



Environmental Dynamism in Increasing Innovation and Performance in Guitar MSMEs in Central Java

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ABSTRACT

The creative industry in Indonesia is one of the sectors expected to contribute to the economy, one of which is the guitar craft industry. Guitar Crafts is one of the MSMEs in Sukoharjo district with extraordinary potential because their business has reached foreign markets. This research aims to determine the influence of innovation on the performance of the Guitar MSME business and to determine the effect of innovation on performance moderated by environmental dynamics. This research was conducted in Sukoharjo Regency with a sample size of 51 guitar MSMEs. The research results show that innovation has no significant effect on the performance of Guitar MSMEs, environmental dynamics have a significant effect on performance, and environmental dynamics weaken the relationship between innovation and the performance of Guitar MSMEs in Sukoharjo Regency. Guitar MSMEs need to adapt to a rapidly changing environment so that environmental dynamics will further strengthen the innovation and performance of Guitar MSMEs in Sukoharjo district.

Keywords: *Innovation; environmental dynamics; performance; MSMEs*

1. INTRODUCTION

The economic concept in Indonesia in the current era is to invest information and creativity with the creative economy. The potential of the creative economy needs to be developed based on knowledge of human resources because the creative economy is an effort to develop the economy sustainably through renewable resources. The growth of the creative economy is beneficial for the economy in Indonesia, such as the development of innovation which can open up new types of ideas to create competitive competition between one business and another, the quality of products is getting better because products are better developed and opening up more job opportunities for the community.

Currently, there are 8.2 million creative industries in Indonesia which are dominated by culinary, fashion, and craft businesses. According to publications from the Ministry of Tourism and Creative Economy, it was recorded that in 2019 the creative economy sub-sector contributed around Rp. 1.1.53.4 Trillion GDP or 7.3% of the total National GDP, 15.2% of employment and 11.9% of exports [1] In 2023, the creative industry can be expected to have a positive impact on the Indonesian economy, but challenges and opportunities need to be considered. The growth rate in Indonesia reached almost 30% for exports of creative goods in 2012-2015. Thus, Indonesia attaches importance to the development and promotion of the creative economy in its medium and long-term development plans at the national and regional levels. However, this condition changed with the Covid 19 pandemic which had an impact on the creative industry, especially the craft industry.

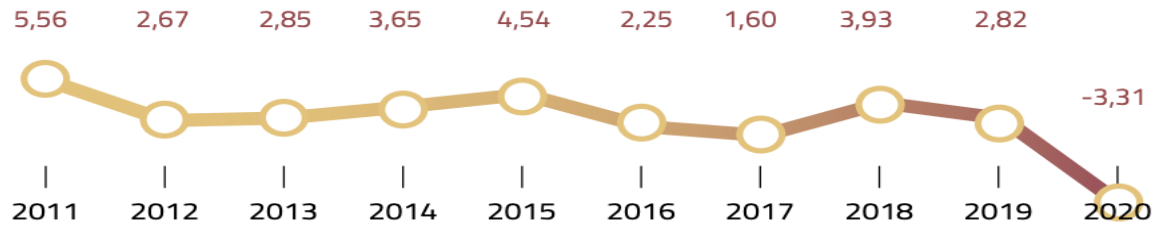


Figure 1. Craft subsectors affected by the 19 pandemic

The growth of the Crafts sub-sector during the pandemic is very worrying because it fell drastically to an index of -3.31. This negative growth occurred during COVID-19 so that it will have an overall impact on—the craft industry in almost all regions of Indonesia. In Central Java Province, the creative industry since 2017 has had 3,548 creative economy actors, 204 communities, 50 creative institutions, and 13 creative economy districts/cities. The leading sectors of the creative economy in Central Java show culinary (41.40%), fashion (18.01%), and crafts (15.40%) [3]. However, in the COVID-19 pandemic situation, the condition of the creative industry, one of which is the guitar industry in Sukoharjo, Central Java, is terrible. This craft industry was only able to produce 50% of guitars compared to the previous year, and only half of the raw materials for guitars were sent to be processed from 130 dozen to only 50 dozen per month [4]. Guitar crafts in Sukoharjo Regency, Central Java, have a Guitar Village that offers custom orders for guitars that are not sold on the market so that orders are according to consumer tastes, both design and raw materials, which in turn also allows foreign markets to order them, even foreign markets. According to craftsmen in Sukoharjo, apart from being marketed in several cities in Java and outside Java, their products penetrate world markets, such as Denmark, Germany, and Malaysia.

