Innovation Role in Mediating the Effect of Human Resource Management Strategy and Market Orientation on Business Performance (Studies at SMEs in Southeast Sulawesi)

1Muhamad Masri, 2Armanu, 3Ghozali Maskie, 4Rofiaty

1University of Brawijaya, Management Doctoral Program, Faculty of Economics and Business, 65144, Malang-Indonesia
2,4 University of Brawijaya, Department of Management, Faculty of Economics and Business, 65144, Malang-Indonesia

ARTICLE INFO
Article history:
Received 28 August 2015
Accepted 15 September 2015
Available online 15 October 2015

Keywords:

ABSTRACT
This study provides the basic configuration of modeling development the relationship of human resource management strategy and market orientation on innovation and business performance, either directly or mediated by innovation. This study objective is to examine and explaining the effect of HRM Strategy and market orientation on business performance through innovation at SMEs in Southeast Sulawesi. Analysis unit is SMEs in Southeast Sulawesi. Respondents are 120 SME owners who produce goods and services of stoves and pans, making/repairing the body vessel, welding shop, iron fence maker, iron furniture and auto repair. Quantitative approach is applied by Amos software. This study findings are follows (1) human resource management strategy has significant effect on innovation; (2) human resource management strategy has a significant effect on business performance; (3) market orientation has significant effect on innovation; (4) market orientation has no significant effect on business performance; (5) innovation has a significant effect on business performance; (6) human resource management strategy indirectly has significant effect performance mediated by innovation, the mediation is partial mediation; (7) market orientations indirectly has significant effect on innovations mediated by innovation, the mediation is complete mediation; (8) long-term strategy of company affect on short-term strategy.

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INTRODUCTION

People success of a nation closely relates with advantages of renewable human resources. Experience in developed countries shows that human resources quality allows them efficiently implement and control science and technology with high productivity (Habibie, 2004). Human resource management strategy is a complex issue which needs serious attention, especially in small and medium enterprises (SMEs). Many SMEs underestimate this issue, while consumer’s demands toward quality and speed of service absolutely must be fulfilled. General problem of SMEs in Indonesia are marketing, capital, technology, organization, and management. It needs research to examine the environmental conditions that will affect on process of strategic planning, knowledge management, and innovation of SMEs. This unsolved can reduce the SMEs performance (Rofiaty, 2012).

Interesting issues of Southeast Sulawesi SMEs is the human resource management still low. It can be proven from the average level of employees education are senior high school and work experiences are very low. They cannot work at initial entry. They learn after become employee. This proves that they have no work experience in SME sector. This will have implications to low products innovation to affect on low products quality that cannot compete with products of other SMEs. As a result, SMEs products in Southeast Sulawesi have a limited market. Generally it will cause the low performance of SMEs business.

Review of theoretical and empirical phenomena creates concept the role of innovation in mediating the effects of human resource management strategy and market orientation on business performance. It is important research gap and interesting for further study into new findings that inspire researchers as follows. There is inconsistence of research results the effect of human resource management strategy on business performance. Several studies have shown that human resource management strategy have a significant effect on business performance (Shang & Lin, 2008; Daniel and Micela, 2009; George & Prodmoros, 2009; Osman et al., 2011; Moideenkutty et al., 2011; Nazlida & Rohadia, 2011). While other studies explain that human resources management...
strategy has no significant effect on business performance (Harris and Ogbonna, 2001; Ingmar and Pawan, 2007; Dimba, 2010; Katou, 2012).

There are inconsistent research results the effect of market orientation on business performance. Several studies have shown that market orientation have a significant effect on business performance (Narver & Slater, 1990; Huselid, 1995; Guest, 1997; Kim, 2003; Cano et al., 2004; Shoham et al., 2005; Joaquin et al., 2005; Kirca et al., 2005; Sangen, 2005; Tien-Shang Lee & Hsin-Ju Tsai, 2005; Grinstein, 2008; Ansir 2009; Saints, 2009; Oscar & Pablo, 2009; Sanjaya, et al ., 2011). While other studies say that market orientation has no significant effect business performance (Appiah-adu & Singh, 1998; Appiah-Adu and Ranchhod, 1998; Pelham, 2000; Monica and Alan, 2002; Keskin, 2006; Daniel et al ., 2008; Tan & Liu, 2008; Chen & Spillan, 2010). This study will fill the gap by putting innovation variable as mediation the effect of market orientation on business performance.

