

DOES Institutional Intervention play a role in small business clustering

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Does Institutional Intervention play a Role in Small Business Clustering? An Empirical Evidence from Semarang, Indonesia

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Abstract

This study examines the effect of relational capability on competitive advantage to support innovation and value co-creation capacity. Five hypotheses were tested by structural equation modeling. The population of this study included 332 small and medium-sized enterprises (SMEs) entrepreneurs united in the Forum for Economic Development and Employment Promotion in Semarang categorized into a milkfish cluster, batik cluster, food processing cluster, and handicrafts cluster. A total of 188 SMEs were selected as the sample through random sampling stratification. The data was tested using AMOS software version 22. The results show that relational capability has a significant effect on innovation capability, value co-creation capacity, and competitive advantage. Furthermore, value co-creation capacity and innovation capability have a positive effect on competitive advantage. In this regard, relational capability and value co-creation capacity allow SMEs to increase their ability to adapt to environmental changes and to create new capability. The conclusion of this study is that SMEs must have capabilities to develop potential, expanding and enriching business networks and make-business development strategies in order to achieve sustained competitive advantage.

Keywords: relational capability, value co-creation, innovation capability, competitive advantage.

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1. Introduction

Since the last decade, there has been a change in how businesses operation, largely due to the globalization, which often leads to stiff competition. Companies then cooperate with various parties to survive in the market to face competition (Koufteros et al. 2012; Ireland et al. 2011). In addition, companies collaborating with entrepreneurs can often achieve greater efficiency and effectiveness (Lee & Trim 2006). A company's ability to build business relationships often determines the ultimate success of the business (Ellram 1990; Kannan & Tan 2002). Fill (2009) notes how interaction and dialogue are able to foster a continuing relationship with customers as part of a strategic relationship. Peppers and Rogers (2002) argue that cooperation networking causes interactivity to occur.

In heightened business competition, companies must be able to develop and create new values and innovation to be able to exist. Some ways can be done, among others, by creating new values through improvements in business processes. The value creation competence, henceforth, is considered valuable as the addition of new values to the individual or group activities to produce products and services that are faster, more precise, more efficient, of better quality, more responsive, and more flexible. Moreover, past experience with business partners greatly influences relational capabilities (Ellram 1990; Koufteros et al., 2012). Companies that are able to build open and honest communication generate trust in the business (Yen et al., 2011). The company is also committed to solve business problems with good business networks, thereby fostering confidence that the

company seeks to protect common interests. This commitment enhances partners' beliefs that the company has a long-term cooperation orientation that is not based solely on profitability but maintains a sustainable business relationship (Koza and Dant 2007).

Croom and Watt (2000) introduce the role of relational capability in improving the operation of small and medium-sized enterprises (SMEs) developing relational capability based on the concept of trust. The concept consists of competence, contractual relationships, and goodwill trust, referring to closeness and commitment in relationships with partners. This capability refers to the ability of company in building relationships with customers and clients. This is consistent with the statement of Peterson (2009) that service providers should be the key maker of a positive relationship with customers. Lorenzoni and Lippardini (1999) _ENREF_24 find empirical, significant evidence based on relational capability with a competitive advantage. However, Welbourne and Pardo-del-Val (2009) find no effect of relational capability on continuing competitive advantage. Similarly, Raza (2013) finds an insignificant relationship between relational resources in terms of the relationship between strategic alliances with competitors and the government and the company's ability in achieving a competitive advantage. Hill and Jones (2001) argue that competence at the functional level can be a source of competitive advantage through four factors, namely efficiency, quality, innovation, and responsiveness to customers.

