# CHAPTER II

# LITERATURE REVIEW

## 2.1 Human Resources Management

### 2.1.1 Definition of Human Resources Management

Human resource management (HRM) has evolved substantial change and redefinition over the past century in its theory, research and practices, and mainly in the last two decades, it has gone through a major process of transformation in terms of form and function. The increasing pressure from internal and external environmental factors have significantly pushed HRM to devote from their mostly function of administrative tasks to the role as a source of sustained competitive advantages in support of organization that operate in a worldwide economy (G. Ferris, Hochwarter, Buckley, Harrell-Cook, & Frink, 1999).

Human resource management is defined as a strategic and coherent approach to the management of an organization’s most valued assets – the people working there who individually and collectively contribute to the achievement of its objectives. Storey (1989) believes that HRM can be regarded as a ‘set of interrelated policies with an ideological and philosophical underpinning’. He suggests four aspects that constitute the meaningful version of HRM:

1. A particular constellation of beliefs and assumptions;

2. A strategic thrust informing decisions about people management;

3. The central involvement of line managers; and

4. Reliance upon a set of ‘levers’ to shape the employment relationship

Human Resources Management (HRM) is the process of acquiring, training, compensating employees and of attending to their labor relations, health and safety, and fairness concerns (Dessler, 2017). Human Resources Management provides with the concepts and techniques every manager needs to perform the “people” or personnel, aspects of management. These include:

- Conducting job analysis (determining the nature of each employee’s job)
- Planning  labor needs and recruiting job candidates
- Selecting job candidates
- Orienting and training new employees
- Managing wages and salaries (compensating employees)
- Providing incentives and benefits
- Appraising performance
- Communicating (interviewing, counseling, disciplining)
- Training employees and developing managers
- Building employee relations and engagement

Related to the Human Resources Management's understanding, there are some characteristics that indicate Human Resources Management, and the characteristics of the HRM concept as they emerged from the writings of the Pioneers (Armstrong, 2006) and later commentators are that it is:

- Diversity; which a distinction that made by Storey (1989) between the hard and soft versions of Human Resources Management. The hard version emphasizes that people are important resources through which organizations achieve competitive advantage. The soft version of Human Resources Management traces its roots to the human-relations school. It emphasizes communication, motivation and leadership.
- Strategic with an emphasis on integration; is a key police goal of Human Resources Management, which is concerned with the ability of the organization to integrate Human Resources Management issues into its strategic plans, to ensure that the various aspects of Human Resources Management cohere, and to encourage line managers to incorporate a Human Resources Management perspective into their decision-making.
- Commitment – oriented the achievement of high commitment, behavioral commitment to achieve agreed goals, and attitudinal commitment reflected in a strong identification with the enterprise' (Guest, 1987).
- Based on the belief that people should be treated as assets (human capital); which means human resources are valuable and a source of competitive

advantage. Armstrong and Baron (2002) stated that people and their ability and collective skill making a significant contribution to the organization success.

- Unitary rather than pluralist, individualistic rather than collective in its approach to employee relations; means it is believed that employees share the same interest as employers. The individualistic emphasize the importance of maintaining links between the organization and individual employees in order to operating through group.
- A management-driven activity – the delivery of HRM is a line management responsibility; Sisson (1990) suggest that the locus of responsibility for personnel management no longer resides with specialist managers.
- Focused on business values; HRM policies are adapted to drive business values and are modified in the light of charging business objectives and conditions (Legge, 1995). She also describes this process as ‘thinking pragmatism’ and suggests that evidence indicates more support for the hard versions of HRM than the soft version.

### 2.1.2 Human Resource Management System

Human resource management operates through human resource systems that bring together in a coherent way:

- HR philosophies describing the overarching values and guiding principles adopted in managing people.
- HR strategies defining the direction in which HRM intends to go.
- HR policies, which are the guidelines defining how these values, principles and the strategies should be applied and implemented in specific areas of HRM.
- HR processes consisting of the formal procedures and methods used to put HR strategic plans and policies into effect.
- HR practices comprising the informal approaches used in managing people.
- HR programs, which enable HR strategies, policies and practices to be implemented according to plan.

Becker and Gerhart (1996) have classified these components into three levels: the system architecture (guiding principles), policy alternatives and processes and practices.

### 2.1.3 Human Resources Management Practices

As defined by Noe, Hollenbeck, Gerhart, & Wright (2010), human resource management practices is a philosophy, policy, system and practices that can affect the behavior, attitudes and performance of employees. Activities of HRM practices include HR planning, staffing, training and development, performance management, compensation management, safety and health and employee relations. In an early stage, the management of organization has ignored the function of HRM practices as a main driver of organizational success.

Only lately, the potential role of HRM in enhancing organization performance has been realized. HRM practices can improve the performance of organizational by contributing to employee and customer satisfaction, innovation, productivity, and development of good reputation among firm's community (Delaney & Huselid, 1996; Noe et al., 2010).

