, 2012). Innovation management in family SMEs is also inherently interesting because there are strong theoretical reasons to believe that it differs from innovation management in nonfamily SMEs (Chrisman *et al.*, 2015).

*Ability* and *willingness* are two key drivers of family governance that theoretically cause the differences in behavior and performance between family and nonfamily SMEs as well as among family SMEs (Chrisman *et al.*, 2015). Family SMEs have some particular advantages over their non-family counterparts with respect to discovering new opportunities through a combination of some of the common family business characteristics such as long-term orientation, low staff turnover, long leader tenure, and family ties that may lead to this advantage (Patel and Fiet, 2011) cited in (Brines *et al.*, 2013). Familiness also a unique resources of family SMEs that make family SMEs behaving entrepreneurially and innovatively (Brines *et al.*, 2013; Llach and Nordqvist, 2010; Kellermanns *et al.*, 2012; Casprini *et al.*, 2017)

Initial studies regarding innovation in family SMEs found that they were less innovative than non-family SMEs due to their risk averse behavior (Llach and Nordqvist, 2010; Taneja *et al.*, 2016; Nieto *et al.*, 2015; Casprini *et al.*, 2017; Werner *et al.*, 2017; De Massis *et al.*, 2015). Risk-taking behavior of the family firm is mostly affected by the organizational context (i.e., family ownership, family management, and family control) (Kraiczy *et al.*, 2015), and due to the overlapping nature of the family and business, family firms are more apt to be risk adverse (Kellermanns *et al.*, 2012). The lack of Innovation of family SMEs also occurs from the resource scarcity. Compared to large corporations, family SMEs are generally more resource constrained in their ability to develop and commercialize new products and services. To be innovative and maintain competitive advantage, Family SMEs must overcome resource scarcity by finding ways of deploying and combining existing resources in a value-creating approach (De Massis *et al.*, 2018).

The predecessor of family SMEs intends to inherit the company to the successor (Chirico, 2008; Kusuma and Indarti, 2017; Varamaki *et al.*, 2003). Family firms at later generational stages tend to become more professional than family firms at earlier generational stages (Kraiczy *et al.*, 2015), but the succeeding generations of family firm leaders seem to be more risk averse than the founder generation. As a result, the innovation output continuously decreases from generation to generation. Founder generation acts more innovatively than succeeding generations (Werner *et al.*, 2017).

A Family SMEs' successor must have the skills and master the knowledge of the predecessor to have credibility and to be accepted by the company's key stakeholders (Lee *et al.*, 2003). Accordingly, transferring knowledge internally sets the basis for innovating and improving efficiency (Davenport and Prusak, 1998, cited in Cabrera-Suarez *et al.*, 2001). Family SMEs successors need to be more realize about innovation strategy. One element of the strategy that they must concieve is internal capabilities. Internal capabilities are the necessary resources that family SMEs must have to be strategically innovative, including people, skills (i.e. knowledge), and technology (Taneja *et al.*, 2016).

Innovation is critical for the sustainable success of family SMEs (Brines *et al.*, 2013; Taneja *et al.*, 2016; De Massis *et al.*, 2018). A recent review article indicates that research about family firm innovation management is very much in its early stage and that, unsurprisingly, results are inconsistent (Chrisman *et al.*, 2015). Many studies have explored innovation in family SMEs, but there is a lack on the exploration of the process (or inputs) that influence innovation in family SMEs (Glover *et al.*, 2016; Roessi *et al.*, 2010). Continued research around innovation within family SMEs is needed to better understand the

influence of specific resources and capabilities that might promote and/or constrain entrepreneurial activities (Brines *et al.*, 2013). since many family firms can be classified as SMEs, it seems appropriate to also have a study on innovation in family SMEs (Roessi, *et al.*, 2010).

The current study is intended to fill the above mention gap. The current study explores the process of building internal capability (i.e. knowledge) on family SMEs. This study conducted in Indonesia, where the vast majority of SMEs owned by family (Indarti, 2010). Using the Knowledge Based view Theory as frame of this study, the study aims to answer the following question: How do Family SMEs build their internal capability (i.e. knowledge) to innovate?

## **II. Literature Review**

### *Family SMEs*

Family SMEs can be considered as a unique bundling of two influencing system: the family and the business (Habbershon and Williams, 1999; Brines *et al.*, 2013). The “borders” between family and business are blurred due to the business and family systems interacting and overlapping in unique and dynamic ways over time and across generations (Brines *et al.*, 2013).

