

A CONCEPTUAL MODEL OF INCORPORATING SUSTAINABILITY INTO INNOVATION AND ITS EFFECT ON BUSINESS PERFORMANCE

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ABSTRACT

Small and Medium Enterprises (SMEs) have an important role in Indonesia's economy. Currently, SMEs can be regarded as the backbone of Indonesia's economy which contributed more than half of Gross Domestic Product and also absorbed many workers. In order to survive and deal with competitors, not only from within the country but also from abroad, SMEs need to innovate continuously. However, in their activities, SMEs can be giving an impact on environmental pollution. Therefore, it is necessary that SMEs incorporate sustainability principles in innovation they undertake. There were several studies related to sustainable innovation in SMEs. Some of them could identify the trigger factors of sustainable innovation that consist of internal and external factors, such as the pressure from stakeholders and employees, the organization identity, management perspective, and corporate social responsibility, whereas the external trigger factors include consumer demand, government regulation, social activities, and technological developments. Other studies have shown obstacles encountered in the implementation of sustainable innovation, like firm size, organizational structure, human resources, reluctance to innovate, and difficulty developing new products and expansion into new markets, minimal institutional support, high bureaucracy, and its dependence on technology. However, there have been no studies yet about sustainable innovation among SMEs in Indonesia. Therefore the research will be conducted to analyze the implementation of sustainable innovation in SMEs, particularly in Indonesia with the objectives as follows: (1) To get an understanding how SMEs in Indonesia incorporate sustainability principles when conducting innovation, (2) To provide a deeper understanding and conceptualization on the internal and external factors which have an impact on the sustainable innovation within SMEs in Indonesia, (3) To identify the constraints faced by SMEs in Indonesia in implementing sustainable innovation, and (4) To understand the linkage between sustainable innovation and SME's business performance. Data will be collected through survey, both interviews and questionnaire that will be distributed to 100 SEMs in Surabaya for a preliminary study. The analysis will be using SPSS for descriptive analysis and SEM for creating a model and getting a deeper understanding about the relationship among the identified variables. It is expected that results of this study may provide input for SMEs in Indonesia to intensify their innovation and apply sustainability principles in their daily practices.

Keywords: sustainable innovation, trigger factors, constraints, SMEs

RESEARCH BACKGROUND

In the MDGs post-2015 agenda Indonesia includes the program of Sustainable Development and Sustainable Consumption and Production in the National Medium Term Development Plan 2015-2019 (Bappenas, 2014). There are three dimensions of sustainable development which may be used as a reference to the MDGs post-2015 agenda, namely the economic, social and environmental, as has been confirmed in the United Nations Conference on Sustainable Development. Future development needs to implement a development model that ensures inclusive growth and sustainability. Changes in patterns of production and consumption are crucial requirements to achieve that goal. Moreover, the adoption of sustainable production and consumption will be preventing pollution and environmental destruction, as well as encouraging

the growth of industrial capacity products and services more environmentally friendly. To achieve these objectives, the government requires the involvement and cooperation of society, social institutions, universities, and industries.

Small and Medium Enterprises (SMEs) is one important part of the economy in a country, not least in Indonesia. According to data from the Central Statistics Agency (BPS), in 2007 SMEs contributed Rp. 2,12.3 trillion, equal to 53.6% of the total GDP of Indonesia. There are some scales in SMEs, namely: (1) Micro: maximum assets of Rp 50 million with a maximum turnover of 300 million; (2) Small Business: assets between Rp 50 million to 500 million and a turnover of between Rp 300 million-2.5 billion; (3) Medium: assets between Rp 500 million-1 billion and a turnover of 2.5 billion-50 billion (Departemen Koperasi, 2014).

Cumulatively SMEs have considerable impact, not only on the economy, but also on the social and natural environment (Lawrence et al., 2006). The production activities of SMEs contribute high enough to pollute the environment due to lack of capital, lack of knowledge and understanding of environmental impacts and the limited use of the latest technology (Indonews, 2014). An example was in 2013 SMEs contributed 2.3 million tons and 0.96 million tons of methane or equivalent 24 million CO₂. Environmental management is often considered burdensome by the SMEs so it is not managed properly. A result of environmental pollution can cause social conflict and give an impact on the availability of clean water and sanitation, as well as prohibition or restriction of SMEs products by the importing countries.

