

FINANCIAL PERFORMANCE OF SMALL AND MEDIUM BUSINESSES IN MAKASSAR: THE ROLE OF INTELLECTUAL CAPITAL AND COMPETITIVE ADVANTAGE

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ABSTRACT

Small and Medium Enterprises in the city of Makassar continue to experience rapid development. One of the challenges in Small and Medium Enterprises in Makassar is the low financial performance of SMEs. This is caused by low productivity because the quality of human resources is still low because of the lack of knowledge and entrepreneurial competence. Good management of intellectual capital can improve the company's financial performance. This study aims to examine the effect of intellectual capital on financial performance with a competitive advantage as an intervening variable in small and medium enterprises in the city of Makassar. This research conducted a quantitative method with an associative approach. Data of this research was primary data collected through questionnaire surveys. The research used multiple linear regression and path analysis with IBM Statistics SPSS 21. The results showed that intellectual capital had a positive and significant effect on the financial performance of SMEs in Makassar. Furthermore, intellectual capital impacted the competitive advantage of SMEs in Makassar city positively and significantly. Competitive advantage was also proven to have a positive and significant influence on the financial performance of SMEs in Makassar. The results of this study also indicated that competitive advantage was a mediating variable between the relationship of intellectual capital to the financial performance of SMEs in Makassar.

Keywords: Intellectual Capital, Competitive Advantages, Financial Performance

INTRODUCTION

The success of a country's economy can be measured through various economic indicators, such as national income, per capita income, the level of employment, the general price level, and the balance of payments position of a country. Small and Medium Enterprises are an important part of the economy of a country, especially in Indonesia. In developing the national economy in Indonesia, Small and Medium Enterprises (SMEs) is one of high priority. Small and Medium Enterprises (SMEs) are the backbone of the people's economic system to reduce the problem of poverty and its development is able to expand the economic base that can provide a significant contribution in improving the regional economy and the resilience of the national economy.

Small and Medium Enterprises have been able to prove their existence in the economy in Indonesia. When the monetary crisis hit Indonesia in 1998 which caused the collapse of the national economy, many large-scale businesses in various sectors such as industry, trade, and services experienced problems and even stopped their activities. Additionally, many large investors and entrepreneurs shifted their capital to other countries, so that Indonesia's economy at that time was getting worse. However, small businesses and the real sector were able to survive and could even restore the economy amid the deterioration due to the monetary crisis in various sectors (Veitzal, 2013).

The Ministry of Cooperatives and SMEs said that Small and Medium Enterprises which are currently developing are divided into several sectors, namely agriculture, livestock, trade, restaurants, private services, and management industries, one of which is the creative industry. Small and Medium Enterprises are believed to be able to survive when various other economic sectors are hit by the global financial crisis. Small and Medium Enterprises are business actors engaged in various fields that touch the interests of the community. The number of Small and Medium Enterprises (SMEs) in Indonesia continues to grow every year. Based on data from the Central Bureau of Statistics, the contribution of the SME sector to Gross Domestic Product (GDP) increased from 57.84% to 60.34% in the last 5 years. Moreover, the contribution of Small and Medium Enterprises (SMEs) to employment absorption from 96, 99% to 97.22% in the same period (Chandra, 2016).

One of the Micro, Small and Medium Enterprises sectors that have a large economic potential and is very likely to be developed is the city of Makassar. Makassar is known as one of the major cities in Indonesia which is the center of trade and services, the center of industrial activities, as well as the potential for economic development in Eastern Indonesia. Makassar continues to show progressive growth from various sectors both from the education, economic and social sectors. One of the sectors driving the economy of Makassar is the Small and Medium Enterprises sector.

Small and Medium Enterprises (SMEs) in the city of Makassar already have such a rapid development in the business side. The Makassar City Office of Cooperatives and SMEs recorded a growth of 8,702 Small Businesses, while Medium Enterprises reached 2,379 so it can be concluded that Small and Medium Enterprises recorded since 2017 were 11,081 spread in 15 Subdistricts in Makassar City (Dinas Koperasi and UKM, 2017). However, the growth rate of small and medium enterprises since 2011-2015 continues to decline, the growth rate of output of small and medium enterprises tends to decline and is still lower with the growth rate of large businesses. The productivity of Small and Medium Enterprises is still low because businesses are still faced with various problems. The several common problems faced by Small and Medium Enterprises are lack of capital, marketing difficulties, strong competition, raw materials' difficulties, low technology's competencies, weak entrepreneurship and limited creativity, poor managerial skills, low competence of financial administration and financial management system.

