# MSMEs Scale Up Model Post Next Normal through Frugal Innovation, Transformational Leadership, Blue Ocean Strategy and Government Policies

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**Abstract.** This study aims to produce a scale-up model for Bangka Belitung MSMEs through frugal innovation, transformational leadership, blue ocean strategy and government policies and to produce policies that can be used by local governments. This type of research is a combinationresearchwith a total sample of 100 MSMEs in Pangkalpinang. The data analysis method for testing the variables is PLS (Partial Least Square) using SmartPLS.3 software. Qualitative analysis using coding techniques. The results of the analysis found that the Transformational Leadership and Blue Ocean Strategy variables had a significant influence on Frugal Innovation and had an indirect effect on the MSMEs Scale Up Model. The government policy variable has no effect on Frugal Innovation and does not have a significant effect on the MSMEs Scale Up Model in Pangkalpinang City.

**Keywords:** Scale Up Model; Frugal Innovation; Transformational Leadership; Blue Ocean Strategy

## 1 Introduction

MSMEs as the backbone of the national and regional economy have suffered a severe blow from the Covid-19 pandemic, if in the 1997/1998 economic crisis MSMEs were able to survive, on the contrary, in this crisis, many of them collapsed by laying off workers and closing businesses. When viewed from the structure of the economy in Indonesia, Micro Enterprises amounted to 98.68%, Small Enterprises amounted to 1.22%, Medium Enterprises amounted to 0.09%, while large Enterprises was only 0.01%. Based on the number of exports, it is still dominated by large businesses, namely 85.63%, and micro enterprises by 1.22%, so that the number of businesses and their exports is inversely proportional. To balance this condition, new architects in the Indonesian economy are needed that are in favor of MSMEs by creating models to scale up MSMEs. As stated by Peter Drucker (2009), “small enterprises represent the main catalyst of economic development. Those small businesses contribute intensely to achieving the fundamental goals, becoming the backbone of social-economicalprogress”. Based on the initial survey, it turns out that the impact of the Covid-19 pandemic on the performance of MSMEs is very significant. A survey from Bank Indonesia in April 2020, as many as 536 or 67.1% of MSMEs stated that they were affected by Covid-19,

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the remaining 263 or 32.9% had not been affected. The number of MSMEs in the Bangka Belitung Islands Province reached 161,186 units and also experienced the impact of the pandemic. Covid-19 has radically changed consumption behavior. Facing these conditions, Frugal Innovation is very relevant to be developed. Frugal innovation is a local phenomenon through which entrepreneurs try to make the most of what they control to fulfill local needs, needs which have been for too long neglected by mainstream businesses (Basu 2013). Implementing frugal innovation requires the presence of transformational leadership (Barden and Morgan, 2015). In addition, the blue ocean strategy is also believed to be a collaborative, not competitive strategy to increase the scale-up of MSMEs themselves, especially in terms of implementing digitalization and increasing MSME exports.

## 2 Literature Review

### 2.1 Frugal Innovation

#### 2.1.1 Concept

Frugal innovation is the process of adapting goods and production tailored to customer needs. Frugal innovation means finding new business models, reconfiguring value chains and redesigning products based on the ability to use resources effectively and efficiently (Berger, 2013). In terms, frugal innovation is product or process innovation that is much cheaper than existing products in response to limited resources (Zeschky et.al, 2011). Frugal innovation products also often have features that are inferior to existing products, but these inferior features are considered adequate by lower-class users. The main feature of frugal innovation is its very low price compared to similar products. Basically, frugal innovation seeks to reconfigure products intended for low-income groups by finding new business models in producing them (Bhatti, 2011). Products with frugal innovation usually differ from one region to another. This innovation is local to certain communities, because each community has different needs (Singh et al., 2011).

#### 2.1.2 *Three Criteria Model* by Weyrauch

Weyrauch&Herstatt (2016) developed a model to differentiate between frugal innovation and other types of innovation. This model was developed and then resulted in 3 (three) criteria: (1) Cost reduction; (2) Concentration on function; and (3) performance optimization.