Basically SMEs have classic barriers and obstacles associated with the low quality of human resources, lack of business management, lack of access to sources of finance and markets, as well as limited information and proprietary technologies (Hardono, 2006). In conducting their business, SMEs receive less publicity, lack of assistance from the community and the media spotlight, which makes them less aware of environmental issues. As a result, SMEs tend to be indifferent to the implementation of environmentally friendly practices, which usually requires more capital and public scrutiny. Perhaps the reluctance of SMEs to implement sustainability is because sustainability does not seem to affect the company's financial performance significantly (Prabawani, 2013). For example, research by Scholtens (2006) revealed that financial performance has a weak relationship with the company's sustainability. Considering the consequences for ignoring the impact on the environment, thus it is necessary for SMEs to pay attention to the impact of their innovation on the environment and social, in addition to profit, when they do innovation. In other words, SMEs need to incorporate the principles of sustainability into their innovation. The approaches on sustainable development and innovation used with and within large, multinational corporations cannot be 'transplanted' within the context of SMEs, without regard for their specific characteristics, needs and abilities. There are still many questions regarding the approach of sustainable innovation within SMEs. They operate in relative anonymity and have a limited individual contribution to sustainability issues (Brouwers, 2010).

There are several studies related to sustainable innovation in SMEs. Some of them could identify the trigger factors of sustainable innovation, either internal or external factors. Other studies have shown obstacles encountered in the implementation of sustainable innovation. However, there have been no studies yet about sustainable innovation among SMEs in Indonesia which indicate the trigger factors and the obstacles of conducting sustainable innovation and also get an understanding about the linkage between the impacts of sustainable innovation on business performance. Therefore the research will be conducted to analyze the implementation of sustainable innovation in SMEs, particularly in Indonesia with the objectives as follows: (1) To get an understanding how SMEs in Indonesia incorporate sustainability principles when conducting innovation, (2) To provide a deeper understanding and conceptualization on the internal and external factors which have an impact on the sustainable innovation within SMEs in Indonesia, (3) To identify the constraints faced by SMEs in Indonesia in implementing sustainable innovation, and (4) To understand the linkage between sustainable innovation and SME's business performance.

In general, the results of this study are expected to provide several contributions as follows:

- a. Contributions to the development of science and technology and learning: The results of this research and its publication will expand scientific knowledge about the sustainable innovation applied by SMEs in Indonesia and the obstacles often faced by SMEs in implementing sustainable innovation.
- b. Contribution in supporting development: This research is directed to provide important input to the government in developing SMEs and creating a variety of alternative programs and activities to further improve SMEs as mentioned on ASEAN Strategic Action Plan for SME Development (2010 – 2015). Furthermore, the results of this study can be an input to involve SMEs to achieve Sustainable Development Goals in 2015-2019.
- c. Contributing to the development of institutional: This research is in line with University of Surabaya Research Master Plan 2012-2016, cluster of Business Governance, Business Performance field, and Entrepreneurship and Innovation topic with strategic issues include improved business performance and business competitiveness through innovation activity. This research will enhance the role of universities (research) in supporting SMEs and disseminating sustainable development in society. The results obtained can be used as consideration or reference for institutions about how to organize community service activities and to provide assistance to foster innovation implementation among SMEs.

LITERATURE REVIEW

In this part some of the concepts and theories related to the developed conceptual model will be explained.

Innovation

Two major problems facing the world economic system today is globalization and technological change, both creating the opportunities for developing countries to improve their technological innovation capabilities considered as the key driver of competitiveness and long-term economic development (Shang & Jolly, 2003). Innovation is defined as a result of the development and/or utilization of the knowledge, skills (including technological skills) as well as the experience to create or improve products, processes and / or new system, where the results will provide meaningful value (Jasfar, 2012). Rogers (1995) broadly defined innovation as “an idea, practice or object that is perceived as new to an individual or another unit of adoption.” In regard to business processes and economic development, Luecke and Katz (2003) stated innovation as “the embodiment, combination or synthesis of knowledge in original, relevant, valued new products, processes or services.”

According to Smith (2005), innovation is something new, create something new through the process of learning or knowledge. Innovation can be divided into four types, namely: product innovation, process innovation, organizational innovation and marketing innovation (Cordeiro, 2012). Madrid-Guijarro, Garcia and Auken (2009) stated that innovation is widely recognized as a key factor in the competitiveness of nations and companies.