One thing that is considered still an obstacle or problem that is felt by most of the Small and Medium Enterprises spread throughout the city in Makassar, namely in the form of quality human resources that are still low in the form of lack of entrepreneurial knowledge and competence which results in low business and labor productivity. This is also evident in their inability to manage their business finances, especially in terms of bookkeeping.

Good financial management is very necessary for the continuity of a business. One of the main objectives of establishing a business is to get the maximum profit. Nevertheless, the success or failure of a business in seeking profits and maintaining its business depends on financial management. Financial performance is one of the factors that shows the effectiveness and efficiency of an organization in order to achieve company goals. Therefore, financial performance is important for every company in business competition to run its business (Libyanita and Wahidahwati, 2016).

Another problem faced by Small and Medium Enterprises is generally related to knowledge management problems due to low education, skills and experience and hard access to information. The incremental awareness and knowledge are urgent as a foundation in achieving the wealth for a nation. Additionally, the readiness of business player is also important in building knowledge-based business. It seems that SME's have not yet realized the importance of knowledge-based business, which can be done by optimizing their intellectual capital (Widiastuti and Sulistyandari, 2013).

The preliminary study conducted by and Wahidahwati (2016) shows that Intellectual capital has a positive effect on Competitive Advantage and financial performance. The study also showed that competitive advantages have a positive effect on financial performance. With so, the study indicates that competitive advantages mediate the relationship between intellectual capital and financial

performance. This is in line with the research conducted by Kamukama et al (2011) which shows that competitive advantage of companies can mediate the relationship between intellectual capital and company performance. Therefore, Intellectual capital is considered a competitive advantage that is difficult to imitate by its competitors and can eventually improve the financial performance of Small and Medium Enterprises. Small and Medium Enterprises need to optimize intellectual capital which can have a big influence on financial performance and competitive advantage.

THEORETICAL BACKGROUND

A. Resources Based View Theory (RBV)

The concept of Resource Based View (RBV) began to exist since the 1950s. Then it continues to be developed from the economic literature and strategic management. One of the pioneers of the Resource Based View (RBV) theory is Barney (1991). Resource Based View (RBV), became popular about 20 years ago. Based on several references, the concept of Resource Based View (RBV) is interpreted quite diverse, but in essence, the RBV is a classic approach in strategic management related to the problem of competency and company resources.

In view of Resources Based View (RBV), Wernerfelt (1995) argues that company resources are important to achieve a competitive advantage that will affect the company's profits (Wernerfelt, 1995). Meanwhile, according to Barney, if companies have diverse resources companies will benefit from scarce resources. To win business competition, companies must have a fast and appropriate strategy so as to be able to sustain a competitive advantage on an ongoing basis. Companies that focus on resources and capabilities will be able to compete continuously when compared to companies that only focus on product problems or market positioning.

In the RBV concept, the focus of attention is the problem of internal resources. According to Barney, the success of an organization is determined by internal resources grouped into 3 categories, namely physical resources, covering all factories, equipment, location, technology, and raw materials, human resources, covering all employees, including training, experience, intelligence, knowledge, skills and abilities and organizational resources, including corporate structure, planning processes, information systems, patents, trademarks, copyrights, databases, and so on.

In view of Resources Based View, Barney argues that to achieve a sustainable competitive advantage the company must have four characteristics of resources. Firstly, valuable capabilities as an ability that enables companies to be able to take advantage of opportunities and or minimize the threat of the company's external environment. Second, rare abilities (rare capabilities) as a capability that competitors do not have, both now and in the future. Third,

capabilities that cannot be imitated perfectly (imperfect imitable capabilities) as the ability to produce products of goods or services that competitors cannot emulate easily. Fourth, non-substitutable capabilities as a capability that is difficult to substitute for competitors.

B. Knowledge Based Theory

Resource Based View Theory explains the two views of a company's strategy-making device. The first is a market-oriented view, and the second is a resource-based view. Knowledge based theory holds that knowledge is one of the most important assets for the company. Companies that have assets in the form of knowledge if managed properly will be able to improve the company's financial performance. If the company's financial performance increases, the value of the company will also increase.

