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Roles of Owner-Managers in Achieving SMEs' Dual Goals

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ABSTRACT

Small and Medium Enterprises (SMEs) play an important role in the Indonesian economy. Not only do they generate jobs, they also nurture a culture of innovation and entrepreneurial skills that enable small firms manage economic downturns with minimal fallouts. Because of the SMEs' unique management characteristics and mixed business-personal goals, they are an interesting subject of research. This study examined if the strategy of SMEs executed by owner-managers affected their performance (financial/economic vs. non-economic). One of the strategies pursued by SMEs is a differentiation strategy, characterised by a unique product that is hard to imitate and results in customers' willingness to purchase goods or services at higher prices. Using a small sample size and applying SEM-PLS, this research attests to the strategic role of owner-managers for achievement of their non-economic goals, but not the SMEs' economic/financial goals. These results imply the presence of non-financial goals that may be considered to be important or perhaps more important than the financial goals. Small sample size and self-assessed performance measures are among the limitations of this research.

Keywords: Financial goals, non-financial goals, owner-manager, small enterprise, strategy

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INTRODUCTION

Small and Medium Enterprises (SMEs) are considered to be one of the most flexible types of business especially during economic challenges (Nugroho, 2015). He finds that SMEs in Indonesia survive global economic challenges because of their flexibility. During the 1997-1998 crisis, 96% of SMEs survived whereas many large enterprises

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collapsed (Bank Indonesia, 2015). The lean structure of SMEs allows them to adapt faster in a fast-changing economic environment. Healthy SMEs contribute significantly to the economy by creating more employment opportunities, generating higher production volumes, increasing export and introducing innovativeness and entrepreneurship. The SMEs' contribution to Indonesia's GDP has increased from 57.84% to 60.34% in the past five years. In 2015, SMEs represent 60.7 million units (99.9%) and accounted for approximately 130 million workers (Badan Perencanaan Pembangunan Nasional, 2016).

Despite their success, only 30% of SMEs have access to formal financial sources which contributes to some of their traditional problems (Bank Indonesia, 2015). Earlier Winarni (2006) indicated that Indonesian SMEs still face various fundamental weaknesses, including lack of capital and marketing ability, plain organisational structure, low management quality and poor human resources quality. They have no financial reports nor legal status and low technological capacity. These has led to both weak business network and market penetration as well as low market diversification. They do not have economies of scale as they are unable to lower production cost and this means most SMEs do not have a competitive advantage.

Porter (1980) has long identified three generic strategies that are applicable to the majority of firms: a) cost leadership, which focuses on increasing profits by reducing costs and increasing market share through lower prices; b) differentiation, where firms pursue competitive advantage by differentiating their product or services, making them more attractive than that of their competitors' and creating hard-to-imitate products or services Thus, the customers have a less comparable alternative and therefore are less price sensitive (Armstrong, 2013). The third alternative is a focus strategy, a combination of cost leadership and differentiation, where the firms target niche markets. By understanding the dynamics of the market and the uniqueness of customers, the firms develop uniquely low-cost or well-specified products for the market.

The SMEs tend to pursue a differentiation strategy because quality of service is their strength (MacLaran & McGowan, 1999). Armstrong (2013) reports that SMEs will differentiate their products and services through creating the highest possible quality, and/or providing better services. By providing the highest possible quality to customers, SMEs improve their survivability. Firms that pursue better services, on the other hand, will build perceived brand awareness through reputation and word-of-mouth promotion.

This research aims to examine if the differentiation strategy of SME owner-managers leads to higher performance. For most of the SMEs, this strategy is not as easy as *cost leadership*, but not as difficult as a *focus strategy*. This strategy choice should make the current research relevant and timely (Li & Tan, 2013; Thomas & Ramaswamy, 1996). This research presumes that SMEs have two different sets of goals: economic/financial and non-financial goals (such as social responsibilities and personal satisfaction). The results confirm that owner-managers play a crucial role in achieving non-financial goals, directly or indirectly, through the firm's strategy. However, the results cannot verify the important role of owner-managers in achieving economic/financial performance. Thus, this research contributes to our better understanding that SMEs' achievement might not be correctly measured in financial terms alone.

