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The Effect of Market Capability, Co-creation and Innovation on Marketing Performance: Batik Sragen Small and Medium Enterprises (SMEs), Central Java, Indonesia

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Abstract

This research is done in Batik SMEs in Sragen. The aims of this research are (1) to test the influence of market capabilities on innovation; (2) to test the influence of innovation on marketing performance; (3) to test the influence of market capabilities on marketing performance; (4) to test the influence of co-creation on innovation; and (5) to test the influence of co-creation on marketing performance. The sample of this research is 120 Batik SMEs in Sragen. The population of this research is 120 batik craftsmen in Sragen. Sampling technique used in this research is purposive sampling. Data is analyzed by using SEM-PLS and cultivated by WarpPLs. Research findings show that (1) market capabilities significantly improve innovation; (2) innovation significantly improve marketing performance; (3) market capabilities significantly improve marketing performance; (4) co-creation significantly improve innovation; and (5) co-creation significantly improve marketing performance.

Keywords: Co-creation; Innovation; Market Capability; Marketing Performance

1. Introduction

ASEAN Economic Community era has been starting in 2015. Indonesia has various creative industries which have potential to be developed, including tourism, animation, furniture, crafts such as tenun (traditional cloth) and batik. One of the industries which is developed in Sragen is batik crafts. However, the small and middle enterprises existing in Sragen has not been well-developed, although improved. This indicates that batik craftsmen have not been able to develop innovation, design, motif and pattern to satisfy the need of the consumers. Therefore, it is necessary to develop the concept of co-creation between small and middle enterprises with the customers by providing the value demanded by the customers.

The aims of this research are (1) to test the influence of market capabilities on innovation; (2) to test the influence of innovation on marketing performance; (3) to test the influence of market capabilities on marketing performance; (4) to test the influence of co-creation on innovation; and (5) to test the influence of co-creation on marketing performance.

2. Literature Review

2.1. Market Capabilities

Resources Based View (RBV) notices a difference between capabilities and resources (Teece, Pisano, & Shuen, 1997). Capabilities is usually defined as a set of skill and collective learning carried out through organizational processes ensuring a good coordination of each company's functional activity (Day, 1994). Capabilities is a specific type of resources (Fang, Chang, Ou, & Chou, 2014) which needs to be developed to build a competitive company (Prahalad & Hamel, 1990; Vorhies, Harker, & Rao, 1999). The developed capabilities should be difficult to be imitated and supporting business strategy (Barney, 1991; Day, 1994; Day & Wensley, 1988)

Market capabilities is marked as capabilities focusing on how to make company's product and service be successful in the markets (Liu, Hou, Yang, & Ding, 2011). Market capabilities can be seen from market sensing capabilities, ability to communicate with customers, and ability to tie marketing channel (Day, 1994). Liu et al. (2011) explained that market capabilities can be elaborated as price ability, product development and management ability, marketing channel development ability, promotion management ability. Other experts also state that there are several indicators of market capabilities, they are, environmental understanding, innovation creation, uniqueness function, and market capabilities (Barney, 1991; Narver & Slater, 1990).

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2.2. Innovation

Innovation is a key of success in entrepreneurial process (Schaper & Volery, 2003). Numerous experts define innovation. Basically, innovation focuses on novelty or newness (Janssen, Stoopendaal, & Putters, 2015). Porter (1990) defines innovation as attempts to create competitive advantages by observing or finding new and better ways to compete in an industry. Boer and During (2001) view innovation as a creation of product, market, technology, new organization and its combination. West (1990) views innovation from psychological side by defining it as ideas, process, new product or procedures in a unit.