This theory provides strong support for the recognition of intellectual capital as one of the company's assets. Knowledge-based theory considers knowledge as a resource that is very important for the company because knowledge is an asset that if managed properly will improve company performance. The theory also emphasizes that if the company's performance increases due to the increase in company assets in the form of knowledge, then the value of the company will automatically increase.

C. Intellectual Capital

Bataneh and Al Zoaby define intellectual capital as the skills, knowledge and technology used to create a competitive advantage for organizations. Therefore, knowledge and information is needed to improve the performance of the company in order to participate in today's competitive market.

Intellectual capital includes all knowledge of employees, organizations and the ability of companies to create value-added and competitive advantage. Intellectual capital is an intangible asset that plays an important role in increasing a company's competitiveness and is also used effectively to increase company profits. Intellectual capital is the foundation for companies to develop and have advantages over other companies.

D. Intellectual Capital Components

Intellectual Capital can be defined as the sum of what is produced by the three main elements of the organization (human capital, structural capital, customer capital) related to knowledge and technology that can provide more value for the company in the form of organizational competitive advantage.

Many practitioners such as Stewart, Sveiby, Saint-Onge, Bontis stated that intellectual capital consists of three main elements as follows:

a. **Human Capital**

Human Capital is a component of intellectual capital which includes various knowledge, skills, abilities, experience, intelligence, creativity, and motivation that are owned by individual individuals within a company or organization.

b. **Customer Capital**

Customer Capital is a component of intellectual capital that provides real value. Customer capital is a harmonious or association network relationship that is owned by the company and its partners, both from reliable and quality suppliers, coming from loyal customers and satisfied with the services of the company concerned, originating from the company's relationship with the government and with local communities.

c. **Organizational Capital**

Organizational capital is the ability of an organization or company to fulfill the company's routine processes and structures that support employees' efforts to produce optimal intellectual performance and overall business performance, for example the company's operational systems, manufacturing processes, organizational culture, management philosophy and all forms of intellectual property owned by the company.

E. Financial Performance

Performance is a description of the achievements of the company in its operational activities both concerning the financial aspects, marketing aspects, aspects of fund raising and channeling of funds, technological aspects, and aspects of human resources. Financial performance is one of the factors that shows the effectiveness and efficiency of an organization in order to achieve company goals. The company's goal will be difficult to achieve if the company does not work efficiently, so the company is not able to compete with competing companies. The measurement of company performance is very necessary for showing the company's ability to carry out its production process. Financial performance in this study is measured based on ten indicators as follows: industry leadership, future prospects, overall response to competition, the level of success in new product launches, overall company performance and success, employee production power, production process, sales growth, profit growth and company market valuation.

F. Competitive Advantage

David argues that competitive advantage is a situation where a company can do something and other companies cannot, or have something they want.

Gaining and maintaining a competitive advantage is very important for the long-term success of an organization. Grant stated that the definition of competitive advantage is when two companies compete (on the same market and customer), one company has a higher level of profit and the potential for profit than other companies. A company can maintain a competitive advantage over a certain period of time because competing companies will immediately imitate and exert such superiority. There are 2 ways to achieve sustainable competitive advantage which are firstly constantly adapting to changes and trends and external activities and capabilities, competencies, and internal resources, and secondly, effectively formulating, implementing, and evaluating various strategies that further strengthen these factors.

According to Porter, there are three main ways a company achieves sustainable profits as follows:

a. **Cost Leadership**

Cost leadership means providing fair value at a lower price. The company does this by continuing to improve operational efficiency. Under these conditions, the company must reduce the cost of workers. Some companies provide a form of compensation by offering intangible benefits such as stock options, benefits or promotional opportunities. Meanwhile, other companies use the advantages of unskilled labor.

b. **Differentiation**

Differentiation means providing better benefits than others. A company can achieve differentiation by providing unique or high-quality products. A company with a differentiation strategy can set a premium price. Thus companies usually have a higher profit margin. Companies usually achieve differentiation with innovation, quality, or customer service. Through innovation, the same needs are met in new ways.

c. **Focus**

Through this strategy, a company is able to understand and serve the target market (specific) better than others.

