

SOCIAL CAPITAL AND PERFORMANCE IMPROVEMENT OF MSMEs THROUGH INNOVATION CAPACITY

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ABSTRACT

The purpose of this study is to prove the effect of social capital on the ability of innovation and the performance of MSMEs and the ability of innovation as a mediator. Using a quantitative approach with a sample of 110 MSME owners in Malang City, East Java, Indonesia. By using Structural Equation Modeling (SEM) analysis, it shows that social capital has an influence on the ability of innovation and the performance of MSMEs and the ability of innovation has an influence on the performance of MSMEs and the ability of innovation is able to mediate the relationship between social capitals on the performance of MSMEs. Based on the research findings, suggestions are put forward that MSME actors must be able to adapt to environmental changes so that future researchers can conduct studies on the business environment and market orientation in order to improve MSME performance.

Keywords: social capital, innovation capability, and MSME performance

1.0 INTRODUCTION

Micro, Small and Medium Enterprises (MSMEs) are a sector that is quite important for the Indonesian economy, including in Malang City. The number of MSMEs in Malang City continues to increase from year to year. The leading MSME industrial centers in Malang City are Batik, Fashion, Painting, Ceramics, Rattan, Sanitair, Pottery, Furniture, and Racket. According to data from the Central Statistics Agency (BPS), in 2020 there were around 63,556 MSME units in Malang City making a sizable contribution to the Gross Domestic Product (GDP) of around 49.2% in 2020. Even so, MSMEs in Malang City also still facing various challenges, such as problems of access to markets, financing, and regulations. The problems faced by MSMEs in Malang City are interesting for conducting studies on the performance of MSMEs.

Performance is the outcome attained by people or groups to accomplish specific objectives under predetermined environmental conditions. (Daft, 2010). It is feasible to use the owner's perception method because Dess and Beard (1984) found that the majority of SMEs are either not opposed to or unwilling to provide company performance data with data related to finance. According to Hafeez et al. (2012), Li et al. (2006), and Nybakk Erlend (2012), financial performance, marketing performance, and competitiveness are used to evaluate performance indicators. Gin and Chong (2008) clarify that financial performance, product performance, and marketing performance can all be used to gauge how well SMEs are performing.

Improving the performance of MSMEs can be done by implementing social capital. Kim & Aldrich (2005) describe Social Capital as a network of social relations that generate benefits for individuals or groups in obtaining resources, information, and support to achieve common goals. MSMEs that have a network of strong social relations with suppliers, customers and other business partners have easier access to the resources and information they need. Thus, social capital can increase the operational efficiency and effectiveness of SMEs, which in turn can improve business performance. Results of studies conducted by Khoirriani & Kartika (2016), Andriani (2010), Kusumastuti (2018), Yadap, et al (2018) Meflinda, et al., (2018), Kanapathipillai and Azam (2019), and Zulpicha, et al. (2019) shows that social capital affects the performance of SMEs, different results shown by Prasetyo & Harjanti (2013), Hartono et al (2013) and Winarni (2011) show that social capital has no relationship with micro and small performance.

There are still discrepancies in some of the findings from earlier studies on the impact of social capital on the performance of MSMEs (research gaps), which creates a need to reevaluate the relationship between social capital and MSMEs' ability to innovate.

Ussahawanithakit (2007) defined innovation capability as the capacity to create goods or services in reaction to market demands by putting processes in place appropriately and quickly in response to technological changes and unanticipated opportunities created by rivals. Terziovski (2010) argues that the ability to innovate provides the potential for the emergence of an effective innovation. In the innovation development process, social capital has a very important role (MartínezCan˜as, 2012; Alguezaui & Filieri, 2010; Camps & Marques, 2014). Not only in large companies, has the influence of social capital on innovation also occurred in Micro and Small Enterprises. Brata (2011), Camps & Marques (2014) found that there is an influence of the closeness of the cooperation network with business partners and relationships with partner groups on innovation. This means that social capital can provide access to the resources necessary for innovation, such as knowledge, skills and technology.