A firm also can be considered as a family firm when the business is owned and managed by a nuclear family (Chua *et al.*, 1999). However, most of the authors base their criteria in three conditions, ownership (the family has to hold more than 50% of the ownership of the firm), governance (a family is controlling the business) and management (significant proportion of the senior management is drawn from the same family) (Llach and Nordqvist, 2010; Floren, 2002).

According to Floren (2002), the family SMEs applies the business system and the kinship system all at once. The kinship system is oriented to balancing and minimizing the conflict, while business system aims to produce goods or services for profit. In order to survive, it uses the alteration to effectively adapt to the environment. In the family SMEs, these two systems interact and overlap, as well as depend on each other. Family SMEs must be able to balance the two systems ( Kusuma and Indarti, 2017; Ramadani and Hoy, 2015; Floren, 2002). The interaction between the kinship system and the business system generate a unique resource and become the main characteristic of family SMEs called familiness

(Cabrera-Suarez *et al.*, 2001; Higginson, 2009; Chirico, 2008). The difference between the kinship system and the business system can be seen in Table 1.

Increasing business competition, in particular against large and modern competitors, put Family SMEs in a vulnerable position (Indarti and Langenberg, 2004). Family SMEs have some hard-to-duplicate capabilities or ‘familiness’ while on the other hand family firms suffer a lack of financial capital due to family ownership and control (Llach and Nordqvist, 2010). Compared to large corporations, SMEs are generally more resource constrained in their ability to develop and commercialize new products and services (De Massis *et al.*, 2018; Indarti and Langenberg, 2004).

In Indonesia, most Family SMEs operate along traditional lines in production and marketing, and the main problem for family SMEs in developing countries is not their small size but their isolation, which hinders access to markets, as well as to information, finance and institutional support (Mead and Liedholm, 1998; Swierczek and Ha, 2003, Cited in Indarti and Langenberg, 2004). To be innovative and maintain competitive advantage, family SMEs must overcome resource scarcity by finding ways of deploying and combining existing resources in a value-creating approach (Boyd, 2010; Eddleston *et al.*, 2008; Sirmon *et al.*, 2011 cited in De Massis *et al.*, 2018)

**Table 1. The Difference between the Kinship System and the Business System Factors**

<b>Factors</b>	<b>Kinship System</b>	<b>Business System</b>
Relation	Connected by birth	Joined by choice
Duration	The rest of life	Temporarily
Decision	Based on emotion	Based on ratio
Behavior	Unconscious Behavior	Conscious Behavior
Reward	Based on equality	Based on achievement
Orientation	Internal	External
Character	Conservative	Dynamic

Source: Floren (2002)

#### *Internal Capabilities of Family SMEs*

The objective of the entrepreneur is to successfully hand over the firm to the next generation (Werner *et al.*, 2017; Cabrera-Suarez *et al.*, 2001; Chirico, 2008). Family SMEs’ successor must continuously innovate and be ready to adapt to changes in the marketplace by improving their learning capability to survive and surpass the competition (Taneja *et al.*, 2016).

One of the most important factors for generating innovations is the knowledge basis of the workforce. It can represent a competitive advantage when the company is able to develop,

keep, and exchange the knowledge as it is based at least partially on experience (Cabrera-Suarez *et al.*, 2001; Werner *et al.*, 2017; Chirico, 2008). A company successor must have the skills and master the knowledge of the predecessor to have credibility and to be accepted by the company's key stakeholders (Lee *et al.*, 2003).

Family SMEs need resources, skills, and proficient leaders who care about innovation to use their innovation capabilities (Taneja *et al.*, 2016; De Massis *et al.*, 2018). Innovation capability describes the actions that can be taken to improve the successful implementation of innovation strategies and activities in a firm. Innovation capabilities allows SMEs to integrate, build, and reconfigure internal and external competences to address rapidly changing competitive environments (Taneja *et al.*, 2016). This study focus on internal capabilities, especially on knowledge and skill.

The knowledge based theory identifies knowledge as the most fundamental asset of the firm that all other resources depend on (Grant, 1996; Spender, 1995 cited in Chirico, 2008). In Family SMEs context, successor need to acquire knowledge from the previous generations but also add new knowledge gained through education and personal experience within and outside the family SMEs (Cabrera-Suarez *et al.*, 2001). Assimilating knowledge from outside the firm requires "learning" or "absorptive" capacity (Cohen and Levinthal, 1990). Family firms need to invest in absorptive capacity in order to extract the benefit from innovation (Feranita, *et al.*, 2017).