This research aims to determine the effect of innovation on performance with environmental dynamism moderation. Several researchers conducted research that stated that environmental dynamism plays a moderating role between dynamic capabilities and competitive advantage [5]. Other research finds that environmental dynamism is a force for driving dynamic capabilities [6]. Previous research that uses environmental dynamism as a moderating variable that strengthens the relationship between innovation and performance has yet to be found. Hence, this research aims to further explore the moderation of environmental dynamism as a factor that can strengthen or weaken innovation on performance.

Improving creative businesses, one of which is innovation, can improve the business performance of the creative industry. Empirical studies of creative industries in Austria show a relationship between technological innovation and performance, which can contribute to innovation in new products. In the creative industry, there is a primary source of innovative ideas that contribute to the potential for innovation and production of new products and services. The creative industry is also an intensive user of technology and demands adaptation to technology to encourage technological innovation[7]. Research conducted by [8] shows that innovation has no significant effect on performance. Other research finds that innovation does not directly impact company performance [9]. Research conducted by [10] on the relationship between innovation and performance shows the same thing, namely that innovation has no significant effect on business performance. Different results were shown by research [11], which found that innovation significantly affected the performance of MSMEs in Indonesia's creative industry sector.

Innovation is a new method of doing something through technological progress [12]. One of the keys to long-term success is to carry out innovation that needs to be maintained [13]. MSMEs have an essential role in every country where their development will affect a country's economy. Thus, the growth of MSMEs will be a measure of developing countries, such as innovation, which can foster creativity and a better ability to adapt to high market changes [14].

[15] defines performance as success, the result of an action, a development that goes through a process. Performance measurement systems refer to business planning and management efforts, a series of multi-dimensional performances [16]. According to [17], strategic performance measurement systems provide company information to achieve company goals, aligning management processes such as target setting, decision making, and performance evaluation with attaining strategic goals.

The trend in the current business environment is that companies survive by shortening product lifespans and business model cycles so that in the future, there will be uncertain profits, so companies need to look for new opportunities. Companies must look for new opportunities and reconstruct business models when facing tentative changes. With different skills possessed by human resources, companies can redesign business models. Environmental

dynamism, according to [18], is a change in the competitive environment that impacts how companies compete with other companies and how companies respond to this competition.

With environmental dynamism, this condition can strengthen or weaken the influence of innovation on performance. Especially for MSMEs in the creative industry sector, guitars are craft products where demand for this product is limited to customers with habits and hobbies for guitar art. In this way, this industry can respond to opportunities and challenges to gain more comprehensive customers by innovating new products, methods, and business models. As previously discussed, this research is located in Central Java, with the guitar-producing area in Sukoharjo Regency. One of the guitar producers is Ngrombo Village, Sukoharjo district. Guitars from Ngrombo village have been marketed to regions in Indonesia such as Pontianak, Makassar, East Java, DKI Jakarta, and even Malaysia. However, with the COVID-19 pandemic, this craft has stopped. Usually, 1 (one) MSME can produce 8 guitars a week, but during the pandemic, only 4. This condition should encourage MSME owners to innovate so that environmental dynamism, such as the COVID-19 pandemic, can strengthen MSME business performance.

2. Literature Review Theoretical and Conceptual Background

2.1 Innovation

Innovation is a process that transforms new ideas into knowledge of new products and services. Innovation is an activity that leads to a new production function or new product. Innovation leads to new production or new products. Innovation is about the following things [19]:

- a. Introducing new goods is introducing new products that are easy to sell and not offered on the market
- b. The introduction of a new production method, namely a new production scheme method that causes an increase in output, a decrease in the cost per unit of product, the introduction of new inputs and changes to existing ones.

According to [20] innovation is a process in which new ideas are brought to make money. This dynamic thing involves economic and social processes that require interaction with other people. Innovation represents creating new products and services, new technologies, new organizations, and improving existing products using existing technologies.

2.2 Performance

According to [21] performance is the final test of every organization. This test has an economic dimension. [22] defines organizational performance as a set of financial and non-financial indicators that offer information regarding the level of achievement of goals and results; performance is dynamic which requires assessment and interpretation; performance using causal models that describe how future developments can be influenced by current performance; performance may vary depending on the person; need to know the basic characteristics of responsibility; the ability to measure performance results is required.