G. Hypothesis

1. **Effect of Intellectual Capital on Financial Performance**

Intellectual Capital is knowledge and information that can create added value efficiency to generate wealth for the company (Stewart, 1997). Intellectual capital is defined as knowledge that can be converted into corporate value (Edvinsson & Malone, 1997). With the increase in the value of the company through an increase in IC, the possibility of generating wealth will be large. The better the company in managing the components of intellectual capital will have an influence on the company's assets. In this case, the company will manage the

assets owned by the company effectively and efficiently. The higher the intellectual capital, the profit increases, which makes the Return On Asset value increase. Thus intellectual capital will contribute to the financial performance of the company. This is in line with research conducted by Ulum (2007) and Ghosh and Mondal (2009) which show that intellectual capital has a positive effect on financial performance. Based on the description above, the following hypotheses can be arranged:

H1: Intellectual Capital has a positive and significant effect on financial performance

2. Effect of Intellectual Capital on Competitive Advantages

Companies that are able to manage intellectual capital well will greatly influence the competitive advantage of the company, the higher the value of intellectual capital, the greater the company's competitive advantage. This is in accordance with the research of Wu et al. (2012) and Siddiq (2013) which show that Intellectual Capital has a positive influence on the company's competitive advantage. Based on the above description, the following hypotheses can be arranged:

H2: Intellectual Capital has a positive and significant effect on competitive advantage

3. Effect of Competitive Advantages on Financial Performance

In Resource-Based View, which was pioneered by Barney, the view that economic value and competitive advantage of a company lies in the ownership and effective use of organizational resources that are capable of adding value, are rare, difficult to imitate and not replaced by other resources (non-substitutable). Therefore, competitive strategies are put in place to seek, obtain, develop and maintain strategic resources. Strategic resources in question are intellectual capital.

The resources owned by the company, especially intellectual capital, will greatly affect the company's performance in the future. This is in line with the research conducted by Nurfisira (2017) and Libyanita and Wahidahwati (2016) which show that competitive advantage has a positive influence on financial performance. Based on the description above, the following hypotheses can be arranged:

H3: Competitive advantage has a positive and significant effect on financial performance

4. The Influence of Intellectual Capital on Financial Performance with Competitive Advantages as Intervening Variables

In business competition, a company needs to create a competitive advantage to maintain the continuity of its business. Competitive advantages

and performance of companies are largely influenced by intellectual capital. In this case competitive advantage has a mediating effect that connects intellectual capital to the company's financial performance. This is in line with research conducted by Kamukaan et al (2011) and Libyanita and Wahidahwati (2016) which state that competitive advantage of companies can mediate the relationship between intellectual capital and company performance. Based on the description above, the following hypotheses can be arranged:

H4: Intellectual Capital has an effect on financial performance with competitive advantage as an intervening variable.

METHODOLOGY

The type of research used is quantitative research. Quantitative research is a method for testing certain theories by examining relationships between variables. This variable is measured by research instruments. With so that data consisting of numbers can be processed and analyzed based on statistical procedures. This research was conducted on Small and Medium Enterprises (SMEs) located in Makassar, South Sulawesi. The research approach was associative. Associative research is research that aims to find out the relationship between two or more variables. With this research, a theory can be built that can function to explain, predict and control a phenomenon.

The population in this study are all small and medium enterprises in the city of Makassar. The sample is part of the population that has certain characteristics or conditions to be examined. The sampling technique used in this study was purposive sampling with the criteria of small and medium businesses that had been registered in 2015 at the Makassar's Cooperative and SMEs Office and it has assets above Rp. 50,000,000, - with sales at least Rp 25,000,000, - and has been established for 5 years. The sample is 80 small and medium enterprises. There are three methods of data collection in this study, namely questionnaires, documentation, and interviews. The responses given by respondents were tested for validity and reliability, the analysis model used was the Classical Assumption, Multiple linear Regression and Path Analysis.

RESULTS

A. Effect of Intellectual Capital on Financial Performance

Based on the analysis, it shows that the value of t for Intellectual Capital variable is 3.007 with a probability level of 0.004. It can be concluded that Intellectual Capital has a positive and significant effect on financial performance because the significance value is <0.05 . The result obtains the standardized Coefficients Beta value of 0.298 for the value of path and the unstandardized Beta Coefficients value of 0.204.