There are several approaches in studying HRM practices in relation to organizational performance: universalistic, contingency or configurational approach (Delery & Doty, 1996; Youndt, Snell, Dean Jr, & Lepak, 1996). The universal, or "best practices" perspective is the simplest form of a theoretical model in HRM literature, and their researchers are micro analytical in nature. This perspective involves a direct relationship between HRM practices and performance (Youndt et al., 1996) whereby some HRM practices are hypothesized as constantly superior to others and these best practices should be adopted by all organizations (Delery & Doty, 1996).

The contingency perspective, on the other hand, posits that the impact of HRM practices on firm performance is conditioned by an organization's strategic posture. Researchers in the contingency approach dispute that HRM practices that applied by any organization must be coherent with other aspects of the organization so as to be effective. They have tried to explain the interaction between various HRM practices and specific organization strategies as they relate to organizational performance (Youndt et al., 1996). In contrast to "best practice" and contingency approach, the configurational perspective is interested on how the pattern of multiple HRM practices is related to organizational performance.

#### 2.1.3.1 Outcomes of Human Resources Management Practices

In prior studies on internal organizational resources, the resources that are rare, inimitable and valuable are considered as sources of sustainable competitive advantage and organizational effectiveness (Barney et al., 2001; Lado and Wilson, 1994). In addition, HRM practices contribute a lot to accomplish firm objectives and to create value. Hence, an organization must invest in human resource to guarantee long-term success.

HRM practices in every type of organization must support relations among organizational departments. Especially, organizations should consider systematic, cultural and structural alignment of HRM practices (Way and Johnson, 2005). Systematic, cultural and structural alignment of HRM practices supports organizational goals, objectives and strategies. In addition, HRM practices should enhance the value of an organization's employees (Welbourne and Andrews, 1996). The enhancing value of employees should be balance on the HRM practices and the firm's objectives.

Over the years, researchers have suggested many HRM practices that have the potential to improve and sustain organizational performance. These practices include emphasis on employee selection based on fit with the company's culture, emphasis on behavior, attitude, and necessary technical skills required by the job, compensation contingent on performance, and employee empowerment to foster team work, among others. Pfeffer (1998) has proposed ten HRM practices that are expected to enhance organizational performance. The practices proposed by (Ahmad and Schroeder, 2003; Pfeffer, 1998) :

a. Employment/job security
b. selective hiring or new personnel
c. Extensive Training
d. Interaction Facilities
e. Team Activities
f. Sharing information-feedback
g. Performance Review
h. Incentives to meet objectives
i. Written policy
j. Communication strategy

#### 2.1.3.2 Dimension of Human Resources Management Practices

A growing number of empirical examinations have confirmed that not every human resource practice can impact to organizational performance (Ahmad & Schroede 2003). For the purpose of examining the influence of human resource practices on organisational performance, there are the dimensions in human resource practices proposed by Pfeffer (1998) and adapted by Vlachos (2008), which, are expected to influence organisational performance.

The seven human resources management practices are: (1) employment/job security; (2) selective hiring; (3) extensive training; (4) interaction facilities; (5) team activities; (6) sharing information-feedback; (7) performance review; (8) incentive to meet objectives; (9) written policy; and (10) communication strategy.

We examine this ten practices as the HRM system for manufacturing plant and check the effectively of this ideal systems. This is going to be a set of HRM systems that we used in our research.

The following sections we will develop hypothesis concerning the relationship between HRM practice and firm Performance.

#### 2.1.3.2.1 Employment Security

Employment security refers to job security via work force stabilization in a careful way (Lee et al., 2010). Security in employment can be defined as a measure to see how the organization provide job for the employees. The ability of a firm to provide job security to its employee indicates the commitment to its workforce. Therefore, in a situation where they provide employment security, then there is possibility that performance will improve.

From the Job security, it will create a climate of confidence among employees which cultivates their commitment on the company’s workforce. Its requires a certain degree of reciprocity; first, a firm must know the message that job are safe; then employee believe, confident and they will contributes more effort to the firm and finally a firm will get their job security well done and its will invest to the firm performance, (Pfeffer.1998).

Other things are emphasized on training in order to know the characteristics and understand whether they are able to follow the flow of the company. One of the examples is training in multiple functions. This training is conducted to help other employees who are experiencing difficulties. Some of these parts help employees to get job security because the capabilities they have become things that can be considered by the company.

Thus, when companies do provide job security then the empirical evidence suggest that it has a positive effect on to firm performance. From Pfeffer (1998), Ahmad and Schroeder (2003) found that among others, job security impacts operational performance indirectly through organizational performance.

#### 2.1.3.2.2 Selective Hiring

Selective hiring is the process of using extensive procedure to assess the skills and abilities for job fit, relevant knowledge and organization fit such as interpersonal skills, selective screening, technical skills, attitude and/or personality (Ahmad and Schroeder, 2003). Some of the vital decisions made in organizations include Human resource staffing decisions. Employment interview is an essential focus of staffing decisions (Ferris et al., 1999).