Knowledge is defined here as the integration of information, ideas, experience, intuition, skill and lessons learned that creates added value for a firm (Dana *et al.*, 2005). The literature clearly distinguishes between pure knowledge and skill. Pure knowledge regarding the information and understanding of fundamental principles acquired through education, hence, skill is the ability to apply the accumulated pure knowledge through the experience gained (Chirico, 2008). Skill is the ability to carry out a particular task or activity, especially because it has been practices. Pure knowledge is the information behind that skill (Chirico, 2008; Nonaka and Takeuchi, 1995).

The knowledge takes two forms, tacit and explicit, raises a dilemma for companies, referred to as the paradox of tacit and explicit knowledge. These dilemmas have lead to idiosyncratic knowledge, or the combination of tacit and explicit knowledge (Jassimuddin *et al.*, 2005). The majority of knowledge in family SMEs is idiosyncratic (Cabrera-Suarez *et al.*, 2001; Lee *et al.*, 2003). Key knowledge which transferred from predecessor to successor in Family SMEs summarized in Table 2.

In family SMEs, the predecessors have a great desire to transfer their knowledge and have the willingness to teach their successors everything they know about the company (Trevinyo-Rodriguez and Tapies, 2006). Knowledge transfer is the key to the sustainability of a family SMEs after the transfer of responsibility from one generation to the next (Cabrera-Suarez *et al.*, 2001). Knowledge transfer in family SMEs is done slowly and in stages. The transfer begins with conveying simple practical know-how before moving on to more complex and abstract knowledge ( Kusuma and Indarti, 2017).

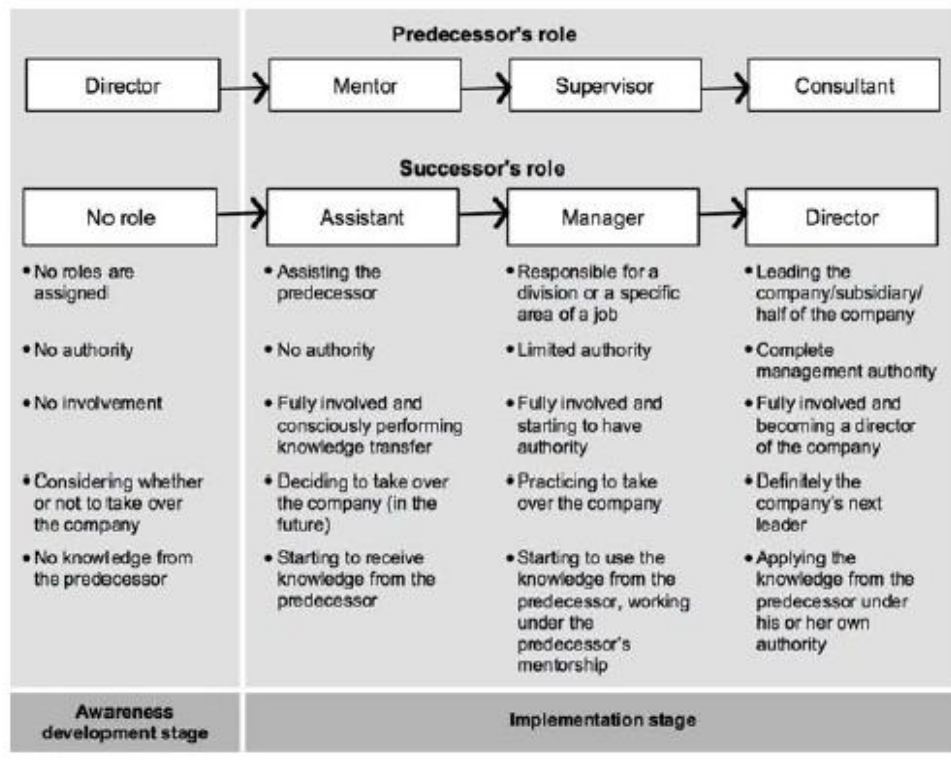
**TABLE 2. KEY KNOWLEDGE OF FAMILY SMEs**

<b>Transferred Knowledge</b>	<b>Description</b>
Knowledge of the product	Product composition Quality standard Process of product making
Knowledge of company management	Financial management Employee engagement Business risk Company partners Competitors and business environment Trend and business cycle
Technical knowledge	Negotiation and make a deal Consumer handling
Philosophical knowledge	Professionalism: work ethic, discipline, commitment Honesty Religion values Intuition (identified threats and seize the opportunities).