Conceptually, this study is mainly based on the opinions of Ha et al. (2011), Kannan and Tan (2006), and Prior (2012), who highlight that the quality of the synergy of a network encourages

collaborating parties to gain mutual benefit. Hence, the government can play a role by establishing collaborative partnerships between producers, as well as in bridging the producers-customers relationship based on mutual needs and benefits to increase collective sales. Governments can also help in the addition of sales product variation and the degree of involvement in joint promotional activities. This study examines the relational capability as a single model unit with the variables of innovation capability and value co-creation capacity mediating the relationship between relational capability and competitive advantage. This study was conducted in Semarang City, that has an applied collective forum for SME owners united in the Forum for Economic Development and Employment Promotion (FEDEP), in parallel to a constellation of regional arrangements of SME competitiveness. FEDEP is a business association established by the Semarang City Government whose aims are to increase the benefits of the external economy and collective efficiency, and lead to an increase in productivity and employment. Accordingly, this study examines whether SMEs institutionalization by establishing collective- and governmental-supported relationships among other SMEs is able to promote innovation capability and competitive advantage. The originality of the study explores the important role played by governments as regulators and managers of trade governance in the region, especially the role in coordinating, facilitating and synergizing local SMEs to jointly advance and develop their businesses.

2. Literature Review

2.1. Resource-Based View (RBV)

The resource-based view (RBV) theory explains that a company is established from various resources and organizational capabilities (Das & Teng 2001). This theory focuses on making an organization continue to develop and accumulate a combination of valuable, rare, difficult to imitate, non-substitutable resources and capabilities – commonly known referred to as the valuable, rare, imitable, and not substitutable (VRIN) concept or valuable, rare, imperfectly imitable, organization (VRIO) (Barney & Clark 2007). In addition, Helfat and Peteraf (2003) introduce the theory of dynamic capabilities as an extension of RBV combining the processual dimension and the knowledge of the establishment of company quality every now and then. Dynamic capabilities relates to strategic insights allowing companies to understand the intrinsic values of new competing strategies.

2.2. Relational Capability

Capability refers to a set of integrated resources utilized to carry out important activities (Hitt et al., 2011). The capability becomes the employees' skills and knowledge base. Therefore, companies must continuously develop core competencies, prepare transformations, and develop other new resources to maintain competitive. In the relational management literature, several terms are introduced indicating a company's ability to develop and to manage its business operations. The term *relational capability* is introduced by Dyer et al. (2001), Lorenzoni and Lipparini (1999), Ling-Yee and Ogunmokun (2001), *relational capacity* is presented by Croom and Watt (2000), the *networking competency* is proposed by Ritter and Gemünden (2003), while *networking capabilities* is first introduced by Jarillo (1989) and later by Walter et al. (2006).

Croom and Watt (2000) state that relational capability is the ability in the process of communication, interaction, problem solving, and the emphasis on the ability to utilize external resources through relationships and to maintain social relationships as organizational networking skills. Walter et al. (2006) describe company networking skills as an ability to initiate, maintain, and utilize relationships with various external partners. In summary,

relational capability refers to the ability to utilize external resources through relationships and to maintain social relationships.

Ling-Yee and Ogunmokun (2001) note that the nature of the exporter environment run by export companies does not rely solely on the competitive advantage of its internal resource factors such as the RBV, but also depends on external resource factors contained in their network. Thus, increasing the capability of inter-company relationships becomes an important determinant for companies to achieve a competitive advantage. Moreover, inter-firm relational capabilities has important contributions to cost-based and deferential-based competitive advantages.

2.3. Innovation Capability

According to Lawson and Benn (2001), innovation capability refers to the ability of a company to develop new ideas into an innovation. This capability is proposed as a high-level integrated ability to create and to manage varied capabilities. Innovation capability refers to a company's ability to develop new products or markets through strategic innovation orientation and innovation processes and behaviors (Wang & Ahmed 2007).

In summary, innovation capability refers to a new set of skills owned by a company to formulate and implement an innovation strategy involving the process of creation, extension and modification of all resources. In line with this, Bell (2009) states that innovation capabilities are necessary to create, develop, and implement new products and processes of technology configuration, and changes or improvements in current technologies.

