

## Exploring market orientation, product innovation and competitive advantage to enhance the performance of SMEs under uncertain events

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### ABSTRACT

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The purpose of this study is to build an empirical research model and prove the influence of market orientation on product innovation and competitive advantage. The study also proves the intervening role of product innovation and competitive advantage on increasing market performance. In addition, market uncertainty is also tested in moderation in strengthening the relationship between product innovation and competitive advantage in market performance. The study tests 178 samples of Batik SME players in Surakarta. A purposive sampling was used as this research's sampling method. The result of this study proves empirically that market orientation positively, significantly influences product innovation and competitive advantage. The test of mediation role between product innovation and competitive advantage in market performance also shows positive and significant results. The result of the test on moderation role between Market uncertainty in the relationship between product innovation and competitive advantage on market performance also shows positive and significant influence on market performance.

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## 1. Introduction

Innovation and achievement of corporate competitive advantage play a strategic role in improving business performance in a rapid environmental change (Simpson, 2004). Innovation also plays a strategic role for a company in building its competitive advantage (Hsu, 2012; Priagung Hutomo & Pudjiarti, 2021). Various efforts need to be performed by business players in improving its marketing activities, that is also an important part in creating strategy through new product development, focus on marketing activities, thus it is able to create competitive advantage for survival in the market (Munck et al., 2020; Lertpachin et al., 2013). The study conducted by Gomes et al. (2009) explains competitive advantage and business operational activities in an increasingly complex environment and conditions that need business strategy that is able to quickly respond to competitors' movement. In a dynamic, globally competitive, technology-based environment, a company's orientation only to strategy may be insufficient. Company needs to respond to and collaborate with business partners for the organization's survival. Bharadwaj et al. (1993) explain the purpose of competition strategy is to achieve continuous competitive advantage and, thus, improve business performance. In addition, company strategy is directed more to improving the company's long-term operational performance (Yu et al., 2018). Long-term performance may be reached through orientation to customers, competitors and cross-functional coordination in the company, thus competitive advantage may be achieved (Huhtala et al., 2013). Besides innovation with impact on business performance, the role of collaboration and market orientation in company networking also contributes to performance. Kropp et al. (2006) find that innovation, market orientation and organization learning strongly influences business performance. Innovation is an important function in management. Innovation is associated with company performance. Eris and Ozmen (2012) explain that market orientation and innovation are a strategy chosen by a company in achieving company performance. Company's role in viewing the

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importance of customers, competitors, and cross-functional coordination is the determining factor in creating innovation, leading to improved performance (Huhtala et al., 2013; Nupus & Ichwanudin, 2021).

This research was conducted to measure SMEs' performance. The performance of SMEs in this study is influenced by market orientation, product innovation quality and competitive advantage. SMEs have many limitations in achieving superior performance (Lin et al., 2014), limited innovation through information technology (Dibrell et al., 2008), and weak resource capability (AlQershi et al., 2020). The importance of market orientation, product innovation quality and competitive advantage make SMEs able to survive in the ever-changing environment. The speed in responding to competitors, customers and product innovation quality make SMEs advantageous and able to improve their performance.

This research has some parts. First, literature review arrangement was focused more on the concept associated with market orientation, new product innovation, competitive advantage and SMEs' performance. Second, development of empirical research models and arrangements referring to previous studies were conducted thoroughly. Third, data analysis was conducted by arranging managerial implications and recommendations for future studies. In addition, this study specifically aims at testing the influence of market orientation on SMEs' performance through new product innovation and competitive advantage as relationship mediation. Besides, this study also directly tests the influence of market orientation on SMEs' performance.

## 2. Literature Review and Hypotheses

### 2.1. Relationship of Market Orientation with Product Innovation

Market orientation encourages companies to build business networking (Baker et al., 1999; Webb & Kreppa, 2000). Furthermore, it is explained that market orientation positively influences company relationships with its business partners. It is important for companies to develop their networking, such as marketing of relationships to improve customer loyalty and lead to creation of innovation and performance. Organization capability effectively builds and maintains appropriate customer relationships after organization identifies and understands the needs of target customers through creation of innovation and networking of the company (Yadav et al., 2019; Riswanto, 2021). Meanwhile, the study conducted by Fang et al. (2014) finds that market orientation influences market performance and non-marketing performance (financial performance, innovation performance, and market performance). Thus, the following hypothesis is developed:

**H<sub>1</sub>:** *Market orientation positively and significantly influences product innovation.*

### 2.2. The Influences of Market Orientation and Competitive Advantage

Market orientation is the company view of customer, competitor and inter-functional coordination in a company so as to be able to achieve competitive advantage and superior performance (Hinson et al., 2017; Yadav et al., 2019). Market oriented companies need to develop competitor strengths and weaknesses, use the knowledge to develop and implement strategies to create superior advantage and performance. The study conducted by Narver and Slater (1990) explains market orientation dimensions, including customer orientation and competitor orientation. For a company to apply the two orientations, it needs superior strategy and combining the third dimension, namely coordination between functions to improve company resistance to competitors as well as improve customer satisfaction (Nuryakin, 2018). Kohli and Jaworski (1990) study antecedent model and consequence of market orientation. The study result shows the role of senior manager policy, dynamics in interdepartmental cooperation in company, and organization system as antecedent of market orientation, followed with role of employee response, customer response, and company performance as the consequence of market orientation. Further, it is explained that a successful market orientation according to Kohli and Jaworski (1990) has 3 (main requirements, namely: focus on customer, coordinated marketing, and inter-department coordination in the company. Company must understand customer needs, so that company is able to apply orientation, either reactive or proactive orientation. Reactive orientation commonly makes companies concentrated on understanding and satisfying current consumer needs (Slater & Narver, 1998). Thus, the following hypothesis is proposed:

**H<sub>2</sub>:** *Market orientation positively, significantly influences competitive advantage.*

### 2.3. Product Innovation and Market Performance

Innovation is reflected in the use of information technology in company operational processes (Dibrell et al., 2008). Innovation also influences company competitiveness (Kiveu et al., 2019). Company capability to innovate may be viewed from its company business performance (Low et al., 2007). The significance influence of product innovation on business performance may be viewed from some previous researchers who test the concept of innovation in banking, company only, MSMEs, commercial company and logistic industry sectors such as in the studies conducted in previous research (Avlonitis & Salavou, 2007; Eris et al., 2012; Deni et al., 2021; Han et al., 1998; Matear et al., 2002; Olavarrieta & Friedmann, 2008).

Another study also finds strong influence of product innovation on performance (Eshlaghy & Maatofi, 2011). Innovation is needed by companies in response to environmental fluctuation and achieving comparative advantage and superior performance. The study conducted by Khin et al. (2010) finds that product innovation is an important determiner for companies in which through creation of innovative products, consumers obtain its benefit from the perspective of new features, design and function (Mughal, 2019). For a company to compete in the competitive market, the company does not only offer similar products or compete with price reasons only, but products of high quality must be created. Creation of high quality products is part of product innovation (Zhou, 2006). Thus, we propose the following hypothesis:

**H<sub>3</sub>:** *Product innovation positively, significantly influences market performance.*

#### 2.4. *The Relationship of Competitive Advantage with SMEs' Performance*

The study conducted by Hult and Ketchen (2001) finds that a resource based view makes companies achieve a high degree of positional advantage, positively influencing business performance. Company expects the best market position, thus the market positional advantage influences improved business performance (Day & Wensley, 1988; Srikarsem & Ussahawanitchakit, 2010). Other researchers state there are two types of positioning advantage, namely achieving cheap cost and differentiation which influences business performance (Langerak, 2003). The study conducted by Baaij et al. (2004) tests the competitive advantage of companies entering the global market. The study results show that competitive advantage may be achieved through creation of innovation, improving superior business performance. Meanwhile, Clark and Machado (2006) in their study test exporter companies in creating competitive advantage based on technology advantage which increases business performance. Therefore, the following hypothesis is drawn up:

**H<sub>4</sub>:** *Competitive advantage positively influences market performance.*

#### 2.5. *Market Uncertainty, Product Innovation and Market Performance*

Innovation strategy encourages creation of organization competitiveness and performance in a dynamic environment (Lin & Chen, 2007). Meanwhile, the study conducted by Holtzman (2008) emphasizes the importance of organization growth and innovation in creating a company's future opportunities and success. The effort in achieving the company's long-term purpose, strategy focusing on innovation through collaboration is the main key to achieving business and performance sustainability (Gomes et al., 2009; Tanwari, 2020). Darroch and McNaughton (2002) explores the important role of innovation in achieving competitive advantage and dynamics of the business environment. Innovation is also viewed as a company strategy in achieving superior performance (Eris & Ozmen, 2012). The study conducted by Singh and Garg (2008) explains that when a company is faced with various constraints related to resources, difficult innovation capability will be developed. Strategy in achieving competitiveness, companies need to have assets available, process and performance in creating the best product advantage in their industry. The dynamics of market and competition as the moderator effect in relationship between business strategy and competitive performance level are company focus in developing business strategy (Nandakumar et al., 2010; Wahyuni & Praninta, 2021). Thus, the following hypothesis may be drawn up:

**H<sub>5</sub>:** *Market uncertainty strengthens relationship between product innovation and market performance.*

#### 2.6. *Market Uncertainty, Competitive Advantage and Marketing Performance*

The study conducted by Verhees and Meulenber (2005) explains company capability in market response full of competition dynamics is, among others, built by creating superior product, improving market intelligence so as to affect improved performance. Company also needs to achieve competitiveness and improved satisfaction of customer needs (Huang et al., 2019). Competitive advantage is the factor to drive achieving superior performance (Meutia & Ismail, 2012; Arifiani et al., 2021). Achieving a high degree of competitive advantage, the performance achieved by the company improves. Rapid market and environmental change needs organization dynamic capability (Teece et al., 1997; Bukhori, 2021). Dynamic capability is deemed company capability in reconfiguring internal competence, integrating, building networking and responding to environmental change quickly.

**H<sub>6</sub>:** *Market uncertainty strengthens the relationship between competitive advantage and market performance.*

### 3. Research Methods

Quantitative approach was chosen to test the research hypotheses in this study. The data were collected through questionnaires distributed to batik SMEs owners or managements. The questionnaire was designed by developing instruments and indicators which reflect the variables of market orientation, product innovation, competitive advantage, market uncertainty and market performance of SMEs. The indicators measured were the reflective indicators of the variables. This study took samples of 171 Batik SME players in Surakarta City. Meanwhile, the analysis unit in this study was Batik SME owners or management. The samples were sampled using purposive sampling under consideration of experience and existence of Batik SMEs in

operational and marketing process, number of employees and sales turnover of the product. Batik SMEs were chosen considering that until now Batik SMEs players grow in line with government support in developing Batik products as local wisdom. The data were collected by distributing questionnaires to the research samples. Based on previous studies and in-depth literature review, some constructs were measured using items of question which reflected the research indicators. The indicators were measured using a five-point scale. The indicators were developed to operate the research variables for empirical tests. This research used quantitative design to test the hypotheses and empirical models. After literature review for identification of validity and reliability of measures in testing the five constructs, including market orientation, product innovation, competitive advantage, market uncertainty and market performance. The testing of the indicators of the five constructs has resulted in the instrument of validity and reliability and was tested with a five-point Likert scale (1 strongly disagree – 5 strongly agree).

#### 4. Results

This study tested six research hypotheses. The hypotheses were tested using Structural Equation Modeling (SEM) in multivariate statistics program AMOS. The measurement model test was conducted in testing uni-dimensionality. The parameters that must be fulfilled in this test include viewing the value of Goodness of Fit (GoF). Measurement models in multivariate tests may be tested by viewing convergent validity. Further testing with SEM was conducted to test the parameters produced in goodness of fit and test on empirical research models explaining the causality relationship developed in this research. The result of a descriptive statistical test and correlation matrix explaining average value, standard deviation and relationship between constructs of market orientation, product innovation, competitive advantage, market uncertainty and market performance can be explained in Table 1.

**Table 1**  
Correlation matrix, Mean and Standard Deviation

Constructs	Mean	Std. Dev	1	2	3	4	5
Market orientation	3.026	.604	1.000				
Product innovation	3.091	.588	.565**	1.000			
Competitive advantage	3.273	.546	.577**	.563**	1.000		
Market uncertainty	3.537	.488	.583**	.552**	.535**	1.000	
Marketing performance	3.050	.644	.518**	.192*	.167*	.350**	1.000

\*p < 0.05, \*\*p < 0.01

This study used confirmatory factor analysis to analyze the validity and reliability of research instruments. Statistically, the result of the construct validity and reliability test, Variance Extract (VE), and Discriminant Validity (DV) may be explained in Table 2. Based on Table 2, the constructs of market orientation, product innovation, competitive advantage, market uncertainty and marketing performance meet the determined criteria, Validity Construct (VC) > 0.7, Average Variance Extract (AVE) > 0.5, and Discriminant Validity (DV) respectively higher than 0.7. The result of a test using the AMOS Program which explains the result. Table 2 explains the test on validity and reliability of constructs market orientation, product innovation, competitive advantage, market uncertainty and marketing performance. The result of validity and reliability test shows that each indicator of the five constructs meets the determined criteria, loading factor value > 0.6. This conforms to the parameters developed by Hair et al. (1998) in testing construct validity and reliability.

