

CHAPTER 2

LITERATURE REVIEW

In this chapter, the author will provide theories and conceptual frameworks and relevant past findings that are related to the research topic and questions. The theories in this research study are from the previous studies that have been conducted by some scholarly papers and researchers. Chapter 2 will start by explaining the basic concept of relevant theory of competitiveness and followed by the specific information theory in competitiveness, funding and innovation that influence the competitiveness in Indonesian SMEs focusing on the food and beverage sector. The main theory of this research study will be Porter's generic strategy. In this research study, the main focus is on the food and beverage sector specifically the local coffee shop industry in Jakarta SMEs since it is currently the largest percentage of the growth sector in Indonesian small and medium sized enterprises (SMEs).

2.1 Indonesian SME Food and Beverage Categories and Groups

According to Badan Pusat Statistik (2015), Indonesian SME that focuses on the food and beverage sectors is divided into 5 categories and groups. These include restaurant/food stalls, food stores, street food, catering services and bar/coffee shop. Restaurant/food stalls are groups that include the type of food service businesses which are located in part or in whole permanent buildings that sell and serve food and drinks to the public at place of business. Second, food stores are the groups that include food service businesses that sell and serve prepared food consumed through the process of making it in a movable place, usually by using tents, such as seafood and chicken stalls. Third, street foods are the group that includes food service businesses that sell

and serve pre-prepared food to be consumed that was preceded by the manufacturing process and is usually sold in a spontaneous way, like a meatball cart vendor or a fried food vendor. Fourth, catering services are the group that includes the provision of food services based on contractual agreements with the customer, in which the location is determined by the customer for a particular event such as parties, celebrations, seminars, meetings, and etc. Lastly, bars/coffee shops are the group that includes the types of food service businesses which are located in part or whole permanent buildings that sell and serve mainly beverages to the public.

2.2 Theoretical Foundation

To grow a small and medium sized enterprises, competitiveness level is crucial to be sustained at an optimum level. The definition of competitiveness itself is related to the whole structure of the company from a conceptual, complex and comparative point of view (Depperu, & Cerrato, 2004). Small and medium enterprises have their own competitive advantage, despite whether the company is producing goods or services. Competitiveness can essentially be determined by relative success in terms of innovation and funding (Budd, & Hirmis, 2004). The two important factors, which are funding and innovation, affect the competitiveness in the organization itself. Therefore, SMEs need to consider these two factors as such that it affects competitiveness in a larger scale.

2.2.1 Innovation in SME

Innovation is classified as a development of a fresh and new concept. These concepts may be ranging from a creation of a new item, an upgrade of a previous product model or even a refinement in business processes (Verhees and Meulendberg, 2004). Therefore, as Raymond and Pierre (2010) composed, innovation is a pure

concept that has been moulded and illustrated in many ways to achieve a certain goal. In order to produce a certain innovation milestone, business owners need to constantly brainstorm for ideas and solutions to be able to compete within the global markets. Another perspective regarding the definition of innovation itself is from Forsman (2010) where he stated that innovation is a state of improving and implementation of new products and services to leverage the competitiveness level of a firm.

Since innovation is essential to be able to compete with the global markets, developing countries such as Indonesia is highly pressured to create unique products and services in order to maintain their competitiveness level. With the presence of globalization, things are worse off as developed countries have produced a more advanced technology for manufacturing and increasing the standard of quality of life (Dogan, 2016). Company departments that drive the growth of the business, such as R&D, technology, training and management, need to innovate and increase their capacity on doing research that is relevant in order to maintain competitiveness at all times. Innovation capabilities are dependent on the research that is implied. These innovations can come from an external or internal research depending on the industry category of the company (Chen et al, 2006). As for external research, it may come from research on competitors' movements or from articles and journals that may inspire the innovations. Being up to date on how the market reacts towards a certain product/services is one of the keys to having a successful innovation research (Hillebrand and Biemans, 2004). As for internal research, company meetings and internal conversations may spark ideas where then it may be developed and analysed to reach a feasibility study on the idea (Distanont et al, 2012).

According to Baregheh et al (2012), the food and beverage industry is one of the most sensitive industries towards the innovation of products. Due to the sensitivity of this sector towards innovation, the growth of SME business in food and beverages is largely dependent on the capability of innovating new and unique products. Hence, the increase in innovation is linearly proportional on the level of competitive advantage for this sector.