In identifying a right candidate with the ability to perform a function, a sophisticated selection system which is valid and rigorous is essential. In a situation where there is a mismatch between the people employed and their jobs, there is possibility that the performance of the organization will be affected. A study by Singh (2003) has shown that a human resource selection process that is based on selective hiring leads to about 6% variation in firm performance.

Therefore, a selection process that focuses only on structured interview might be misleading if to assess the elusive and poorly defined notion of fit is the usefulness and true goal of an interview. Where fitness to the job and technical qualifications are best measured by tests and other objective procedures, dual assessment process should be the focus for recruiters.

In HRM system, selective hiring has an important place. This practice can ensure that the right people that hired when full with desirable characteristics, skills and knowledge will stay fit in the culture and the climate of the organization (Vlachos, 2008). During selection process, the organization should find out the attitude and behavior that employee have that encourage them to use problem solving method and great in team working, they need to hire a skillful employee and align them with the firm's goods and values (the skillful employee should be kept longer in the firm).

In addition the employee must be able to do multiple tasks to help each other whenever they needed some help. Employees who have skilled and talented jobs in their serving can increase the company's sight and entrepreneurial insight. Successful hiring practices provide firm with employee who can make a good start and a good decisions. Firm that have such a Human Resource can react quickly with unexpected opportunities and change.

#### 2.1.3.2.3 Extensive Training

Extensive training could be explained as the amount of formal training given to employees. Such training include technical and inter personal training, cross training, training for future and current skills, on the job training, off-job training, skill training, training for both newly hired and experienced employees (Lee et al., 2010; Ahmad and Schroeder, 2003). Therefore, firm investments in training both for non-technical and technical will produce a positive effect in the skills/knowledge development of its employees and the extent to which the firm will succeed.

Extensive training becomes one of important part that built the organization systems. Extensive training provides training in all aspects, which needed sufficient money and time to proceed. Extensive Training applies to all employees in order to develop and monitor employee's performance during that the process. The consistency of the training also evaluated to lead the satisfactory result.

#### 2.1.3.2.4 Interaction Facilities

Some of the simple ways facilities managers can encourage worker connections is to arrange workstations so that employees can see and speak with each other, which helps foster communication. Day-to-day employer/employee interaction includes leadership, motivation, problem solving session, and communication that build on hiring, orientation, and training. Employer/employee interaction cannot make up for an ill-defined job, having hired the "wrong" person, or inadequate orientation and training.

Managers and HR management create teams and use them to develop positive employee relation. They encourage the employee to engage with them by giving them the right to participate in presenting their options and ideas in problem-solving sessions. The other way is manager frequently holds group meetings where the people who work for them can really discuss things together. In addition, the relation between them will build a strong relation among others, and it’s give a positive effect to the firm performance (Dessler, 2017).

#### 2.1.3.2.5 Team Activities

A group of employees formed with the aim to carry out a particular job and/or to solve problems is regarded as team work, and their action known as team activities. Some studies noted HR systems that supposed team activities were critical to organizational competitiveness and innovativeness (Lau and Ngo, 2004). While team activities improve co-operation and communication among employees, at the same time they create an appropriate work culture. Therefore, it’s needed in the firm to encourage the employees to apply this in their work-related activities efficiently and effectively.

Another studies found that there are positive linkages between firm performance (Hamran, Khulida Kirana, Suhaimi &Rashid, 2016). The team activities help the company to solve problems related to the production, manufacturing, processing, packaging, and distributing. They create a good relation, communication, and help one to each other among the teams. Thus it will generate a positive firm's performance. It is logical to reason that teamwork will enhance performance of any organization which aims profit maximization.

#### 2.1.3.2.6 Sharing Information-Feedback

Feedback on performance is a practice that is needed by supervisors and employees to enhance effectiveness. It is a means of improving communications between supervisors and employees. Sharing Information on the individual performance of employees fosters organizational openness. It enhances loyalty and trust of the employees' effectiveness. This increase trust motivates co-operative behaviors in the firm (Stone, 1998).

The aim of sharing information and feedback is to measure the chart of the company performance that includes the defect rates, the frequency of machine breakdowns, and the schedule compliance that posted on the shop floor. The chart gives some information that employee needs to encourages their productivity, and help them to understand their position on the company, and what other things they should achieve in order to reach the goals (Ahmad & Schroede 2003).

#### 2.1.3.2.7 Performance Review

Performance evaluation can be known as performance review means evaluating an employee's current and performance relative to his or her performance standards (Dessler, 2017). Performance evaluation or performance review is an ideal option for an organization to determine the ability of an individual employee to accomplish his tasks. This effective system must focus on individual performance and his development (skills).

An organization have several reason to appraise it employees. For instance, the managers require performance review to provide feedback, support the performance, make valid decision, recognizes training and development needs. Thus the given uses of performance evaluation influence the firm's growth.

#### 2.1.3.2.8 Intensive to Meet Objectives

Intensive is particularly important in small firms due to its effect in significantly affecting the recruitment and retention of qualified human resource; if the small firms are unable to provide better payment for applicants, then they may not be able to recruit or retain knowledge or critical skills that will be needful for effective operation (Cardon and Stevens, 2004).