2.4. Value Co-Creation

Ullaga and Chacour (2001) argue that value creation can be seen in three perspectives, namely the buyer's perspective, the seller's perspective, and the buyer-seller's perspective. On the buyer's perspective, value creation can be accomplished through the acquisition of products and services. From a seller's perspective, value creation is achieved by providing customer equity, while from a buyer-customer perspective, value creation is conducted through networking. Hammervoll (2012) identified that value creation exists in three different types of interactions (i.e., unilateral supplier learning, unilateral supplier development, and bilateral learning). Furthermore, Payne et al. (2009) note that in business and networking relationships, values can be determined from three perspectives in the forms of value creation perspectives for customers, value creation for suppliers, and value co-creation. Hence, value creation from a customer perspective is related to how customers perceive the value of customer offerings as compared with available alternatives.

Totanan (2004) argues that value creation refers to a function of leadership skills, an ability to find sources, and the ability to optimize process management. In creating value, the role of business process improvement is very necessary involving various stakeholders in the company. To achieve the value, the knowledge of customers and their needs is essential. Restuccia and Ouellet (2009) state that value co-creation orientation is the process of integration and transformation of resources (human, technology, organization, and information sharing) implicating the value of networking. Value co-creation generally has a lasting positive effect on business performance (Restuccia & Ouellet 2009).

2.5. Competitive Advantage

Barney (2001) states that competitive advantage refers to the achievement of unique values not owned by other competitors. In addition, a company is considered to possess a competitive advantage if it is able to create value, not being implemented by competitors and potential competitors. Compa-

ny resources are potentially having competitive advantage, provided that the resources have four attributes in terms of unique, rare, difficult to imitate, and non-substitutable (Barney 2001). Day and Wensley (1988) argue that there are two factors affecting the company efforts to create competitive advantage including superior capabilities and superior resources. Ferdinand (2000) supports this opinion stating that based on the resource-based theory, the essence of competitive advantage is a unique combination of resources and capabilities. Meanwhile, to perpetuate the competitive advantage, the company should possess unique resources and capabilities.

3. Hypothesis Development

Ferrer et al. (2010) gives an understanding regarding the relational capability of supply chain participants in developing innovation chain capacity. The study shows that by building relationships with customers and suppliers, the company is able to increase the capability for supply chain innovation. Innovations arise when intensive interaction and communication between a company and its surroundings occur (Saren 1984). Interaction and communication with the external environment is a relationship between a company and its customers, suppliers, competitors, external R&D institutions, and an industry association (Romjin 2001). Interaction with customers will contribute to innovation by raising the demand (Slappendel 1996).

H1: Relational capability positively affects innovation capability.

Regarding the inter-organizational relationships and competitive advantage, Ngugi et al. (2010) argue that relational capability is able to improve the value co-creation including cost utility, income levels, new competencies, and risk sharing as a determinant of the success of the company. Furthermore, Lavie (2007) provides an understanding of value creation based on networking alliance stating that the mechanism of value co-creation can increase the company ability and focus on creating value from relationships. Collectively, the members of the alliance have a common goal and extend the value of relational chain affecting the performance of each party in the network.

In addition, Lavie (2007) identifies the characteristics in that mechanism. The characteristics include using networking resources to expand the opportunities of value creation, focusing on generating value from the combination of resources, and benefiting indirectly from networking resources. Value co-creation occurs through the interaction between customers and suppliers in an efficient relationship. Möller (2006) notes that the value co-creation is obtained by developing relational networking capabilities.

H2: Relational capability positively affects value co-creation capacity.

Relational capability refers to the ability to select partners and maintain high-quality relationships using an appropriate administrative mechanism (Johnson & Sohi 2003). Ojha et al. (2014)_ENREF_28 find a significant positive correlation between relational capability and the company's performance. The results show the relationship of the hypothesis including building a relationship with other companies and predicting the maximum rate of change of relational capability. Furthermore, Lasisi et al. (2014) and Bhatt and Grover (2005) find a positive and significant correlation between business relation and company effectiveness.