The remaining sections are arranged as follows. The next section synthesises important ideas through a literature review, followed by the description of research methodology. Subsequently, findings of the research are presented and discussed. In the last section, conclusion and recommendations are provided.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Goals of SMEs

Thus far, there is no single criteria to measure the performance of SMEs due to the multi-dimensional aspects of their performance (Gerba & Viswanadham, 2016). Usually, a firm's performance is measured based on staff strength or financial performance, such as profit, turnover or return on investment (Forsaith & Hall, 2001). These measures assume that all small business owners want to 'grow' their businesses (Walker & Brown, 2004).

However, there is another side to the success story of SMEs. Previous studies have recognised the importance of non-financial performance of the firm, including job and personal satisfaction, independence and work- life balance (Buttner & Moore, 1997; Kuratko, Hornsby, & Naffziger, 1997; Walker & Brown, 2004). Similarly, Jennings and Beaver (1997) argue that success is more than money and pursuit of financial goals; it involves some aspects of intrinsic reward for the entrepreneurs themselves.

Owner-Managers and Strategy

Strategy is a key aspect of management in large organisations (Gibcus & Kemp, 2003). Large firms often have written or formal statements of their strategies. In contrast, strategies are less formal in small firms and originate from owner-managers who are the key decision-makers (McCarthy, 2003). Because small firms do not normally write statements of strategy, these are inferred from evolving patterns of owner-managers' behaviour and resource allocation (Schindehutte & Morris, 2001). Strategies are based on the owner-managers' interpretations of and reactions to the situations faced by the firm (d' Amboise, 1993; Williams & Tse, 1995).

This research will examine if owner-managers' characteristics have a positive and significant influence on differentiation strategy. The SMEs' owner-manager characteristics are represented by indicators such as innovativeness, planner, the use of new technology, risk taking, and work independently. Differentiation strategy on the other hand will be represented by indicators such as firm offer highest possible quality, better service, and customised products.

Hypothesis 1: Owner-manager's characteristics influence their differentiation strategy.

Firm's strategy and economic/financial performance. A differentiation strategy (Porter, 1980) is where a firm offers something different from its competitors. One of the characteristics that a differentiation strategy possesses is that it can lead to a higher performance when the price premium for the differentiation exceeds its additional costs. Firms can achieve differentiation by varying the product characteristics individually or simultaneously. In practice, they are frequently changed in combination (Leitner & Güldenberg, 2010).

Hypothesis 2: Differentiation strategy influences a firm's financial performance.

Firm's strategy and non-economic/ financial performance. The SME owner-managers have multiple goals that are not limited to economic growth (Beaver, 2002). This research attempts to seek evidence that the owner-managers' choice of strategy influences the non-financial performance of their firms, such as their personal satisfaction and pride.

One of many factors that influence someone to start a business and become owner-managers is their characteristic of being a risk taker and a preference to work independently (Kuratko et al., 1997) or other entrepreneurial characteristic, such as innovativeness and pro-activeness. Although the strategy may not initially show an economic value such as return of capital or employment growth, the owner-managers will already feel successful to a certain extent.

Hypothesis 3: Differentiation strategy influences firms' non-financial performance.

Owner-managers and firms' financial performance. In SMEs, usually the owners act as managers who implement the strategy. Therefore, their characteristics influence the success of the strategy. This research uses measures developed by Blackburn, Hart and Wainwright (2013) where the owner-managers were asked to rate themselves against statements showing their likelihood to innovate, act opportunistically and independently, use new technologies, assume risk, become bored easily, or seek out publicity.

Although specific managerial skills and behaviours associated with a differentiation strategy were not directly addressed by Porter, Szilagyi and Schweiger (1984), they inferred that a differentiation strategy requires product engineering and creative skills and ability, which implies the use of new technologies, taking risks and behaving opportunistically. Therefore, the owner-manager's characteristics significantly influences the relationship between differentiation strategy and a firm's performance.

Hypothesis 4: Owner-managers' characteristics influence firms' financial performance.