Source : Indarti and Kusuma, 2016

The learning process stages are based on the successor's level of understanding. The knowledge transferred by the predecessor to the successor begins simply and then becomes more complicated over time ( Kusuma and Indarti, 2017; Chirico, 2008). From a knowledge-based view, this process includes know-how gained through education, training, and experience as well as the ability and motivation to share and exchange one's knowledge within the firm and to absorb new knowledge from colleagues (Cohen and Levinthal, 1990). In the family SME context, the predecessor has rich tacit knowledge due to the accumulation of knowledge and experience (Chirico, 2008) Learning from experience should be transferred to the next generation so that the successor has the same level of capabilities with the predecessor (Trevinyo-Rodriguez and Tapies, 2006). On the knowledge transfer proses, the predecessor's and successor's roles gradually change. The successor's roles and responsibilities increase with the decrease of the predecessor's roles and responsibilities (Kusuma and Indarti, 2017). The role adjustment illustrated on figure 1.

Figure 1. Role adjustment on knowledge transfer process in Family SMEs



Source : Kusuma and Indarti, 2017

### *Innovation in Family SMEs*

Innovation is capability that allows SMEs to integrate, build, and reconfigure internal and external competences to address rapidly changing competitive environments (Saunila and Ukko, 2014). Innovation is an improvement anywhere in the business; not only in products, services, and processes, but also in leadership, HR, communication, organization, marketing, and any other activities (Csath, 2012 cited in Taneja *et al.*, 2016).

Innovativeness is an important entrepreneurial capability that family-run firms can use to achieve competitive advantage (Llach and Nordqvist, 2010). The social capital created by the notion of “familiness” is a key contributor to family SMEs behaving entrepreneurially and innovatively (Cabrera-Suarez *et al.*, 2001; Brines *et al.*, 2013; Lee *et al.*, 2003). The form of a firm’s capability to innovate can be viewed as how it introduces a new product, a new process, and new ideas (Koc and Ceylan, 2007)

Family SMEs tend to have flexible innovation cultures with low resistance to change, low risk aversion, and high tolerance for ambiguity (Taneja *et al.*, 2016). The characteristics of family firms may influence their decisions on innovation strategies (Nieto *et al.*, 2015). In small and medium-sized family firms, where decision-making is often centralized and the

firms' size are rather small, it is the CEO's disposition and resulting behavior that most strongly influence innovation in family SMEs (Kraiczy *et al.*, 2015).

Innovation in family SMEs are more informal and risk averse rather than non-family SMEs (De Massis *et al.*, 2015). Family SMEs also invest less in R&D due to higher risk aversion and resource constraints (Nieto *et al.*, 2015). Non-family firms are more likely to use formal monitoring and control mechanism that oppress innovation activities, whereas in small family firms, open channels of communication, informal decision making, and flexibility in processes are prevalent and lead to a more innovation-friendly atmosphere (Craig and Dibrell, 2006).

Family SMEs should have incentives to innovate as innovation creates wealth and opens new business opportunities (Nieto *et al.*, 2015). Compared to large corporations, Family SMEs are generally more resource constrained in their ability to innovate. They must overcome resource scarcity by finding ways of deploying and combining existing resources in a value-creating approach (De Massis *et al.*, 2018). Resource constraint and market uncertainties limit SMEs ability to invest on R&D to experiment with new product development, Hence, it is advantageous for SMEs to connect to local networks in their community because it helps them to get the benefit from the community to enhance their innovativeness (Taneja *et al.*, 2016).

Innovation occurs primarily through new combinations of resources, ideas, and technologies. However, a fertile innovation environment requires a constant inflow of knowledge from other places (Fey and Birkinshaw, 2005). Concerning the type of innovation output, family firms are more likely to achieve incremental than radical innovations and are less inclined to assimilate external knowledge than their non-family counterparts (Werner *et al.*, 2017). Family SMEs tend to prefer using internal knowledge, thus adopting a more closed approach to innovation, unless specific knowledge management practices are adopted (Casprini *et al.*, 2017).

The benefits of innovativeness vary depending on the generational ownership dispersion of the family firm (Kellermanns *et al.*, 2012). Family SMEs at later generational stages tend to become more professional than family firms at earlier generational stages (Kraiczy *et al.*, 2015) but less innovate than their predecessor. The successor become less innovate because they feel the pressure (from the family) to preserve the company. They need to cautiously weigh whether it is worth to invest in (risky) innovations (Werner *et al.*, 2017). Although family SMEs have superior ability to innovate, they are less willing to do so (Chrisman *et al.*, 2015)



### III. Research Method

This study required the participants to share their experiences and understandings related to the study context. The participants were required to describe the condition (setting) in which they were connected to the study problem as well (Creswell, 2010). Based on that issue and also the opinions from McCollom (1990) in Chirico (2008), this study used a qualitative approach with various case studies. Each case was examined independently, and the results were compared based on the characteristics of the study (Yin, 2009).

