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## Market orientation, performance and the mediating role of innovation in Indonesian SMEs

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*Published in:*  
Asia Pacific Journal of Marketing and Logistics

*DOI:*  
[10.1108/APJML-08-2021-0624](https://doi.org/10.1108/APJML-08-2021-0624)

E-pub ahead of print: 15/12/2021

*Document Version*  
Peer reviewed version

[Link to publication](#)

*Citation for published version (APA):*  
D'souza, C., Nanere, M., Marimuthu, M., Arwani, M., & Nguyen, N. (2021). Market orientation, performance and the mediating role of innovation in Indonesian SMEs. *Asia Pacific Journal of Marketing and Logistics*, 1-17.  
<https://doi.org/10.1108/APJML-08-2021-0624>

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**Market Orientation, Performance, and the mediating role of Innovation in Indonesian SMEs**

Journal:	<i>Asia Pacific Journal of Marketing and Logistics</i>
Manuscript ID	APJML-08-2021-0624.R3
Manuscript Type:	Research Paper
Keywords:	Marketing in developing countries, Market orientation, SME marketing, Structural equation modelling

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## Market Orientation, Performance, and the mediating role of Innovation in Indonesian SMEs

### Abstract:

### Purpose:

Despite the theoretical advancements of market orientation and firm performance, there is a paucity of research regarding SMEs in Indonesia. Customer and competitor orientation were examined as two distinct constructs as per the literature, as it has been questioned for its robustness. They have been used synonymously, even though customer orientation is operationalised as a component of a market orientation construct. There is support for the argument from a theoretical point of view to keep customer orientation and competitor orientation separate. The objective of this research was to empirically test market orientation concepts on firm performance and assess customer and competitor orientation separately. Furthermore, it also tests whether innovation plays a mediating role.

### Design/Methodology/approach:

A sample of 309 small and medium-sized firms was found eligible for this study. Structural Equation Modelling was used to analyse the data. A multi-industry sample of firms was used to strengthen the generalisability of the results. The sample was acquired from two databases of SMEs directory in Kudus and Pati, East Java Indonesia, participants were randomly selected.

### Finding:

The findings show that innovation mediates the relationship between competitor orientation and firm performance, while competitor orientation had no significant relationship with firm performance. Customer orientation was found to positively influence firm performance.

### Originally:

The role of innovation as a mediator within SMEs in a developing country opens up avenues for further research among other developing countries. By examining both the concepts of customer and competitor orientation separately and establishing relationships, we validate support for this argument both from a methodological and theoretical point of view.

**Keywords:** market orientation, innovation, competitor orientation, and customer orientation, firm performance

## 1. Introduction

The central tenet of the present article is to examine SME's market orientation in Indonesia and the influence of innovation on a firm's performance. Studies suggest market orientation involves, customer orientation, competitor orientation, inter-functional, and behaviour. Market orientation as a business culture has grown over the years and implemented by both, large enterprises, and small and medium-sized enterprises (SMEs) (Genc, Dayan, and Genc, 2019; Iyer, Davari, Zolfagharian, and Paswan, 2019). With its popularity growing, it is also a preferred option that firms with an international joint venture have a strong market orientation (Farrel, Oczkowski, & Kharabsheh, 2008). This research in particular sheds some light on SMEs and the impact of market orientation. Yet, notwithstanding the emerging importance of SMEs, there is limited research addressing innovation (Hossain, 2013). Investigating the success factors is crucial for sustaining the competitiveness and existence of SMEs (Genc et al., 2019).

Seminal works by Kohli and Jaworski (1990); and Narver and Slater (1990) have been investigated to a large extent, following which many studies have demonstrated that market orientation is pivotal in explaining firm performance (e.g., Ellis, 2006; Kirca, Jayachandran, and Bearden, 2005) and in other cases brand performances (Iyer et al., 2019). More formally, as Kohli and Jaworski (1990) proposed that market orientation can be perceived as the organization-wide assimilation of market intelligence, dissemination of the intelligence within departments, and organization-wide receptiveness. These are postulated to bring about larger customer satisfaction and commitment of employees. While others have found support for this assumed or implied relationship between market orientation and performance (Narver and Slater, 1990). Jaworski and Kohli (1990) also show that some firms can be more market-oriented than others, it is related to overall business performance and while it is robust across environmental contexts they are exemplified by market uncertainty, competitive intensity, and technological volatility. Kohli and Jaworski (1990) in their attempt to clarify the market orientation construct identifies three classes of factors affecting market orientation and the interrelationships such as organisation's strategy, employee dispositions, and customer attitudes and behaviour.