Reviews by Brown, Sturman and Simmering (2003) and Cardon and Stevens (2004) indicate support for the nation that Incentive have an impact on both employee and organizational performance. The theories said that Incentive influences employee performance because when employees expect to receive reward after fulfilling their job well (*Ngo et al.*1998).

In many studies, it is found that incentives have impacts on firm performance (Bae et al., 2003; Park et al., 2003). A general objective of incentives is to change attitudes and motivate employees. Incentives that enhance positive attitude and motivation of employees can contribute to firm's growth.

Another aim of giving an employee incentive is to attract the employee to give more attention to their job and motivate them towards great performance. It will encourage the employee to pursue firm objective. The incentive will give to the employee who is already meeting the goal of the target.

#### 2.1.3.2.9 Written Policy

HR policies are continuing guidelines on the approach the organization intends to adopt in managing its people. It is the formal rules and guidelines that businesses put place to hire, train, assess, and reward the members of their workforce. They define the philosophies and values of the organization on how people should be treated, and from these are derived the principles upon which managers are expected to act when dealing with HR matters (Armstrong, 2002). HR or employment policies help to ensure that when dealing with matters concerning people, an approach in line with corporate values is adopted throughout the organization.

Having policies written is important so that it is clear to all what the policies are and that they are applied consistently and fairly across the organization. There are many written policy that applied to the firm, as it follows discipline policy, written procedures, and written instruction. The written procedures and instruction are given in a special importance moments.

#### 2.1.3.2.10 Communication Strategy

Communication of strategy refers to the communication of systematic and related decisions by the management to the employees with a view of achieving better performance (Ahmad and Schroeder, 2003).

Communication with employees is an integral part of all human resources management functions (Messmer, 2008). Communication is one of the key elements of an effective employee relations program. Just as communicating with customers, managers and employers is crucial, keeping employees informed about business needs and developments is equally important for firm performance. An employee communication program can do the following (Messmer, 2008):

- Motivate employees and build their enthusiasm for their work
- Allow employees to give input to leaders developing operating plans
- Provide a means for clearing up misinformation.

Communication helps the company to share the goals, objectives and strategies to the employee in order to help them understand the long-run competitive strategy and encourage them to be competitive at the firm.

## 2.2 Corporate Entrepreneurship

### 2.2.1 Definition of Corporate Entrepreneurship

Ferreira (2002) states that corporate entrepreneurship is a new study that is growing, but until now the definition used by different experts. Corporate entrepreneurship definition of some of the experts are as follows (Puspo 2006, and from various sources):

1. Kuratko, *et.AL* (1993) corporate entrepreneurship is Entrepreneurship within the corporate/enterprise that describe the entrepreneurial behavior within existing organizations (established firm).
2. Lumpkin & Dess (1996), Enterprise company/corporation is a process, workmanship, and decision-making activities (orientation at entrepreneurial Orientation, consisting of three dimension innovation (innovativeness), proactive (proactiveness) and risk taking (risk taking) in achieving the company's performance.
3. Dess, *et.Al* (1999), Corporate Entrepreneurship is a process of the two types of problems, namely,
   (1) To trade / new commerce within the existing organization through internal innovation and corporation.
   (2) Changes in the organizational form through renewal strategies, such as the creation of new wealth through sources available.

4. Ucbasaran, *et.Al* (2001), is Process of renewal in the organization associated with different dimensions, but is linked to one another, namely, (1) the creation of a new commerce through product development and market expansion (market share), processes, technology, and innovation, and (2) changing the form of the concept of trade, adjustment of organizational form, and change the overall system for innovation.
5. Stoner, 2000; Kotler, 2005; Cravens (2005), is a Process of three-dimensional Corporate Entrepreneurship) namely, innovation, proactive, and risk-taking that is the dimension that is already well established / recognized (established).

So, from the definition about Corporate Entrepreneurship (CE) above, it can be concluded that corporate entrepreneurship is both formal and informal activities aimed at the creation of new businesses within established company to create new products related to the previous product through the process of innovation and proactive measures and market development in the achievement of the company's performance.

### 2.2.2 Model of Corporate Entrepreneurship

Corporate Entrepreneurship models proposed by Lumpkin and Dess (1996) which states that there is Corporate Entrepreneurship five dimensions that affect performance company / corporation of freedom (otonomy), innovation, willingness to take risks, proactive, and competitive aggressiveness. In this research we only emphasize more in proactive, innovativeness and risk taking (Baringer and Bluediorn, 1999).

#### 2.2.2.1 Risk Tasking

Risk taking shows a firm's willingness to engage in risky projects. Ruefli *et al*. (1999) suggest that risk taking is also an important element of strategic management; and according to Zahra (1993) employees' risk taking behavior is a relevant aspect of Corporate Entrepreneurship. Therefore, it's suggested to pursue opportunities by developing the innovative and proactive ideas, employees are welcomed to take risks as the entrepreneurs in a firm.

Hostager *et al*. (1998) defines intrapreneur as 'individuals and groups working within the corporation to:

(1) identify ideas for new products or services;

(2) Turn these ideas into profitable products or services

The level of risk taking shows the level of commitment of firm resources.

