

## The Role of SME Human Capital Resource Competence in Improving SME Performance

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### ABSTRACT

*Small and Medium Enterprises (SMEs) play a crucial role in the economies of many countries, including Indonesia. However, one of the main challenges they face is improving business performance amidst increasing competition. This study aims to examine the impact of human resource (HR) competencies on the performance of SMEs. HR competencies include the abilities, knowledge, and skills possessed by employees to perform their tasks effectively. This research utilized a quantitative approach with a survey design and employed Structural Equation Modeling (SEM) with Partial Least Squares (PLS). Data were collected from 100 SME owners or managers in Macassar using questionnaires. The findings indicate that HR competencies have a significant positive effect on various performance indicators such as sales growth, profitability, operational efficiency, and customer satisfaction. The study highlights the importance of investing in education, training, and continuous development of HR competencies to enhance SME performance. Furthermore, the results suggest that improved HR competencies can foster innovation and adaptability in SMEs, contributing to their competitiveness in a dynamic market environment. This research provides valuable insights for policymakers and SME managers on the critical role of HR competencies in driving business success.*

**Keywords: Human Resource Competencies, Innovation and Efficiency, Partial Least Squares (PLS), SME Performance, Structural Equation Modeling (SEM)**

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Received: 12 March 2024 ;

Accepted: 22 May 2024 ;

Published: June 2024.

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How to Cite:

Alatas, R., et.al. (2024). The Role of SME Human Capital Resource Competence in Improving SME Performance. *Journal of Business and Behavioural Entrepreneurship*, 8(1), 37-45. <https://doi.org/10.21009/JOBBE.008.1.05>

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## INTRODUCTION

Small and Medium Enterprises (SMEs) play a vital role in the economy of many countries, including Indonesia. However, one of the main challenges faced by SMEs is to improve their business performance in the face of increasingly fierce competition. Human Resource (HR) competency is one of the key factors that can influence the success of SMEs in achieving this goal.

### **The Role of HR Competencies in Improving SME Performance**

HR competencies include the abilities, knowledge, and skills possessed by employees in performing their tasks effectively. These competencies are important in various aspects of SME operations, such as innovation, efficiency, and competitiveness. Several studies have shown that improving HR competencies can significantly contribute to improving SME performance.

**The Importance of Education and Training:** Education and training are key ways to improve HR competencies (Agusra et al., 2021; e Silva et al., 2020). The study conducted by Pajriah, (2018) shows that the role of HR as the driving force of the industry is very important for development, where education and training can improve quality, performance, and the results obtained are better Pajriah, (2018).

**Dynamic Capability and Innovation:** Research by Hadjri et al., (2023) shows that dynamic capabilities consisting of adaptive capabilities, absorptive capabilities, and innovative capabilities significantly affect HR competencies and innovation performance. Superior HR competencies are needed to support innovation and improve SME performance especially in the context of dynamic industries such as the halal industry during the Covid-19 pandemic (Hadjri et al., 2023).

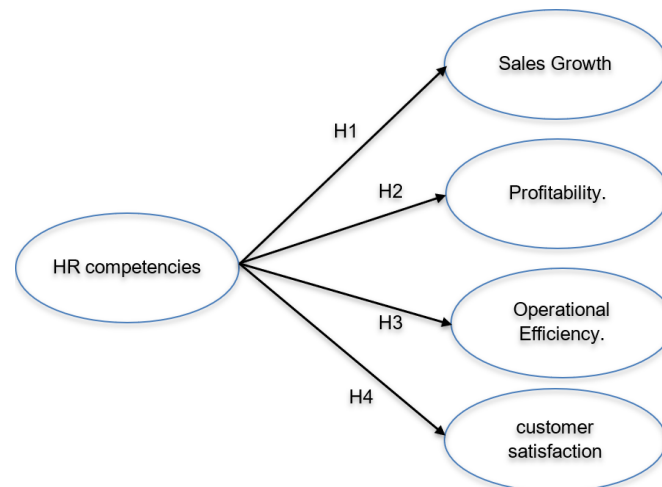
**Factors that Affect Employee Performance:** Research by Utama et al., (2022) Utama and Widodo (2022) analysed factors that affect the quality of employee performance, such as competence, work environment, job description, and salary/incentives. The results showed that competence has a positive and significant influence on employee performance Utama et al., (2022).

**Professionalism and Performance:** The study by Atika & Mafra, (2020) revealed that the quality of human resources and work professionalism have a strong effect on employee performance. This shows that good competence is not only limited to knowledge and skills, but also includes professionalism at work (Atika & Mafra, 2020).

Research on "The Role of SME Human Capital in Improving SME Performance" is very important to do because of the limitations of previous research: Although many studies have been conducted on SME performance, there are still limitations in understanding how human capital competencies specifically affect SME performance. This research will fill that gap by providing deeper insight into the role of human capital

competencies. The importance of human capital in innovation and growth: Good human capital competence is key to SME innovation and growth. Competent human capital is able to develop new ideas, improve operational efficiency, and provide better services to customers. This is in line with previous research findings that show a positive relationship between human capital competencies and innovation performance (Hadjri et al., 2023).