2.2.1.1 Types of Innovation

To breakdown into a more specific category of innovations, there are 4 types of innovations that a company may conduct, particularly in food and beverage SME (Purba, Yuliasih, Maarif, & Hermawan, 2018). The four types of innovations are product, process, organizational innovation and business model.

Product Innovation

First, product innovation involves the introduction of new products or services that are created uniquely. According to Baregheh, Rowley, Sambrook & Davies (2012), Product innovation has the capability in creating and changing existing products, into serving better and advanced purposes. This type of innovation is important and needs to be considered by SMEs in order to achieve the competitive advantage (Distanont, & Khongmalai, 2012). For example, Starbucks coffee created a new product by mixing unique recipes into their coffee, such as mixing pumpkin into a latte. This mixing has not been done in any sort of coffee shops around the world, hence making it an attractive product for the market and leveraging the competitive advantage of the company (Fournier, 2019).

Process Innovation

Second, the process innovation involves the improvement on execution to the overall business operations. By improving and innovating the business process, it will result in constructive feedback for the business to maintain their competitiveness level (Riyardi & Sumardi, 2017). They also stated that process innovation has greater influence in improving business competitiveness compared to the other strategies.

Organizational Innovation

Third, organizational innovation involves refining and developing new organization structure and reporting flow processes (Lam, 2015). By focusing on this type of innovation, it may impact the line of communication within the organization, system of the operations, and organizational behaviour. For instance, McDonalds, a company that sells food and beverages, have created an innovation culture and develop their innovation competency. The organization has become successful and prosper in terms of organizational innovation, which leverages competitive advantage for the company.

Business Model Innovation

Fourth, a business model is one of the types of innovation that describe the plans of the business in making profit and becoming sustainable (Muller, 2019). According to Landry (2020), a company that puts value on business model innovation will enhance how the company develops more income through emphasizing customer experiences and translating value in a unique kind of way to the market. Like other types of innovations, by emphasizing on the business model innovation, this will affect the competitiveness level of the business itself and may result in a sustainable positive long term effect. (Verma, & Bashir, 2017).

Through these four types of innovations, the author has different perspectives on how innovation may impact the competitiveness level of SME. The types of innovation that has been mentioned are directly proportional to the level of competitiveness of the business. Therefore, it is crucial that a SME choose the appropriate innovation strategy and being consistent throughout the process to compete in the global market (Riyadi, Sumardi, 2017). In addition to the theory above, the author agrees that senior management should decide on which types of innovation will be beneficial for their food and beverage business in accordance to the vision and strategy of each owner.

2.2.1.2 Importance of Innovation in SME

The key importance of innovation is to give SME an association within the global market. By providing something unique to the market, it may lead to a broader scope of opportunities, which then leads to a wider market reach (Hendersen, 2017) . Innovation may also act as a bridge between problem and solution, therefore it is essential for SME to develop innovative thinking on a constant basis. To provide a stronger argument regarding the importance of SME, several researchers had provided some results on the impact of innovation to SME. Sungjoo et al (2010) stated that competitiveness level is determined mostly on the unique product features that were being offered by a certain company. By the ability to offer a unique value to the customers, this may lead into a higher competitive advantage. According to Anglemar (1990), innovative thinking is the fundamental mindset that all business owners should have to be able to gain competitive advantage in the aggressive market. By the strength of the argument above, innovation can be considered as one of the most important factors in determining the competitiveness level in the food and beverage industry.

Thus, the author thoroughly supported the arguments due to the abundance of evidence in place, for the effect of innovation towards competitiveness level. By this, the first hypothesis is:

Hypothesis 1: There is a correlation between innovation and competitiveness in the local coffee shop industry.

2.2.2 Funding in SME

To be able to grow SME in the food and beverage industry, funding is needed to be able to run and operate the business. Since funding is critical to power up a business, developing and raising funds for SME can be challenging at times for SMEs (OECD, 2004). Challenges in raising funds vary from the perspective where SMEs are not attractive enough to gain a turnover for investors into an alarming level of risk and ambiguity that SME might possess (Parrot, 2020). Due to the risk and challenge presented, investors are doubtful in terms of putting funds into the growth of SME and stock exchanges are not available for SME due to the inconsistency of growth over time (Wagenvort, 2003). By this condition, SMEs are not getting enough funds to grow their business, since this risk produces unavailable information and connections presented by the global market and investors (Stiglitz & Weiss, 1981).