Much of the seminal work of market orientation (Kohli and Jaworski 1990; Jaworski and Kohli 1993; Kohli, Jaworski, and Kumar 1993) shows that it is a unified emphasizes of employees and the organisation that leads to superior performance. Following this, Slater and Narver's (1994) work shows that the market-oriented culture provides a strong foundation for these value-creating capabilities. In their efforts to validate market orientation measures Narver and Slater (1990) used a sample of commodity products and non-commodity products businesses and tested the relationships between market orientation and performance. While this has been accepted in the general literature, many studies also show that the relationship between a firm's market orientation and its success is sometimes weak and that moderating variables are required to be considered (Helfert, Ritter, & Walter, 2002). Yet scholars have also debated the relationship between market orientation and innovation. The results show that market orientation has some significant

relationships with innovation and other characteristics (Atuahene-Gima, 1996). Liu (2013) found that market orientation leads to greater innovation performance. Beck et al., (2011) also examined the measures of market orientation and innovation in family firms. Innovation appears to be important in understanding its relationship with performance, with customer orientation and competitor yielding as independent variables. Past research was based on mainly investigating highly industrialized with a high focus on customer-oriented, where firms are highly involved in the marketing concept. Countries such as Indonesia, having recourse now to competition and moving from production orientation to more customer orientation have led to increasing consumer expectation and thus factors such as competitor and customer orientation can have a significant effect.

Market orientation shows a positive influence on business performance in SMEs and is supported by the results of Šályová, Tábořecká, Nedelová, and Jaroslav (2015); and Buli (2017). Similarly, there have been several studies that have demonstrated relationships between market orientation, innovation, and company performance (Hurley and Hult, 1998; Jaworski, Kohli, and Sahay, 2000; Slater and Narver, 1998). Despite the growing body of research supporting firm performance, questions remain as to how the concept of market orientation would translate to SMEs in Indonesia. In Indonesia, SMEs productivity had increased which is as close to that of large firms (Berry, Rodriguez and Sandee, 2001), even though inadequate finance is a constraint (Huda, 2012), SMEs in Indonesia are still in need of developing marketing capabilities (Nuryakin, 2018). Some research undertaken for SMEs in Indonesia shows that there is no significant relationship between market orientation and marketing performance and the better the local product innovation, the higher is the market performance (Winarso, 2020). Other authors compared the competitiveness between clustered and dispersed SMEs in the Indonesian food processing industry (Najib, Kiminami, and Yagi, 2011).

Regardless of the importance of market orientation, its positive impact on firm performance, and its perception, as a form of innovative behaviour among firms (Kohli and Jaworski 1990) in Indonesia, has not been explicitly examined, neither is their applicability and generalisability within the context of a non-western business adequately researched. There is scant literature regarding developing countries (Ellis, 2006) and thus generalising firms may not be relevant (Aulakh, Kotabe, and Teegen, 2000). As a result, the contributions to the study are threefold. Firstly, there is very limited research regarding market orientation and SMEs in Indonesia, this research adds to the literature by empirically testing market orientation concepts on firm performance. Secondly, we explore the mediating effect of innovation on competitor orientation and firm performance. Finally, by examining both the concepts of customer and competitor orientation separately and establishing relationships, we validate support for this argument, both from a methodological and theoretical point of view (Lengler, Sousa, and Marques, 2013).

## 2. Literature review and hypotheses development

## 2.1 Market Orientation

Market orientation influences SMEs in many ways. Many researchers have identified that market orientation, as a whole, has a significant impact on SME innovativeness (Alhakimi, & Mahmoud, 2020). Marketing orientation is also seen to have a moderating effect on SMEs firm performance (Asad et al., 2020). In terms of the impact of internationalisation, some authors have considered the market orientation of SMEs to fall within the export category (Fernandes, Ferreira, Lobo, & Raposo, 2020). Notably, understanding market orientation is thus useful if SMEs firm performance can be enhanced.

There are three major components to market orientation, namely, customer orientation, competitor orientation, and inter-functional coordination (Slater and Narver, 1994). Needless to say, that market orientation has been questioned for its robustness (Shoham, Rose, and Kropp, 2005; Lengler et al., 2013) and both concepts, market orientation, and customer orientation have been used synonymously, even though customer orientation is operationalised as a component of a market orientation construct (Narver and Slater, 1990).

While Narver and Slater (1990) are of the view that customer orientation is a behavioural component of market orientation, others contend that there is no clear distinction between customer orientation and market orientation (Webster, 1988). Since competitors and customers are important to a firm's success many scholars have only considered these two constructs of the market orientation framework as proposed by Narver and Slater, (1990). Many scholars have not considered inter-functional coordination, as this construct needs to be theoretically different from the market orientation of the firm (Lengler et al., 2013), while others contend that market orientation should only consider customer and competitor orientation constructs (Sørensen and Slater, 2009). Given the fact that consumer orientation is distinctive by nature, several studies have used them as a separate construct (Herhausen, 2011). Yet, many other studies have thus adopted a segregated approach for better modelling and understanding of market orientation (Chung, 2012).