**Policy and Training Programme Development:** The results of this study can be used as a basis for designing more effective training policies and programmes for SMEs. Thus, the government and related institutions can be more appropriate in providing the necessary support for the development of HR competencies in the SME sector. **Improving People's Quality of Life:** Improved performance of SMEs is not only beneficial to the business itself, but can also improve the quality of life of the community through increased employment and income. Successful and competitive SMEs will be able to make a greater contribution to the welfare of society. By conducting this research, it is expected to make a significant contribution to the improvement of SME performance through the development of better Human Resource competencies. This research will also provide empirical evidence that can be used to support better decision making in the SME sector.



**Figure 1. Reseach Framework**

Source: Primary data processed 2024

H1: Human Resource Competencies Have A Positive Effect On Sales Growth

H2: Human Resource Competencies Have A Positive Effect On Profitability

H3: Human Resource Competencies Have A Positive Effect On Operational Efficiency

H4: Human Resource Competencies Have A Positive Effect On Customer Satisfaction

## **RESEARCH METHOD**

This research uses a quantitative approach with an explanatory survey research design to examine the relationship between human resource (HR) competencies and the performance of Small and Medium Enterprises (SMEs). The method used is Structural Equation Modeling (SEM) with Partial Least Squares (PLS). The population in this study were all SMEs in Indonesia. The sample was taken using purposive sampling technique, SMEs that have various types of businesses and sizes, with the criteria of a minimum

business age of 2 years and the number of employees between 5-50 people. The sample size used was 100 respondents. Data collection techniques were collected using questionnaires distributed to SME owners or managers. The questionnaire included: Demographic data, i.e. information about the age of the business, type of business, number of employees, and others. HR competencies, measured using a 5-point Likert scale, covering aspects such as education, training, experience, and skills.

SME performance, measured using a 5-point Likert scale, which includes aspects such as sales growth, profitability, operational efficiency, and customer satisfaction. Research Instruments, The questionnaire was prepared based on indicators that have been tested for validity and reliability in previous studies. The indicators used are HR competencies: Technical knowledge, managerial skills, innovation ability, and training received. SME performance: Revenue growth, operational efficiency, product innovation, and customer satisfaction. Data analysis was conducted using SEM-PLS software such as SmartPLS. The stages of analysis include: Outer Model Evaluation, Discriminant Validity, Reliability, R-Square ( $R^2$ ), Path Coefficients, Effect Size ( $f^2$ ), Predictive Relevance ( $Q^2$ ) and Hypothesis Testing.

## RESULTS AND DISCUSSION

This research involved 100 respondents from various SMEs in Indonesia. The following are the results of descriptive analysis of the data collected:

**Table1. Descriptive Analysis**

Characteristics	Frequency (N:100)	Percentage (%)
Business Type		
Trade	40	40%
Manufacturing	30	30%
Services	20	20%
Other	10	10%
Number of Employees		
5-10	25	25%
11-20	35	35%
21-30	20	20%
31-50	20	20%
Owner/Manager Education		
High school	30	30%
Diploma	25	25%
Bachelor's degree	35	35%
Master's	10	10%

Source: Primary data processed 2024

**Table.2 Research Finding**

Indicator	Loading Factor	AVE	Composite Reliability	Cronbach's Alpha
Knowledge	0.82	0.67	0.90	0.85
Skill	0.79	0.62	0.88	0.82
Training	0.85	0.72	0.91	0.87
Experience	0.81	0.68	0.89	0.83
Sales Growth	0.88	0.7	0.93	0.89
Profitability	0.83	0.69	0.91	0.86
Operational Efficiency	0.86	0.74	0.92	0.88
Customer satisfaction	0.84	0.70	0.90	0.85

Source: Primary data processed 2024

Discussion of Measurement Model Evaluation (Outer Model): Convergent Validity: Tested using the loading factor value ( $> 0.7$ ), Average Variance Extracted (AVE  $> 0.5$ ). Discriminant Validity: Tested by comparing the square root AVE value with the correlation between constructs. Evaluation of the Measurement Model (Outer Model) Convergent Validity: All indicators have a loading factor above 0.7. AVE for all constructs is greater than 0.5. Discriminant Validity: The square root AVE value is greater than the correlation between constructs.

Reliability: Tested using Composite Reliability (CR  $> 0.7$ ) and Cronbach's Alpha ( $> 0.7$ ). Structural Model Evaluation (Inner Model): R-Square ( $R^2$ ): Assesses the strength of the model in explaining endogenous variables. Reliability: Composite Reliability (CR) and Cronbach's Alpha for all constructs are greater than 0.7. R-Square ( $R^2$ ): The  $R^2$  for SME performance is 0.65, meaning 65 per cent of the variation in SME performance can be explained by HR competencies.