Owner-managers and non-economic/ financial performance. This research assumes owner-managers' characteristics indicate their level of satisfaction, pride, and social recognition. Since owners who have characteristics such as being innovative, a risk taker, planner, and preference for working independently are strongly affiliated with entrepreneurial traits, they are also aggressive and concerned about social recognition (Kotey & Meredith, 1997).

This study suggests that when these owner-managers own a business, being a boss and generating employment, business ownership increases their personal satisfaction as well. Therefore, this study proposes a causality between these characteristics (innovative, a risk taker, planner, and preference for working independently) and non-financial performance.

Hypothesis 5: Owner-managers' characteristics influence firms' non-financial performance.

Conceptual model. This research adopts Armstrong's conceptual (2013) model by looking at the SMEs' generic strategy in differentiation and combining it with Blackburn et al. (2013), who focus on owner-manager characteristics. This research attempts to verify the strong causality between owner-managers of SMEs and their business strategy. According to Sarwoko, Surachman and Hadiwidjojo (2013), the stronger the characteristic, the greater the performance of the firm. Agbim, Oriarewo and Zever, (2014) found a significant moderating effect of the entrepreneur's characteristic towards the relationship between interest and frequency of scanning towards entrepreneurial performance. This relationship implies the entrepreneur characteristic has a strong influence towards the owner-manager's decisions and the operation of their business.

While previous research correlates the choice of business strategy between competence-based and flexibility-based strategy to a firm's growth and survival (Armstrong, 2013), this research focuses on the differentiation strategy (competence based), as suggested in earlier research, whereas the flexibility-based strategy is too difficult to be identified in SMEs' business.

According to earlier research, success can be interpreted according to a specific performance measure (Brush & Vanderwerf, 1992), while others interpreted success as high performance (Brooksbank, Kirby, Tompson, & Taylor, 2003). The debate regarding what constitutes success and the way to define and measure performance in SMEs is unresolved (Leković & Marić, 2015). Success and performance of small businesses are very narrowly connected (Brooksbank et al., 2003). For businesses to be successful, financial measurements require increases in profit or turnover and/or increased numbers of employees. Walker and Brown (2004) argue that the most obvious measures of success are profitability and growth. In economic terms, this is considered to be profit maximisation (Jennings & Beaver, 1997). For SMEs, goals do not necessarily coincide, nor are they comparable and a real success statement is difficult.

Based on the above arguments, this research proposes an overall conceptual model as shown in Figure 1.