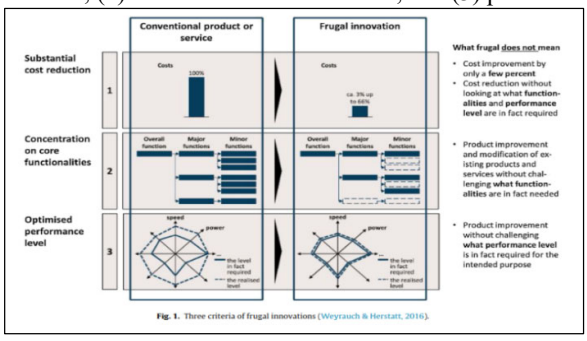



**Fig. 1.** *Three Criteria Model* by Weyrauch

## 2.2 Blue Ocean Strategy

### 2.2.1 Concept

Blue Ocean Strategy is a strategy that is consistent with creating new markets and industries where demand is created in conditions of absence of competition (Kim, 2014). Randall (2015) states that Blue Ocean Strategy is the first approach to getting the right customers by innovating. “The Blue Ocean Strategy role of innovation and value help organization survives in a competitive market” (Dehkordi, Rezvani, & Behravan, 2012). Value innovation is a way to execute a blue ocean business strategy that leads to the creation of new markets. Creation of blue oceans by reducing costs to increase value for buyers. Because buyer value stems from the benefits and prices the firm will offer to consumers, and because the value to the firm results from pricing and cost structures, value innovation is achieved only when the firm's entire system of beneficial activities, prices, and costs will be properly integrated. Value innovation in the blue ocean business strategy is a matter of strategy that covers the entire system of activities carried out by the company. Value innovation shapes the company to direct the entire system towards the goal of achieving increased value for consumers and the company itself.

### 2.2.2 *Blue Ocean Strategy* and *Red Ocean Strategy*

Blue Ocean Strategy was first introduced by W. Chan Kim and Renee Mauborgne. Blue Ocean Strategy is a strategy to escape from a condition called Red Ocean. Red Ocean Strategy is a condition where there is very tight competition to get the same market as competitors. This Red Ocean Strategy competition is becoming increasingly fierce because what happens to the market is that there is less demand than supply. As a result, competition with competitors becomes very tight and does not rule out the possibility that competitors will bring each other down. The condition of the Blue Ocean is inversely proportional to the Red Ocean. In Blue Ocean, there is almost no competition, because from the beginning the existing businesses have dared to appear different. Because it is different from competitors, the market that is interested in the company's products is also a special segment, so this creates higher demand.

**Table 1.** Difference between Blue Ocean Strategy and Red Ocean Strategy

| Red Ocean Strategy | Blue Ocean Strategy |
|---|---|
| Compete in the existing market space | Creating an unrivaled market space |
| Fighting the competition | Making competition irrelevant |
| Exploiting existing requests | Creating and capturing new requests |
| Choose between value-cost | Breaking the value-cost exchange |
| Integrating the entire system of company activities with a strategic choice between differentiation or low cost | Integrating the whole system of company activities in pursuit of differentiation and low cost |

Resouce: Kim&Mauborgne (2005)

## 2.3 Transformational Leadership

The theory of transformational leadership begins with the concept of Burns (1978) and Bass (1985) which states that transformational leadership stimulates subordinates to create perceptions of leadership with new perspectives through intellectual stimulation. Leaders are able to create perceptions as individuals who always support and give attention to subordinates

through their motivation and charisma. The four dimensions of transformational leadership are: (1) idealized influence; (2) inspirational motivation; (3) intellectual stimulation behavior; and (4) individual considerations (Eliyana, 2019). Based on research by Jung, et al, 2003; Gumuslouoglu & Ilsev, 2009; Slåtten & Mehmetoglu, 2014, found that transformational leaders are able to increase the general tendency of companies or organizations to innovate. Bass suggests that the four most important dimensions of transformational leadership in creating innovation are intellectual simulation and leaders as inspirational motivation. The study also revealed that transformational leadership can motivate employees to do something beyond their expectations, such as innovating (Virgianty, 2020).

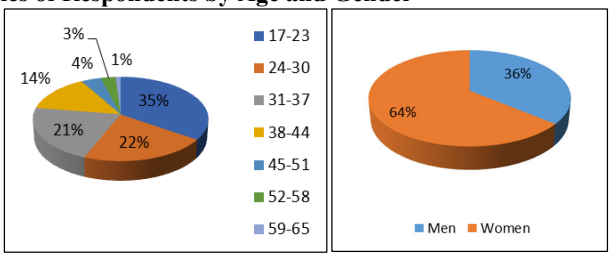
## 3 Methodology

This type of research is a combination research with explanatory research. Collecting data using a survey method within-depth interviews and questionnaires. The population is MSMEs in the Bangka Belitung Islands Province with a specified sample of 100 MSMEs in the city of Pangkalpinang. This study uses the analytical method used to test the variable, namely PLS (Partial Least Square) using SmartPLS 3.0 software.

