

## Conference Paper

# The Relationship of Human Capital, Innovation, and Corporate Performance (A Study of Small and Medium Rattan Businesses in Palu City Central Sulawesi Province)

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## Abstract

Human capital, from the perspective of finance, is an intangible fixed asset, which is able to create corporate value and provide contributions in the form of knowledge and also experience into a certain product or future asset of the company. From the perspective of human capital strategic management, it is the organization's resource with the ability and capability to become their main source of competitive advantage. Human capital has the power to be the source of competitive advantage in the form of knowledge, experience, and also individual soft skills such as creativity, which cannot be imitated by other parties. Human capital has an important role in the continuity of a company, because human capital continuously contributes ideas and new suggestions for the product or service through creativity. Human creativity may be in the form of events that can change the product to meet the preference of the market and to be able to compete with their competitors' products. This will definitely influence the corporate performance; customers' satisfaction with the product will result in a positive effect on the corporate performance by increasing the sales level, which also affects the profitability of the company. The success of the corporate performance can be measured by the increment of sales, ROA, ROE, and profitability as the indicators of success. However, the feedback of the success of corporate performance in reality starts from the human capital, which is creative in product innovation. With creative product innovations, even in the maturation stage of the company's product life cycle, new products or product lines of previous products can be developed. The aim of this research is to examine the relationship between human capital, innovation, and corporate performance, be it in big companies or even small industries.

**Keywords:** human capital, innovation, and corporate performance

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## 1. Introduction

The resources owned by the company are an important factor that supports the continuity of the company. Furthermore, it is also the main source to achieve competitiveness, which influences the corporate performance. The high level of sales and profitability of a company indicate that the company has successfully managed its resources as one of its competitive advantages. The success of the corporate performance depends on strategic planning that is suited to the characteristics of the environment. There is a need for the company to align its performance measurement system with the strategic goals that have been determined by the company [13, 16, 26]. To achieve the corporate goals, a number of frameworks and processes (approach) are needed to determine what kind of performance is enough to be considered effective as a whole [10]. Product quality and market share define a broader conceptualization of company performance by focusing on factors that ultimately lead to financial performance [20, 26]. The last approach to measure performance is by considering various factors such as financial or non-financial [9, 23, 53]. Venkatraman and Ramanujam (1986) provided a framework to classify performance which facilitates future research by making it adaptable to the conditions in the field. Corporate performance is the final result which proves that a company has successfully managed its resources and made them a source of power that can defeat its competitors.

All companies should always protect and maintain their resources, especially when their resources are among their sources of knowledge such as human capital that can operate, use, and run the fixed assets or tangible assets. Thus, human capital (intangible asset) can be said to be the core capability and competence of the organization. Human capital is the main source of competitive advantage for the company [3], which is rare and difficult for competitors to imitate. Human capital is comprised of people who have the intellectual capital, be it from education or experience. Knowledge owned by the human capital makes them creative, so their knowledge can be transferred into products they create or share with other people [33].

In the literature written by Nonaka and Takeuchi (1995), knowledge owned by humans originates from themselves, has tacit characteristics, and will afterward be used to process information explicitly. Tacit knowledge is something that is not easily seen and can only be shared with others through communication. A company is able to improve its human capital through training programs that can develop knowledge and creativity. In some articles, the company's resources consist of all assets, ability, organizational process, company's information attribute, knowledge, etc., which are

controlled by the company and which make it possible for the company to understand and implement its strategy [30, 36].

Several studies have found various components that influence companies, making it possible for companies to understand and implement strategies that can create value [19, 44]. For the purpose of this discussion, the resources are classified into three categories; namely, physical capital, which includes physical technology used in factories and company equipment; geographical location and access to raw resources [49]; human capital, which includes training, experience, intelligence, relationship, individual managerial insights, and workers in the company [4]; and organizational capital, which includes the company's formal reporting structure, planning, formal and informal control, coordination system with informal relationships among the groups in the company, and between the company and the people in the surrounding area [45].

## 2. Literature Review

### 2.1. Human capital

Theoretical reviews on human capital were continuously conducted by economists in the twentieth century, including Mincer (1974) and Becker (1975), who argued that education and experience are the foundation of human capital, which ultimately led to investment in knowledge and expertise to increase a person's success. Along with the discovery of new advancements in technology, workers need to be educated and have more skill and knowledge; this causes human capital to be viewed as an access to the intangible assets needed. Human capital is then viewed as an important investment among the forms of capital. Wernerfelt (1984) claimed human capital to be one of the most useful assets to maintain the success of the business. According to Becker (2003), there are two indicators to measure the human capital variable, namely (1) education, which is the educational experience undergone by an entrepreneur in order to be able to review current knowledge and support the business toward success; and (2) business experience, which is the experience gained through business that is able to ingrain proficiency, resulting in values and attitudes that can influence business behaviors.