MSMEs can enhance their performance both financially and non-financially by building their innovation capabilities to produce new, more innovative processes and goods. One of the elements that affects company performance is innovation. SMEs' performance can be enhanced by businesses' capacity for innovation. (Rhodes, et al. 2008). According to Lewrick et al. (2010), entrepreneurs who have operated their companies need innovation as a crucial tool for enhancing a company's performance. The conclusion reached by Ndubisi and Iftikhar (2012), Al-Ansari et al. (2013), Hilman and Kaliappen (2015), and Ratnawati (2018) is that the success of MSMEs is influenced by their capacity for innovation.

It is fascinating to reevaluate the impact of social capital on the performance of MSMEs with the capacity for innovation as a mediator in light of the research background and the findings of prior empirical studies.

2.0 LITERATURE REVIEWS

2.1 Performance

According to Mutegi et al. (2015), MSME performance refers to the work completed by people who have adapted to their roles or tasks within a company over a specific period of time, which

is connected to a specific value or standard measure of the work performed by the particular company. Jumingan (2006) defined the performance of SMEs as a company's capacity to accomplish objectives in an effective and efficient manner. Performance in the setting of MSMEs is determined by financial performance, marketing performance, and competitiveness, according to Li et al. (2008) and Nybakk Erlend (2012). Three factors—profitability, productivity, and market are used to evaluate the success of MSMEs by Camison and Villar (2012) and Gin and Chong (2008). Sanchez and Marin (2005) use three criteria profitability, productivity, and marketing—to assess the success of SMEs.

2.2 Social Capital

Bourdieu (1980) defined social capital as a resource that is present in people and groups of people who are connected in a network (network), which is connected through official and non-institutional relations, and which mutually benefits one another. Meanwhile, Coleman (1988) defines social capital as a resource contained in the relationship between individuals and groups that allows cooperation in achieving common goals. Social capital consists of social norms, values, and skills related to organizing and coordinating between individuals. Social capital can also be considered as a social force that enables people to benefit from being involved in social networks.

According to Kim and Aldrich (2005), indicators of social capital consist of the structure of social networks, social resources, beliefs and social norms, social skills and behavior, social identity and access to resources. According to Fukuyama (2001), indicators of social capital can be seen from three main dimensions, namely interpersonal trust, social norms and values and social institutions.

2.3 Innovation Capability

Innovation ability refers to the ability of a person or company to generate and implement new ideas that lead to improvement, development or creation of better products, services or business processes. Innovation ability involves the ability to think creatively, see opportunities, develop new ideas, and apply these ideas in business practices. (Saunila & Ukko, 2012). According to Wu & Sivalogathan (2013), innovation capability can be measured from three aspects, namely innovation capability, technological innovation capability, organizational innovation capability, and marketing innovation capability. Lin et al., (2010) and Toma et al., (2014) made indicators of innovation capability that have relationships with customers, namely product innovation; process innovation: marketing innovation: service innovation and administrative innovation. Jimenez and Valle (2005) created dimensions of innovation capability, namely administrative innovation, technological innovation, product innovation, process innovation. According to Bareghe, et al. (2012), there are various types of innovation and innovative activities such as product innovation, process innovation, and marketing innovation.

Based on the phenomena, theoretical studies, and empirical studies that have been described, the conceptual framework of this research is as follows:

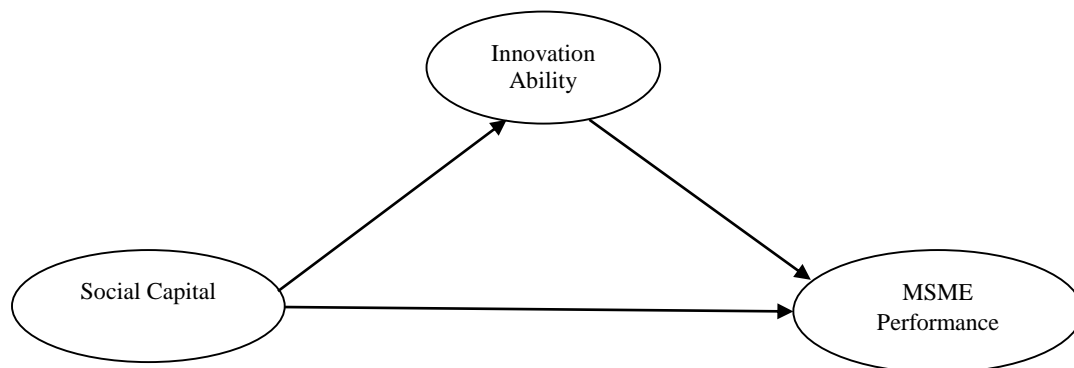


Figure 1 Conceptual Framework Model

3.0 HYPOTHESIS DEVELOPMENT

Khoirrini & Kartika (2016), Andriani (2010), Kusumastuti (2018), Yadap, et al (2018) Meflinda, et al., (2018), Kanapathipillai and Azam (2019), and Zulpicha, et al. (2019) shows that social capital affects the performance of MSMEs.

H1 Social capital has a significant effect on the performance of MSMEs.

According to Terziovski (2010), the capacity for innovation creates the possibility for the emergence of a successful invention. Social capital is crucial to the process of developing innovations (MartnezCanas, 2012; Alguezaui & Filieri, 2010; Camps & Marques, 2014). According to Brata (2011), and Camps & Marques (2014), social capital has an impact on an individual's capacity for innovation. This implies that social capital can give people access to the knowledge, skills, and technology that are essential for innovation. The study's hypotheses can be stated as follows in light of the conceptual structure and the specified variable relationships:

H2 Social capital has a significant effect on innovation ability.

The success of SMEs can be improved in part by their capacity for innovation. (Rhodes, et al. 2008). According to Lewrick et al. (2010), entrepreneurs who have operated their companies need innovation as a crucial tool for enhancing a company's performance. Innovation affects MSME success, according to Ndubisi and Iftikhar (2012), Al-Ansari et al. (2013), Hilman and Kaliappen (2015), and Ratnawati (2018). The study's hypotheses can be stated as follows in light of the conceptual structure and the specified variable relationships:

H3 The ability of innovate has a significant effect on the performance of SMEs

The intellectual capital component, according to Saunila and Ukko (2012), Rodriguez (2011), Zerenler et al. (2008), and Subramaniam and Youndt (2005), significantly affects an organization's capacity for invention. The success of SMEs can be improved in part by their capacity for innovation. (Rhodes, et al. 2008). According to Lewrick et al. (2010), entrepreneurs who have operated their companies need innovation as a crucial tool for enhancing a company's performance. Innovation affects MSME success, according to Ndubisi and Iftikhar (2012), Al-Ansari et al. (2013), Hilman and Kaliappen (2015), and Ratnawati (2018). The study's hypotheses can be stated as follows in light of the conceptual structure and the specified variable relationships:

H4 The ability to innovate mediates the effect of intellectual capital on MSME performance.

4.0 METHOD

Explanatory research is used in this study along with a quantitative methodology. The pattern of influence under test is the relationship between social capital and MSMEs' success, which is mediated by inventiveness. The owners of UMKM in Malang City make up the study's populace. The sample size is calculated by multiplying the number of indicators from the three variables by five because there are an infinite number of people in this community. According to these clauses, a sample size of 11 x 10 or 110 individuals was used. Table lists the operational definitions of the variables used in this research.

Table 1. Operational Matrix of Research Variables

Variable	Indicator	source
Social Capital	Social network structure	Kim dan Aldrich (2005), Fukuyama (2001),
	Social resources	
	Social and behavioral skills	
	Social identity	
	Social norms and values	
Innovation capability	Product innovation	Jimenez dan Valle (2005), Lin <i>et al.</i> , (2010),
	Technological innovation	
	Marketing innovation	
MSME performance	Financial performance	Hafeez <i>et al</i> (2012), Albahusain (2015),
	Product performance	
	Marketing performance	

Structural equation modeling analysis of the study's data (SEM). Meanwhile, a test will be run using the Baron and Kenney method to determine whether a variable can serve as a mediating variable. (1986). the mediation test is used to determine whether partial or full mediation of the mediating variable is occurring.

