

Product Innovations and Business Relationships: Impact on Leather Industry Performance

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Abstract. Small and medium-sized enterprises (SMEs) heavily rely on innovation, which plays a very important role in their competitive advantage and business performance. The present study examines to what extent product innovations and business relationships have an impact on SME performance. The samples were 37 small and medium-scale leather industries in Garut, Indonesia. The results of data analysis showed that product innovations had a significant positive impact on SME performance, so did business relationships. This finding provides an empirical information particularly useful for related parties to determine proper competitive strategies.

Keywords: product innovation, business relationship, business performance, SMEs.

1. Introduction

Business performance has been always a strategic issue and a benchmark for success a company [1][2]. It is one of dominantly subjects discussed by studies in the field of management [3]. Business performance is also a strategic matter in the development of the manufacturing industries, including the leather industry [1].

The development of the manufacturing industries in Indonesia is in the world spotlight for their significant increase. It was recorded in 2018 that the leather industry was the type of manufacture that experienced the highest production growth by 27.73 percent [4]. This broadly indicates that the leather industry has had good business performance [5].

In Indonesia, there are many leather industry centers, one of which is Garut, West Java. Leather products have been one of Garut's leading commodities thanks to abundant supplies of raw materials [6]. Garut leather industry experienced growth in terms of exports. Their jackets have been exported to many countries such as Singapore, Malaysia, Australia and Taiwan with volumes reaching 9,488 pieces worth \$ 448,646 [7].

Table 1. Leather Industry in Garut [6]

Description	Formal	Informal	Total
Business Unit	75	342	417
Workforce	821	2,32	2,953
Investment (IDR million)/Year	404	1,710	2,114
Production Value (IDR million)/Year	27,406,2	30,500	57,906,2

However, Garut's leather industry is still constrained by lack of product innovation [8], limited business networking [9], limited business relationship, which is one of contributing factors to the success of a company [10]. Product innovation is one of the driving factors in

business performance. Its influence was reported significant [11]. The purpose of this study is to examine the influence of product innovation and business performance on the business performance of the small and medium scale leather industry.

2. Theoretical Background

Business performance is a result of a process involving human resources and strategies [12]. It has always been an interesting research topic in the field of strategic management. Strategic decisions in business performance show how competitive advantage, which is at the heart of a good strategy, is acquired [13]. Some studies suggest that business performance could be measured using financial and non-financial indicators [14]–[16].

The concept of product innovation emphasizes the sustainability of a long term competitiveness of a business through the introduction of new product or service to the consumers [17]. A new product or service is a cumulative process that is adjusted to and refined in accordance with the development of new technology [18]. Previous studies reported that product innovation could improve business performance [1][19][20].

Business relationship is essentially a business effort to partner up with related stakeholders [14]. In previous studies, business relationship was measured using several indicators including internal partnership, supplier partnership, lateral partnership, customer [14], trust, commitment, communication, cooperation, and relationship-specific investment [10].

3. Methodology

This research used a quantitative explanatory design, aiming at explaining causal relationships between variables and testing the hypothesis. The samples were 37 small and medium-scale leather industries in Garut, Indonesia. Measurement model and structural model test were performed using SEM-PLS (Partial Least Square). Indicators for Product Innovation included Quality Product (X1), Product Varian (X2), style and Design Product (X3). Indicators for Business Relationship included Continuity Marketing (Y1), One to One Marketing (Y2), Partnering Program (Y3). The variables of SME / Business Performance included Financial Performance (Z1) and Non-Financial performance (Z2).

4. Result and Discussion

Data in this study were analyzed using SEM-PLS. Figure 1 is the resulting modeling.

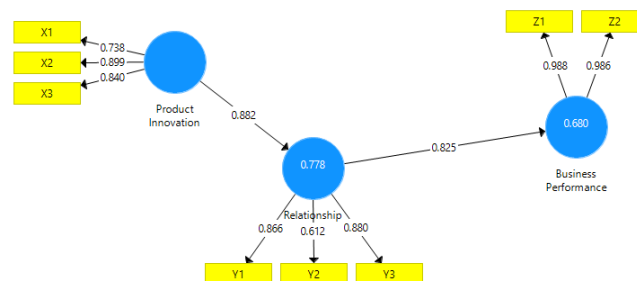


Figure 1. SEM-PLS modeling

In PLS algorithm, indicators and variables could be said valid if their loading values are above 0.6 and have convergent validity. Any indicator or variable with loading value below that must be removed from the model. In this study, all indicators and variables were valid.