Family SMEs were selected using theoretical sampling by considering the following characteristics: age of successor (younger or older); gender of predecessor and successor (different or the same); and number of successors (one or more). We used purposive sampling procedure to see participants in this study. The criteria to select the participant: 1) the family SMEs were already run by the next generation and 2) the successor was involved in the daily operation of the family SMEs. Data were collected by means of in-depth interview and observation.

The data collection was done by personal in-depth interviews with the owner of the family SMEs. The Family SMEs details are described in Table 3. The interviews were conducted with the predecessor and/or successor. To increase the validity, the data was also supported by the company's documents, archives recorded, direct observation, participant observation, and physical artifacts (Yin, 2009).

Semi-structured interviews were conducted with the predecessor and the successor of the company. Each session was conducted in two stages. The first stage was done by providing an open question without informing the participants about the purpose of the study, so that it does not affect them. The second stage was done in the structured questions in which those are related to the transfer of knowledge between generations that occurs in the company. The data collection was over when the data obtained was saturated. Saturation in data collection happens when there is no new information. The indicator of saturation occurs when there is replication or repetition in the information obtained from different informants (Creswell, 2010).

To ensure validity and credibility, this study used triangulation technique and member checking (Yin 2009; Creswell 2010). Triangulation includes source triangulation (the participants were predecessors and successors; primary and secondary data); method triangulation (observation and indepth interview), and time triangulation (the studyer interacted intensely with the family SMEs in a determined time frame). Member checking

was done by sending back interview transcripts to the participants to ensure data congruity with the participants' perspectives. This process also ensured that there was no bias in the study (Yin 2009; Cresswell 2010). The data were analyzed using content analysis method, visual map strategy, and temporal bracketing (Langley, 1999).

**Table 3. Participant Profiles**

No	Firm	Year of establishment	Sectors	Generation
1	KFS	1981	Photography	2
2	BRJ	1981	Food Production	3
3	ECH	2000	Construction	2
4	CVA	2000	Construction	2
5	CVM	1978	Offset	2
6	EPP	1995	Tailoring	2
7	KBI	1978	Tailoring	2
8	AMN	1990	Hotel	3
9	CRF	1990	Offset	2
10	TGC	1985	Catering	2
11	ADM	1985	Restaurant, Music store	3
12	PLJ	1997	Interior Design	2
13	APS	2000	Sanitation	2
14	BNM	1997	Sanitation	2
15	BBS	1990	Construction	2
16	BPP	2004	Food Production	2
17	PAR	1980	Fashion	4
18	NMK	1990	Fashion	3
19	TBD	1965	Grocery	4
20	LSS	1974	Offset	3
21	SBA	2000	Grocery	2
22	RPA	2000	Hospital	2

#### **IV. Data Analysis and Discussion**

Internal capabilities development is crucial for Family SMEs. This process is central and crucial to the existence of Family SMEs (Taneja *et al.*, 2016). Innovation capabilities development needs involvement of the owner of the Family SMEs. This study reveals that the involvement of predecessor and successor of Family SMEs are crucial. The predecessor is one of the capabilities source, and the successor is the new energy for company innovativeness.

In line with Chirico (2008), this study found that there are knowledge accumulation on Family SMEs, and the new generation add new knowledge and offer new innovation for the family SMEs. This study found internal and external sources of innovativeness, including predecessor's experience.

## **4.4 Innovativeness Sources**

### *4.4.1 Internal Sources*

#### c. Internal Family

The owner of Family SMEs plays important role on firm's innovation. Predecessor and successor determine how the firm will innovate. The main resources of the knowledge came from founder (predecessor). Second generation of BRJ confirmed this: "This company built by my mother, all of the food products that we produce are based on her recipe". The 3<sup>rd</sup> generation of BRJ add: "We make the basic product based on my grandmother recipe, but now we make new variance of those products".

The knowledge from the predecessor is not only about the product, but also about process. They innovate incrementally in line with their daily process. They found new method when they do their job. They learn from their mistake and also from trial and error process. They use Learning by doing method to build their knowledge. The second generation of KBI confirmed this: "My father has his own method to sew the clothes. He has special formula to make a fit and comfortable clothing model that he got from his experiences as a tailor." Predecessor of KBI confirmed this statement: "I made my own method to tailor the clothes. I got it from my experiences on tailoring for more than 30 years."

