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**INNOVATION AND BUSINESS STRATEGIES  
TO ENHANCE FIRM PERFORMANCE:  
STUDY OF SMEs CLUSTER IN MALANG**

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**Abstract:** This research aims to know the direct influence of innovation against the performance of the company and to find out the direct influence of business strategy on performance of the company. The population of this research was the whole SME Centre In Malang. The number of samples used was 100 SMEs. Sampling procedure was done by using the method of probability sampling, with Proportional Random Sampling techniques namely sampling proportionately to each region. Data analysis used in this research was Multiple Regression method. Based on the results of hypothesis testing, it shows that innovation directly and positively effects performance of the company. Furthermore, the results of this study also found that business strategy will affect the achievement of the company's performance. This means that if the companies do innovation and business strategy, it will improve the company's performance

**Keywords:** *Innovation, Business Strategy, Firm Performance, SMEs Cluster*

## INTRODUCTION

SMEs have an important role in the economic and industrial growth of a country (Husband & Purnendu, 1999; Mahemba, 2003; Tambunan, 2005). SMEs also have a contribution to the absorption of Labor (Tambunan, 2005). The contribution of SMEs against the absorption of labour, both in developed countries or developing countries, including Indonesia, have a significant role in tackling the problem of unemployment.

During this time, the potential of the SMEs are not offset by the ability to compete. The SMEs competitiveness has been low thus causing the difficulties in raising output (Tambunan, 2008). Inability of SMEs to improve the competitiveness of SMEs is due to various limitations, such as lack of ability to adapt to the environment, less sure-footed in opportunities – business opportunities, and lack of creativity and innovation in anticipation of the wide range of environmental challenges. In addition, internally the SMEs are lack of managerial ability and skills as well as capital and markets.

On one hand, the literature review explains that there are three key aspects that will determine the competitiveness and having an impact on the firm performance, namely the company's internal environmental factors, the external environment and entrepreneurship. Results of a study conducted by Hadiyati (2008) which states that the factors - environmental factors that distinguished the internal and external factors either directly or

indirectly affect the competitiveness strategy. The right strategy is necessary for SMEs, given the effort required in developing the ability to identify opportunities and threats that exist in the business environment. The determination of a good business strategy will have an impact on achieving superior performance. Some of the results of empirical studies show that the strategy of the business will be able to produce the performance for the company (Ritter & Gemünden, 2004; Hankinson, 2000). This research aims to know the innovations and business strategies on performance.

### **Innovation**

In the study of literature, Schumpeter (1934) mentions that there are five possible types of innovation that can be done by the company, namely (1) the introduction of a new product or a qualitative change of an existing product; (2) the process of innovation for the industry; (3) the opening of new markets; (4) the development of sources – sources of supply of raw materials or other inputs; as well as (5) changes in the organization. Based on the source, Tidd, et al., (2001) describes several classifications of innovation, Emergent, (Imported) and imposed. Definitively, Amabile (1996) describes innovation as a concept that addresses the application of the idea, a product or process that is new. Therefore the company is expected to form a thought – new thinking in the face of good competitors, customers and markets. Robbins (2002) defines innovation as a new idea being applied to initiating or improving a product or process or service. Based on that explanation, innovation focused on three major things, namely: (1) new ideas, that is a sport thought in observing a phenomenon that is happening; (2) product or service, namely the advanced steps of the new idea that follow up with a variety of activities, studies, and experiments so that gave birth to the concept more concrete in the form of products and services that will be developed and implemented; (3) improvement efforts, i.e. systematic efforts to perform refinement and make improvements continuously.

Furthermore, Gatignon and Xuerob (1997) explained that in doing product innovation, there are 3 important things to be aware of, namely the excellence of the product, the product uniqueness, as well as the cost of the product. Product innovation can fail for many reasons. Error in applying the strategy into a cause that often happens, other causes include product design that is not innovative, wrong estimate competition, the problem lies in the design or production costs are much higher than expected.

