

THE EFFECT OF ORGANIZATIONAL INERTIA AND CUSTOMER ORIENTATION WITH INCREMENTAL INNOVATION AS THE MEDIATING VARIABLE TOWARDS ORGANIZATIONAL PERFORMANCE

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JEE
11, 1
Received, February '22
Revised, February '22
Accepted, March '22

Abstract: The purpose of this study was to find out the relationship between Organizational Inertia, Customer Orientation, Incremental Innovation and Organizational Performance. The sample used in this study were 180 Micro, Small and Medium Enterprises (MSME) companies spread across East Java. The reason MSMEs are used in this study is related to the concept of organizational inertia that is attached to small-scale companies. From this study it was found that incremental innovation is not a mediating variable that links organizational inertia and customer orientation with organizational performance.

Keywords: organizational inertia, customer orientation, incremental innovation, organizational performance

INTRODUCTION

In the last century, the global economy has been faced with several recessions caused by sudden changes. But in the case of COVID-19, academics and practitioners find a new threat in human life that is global in nature. The spread of the virus known as Covid-19 has become a worldwide pandemic. The virus first appeared at the end of 2019 in Wuhan, China (Lin et al., 2013). After that, it spread so fast and massively to various countries in the world. Not only dangerous for the health sector, Covid-19 also brings losses to the economic sector. The losses to countries affected by this virus are quite large (Hidayaturrahman & Purwanto, 2020; Irawan, 2020)

The COVID-19 pandemic has had a negative impact on the world economy in all types of

industries and sectors (Patma et al., 2020). Actions and steps taken are not only to contain the spread of the pandemic but also to keep the economy able to sustain and minimize negative impacts. One of the actions taken by many countries is to limit the activities of their citizens in several stages, ranging from physical distancing to lockdown measures. Due to these steps and actions taken, many people are unable to run their normal business by interacting directly with customers locally or globally (Schafer, 2007). Unless there is a permanent solution to cure the pandemic or put in place proper precautions and live with the virus, this condition can last for a long time. This situation not only has an impact on their current business performance but also threatens the viability and sustainability of their business (Priambodo et al., 2021).

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Based on information submitted by the Director of Apprenticeship Development at the Ministry of Manpower, Siti Kustiati, 96% of companies in Indonesia have been affected by the Corona pandemic. This conclusion was drawn based on a survey conducted with the Indonesian Institute of Sciences (LIPI) and the Demographic Institute of FEB UI. In detail, there are 57.1% of companies whose income has decreased due to the corona pandemic. Then, there were 39.4% of companies that stopped operating due to corona. Only 1% of companies claim their revenue has increased during the pandemic. Meanwhile, 2.5% of companies stated that they were not affected by the corona pandemic (Katadata, 2020).

The development of the digital era in the era of globalization must be recognized as greatly affecting the economy, including the retail industry. If in the last few years, the retail industry wants to displace the existence of traditional markets, under current conditions, one by one, the existence of retail industry players must fall one by one. The main cause is the fear of consumers to make conventional shopping transactions. Therefore, many industry players must innovate by providing a virtual way of learning to facilitate consumer transactions, of course by using information technology using online applications (Amri, 2020).

Ahlstrom et al., (2020) stated that the new normal environment and life will have an impact on business practices and methods, for that the role of organizational leaders or MSME owners must prepare personnel both through information technology and other strategies. For this reason, the ability of leaders is very important in facing the new normal of today where business practices will inevitably change and will have an impact on the marketing,

production and sales processes as well (Postavaru et al., 2020). Furthermore, to improve business performance, small and medium business owners must have entrepreneurial knowledge and skills as well as strategic agility that will support their business performance (Widjajani & Nurjaman, 2020). In addition, small and medium Enterprises must have an assessment of their business performance, have a business performance evaluation matrix that is applied periodically to ensure business growth (Mahmudova, 2018). Small and medium enterprises must carry out open innovations such as understanding customer desires that prioritize commercial aspects, besides that product innovation is also important, as an important note that small and medium enterprises have very limited funding so that innovations made must be in accordance with their business goals (Khan & Arshad, 2019).

THEORETICAL REVIEW

From the explanation that has been given, companies must use the resources they have to make changes following market changes, for example changes caused by the Covid-19 pandemic. Changes or adaptability made by the company is called dynamic capability. Thus, it can be said that dynamic capability tries to use company routines related to strategic capabilities to be able to make changes, adapt to changes that occur in the environment. dynamic (Teece et al., 1990; Teece et al., 1997; Helfat et al., 2009). Many experts even state that dynamic capability is a critical success factor that must be owned by a company. Therefore, the author uses dynamic capability as a grand theory in this research.