Indonesian Family SMEs also get the innovation capabilities from relatives. Family members outside the nuclear family also play important role on Family SMEs innovation. Owner of ECH said: "I learnt about this business from my uncle. He also gave me his network, so i can develope my own network."

#### d. Internal Company

Indonesian family SMEs also get their innovation capabilities (knowledge) from the employees. The firms which already established for several generation have employees whose age are older than the successor. These employees have experinces and also valuable tacit knowledge that build for many years. The successor of LSS told his experience: "I also learn from senior employees at my company. They have valuable experiences that help me to solve the problem creatively. I can not find their way to solve the problem at school or anywhere else."

Innovation capabilities also arise from combination between pure knowledge which the owner got from formal education and employees experiences. ECH owner confirm this. He said:"I studied architecture at university, but in daily operation, I also need my

employees' experiences. They know how to build the house technically, but they don't understand the concept comprehensively. Hence, my knowledge is a combination of my knowledge from college, my employees experiences, and my own experiences from learning by doing."

Research and development department also become one of Indonesian Family SMEs alternative to develop their innovation capabilities. Family SMEs which have R&D department are the companies that have sufficient resources. They hire competent employee for R&D, but the control of the R&D still on the owner's hand. The owner involve in the R&D operation, and they keep the knowledge from R&D result. The owner of BPP explain this: "We have R&D department. My daughter is the head of R&D department." The APS successor also explain."My father controls the R&D department."

#### 4.4.2 External Sources

##### d. Institution

School or college is an option for Indonesian Family SMEs to develop their innovation capabilities. Company invest their money on education especially for the successor. They choose education that relevant and support the company sustainability. KFS successor confirmed this. He said "My parents asked me to study abroad and learn about photography." Predecessor of PAR also confirmed this by saying "I asked my first daughter to study about business, and her younger sister went to fashion design college."

Government is an important part on Indonesian Family SMEs innovativeness development. Indonesia Family SMEs had been facilitated by the government in term of technology improvement. The owner of BNM explain this: "I used to make my product manually, I change my production process after I joined government program on sanitation technology."

It is advantageous for SMEs to connect to local networks in their community because it helps them to get the benefit from the community to enhance their innovativeness (Taneja, et al., 2016). Business associations help the Indonesian family SMEs to enhance their knowledge to support innovation. It is a common to share their knowledge to the other company on the association. It explained by APS owner. He said "I learnt about this business from my friend on association. He shared his experiences, He already work in this field for 25 years."

#### e. Supply Chain Network

Innovation environment requires a constant inflow of knowledge from other places (Fey & Birkinshaw, 2005). Supply Chain Network need to be integrated, hence it encourages each part to enhance their capabilities. It explained by SBA owner that said his company must improved their accounting system and also warehousing system in term of integration to their supplier.

Company also get input for their innovation from their retailer or customers. Idea for new product design arise from customer request. It explained by ECH owner. He said: "Sometimes I got new idea for designing a house from my customers."

#### f. Internet

Participants on this research already familiar with the internet. Internet has been an alternative for Indonesia family SMEs to get information to enhance their capabilities. Even the predecessor did not familiar with the internet, the next generation use this technology. It said by ADM successor. He said: "I always use internet to get idea for new recipee. I combine the informaton on internet and my prior knowledge on cooking to make innovative product for my restaurant."

### 4.5 *Internal Capabilities Development Process*

#### 4.5.1 Knowledge Accumulation and Absorptive Capacity

Inline with Chirico research (2008), this research found the knowledge accumulation on Indonesia Family SMEs. The knowledges that owned by predecessor (i.e. founder) are in the form of tacit knowledges. The owner learn from daily process. Most of the participants said that they got the knowledge based on their learning by doing experiences. These experiencess transferred to the successors and become their basic capabilities. It explained by KBI successor, he said "I learnt from my father. He has his own method to do tailoring. We can not find his method on any books.

The successor obtained his/her knowledge from the predecessor by verbal explanation, example, and chance to practicing their knowledge. Time required in this process depend on successor ability to understand the knowledge. Absorptive capacity (Cohen & Levinthal, 1990) also plays a role in this process. Sucessor of CVA said "I need years to understand my father's method."