Sustainable Innovation

It is important that in running innovation, the company will not only prioritize profit, but also consider the welfare of society, and think about the impact of innovation on the environment. This is consistent with the idea that the use of natural resources currently will not sacrifice the interests of future generations, which is termed as sustainable development (Wheeler & Elkington, 2001). Thus the company is expected to deliver sustainable innovation that consist of the development of new products, processes, services and technologies that contribute to the development and well-being with regard to natural resources and regenerative capacity (Tello,

2008). Furthermore sustainable innovation can be defined as innovation activities that contribute to the sustainable development that is beneficial in terms of economic, ecological, and social (Boersema & Bertels, 2000). Companies are faced with several choices of sustainable innovation; whether they just react to the situation by using the minimum of resources to address the factors triggering or company should be proactive, considering their responses can be used as a strategic advantage (Tello, 2008).

There is a combination of internal and external triggering factors that affect the company's commitment to running a sustainable innovation (Yoon, 2009). Some studies suggest the internal trigger factors of which are the pressure from stakeholders and employees, the organization identity, management perspective, and corporate social responsibility, while the external trigger factors include consumer demand, government regulation, social activities, and technological developments. Company's response to the trigger factors is different from each other, depending on the company's view of the relationship between growth and the environment with a combination of trigger factors they face.

In addition to trigger factors, there are also obstacles encountered in the implementation of sustainable innovation. Internal constraints come from the organization itself, such as the age of the firm, firm size, organizational structure, bureaucracy, conservative organization, the age of the employee, and the difficulties of mobility from the top management to investment innovation. Other internal constraints are related to human resources, namely low skill of employee, poor motivation, reluctance to innovate, and the lack of incentives. External barriers could be conservatism and market volatility, size and situation of the business sector, global crisis, difficulties implementing new products, higher taxation, difficulty developing new products and expansion into new markets, lack of financial support, minimal institutional support and inadequate disclosure and access to information, credit policies, high bureaucracy, and its dependence on technology (Cordeiro, 2012).

Natarajan (2011) developed a framework of how the triggering factors and constraints were affecting the sustainable implementation shown in Figure 1. The triggering factors were classified into two, namely (1) internal factors: lower costs, reduce waste, and improve the working environment and (2) external factors: regulations and consumer demand. Constraints were also categorized into two, namely (1) internal constraints: lack of finance and expertise, and (2) external constraints, namely the lack of information and historical data requests. The model was tested on SMEs in the United States, with the result that SMEs had a little motivation to undertake sustainable practices. Therefore, attention should be given to the constraints affecting the performance of sustainability. This study will use the model as a reference, which will be adapted to the circumstances of SMEs in Indonesia.

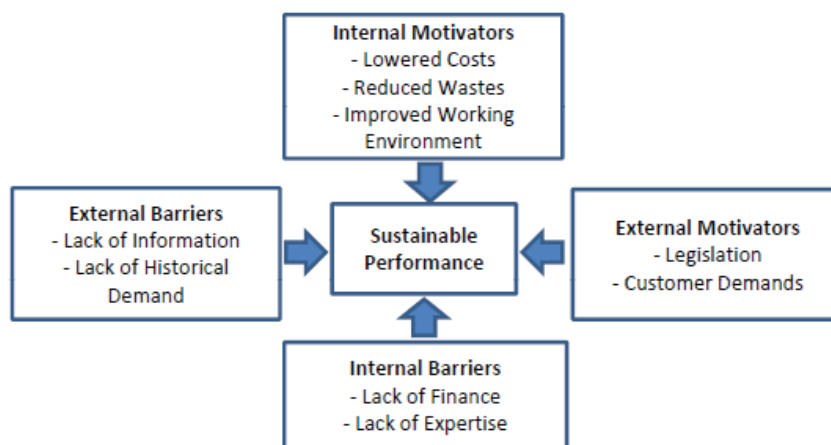


Figure 1. Sustainable Performance Four Force Model (Natarajan, 2011)

Overall, the research roadmap which presents the comparison of the results of several preliminary studies can be seen in Table 1.

Table 1. Research Roadmap

Year	Researcher	Topic	Results of Research
1999	Athanasios Hadjimanolis	Barriers to innovation for SMEs in a small less developed country (Cyprus)	Internal obstacles: lack of time, inadequate R&D, and inadequate finances. External obstacles: government regulatory policies, the acquisition of resources, access to technology providers and and government environment, labor, and consumer protection policies.
2009	Madrid-Guijarro <i>et al.</i>	Barriers to innovation among Spanish manufacturing SMEs	Internal barriers: lack of financial resources, inappropriate human resources, and weak corporate financial position, high costs and high risk; external barriers: turbulent business environment, lack of external cooperation opportunities, lack of information, and lack of government support.
2009	Yoon, Eunsang & Steven Tello	Drivers of Sustainable Innovation: Exploratory Views and Corporate Strategies	A conceptual framework for examining how companies respond to the key drivers of sustainable innovation and suggested that the manner of response is related to a firm's view of the relationship between economic growth and the environment.
2011	Ganapathy S. Natarajan, David A. Wyrick,	Framework for Implementing Sustainable: Practices in SMEs in the United States	The major trigger factors: financial strength, technological expertise, availability of information, legislation, consumer pressures, and organizational culture.
2012	Ana Sílvia Cordeiro, Filipa Dionísio Vieira	Innovation: A Strategy that Leads to Competitiveness in SMEs	Barriers to innovation : the current economic climate, the limitation of monetary resources, the reduced risk-taking culture, the mechanical performances, the routine and cemented process, the organisational and human resources resistance to change, the lack of incentives and compensation for innovation, the high cost of new tools, the processes and the small size of companies.