2.2.2.1 Types of Funding

In terms of the business financing, it is crucial that an SME has good funding in order to maintain the stability of the business economy. Therefore, two types of funding sources in an SME that the author looks at. According to Abdulaseh, & Worthington (2013), internal investors and external investors are the types of funding

sources in a SME. Internal funds were the resources that was procured within the company's assets and revenues, such as employees and personal incomes. While external funding is sourced from other entity, such as banks and venture capitalists (Leonard, 2018).

Internal funding

Internal funding refers to when a business uses its savings, revenues and withdrawal of other assets to develop new strategies of the business (Leonard, 2018). By the term internal funding, the source of funding came from an inside connection and is within the internal business entity (Thompson, 2018). Funding is needed since it is the most convenient way of how business can attain their resources to develop their new product/services. Businesses will save time and resources in acquiring extra funding through a direct approach to investors or employees within the company (Dixit & Pindyck, 1995). However, every funding that is proceeded from the internal side, requires extra responsibility from the owners and senior management. To fund growth appropriately, owners and senior management needs to have a clear vision and pathways in using the funds to resource an aspect of the business, whether it might be research and development, marketing or even human resources (Surbhi, 2017). According to Bougheas (2004), the examples of internal fundings includes, retained profits, sales from an asset, or employee stock options. The majority of businesses used internal fundings to resource daily operations and the things that keep the business running daily. To acquire internal funding, this requires lesser cost of business as it might not require a significant amount of preparation time to convince other people to fund the business (Fitzsimmons, & Douglas, 2006). Therefore, internal funding can be used to fund an SME that are emerging and growing.

External funding

External funding in definition is acquiring funds and resources through an external entity of a business, such as angel investors, bank and venture capitals (Fitzsimmons, & Douglas, 2006). External funding are often used to invest in the growth trajectory, asset procurement, building the foundations of a business or even an emergency relief (Harrison, 2018). Therefore, angel investors, venture capital and bank loans are the types of funding that businesses used to boost their company (Biberdorf, 2019). To briefly describe the types of external fundings, some comparison are required in dependant on the need of the business. Angel investor is usually presented by an individual that has no prior connection towards the owner or management of the business. Angel investors often sees an opportunity in emerging SMEs or startups, where funds will be used to finance the growth of product development (Mason & Harrison, 2008). The other type of external funding is through a venture capital, where the funding model looks similar with an angel investor. However, for venture capitals, this involve a group of people that analyzed and forecast the growth of a business prior (Novarlic et al , 2017). Other than funds, venture capitals, also caters knowledge download and broad connections for SMEs to further increase their development and growth. The last type of external funding are bank loans, where banks invest a certain amount of funds to an SME through mutual funds of stakeholders (De Bettignies & Brander, 2007). Therefore, since external sources of funds lie outside the organization, to attain these type of humongous funds that are able to fund growth, preparation and clear pathways for the business development are needed to be well prepared, with extra cost and effort (Borad, 2019).

2.2.2.2 Importance of funding in SME

Mawarti (2009) argues that funds are important for businesses like small and medium sized enterprises in order to sustain the operational activities. It is to achieve the sustainable competitive advantage and capable of increasing the competitiveness as well as growth of the business, particularly in the food and beverage sector. Therefore, funding is also needed in enhancing the products/services and technologies of a SMEs. Moreover, previous researchers have stated that lack of funding is one of the most important factors that influence competitiveness, especially in the small and medium sized enterprise (Soini & Veseli, 2011). Key factors that affect SMEs in acquiring funds are the nature of the high level risk of an SME and lack of connection to the bigger and global markets (Johnson, 2020).

To support the importance of funding in SME, researches have come up with a conclusion that funding is essential to maintain competitiveness level in food and beverage SME (Nikolic, Dharmo, Schulte, Mihajlovic, & Kume, 2015). According to Jacinda, Viverita & Bustaman (2012), funding has a direct impact and relationship towards the competitiveness level of an SME. Thus, making it as one of the focus in this research. Consequently, the author of this research paper is aligned with the theory and importance, thus agreeing with the arguments above. Therefore, the second hypothesis is:

Hypothesis 2: There is a correlation between funding and competitiveness in the local coffee shop industry.

2.2.3 Competitiveness and Competitive Advantage

According to McGahan (1999), 36% of the earnings of the company is contributed by the level of competitiveness of the company. It may be more impactful towards other sectors of industry, such as FMCG and technology (McGahan 1999). Thus, making competitiveness an important aspect to be monitored in an SME. Porter (1985) described competitiveness as a value creation strategy implemented by a company, to provide a unique value proposition to the market in comparison to competitors. Since products or services utilization may be similar among countries, competitiveness is much more aggressive in the global market due to the mobility of items throughout locations. Competitiveness level can be perceived as a challenge, however, it shows signs of financial strength when compared to the other countries or companies in the market. It drives the company to push more on innovation and developing a strategy to maintain the sustainability of the business (Murths, 2008).