There are inconsistent research results the effect of innovation on business performance. Several studies have shown that innovation significantly affect on business performance Kurnianto (2005), Tien-Shang Lee & Hsin-Ju Tsai (2005), Prajogo (2006), Lin and Chen (2007), Sheng & Yicui (2007), Carlos (2008), Daniel et al. (2008), Saints (2009), Ansir (2009), Kamhawi (2010), Jimenez & Valley (2011), Rofiaty (2012). While the research results of Cruz, et al. (2009), Rhee et al (2009), Hilmi et.al. (2010), and Rosli & Mahmood (2011) shows that innovation does not have significant effect on business performance.

The above description shows that human resource management strategy (HRM strategies) and market orientation mediated by innovation can create added value to enhance SMEs performance, but the research results are still not consistent. Therefore, researchers sought to clarify the role of innovation to mediate the effect of human resource management strategy (HRM strategies) and market orientation on business SMEs performance in Southeast Sulawesi.

**Research Objectives and Problems:**

Testing the relation between innovation and business performance is very interesting in various contexts. Therefore, this study confirms and reexamines the effect of innovation on business performance in context of Southeast Sulawesi SMEs. Based on these descriptions, researchers attempt to examine the role of innovation to mediate the effects of human resource management strategy and market orientation on business performance in Southeast Sulawesi SMEs.

**Theory Review and Research Hypothesis:**

Based on the concept of thinking, formulation of a conceptual framework in this study is started to explain relationship between human resource management strategy and innovation. Sange (2005) indicate that HRM Strategy has a significant effect on innovation. There is a positive relationship between human resource management strategies to organizational performance. Research results Kroger (2007) showed that human resource management strategy of a company positively relates to business performance.

Ilona research and Ruta (2012) show that practice of human resource management (HRM) has positive and significant effect on organization performance. Osman et al. (2011) found that effectiveness of HR practices implementation within a company has a great effect on company performance. This result differs from A. Katou (2012) who found that practice of HRM policies directly has no significant effect on organization performance.

Ansir (2009) indicates that market orientation and innovation have a significant effect on business performance, either partially or simultaneously. HRM Strategy, market orientation and innovation have significant effect on business performance, either partially or simultaneously. Another study by Jimenez et al. (2008) show that market orientation has positive effect on innovation, but market orientation has no significant effect on performance. Huang Lin et al. (2008) found different results, namely market orientation has no direct and significant effect on innovation.

Yun Ching Lin and Chen (2007) conducted SMEs study in Taiwan. Research results show a positive relationship between incremental innovation and SMEs performance and radical innovation has a positive relationship with SMEs performance. Other studies have found that innovation has positive effect on performance (Jimenez et al., 2008; Huang Lin et al., 2008; Rofiaty, 2012). Most empirical studies have focus to build relationships between market orientation and business performance in environmental conditions and various organizations (eg, competitive intensity, size of company) and three meta-analyzes (Cano et al., 2004; Kirca et al., 2005; Shoham et al., 2005) confirm the positive relationship between market orientation and business performance.

This study will confirms and reexamine the effect of HRM Strategy and market orientation towards innovation, and effect of HRM Strategy and market orientation on business performance in Southeast Sulawesi SMEs. The hypotheses are follows:

H1a: Better HRM Strategy is expected to increase innovation.

H1b: Better HRM Strategy is expected to improve business performance.

H2a: Better market orientation is expected to improve innovation.
H2b: Better market orientation is expected to improve business performance.

H3: Better innovation is expected to improve business performance.

H4a: HRM Strategy is expected to improve business performance mediated by better innovation.

H4b: Market orientation is expected to improve business performance mediated by better innovation.