B. Effect of Intellectual Capital on Competitive Advantages

The results show that the calculated t value for intellectual capital is 7.422 with a probability level of 0.000. With so, it can be concluded that intellectual capital has a positive and significant effect on competitive advantage because the significance value is <0.05 . The analysis indicates standardized Coefficients Beta value of 0.643 for the value of path, while the unstandardized value of Beta Coefficients is 0.555.

C. Effect of Competitive Advantages on Financial Performance

The value of t for the competitive advantage variable is 5,223 with a probability level of 0,000. Because the significance value is <0.05 , it can be concluded that competitive advantage has a positive and significant effect on financial performance. The result indicates the standardized Coefficients Beta value of 0.518 for the value of the path, whereas the unstandardized Beta Coefficients value is 0.410.

D. The Effect of Intellectual Capital on Financial Performance with Competitive Advantages as an Intervening Variable

Based on the Sobel test, the value of t is 5.1865 greater than the value of t table 1.99125. Therefore, it can be concluded that the mediation coefficient is 0.22755. It means there is an influence of mediation. The result indicated that Intellectual Capital has an effect on financial performance through competitive advantage.

DISCUSSION

A. Effect of Intellectual Capital on Financial Performance

The results of the analysis indicate that the path coefficient value of the influence of intellectual capital on financial performance is 0.298 or 29.8% and the remaining 70.2% is influence outside of variable intellectual capital. The significance value is $0.04 < 0.05$. These results show that intellectual capital has a positive and significant influence on the financial performance of Small and Medium Enterprises in the city of Makassar.

The results of this study are supported by previous research. The findings of this study is similar with Tan et al. (2007). Tan et al. (2007) showed that there was a significant influence of IC on financial performance. This means that industrial companies in Indonesia are maximally managing and developing their intellectual property to win the competition. Intellectual capital has been developed in order to create value for the company. Companies are still more focused on short-term interests, namely increasing financial returns.

This finding is in accordance with Research Based Theory. Research based theory which was pioneered by Penrose (1959) states that companies, in order to excel competition, must have value and optimize the function of assets

they have. The higher intellectual capital, the higher productivity. The theory is also said that the Intellectual Capital concept will trigger the company's performance to be better. The higher the intellectual capital, the higher the utilization of company resources in generating profits. The better the company in managing the components of intellectual capital namely human capital, structural capital and relational capital will have an influence on the company's assets. In this case, the company will manage assets owned effectively and efficiently.

The results of this study are also in accordance with Knowledge-based theory which states that if a company can manage and develop its knowledge resources it can increase company profits. This shows that through good management of intellectual capital is able to improve the company's financial performance.

B. Effect of Intellectual Capital on Competitive Advantages

Based on the results of the analysis obtained the path coefficient value of the influence of competitive advantage on the financial performance of 0.643 or 64.3% and the remaining 35.7% is influenced by other factors not examined in this study. The significance value is $0.04 < 0.05$. These results indicate that intellectual capital has a positive and significant influence on the financial performance of Small and Medium Enterprises in Makassar.

The results of this study are supported by research conducted by Edvisson & Malone (2003) explaining that the implementation and measurement of Intellectual Capital which is Human Capital, Structural Capital, and Customer Capital. Human Capital leads to individual abilities, knowledge, skills, experience, and also corporate creativity and innovation. The good role of the utilization of Intellectual Capital will affect the ability to create innovation and creativity of the company so that it still exists in industrial competition. This will encourage companies to continue to develop resources in the form of intellectual capital in order to be able to excel in industrial competition.

The competitive advantage achieved by the company comes from the company's internal form of intellectual capital. Companies that are able to manage intellectual capital well will greatly influence competitive advantage. This is in accordance with the view of Resources Based View (RBV), which states that the success of an organization is determined by internal resources grouped into 3 categories, which are Physical resources, including all factories, equipment, location, technology, and raw materials, Human resources, including all employees, including training, experience, intelligence, knowledge, skills, and abilities they have, and Organizational resources, including corporate structure, planning processes, information systems, patents, trademarks, copyrights, database, and so on. This hypothesis is supported by research

conducted by Wu et al. (2012) and Siddiq (2013) which shows that Intellectual Capital has a positive influence on competitive advantage.