Innovation is divided into product and process innovation, administrative and technical innovation, radical and incremental innovation (Damanpour, 1991). First, product and process innovation. There is differentiation in the two types of innovation (Utterback & Abernathy, 1975). Through product innovation, company can get competitive advantages by differentiating output and quality improvement, and various goods enabling an increase in demand and opening development opportunity. Product innovation emphasizing on market especially customers. It is driven by consumers' need and current trend, while process innovation is driven by efficiency. Innovation process enabling companies to increase product quality or production efficiency. Second, Administrative and technical innovation. Technical innovation is related to product, service and production process technology; and also related to basic working activity. It is related to basic working activity and craftsmen pay attention to the product as well as the process. Meanwhile, administrative innovation involves organizational structure and administration process. It is not directly related to basic working activity of an organization and more directly related to management. Third, Radical and incremental innovation. Radical innovation tends to do innovation in a big scale, while incremental innovation innovate in a small scale.

2.3. Co Creation

Technological changing, competition and customer demand fundamentally change business operation. Traditionally, business operation is centered on the companies (Pralhad & Ramaswamy, 2004b). The strategy of traditional value creation lost its utility in economic development (Lehrer, Ordanini, DeFillippi, & Miozzo, 2012). Companies shifted their focus from internal efficiency improvement to external one, especially customers, to achieve a new competitive advantage in a new economy (Pralhad & Ramaswamy, 2004b; Zhang & Chen, 2008). In this era, consumers have shifted from focusing on companies to focusing on consumers' experience, for instance doing collaborative creation to create value (Pralhad & Ramaswamy, 2002).

Pralhad and Ramaswamy (2004a) defines co-creation as creating value together between businesses and consumers, including defining problems and solve them together. Fuller (2010) defines co-creation as consumer participation in product development. In co-creation, the consumer has an important role in the success of new product creation. The focus of co-creation is the maximum involvement of consumers in creating and developing products.

2.4. Marketing Performance

Performance measurement has become a major concern in marketing and remains an important issue in many companies (da Gama, 2011). More, da Gama (2011) explains that the performance must be measurable, dynamic, relative and multidimensional. First, the performance should be measurable because performance measurement is not an abstract measurement. If the performance can not be measured, the company will not know if the company has successfully hit the target or not. Second, Dynamic. Performance should be dynamic meaning that the choice of measurement indicator is not a static but a dynamic one. Third, relative. The company's relative performance is defined as a context involving a comparison of performance - no manifestation performance is intrinsically good or bad; it will always require some comparative terms to qualify it, in time, in space, or planned on the results. Fourth, Multidimensional. Performance can be evaluated in various ways, or in other words, there is no such thing as a unique measure of performance

da Gama (2011) argued that the word "marketing" in marketing performance is considered as a management philosophy that seeks to reveal why and how a company must adapt to and influence the market and on the other hand, embody company subsystems, often with the name of the department, which develop a set of tasks on the implementation of marketing. In the theory of competition, performance marketing is considered as the process (Hunt, 1995; Hunt and Morgan, 1996) which are arranged in three levels, namely: identifying the resources provided by the company, evaluating the superior position, and knowing financial (sales, earnings, and cash flow) and non-financial (market share, customer satisfaction, loyalty, brand) outcome.

Gronholdt and Martensen (2006) explains that marketing performance are divided into four dimensions namely mental consumer result, market result, behavioural customer result, and financial result. The following Table 1 describes the dimensions of marketing performance.

Table 1. Dimension and Indicator of Marketing Performance

| Mental Consumer Results | Market Results | Behavioural Customer Result | Financial Result |
|---|--|---|--|
| <ul style="list-style-type: none"> • Brand awareness • Reliance to Customer • Perceived differentiation • Perceived quality • Image • Preference • Customer satisfaction • Customer Loyalty | <ul style="list-style-type: none"> • Sales (volume and value) • Sales to new customers • Sales trends • Market share (volumen and value) • Market trend • Number of customers • Number of new customers • Number of new prospects • (leads generated/inquiries) • Conversion (leads to sales) • Penetration • Distribution/availability • Price • Relative price (SOM value/volume) • Price premium • Price elasticity | <ul style="list-style-type: none"> • Customer Loyalty • Churn Rate • Number of customer complaint • Share of Wallet | <ul style="list-style-type: none"> • Profit/profitability • Gross margin • Customer profitability • Customer gross margin • Cash flow • Shareholder value/EVA/ROI • Customer lifetime value |