### **Business Strategy**

In the literature, small business strategy has presented a continuum ranging from conservative to be proactive-reactive (Covin and Slevin, 1991). From the study of literature on strategic planning and performance shows that companies proactively invest time in developing the strategy and showed a higher level of performance than a proactive company but do not develop strategies (Covin and Slevin, 1991)..

In the long term, planning strategies derived from the company's efforts to create a competitive advantage through a generic strategy (Pearce and Robinson, 2007): (1) Overall Cost Leadership, (2) Finding, and (3) Focus. Miles and Snow (1978) formulate a typology of business level strategy involving four types of strategic; (1) the Defenders, Prospectors (2), (3) Analyzer, and (4) Reactor.

Hisrich, et al. (2008) used the term strategy entrepreneurship which is defined as a number of decisions, actions, and reactions that are first created, and then exploit a business with how to

maximize the benefits of novelty as well as minimize costs. Entrepreneurial strategies include new business strategies or growth strategy.

1. New business strategy

Is the creation of a new business opportunity, include

- a. resources as a source of competitive advantage
- b. entrepreneurship resources

2. Growth strategy

Strategies that focus on where it should look for opportunities to develop which the company may have had a basis for a sustainable competitive advantage. This growth strategy includes

- a. penetration strategy
- b. market development strategy
- c. product development strategy
- d. diversification strategy

### **Firm Performance**

From the theoretical view, some authors provide articulation of the company's performance in different ways. Comprehensively, Mwita (2000) describes the performance as a link between behavioral variables (processes), outputs and outcomes (value added or impact). Chakravarthy (1986) stated that the company's performance is an invalid constructs which are generally used to measure the impact of a company's strategic orientation. Pelham and Wilson (1996) defined the company's performance as a successful new product in the development of the market, where the company's performance can be measured through the growth of sales and share of the market.

Based on these measures, Neely (1999) describes the measurement of business performance can be done by combining two factors, namely; (1) firm performance measurement can adopt the existing size, (2) performance measurement should be relevant so that companies must always make changes any time. Sang et al., (1999) explains that performance can be measured through financial performance, customer satisfaction, internal processes, and learning and growth. Studies conducted by Bititci, et al. (2000) explains that the performance of a business can be measured; the level of sales, cost of sales, assets owned, brand image and fixed assets owned by the company.

### **Conceptual Framework**

Several empirical studies indicate that innovation is directly and positively effect on the firm performance. The research conducted by Bharadwaj et al. (1993) found that the company's ability to continue to product innovation will keep the product is fixed in accordance with the wishes and needs of customers. Study conducted by Prajogo (2006) explores the relationship between innovation and business performance. The results showed that (1) there are no significant differences between manufacturing companies and service companies from both the product innovation as well as innovation process; (2) innovation process demonstrates a relatively stronger relationship with business performance rather than product innovation in the manufacturing sector.

Different results about the influence of innovations and performance found by Darroch (2005). In their study, the researchers used a variable knowledge management, innovation and

performance. The results showed that innovation has no relationship with the performance significantly. Research conducted by David, et al., (2007) aiming to explore the nature of the interaction between two strategies, innovation and market orientation on performance. The results showed that innovation is positively correlated with the market orientation and the invalid constructs both correlated positively with the company's performance in a competitive environment. Damanpour (2001) research carried out for the purpose of testing the dynamics that determine the adoption of innovations in products and processes in the company. The results showed that the adoption of innovation products faster than the adoption process at the bank, and the adoption of product innovation have a positive relationship with the adoption of the innovation process.

Kotley, et al. (1997) aimed to examine the relationship between the variables values personal owner/manager, a strategy that was adopted in connection with the performance of the business. The result of his research showed that personal values/owner, business strategy, empirically has influence to the performance. Boohene et al. (2008) researching on gender, personal values, strategies and small business performance with the aim to test the influence of gender on performance of small businesses in Ghana by exploring the influence of personal value against business strategy. Specific questions that would like to be answered are whether the employers of women and men differ in the implementation strategy of the business, and how personal values affect the strategy and its impact on performance. The research results show that the difference in personal characteristics will determine the difference strategy is taken, which in turn affects the performance of the business. Sacred (2009) researched on performance improvements through the entrepreneurial orientation, management capabilities, and business strategy. The results of the analysis showed that the business strategy is influenced by the SME management skills and will affect performance. While the research results of Hashim (2000) found that the performance of Smash in Malaysia varies with the difference the choice business strategies adopted.