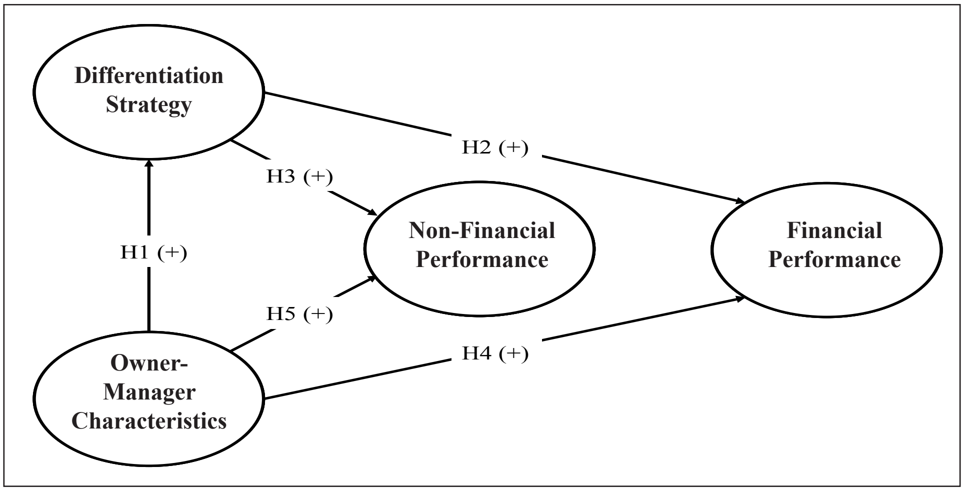

Figure 1. Conceptual model
Source: Authors' formulation

METHODS

Sample

Respondents of this research were SMEs located in Jakarta and Depok, West Java. The of SMEs in Indonesia according to Law No. 20/ 2008 are: (1) Micro businesses whose net assets are up to Rp.50 million, excluding land and buildings, or an enterprise with annual revenues less than Rp.300 million (net); (2) Small businesses whose net assets are between Rp.50 and Rp.500 million, excluding land and buildings, or an enterprise with annual revenues between Rp.300 million and Rp.2.5 billion; (3) Medium businesses whose net assets are more than Rp.500 million up to Rp.10 billion, excluding land and buildings, or an enterprise with annual revenues more than Rp.2.5 billion up to Rp.50 billion. Using the above criteria and the convenience sampling technique, this research surveys 162 SMEs with a final sample size of 131. The sample size is relatively small but is expected to still the able to document the existence of the relationship among the variables. A follow up research with a larger sample size will be conducted in the future.

Variables

The variables used in this research are adopted from several earlier researches (see

Table 1). For each of variables, this research utilises three and five indicators that are measured using a Likert scale where 1 = strongly disagree, 2 = disagree, 3 = almost agree, 4 = somewhat agree, 5 = agree, and 6 = strongly agree.

The variables indicated in Table 1 are converted into questionnaires. Table 2 shows the operationalisation of the construct "Owner-Managers Characteristics," which include six indicators. Due to limited space, however, other variables are not discussed or elaborated in this paper.

Estimation Method

The research is carried out using a quantitative methodology, namely Structural Equation Model (SEM). To accommodate the structural equation analysis, this research uses PLS (Partial Least Square). First, PLS is suitable in research that focuses on areas where theory is not yet well developed, or in other words, is exploratory based. Second, PLS is easier operationalised in applied settings. Third, PLS is useful for research with relatively small sample sizes. Fourth, it is also appropriate when there are limited participants and when the data distribution is skewed, e.g. micro sized enterprise.

Table 1
Description of variables

Variables/Constructs	Description	Reference
Owner-Managers' Characteristics	Owner-managers of the SMEs were asked to rate themselves against statements that reflected their likelihood to innovate, act opportunistically and independently, use new technologies, take risk, and whether they could become bored easily.	Blackburn et al. (2013).
Differentiation Strategy	A competitive strategy that is characterised by a unique product that is hard to imitate by competitor, resulting in customers having a less comparable alternative and thereby less price sensitive.	Armstrong (2013); Porter (1980)
Firm's Financial Performance	Self-assessment using common indicators used to measure business performance, financially or economically. Reported SMEs' financial data is not available.	Reid & Smith (2000); Paige & Littrell (2002); Greenbank (2001).
Firms' Non-Economic/ Non-Financial Performance	Personal satisfaction, pride and flexible lifestyle as non-financial goals or consideration of SMEs' owners when they run the business.	Walker & Brown (2004).

Table 2
Operationalise of variable

Variables	Definition	Indicators	Source
Owner-Managers' Characteristics	Owner-managers are asked to rate themselves against either/or statements that reflect their likelihood to innovate, act opportunistically and independently, use new technologies, take risk, and become easily bored.	Innovative Planner Uses new technologies Restless and easily bored Risk taker Work Independently	Blackburn et al. (2013)

RESULTS

Descriptive Statistics

The following is a description of business sectors, location, size, and business experience by the respondents. The home industry sector had the largest representation (35% of the respondents). Most of these SMEs produce snacks, milk-based products, and clothing. Retail is the second largest, 31%, followed by food culinary, 18% (see Table 3).

Table 3
Respondents profile by sector

Sector	Number	Percent (%)
Manufacture	46	35%
Retails	41	31%
Food Culinary	24	18%
Services	15	11%
Others	5	4%
Total	131	100%

Based on the business size, the respondents were primarily micro-sized enterprises, accounting for 49% of the sampled population. This type of enterprise is characterised by a revenue that is less than Rp.10 million per month and has no more than two employees. About 34% of the respondents who represent small sized enterprises, have revenue between 10 million and 50 million a month and medium sized enterprises had revenue more than 50 million per month (Table 4).