Construct Reliability and Validity

Matrix	Cronbach's Alpha	rho_A	Composite Reliability	Average Variance Extracted (...)	Copy to Cli
	Cronbach's Alpha	rho_A	Composite Reliability	Average Variance Extracted (AVE)	
Business Performance	0.974	0.978	0.987	0.975	
Product Innovation	0.775	0.819	0.867	0.686	
Relationship	0.724	0.813	0.834	0.633	

Figure 2. Construct Reliability and Validity

Indicators and variables could also be stated valid if their Average Variance Extracted (AVE) value is above 0.5. Hence, as shown in Figure 2, all variables in this study were valid. Indicators and variables could be stated reliable if their Composite Reliability (CR) value is above 0.7. All variables in this study were stated reliable. Their Cronbach' Alpha values were also above 0.6. All indicators, variables, and the modeling could then be said valid and reliable.

The hypothesis testing was performed using the bootstrapping method. The result is illustrated in Figure 3:

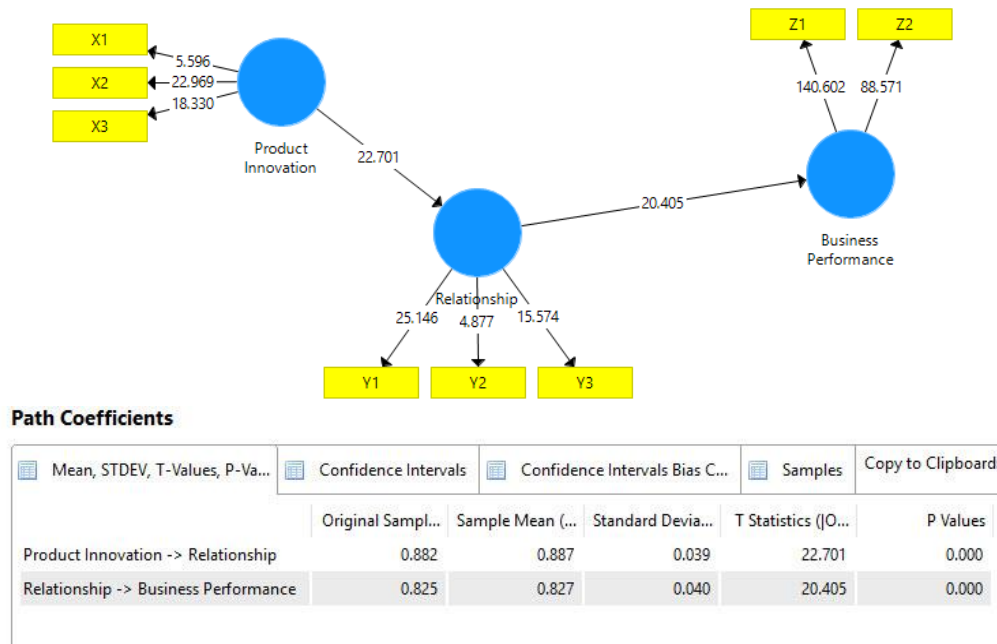


Figure 3. Result of Bootstrapping and Path Coefficients

Figure 3 shows that the relationship of product innovation (X) and business relationship (Y) was significant with T-Statistics value of 22.701, higher than the suggested value of 1.66. This X-Y relationship was also positive since the original sample estimate value was positive.

The relationship of business relationship (Y) and business performance of the small and medium scale leather industry in Garut (Z) was also significant since the T-Statistics value was 20.405 (>1,66). It was also positive because the original sample estimate value was also positive.

5. Conclusion

The finding of this study leads to a conclusion that product innovation has significant influence on business relationship and that business relationship has significant influence on business performance. This confirms some previous studies suggesting that product innovation and business relationships are two factors supporting sustainable improvement of business performance.

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