Notably, there is support for the argument from a theoretical point of view to keep customer orientation and competitor orientation separate (Lengler et al., 2013). Since this is investigated in a confined form, it justifies further research that would test these concepts separately (Sørensen, 2009). Furthermore, in developing economies like Indonesia, customer needs and expectations are evolving and the need for market-oriented firms is in high demand. Indonesian SMEs showed that firms in search of innovation found that business strategies had a positive and significant effect on innovation capability (Putra, Sunarsih, Novitasari, and Setini, 2020). However, in terms of competition, it is not clear whether innovation would mediate a firm's performance? This research tests the viability of the two antecedents of market orientation (customer and competitor orientation), the indirect effects of innovation, and their influences on business performance in the light of

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3 facilitating greater integration and stronger conclusions. The next few paragraphs explain  
4 the theoretical perspective of market orientation for testing the central objective of our  
5 research.  
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### 8 *2.2.1. Customer Orientation*

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11 Customer orientation aims to satisfy customer needs and help firms to acquire and retain  
12 their customers (Slater and Narver, 2000). Customer orientation is seen as the driver of firm  
13 performance (Kirca et al., 2005). While the extant literature provides varying definitions of  
14 customer orientation by eminent scholars such as Kohli and Jaworski, (1990); Narver and  
15 Slater, (1990); and Deshpande, Farley, and Webster, (1993), much of the research  
16 conceptualises that customer orientation analyses the customer, as the key and  
17 dissemination of information about their needs should be addressed organization-wide to  
18 create superior value.  
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24 Scholars have argued that customer orientation may not be feasible when SMEs have simple  
25 structures and more unified cultures; limited range of products which minimizes the need  
26 for formal procedures in gathering and disseminating customer orientation. Yet, these  
27 conditions are likely to increase and exploit a culture that encompasses customer  
28 orientation (Pelham and Wilson, 1999). Research has also shown that customer orientation,  
29 innovation capability, and firm performance vary depending on firm sizes and customer  
30 types (Racela and Thoumrunroje, 2019).  
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36 Other effects of customer orientation show a positive effect on firm performance when a  
37 decentralized organization was combined with formalization (Auh and Menguc, 2007).  
38 Nwankwo's (1995) view on customer orientation suggests that in reality to implement  
39 customer orientation is complex, it does provide a framework to direct management  
40 through the means of creating a "customer-driven philosophy" (Nwankwo, 1995, p.5). Not  
41 to mention that it is also considered as an essential antecedent of competitive  
42 advantage ( Ganesan, 1994), vital for improving business profitability ( Narver and Slater,  
43 1990), and a promise for a successful business (Hall, 1992).  
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49 While there is a significant relationship between customer orientation and firm  
50 performance (e.g., Frambach, Fiss, and Ingenbleek, 2016), it is also indicative of acquiring a  
51 competitive advantage. Similarly, Deshpande et al. (1993) found customer orientation had a  
52 positive significance among the performance of Japanese firms. Similarly, there has been a  
53 positive effect of customer orientation on SME's firm performance (Appiah-Adu and Singh,  
54 1998). Yet, other results contradict, consumer orientation on performance was not  
55 significant among SMEs (Pinho, 2008); Based on the preceding discussion, we believe that  
56 customer orientation in SMEs in Indonesia has a strong association on firm performance –  
57 we hypothesize that:  
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3 **H1.** Customer orientation has a significant and positive relationship with firm performance.  
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6 *2.2.1 Competitor Orientation:*  
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8 Competitor orientation involves identifying a competitor's strengths and weaknesses which  
9 is critical for maintaining a competitive advantage (Narver and Slater, 1990). Several studies  
10 have argued that the culture of market orientation can be a leading source of competitive  
11 advantage for SMEs, particularly when they have limited resources, have stronger flexibility  
12 and capacity to build customer relationships, understand their competitors better (Pelham,  
13 1999; O'Dwyer and Ledwith, 2010). There is also a relationship between consumer  
14 orientation and competitor orientation in developing countries, as the products in these  
15 countries are challenged to offer products at a low cost and thus propose competitor  
16 orientation to achieve a cost advantage (Dev et al., 2009). It has been argued that SMEs  
17 considering their nature and size and the limited products they deal with have generally  
18 shown to have placed a lesser emphasis on competitor orientation (O'Dwyer and Gilmore,  
19 2019).  
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21  
22 Research suggests that there is a positive interaction between market orientation and  
23 competitive advantage (Zhou, Brown, and Dev, 2009). However, many of these studies have  
24 focused on competitor-orientated innovation in the form of the introduction of new  
25 products and processes to gain a sustainable competitive advantage (Johannessen, Olsen,  
26 and Lumpkin, 2001).  
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29 Researchers have found that SMEs consider competitor orientation as their benchmark in  
30 two stages, of which one is to translate competitor intelligence into innovation (O'Dwyer  
31 and Gilmore, 2019). While it is profitable, it certainly can create a competitive advantage  
32 and have a positive influence on business performance (Talke, Salomo, and Kock, 2011).  
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35 Competitive advantage influences innovation in firms (Hsu and Ziedonis, 2013). SMEs in  
36 China showed that they had a greater likelihood of survival if they developed a competitive  
37 advantage (Naidoo, 2010). Since the aim of competitor-centered techniques is to keep  
38 abreast of the competition, this competitor-oriented culture is likely to influence  
39 innovations (Han, Kim, and Srivastava, 1998). Some have suggested the lesser developed the  
40 economy is, the higher are the effects of competitor orientation on a firm's performance  
41 (Dev et al., 2009). Even though there is a positive correlation between competitor  
42 orientation and business performance (Wang and Miao, 2015), other research suggests that  
43 competitor orientation was not significant for SMEs in Ghana (Bamfo and Kraa, 2019). Given  
44 that market orientation can be a leading source of competitive advantage for SMEs, we  
45 propose:  
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3 **H2a.** Competitor orientation has a significant and positive relationship with firm  
4 performance  
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7 **H2b.** Competitor orientation has a significant and positive relationship with innovation  
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## 9 *2.2 Innovation*