Simpson et al. (2001) suggest relational factors as potential determinants influencing value creation activities. These relational factors are activities that help to develop and maintain successful relational exchanges, such as commitment, communication, cooperation, ethical sharing, trust, contact frequency, and professionalism. The empirical study from Ulaga (2003) finds eight relational dimensions that form a shared value in the forms of product quality, service support, delivery, supplier

know-how, time-to-market, personal interaction, product pricing, and process costs.

H3: Relational capability positively affects competitive advantage.

The success of managing the exchange and value co-creation leads to the maximization of the company revenue and profit. Edvardsson et al. (2011) argue that the process of value co-creation is through social structures and systems conveyed by norms, values and ethical standards guiding the acceptance of interactions or relationships between individuals or groups. This implicates the process of exchange and value co-creation.

A company must have a core competence to increase its competitive advantage. Pehrsson (2004) notes that a company needs to have a core competence as an important factor to achieve high competitive advantage and performance. Hill and Jones (2001) believe that functional competence can be a source of competitive advantage through four factors including efficiency, quality, innovation, and responsiveness to customers. O'Casey and Sok (2015) emphasize that the strategic role of value creation from the perspective of a company is important. From this perspective, value is a guide to the development and management of customer value. According to Adner and Zemsky (2006), resources form the value creation in the process of developing a position of company competitive advantage.

The quality of the synergy of a network encourages the collaborating parties to gain benefit (Ha et al. 2011). The company-customer partnership is based on mutual needs and benefits and provides mutual benefits of increased sales together, the addition of sales product variation, and increased involvement in joint promotional activities (Kannan and Tan 2006; Prior 2012). The marketing performance depends on the ability of the parties to maintain the partnership. Communication skills, commitment to joint problem solving and adaptability determine the sustainability of relationships (Hsu and Kannan 2008; Lam et al. 2007; Canning and Hanmer-Lloyd 2001).

H4: Value co-creation capacity positively affects competitive advantage.

Mariotti et al. (2008) state that innovation capacity development may have different meanings in different kinds of companies performing in a market segment and in providing multiple levels of technology. In the industrial sector, innovation capacity of a company is able to allocate resources in order to develop competitive advantage. In addition, Gomez et al. (2011)_ENREF_15 note that several factors play an important role in developing competitive advantage. Those factors include market leadership indicating the necessity of market response, product making and specific products, and organizational innovation.

H5: Innovation capability positively affects competitive advantage.

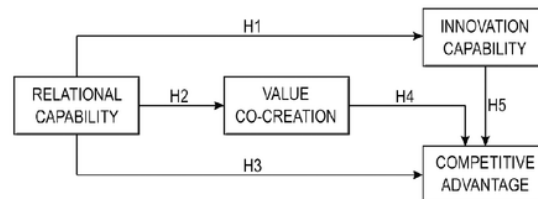


Figure 1. Conceptual Model

4. Conceptual Model

This study examined the effect of relational capability on value co-creation capacity, innovation capability, and competitive advantage. The variable of value co-creation capacity and innovation capability were intended to be the mediating variables in the relationship between relational capability and

competitive advantage. This research aimed to empirically examine the effects of the establishment of the organization and institutionalization of SME cooperation such as FEDEP on the competitive advantage of SME products.

5. FEDEP: A Brief Overview

The Forum for Economic Development and Employment Promotion was established in 2008. The agency was created by the Central Java provincial government to support the business development of non-formal institutions in the development of social economy. This Forum is held in all administrative regions in Central Java (comprising 35 districts/municipalities). At the local level, FEDEP serves as a forum orienting towards institutionalized partnership programs for local stakeholders. The stakeholders consist of the elements the government, universities, business communities and society, including business associations and business facilitation agencies. FEDEP provides freedom for stakeholders to actively convey shared problems, needs, wants, and concerns, to propose and discuss ideas, and to organize strategies concerning local development. The output of FEDEP is subsequently used as an input for local government in formulating policy of economic development.