2.3 Environmental Dynamism

The environment is significantly changing, and the changes are very dynamic [23]. Two views say that the external environment is a source of organizational assets. The second view describes the external environment as a source of data and information for many organizations facing uncertain environmental conditions [24]. Previous research results interpret the external environment as a variable that includes macro and micro aspects. Macro aspects of the external environment have socio-cultural and economic dimensions, government policies, advances in information technology, financial institutions, industry and labour markets. In contrast, the micro-environment relates to competitors, customers and suppliers [25].

2.4 Empirical Review and Hypothesis Development

Based on the empirical studies described previously, the hypotheses in this research are presented in Figure 2.

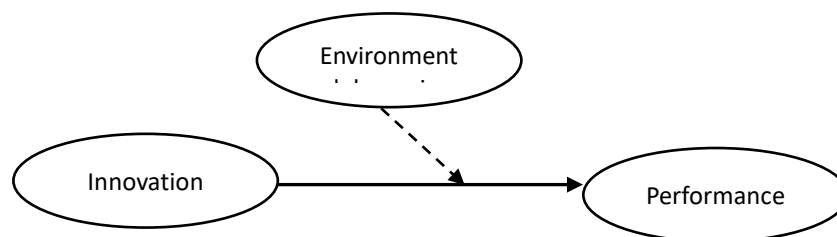


Figure 2: Theoretical Framework

3. RESEARCH METHOD

This research uses quantitative methods by surveying guitar MSMEs in Sukoharjo Regency. The reason for choosing Sukoharjo Regency is because most of the guitar craft producers are in Sukoharjo Regency, so the representation of guitar MSMEs in Central Java is represented by one of the guitar-producing areas, namely Ngrombo Guitar Village in Sukoharjo Regency. The sampling method was saturated with a population of 51 guitar MSMEs in Sukoharjo Regency. In a sampling of 51 guitar MSMEs in Sukoharjo Regency, researchers distributed questionnaires to guitar MSME owners. The research measurement scale uses Likert. Variable measurements were derived from previous research. This research uses the SmartPLS analysis tool, which applies validity and reliability tests by applying convergent validity and composite reliability to data collected from respondents. Moderation tests were also conducted to test whether the environmental dynamism variable strengthens the relationship between innovation and performance.

Table 1
Socio-demographic characteristics

<i>Description</i>	<i>Frequency</i>	
Gender	Male	100%
	Female	0
Age	23-36 year	20%
	37-50 year	56%
	>50 year	24%
Education	elementary school	22%
	Junior high school	44%
	Senior High School	30%
	Bachelor	4%
Business age	3-7 year	18%
	>7-12 year	20%
	>12 – 17 year	18%
	>17-27 year	35%
	> 27 year	8%

Based on Table 1, 100% of the respondents are female. The highest age of respondents was 37-50 years old, with a percentage of 56%, and the highest number of years of running a business was 17-27 years old, with a rate of 35%. Meanwhile, the education level of the respondents was mainly junior high school, with a percentage of 44%.

This research uses the Smart PLS analysis tool to test hypotheses. This research has 2 parts: the confirmation model part must precede the structural model analysis. Measurement analysis consists of convergent and discriminant validity. This study included factor loadings and showed above 0.70[26]. The factor loading for this research can be shown in Table 2.

Tabel 2 Factor Loading

	env	inno	perform
inno1		0,950	
inno2		0,922	
inno3		0,947	
inno4		0,938	
inno5		0,942	
Perform1			0,791
Perform2			0,867
Perform3			0,836
Perform4			0,751
Perform5			0,845
Perform6			0,74
Perform8			0,727
env1	0,820		
env2	0,907		
env3	0,826		
env4	0,776		
env5	0,744		

Note: inno = innovation, env= environmental dynamism; perform = performance

Table 3. Reliability

	Cronbach's alpha	Composite reliability	Average Variance Extracted (AVE)
Environmental dynamism	0,876	0,909	0,666
Innovation	0,969	0,974	0,883
Performance	0,904	0,923	0,633

The AVE value was above 0.5 of the three variables studied, so the variable was declared valid when used to explain the latent variable. It shows that the manifest variable meets the AVE requirements. Therefore, all manifest variables meet the convergence validity criteria. The convergent validity in Table 3 shows that it is valid because it exceeds 0.70. So, based on Table 3, this research has been tested as valid and reliable.