### 2.2.2.2 Innovativeness

Innovative refers to a modification in the existing or established human resources management practices of the organization, which is new to the organization as well as improved, even if the modification is by way of adopting or adapting the human resources management practices of other organization. (Agarwala, 2003)

In the case of Corporate Entrepreneurship, innovativeness is explained as willingness of a firm to support new ideas and introduce new products, production processes and organizational systems (Lumpkin and Dess, 1996). This dimension is seen as the creativeness in organizations.

### 2.2.2.3 Proactiveness

Proactiveness is a firm's process with two stages:

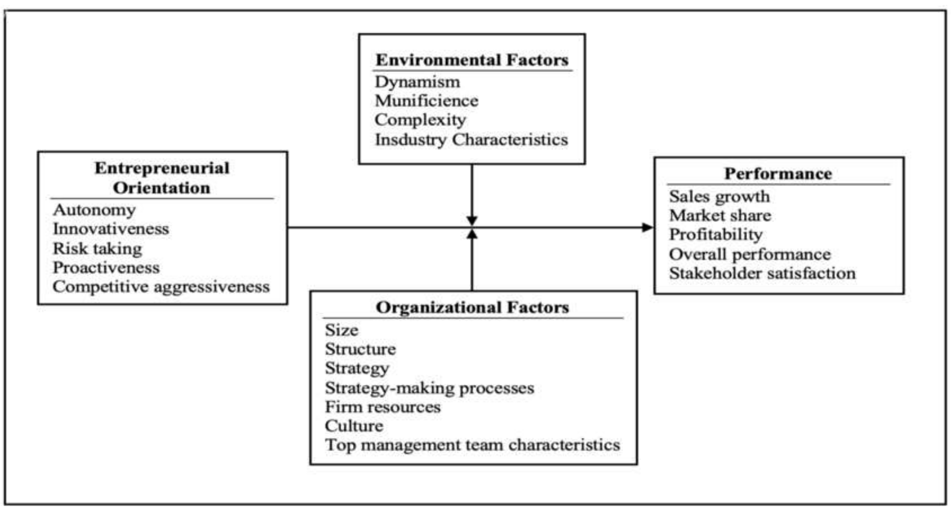
(1) anticipating changes in the environment and
(2) Acting according to these changes and future needs (Venkatraman, 1989).

In addition, proactiveness helps the company to identify new opportunities, start the pretentious strategic action, and doing the comprehensive in order to get their competitive advantages and be the earliest action in each opportunity. This strategy will create a great firm performance compared to the competitors.

On the other hand, Lumpkin and Dess stated that the primary key of the dimensions of entrepreneurial orientation is covering what can be done independently or not depends on the other party, meaning the will to conduct reforms and is willing to bear the risk, tend to be more aggressive than competitors, as well as proactive in helping people see/predict and anticipate the opportunities that exist in the market.

This Model suggests that aspects of the company / corporation will influence the relationship between orientation entrepreneurial performance company/corporation. However, they do not state that the company's performance affects the entrepreneurial orientation. It can be concluded that Lumpkin and Dess define the models that stand the picture, no feedback (feedback) between entrepreneurial orientations, corporate /enterprise, and organizational factors. This model can be seen in the image below.

**Figure 1. Entrepreneurial Orientation**




Source: Lumpkin and Dess (1996), Academy of Management Review, p. 152

### 2.2.3 Forms of Corporate Entrepreneurship

Corporate Entrepreneurship (CE) is a set of company-wide activities that centers on the discovering and pursuing new opportunities through innovation, creating new business, or introducing new business models. Successful Corporate Entrepreneurship involves simultaneous attention to both innovation and exploitation (Zahra, 1996); therefore, an array of activities and processes are implemented. This is in line with Guth and Ginsberg's (1990) view that Corporate Entrepreneurship is the "birth of new business within existing organizations, i.e., internal innovation or venturing".

There are two basic understanding of Corporate Entrepreneurship. On the one hand there is the "strategic philosophy approach," or "resources based which addresses the company's philosophy to act entrepreneurially (Lumpkin & Dess, 1996; Miles & Arnold, 1991). On the other hand, there is the "activity approach" that deals with examining entrepreneurial activities and actions (Antoncic & Hisrich, 2003; Birkinshaw, 1997).

In our discussion, we follow the activity-based Corporate Entrepreneurship concept, because it is compatible with the majority of Corporate Entrepreneurship definitions. It is also more consistent with the assumption of a link between concrete activities and company performance than, for example, the philosophy approach (Covin & Slevin, 1991). It also fits our assumption of an even more direct link between management practices and Corporate Entrepreneurship in the context of SMEs.

The Corporate Entrepreneurship approach provides important benefit by providing effective use of organizational resources. In some studies that investigated the relationship between Corporate Entrepreneurship and firm performance, it is found that Corporate Entrepreneurship leads to improvement in firm performance ((Naman and Slevin, 1993; Zahra, 1991, 1993; Zahra and Covin, 1995)

## 2.3 Firm Performance

### 2.3.1 Definition of Firm Performance

According to Hyndman and Anderson (1997) the performance can be seen from the production model, consists of three phases, inputs, outputs and results and performance can be interpreted in efficiency and effectiveness.