From Edvinson and Malone's (2007) perspective, human capital is represented as the basic resources to make creations such as new knowledge, studies, individual knowledge in the form of skills, experience, expertise, ideas, knowledge, capabilities and values owned by the people in performing their job. Human capital is deemed

to be the process to update skills, experiment and control. Nassei (1996) in Nahapiet (2008) defined human capital as the accumulation of talent and individual knowledge attained through education, training, experience and cognition, while Pfeffer (2008) defined human capital as the knowledge, skill and ability of a person who is able to produce professional service and economical return. Human capital is also the starting point of innovation and ideas or renewal.

## 2.2. Innovation

When the company's product life cycle is in its maturation stage, companies take action by developing the product through innovation, so that the company can succeed against its competition. In the literature with a narrower definition, innovation only occurs if something is completely new, or has never been done before (Levitt, 1988). According to Keegan (1989), 'innovation is something new or different in an absolute definition or in a situational definition'. Furthermore, innovation is the activity that leads to changes in the product or service (technical) and the administration (managerial) offered by companies to adapt to the dynamic environment. According to Griffin (2004), innovation is the management of an organization's business to develop products/new services, or new uses of available products/services. Griffin divided the dimensions of innovation into radical innovation, process innovation, managerial innovation, and incremental innovation.

Innovation is increasingly viewed as a contributing factor to improve performance in all industries [52] and specifically, to strengthen the competitive advantage of the company in facing competitors [32]. Kanter (1999) stated that to prevail against the competition in business today, innovation is needed. Small industries that have the ability to innovate effectively will develop new products faster than big companies [43, 46]. Harrison and Watson (1998) argued that, even though small, there are doubts as to whether small and medium-sized enterprises are able to conduct innovation effectively. De Brentani (2001) explained how to achieve positive product results by exploring product innovations that are being developed by companies, by investigating the innovation taxonomy of big and small companies. Conversely, there are many studies regarding the types of innovation conducted by big companies, such as the study by Avlonitis et al. (2001) regarding innovativeness in the financial sector and a study of new product development practices [17].

In the literature, generally there are various classifications of innovation types in big companies, such as (1) product innovation, which could possibly be new products or an

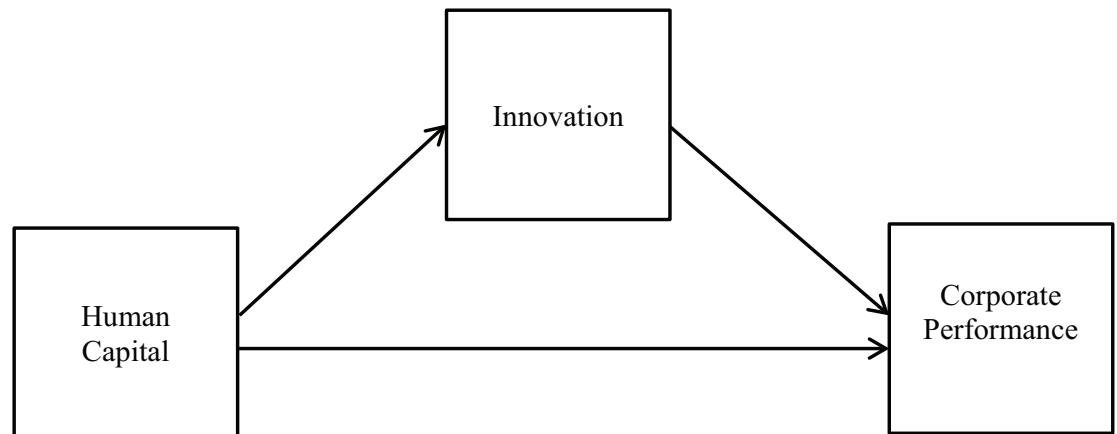
improvement of an existing product by changing the shape of the package and design into something more attractive; (2) service innovation, such as a new development in activities conducted to produce the core products and make them more attractive to consumers; (3) process innovation, which is creating or improving the method of service production or administrative operations and the development in the system process and reengineering activities conducted to develop new products. For example, to support the production of new products and increase the competitiveness of the technological process, operational process, and organization practice can be improved by modification or replacing it with new follow-up processes ([1]; Trott, 1998). This refers to innovation in management's initiative, where organizational innovation is the corporate level innovation type. Previous studies regarding the types of innovation and their impacts on performance have mainly focused on big companies, and also the innovation types can be used on SMEs if they are suitable with their problems.