Source: Gronholdt and Martensen (2006)

3. Hypothesis

3.1. Market Capabilities, Innovation and Marketing Performance

Companies with high market ability can predict trends, thus, making their innovation more consistent with market needs and trends, and thus, the company's innovation is more likely to be fit for the customer's needs (Liu et al., 2011). Companies with a high market capability are capable of bringing the design of innovative and proactive product to a market-successful product (Liu et al., 2011). In particular, because market skills knowledge reduces the level mismatch between new product and customer requirements, market capabilities increases the likelihood of the successful innovation in the market (Cooper & Kleinschmidt, 1997)

Corporate leaders tend to develop a strong market capabilities and try to take action more quickly to respond to movements of competitors in the fierce market competition (Boisot & Child, 1996). Srivastava, Fahey, and Christensen (2001) show that companies with superior market-based capabilities can get a turnover faster and more efficient and more capable of changing a risky venture into a profitable business.

Innovation becomes an important part in increasing market share, survival (Banbury & Mitchell, 1995), increasing value, competitive advantage of companies, (Subramaniam, 2005), obtaining better outcomes, and controlling market position (Vazquez, Santos-Vijande, & Alvarez -Gonzalez, 2001) in an environment that is complex and rapidly changing. Several other experts explain the direct impact of innovation on performance (Avlonitis & Salavou 2007; Eris, Neczan, and Ozmen, 2012; Han, Kim, & Srivastava, 1998; Olavarrieta & Friedmann, 2008). Companies that are able to offer innovative products, the new products with new features, new design and new functions, will be able to stand out in the industry (Khin, Ahmad, and Ramayah, 2010). The higher the speed the rate of innovation is done by a company (Kessler and Chakrabarti, 1996) the faster consumers will receive the new products. Consumers have a tendency to look forward to new products that will be launched by the company. The faster the innovation goes into the market, the higher company's marketing performance (ZW Wang & Wang, 2012).

From some explanations above, the hypothesis of this study is:

H1: Market Capabilities give positive and significant impact on innovation

H2: Innovation gives positive and significant impact on marketing performance

H3: Market Capabilities give positive and significant impact on marketing performance

3.2. Co-Creation, Innovation and Marketing Performance

Chen, Tsou, and Ching (2011) conducted a study on 157 IT companies in Taiwan. One of the results of this research is to conduct joint operations between companies and consumers to develop something new or complex innovation. Santamaria, Nieto, and Miles (2012) say that the cooperation or consultation with a variety of external participants

positive influence on the innovation performance of a company. Cooperation among partners to conduct joint production can create.

Sharing knowledge is the dimension of the joint creation (Liao & Kuo, 2014). A study conducted by Y. Wang and Wu (2013) views the joint creation between enterprises with suppliers and companies with consumers. Results of the study explained that sharing the experience gives positive and significant effect on performance. Sharing knowledge is the dimension of the joint creation (Liao & Kuo, 2014). Grissemann and Stokburger-Sauer (2012) explains that the level of co-creation will give positive and significant impact on the dimension of marketing performance (satisfaction, loyalty, and customer service costs).

From the above explanation, hypotheses of this research are:

H4: Co-Creation give positive and significant impact on innovation

H5: Co-Creation give positive and significant impact on marketing performance

4. Research Method

4.1. Population and Sample

The population in this study is the entire craftsman or owner of Batik Small and Medium Enterprises (SMEs) in the region of Sragen. This research is conducted using purposive sampling technique with criteria: 1) Respondents have minimum experience of becoming owners or craftsmen for 2 years, 2) SME owners are domiciled in Sragen 3) The SMEs owners / craftsmen are willing to be interviewed. The total sample of 120 people is the owner of batik SMEs selected by accidental sampling. The scale of measurement used a Likert scale with 5 scale statements: 1) Strongly Agree 2) Agree, 3) Neutral, 4) Disagree and 5) Strongly Disagree and analysis techniques with SEM-Partial Least Square (PLS).