5.0 RESULTS

5.1 Inferential Statistical Analysis

5.1.1 Confirmatory Factor Analysis Results

The measurement results of the dimensions or variable indicators that can form latent variables with CFA and the determination of indicators from social capital, innovation capability and MSME performance are based on factor loading values. A summary of the results of the CFA test on the indicators that make up the variables of social capital, innovation capability and MSME performance is shown in Table 2

Table 2. Factors loading (λ) Measuring Variable Dimensions of Social Capital, Innovation Capability and MSME Performance

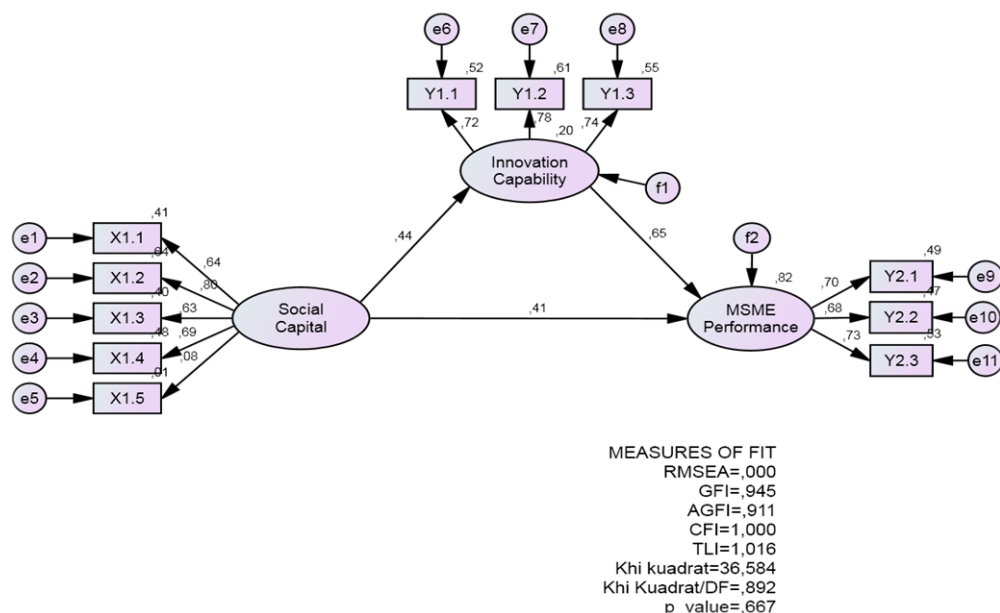
Variable and Indictor			FL	CR	p
Social Capital	->	Social network structure	0,666	5,060	0,000
Social Capital	->	Social resources	0,673	5,059	0,000

Social Capital	->	Social and behavioral skills	0,628	-	-
Social Capital	->	Social identity	0,656	5,446	0,000
Social Capital	->	Social norms and values	0,719	5,665	0,000
Innovation capability	->	Product innovation	0,733	-	-
Innovation capability	->	Technological innovation	0,760	6,260	0,000
Innovation capability	->	Marketing innovation	0,756	6,257	0,000
MSME performance	->	Financial performance	0,698	-	-
MSME performance	->	Product performance	0,684	5,179	0,000
MSME performance	->	Marketing performance	0,734	5,170	0,000

The dimensions that comprise the variables of social capital, innovation capacity, and performance of MSMEs have factor loadings (FL) values with significance levels (p) 0.05, as can be seen in Table 2. As a result, it follows that each of these factors is crucial to the formation of social capital, innovation potential, and MSME success. Social norms and values are additionally thought to play a major role in the formation of social capital when examined from the loading factor value of each indicator. The indicator that is thought to have the biggest influence on how innovative people can be is technological innovation, and the indicator that is thought to have the biggest influence on how well MSMEs perform is a marketing success.