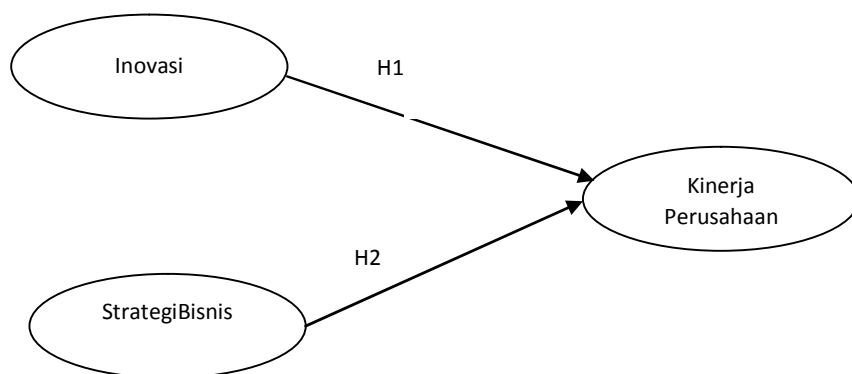


Figure 1.1 The research framework

**METHOD**

This research was conducted on small and medium businesses that registered in Malang local government in the year of 2011. The criteria of small and medium businesses that are used are:

1. The listed SMEs have a business license and can be identified by the Department of industry and trade of Malang.
2. The SMEs produced flagship products and have the potential to be developed

Based on these criteria, then the population of the research was centered on SMEs which engaged in the field of food processing. Population the population used in this study of 283 business unit. The sample on this research was determined based on a formula of Slovin (Husein Umar, 1997) assuming normal distributed population and sampling error rate of 10%. Based on the calculation, then the number of samples used in the study was 82.394 SMEs (SME 100 rounding). Sampling was done by the method of probability sampling, with proportional random sampling techniques.

This research used primary data and secondary data. Primary data was collected through the dissemination of the questionnaire to the respondents who were the owners or managers of SMEs, with based on the research instrument. While secondary data obtained through Government of Malang Regency and Office of small and medium businesses, BPS, and related institutions. Variables used in the study of innovation, business strategy, the company's performance. Method of data analysis that is used to answer the problem formulation in this research is the Multiple Regression. Multiple linear regression aims to show the relationship between the variables is dependent (Y) variable against a free (X 1, x 2), to know how the innovation, business strategy and performance of the company.

**FINDINGS AND DISCUSSION**

Statistical testing with multiple linear regression analysis tools intended to find out the influence of innovation (X 1) and business strategy (X 2), against the performance of SMEs (Y). As for the overview of research output can be seen in the table below.

Tabel .Multiple Linier Regression Output

Independent Variable	Unstandardized Coefficients		Beta	t-value	Sign. T
	B	Error			
(Constant)	0.138	0.419		0.329	0.742
Innovation (X <sub>1</sub> )	0.311	0.085	0.295	3.639	0.000
Business strategy (X <sub>2</sub> )	0.643	0.105	0.498	6.131	0.000
R	= 0.661				
R Square (R <sup>2</sup> )	= 0.437				
Adjusted R Square	= 0.425				
F-value	= 37.597				
Sign-F	= 0.000				
SE	= 0.397				
Variable Dependent= firm performance					

Hypothesis test results show that the influential innovation positively and significantly to the company's performance. These results give meaning that the more good innovations that are owned by the SMEs cluster to the achievement of the company's performance then will also be getting better. With strong innovation it will assist companies in the development of ideas about new products, focusing on efforts to produce products and always sought to market the product markedly in the market. This is due to the SMEs that are in Malang region administered by age of productive happy to challenges to create new products and develop existing products. So in his attempt to create and develop product innovation, what he has been done can be used as the basic for the company to achieve a competitive advantage in the long term. These findings provide an overview that SMEs cluster in Malang region has made efforts in applying the innovation as the basic in carrying out business activities. Through the process, the SMEs Center proved to be able to develop new products and make modifications on the market so that it is able to survive.