Mwita (2003) and is supported by Bromwich (1990) that supports a more comprehensive view, the performance includes several variables related and cannot be separated: input, behavior (process), outputs, and outcomes-outcomes (added value or impact). Further Ferry (2005) states that in an organization consisting of individuals who have different characteristics, influence on output and outcome which will be achieved that can be directed and motivated to achieve goals.

Further Pause (2000), states that the measurement of performance (performance) is one of effort in order to do resources effectively and can provide direction on strategic decision making regarding the development of an organization in the future. Performance is the organization's overall status compared to other similar organizations, or on a mutually agreed standard.

### 2.3.2 Model of Firm Performance

Performance was defined in case by a mix of financial and non-financial measures. Financial measures were predominant with close monitoring of sales. In this study the firm performance is measured as multidimensional and nine different dimension of performance are measured. These dimensions are sales growth, market share growth, return on sales, returned on assets, overall profitability, product/service quality, new product/service development capability, job satisfaction of employees, and customer satisfaction. This measurement are adopted from Barringer and Bluedorn (1999) and Wiklund and Shepherd (2003).

#### 2.3.2.1 Sales Growth

A sale is an exchange of goods and services for money (Kotler, 2009)**.** Sales as we see is the end result of marketing effort, it is the objective of marketing toward which all marketing is direction explains there is an exchange process in a sale. Sales growth refers to the developing, and the growing of the sale in a period of the time.

#### 2.3.2.2 Return on Sales

Return on sales is the profit margin on sales. It represents the percentages of each dollar that left over as net income after all expenses have been subtracted. Return on Sales is one of measure of the efficiency of a firm (Mowen, 2016).

#### 2.3.2.3 Return on Assets

Return on assets (ROA) is used to determine the financial performance of the sample firms. Basically, Return on assets measures an organizations ability to utilize its assets to create performance, expressed as a percentage of profit that a firm earned in relation to its overall assets. Return on assets is chosen to measure financial performance because several authors emphasize that this measure is widely used and most appropriate to operationalize performance (Lee, 2011).

The measurement is such that the higher the Return on assets, the effective is the use of assets to the advantage of shareholders (Haniffa & Huduib, 2006). Higher return on assets also reflects the company's effective use of its assets in serving the economic interests of its shareholders (Ibrahim & AbdulSamad, 2011).

#### 2.3.2.4 Product/Service Quality

Services can be defined as any act or performance that one can provide another which is intangible and does not provide ownership (Kotler, 1997). The concept of service quality in general can be defined as the process of meeting and exceeding the expectation of customers. According to Savidos and Baker –Prewitt (2000) service quality can be viewed from multiple directions such as the clientele contacts, the attitudes and the infrastructures as well.

#### 2.3.2.5 New Product/Service Development Capability

New service Development is thus a process that requires continuous adaptation to evolving customer needs (Kindstrom *et al*, 2012). Capability studies have tended to concentrate on either products or service innovations without consideration on how New Service Development in customers is done (Lin and Huang, 2013). The expert note that the competency of New Service Development in the ability of sense, seize and reconfigure are important to the innovation of the services (Kindstrom *et al*, 2012). In addition, the supplier's capability to identify customer needs, technological options, conceptualize, and education have been proposed as means to help service providers to deliver successful services (den Hertog *et al*, 2010).

#### 2.3.2.6 Job Satisfaction of Employees

Job satisfaction can be defined as the level of satisfaction an employee experiences in his/her job. Job satisfaction acts as the main motivation for the employee to work productively. It is not temporary feeling which following by short-term goals, but it's the great relationship between employer and employees. When the job satisfaction is one of the positive sides of the employee's role, the individual will be able to provide their contributions toward the success of the job. In addition, Job Satisfaction leads to the frame of thinking where the employee will be confident and comfortable to find more opportunities to show his talents and skill which lead more challenging tasks and responsibilities, thus its end up with the increasing pay and other relevant recognitions.

#### 2.3.2.7 Customer Satisfaction

Customer satisfaction is a measure of how your organization's total product performs in relation to a set of customer requirements. Customer satisfaction is in the customer's mind and may or may not confirm the reality of the situation. (Hill & Alexander, 2000) In an easier way, customer satisfaction is the measurement that determines how happy customers are with the company's products, services, or capabilities. Customer satisfaction information, including surveys and ratings can help a company determine how to best improve or changes its products and services. It is important for all organization to meet all customers' expectations and identify that they are satisfied customer hence the more is customer satisfaction, the more is the business and the bonding with customer.