**Table 2**  
Validity and Reliability

Construct	Loading Factor	CR	VE	DV	Construct	Loading Factor	CR	VE	DV	
Market orientation	0.814	0.916	0.563	0.750	.... Comp. advantage	0.771	0.904	0.565	0.752	
	0.760					0.719				
	0.811				Market uncertainty	0.859				
	0.752					0.730				
Product Innovation	0.734	0.899	0.572	0.756	Marketing performance	0.803	0.910	0.557	0.747	
	0.776									0.654
	0.758									0.788
	0.711									0.787
Competitive advantage...	0.742	0.904	0.565	0.752		0.803				
	0.809					0.799				
	0.770									

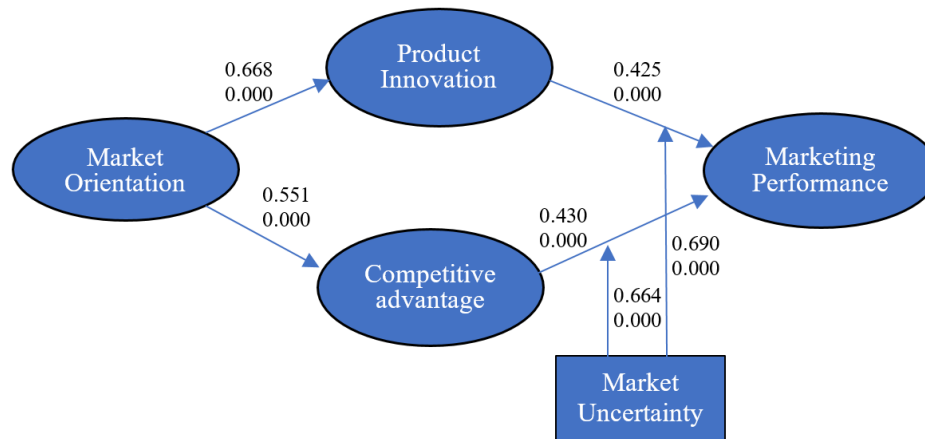
The confirmatory test on analysis factors and full model shows good results, that they have met the test criteria at assumption of goodness of fit of model. Meanwhile, the hypotheses in this study were proven using the assistance of Structural Equation

Modeling (SEM) program. The result of statistical test with assistance of software AMOS shows the result of criteria cut off in goodness of fit has met the Chi-Square of 191.628, the result of probability value is 0.000, CMIN/DF of 1.666, TLI of 0.943, GFI value of 0.883, AGFI value of 0.844 and RMSEA value of 0.063 indicating that the values conform to the determined cut-off. The value of standardized path coefficients testing the relationship between variables with the influence of market orientation, product innovation, competitive advantage and market performance is presented in the table below. Meanwhile, tests on the path analysis with respective hypotheses and test on moderation role in this research are shown in Table 3, consisting of 6 research hypotheses.

**Table 3**  
Structural Model Analysis

	Hypothesis	CR	$\beta$	<i>p</i> -value	Result
H <sub>1</sub>	Market orientation – product innovation	7.977	0.668	0.000	Supported
H <sub>2</sub>	Market orientation – competitive advantage	8.032	0.551	0.000	Supported
H <sub>3</sub>	Product innovation – marketing performance	4.742	0.425	0.000	Supported
H <sub>4</sub>	Competitive advantage – marketing performance	4.234	0.430	0.000	Supported
H <sub>5</sub>	Moderating 1: Market Uncertainty, Product Innovation and Market Performance	11.549	0.664	0.000	Supported
H <sub>6</sub>	Moderating 2: Market Uncertainty, Competitive Advantage and Marketing Performance	12.395	0.690	0.000	Supported

The result of the full model in testing the research hypothesis shows that the testing on H1 on the influence of market orientation on product innovation empirically proves the values of  $\beta = 0.668$ , and  $\text{sig} = 0.000 < 0.05$ . Therefore, the hypothesis test shows the results that market orientation positively, significantly influences product innovation. H1 test is accepted. The testing on H2 testing the influence of market orientation on competitive advantage shows values of  $\beta = 0.551$ , and  $\text{sig} = 0.000 < 0.05$ . Therefore, the hypothesis test shows the results that market orientation positively, significantly influences competitive advantage. H2 test is accepted. Statistical output on H3 testing the influence of product innovation on market performance shows values of  $\beta = 0.425$ , and  $\text{sig} = 0.000 < 0.05$ . Therefore, the hypothesis test shows the results that product innovation positively, significantly influences market performance. H3 test is accepted. Moreover, the analysis on H4 testing the influence of competitive advantage on market performance shows values of  $\beta = 0.430$ , and  $\text{sig} = 0.000 < 0.05$ . Therefore, the hypothesis test shows the results that competitive advantage positively, significantly influences market performance. The H4 test is accepted.