#### 4.5.2 *Designing internal capabilities platform*

On the planning level in Indonesia Family SMEs, this research found that there are two types of internal capabilities development design. First type is a well design internal capabilities development, and the second is a spontaneous internal capabilities development design.

A well design internal capabilities development has a systematic scheme and a clear time schedule, otherwise a spontaneous internal capabilities development design does not have scheme and clear time schedule.

For the family SMEs, owner's disposition and resulting behavior that most strongly influence innovation (Kraiczy, et al., 2015). The owner's role, in this case is the predecessor, determine the form of design. The factors such as the owner's orientation, the owner's expectation, and also their pride to be an entrepreneur influence the internal capabilities development design. The design will give impact to the innovation process at Indonesian Family SMEs.

The owner's orientation based on their awareness of the importance of innovation. The owner of KFS explained "I know that the innovation is important to our company, hence, i made a plan for my successor. I sent him to study abroad. I think international exposure will give us benefit." In the other hand, NMK owner said "I am too busy to think about that (internal capabilities development)." The owner that aware about the importance of innovation will develop a scheme and make a plan especially for the successor. In contrast, an owner who are too busy with daily company operation would not prepare the internal capabilities development for successor.

Family SMEs always related to the involvement of owner's family members, especially children as successor. Innovation in Indonesia Family SMEs influenced by the owner expectation to their children. The owner who expect their children to be an entrepreneur will develop a clear scheme for internal capabilities development, especially for preparing their successor. It was explained by BPP owner "I want her (successor) to be an entrepreneur, therefore I already arrange her a learning plan in the company. She must be able to handle the company." In the other hand, the owner who do not expect their children to take the company's torch, do not make any plan to their successor, even they prefer their children will get a better job at the bigger company or to be a government employee. It said by the BNM owner "This sludge removal business is not prestigious for our society. I want my children have a better job than this. So i do not prepare them to lead this company in the

future. I also run this company as it is. I only think how to survive until my children have their own job.”

The prideness to be an entrepreneur also give impact on the decision to design of internal capabilities or not. It said by The PAR owner “I proud to be an entrepreneur, hence, I want this company sustained. I develope R&D department even it costs much. My daughter should mastering the knowledge, therefore I ask her to lead the R&D department.”

#### *4.5.3 Process of internal capabilities development*

The company which has a well design of internal capabilities development plan the scheme carefully. It has clear activities and also time schedule. The CFS owner strenghten this by his statement “I change my company production technology. Therefore, I develope the steps with a clear time schedule to integrate the new system in my company.”

A well design of internal capabilities also take a part on the successor preparation to be the next leader. Predecessors have a clear and systematic method to prepare the successor. They know how and when to start the process for their successor. The ADM owner explained this “My father has a clear track for me. He developed a process so i can get the capabilities to manage this company. My first involvement was when I studied at elementary school. I started from a simple tasks and the complexity increased proportionally.”

A spontaneous internal capabilities, in contrast, does not have systematic scheme. It flows naturally without any planning. Therefore, the company with a spontaneous design does not have clear activities and time schedule. The owner of NMK explained this. She said “I never think about planning to make a new product or have a R&D department. I get new idea from my interaction with customers on my daily routine.”

A spontaneous design also impacting the successor preparation. The successors of the companies with a spontaneous internal capabilities design do not have a clear path to develope their internal capabilities. The owner of ABR explained this “My mother persists with her traditional business concept. She never think about internal capabilities. Hence, I do not have a clear scheme about that.”

Initiator of the innovation also influenced by these designs. In the company which has a well design, the innovation arise from a systematic process. The decision to innovate come from the consensuss between predecessor, successor, and also employess. The KFS owner explained this “When we want to make a change or an improvement, we always have a discussion process. The decision should based on data, so we need employees input at this point.” On the other hand, Initiator of the innovation at the company with a spontaneous design are the owner. In some case, the successors are the initiator. The CVM owner

explained “I got this company with an old system and also an obsolete technology. I change the system and also the technology. It was not easy because i had to convince my father to change it all.” This statement also illustrate that in some cases, successor is a risk taker and more innovate rather than the predecessor. It is contrast with the research by Werner *et al* (2017) that found the successor be more risk averse than the founder.

## V. Conclusion

Indonesia Family SMEs have two source of innovation. They get the innovation from internal and external sources. Internal sources are internal family and internal company. External sources are institution (School/college, government, and business association), supply chain network, and internet.

Predecessor’s experiences and knowledge become the basic of the internal capabilities for the successor. Therefore, knowledge accumulation and absorptive capacity take a part in the development process.