Research Methods:

This is an explanatory research with a quantitative approach. Study population is the small and medium Enterprises (SMEs) that producing goods and services such as stoves and pans, making/repairing the body vessel, welding shop, iron fence maker, iron furniture and auto repair. Analysis unit in this study is entrepreneurs/managers/leaders of SMEs with consideration of the product was still able to compete and sell in market. The study populations are 171 SMEs. Proportional sampling with stratified random sampling can select samples taken of 120 SMEs. Respondents are represented by one person, leaders or employees of company who understand about the study variables. Data is collected by questionnaire with answers. Likert scale five point is used with 1=Strongly Disagree to 5=Strongly Agree. Data was analyzed by path analysis with AMOS software version 18.

Operational Definition:

This study measures the exogenous variables, namely human resource management strategy (X1) and market orientation (X2), as well as innovation (Y1) as intervening/endogenous variables. The endogenous variable is the business performance (Y2). Variable Measurement Human resource management strategy refers to indicators of Delery and Doty (1996) and Huselid (1997), Dimba and K'Opanyo (2009) develop indicator of: (a) Training, (b) empowerment, and (c) performance appraisal. While the market orientation is measured by indicators developed by Narver and Slater (1990) as customer orientation, competitor orientation and coordination between functions, then it was developed by Vitale et al., (2002) to modify in accordance with object studied of SMEs in Sulawesi Southeast namely: (a) customer orientation, (b) Competitors orientation, and (c) Coordination between functions.

Innovation is measured by indicators of Griffin (2004), then developed in research Jimenez and Valle (2011) by dividing innovation in three indicators, which is modified in accordance with object of SMEs surveyed in Southeast Sulawesi. They are (a) technical innovation, (b) administrative innovation, and (c) managerial innovation. Indicators of business performance are adopted from theory of Jauch and Glueck (1999), Lee and Tsang (2001) develop the theory follows: (a) sales growth, (b) profit growth, (c) asset growth, and (d) market share growth. Measurement of model study variables can be seen in Figure 1 below:

![Diagram of Research Variables](image)

Fig. 1: Measurement of Research Variables

RESULTS AND DISCUSSION

Empirical model of this study is used to test hypothesis using path coefficients in structural equation model. Complete analysis of results can be seen in Figure 2 below.

Figure 2 shows the research result of variables effect, whether significant or not. More clearly, direct effect the test results can be seen in Table 1 below:
Table 1: Direct Effect Testing

<table>
<thead>
<tr>
<th>Independent Variables</th>
<th>Dependent Variables</th>
<th>Path Coefficient</th>
<th>Prob.</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>HRM Strategy</td>
<td>Innovation</td>
<td>0.329</td>
<td>0.002</td>
<td>Significant (s)</td>
</tr>
<tr>
<td>Market Orientation</td>
<td>Innovation</td>
<td>0.316</td>
<td>0.010</td>
<td>Significant (s)</td>
</tr>
<tr>
<td>HRM Strategy</td>
<td>Business Performance</td>
<td>0.326</td>
<td>0.004</td>
<td>Significant (s)</td>
</tr>
<tr>
<td>Market Orientation</td>
<td>Business Performance</td>
<td>-0.021</td>
<td>0.835</td>
<td>Insignificant (ns)</td>
</tr>
<tr>
<td>Innovation</td>
<td>Business Performance</td>
<td>0.260</td>
<td>0.012</td>
<td>Significant (s)</td>
</tr>
</tbody>
</table>

Source: Processed data, 2014.

Table shows that four relationships are significant and one is insignificant. HRM Strategy significantly affects on innovation, HRM Strategy significantly affects on business performance, and market orientation significantly affect on innovation. Variable market orientation has no significant effect on business performance, and innovation significantly affect on business performance. Description of hypothesis testing results can be explained below.

**Hypothesis 1a: Better HRM Strategy is expected to increase innovation:**

Analysis result shows that path coefficients the direct effect of human resource management strategies to innovation has a value of 0.329 with probability 0.002. This shows that there is enough empirical evidence to accept the hypothesis (H1a) that better company human resource management strategy will increase the company's innovation. Positive path coefficient means that relationship between human resource management strategies with innovation is unidirectional. It means that better human resource management strategy will improve SMEs innovation.