**Fig. 1.** Result of SEM analysis

The next analysis is to show the moderating effects. The result of test on moderation role of market uncertainty in the relationship of product innovation with market performance and relationship of competitive advantage with market performance showed that on the testing on H5 to examine the moderation role of market uncertainty in the relationship of product innovation with market performance empirically shows values of  $\beta = 0.664$  with  $\text{sig} = 0.000 < 0.05$ . Therefore, the hypothesis test shows the results that market uncertainty strengthens the relationship between product innovation and market performance. The H5 test is accepted. Furthermore, the empirical testing on H6 to examine the moderating effect of market uncertainty in the relationship of competitive advantage with market performance shows values of  $\beta = 0.690$ , and  $\text{sig} = 0.000 < 0.05$ . Therefore, the hypothesis test shows the results that market uncertainty strengthens the relationship between competitive advantage and market performance. The H6 test is accepted.

## 5. Discussion

The research results show that market orientation positively, significantly influences product innovation. These study results conform to previous study that finds that market orientation positively influences achievement of innovation and performance

(Baker et al., 1999; Webb & Kreppa, 2000). This study finding also conforms to the result of previous study conducted by Fang et al. (2014) that market orientation influences market performance. Empirical evidence of the influence of market orientation on competitive advantage shows positive and significant results. This study result conforms to the finding of previous research explaining that market orientation is able to improve competitive advantage and superior performance (Hinson et al., 2017; Yadav et al., 2019). The study conducted by Narver and Slater (1990) also strengthens this study explaining that market orientation improves company resistance. Kohli and Jaworski (1990) also support this study result with finding that market orientation is able to achieve company competitiveness. The result of another hypothesis test also finds that product innovation positively, significantly influences market performance. This study result conforms to the finding of previous study that innovation influences company competitiveness (Kiveu et al., 2019; Mansyur, 2021). This study also conforms to other findings explaining that innovation influences business performance (Low et al., 2007). Another study also confirms this study finding, explaining that product innovation's influence on performance (Eshlaghy & Maatofi, 2011). This study's finding supports the finding of previous study, explaining that positional advantage positively influences business performance (Hult & Ketchen, 2001). Strong market position through market positional advantage influences improved business performance. This study finding also conforms to the finding that advantage influences business performance (Langerak, 2003). The study conducted by Baaij et al. (2004) also confirms this study finding on the positive influence of competitive advantage on performance. Clark and Machado (2006) also conforms to the finding of this research, explaining that competitive advantage improves business performance. Test on moderation role of market uncertainty that strengthens the relationship between product innovation and competitive advantage on market performance. This study result conforms to the finding of previous research, explaining that innovation encourages creation of competitiveness and performance in a dynamic environment (Lin & Chen, 2007). Holtzman (2008) also supports the finding of this research that emphasizes the importance of innovation in creating a company's future opportunities and success. Darroch and McNaughton (2002) also conforms to this research finding, explaining that competitive advantage and dynamics of the business environment are important factors that companies need to pay attention to. The study conducted by Verhees and Meulenberg (2005) also supports this study finding, explaining that market response and dynamics of competition encourage companies to create superior products, improve market intelligence and affect improved performance. The result of another study also conforms to the finding of this research, that the effort to achieve competitiveness and improved satisfaction of customer needs are company's focus amidst market uncertainty (Huang et al., 2019). Competitive advantage is the factor to encourage achieving superior performance (Meutia & Ismail, 2012).

## 6. Conclusion

The results of this research have contributed theoretically and practically. Theoretically, the results of this study have shown empirical proof of the influence of market orientation, product innovation and competitive advantage on market performance. In line with the results of this study, theoretically the results of this study have contributed to the body knowledge of resources-based view, a theory explaining company internal capability as superior resource to achieve competitive advantage and performance. The results of this study also prove the findings of previous studies indicating that market orientation is an important strategy in achieving the degree of product innovation and competitiveness of a company in improving performance and is part of growth strategy in response to rapidly changing market dynamics. The practical implication of the result of this study also shows that it is important for Batik SMEs players and owners in Surakarta in improving their market performance. In addition, the findings of this research also show the mediation role of product innovation and competitive advantage as a bridge to connect the role of market orientation in market performance. The interesting finding in this study proves that market uncertainty strengthens the relationship of product innovation and competitive advantage on market performance. This indicates that an uncertain market condition encourages Batik SMEs players to develop their product innovation and competitive advantage in order to achieve superior market performance.

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