This research also found two types of internal capabilities development design. These designs are a well design and spontaneous of internal capabilities development. The details of the designs can be seen at table 4. The research also found that in some cases, successor is the initiator of the company innovation. It shows that in some cases, successor are more risk taker and more innovate than their predecessor.

**Tabel 4. Details of Internal Capabilities Development Design on Family SMEs**

<b>Internal Capabilities Development</b>		
<b>Factors</b>	<b>Well designed</b>	<b>Spontaneous</b>
Components	Have systematic scheme, clear activities, and clear time schedule	Flow naturally, does not have scheme, spontan
Owner’s orientation	The owner (predecessor) aware the importance of internal capabilities development for the company and the successor	The owner (predecessor) too busy with the daily operation, hence, they neglect the internal capabilities development to their successor.
Owner’s expectation	The owner expect the successor will continue their company	The owner (predecessor) expect that the successor will get a better job rather than continue their company.
Prideness to be an entrepreneur	The owner proud to be an entrepreneur, therefore they develop innovation in the company	The owner does not proud to be an entrepreneur, hence, they manage the company without long term planning.
Impact to the successor	Successor has a clear path to develop their capabilities	Successor does not have a clear path to develop their capabilities.
Initiator of Innovation	Predecessor play a significant role to develop innovation	Successor become an initiation of Family SMEs innovation



## **VI. Limitation and Future Research**

This research conducted in service and manufacturing sectors. It needs to explore more on each sectors and details based on service or manufacturing. In the future, exploring the internal capabilities development design and the impact of the design to the Family SMEs innovativeness will be interesting. The future research also can explore the role of supply chain network and business associations to the Indonesia family SMEs' innovativeness.



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### ATTACHMENT 3. RESEARCHER PROFILE

#### A. Identitas pribadi

1.	Nama Lengkap (dengan gelar)	:	Gabriella Hanny Kusuma, SE.,M.Sc
2.	NIP	:	08.14.881
3.	NIDN/NIDK/NUP	:	0519028101
4.	Pangkat dan Golongan Ruang	:	Asisten Ahli/IIIB
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11.	Nama Institusi	:	Universitas Atma Jaya Yogyakarta
12.	Alamat institusi	:	Jl. Babarsari No. 43, Yogyakarta

#### B. Riwayat pendidikan

No.	Nama Pendidikan	Jurusan	Tahun	Tempat
1	Universitas Gadjah Mada	Ekonomi – Manajemen (S2)	2011	Yogyakarta, Indonesia
2	Universitas Sanata Dharma	Ekonomi – Manajemen (S1)	1999	Yogyakarta, Indonesia

#### C. Riwayat pekerjaan (5 tahun terakhir)

No	Jabatan di Institusi	Tahun	Keterangan
1	Dosen	2014-now	Universitas Atma Jaya Yogyakarta
2	Research assistant	2013-2014	P2EB Universitas Gadjah Mada
3	Yayasan SATUNAMA	2005-2010	Program Manager for Konrad Adenauer Stiftung, Germany

#### D. Publikasi

No	Judul	Nama Jurnal atau Buku	Tahun
1	Mechanisms of intergenerational knowledge transfer among Indonesian family SMEs	International Journal Entrepreneurship and Small Business (IJESB) – Scopus Index (Q2)	2017
2	Types of Knowledge Transferred in Family Business Succession	International Conference on Industrial Engineering and Engineering Management (IEEM) – Scopus Proceeding	2016
3	Understanding the Perception of Millennial Generation toward Traditional Market (A Study In Yogyakarta)	Review of Integrated Business and Economics Research (RIBER) – Co author	2016
4	Metode Transfer Pengetahuan Pada Perusahaan Keluarga Di Indonesia	Modus – UAJY Jurnal Ekonomi dan Bisnis	2015
5	Transfer Pengetahuan Terencana dan Tidak Terencana Pada Proses Regenerasi Perusahaan Keluarga Di Indonesia	Jurnal Siasat Bisnis – UII (terakreditasi)	2015

Semua data yang saya isikan dan tercantum dalam biodata ini adalah benar dan dapat dipertanggungjawabkan secara hukum. Apabila dikemudian hari ternyata dijumpai ketidaksesuaian dengan kenyataan, saya sanggup menerima sanksi.

Demikian biodata ini saya buat dengan sebenarnya untuk memenuhi salah satu persyaratan dalam pengajuan Penelitian Internal Perorangan UAJY.

Yogyakarta, 16 April 2018

Peneliti,

( Gabriella Hanny Kusuma, SE., M.Sc.)