Moon, Rugman, & Verbeke (1998) argued that the competitiveness level is interconnected with competitive advantage. From this, the competitive advantage will affect their growth of the business in comparison with their competitors in the food and beverage industry, therefore, influencing the competitiveness level. According to Putra, Sudarmiati, & Suharto (2018), the definition of competitive advantage itself has two distinct but associated meanings. The first definition indicates the strength, determining the company's assets and skills. Competitiveness advantage is directly proportional to the abundance of resources and expertise in the companies. These may affect the company in terms of doing its innovation, marketing, manufacturing, creating unique business processes and funding (Putra, Sudarmiati & Suharto, 2018).

Through these areas of competence, the company can develop strategies to produce products that sell well in the market.

From the second definition, company performance is directly proportional to its performance in matching with competitors. By giving more focus on improving the performance of the company, it also may result in a better competitive position, since revenue and capital may increase to invest in competitive advantages (Gluck, Kaufman, & Walleck, 1980). In order for companies to achieve a higher competitive advantage, creative strategies need to be implied at a constant basis to make sure that competitiveness level is maintained and dominating the global markets. To leverage competitive advantage, one of the strategies that can be applied is that companies may set a unique value proposition to attract the market and push off competitors in the food and beverage sector (Porter, 1990). In conclusion, past researchers stated that funding and innovation will have a strong relationship towards the competitiveness in the f&b sector especially in the coffee shop industry in Jakarta. Hence, the third hypothesis is:

Hypothesis 3: Both funding and innovation has a strong relationship towards the competitiveness in the coffee shop industry.

2.3 Porter's Generic Strategy

The author has argued from the researched theory above that funding and innovation plays a significant role in the impact of competitiveness in a SME. Therefore, it is crucial that SME concentrate on the strategy that the SME uses in order to have a sustainable competitive advantage (Dichovska, & Boshkoska, 2018). By this,

Porter's generic strategy is the main theory of this research study. In order to maintain a sustainable competitive advantage in a firm, Porter has summarized three strategies (see **Figure 4**) that are vital for SME businesses (Tanwar, 2013). Amadeo (2019) in his research, has proved that by using these three strategies, it helps the firm to achieve and build a sustainable competitive advantage.

The three ways are cost leadership, differentiation, and focus. In the cost leadership strategy, a firm needs to have the smallest expenditure cost and an adequate amount of funding in order to form a competitive advantage (Gluck, Kaufman, & Walleck, 1980). By having the lowest price and funding for a business, the company achieves a sustainable competitive advantage and wins the competition with the other competitors since cost management and controlled funding are the most important thing to have in a business (Kumar, 2006). The author sees a correlation between cost and funding, since by saving operational cost, the funding of the business may be sustainable towards developing and improving other products.

The second strategy is differentiation, where SMEs have the ability to create innovative and unique products to differentiate themselves with other competitors in the market (Putra, Sudarmiati, & Suharto, 2018). In order to achieve a differentiation in the market, owners are to seek out product attributes and characteristics that are worth innovating to be able to achieve competitive advantage. By implementing the differentiation strategy, competitors in the market are limited with options to gain back their competitive advantage. Based on past studies (Hamdan, 2017), in order to use the differentiation strategy, SME in the food and beverage industry necessitate an acceptable amount of funding and innovation ability in order to develop their

competitive advantage even further beyond. Thus the author agrees with Kumar (2006) that innovation and funding are the most important factors in implementing Porter's generic strategy in differentiation to stimulate the competitiveness level in the food and beverage sector.

The last strategy is to focus on the competitive advantage that can be gained by SME in order to maintain the survival of the business. By focusing on the competitive advantage, it can energize and empower innovation and determination to attain funding for the business (Bhuyan & Prasanta, 2018). The focus strategy also helps businesses in focusing their strengths and capabilities. An illustration for this is, a SME focuses on developing loyalty programs for a specific target group of consumers in order to maintain competitiveness level for the specific group (Tanwar, 2013). As it has been argued above, the author agrees that while businesses are strategizing to gain competitive advantage, focusing towards a certain competitiveness strategy is the key to gain funding and innovations.