The findings in this study are in line with the results of a study of Baer and Frese (2003) that innovation is considered as a component that can provide benefits for the company in achieving competitive advantage. Furthermore, innovation is measured from the production process, the resulting product; new thinking in the Organization had a close relationship with the company's innovation capability so as to encourage performance improvement (Hurley and Hult, 1998; Hurley et al, 2003). The results of this research are also expanding the results of research conducted by Prajogo (2006) who discovered the existence of a positive relationship between innovation and performance. In this study, innovation is measured from product innovation and process innovation.

Test results showed that the hypothesis of influential business strategy positively and significantly to the company's performance. These results give the meaning that the better the business strategy that is owned by the SMEs cluster of the achievement of the company's performance then will also be getting better. With the increasingly powerful business strategy it will help companies in creating new ideas, opening the opportunity for market penetration and experimenting though risky, so that in the end can be a market leader by implementing strategies and long-term goals. These findings provide an overview that SMEs cluster in Malang Region has made efforts in applying the business strategy as the Foundation in carrying out business activities. Through the process, the SMEs cluster proved to be able to respond to changes in the environment through the implementation of good business strategy so that it is able to survive.

The findings in this study are consistent with the conception of Porter (1980); Barney (1991; 1997) that a business strategy capable of improving the performance of the business. This is also in line with the results of the study conducted by Covin and Slevin (1991) where the performance of small companies depends on the strategies they use. This study gives a meaning that the ability of small businesses to formulate and implement effective strategies have a great influence towards survival or failure of a small business.

Technically, the initial actions that can be undertaken by SMEs in business strategy is to increase the capability of human resources owned, either through training, seminars or workshops, which will improve competencies. The emphasis on improving the ability of human resources owned by SMEs in business strategy reinforced by the opinions of Tan and Wang (2010) that in the perspective of Resource – Based View (RBV), a superior resource ownership will lead to companies capable of creating economic value better than competitors. By

implication, the RBV will generate a competitive advantage in the long term for the company on the dynamic market situation. Thus, the ability and a strong commitment to generate and utilize the resources controlled by the SMEs will deliver business performance to improve continuously.

Innovation is a very important component in business development efforts. In the absence of innovation, a business will be hard to be able to compete with other companies. Business strategy is a very important component in an attempt to compete with other companies with business strategy, including determination of strategy of market penetration, development strategies, product development strategy and the strategy of diversification so that in the end the performance achieved by SMES in running business activities have been met.

### **CONCLUSIONS AND SUGGESTIONS**

Overall, the results showed that innovations and influential business strategy significantly to the company's performance. Improvement of the performance of SMEs Centers in Malang is inseparable from the ability of entrepreneurs to do innovation and business strategy. Nonetheless, the understanding of SMEs Centers in applying entrepreneurial orientation, innovative activities and devise business strategies still need to be improved. The findings resulting from the hypothesis testing shows that innovation is directly and positively effect on performance of the company. Furthermore, the results of this study also found that business strategy will affect the achievement of the company's performance. This means that the stronger entrepreneurial orientation, innovation and business strategies that are owned by the company, it will improve the company's performance.

SMEs should always strive to add value to products produced and always strive to provide the best service to customers. In addition, the presence of competitors, both existing competitors and potential competitors, should also be more aware of. Innovative actions and the determination of the business strategy is a very important component to determine the sustainability of the effort. Therefore, the SMEs cluster should always strive to find ways to market your product or service better, running a business by producing products or services with different attributes of competitors as well as utilizing technology to produce goods more effectively and efficiently. In addition, it should be also considered for creating new business units that can be used to minimize the level of risk that may be received. To develop entrepreneurship concept further, researchers need to examine the size of the SMEs related with business activity and performance.

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