Specifically, in Semarang City, the vision of FEDEP is to become a coordinating agency and facilitator in helping to develop the local economy and employment expansion in Semarang. The mission of FEDEP includes becoming a facilitator for SMEs from the government, universities, private members and public; recommending the city government regarding the innovative and sustainable development program of SMEs; and synergizing the FEDEP program and the city government program comprehensively in the cross-sector of SMEs and stakeholders.

In 2016, there were 10 clusters including the milkfish cluster, batik cluster, food processing cluster, handicraft cluster, tourism cluster, bag cluster, cluster lumpia, herb cluster, metal cluster, and furniture cluster. Realistically, FEDEP has various actual programs to support the growth of SMEs through cooperation. Among them are the promotion of superior products of Semarang to increase the development of market for cluster/SME superior products, the centralization of cluster superior

products with local design and international quality, the increase in competitiveness of cluster/SME superior products in local and international markets, the increase in excellent product promotion and exhibition, and trainings (business plan development, business management, clusters consultation facilitation).

Achievement of FEDEP institutional facilitation in Semarang through the economic development program has been able to encourage economic growth in Semarang City, especially the increase in economic welfare of clusters/SMEs contributing to local revenue of Semarang City. FEDEP is able to create a conducive business climate and market accessibility, and clusters/SMEs promotion. Moreover, it is able to develop strategic networks in order to improve the democratic nature of the economy. The strategy includes the utilization, development, and improvement of innovation, technology, and human resources.

6. Methods

6.1. Sampling

This study used a survey method approach with a questionnaire as an instrument to collect data. The variables were measured using a 10-point Likert scale, ranging from 1 (strongly disagree) to 10 (strongly agree). The population of this study was comprised of 332 SME entrepreneurs united in FEDEP in Semarang categorized into one of four clusters: milkfish, batik, food processing, and handicrafts. Ultimately, 188 SMEs were selected as the sample through random sampling stratification.

6.2. Measurement of Variables

Previous studies were used as the reference to define the concept and measurement of relational capability variable (e.g. Dyer et al. 2001; Lorenzoni & Lipparini 1999; Walter et al. 2006; Ngugi et al. 2010), value co-creation (e.g. Totanan 2004; Restuccia & Ouellet 2009; Ngugi et al. 2010; Smirnova 2011; Yi & Gong 2013), innovation capability (e.g. Lawson & Benn 2001; Wang & Ahmed 2007; Bell 2009), and competitive advantage (e.g. Barney 2001; Day & Wensley 1988; Ferdinand 2000; Porter 1980; Kotler 2003).

Table 1. Variable Measurement

| Variable | Concept | Reference | Measurement | Reference |
|----------------------------|--|---|---|---|
| Relational Capability | The capability to utilize external resources through social relationship | Dyer et al. (2001), Lorenzoni and Lipparini (1999), Walter et al. (2006), Ngugi et al. (2010) | 1. Ability to build networks 2. Ability to cooperate 3. Ability to respond 4. Communication skills 5. Ability to understand the customer wishes | Lorenzoni and Lipparini (1999), Ngugi et al. (2010) |
| Value Co-creation Capacity | An integrated process and resources transformation (human, technology, organization, shared information) involving several parties in the organization | Totanan (2004), Restuccia and Ouellet (2009) | 1. Cost efficiency 2. Product accuracy 3. Speed of service 4. Profit gaining | Ngugi et al. (2010), Smirnova (2011), Yi and Gong (2013) |
| Innovation Capability | A set of skills owned by companies to develop new ideas of products, processes and new markets through the synchronization of strategic innovation orientation and innovation process and behavior | Lawson and Benn (2001), Wang and Ahmed (2007), Bell, (2009) | 1. Ability to develop products fitting the market requirements 2. Ability to utilize technology to develop new products 3. Ability to develop services | Lawson and Benn, (2001), Wang and Ahmed (2007), Bell (2009) |
| Competitive Advantage | The achieved advantage by the implementation of unique value achievement strategy; not being implemented by competitors/potential competitors because of the inability to imitate | Barney (2001), Day and Wensley (1988), Ferdinand (2000) | 1. Something important to consumers worth superior 2. Something peculiar and unique 3. Something new/pioneer 4. Affordable (purchasing power) and benefits | Porter (1980), Kotler (2003) |

6.3. Data Analysis

The main analysis used from the collected data was based on structural equation modeling (SEM). The SEM has been developed in a number of disciplines. Testing the relationship of latent variables was accomplished using AMOS version 22. In the SEM analysis, the general rule of minimum sample threshold is 100 subjects (Williams et al., 2004), thereby the sample has met the threshold.