A Conceptual Model

From previous studies, some development can be carried out in this study. Innovation in SMEs will be identified which refers to sustainability that covers the economic aspects (profit), human (people), and environment (planet). This research will try to investigate not only the factors that trigger sustainable innovation, but also simultaneously to analyze obstacles or barriers faced by SMEs in the implementation of sustainable innovation. Moreover, it will be analyzed the linkage between sustainable innovation and business performance. As a preliminary study, the research will be conducted on SMEs in the city of Surabaya.

A conceptual model of sustainable will be created to describe the causal relationship between trigger factors and obstacles of sustainable innovation and also the impact of it to the business performance with explanations as follows:

- Trigger factors will be grouped into internal and external factors. Internal factors are organization itself, profit, and competitive advantage, while external factors are consumer demand, competitor, government regulation, social activities, and technological developments.

- Obstacles will be in two categories that include internal obstacles, such as lack of financial, lack of time, lack of human resources, and the reluctance to innovate and external factors that include lack of information, government, and access to technology providers.
- Sustainable innovation performance of the SMEs will be analyzed through assessment that covers aspects of economics, human, and environmental.
- Business performance will be measured through profit, employee performance, and company image/reputation.

In general a complete conceptual model of sustainable innovation can be seen in Figure 2.

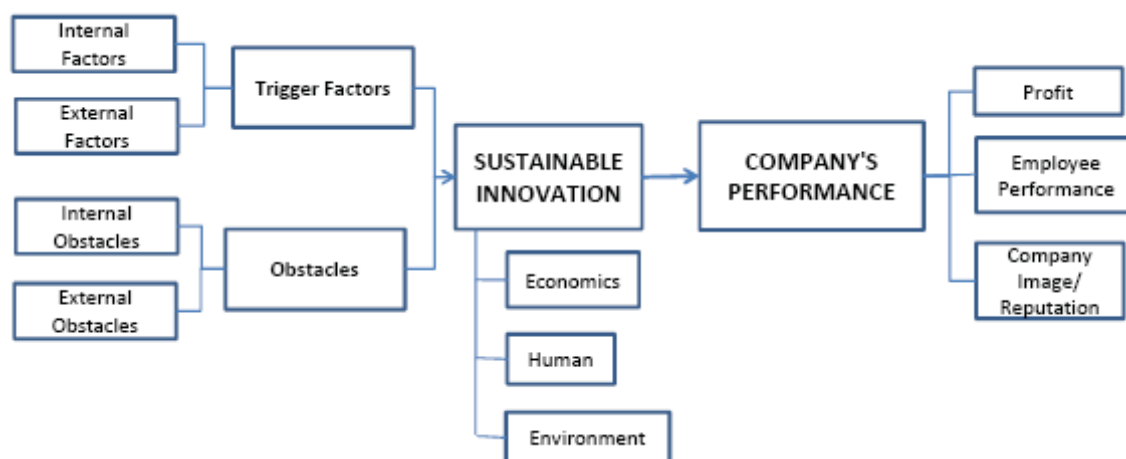


Figure 2. A Conceptual Model of Sustainable Innovation in SMEs

RESEARCH METHODS

This research can be categorized as an exploratory research because the purpose is to identify the factors that trigger companies to sustainable innovation, and the constraints faced by them in implementing sustainable innovation. Due to limited time and resources, the research will be limited only on some manufacturing companies in Indonesia, especially small and medium enterprises (SMEs). There are four questions to achieve the research objectives as follows:

Q1. How do SMEs incorporate sustainability into their innovation? This question firstly concerns with the condition of sustainability principles implemented by companies in innovation they undertake.

Q2. Why do SMEs implement sustainable innovation? The answers will lead to the identification of trigger factors of sustainable innovation.