C. Effect of Competitive Advantages on Financial Performance

The results obtained path coefficient value of the influence of competitive advantage on financial performance of 0.518 or 51.8% and the remaining 48.2% is influenced by other factors not examined in this study such as entrepreneurial orientation and innovation. The significance value is $0.04 < 0.05$. These results indicate that competitive advantage has a positive and significant influence on the financial performance of Small and Medium Enterprises in Makassar.

The result means that with the concept of intellectual capital, the company will be able to produce competitive advantages that will affect the company's assets. In this case, the company will manage the assets owned by the company effectively and efficiently. The results of the study show that competitive advantage can be obtained from the company's ability to process and utilize its resources and capital. Companies that are able to create a competitive advantage will have the power to compete with other companies. Thus competitive advantage will have an impact on increasing financial performance.

This study is supported by research by Li et al. (2006) and Wang et al (2011). Li et al. (2006) and Wang et al (2011) stated that there is a positive influence between competitive advantage and performance measured through sales volume, profit, market share, and return on investment, and corporate culture that emphasizes the importance of companies to pay attention to the market will lead to strengthening the company's competitive advantage.

D. The Effect of Intellectual Capital on Financial Performance with Competitive Advantages as an Intervening

Intervening variables are interrelated variables between the independent variables and the dependent variable so that the independent variable does not directly affect the change of the dependent variable. The analytical tool used to determine how much influence the intervening variable is path analysis. The path coefficient is the standardized regression coefficient. Path coefficients are calculated by making 2 structural equations namely regression equations which show hypothesized relationships.

The fourth hypothesis (H4) proposed in this study is that intellectual capital influences financial performance with a competitive advantage as an intervening in Small and Medium Enterprises in Makassar. The amount of direct influence is 0.298 or 29.8% while the magnitude of the indirect effect must be calculated by diverting the coefficient not significantly, namely $(0.643 \times 0.518) = 0.333$ so that the effect of total intellectual capital on financial performance is

$0.298 + (0.643 \times 0.518) = 0.631$ or 63,1% while the remaining 36.9% are external factors not examined in this study.

From the large percentage of direct and indirect influences, the researcher is more inclined to use indirect influence, namely using the variable of competitive advantage as an intervening variable rather than using the direct influence of intellectual capital on financial performance. This is due to the greater percentage of indirect influence (through intervening variables), which is 0.333 or 33.3% compared to the direct effect of 0.298 or 29.8%. This shows that competitive advantage also greatly helps a company in increasing profits. The competitive advantage achieved by the company comes from the internal company in the form of intellectual capital. Companies that are able to manage intellectual capital well will greatly influence competitive advantage.

The results of the above research indicate that, when directly related to company performance, intellectual capital has a significant influence. When mediated by competitive advantage, intellectual capital has an influence on company performance. In the sense that when competitive advantage becomes the mediation between intellectual capital and company performance can have a positive effect. This is because the competitive advantage possessed is a characteristic that distinguishes it from other companies.

This research is supported by the viewpoint of Resources Based View (RBV), namely the success of the organization determined by internal resources grouped into 3 categories which are Physical resources, including all factories, equipment, location, technology, and raw materials, Human resources, including all employees, including training, experience, intelligence, knowledge, skills and abilities they have, and Organizational resources, including corporate structure, planning processes, information systems, patents, trademarks, copyrights, databases, etc.

The results of the study found that the application of intellectual capital to Small and Medium Enterprises in the city of Makassar had a considerable influence on competitive advantage and financial performance. This research is supported by research conducted by Kamukaan et al (2011) and Libyanita and Wahidahwati (2016) which state that competitive advantage of companies can mediate the relationship between intellectual capital and company performance.

FURTHER STUDY

This research has some limitations. Firstly, this research only has sample which is SMEs in Makassar. With so, it is recommended to expand the research area outside Makassar to explore more characteristics of SMEs in South Sulawesi. Second, this research only focused on intellectual capital and financial performance. For the next researcher, there are still several factors that are assumed to influence the financial performance of Small and Medium Enterprises (SMEs). Therefore, it is recommended for future researchers to add

other variables such as market orientation, entrepreneurial orientation, product innovation and others which are also some of the determinants in improving the company's financial performance.

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