The survey was conducted in Jakarta and Depok. About 35% and 34% of the respondents were from Jakarta and Depok respectively. The rest were from satellite cities near Jakarta, such as Tangerang (10%), Bogor (8%) and Bekasi (7%) (Table 5).

Based on their business experience, most of the SMEs surveyed in this study, 47%, are new ventures, being 2 years old or less. This is followed by enterprises that have been established for three and five years (31%) and the rest are more than 5 years (22%) (Table 6).

Table 4
Respondent profile by size

Size of Enterprise	Number	Percent (%)
Micro	64	49%
Small	45	34%
Medium	22	17%
Total	131	100%

Table 5
Respondent profile by location

Location	Amount	Percent (%)
Jakarta	46	35%
Depok	44	34%
Tangerang	13	10%
Bogor	10	8%
Bekasi	9	7%
Other cities in West Java	9	7%
Total	131	100%

Table 6
Respondent profile by business experience

Business Experience	Amount	Percent (%)
2 Years or less	62	47%
3 – 5 Years	41	31%
More than 5 years	27	22%
Total	131	100%

Validity of the Model

In order to validate the model, this research used Goodness of Fit (GoF) measures. The overall GoF of the model should be the starting point of model assessment. If the model does not fit the data it means the latter contains more information than the model conveys. There are many measures of validity obtained from the SEM-PLS, but not all are reported here. The GoF values of above 0.35, 0.15, and 0.02 can be regarded as strong, moderate, and weak respectively. Based on the results of our model, GoF value is 0.380, greater than 0.36 and therefore, the model is sufficiently valid.

This research uses loading factors to evaluate construct validity. The minimum eligible loading factor point required is 0.7 (Fornell & Larcker, 1981), while the minimum eligible Cronbach's Alpha is 0.7 (Fornell & Larcker, 1981). To evaluate convergent validity, AVE was assessed. The required AVE is above the level of 0.5 (Hair, Ringle, & Sarstedt, 2011). Based on these criteria, some of the owner-managers' indicators (risk taker, work independently and restless and easily bored) do not pass the validity and reliability measurement tests, and therefore are dropped from further analysis. Similarly, among non-financial performance measures, only NFP_3, NFP_4, and NFP_5 (which indicate prides and personal satisfaction) are considered valid. The rest do not fit the validity and reliability criteria.

Structural Model

The structural model exhibits all possible relationships among variables or constructs in the model. This model is used to test the hypotheses. Figure 2 shows the t-values of the model after excluding all indicators that do not pass the validity criteria. The values equal to or higher than 1.96 indicate that the causality is statistically significant. Thus, in this research, two paths are not statistically significant, i.e. from owner-managers to financial performance.

Table 7
Goodness of fit result

Latent Variable	Communality	R-Square
Differentiation Strategy	0.670	0.329
Owner-managers' Characteristics	0.638	-
Non-Financial Performance	0.671	0.225
Financial Performance	0.743	0.089
Average Value	0.680	0.214
GoF $\sqrt[2]{AVG(Communality) * AVG(R - Square)}$	0.380	