4.2. Operational Definition

In this study, there were 4 constructs studied, namely market capability, co-creation, innovation, and marketing performance. Market capability is defined as the ability of firms to face the environment, including understanding the environment, creation of innovation, functionality and capability. There are 3 indicators of market capabilities, they are, understanding the environment (KPS1), function (KPS2) and capability (KPS3). Co-creation is defined as jointly create value for the product. Indicators of co-creation is dialogue (CO1) and shared access (Co2). Innovation is defined as the newness in a product, process, or idea (IN3). Indicators of innovation is the newness of the product (in1), process (IN2), and ideas (IN3). Marketing performance is the performance achieved by the company with the measurement of sales growth, the number of subscribers, market share and profits increase. There are 4 indicators of marketing performance, they are, growth in sales (KP1), the number of subscribers (KP2), markets share (KP3), profits increase (KP4). All indicators of each construct in this study were measured by a Likert scale (5 scale).

4.3. Analysis

The result of descriptive analysis based on the identity of the respondents indicated that of the 120 respondents 80 respondents were male and 40 respondents were women, the education level of respondents is as many as 46 respondents are high school, 36 respondents are elementary school, 15 respondents are junior high school, 11 respondents are bachelor and 12 respondents are Diploma. In terms of marriage status, 120 respondents are married. In terms of the age, of the respondents were 45 people aged between 30 years to 40 years, as many as 36 people aged between 40 years to 50 years and as many as 39 people aged between 50 years to 60 years. In terms of bussines period, as many as 99 people has run the bussines more than five years, 13 people have run the bussines for 4 to 5 years and the remaining 8 people have run the bussines between 2 to 3 years. The majority of respondents are entrepreneurs (as many as 112 people), as many as 6 people are farmer and 2 people are civil servant. Based on the income per month, as many as 90 people have income of more than Rp. 7 million, as many as 22 people have income between Rp 4 million to 6 million and as many as 8 respondents have income between 1 million to 3 million.

Data processing technique used in this research is SEM-PLS in which WarpPLS version 5.0 is used as tools to process the data.

5. Analysis

5.1. Validity and Reliability

Validity and reliability testings are used to test whether research instrument is valid and reliable. Table 2 and Table 3 show the result of reliability and validity testings.

Table 2. Convergent Reliability and Validity Testings (Loading factor and AVE)

| VARIABLE | INDICATOR | LOADING FACTOR | COMPOSITE RELIABILITY | CRONBACH ALPHA | AVE |
|--------------------------------------|-----------|----------------|-----------------------|----------------|-------|
| Market Capabilities | KPS1 | 0,809 | 0,853 | 0,74 | 0,661 |
| | KPS2 | 0,735 | | | |
| | KPS3 | 0,888 | | | |
| Co-Creation | CO1 | 0,914 | 0,91 | 0,803 | 0,835 |
| | CO2 | 0,914 | | | |
| Innovation | IN1 | 0,726 | 0,914 | 0,853 | 0,782 |
| | IN2 | 0,946 | | | |
| | IN3 | 0,961 | | | |
| Marketing Performance | KP1 | 0,853 | 0,858 | 0,779 | 0,604 |
| | KP2 | 0,79 | | | |
| | KP3 | 0,726 | | | |
| | KP4 | 0,732 | | | |
| Validity and Reliability Requirement | | > 0,70 | > 0,70 | > 0,60 | > 0,5 |