Figure 4: Porter's Generic Strategy

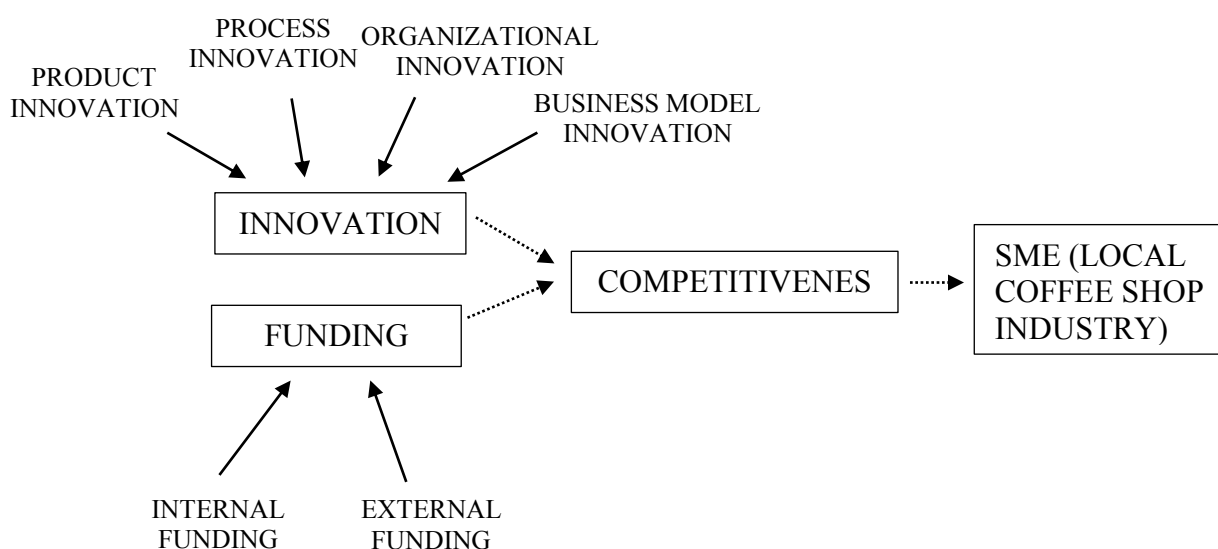


Source: Porter, M. *Competitive Advantage: Creating and Sustaining Superior Performance* (1985)

2.4 Theoretical Framework

The theoretical framework provides an overview of why the research is important and how the researcher expect the literature to fill the gap based on the theory that is mentioned (Imenda, 2014). In this research study, the theoretical framework (see **Figure 5**) represent the two most important factors that influence the competitiveness in the local coffee shop industry. The dotted line in the figure below represent the two factors that influence the competitiveness which is the main research topic. Funding and innovation are the two most important factors since based on the research data that has been explained in the previous chapter, funding and innovation were the highest constraint among other factors. These two factors which are innovation and funding, has individual sub-types that have a relationship and influence the competitiveness level which affect the SME particularly in the food and beverage sector. The sub-types represent the types of each factors that is important for the growth of the food and beverage sector in Indonesian SME. The explanation of the figure below had been explained in the subchapters above.

Figure 5: Theoretical framework for this research



2.5 Hypothesis Development

2.5.1 Hypothesis for this research

H1: *There is a correlation between innovation and competitiveness in the local coffee shop industry.*

H2: *There is a correlation between funding and competitiveness in the local coffee shop industry.*

H3: *Both funding and innovation has a strong relationship towards the competitiveness in the coffee shop industry.*

2.5.2 Conceptual Model/ Framework

Conceptual model is a framework that is initially used in research to present an idea or thought (Elangovan and Rajendran, 2015). The figure below (see **Figure 6**) shows the conceptual model of this research based on the hypothesis that is conducted in this research. The first hypothesis (H1) represent that there is a correlation between innovation and competitiveness in the local coffee shop industry in Jakarta. The second hypothesis (H2) consider that there is a correlation between funding and competitiveness in the local coffee shop industry in Jakarta. Lastly, the third hypothesis (H3) which applied that both funding and innovation has a strong relationship towards the competitiveness in the local coffee shop industry, especially in Jakarta. These hypothesis concept were illustrated using the figure below which refer to the variable and factor of this research. This conceptual model helps the reader to know, understand the idea of this research easily. The explanation of the variables had been explained in the subchapters above.

Figure 6: Conceptual Model/ Framework for this research