In order to increase the internal validity of instrument likelihood (Van Teijlingen & Hundley 2010), this study conducted a pilot study to 30 respondents. As shown in Table 2, the result of the pilot study illustrated that the data was valid and reliable for hypothesis testing. The result of the test showed that the Cronbach's alpha coefficients for all variables were above the cut of value of 0.6, the validity coefficients were above the cut of 0.203 (df = 30, $\alpha = 0.05$), and the matrix components coefficients were above the cut of value 0.5.

Table 2. Pilot testing (30 respondents)

| Variable and Indicator | Cronbach Alpha | Validity | Matrix Component |
|--|----------------|----------|------------------|
| Relational Capability | 0.924 | | |
| a. Ability to build networks | | 0.822 | 0.687 |
| b. Ability to cooperate | | 0.782 | 0.731 |
| c. Ability to respond | | 0.824 | 0.692 |
| d. Communication skills | | 0.806 | 0.682 |
| e. Ability to understand the customer wishes | | 0.798 | 0.736 |
| Value Co-creation | 0.917 | | |
| a. Cost efficiency | | 0.699 | 0.678 |
| b. Product accuracy | | 0.896 | 0.749 |
| c. Speed of service | | 0.805 | 0.686 |
| d. Profit gaining | | 0.847 | 0.768 |
| Innovation Capability | 0.838 | | |
| a. Ability to develop products fitting the market requirements | | 0.742 | 0.685 |
| b. Ability to utilize technology to develop new products | | 0.632 | 0.649 |
| c. Ability to develop services | | 0.733 | 0.605 |
| Competitive Advantage | 0.862 | | |
| a. Something important to consumers worth superior | | 0.774 | 0.738 |
| b. Something peculiar and unique | | 0.697 | 0.799 |
| c. Something new/pioneer | | 0.791 | 0.682 |
| d. Affordable (purchasing power) and benefits | | 0.586 | 0.738 |

7. Results

7.1. Demographic Characteristic of Respondents

The majority of the respondents were women (67.14%) showing that the members of FEDEP were largely dominated by women. Most respondents were over 40 years old (63.97%), thus being able to make business decisions with careful consideration, while nearly half of all respondents were high school graduates (46.89%).

7.2. Goodness of Fit

SEM testing showed the results of a chi-square analysis (114.390 < 123.22, df = 99, $\alpha = 0.05$, p = 0.138), CMIN/df = 1.155, goodness of fit index (GFI) = 0.930 \geq 0.95, adjusted

goodness of fit index (AGFI) = 0.904, root mean square residual (RMR) = 0.083, normal fit index (NFI) = 0.922, incremental fit index (IFI) = 0.989, comparative fit index (CFI) = 0.898, RMSEA = 0.029. This meant that the path model fit because it was in the cut of the value range.

Similarly, the SEM testing showed that the multivariate and univariate data was normal, free from outlier, free from multicollinearity and singularity. The testing of variance extract and reliability per construct resulted coefficients for all variables were above the expected cut of values 0.7 and 0.5, respectively.

7.3. Hypothesis Testing

The hypothesis testing as shown in Table 3 and Figure 2 revealed several important findings. First, the results show the value of CR = 3.377, p = 0.001 of the first hypothesis stating that relational capability has a significant effect on innovation capability. It means that the first hypothesis is accepted. The second hypothesis stating that relational capability has a positive effect on value co-creation capacity is accepted, as indicated by the value of C.R. = 3.454, p = 0.001.