Table 3. Discriminant Validity Testing

| | Innovation | Market Capabilities | Co-Creation | Marketing Performance |
|-----------------------|------------|---------------------|-------------|-----------------------|
| Innovation | (0.884) | 0.507 | 0.471 | 0.473 |
| Market Capabilities | 0.507 | (0.813) | 0.682 | 0.625 |
| Co-Creation | 0.471 | 0.682 | (0.914) | 0.610 |
| Marketing Performance | 0.473 | 0.625 | 0.610 | (0.777) |

5.1.1. Reliability Testing

Reliability test in this study uses the composite reliability and Cronbach alpha. Instrument is said to be reliable if the value of composite reliability is > 0.7 and its value of Cronbach alpha is above 0.60. In this study, both the value of composite reliability (market capabilities = 0.853; Co-Creation = 0.910; Innovation = 0.914; and Marketing Performance = 0.858) and Cronbach alpha (market capabilities = 0.740; Co-Creation = 0.803; Innovation = 0.853; and performance Marketing = 0.779) are above the required value. The conclusion drawn is that the research instruments developed are reliable.

5.1.2. Validity Testing

Validity testing in this study looked at three measurements, they are, loading factors, Average Variance Extracted (AVE), and discriminant validity. Loading factors shows that the indicators of the constructs are declared to be valid if the value is above 0.5. From Table 2, all grades of loading factor of each indicator have been above 0.5, so all indicators are declared as valid. AVE is a summary of convergent indicator. Construct is declared as valid if the value of AVE is more than 0.5. From Table 2, it can be concluded that all the constructs are declared as valid. Discriminant validity is compared whether the square root of the AVE is greater than the correlation between constructs. Based on Table 3, it can be concluded that each construct is valid because the square root of the AVE is greater than the correlation between constructs.

5.2. Fit Model

There are 3 criteria of fit indices model, that is, Average Path Coefficient (APC), Average R-Square (ARS), and Average Variant Inflation Factor (AVIF). The model is said to be fit if the significance of APC and ARS is less than 0,05, while the ideal AVIF value is below 3,3. From table 4, it can be concluded that all indicators of fit model are met, that the model is fit with the data.

Table 4. Fit Model Output

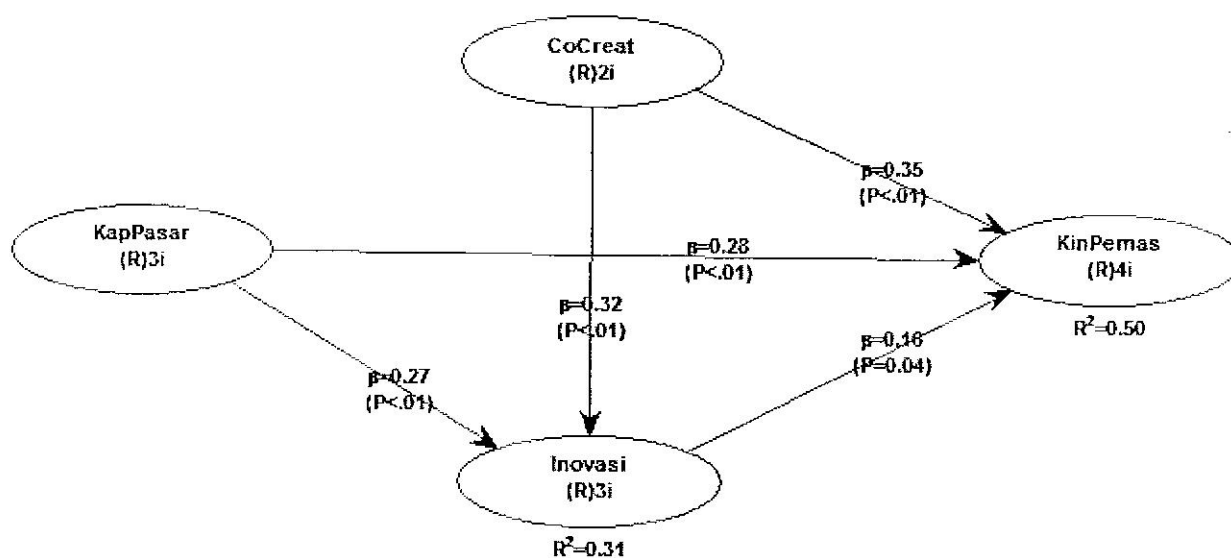
| | value | p value | Standard |
|---|-------|---------|----------|
| Average Path Coefficient (APC) | 0,276 | <0,001 | <0,05 |
| Average R-Square (ARS) | 0,405 | <0,001 | <0,05 |
| Average Variant Inflation Factor (AVIF) | 2,562 | - | < 3,3 |