Q3. What are the constraints faced by SMEs in carrying out sustainable innovation? The results of this answer will give an understanding of the obstacles faced by SMEs in implementing sustainable innovation.

Q4. How is the connection between sustainable innovation and SME's business performance? The answers will describe the impacts of sustainable innovation on the business performance.

Research will use two types of data needed in this study, namely primary data and secondary data. Primary data will be obtained directly from interviews with the owners and by distributing questionnaires to the owners. These data include the characteristics of company (scale, age, type of product, capacity, and location), internal factors and external triggering sustainable innovation, as well as the constraints faced by companies in implementing sustainable innovation, and also the performance of current business. Questionnaire includes questions on the multiple choices to get a profile of the respondents and the variables associated to sustainable innovation with the Likert scale. Secondary data will be obtained indirectly from the source, such as sales history, type of product, production process, and the history of the SMEs. Data processing will be conducted with SPSS to test the validity and reliability, and then proceed with the cross tabulation

analysis to determine differences among groups of respondents' profiles, as well as MANOVA analysis to discern the factors and also factor analyses to identify the variables which have a significant impact. A model using SEM will be created to analyze the relationship among the identified variables of sustainable innovation and to understand the linkage between sustainable innovation and business performance as explained in Figure 2. There will be also recommendations to foster sustainable innovation practices in SMEs. From data processing and analysis, the conclusion can be obtained from this study that includes the analysis of the factors that trigger sustainable innovation in SMEs as well as what are the constraints faced by SMEs in implementing sustainable innovation, and also the connection between sustainable innovation and business performance. Suggestions will be given for further research.

The research methodology can be explained through the flow chart in Figure 3 below:

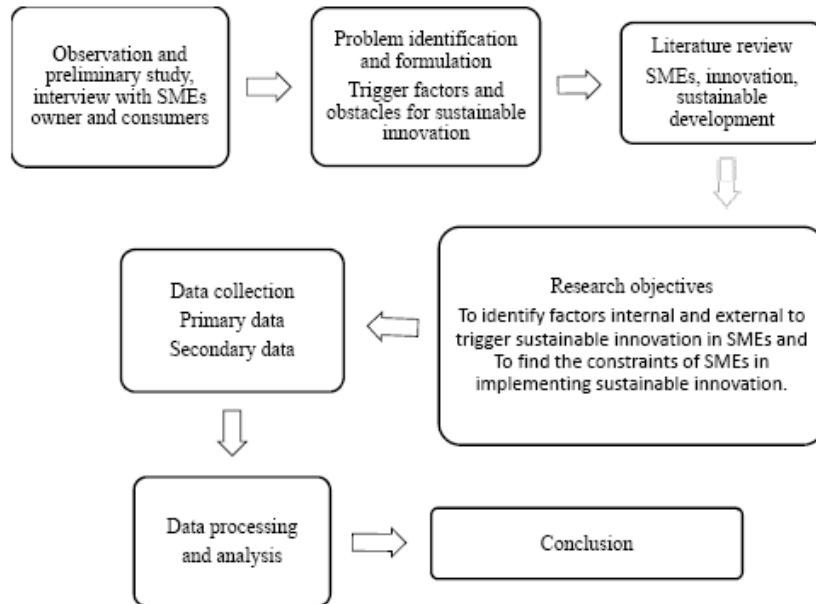


Figure 3. Research Flowchart

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FOREWORD

INSYMA has become a tradition of its own for the Management Department of Universitas Surabaya. For more than a decade this event has become a forum for academics and practitioners to share knowledge. Every year Management Department always brings the latest theme that becomes an important issue for the development of science.

This year, INSYMA raise the theme **SUSTAINABILITY AS A STRATEGIC BUSINESS ORIENTATION IN GLOBAL ECONOMY RECOVERY PHASE**. This theme interesting, considering recently, the companies are adapting to volatile and uncertain conditions as a way of life to survive. There are some important business issues and each requires a specific and appropriate response. These issues are namely governance, innovation technology, operations, regulations, risks, strategy & growth, sustainability, talent and the economy issues. The company requires its own way to deal with each of these issue so that the companies can achieve business growth and survival.

Hundreds of scientific papers are sent to a conference committee, and the results of a rigorous selection of more than 90 elected. This paper is derived from a variety of authors, both within and outside the country, academics and practitioners. All the articles are then presented at the symposium and documented in these proceedings.

We hope that these proceedings can contribute to the development of science and business practices. Hopefully you can enjoy and gain valuable lessons from this article collection. We look forward to your participation in next INSYMA.

Makassar, South Sulawesi, Indonesia
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