Table 3. Hypothesis Testing

| Causality Relationship | | Standardized Loading | S.E. | C.R. | P |
|------------------------|-------------------------|----------------------|-------|-------|-------|
| Relational Capability | → Innovation Capability | 0.295 | 0.104 | 3.377 | *** |
| Relational Capability | → Value Co-creation | 0.298 | 0.091 | 3.454 | *** |
| Innovation Capability | → Competitive Advantage | 0.337 | 0.094 | 3.661 | *** |
| Value Co-creation | → Competitive Advantage | 0.191 | 0.094 | 2.313 | 0.021 |
| Relational Capability | → Competitive Advantage | 0.221 | 0.103 | 2.594 | 0.009 |

The third hypothesis testing shows the value of CR = 3.661, p = 0.001. It means that the hypothesis stating that relational capability has a positive effect on competitive advantage, and is accepted. The result also shows that the fourth hypothesis stating that value co-creation capacity has a positive effect on competitive advantage was accepted with the value of CR = 2.313, p = 0.021.

Finally, the fifth hypothesis stating that innovation capability has a positive effect on competitive advantage is accepted with the value of CR = 2.594, p = 0.009. It means that the higher the degree of innovation capability, the higher the competitive advantage.

7.4. Sobel Test

The Sobel test calculator for the significance of mediation was used to determine the possibility of an intervening variable being a mediator. This test determines the significant value of one-tailed and two-tailed probability. The calculation showed that the significance of each probability was below 0.05. This means that the variable of innovation capability and value co-creation capacity affect the relationship between the variable of relational capability and competitive advantage.

8. Discussion

The result of the significant effect of relational capability on innovation capability supports the research of Ferrer et al. (2010) and Saren (1984) who note that innovation capability is the company's ability to accumulate knowledge to improve the company performance through cooperating with all parties, and to utilize the knowledge to develop and to improve specific

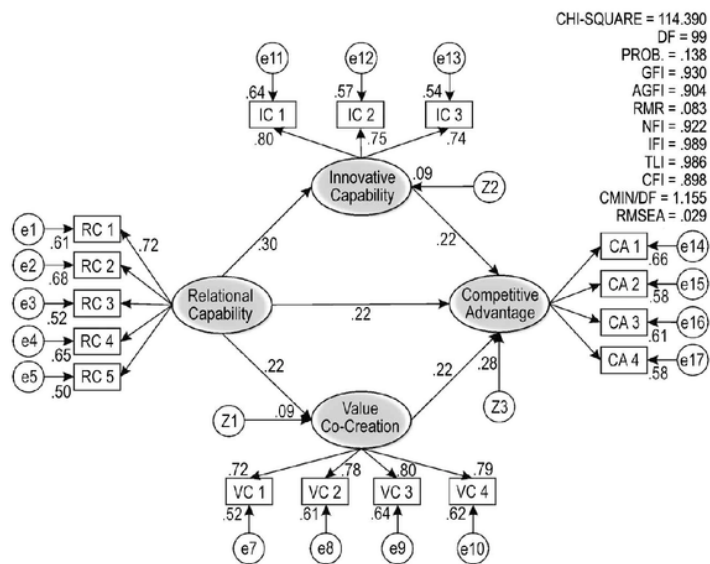


Figure 2. Structural Equation Model

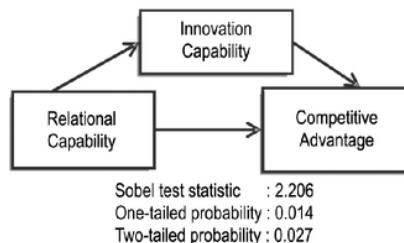


Figure 3. Sobel Test of Innovation Capability

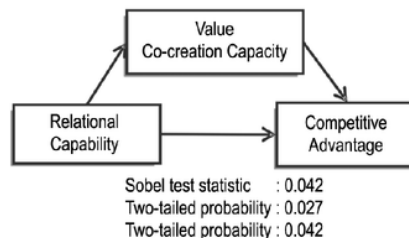


Figure 4. Sobel Test of Value Co-Creation Capacity

products fitting the customer needs. Interaction and communication with the external environment is a form of the company interaction with customers, suppliers, competitors, institutions, external R&D institutions, and Industrial Association (Romjin 2001).