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12 Regardless of being large or small, firms are recognizing that innovation is critical to an  
13 organisation's success, and they need to continuously innovate if they are to sustain (Brem  
14 and Voigt, 2009). Innovation is perceived as "an integral activity that involves the whole  
15 organization and conditions the organizational behavior" (Martinez-Roman, Gamero, and  
16 Tamayo, 2011, p. 460). It often stems from a unique concept based on existing ideas  
17 (Cummins, Gilmore, Carson, and O'Donnell, 2000), and the success of the innovation is  
18 determined by its newness and its rate of adoption. The need for innovation has been long  
19 debated and argued that while changes within the competitive environment keep  
20 transforming the marketplace, the necessity for innovation will be greater than ever  
21 (Prahalad and Ramaswamy, 2003). It is clear that innovation is needed to compete and  
22 survive (Elci and Karatayli, 2009), and competitive orientation is likely to influence  
23 innovation.  
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31 More recent studies have examined dynamic capabilities in fostering business model  
32 innovation (Randhawa, Wilden, and Gudergan, 2021). When compared to large firms,  
33 smaller firms lack scale economies, have limited resources, and have smaller size markets  
34 (Cagliano, Blackmon, and Voss, 2000). SMEs undertake more risks when it comes to  
35 innovating to improve their businesses (Latham, 2009). Nonetheless, due to their prime  
36 entrepreneurial position, willingness to take risks, and flexible nature they can adopt,  
37 integrate, or create innovation through their networks or value-added activities, a  
38 commitment to innovation is considered essential to the growth of SMEs (Fiol, 1996).  
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SMEs can be successful and competitive if they put all their efforts into innovation. How  
firms adapt to the innovation process in SMEs was also examined in food and beverage  
firms (Prihadyanti, 2013). Research shows that innovation significantly affects the business  
performance of SMEs in Indonesian small food processing firms (Najib and Kiminami, 2011).  
Innovation influence on SMEs was shown to be statistically significant concerning  
performance within SMEs in Dubai (Al-Ansari, Pervan, and Xu, 2013). While innovation is  
also found to be directly positively related to performance (Gunday, Ulusoy, Kilic, and  
Alpkan, 2011; Saunila and Ukko, 2013). Contrary to Saunila's (2014) findings, innovation  
reported no significance on firm performance. For instance, there are no mediating effects  
of innovation between competitor orientation and firm performance in SMEs in Ghana  
(Bamfo and Kraa, 2019). Others have also found that innovation capability mediates the  
effect of a competitor orientation during a downturn of the economy (Huhtala, Sihvonen,

Frösén, Jaakkola, and Tikkanen, 2014). Despite the controversy, we propose the following hypothesis:

**H3a.** Innovation has a significant and positive relationship with firm performance

**H3b.** Innovation mediates the relationship between competitor orientation and firm performance

Given below in Figure 1, the conceptual model for the above hypothesis is proposed.

**Figure 1: Conceptual Model – place here**

### **3. Methodology**

#### *3.1. Measures*

The measures used in this study were adapted from Narver and Slater (1990), Powell (1995), Prajogo and Ahmed (2006), it was slightly modified to suit our study and measured on a 7-point Likert scale ranging from 1= strongly disagree to 7 = strongly agree. Four academics who had expertise in the area assessed the content validity of the items. It was then tested on a sample of firms with further revisions made to express clarity of the language of the questionnaire. The questionnaire was structured in English and translated into the Indonesian language by a native Indonesian researcher from the academic where this survey was conducted and back-translated again, compared and reconciled the differences. This three-stage helped with the quality control of the questionnaire (Behr, 2017).

#### *3.2 Participants and procedures*

A multi-industry sample of firms was used to strengthen the generalisability of results (Morgan, Leech, Gloeckner, and Barrett, 2004). The SMEs' firm category ranged from food and beverage, brick industry, textiles, paper, furniture, automotive, home appliances, and tobacco all SMEs. The sample was acquired from two databases of SMEs directory in Kudus and Pati, East Java Indonesia, participants were randomly selected.