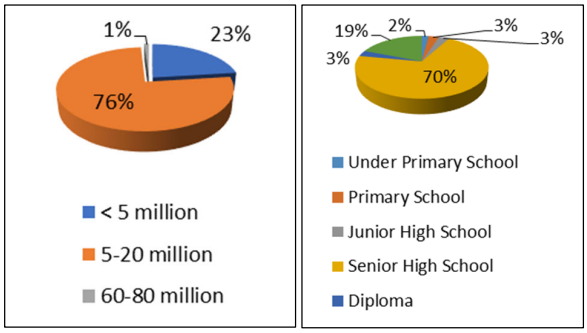
## 4 Results and Discussions

### 4.1 Respondent Profile

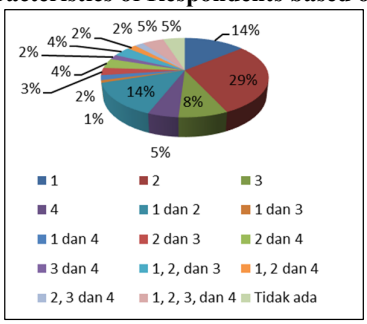
**a) Characteristics of Respondents by Age and Gender**




**b) Characteristics of Respondents based on Level of Formal Education and Sales Turnover**

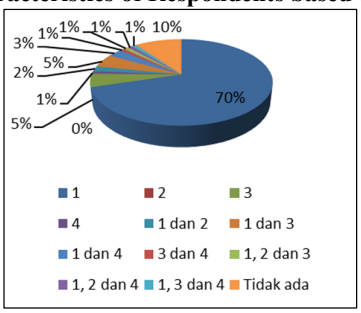


**c) Characteristics of Respondents based on Business Constraints**




**Information:**
1 = Financial
2 = Marketing
3 = Human Resources
4 = Production Process Technology

**d) Characteristics of Respondents based on the Impact of Covid-19**




**Information:**
1 = Decrease in Sales Turnover
2= Termination of Employment
3 = Product Replacement
4 = Business Closure

**e) Analysis of Measurement Model**

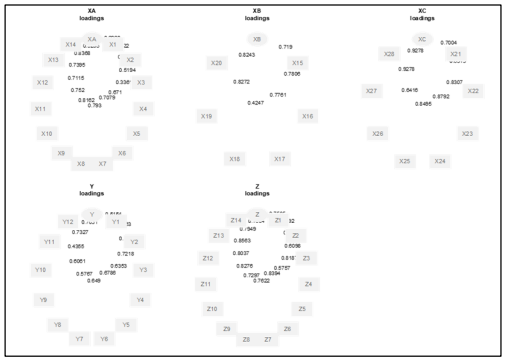


**Table 2.** Analysis of the Transformational Leadership Variable Measurement Model

| Indicator | *Loading Factor* | $R^2$ | *Variance error* |
|---|---|---|---|
| X1 | 0.697 | 0.486 | 0.514 |
| X2 | 0.742 | 0.551 | 0.449 |
| X3 | 0.632 | 0.400 | 0.600 |
| X4 | 0.519 | 0.270 | 0.730 |
| X5 | 0.336 | 0.113 | 0.887 |
| X6 | 0.671 | 0.450 | 0.550 |
| X7 | 0.708 | 0.501 | 0.499 |

| Indicator | *Loading Factor* | $R^2$ | *Variance error* |
|---|---|---|---|
| X8 | 0.793 | 0.629 | 0.371 |
| X9 | 0.816 | 0.666 | 0.334 |
| X10 | 0.752 | 0.566 | 0.435 |
| X11 | 0.712 | 0.506 | 0.494 |
| X12 | 0.739 | 0.547 | 0.453 |
| X13 | 0.837 | 0.700 | 0.300 |
| X14 | 0.526 | 0.277 | 0.723 |
| *Composite* | | 0.925 | |
| AVE | | 0.476 | |

The results of the validity and reliability analysis for the Transformational Leadership variable found all items were valid with a factor loading value greater than 0.50 and all items were reliable with composite reliability greater than 0.700 and AVE greater than 0.50..