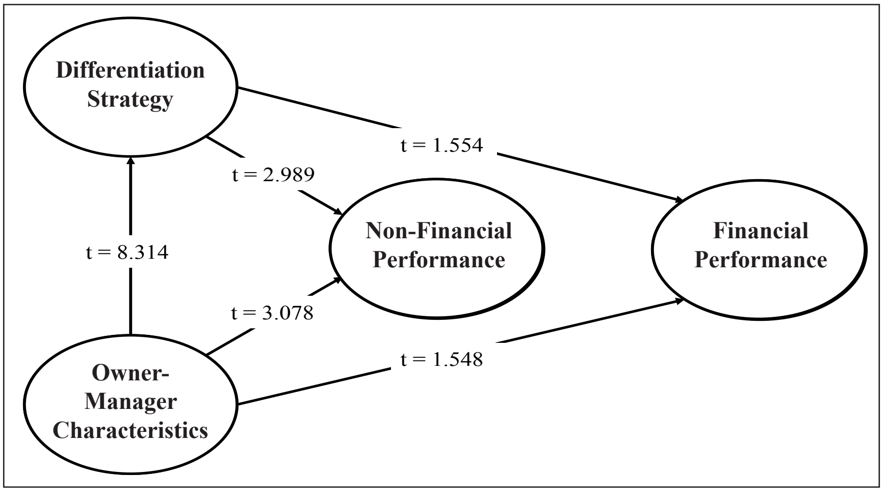

Figure 2. Structural model

DISCUSSION

The results suggest that owner-manager's characteristics have a positive impact on differentiation strategy. This finding supports previous research by D'Amboise (1993), and Williams and Tse (1995) who showed that owner-manager's subjective behaviours and characteristics affect firms' strategy.

While it is already known that owner-managers of small firms determine the direction of strategy, differentiation strategy in this research is proven as the strategy that is favourable and influenced by owner-managers who are innovative, planners, and characterised by the use of technology. Given this relationship, it is clear that this characteristic and differentiation strategy would lead to better performance. Previous research by Linton and Kask (2017) also found that the best configuration among Porter competitive strategy and entrepreneurship orientation (owner-managers' characteristic) is the strategy that focuses on differentiation combined with innovativeness and pro-activeness.

In this study, data suggest that most of the small firms pursue a differentiation strategy based on providing the best possible product quality, followed by better service. This is consistent with Armstrong's findings (2013), while the strongest characteristic among the owner-managers is being a planner, followed by innovativeness. This indicates that the owner-managers' try to innovate their products and services by making well-planned changes to achieve the highest possible quality and r service. Therefore, this research concludes that owner-managers' characteristics would fit into a firms' differentiation strategy. For a firm to deliver high quality and a customised product with better service, innovativeness or creativity is required. Moreover, when supported with a proper plan and new technology, this combination would boost the company's performance.

The research result also suggests that the differentiation strategy and owner-manager characteristics have a positive impact on a firm's performance. However, results show that the significant relationship is towards non-financial characteristics instead of more commonly assumed financial measures characteristic of larger firms that are not owner managed. This finding is in contrast with Armstrong's (2013) where the highest possible quality and better service was found positively and significantly related to a firm's growth and survival.

The results show that the differentiation strategy has a positive and significant impact on non-financial performance, which was indicated among others by owner-manager's personal satisfaction. Satisfaction is a major factor that influences the owner-manager's decision to pursue the financial aspect in business (Cooper & Artz, 1995). Previous research also found that many of the small business owners are not financial-minded (Baines, Wheelock, & Abrams, 1997). This finding is affirmed by Soesilo (2016) who showed that many SME owner-managers do not want to develop their business further because they are afraid of taxation problems that diminish the benefit of expansion. As almost half of the sample are young enterprises, this could conceal the importance of financial performance. Thus, they might be concerned about financial performance as well, but do not express it because they have not yet achieved a significant financial level.

The present study's data show that SMEs' owner-managers innovative, planners and use new technology. The results suggest that these characteristics are related to respondents' educational background (most of them are well educated) According to Altinay and Wang (2011) education equips owner-managers with the skills and mindsets of understanding customers and responding to their needs and making a positive impact towards the entrepreneurial characteristic that is characterised by innovativeness, planning, and the adoption of new technology.

CONCLUSION

The research study revealed how the owner-manager's' unique characteristics influence SMEs' strategy execution. Owners who are innovative, good planners and are aware of technology have a positive and significant direct and indirect impact on firms' non-economics/financial performance. Surprisingly, these characteristics have no impact on their financial performance. The results must be interpreted cautiously. It might be true that SMEs have shown no significant improvement in their financial performance, and thus, there is no clear effect of owner-manager's actions. This could also be likely due to insufficient records on financial performance, so they will not claim their financial success confidently. Managerial implications of these results strongly suggest that SMEs should prepare decent financial reports to complement the owner's claims about their success. Regardless of the explanation, this research has pointed out that personal satisfaction, pride, and social recognition are considered important, if not more important than financial performance, for SMEs. Still, the owner-manager's characteristics are very important not only because they influence the firm's performance but also its direction. Despite this, there are limitations to this study principally related to its small sample size and self-assessment for data collection.

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