To administer the questionnaire, training was provided by the author from the Indonesian University. This involved training 10 local government staff before data collection. Around 266 firms were contacted from the Kudus City and 60 firms from Pati East Java. The 266

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3 firms from Kudus City<sup>1</sup> and 66 firms from Pati<sup>2</sup> were randomly selected from the SME  
4 directory (sampling frame). Of the total 332 firms, only 309 firms were eligible for the study.  
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6 Business owners and managers of these firms were contacted to respond to the survey  
7 questions. The trained market researchers handed the questionnaire to the participants.  
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9 Many had questions relating to the survey which were answered by the trainers. The  
10 questionnaires were anonymous and confidential. Few of the questionnaires were not  
11 usable and had to be discarded.  
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#### 14 **4. Data analysis**

##### 15 *4.1. Factor analysis, reliability, and validity*

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17 Exploratory factor analysis was used to examine the dimensionality of a measurement  
18 instrument by multivariate data structures to identify latent structures (Hair, Black, Babin,  
19 and Anderson, 2009). The inter-item and item to total reliability tests were conducted  
20 (Churchill, 1979). The extraction method used was the Maximum Likelihood method using  
21 Promax rotation with Kaiser normalization. Four factors were extracted in 7 iterations that  
22 had eigenvalue greater than one and a significant factor loading i.e., greater than 0.50  
23 (Nunnally and Bernstein, 1994). Inter-functional factors had either very lower loading or did  
24 not load. Jointly the other factors accounted for 58.9 percent of the variance included  
25 within the data. The goodness-of-fit indices were established by using the Bartlett test for  
26 sphericity (8524.421; df 861), while the Kaiser-Meyer-Olkin measure of sampling adequacy  
27 (.895), tested if the partial correlations among variables are small and were found to be  
28 significant. Common method variance (CMV) was used to test for biases as the study used  
29 self-reported measures. The questionnaire was tested for general clarity and reliability  
30 issues by the authors who were Indonesian natives for accuracy of responses. Apart from  
31 this, all participants were also informed that the responses would remain confidential and  
32 anonymous which further increased the transparency of the process (Chang et al., 2010).  
33 Harmen's test was employed and was below the threshold level of less than 50% and hence  
34 CMV was not a problem.  
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49 <sup>1</sup> Kudus sampling frame: [https://kuduskab.go.id/p/177/industri\\_skala\\_besar\\_dan\\_menengah](https://kuduskab.go.id/p/177/industri_skala_besar_dan_menengah);  
50 [https://palingmenarik.name/market/2017/10/55-perusahaan-dan-pabrik-di-kudus-jawa-](https://palingmenarik.name/market/2017/10/55-perusahaan-dan-pabrik-di-kudus-jawa-tengah.html)  
51 [tengah.html](https://alamatpenting.com/daftar-alamat-perusahaan-di-kudus/); <https://alamatpenting.com/daftar-alamat-perusahaan-di-kudus/>;  
52 <https://www.daftarperusahaan.com/bisnis/area/kudus>  
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56 <sup>2</sup> Pati sampling frame: [https://palingmenarik.name/market/2017/09/56-perusahaan-dan-pabrik-di-](https://palingmenarik.name/market/2017/09/56-perusahaan-dan-pabrik-di-pati-jawa-tengah.html)  
57 [pati-jawa-tengah.html](https://www.daftarperusahaan.com/bisnis/area/pati); <https://www.daftarperusahaan.com/bisnis/area/pati>;  
58 <https://kemenperin.go.id/direktori-perusahaan?what=&prov=33&hal=21>  
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This was followed by Confirmatory factor analysis to estimate the construct validity. This method tests the goodness of fit of a pre-specified factor model, and it enables testing of the adequacy of fit of the data of the proposed constructs (Hair et al., 2009). The indicators that had low factor loadings squared multiple correlations, and cross-loadings as shown by high modification indexes were removed (Cheng, 2001). The model provides a satisfactory fit for the following indices: comparative fit index (CFI), incremental fit index (IFI), and root mean square error of approximation (RMSEA) (Hair et al., 2009). The measurement model had an appropriate fit with CFI=.96, TLI = 0.95, NFI = 0.92, IFI = .96, PClose = 0.302; PNFI = 0.67 and RMSEA = 0.05.

There are two stages to assessing the model fit, first, the construct validity of the overall measurement model should be established following which the structural relationships among the constructs and the quality of the overall model are assessed (Anderson and Gerbing, 1988). Table 1 shows the standard loading estimates, composite reliability (CR), and average variance extracted (AVE) for each factor. For all the AVE, all items except for competitor orientation were below the 0.5 recommended level, however, the composite reliability values are all above the suggested thresholds of 0.7, indicating the internal consistency of each construct is high (Hair et al., 2009). Furthermore, individual item reliability for the standardized loadings estimate demonstrates a higher than 0.6 for all items, therefore, convergent validity is verified.