**Table 3.** Analysis of Blue Ocean Strategy Variable Measurement Model

| Indicator | *Loading Factor* | $R^2$ | *Variance error* |
|---|---|---|---|
| X15 | 0.719 | 0.517 | 0.483 |
| X16 | 0.781 | 0.609 | 0.391 |
| X17 | 0.776 | 0.602 | 0.398 |
| X18 | 0.425 | 0.180 | 0.820 |
| X19 | 0.827 | 0.684 | 0.316 |
| X20 | 0.824 | 0.680 | 0.321 |
| *Composite* | | 0.940 | |
| AVE | | 0.530 | |

The results of the validity and reliability analysis for the blue ocean strategy model variable found that all items were valid with a factor loading value greater than 0.50 and all items were reliable with composite reliability greater than 0.700 and AVE greater than 0.50.

**Table 4.** Analysis of Government Policy Variable Measurement Model

| Indicator | *Loading Factor* | $R^2$ | *Variance error* |
|---|---|---|---|
| X21 | 0.700 | 0.491 | 0.510 |
| X22 | 0.697 | 0.486 | 0.514 |
| X23 | 0.831 | 0.690 | 0.310 |
| X24 | 0.879 | 0.773 | 0.227 |
| X25 | 0.849 | 0.722 | 0.278 |
| X26 | 0.642 | 0.412 | 0.588 |
| X27 | 0.928 | 0.861 | 0.139 |
| X28 | 0.928 | 0.861 | 0.139 |
| *Composite* | | 0.962 | |
| AVE | | 0.664 | |

The results of the validity and reliability analysis for government policy variables found that all items were valid with a factor loading value greater than 0.50 and all items were reliable with composite reliability greater than 0.700 and AVE greater than 0.50

**Table 5.** Analysis of Frugal Innovation Variable Measurement Model

| Indicator | *Loading Factor* | $R^2$ | *Variance error* |
|---|---|---|---|
| Y1 | 0.515 | 0.266 | 0.734 |
| Y2 | 0.146 | 0.021 | 0.979 |

| Indicator | *Loading Factor* | $R^2$ | *Variance error* |
|---|---|---|---|
| Y3 | 0.600 | 0.360 | 0.640 |
| Y4 | 0.722 | 0.521 | 0.479 |
| Y5 | 0.635 | 0.404 | 0.596 |
| Y6 | 0.679 | 0.460 | 0.540 |
| Y7 | 0.649 | 0.421 | 0.579 |
| Y8 | 0.577 | 0.333 | 0.667 |
| Y9 | 0.606 | 0.367 | 0.633 |
| Y10 | 0.436 | 0.190 | 0.810 |
| Y11 | 0.733 | 0.537 | 0.463 |
| Y12 | 0.703 | 0.494 | 0.506 |
| *Composite* | | 0.865 | |
| AVE | | 0.364 | |

The results of the validity and reliability analysis for the frugal innovation variable found that all items were valid with a factor loading value greater than 0.50 and all items were reliable with composite reliability greater than 0.700.

**Table 6.** Analysis of the Variable Measurement Model of the MSME Scale Up Model

| Indicator | *Loading Factor* | $R^2$ | *Variance error* |
|---|---|---|---|
| Z1 | 0.750 | 0.563 | 0.437 |
| Z2 | 0.809 | 0.655 | 0.345 |
| Z3 | 0.861 | 0.741 | 0.259 |
| Z4 | 0.610 | 0.372 | 0.628 |
| Z5 | 0.819 | 0.670 | 0.330 |
| Z6 | 0.576 | 0.331 | 0.669 |
| Z7 | 0.839 | 0.705 | 0.295 |
| Z8 | 0.762 | 0.581 | 0.419 |
| Z9 | 0.730 | 0.533 | 0.468 |
| Z10 | 0.828 | 0.685 | 0.315 |
| Z11 | 0.804 | 0.646 | 0.354 |
| Z12 | 0.856 | 0.733 | 0.267 |
| Z13 | 0.795 | 0.632 | 0.368 |
| Z14 | 0.753 | 0.568 | 0.432 |
| *Composite* | | 0.954 | |
| AVE | | 0.601 | |

The results of the validity and reliability analysis for the MSME Scale Up Model variable found that all items were valid with a factor loading value greater than 0.50 and all items were reliable with composite reliability greater than 0.700 and AVE greater than 0.50.