Table 4. Fornell and Larcker

	Environmental dynamism	Innovation	Performance
Environmental dynamism	0,816		
Innovation	0,226	0,940	
Performance	0,481	-0,088	0,795

Table 4 uses the Fornell and Larcker method to determine discriminant validity.) [27] [17] evaluates the matrix and cross-loading in this method, which displays cross-loading with constructs and compares AVE with correlation between latent variables. Suppose each construct's AVE square root value is greater than the correlation value between

the construct and other constructs in the model. In that case, the model is said to have good discriminant validity values. [27]

Tabel 5. Cross Loading

	Env	ino	perform
Inno1	0,198	0,950	-0,121
Inno2	0,177	0,922	-0,071
Inno3	0,207	0,947	-0,060
Inno4	0,286	0,938	-0,034
Inno5	0,245	0,942	-0,071
K1	0,436	-0,157	0,791
K2	0,467	-0,137	0,867
K3	0,412	-0,086	0,836
K4	0,219	-0,027	0,751
K5	0,328	0,006	0,845
K6	0,362	-0,054	0,740
K8	0,345	0,006	0,727
Env1	0,820	0,047	0,429
Env2	0,907	0,168	0,513
Env3	0,826	0,161	0,324
Env4	0,776	0,357	0,337
Env5	0,744	0,255	0,299

Note: inno = innovation, env= environmental dynamism; perform = performance

Because the cross-loading correlation for each latent construct factor for the corresponding indicator is more significant than for other latent constructs, Table 4 shows that all indicators used to assess the latent variable meet the requirements.

3.1. FINDINGS AND DISCUSSIONS

FINDINGS

The first hypothesis of this research is that there is an influence between environmental dynamism on performance, the second hypothesis is that there is an influence between innovation on performance and the third hypothesis is that there is an influence between innovation on performance which is moderated by environmental dynamism. The results of hypothesis testing are presented in Table 5.

Table 5: Direct Results

		beta	SD	t value	P value
H1	Env \square perform	0,549	0,104	5,296	0,000
H2	Ino \square perform	-0,202	0,183	1,106	0,269
H3	Env x inno \square perform	-0,071	0,127	0,558	0,577

Note: inno = innovation, env= environmental dynamism; perform = performance

Then, the structural model is evaluated, which is measured to compare the influence of one latent variable on other latent variables. Testing is done by knowing the t value to determine whether the effect is significant. The following are the results of testing the structural model in Figure 2.

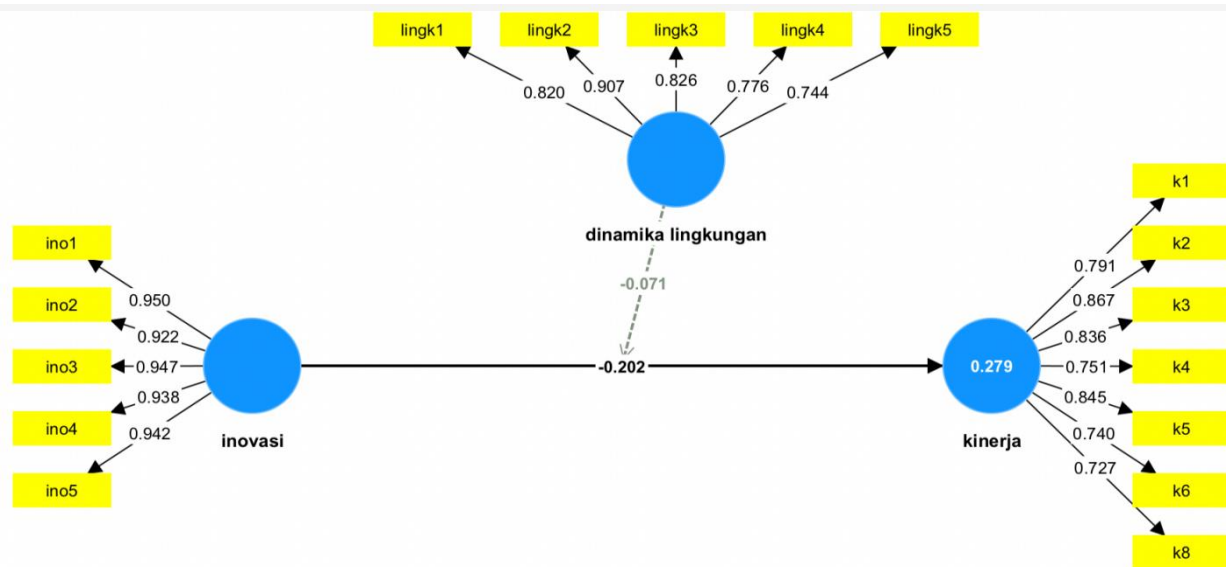


Figure 2. Final Structured Model

Based on Table 5, the test results show that H1 in this study is accepted because p -value = 0.000 indicates that environmental dynamics have a positive and significant effect on performance. Other results show that H2 in this study is rejected because p -value = 0.269 indicates that innovation has no significant effect on performance. The third hypothesis shows a p -value of 0.577. Thus, H3 shows that environmental dynamism weakens the relationship between innovation and performance.