**Table 1. Descriptive analysis, AVE and CR – Place here**

To attain satisfactory discriminant validity, each construct should share greater variance with its measures than with other constructs by evaluating that the square root of the AVE values for each latent construct is higher than the correlations between them (Fornell and Larcker, 1981). This method has limitations and so the other method proposed is the Heterotrait-monotrait (HTMT) ratio of correlation (Henseler et al. 2015). One can examine this by considering the cross-loading of the AVE-SV and HTMT with a cutoff value of 0.85). Our results in Table 2 indicate the results of HTMT which helps to establish discriminant validity as all values are less than 0.85 (Henseler et al. 2015).

**Table 2. HTMT Analysis – place here**

#### *4.2 Hypotheses testing*

To test the hypothesized relationships between customer orientation, competitor orientation, and innovation with SMEs firm performance (figure 1), using SPSS AMOS 26, we conducted a path analysis. This method was considered suitable as it uses bivariate and multiple linear regression techniques to examine causal relations among the variables of a

formerly specified model (Olobatuyi, 2006). The analysis showed that  $\chi^2$  was non-significant. The significance is considered a stringent test for the model fit and thus indicating a good fit (Barrett, 2007; Bollen, 1989). Similarly, the fit of the proposed model was acceptable with GFI = 0.99, CFI = 0.99, AGFI = 0.95, NFI = 0.99, TLI = 0.99, RMSEA = 0.07; PClose = .219; and PNFI = .166, and  $\chi^2 = 2.80$ , with  $p = 0.094$ , all within the recommended levels (Kline, 2005). The squared multiple correlations for innovation were 0.67 and for firm performance was .81.

In Table 3, the regression coefficients of the empirical model show that consumer orientation had a direct positive effect on performance ( $\beta = 0.12$ ,  $p < 0.001$ ). Hence H1 was supported. Likewise, competitor orientation had a direct positive influence on Innovation ( $\beta = 0.82$ ,  $p < 0.001$ ), providing support for H2b. Also, as expected, innovation positively impacted performance ( $\beta = 0.72$ ,  $p < 0.001$ ). Thus, H3a was supported. However, the direct effect of competitor orientation on firm performance was not significant. Hence, H2a was therefore rejected.

**Table 3. Path model – Place here**

To further examine the results of the path model analysis, standardized indirect, direct, and total effects were calculated by SPSS AMOS 26 using bootstrapping mediation analysis (see Table 5). To analyse the data, we use a two-tail significance with 95% bias-corrected bootstrap confidence intervals using 5,000 bootstrap samples. The proposed indirect effect of competitive advantage on performance is mediated by a positive effect on innovation ( $\beta_{ind.} = 0.59$ , 95% bootstrap CI [0.51, 0.672],  $p < 0.001$ ). Thus, H3b was supported.

**Table 4: Total, Direct, and Indirect effects**

## 5. Discussion of findings

Our results show that there is a full mediating role of innovation between competitor orientation and firm performance. The direct effect of competitor orientation on firm performance was non-significant. The proposed theoretical model also shows a positive significant effect on customer orientation and firm performance. Similarly, the results show positive significant direct effects on competitor orientation on innovation, and innovation on firm performance.

The study contributes to the existing theoretical and practical issues in several ways. The two constructs of market orientation were considered, i.e., customer orientation and competitor orientation. Discriminant validity attested that customer and competitor orientation are distinctly different constructs. Thus, market orientation constructs such as

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3 competitor and customer orientation can be considered separately as argued by various  
4 researchers (Lengler et al., 2013), or rather market orientation should only consider  
5 customer and competitor orientation constructs (Sørensen, 2009), as inter-functional  
6 coordination when tested with exploratory factor analysis did not correlate with any of the  
7 factors.  
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11 Without the mediating effect of innovation, when competitive orientation was tested  
12 independently on performance, it showed a significant relationship ( $F(1,309) = 723.0, p <$   
13  $0.001$ ). In other words, we tested another model with competitive orientation  
14 independently and its influence on firm performance which showed there was a significant  
15 effect. Thus, we can also assume that there could also be a possible moderating interaction  
16 effect between innovation and competitor orientation on SME's performance. This could be  
17 investigated for future research.  
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22 It is imperative that identifying competitors play a huge role, even in SMEs. This research  
23 suggests that even though SMEs have a smaller range of competition, those pursuing  
24 optimal performance should pay consideration to direct and indirect competitors in a  
25 turbulent competitive environment if they are to succeed in building sustainable  
26 competitive businesses (O'Dwyer and Gilmore, 2019).  
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31 While the influences of innovation on firm performance continue to remain open for  
32 investigation, our research shows that innovation not only directly impacts performance but  
33 also plays a mediating role between competitor orientation and firm performance. This  
34 shows that competitor information gathered as a consequence of competitor orientation  
35 influences innovations in SMEs. Market orientation can be considered as a source of  
36 competitive advantage (Day and Nedungadi, 1994) and SMEs can draw from it. Failure to  
37 understand how competitors can aid competitive advantage is a firm's biggest disadvantage  
38 (O'Dwyer and Gilmore, 2019) and hence SMEs should take the opportunity to invest in  
39 innovations based on their competitor analysis.  
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45 The literature shows that customer orientation is criticized as limiting some innovation  
46 processes, yet other authors suggest that a focus on market-sensing, customer-relating, and  
47 customer-response capabilities contribute to, rather than impede a firm's competencies in  
48 innovation (Racela, 2019).  
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51  
52 Too much focus on customer orientation has resulted in either overlooking innovative  
53 customer needs, or a decline in bringing out new products (Im and Workman, 2004) and/or  
54 a reduction in the capacity of creating breakthroughs with innovations (Zhou, et al., 2009).  
55 Furthermore, it also leads to diminishing firm performance (Voss and Voss, 2000; Frambach  
56 et al., 2016). Research shows that customer orientation has failed to improve innovation  
57 performance when there appears to be uncertainty in demand. However, our research  
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3 suggests that SMEs should make good use of customer orientation. Given that market  
4 orientation attempts to gather consumer and competitor intelligence, it is useful that SMEs  
5 understand their customers and competitors and address innovation for increasing firm  
6 performance  
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## 9 10 **6. Strategic marketing implications**