This study also indicates that the value co-creation capacity occurs in the context of resources integration through the interaction between customers and suppliers in an efficient relationship. The relationship allows both parties to develop relational competencies including the ability to build trust and commitment among partners. This finding is consistent with the studies of Ngugi et al. (2010), Lavie (2007), Möller (2006), Payne et al. (2009) who note that value co-creation is obtained by developing relational capability in networking.

The result of the significant effect of relational capability on competitive advantage strengthens the findings of Wiklund and Shepherd (2005), Ferreira and Azevedo (2007) Ma'atooft and Tajeddini (2010), Madhoushi et al. (2011) highlighting that relational capability is able to improve a company's ability to produce specific products fitting customer interests. This capability is then able to increase the competitive advantage of SMEs.

Moreover, the statistical result of hypothesis fourth indicates that value co-creation capacity has a positive effect on competitive advantage, meaning that the higher the degree of value co-creation capacity, the higher the competitive advantage. This study reveals that the value co-creation capacity is the company's ability to build customer value, intermediary value, and to develop specific products fitting customer needs. The result supports findings from previous studies which note that the value co-creation capacity is a set of competencies reflecting unique attributes (e.g. Gulati et al. 2000; Simpson et al. 2001; Adner & Zemsky 2006).

In addition, the results of the study explain that high innovation capability is able to help the company to seize opportunities in an uncertain environment, and to gain competitive advantage in the long-term performance of the company (Hitt et al. 1997). This finding is also consistent with the study of Lawson and Benn (2001).

9. Conclusion

Creating competitive advantage is a crucial issue for the success of a company. Not only big companies, SMEs also need competitive advantage to gain success. The results of this study

have examined the development of competitive advantage on SMEs. The application of relational capability allows SMEs to better survive and thrive in the midst of stiff competition and create competitive advantage for SMEs.

Innovation capability and value co-creation are able to improve competitive advantage in for SMEs. However, the innovation process does not always run effectively because of resource constraints that SMEs often face, including human relational capability and lack of modern technologies. Human resource constraints, including knowledge management and references availability are further challenges many SMEs face. Technologies remain as a major problem for the competitive advantage of many SMEs.

The strategic ability view presented in this study includes the company's resources and social capital that are believed capable of improving the efficiency and effectiveness of innovation activities. Inter-company cooperation in value creation is an important factor as well. The results also show that relational capability should be integrated into managerial considerations, as it is a critical process for increasing competitive advantage.

The study also finds that the roots of building SME innovation capabilities are embedded in social relationships – innovation is an important business activity that is considered able to create new market opportunities to sustain a competitive advantage in the future. In conclusion, SMEs will more likely achieve a competitive advantage when the act of creating economic value is carried out in tandem with their interactions and relationships. The study also finds evidence that companies that engage in cooperative interactions are more likely able to have high value benefits for the company, as well as achieve strong and solid teams. They are also more likely to encourage the fulfillment of needs in the development of personal relationships with customers, and in establishing sustained levels trust and connections (Dyer 2000; Nahapiet and Ghoshal 1998; Tsai and Ghoshal 1998).

10. Recommendation for Future Research

This study has several limitations. First, it uses a cross-sectional technique, so the relationship between the concepts tested in this study is a brief overview at a certain point in time. Consequently, when using longitudinal studies, relational capability and value creation competencies will certainly have further

implications for the competitive advantage of SMEs over the long term. Longitudinal studies in future studies can assess the long-term results of innovation capability in an effort to improve the competitiveness of SMEs. Future studies may also inves-

tigate the variability of company performance as a final goal to achieve high performance and show a profit. Future research should also examine SMEs in broader areas including Semarang city or Central Java regions.

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