5.2 SEM Analysis Results

The test results with Structural Equation Modeling (SEM), are presented in Figure 1 below.



The final model test results presented in Figure 1 were evaluated based on the goodness of fit indices criteria. Based on the evaluation of the proposed model, it shows that the evaluation of the model for the construct as a whole has produced a value above critical, therefore the model can be categorized as suitable and feasible to use, so that it can be interpreted for further discussion.

5.3 Hypothesis Testing Results

Testing the direct effect of social capital on the performance of SMEs is used Critical ratio (Cr) from the results of the output regression Weight. If the p value is <5%, then there is a direct effect. Meanwhile, the mediation test is based on the criteria if (a) and (b) are significant, while (c) is significant, where the coefficient value (c) is smaller (decreases) than (d)) then it can be said as partial mediation. The results of hypothesis testing are listed in Table 6 below

Table 3 Results of Regression Weight Analysis

Correlation			Path Coefficient	C.r.	p-value	evidence
Social Capital	->	Innovation Capability	0,445 ^a	3,330	0,000	Significant
Innovation Capability	->	MSME Performance	0,645 ^b	4,850	0,000	Significant
Social Capital	->	MSME Performance	0,407 ^c	3,366	0,000	Significant
Social Capital	->	MSME Performance	0,697 ^d	4,596	0,000	Significant

Note: (a), (b) and (c) are the results of the path coefficients and the overall model, (d) is the result of the path coefficient of the overall model without any mediating variables

The hypothesis that social capital directly has a substantial impact on innovation ability is acceptable because the effect of social capital on innovation ability results in a Cr value of 3.330 and a p-value of 0.000. The hypothesis that the ability of innovation directly has a substantial impact on the performance of SMEs can be accepted because the influence of the ability of innovation on the performance of SMEs produces a Cr value of 4.850 and a p-value of 0.000. The hypothesis that social capital directly influences MSME performance is supported by a Cr value of 3.366 and a p-value of 0.000 for the impact of social capital on MSMEs' performance.

Coefficient value of 0.407 (c), the results of testing the path coefficient of the social capital variable, which is controlled by the ability to innovate, show that social capital has a significant impact on MSMEs' performance. However, without the mediating effect of innovation ability, the effect of social capital on MSME performance is less pronounced. With a 0.697 coefficient value (d). Thus, it can be inferred that the performance of MSMEs can be indirectly influenced by social capital in a way that allows for partial mediation of innovation.

6.0 DISCUSSION

6.1 The influence of social capital on innovation abilities

Social capital is a very important capital for MSMEs in developing their innovation capabilities. Social capital itself refers to the network of relationships and social linkages owned by a person or an organization with other parties around them. MSMEs that have strong social capital, for example through cooperative networks with business partners, industry associations or local communities, will have better access to the resources and information needed to enhance their innovation capabilities. In addition, social capital can also help MSMEs in overcoming the obstacles they face in the innovation process. With a strong network of relationships, MSMEs can collaborate with other parties to find solutions to the problems they face, be it in terms of financing, human resources, or technology.

This conception is in accordance with the opinion of Terziovski (2010) who argues that the ability to innovate provides the potential for the emergence of an effective innovation. In the innovation development process, social capital has a very important role (MartínezCan˜as, 2012; Alguezaui & Filieri, 2010; Camps & Marques, 2014). Not only in large companies, has the influence of social capital on innovation also occurred in Micro and Small Enterprises. Brata (2011), Camps & Marques (2014) found that there is an influence of the closeness of the cooperation network with business partners and relationships with partner groups on innovation

6.2 The influence of innovation ability on the performance of SMEs

The ability to innovate is a very important factor for the performance of SMEs. This is because with good innovation capabilities, MSMEs can develop products or services that are better, more efficient, and more competitive than their competitors. MSMEs that have good innovation capabilities can adapt to environmental changes and increasingly dynamic consumer needs. This allows MSMEs to maintain and increase market share, as well as increase their competitiveness in the market. In addition, the ability to innovate can also help MSMEs in increasing efficiency and productivity. With innovation, MSMEs can develop production processes that are more efficient and reduce production costs, thereby increasing profits and financial performance.