## 2.4 Small Medium Enterprises (SMEs)

### 2.4.1 Definition of Small Medium Enterprises (SMEs)

There is no accepted worldwide definition of SMEs (Hooi, 2006). The definition is sorely based on a fixed quantitative measure; for instance are the total number of workers, the total numbers of capital, total assets and lately by determining sales turn over (Hasim and Abdullah, 2000). SMEs have historically been major player in the Indonesian economy, especially as the largest provider of employment, and primary or secondary source of income for many Household (Tambunan, 2006).

SMEs sector includes a variety of fields, including agriculture, trade, mining, processing, service and others. In Indonesia, the SMEs sector is often associated with social and economic problems, such as high levels of poverty, unequal income level of residents and the number of employed.

### 2.4.2 Criteria of Small Medium Enterprises (SMEs)

The World Bank (1984), the United Nations Industrial Development Organization (1985) and the Asian Development Bank (1990), which categorized SMEs as follows: (1) small-sized firms employing less than 50 workers; (2) medium-sized employing between 50-199 workers; and (3) larger sized firms employing more than 200 employees (Rapiah, 2011). In principle, the definition and criteria of SMEs in foreign country are based on the following aspects: the number of workers, income, and the amount of assets. Ahmad (2007) implied that there was a need to more closely examine the internal factors that can lead to the company success, without ignoring the environmental factors that can also affect the performance of the company, therefore, establishing a set of performance measurement framework to be critical to the success of SMEs.

In Indonesia Act governing SMEs is Law No. 20/2008, in the law of SMEs are described as: "a small company owned and managed by a person or owned by a small group of people with a certain amount of wealth and income." Here are the criteria of wealth and income in the law.

Criteria for SMEs and Large Enterprises Based Assets and Turnover

**Figure 2. SMEs Criteria**

| Size of Business | Criteria | |
|---|---|---|
| | Assets (excluding land & building business premises) | Turnover ( in a year ) |
| Micro Businesses | Maximum of Rp 50 Million | Maximum of Rp 300 Million |
| Small Businesses | More than Rp 50 Million - Rp 500 Million | More than Rp 300 Million - Rp 2.5 Billion |
| Medium Businesses | More than Rp 500 Million – Rp 10 Billion | More than Rp 2.5 Billion – Rp 50 Billion |
| Large Businesses | More than Rp 10 Billion | More than Rp 50 Billion |

Source: Law No.20 / 2008 on Micro, Small and Medium Enterprises

First, it has a net worth of at most Rp50,000,000.00 (fifty million rupiah) excluding land and building of business premises; and secondly it has annual sales of at most Rp300,000,000.00 (three hundred million rupiah) Meanwhile, criteria for Small Scale Enterprises are as follows: First, it has a net worth of more than Rp50,000,000.00 (fifty million rupiah) up to a maximum of Rp500,000,000.00 (five hundred million rupiah) excluding land and building of business premises; and secondly it has annual sales of more than Rp300,000,000.00 (three hundred million rupiah) up to a maximum of Rp2.500.000.000,00 (two billion five hundred million rupiah).

Medium Business Criteria are as follows: First, it has a net worth of more than Rp500, 000,000.00 (five hundred million rupiah) up to a maximum of Rp10, 000,000,000.00 (ten billion rupiah) excluding land and building of business premises; and secondly it has annual sales of more than Rp2.500.000.000.00 (two billion five hundred million rupiah) up to a maximum of Rp50, 000,000,000.00 (fifty billion rupiahs).

The criteria referred to in paragraph (1) a, b, and paragraph (2) a, b, and paragraph (3) a, b the nominal value can be changed in accordance with the economic development regulated by Presidential Regulation.

In the other hand, the sense of SMEs also formulated in UU no 20/1995, according to this act, which referred to small business activities with small scale that meet the criteria of the net worth or annual sales and ownership as stipulated in this law, article 1 point 1 that :

a. Has a net worth of Rp200.000.000, - (two hundred million rupiahs), excluding land and buildings; or
b. Having an annual sales turnover of Rp1.000.000.000, - (a billion rupiah);
c. Owned Indonesian citizens;
d. Standing alone, not subsidiaries or branches of companies owned, controlled or affiliated directly or indirectly with medium or large business;

Form of individual business, a business entity that is not incorporated, or a business entity incorporated including cooperatives.

While in UU No. 20/ 2008 on Business Micro, Small and Medium Enterprises the concept of the SMEs are:

1) Criteria for Micro is as follows :
    a. Have a net worth of Rp50.000.000 (fifty million rupiah), excluding land and buildings; or
    b. Has an annual sales result of Rp300.000.000 (three hundred million rupiah).
2) Criteria for Small Business is as follows :

a. Have a net worth of more than Rp50.000.000,00 (fifty million rupiahs) up to at most 500.000.000,00 (five hundred million rupiahs), excluding land and buildings; or

b. Has an annual sales turnover of more than Rp300.000.000, 00 (three hundred million) up to at most Rp2.500.000.000, 00 (two billion five hundred million rupiah).

3) Criteria for Medium Enterprises is as follows :

a. Have a net worth more than Rp500.000.000,00 (five hundred million rupiahs) up to at most 10.000.000.000,00 (ten billion rupiahs), excluding land and buildings; or

b. Has an annual sales turnover of more than Rp2.500.000.000, 00 (two billion five hundred million) to with the most Rp50.000.000.000, 00 (fifty billion rupiahs).