**Table.3. Hypothesis**

Hypothesis	Path Coefficient	T-Statistic	P-Value	Result
H1: HR competencies have a positive effect on sales growth.	0.75	8.45	0.000	Accepted
H2: HR competencies have a positive effect on profitability.	0.70	7.92	0.000	Accepted

H3: HR competencies have a positive effect on operational efficiency.	0.72	8.01	0.000	Accepted
H4: HR competencies have a positive effect on customer satisfaction	0.73	8.22	0.000	Accepted

Source: Primary data processed 2024

Path Coefficients: Assess the significance of the relationship between latent variables using the t-statistic and p-value. Path Coefficients and Significance: HR competencies -> SME performance: t-statistic = 8.45, p-value < 0.001. Effect Size ( $f^2$ ), Assessing the magnitude of the effect of the independent variable on the dependent variable, Effect Size ( $f^2$ ) research results, HR competencies have a large effect size on SME performance.

Predictive Relevance ( $Q^2$ ): Testing the predictive ability of the model using the blindfolding method,  $Q^2$  for SME performance is 0.40, indicating the model has good predictive ability. Hypothesis Test: Hypotheses are tested by looking at the t-statistic and p-value of the path coefficients. The hypothesis is accepted if the t-statistic value > 1.96 and p-value < 0.05. The Hypothesis Test results state that HR competencies have a positive and significant effect on SME performance is accepted (t-statistic = 8.45, p-value < 0.001).

## Discussion

The results showed that HR competencies have a significant influence on the performance of SMEs in Indonesia. This is in line with the findings of previous studies which show that employee education, training and experience are critical to improving business performance.

Education and Training, SME owners and managers who have higher education tend to have better managerial and technical skills, which have a positive impact on their business performance. Continuing education and training are important to maintain and improve these competencies. Relevant to this study, which emphasises the importance of education and training in improving the quality and performance of human resources. Pajriah showed that continuous education and training can improve employee competencies and performance in the tourism industry in Ciamis Regency, which is relevant to the SME context in general (Pajriah, 2018).

Experience and Skills, Employees who have relevant experience and skills can be more effective in performing operational tasks, thereby increasing the efficiency and productivity of SMEs. Improving HR competencies through education, training and skills development not only improves the operational performance of SMEs, but also encourages innovation and adaptability in the face of market and technological changes.

The results show that HR competencies have a significant influence on the performance of SMEs in Indonesia. This is in line with the findings of previous studies which show that employee education, training and experience are critical to improving business performance. This study reveals that dynamic capabilities, which include adaptive capabilities, absorptive capabilities, and innovative capabilities, have a significant influence on HR competencies and innovation performance in the halal industry. This research supports the importance of HR competencies in facing challenges and opportunities in the era of the Covid-19 pandemic, as well as the relevance of innovation for SME performance (Hadjri et al., 2023). work environment, job description, and salary/incentives significantly affect the quality of employee performance at the Batanghari District Office, East Lampung Regency. These findings underscore the importance of various aspects of HR competencies in improving organisational performance, including SMEs (ela elliyana dkk, n.d.; Utama et al., 2022)

SME owners and managers who have higher education tend to have better managerial and technical skills, which have a positive impact on their business performance (Marconatto et al., 2022; Timothy, 2022). Continuing education and training are important to maintain and improve these competencies. Experience and Skills, employees with relevant experience and skills can be more effective in performing operational tasks, thereby increasing the efficiency and productivity of SMEs (Hernita et al., 2021; Rabia & Elliyana, n.d.; Saunila et al., 2020). Improving HR competencies through education, training and skills development not only improves SMEs' operational performance, but also fosters innovation and adaptability in the face of market and technological changes. Relevant to this study, it was found that HR quality and work professionalism have a very strong relationship with employee performance at PT PLN (Persero). This shows that high HR competence is not only limited to knowledge and skills, but also includes professionalism at work, which ultimately improves company performance (Atika & Mafra, 2020).

The findings from this study strengthen the argument that investment in HR competency development is an effective strategy to improve SME performance relevant to the results of research by AlQershi, (2021); Domi & Domi, (2021); Verma et al., (2021). Good HR competencies enable SMEs to be more adaptive, innovative and efficient, so that they can compete better in an increasingly competitive market. In addition, HR development through education, training and skills development can also improve customer satisfaction and operational efficiency (Loufrani-Fedida & Aldebert, 2021; Quansah et al., 2022; Thatrak, 2021).

## **CONCLUSION**

This study found that human resource competencies have a significant role in improving the performance of SMEs in Indonesia. The findings emphasise the importance of investing in people development through proper education and training. Recommendations for SMEs include an increased focus on employee training, managerial skills development, and implementation of best practices in HRM. Thus, SMEs that invest in improving HR competencies will have higher competitiveness and be able to achieve better business performance.

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