### 2.3. Corporate performance

Most studies up till now have viewed corporate performance as being measured from the financial aspects, because by measuring the ratios, a better result would indicate that the company is healthy. However, the financial and non-financial company performance measures can actually be combined [27]. The measure of company performance depends on the performance measurement itself. Benchmarks are unique, because there are specificities in each company; among others are the business field, background, capital level, and the growth rate. The difference will have an influence on how the business entity behaves, which would also influence the performance and the benchmark used.

Researchers recommend sales growth, employment growth, income growth and market share growth as the most important measures of performance for small companies ([28]; Lee and Miller, 1996; Luo, 1999; Miles et al., 2000). Pelham and Wilson (1996) defined company performance as the success of new products, which is measured through the development of new products, and market development, share growth which is measured through sales growth and market share growth, profitability, measured through operating profits, profit-to-sales ratio, cash flow operation, return on investment, return on assets, and relative quality of products. Empirical support has been demonstrated by many researchers for the usage of the indicators of performance for small companies, such as by Olson and Bokor (1995), Hadjimonalis (2000), Hadjimonalis and Dickson (2000), to use sales, growth, employment growth,

return on assets (ROA), market share, profitability, and size as the indicators of the measurement of corporate performance. Based on prior literature, this paper developed the conceptual model as shown in Figure 1:



**Figure 1:** Conceptual model.

## 2.4. Discussion

Creative human capital, which makes use of the imagination in working, is very good for the development of innovation on products and would result in an increase in company performance. The creation of knowledge requires a leader who can obtain all information regarding the human capital, following the existing theory which states that human capital is the strength in the competitive advantage that cannot be imitated by competitors. Human capital is a valuable resource because it is unique and difficult to imitate [3, 15, 21, 51]. The findings reveal that knowledge and experience can develop new abilities in the business, and there are also companies that are more active in finding out the tacit knowledge of their employees.

Owners or managers must maintain the harmony with workers in order to attain information regarding the knowledge of the employees and to share and exchange knowledge to create new knowledge. Each knowledge conversion model requires different approaches for the knowledge to be developed and shared effectively [35]. For example, the experience attained by workers in internships or training programs in other companies is information to develop the strength and trust in the socialization process. The combination process to share the knowledge can be done utilizing information technology such as online network groups and databases. The knowledge is articulated and formed through simulations or experiments in the internalization process. Managers must be careful in choosing and designing the right method in

alignment with the vision and missions of the company in facilitating the development of knowledge. Afterward, companies must improve the involvement of employees and participation in company activities. Managers must also provide incentives and support to strengthen the desired behaviors in the development of knowledge. Employees will be motivated to share their knowledge by studying and creating knowledge and eventually transform the knowledge to fulfil the goals and execution of strategies.

## 2.5. Conclusion

From the practical perspective, our research has shown that managers must realize the importance of process and the creation of knowledge in any kind of company. The relationship between human capital, innovation and company performance is very close, because creative human capital is the main source to defeat competitors through innovation, which has an impact on the sales level due to customer satisfaction toward the product they consume. Managers must facilitate the dynamics in the creation of knowledge by taking the main role in managing the knowledge management process on the human capital. Companies can strengthen and increase their knowledge through dynamic conversion between tacit knowledge and explicit knowledge in the company.

This research result provides a contribution to industrial practitioners in the rattan craft small or medium-sized businesses, which are more innovative and able to quickly respond to each dynamic environment change, and also to institutes such as the Department of Cooperatives and SMEs in Palu City and the Handicraft Association in Central Sulawesi Province. Utilizing the information from the research result, small and medium-sized businesses should prioritize the quality of raw rattan material instead of exporting and selling good quality raw rattan material out of Central Sulawesi Province. There are three important benefits from utilizing the knowledge of workers in increasing the performance of SMEs in Palu City. **First**, it can result in better SME performance by improving the development of knowledge among workers or employees by cooperating in the sharing of knowledge. **Second**, it can create a breakthrough that can result in good innovation and increase the corporate performance, which would result in greater returns for the company; and **third**, to quickly respond to each change in the market, so that SMEs can compete and utilize the resources and use a flexible strategy in accordance with the characteristics of the environment.

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