This study result reinforces the findings of Morris and Paul (1987); Milles and Arnold (1991); Becherer and Maurer (1997); Ansir (2009) that human resource management strategies are reflected through training, empowerment and capable to improve innovation performance. These findings are not consistent with research of Katou & Budhwar (2010) that business strategy (cost, quality and innovation) affect on human resource management policies, while this study say instead that human resource management strategies affect on innovation.

**Hypothesis 1b: Better HRM Strategy is expected to improve business performance:**

Analysis result shows that path coefficients the direct effect of human resource management strategies on business performance obtained a value of 0.326 with probability of 0.004. This shows enough empirical evidence to accept the hypothesis (H1b) that better human resource management strategy will improves company performance. Positive path coefficient means that relationship between human resource management strategies with business performance is unidirectional. It means that better human resource management will improves SMEs business performance.

This study findings shows good strategy of human resource management can improve SMEs performance. It support the theory proposed by

**Hypothesis 2a: Better market orientation is expected to improve innovation:**

Analysis result shows that path coefficients the direct effect of market orientation on innovation obtained a value of 0.316 with probability of 0.010. It shows enough empirical evidence to accept the hypothesis (H2a) that better market orientation will increase the company's innovation. Positive path coefficient means that relationship between market orientation and innovation are unidirectional. It means that better market orientation improves SME innovation.

This study finding supports the research of Felix et al. (2005); Kroeger (2007); Grinstein (2008); Jimenez et al. (2008); Ansir (2009); Saints (2009) that market orientation has positive effect on innovation.

**Hypothesis 2b: Better market orientation is expected to improve business performance:**

Analysis result shows that path coefficients the direct effect of market orientation on business performance obtained a value of -0.021 with probability of 0.835. This indicates not enough empirical evidence to accept the hypothesis (H2b) that better company's market orientation cannot improve company performance. Negative path coefficient means that relationship between market orientation and business performance is not unidirectional. It means that better market orientation will reduce the company performance.

This study finding supports research of Appiahadu and Singh (1998); Ranchold (1998); Pelham (2000); Monica and Alan (2002); Keskin (2006); Tan and Liu (2008); Spilan (2010) that market orientation has no direct effect on performance. This was confirmed by research of Shoham et al. (2005) that market orientation has indirect effect on performance through geographical location and company size.

This study result confirms the differences with previous studies that market orientation has significant positive effect on firm performance (Joaquin et al., 2005; Lee and Tsai, 2005; Zinc and Yicui, 2007; Grinstein, 2008; Ansir 2009; Saints, 2009; Sanjaya et al., 2011; Oscar and Pablo, 2009; Sanjaya, et al., 2011). On other hand, findings of this study confirm the differences and theory of Narver and Slater (1993) that customer orientation, competitor orientation, and coordination between functions, is a source of competitive advantage through superior performance.

Based on this study's findings compared with some other research findings, it can be stated that effect of market orientation on business performance consistently is good at large and small companies. This study finding do not supports the view that market orientation as an organizational culture in associated with all activities and disseminate responsiveness will give create market orientation (Narver and Slater, 1990). This study findings states that market orientation has insignificant and negative effect on SMEs business performance in Southeast Sulawesi. It rejects several previous studies that market orientation has positive and significant effect on business performance.

**Hypothesis 3: Better innovation is expected to improve business performance:**

Analysis result shows that path coefficients the direct effect of market orientation on innovation obtained a value of 0.260 with probability of 0.012. It shows enough empirical evidence to accept the hypothesis (H3) that better company innovation will have an effect to improve company performance. Positive path coefficient means that relationship between innovations with business performance is unidirectional. It means that better the company's innovation will increase SMEs business performance.

This study result is consistent with findings of several previous studies (Yun and Ching, 2007; Jimenez et al., 2008; Huang Lin et al., 2008) that there is a positive relationship between innovation with SMEs performance and there is a positive relationship between radical innovation with SMEs performance.