It is well known that the strategic role of SMEs in the foundations of the Indonesian economy is both in terms of quantity and distribution, labor absorption, productivity and even in supporting the international trade balance (SME's ability to support export value) (Suharso P, 2010).

However, the development of SMEs mainly related to the support of government policies and programs still feels less focused and focused today. Better quality and long-term support is required to sustain the current development of SMEs, but unfortunately, government support is still spinning on routine and short-term matters. The role and support of the government needs to be improved in quality although the volume of government programs or projects in support of MSMEs development continues to increase from year to year (Kuncoro, 2012).

### 2.4.3 Characteristics of Small Medium Enterprises (SMEs)

The studies that have been done by Mitzerg and Musselma and Hughes, the characteristics of small business, are:

1. Activities tend to be formal and seldom have business plans;
2. The organizational structure is simple;
3. Number of labor is limited by division of labor is loose;
4. Mostly no separation between private wealth of the company's assets
5. The accounting systems is not good, even difficult to reduce the cost;
6. Marketing capabilities and market diversification tends to be limited;
7. Very thin profit margins.

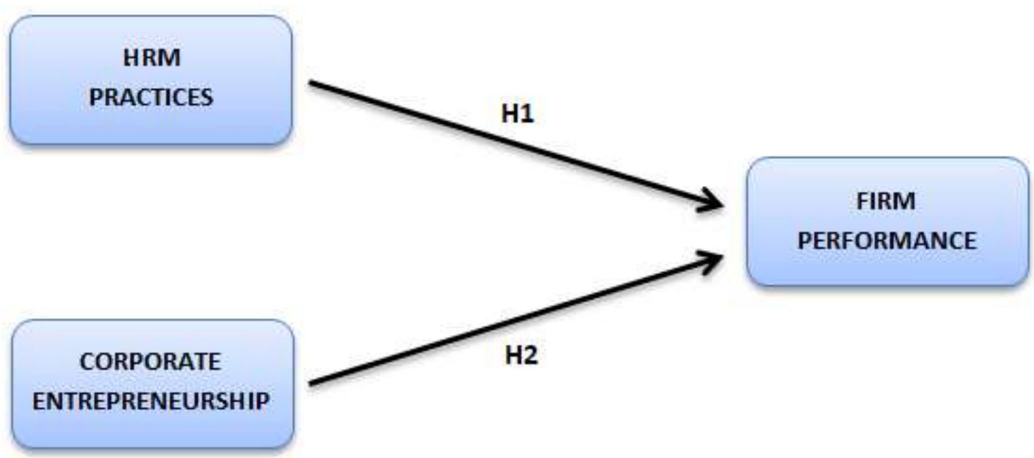
Based on some of the characteristics mentioned above, it can be seen that the weakness of small businesses affected by factors other than lack of capital also looked at the managerial weakness. This matter revealed both in weakness of organization, planning, marketing or weakness accounting.

### 2.5 Research Framework

Adapted to (Lepak and Shaw, 2008) framework must demonstrate an understanding of theories and concepts that are relevant to the topic of a research. To demonstrate an understanding of the theories and concepts of this research, the framework of the research is as follow.

**Figure 3. Research Framework**

**Research framework**



## 2.6 Hypothesis Development

### 2.6.1 The Effect of Human Resources Management Practices on Firm Performance

Human Resources Management is a philosophy, policy, system and practices that can affect the behavior, attitudes and performance of employees (Noe, Hollenbeck, Gerhart & Wright 2010). The potential role of HRM in enhancing organizational performance has been realized. HRM practices can improve the performance of organizational by contributing to employee and customer satisfaction innovation, productivity and development of goof reputation among firm's community (Delaney & Huselid, 1996; Noe et al., 2010).

Some studies notes that HR systems that supported team activities were critical to organizational competitiveness and innovativeness, while the team activities improve co-operation and communication among employees, at the same time the create the great work culture. Feedback on performance also needed to enhance effectiveness, it is means that sharing information one to each others can improve the communications, and fosters organizational openness. It creates loyalty and trust of the employees to the firms, and motivates behaviors in the firm.

As mention above, the HRM practices strengthen one to another seems to contribute to the firm performance and employee's effectiveness.

H1 : Human Resources Management Practices is positively related to Firm Performance

### 2.6.2 The Effect of Corporate Entrepreneurship on Firm Performance

Corporate Entrepreneurship can be defined as a firm's orientation to be more proactive, innovative and risk taking (Barringer and Bluedorn, 1999). In the case of Corporate Entrepreneurship, innovativeness is explained as the willingness of the company to support and introduce new ideas, production process and organizational systems (Lumpkin and Dess, 1996). The Corporate Entrepreneurship approach considered as the point of view to explore the effect of Corporate Entrepreneurship on performance. Corporate Entrepreneurship leads to improvement in firm performance. Therefore:

H2 : Corporate Entrepreneurship is positively related to Firm Performance.