Based on the results in table 5 it can be explained as follows:

3.2. The Influence of Environmental Dynamism on Performance

The test results show a significant influence between environmental dynamics on the performance of Guitar MSMEs in Central Java. Thus, the environmental dynamics faced by Guitar MSMEs will improve the performance of Guitar MSMEs themselves because, with a dynamic environment, MSMEs adapt, which will ultimately improve their business performance. The guitar UMKM in Ngrombo, Sukoharjo district, is very responsive to market demand because the demand for guitars in specific orders aligns with consumer expectations. If demand changes, it will still affect performance because most guitar MSMEs produce according to consumer orders.

3.3 The Influence of Innovation on Performance

The test results show that there is an insignificant influence between innovation on the performance of Guitar MSMEs in Central Java. Thus, if the Guitar UMKM produces innovation, it will not improve the performance of the Guitar UMKM itself because with innovation in the Ngrombo Sukoharjo UMKM, more orders are met, so the level of innovation is less.

3.4 The Influence of Innovation on Performance with the Environmental Dynamism Variable as a Moderator

The test results show an insignificant influence between innovation on performance and moderating the environmental dynamism of Guitar MSMEs in Central Java. It means that environmental dynamism weakens the relationship between innovation and the performance of MSMEs in Gitar Ngrombo Sukoharjo. Environmental dynamism is not a factor in strengthening the relationship between innovation and performance, UMKM Gitar Ngrombo Sukoharjo, but other factors can enhance the relationship between innovation and performance.

4. Discussion and Conclusion

The structural model in this research was developed based on theoretical studies and empirical studies and phenomena in the performance of guitar MSMEs during the Covid-19 pandemic. The sample was selected based on the characteristics of the most considerable turnover among guitar-producing areas in Sukoharjo. This research has 3 (three) hypotheses: The first hypothesis is that there is an influence between environmental dynamism on the performance of Guitar MSMEs; the second hypothesis is that there is an influence between innovation on the

performance of Guitar MSMEs; the third hypothesis: there is a moderating influence of environmental dynamism on the relationship between innovation and the performance of Guitar MSMEs in Sukoharjo.

The first hypothesis, which states that environmental dynamism influences the performance of Guitar MSMEs in Sukoharjo district, resulted in the finding that this hypothesis was accepted with p-value results that met the testing criteria. Based on this, this research supports research conducted by [29] that shows that environmental dynamics can improve company performance. Based on the results of this research, the performance of guitar MSMEs is influenced by environmental dynamism, considering that during the COVID-19 pandemic, production output was minimal, even less than usual. Owners cannot strategize against this dynamic environmental change. Then, the owner produces guitar crafts only to orders, so if no orders come, the craftsmen will have no output.

The second hypothesis states that innovation has an insignificant effect on performance. The results of this study do not support the research conducted by [11]. However, this research supports research from [9] and [30] which found that innovation had no significant effect on performance. Innovation in guitar MSMEs is carrying out production using product customization that is made specifically to meet customer needs. In creating products, these MSMEs adapt to customer orders, but not all use customer ideas. The guitar design has several items that also have a touch of innovation from craftsmen. Thus, guitar product innovation in MSMEs has no significant effect on performance.

The third hypothesis states that environmental dynamism affects moderating the relationship between innovation and performance. The research results show that environmental dynamism weakens the relationship between innovation and performance in guitar MSMEs. In this guitar MSME, the changing environment does not strengthen innovation on performance due to other factors. Because products are produced based on orders, innovation is very limited so environmental change factors are no longer a factor that can strengthen the innovation strategy for Guitar MSMEs. Guitar is a craft that can be designed according to customer needs and desires so that if there is a change in the customer's wishes, the product will continue to follow so that the dynamic environment in the context of guitar craft does not affect innovation and performance.

This research has limitations regarding the sample because the research was conducted on guitar MSMEs in Central Java and because the guitar-producing areas are mostly in the Sukoharjo Regency area. In contrast, in Sukoharjo Regency, there are several guitar crafting villages, but the researcher chose Ngrombo Sukoharjo Village as the sample because it has the highest turnover among other villages. The limitation of this research is the limited number of samples, so the representation of the research population is still lacking.

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