### Table 2: Indirect Effect of Variables

<table>
<thead>
<tr>
<th>Independent Variables</th>
<th>Dependent Variable</th>
<th>Intervening Variable</th>
<th>Path Coefficient</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>HRM Strategy (X1)</td>
<td>Business Performance (Y2)</td>
<td>Innovation (Y1)</td>
<td>0.086</td>
<td>Significant</td>
</tr>
<tr>
<td>Market Orientasi (X2)</td>
<td>Business Performance (Y2)</td>
<td>Innovation (Y1)</td>
<td>0.082</td>
<td>Significant</td>
</tr>
</tbody>
</table>

Source: Primary Data Processed, 2014

Test results the indirect effect between the studies variables are explained below.
Hypothesis H4a: HRM Strategy is expected to improve business performance mediated by better innovation:

Analysis result indicates that path coefficient the indirect effect of human resource management strategies on business performance mediated by innovation obtained a value of 0.086 (partial mediation). The effect of human resource management strategies to business innovation performance is mediated by positive and significant effect. Therefore, there is enough empirical evidence to accept the hypothesis (H4a) that better the company's human resource management strategy is mediated by Innovation Company that both the company's performance will be better.

The nature of mediation is partial mediation. Human resource management strategies can affect on company performance directly and can also through the mediation of innovation. Positive path coefficient values indicate that high innovation can improve business performance. Based on these results, this study was able to provide empirical evidence that innovation is an intervening variable that serves to mediate the relationship between human resource management strategies to business performance partially.

This study result confirm the results of Kurnianto (2005) that innovation is mediation variable of relationship between human resource management practices on performance. It can be said that innovation is partial mediation the relationship between human resource management strategies on business performance.

Hypothesis H4b: Market orientation is expected to improve business performance mediated by better innovation:

Analysis result indicate that path coefficient the indirect effect of market orientation on business performance mediated by innovation obtained a value of 0.082 (complete mediation). The effect of market orientation on business performance mediated by innovation is positive and significant. Therefore, there is enough empirical evidence to accept the hypothesis (H4b) that better market orientation mediated by innovation will improve company performance. These study findings demonstrate empirically that market orientation can improve business performance through better innovation.

This study finding supports the views of Mavondo et al. (2005) that market orientation support innovation, and innovation positively affect on company's performance (Keskin, 2006). It finding also supports the views expressed by Kumar (2002) that market orientation contributes significantly to improve the company’s competence that will drive high performance in areas of cost and success in delivering new services. This study result confirms the views expressed by Ansir (2009) that market orientation and innovation significantly affect on business performance, either partially or simultaneously.

Conclusion:

Based on hypothesis testing, results of discussion, and research findings, it can be argued that human resource management strategy directly can improve business performance. Similarly, human resource management strategy mediated by innovation can improve business performance. The nature of innovation in model is a perfect mediating variable (complete mediation). Relationship between market orientations does not directly affect on business performance. However, through the mediation of innovation, market orientation significantly improves the SMEs business performance in Southeast Sulawesi.

Better innovation directly able to improve business performance. It means that indicators of technical innovation and managerial innovation more dominant to reflect innovation in order to increase sales growth and market share growth, which reflects the business SMEs performance in Southeast. Innovation mediates the relationship between human resource management strategy and market orientation with business performance. It can provide real and important role in supporting the improvement of business SMEs performance in Southeast.

Suggestion:

Based on results and conclusions, it is suggested a recommendation that results of this study indicate that market orientation has no significant effect on business performance. Therefore, management company SME in Southeast Sulawesi focus more on increasing market orientation through increased and understanding of competitor orientation.

The analyzed model was limited to human resource management strategy, market orientation, innovation and business performance (internal factors). Further research should develop a research model by adding environment variables of corporate and government involvement (external factors the company) in order to enhance and enrich the knowledge or information about the concept of SME development in a sustainable manner.

SMEs businesses are a promising sector for future development because it can easily create jobs and reduce unemployment. Therefore, it is expected
to support the facilitation of Local Government in form of empowerment, promotion and support of capital facilities, so this sector can be faster to grow and become a mainstay for community economic development in Southeast.

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