5.3. Hypothesis

Table 5 and Picture 1 show the result of hypothesis testing in this research.

Table 5. Hypothesis Testing Output

| | Coefficient | Significance | Result |
|---|-------------|--------------|----------|
| H1: Market Capabilities → Innovation | 0,272 | <0,001 | Accepted |
| H2: Innovation → Marketing Performance | 0,157 | <0,038 | Accepted |
| H3: Market Capabilities → Marketing Performance | 0,282 | <0,001 | Accepted |
| H4: Co-Creation → Innovation | 0,316 | <0,001 | Accepted |
| H3 : Co-Creation → Marketing Performance | 0,354 | <0,001 | Accepted |



Picture 1. Path Diagram Output

Hypothesis 1 in this study is market capabilities have a positive and significant impact on innovation. These results indicate that market capabilities significantly improve innovation (0.272; $p < 0.001$). Therefore, Hypothesis 1 is accepted. Results of this study are in accordance with the results of previous studies (Liu et al., 2011).

Hypothesis 2 in this study is innovation has a positive and significant impact on marketing performance. These results indicate that innovation significantly improves marketing performance (0.157; $p < 0.038$). Therefore, Hypothesis 2 is accepted. These results support findings from previous research, which explains that innovation has a positive and significant impact on marketing performance (Avlonitis & Salavou 2007; Eris et al., 2012; Han et al., 1998; Matear, Gray, & Garrett, 2004).

Hypothesis 3 in this research is market capability has positive and significant impact on marketing performance. These results indicate that market capabilities is able to improve marketing performance significantly (0,282; $p < 0.001$). Therefore, Hypothesis 3 is accepted.

Hypothesis 4 in this study is Co-Creation has a positive and significant impact on innovation. The results showed that co-creation can significantly increase innovation (0.316; $p < 0.001$). Therefore, Hypothesis 4 is accepted. These results are similar to previous studies (Chen et al., 2011)

Hypothesis 5 in this study is Co-Creation has a positive and significant impact on marketing performance. The results showed that co-creation can improve marketing performance significantly (0.354; $p < 0.001$). Therefore, Hypothesis 5 is accepted.

6. Conclusion

The whole hypotheses in this study are accepted. The results showed that (1) market capabilities significantly improve innovation; (2) innovation significantly improve marketing performance; (3) market capabilities significantly improve marketing performance; (4) co-creation significantly improve innovation; and (5) co-creation significantly improve marketing performance.

Based on the results of this research, there are several managerial implications. (1) companies must be able to collaborate with consumers or other stakeholders. The collaboration will be able to create new value that will increase both the speed and quality of innovation. The results of this research indicate that the effect of co-creation on marketing performance is the highest. Therefore, increasing collaboration both with consumers and other stakeholders certainly will increase marketing performance. (2) companies should focus on a more specific market capabilities that can not be imitated by other companies. The capabilities should be more focused on improving the speed and quality of innovation and company marketing performance.

Limitation of this study is the limited research areas so the results of this study may not be generalized. Suggestions for future research: (1) expanding the area, (2) focusing on exploring the dimensions of market capabilities. By focusing on the dimensions of market capability, the researchers will understand the dimensions of which are able to significantly increase either innovation or marketing performance.

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