This conception is in accordance with the opinion of Rhodes, et al. (2008) that the innovation capabilities of MSME actors can improve MSME performance. Lewrick et al. (2010) stated that entrepreneurs who have run their businesses need innovation as a very vital tool in improving the performance of a company. Ndubisi and Iftikhar, (2012), Al-Ansari, et al. (2013), Hilman and Kaliappen, (2015) and Ratnawati (2018) concluded that the ability to innovate has an influence on the performance of MSMEs.

6.3 The effect of social capital on the performance of MSMEs

Social capital is a capital that is very important for MSMEs in improving their performance. Social capital refers to the network of social relations owned by MSMEs with other parties around them, such as customers, suppliers, business partners and the local community. Strong social capital can assist MSMEs in gaining access to the resources and information needed to improve their performance, such as financing, raw materials, technology and markets. By having good relationships with other parties around them, MSMEs can build a good reputation and image in the eyes of customers, suppliers and business partners. This can help MSMEs in improving their performance, because consumers will be more inclined to buy products or services from MSMEs that have a good reputation.

By having a strong network of relationships, MSMEs can expand market reach and increase market share. This can help MSMEs in improving their performance, because the more consumers buy products or services from MSMEs, the greater the income generated and By having a strong network of relationships, MSMEs can more easily adapt to environmental changes and market needs. This can help MSMEs in improving their performance, because MSMEs can obtain the information needed to develop products or services that are more in line with market needs.

This conception is in accordance with the opinion of Kim & Aldrich (2005) describing Social Capital as a network of social relations that generate benefits for individuals or groups in obtaining resources, information, and support to achieve common goals. MSMEs that have a network of strong social relations with suppliers, customers and other business partners have easier access to the resources and information they need. Thus, social capital can increase the operational efficiency and effectiveness of SMEs, which in turn can improve business performance. Khoirini & Kartika (2016), Andriani (2010), Kusumastuti (2018), Yadap, et al (2018) Meflinda, et al., (2018), Kanapathipillai and Azam (2019), and Zulpicha, et al. (2019) shows that social capital affects the performance of SMEs

6.4 The ability of innovation to mediate the influence of social capital on the performance of MSMEs

The results of the study prove that the ability to innovate is able to mediate the influence of social capital on the performance of SMEs. This result means that the role of social capital as indicated by social norms and values such as the behavior and attitudes of MSME actors in society, as well as in managing social interaction between individuals or between groups contributes to the innovation capabilities of business actors in Malang City which is indicated by technological innovation. Such as having the ability to utilize technology in creating products with new motifs. The existence of the ability of business actors to innovate has an impact on improving the performance of SMEs as indicated by increased marketing performance such as an increase in sales growth and market share.

The results of this study corroborate the studies conducted by Brata (2011), Camps & Marques (2014) found that there is an influence of the closeness of the network of cooperation with business partners and relationships with partner groups on innovation. Ndubisi and Iftikhar, (2012), Al-Ansari, et al. (2013), Hilman and Kaliappen, (2015) and Ratnawati (2018) concluded that the ability to innovate has an influence on the performance of MSMEs.

7.0 CONCLUSION

In Malang City, social capital affects MSMEs' performance and their capacity for innovation, and innovation's capacity for performance affects MSMEs' performance and its capacity to mediate the connection between social capital and MSMEs' performance. The ability to negotiate, communicate, and handle conflict are just a few examples of the social and behavioral skills that MSME owners in Malang must develop. In the current era of globalization, every business will experience complexity, change, and an increase in business competition; therefore, MSME players must be able to adapt to environmental changes in order for researchers to conduct business environment studies and market orientation in the future to improve MSME performance.

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