**f) Analysis of the Effect of Transformational Leadership, Blue Ocean Strategy, and Government Policy on Frugal Innovation and their impact on the MSME scale up model**

The results of the research on the influence of Transformational Leadership, Blue Ocean Strategy, and Government Policy on Frugal Innovation and their impact on the MSMEs Scale Up Model can be illustrated in the following figure:

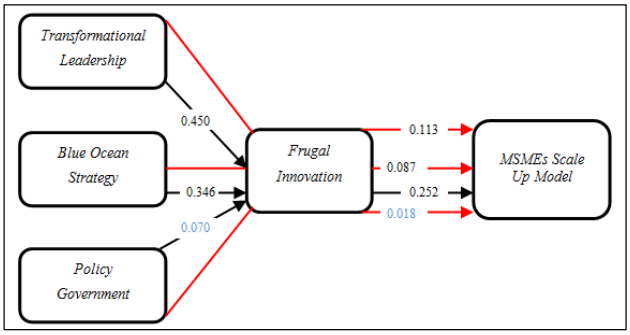



**Fig. 2.** Path Diagram of the Effect of Transformational Leadership, Blue Ocean Strategy and Government Policy on Frugal Innovation and their impact on the MSMEs Scale Up Model

**Table 7.** The Direct Effects of Transformational Leadership, Blue Ocean Strategy, and Government Policies on Frugal Innovation and their Impact on the MSMEs Scale Up Model

| **Direct Effects** | ***Estimate*** | ***Std. Error*** | ***t value*** | ***p.value*** |
|---|---|---|---|---|
| *Transformational Leadership* → *Frugal Innovation* | 0.450 | 0.096 | 4.670 | 0.000 |
| *Blue Ocean Strategy* → *Frugal Innovation* | 0.346 | 0.096 | 3.620 | 0.000 |
| Government policy →*Frugal Innovation* | 0.070 | 0.068 | 1.020 | 0.311 |
| *Frugal Innovation*→ scale up MSMENodel | 0.252 | 0.097 | 2.590 | 0.011 |

The results of the calculation of the direct effect found that the variable with the greatest influence on frugal innovation was transformational leadership with an effect coefficient of 0.450 standard deviation. In the second position is the blue ocean strategy with a large effect of 0.346 and the lowest direct effect is given by government policy variables with a large influence of only 0.070. The results of hypothesis testing found that the transformational leadership and blue ocean strategy variables have a significant effect on fugal innovation with p.value<0.05, while government policies do not have a significant effect with p.value> 0.05. The results of the calculation of the effect of frugal innovation on the capital scale up of MSMEs found that the influence was 0.252 and significant.

**Table 8.** Indirect Effects of Transformational Leadership, Blue Ocean Strategy, and Government Policy on MSME Scale Up Models through Frugal Innovation

| **Indirect Effects** | ***Estimate*** | ***Std. Error*** | ***t value*** | ***p.value*** |
|---|---|---|---|---|
| *Transformational Leadership* → *Frugal Innovation* → *scale up*MSMEsModel | 0.113 | 0.050 | 2.266 | 0.013 |
| *Blue Ocean Strategy* → *Frugal Innovation* → *scale up*MSMEsModel | 0.087 | 0.041 | 2.107 | 0.019 |
| Government policy →*Frugal Innovation* → *scale up*MSMEs Model | 0.018 | 0.018 | 0.948 | 0.173 |

The results of the calculation of the indirect effect of the Transformational Leadership, Blue Ocean Strategy, and Government Policy variables on the MSMEs Scale Up Model through Frugal Innovation found that there was a significant indirect effect of the Transformational Leadership and Blue Ocean Strategy variables on the MSME scale-up model through frugal innovation with the magnitude of the effect is 0.113 and 0.087, respectively. While the government policy variables do not have an indirect effect.

## 5 Conclusion

The results of data analysis found that the Transformational Leadership and Blue Ocean Strategy variables had a significant influence on Frugal Innovation and had an indirect effect on the MSMEs Scale Up Model. The government policy variable has no effect on Frugal Innovation and does not have a significant effect on the MSMEs Scale Up Model in Pangkalpinang City.

### Limitation and Study Forward

The limitations in this study are the number and coverage of the respondent's area which is only limited to 100 respondents of MSMEs actors in Pangkalpinang. Further research is expected to be able to use several predictor variables in other MSMEs Scale Up models such as digital entrepreneurship, financial technology and other digital-based innovations to support the existence of MSMEs, especially in the post-next normal era.

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