11  
12 At the heart of strategy implementation lies a firm's capabilities, processes, and systems  
13 that need to be considered to develop effective strategies. Organisational variables take a  
14 prominent role in addressing the relationship between strategy and performance (Homburg,  
15 Krohmer, and Workman, 2004). Since innovation was found to mediate competitor  
16 orientation and firm performance, marketing strategies involving the type of innovation  
17 should be examined and supported. The consensus surrounding Innovation can be  
18 categorised into three and are all central to SME's activities (O'Dwyer and Gilmore, 2019).  
19 For instance, counts of incremental, radical, and overall innovation. This is generally  
20 undertaken by firms through the expansion or improvements of the existing products,  
21 services, processes, technical or administrative situations (Lewrick, Omar, and Williams,  
22 2011). SMEs involved in reactive marketing strategies should move to more proactive  
23 strategies.  
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26  
27 SMEs should also be encouraged to emphasise customer-focused business  
28 strategies. Keeping in mind an integrated view of a single customer and information  
29 dissemination regardless of their size. As smaller customers over a long-term period provide  
30 stability to the firm. Strategies to improve the effectiveness and efficiency of the processes  
31 included building customer loyalty and stronger relationships. For SMEs' firm performance  
32 to improve there is a need to integrate strategies for enhancing better services and products  
33 for greater customer satisfaction.  
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37 Since competitor orientation was not found to have a direct influence on performance but  
38 an indirect effect through innovation, SMEs need to adopt competitor strategies, either  
39 through cost or resort to innovation in differentiation that would offer firms greater  
40 coherence on competitor analysis. When there are highly fragmented commodity firms  
41 where the movement of a single competitor may not be regarded highly, yet the need for a  
42 competitive strategy may be required. Notably, differentiation and market orientation was  
43 not found to be significantly associated with improved performance (Panayides, 2004), thus  
44 caution should be taken to understand when differentiation strategies are required.  
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## 47 48 **7. Limitations and future research**

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50 The study has certain limitations. Since face-to-face interviews were conducted, it could  
51 have resulted in some biases. Generalisation of the findings based on data derived from the  
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questionnaire should be exercised with some caution. Restricting to one specific industry could have given different results. Furthermore, relying on more objective measures of performance rather than subjective could well be another impediment. More particularly with market orientation extant research demonstrated that results were mixed when objective indicators of performance had been used (Maydeu-Olivares and Lado, 2003). Generalizability of the findings to other developing country environments could also be a limitation, depending on whether there is similar support from government incentives and other regulatory measures to protect domestic and small industries.

Further research should include inter-functional coordination that encompasses the concept of market orientation, as in this research, it did not correlate in the exploratory factor analysis. This would open avenues to further extend the basis of this study. The joint effects of market orientation and corporate social responsibility (CSR) on firm performance can also enhance performance and hence future research could also include innovation within this context (Qu, 2019). Similarly, on a broader level, market orientation impact on organisational harmony and firm performance could be examined (Khan et al., 2018); the link between resource capabilities and performance (Jeong et al., 2019) or how responsive market orientation and proactive market orientation creates competitive advantage (Tinoco et al., 2019).

A comparative study with other similar countries could be investigated to unearth the mediating innovative behaviours among SEMs. Future research could also examine service-oriented SME firms in Indonesia to identify whether the same relationships would be significant, more particularly when compared to large firms. The institutional theory could be used to examine a firm's market orientation in Indonesia (Kshetri, 2009).

In conclusion, the study presents findings that are of interest to SMEs in Indonesia practicing market orientation, and it highlights the importance of competition orientation for innovation and firm performance.

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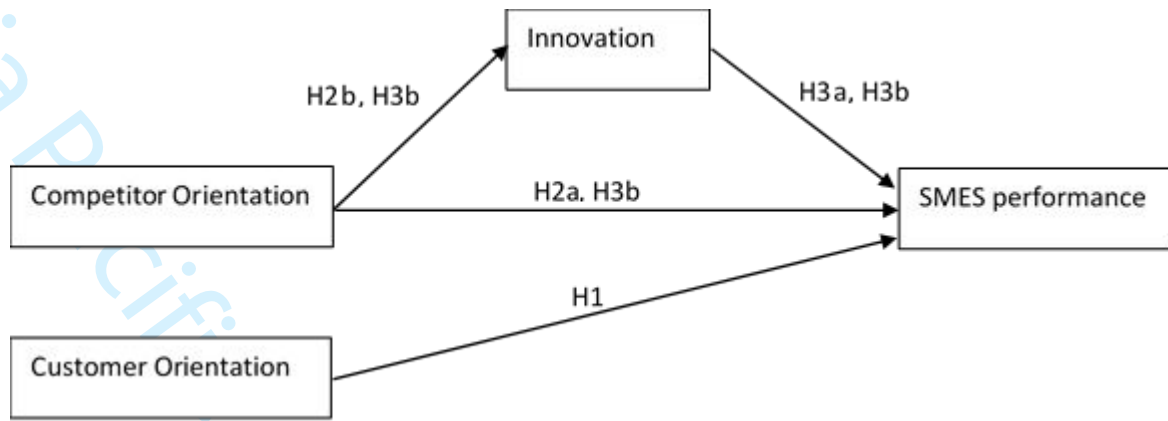


Figure 1: Conceptual Model

**Table 1.** Descriptive analysis, AVE and CR

Constructs and items	F/L	Mean	SD
<i>Business Performance: AVE 0.69, CR 0.87</i>			
Growing faster	0.811	5.2	1.472
Has a higher market share	0.826	5.25	1.421
More success	0.838	5.31	1.471
<i>Innovation: AVE 0.55, CR 0.88</i>			
Rapid rate of change in technical, process and procedure	0.692	5.31	1.528
The level of innovation of new products is very high	0.659	5.21	1.552
Fast in adopting the latest innovation technology in the production process	0.81	5.37	1.464
Fast in developing new products	0.745	5.35	1.491
We have technology that has a competitive advantage	0.737	5.34	1.442
Large number of new products introduced to the market	0.795	5.24	1.481
<i>Competitor Orientation: AVE 0.48, CR 0.88</i>			
Targets opportunities for competitive advantage	0.656	5.3	1.63
Quick to react to competitors' activities	0.746	5.02	1.547
Analyse strengths and weaknesses of competitors	0.693	5.15	1.546
Salespeople share competitor's information	0.739	4.97	1.527
Departments share information regarding firm's competence	0.649	4.99	1.543
Strategy to obtain comp advantage is knowing customers' needs	0.70	5.13	1.603
Approach market segments to leverage competitive advantages	0.785	5.01	1.602
Managers discuss competitor's strategies	0.607	5.21	1.55
<i>Customer Orientation: AVE 0.59, CR 0.87</i>			
Provides services after purchase	0.672	5.44	1.376
Creates value for our customers	0.717	5.53	1.485
Measures customer satisfaction	0.846	5.69	1.375
Understands customer needs	0.793	5.61	1.432
Goal of satisfying customers	0.811	5.76	1.444

Note: F/L Factor loading, SD Standard deviation

**Table 2. HTMT Analysis**

Constructs	1	2	3	4
1. Performance	<b>0</b>			
2. Innovation	0.811	<b>0</b>		
3. Competitor Analysis	0.744	.0762	<b>0</b>	
4. Customer Analysis	0.655	0.583	0.702	<b>0</b>

**Table 3. Path model****Table 3. Path model**

Paths		Estimate	S.E.	C.R.	
H1. Customer orientation	→	Performance	0.1253	0.045	7.223***
H2a. Competitor orientation	→	Performance	0.008	0.054	0.154 Not supported
H2b. Competitor orientation	→	Innovation	0.820	0.031	25.246***
H3a. Innovation	→	Performance	0.724	0.049	16.817***

Note: \*\*\* significant at the 0.001 level

**Table 4: Total, Direct and Indirect effects**

Total	Customer	Competitor	Innovation
Innovation	0	0.82**, [.76, .86]	0
Performance	.25**, [.16, .33]	0.59***, [.51, .68]	.72***, [.61, .82]
Direct	Customer	Competitor	Innovation
Innovation	0	.82**, [.76, .86]	0
Performance	.25**, [.16, .33]	0	.72***, [.61, .82]
Indirect	Customer	Competitor	Innovation
Innovation	0	0	0
Performance	0	0.59***, [.51, .67]	0