Inertia is the strong persistence of the existing structure. For organizational survival

or success, inaction is a double-edged sword, meaning that it can have both positive and negative effects (Wernerfelt, 1984). In a stable environment and conditions, the phenomenon of inertia provides organizations with a sense of stability (Hannan & Freeman, 1984; Amiripour et al., 2017). However, in the current conditions where there are very significant changes due to the Covid-19 pandemic, MSME owners must be able to adapt to be able to survive in business competition. If the company is reluctant to change and adapt, persists with the inaction that has been used as a guide in operating, it can be believed that the company's age will not be long.

Innovation refers to the application of a new concept or behavior. In this context, innovation can be a new product, service, technology, or management method (Damanpour et al., 1989; Damanpour, 1991; Zammuto & O'Connor, 1992). In the face of intense competition and uncertainty, innovation is becoming increasingly significant for organizations to survive and grow (Huang et al., 2020). In the context of current conditions where the global business environment has changed, companies are obliged to innovate, because without innovation the company will not have good performance or be able to survive in the competition. One form of application of innovation is to create value for customers. In the current condition of customer behavior, where the majority of customers are more comfortable doing online shopping transactions than conventional systems, companies must adopt a new system. Because this is a new system, there is a possibility that the adaptation process will not take place perfectly. Therefore, how the company can accept and apply the new system depends on whether the company's values and culture are easy to accept something new or tend to be resis-

tant (Polites & Karahanna, 2012; Moradi et al., 2021).

Innovation, if classified based on the intensity and scope, is divided into incremental innovation and radical innovation. Incremental innovation is a relatively small change from current practice to improve an old product or procedure without having to interfere with the company's existing structure and strategy. This type of innovation introduces relatively minor changes to existing products and often reinforces the dominance of established companies (Nelson and Winter, 2002; Tushman and Anderson, 1986). Meanwhile, radical innovation causes fundamental changes in the company's activities and displays a significant deviation from current practice (Koberg et al., 2003; Abiodun, 2017). In the context of companies experiencing inertia (sluggishness) the application of the type of innovation that is able to be applied is incremental innovation because it does not interfere with the existing corporate culture. This is also reinforced by the existence of MSMEs where the majority of economic practitioners have attached this type of innovation to MSMEs. Oduro & Nyarku (2018) also say that incremental innovation has been recognized as a key factor for the survival and growth of MSMEs in today's highly competitive business world.

Regarding the performance of an organization, there are several views that say that strategic orientation is a strategy that must be owned by the company to help the company achieve the desired goals, in this case the company's performance is good and can survive in the competition. Strategic orientation is defined as a strategic direction carried out by a company to create the right behavior for sustainable superior business performance (Gatignon & Xuereb, 1997;

Menguc & Auh, 2005; Narver & Slater, 1990). An important aspect of strategic orientation is the creation of shared values and behaviors across the organization. When the strategic orientation extends to all levels of the organization, it becomes the culture of the organization.

The question is how can a company that has the right strategic orientation create a corporate culture that supports and facilitates incremental innovation? Some experts (Narver & Slater, 1990) state that if the company focuses on distributing the desired information to all parts of the company on an on-going basis, the desired corporate culture can be achieved, including as well as a culture that values innovation. From the findings presented by researchers, many journals state that organizational inertia has a negative relationship with company performance, but there are also journals that state the opposite. In addition, the strategic orientation carried out by the company is said to have a positive relationship with the company's performance. One example of strategic orientation is customer orientation. Customer orientation is an organizational culture that facilitates understanding of potential customers and a focus on creating sustainable customer value (Narver & Slater, 1990). A customer-oriented company generates data obtained today and for the future needs of targeted customers. Employees in customer-oriented organizations are aware of who the customers are and how they should be served. This study also uses companies that are included in the MSME scale as respondents, while most of the research conducted related to the variables mentioned above uses large companies as research objects. Based on the explanation previously explained, the researcher wants to examine more deeply about: The Effect of Organiza-

tional Inertia and Customer Orientation with Incremental Innovation as the Mediating Variable towards Organizational Performance”

METHOD

The method used in this research is quantitative research. Quantitative research is described as research that collects numerical data, where the numerical data will be analyzed to find conclusions. Variables will be estimated, prepared, and analyzed through statistical methods. This research is a quantitative research in which the data obtained from the questionnaire will be analyzed statistically using Structural Equation Modelling in the SmartPLS program. Quantitative research is mainly concerned with the collection and analysis of data that can be presented numerically (Goertzen, 2017). The whole series of cases from which the researcher's sample is taken is called the population (Taherdoost, 2016).

The population is the whole phenomenon, people, objects that attract the attention of researchers where researchers want to make conclusions based on statistical data (Sekaran & Bougie, 2016). In the context of this study, the population included are owners of MSMEs spread across East Java. The sample is part of the population. In this context, part of the population (not all), will form the sample (Sekaran & Bougie, 2016). Researchers used non-probability sampling that is using purposive sampling technique in which the respondents who are able to fill in the questionnaire are the owner or the manager of the MSME in which they have the full insight of the company using the following criteria:

1. Included in the MSME scale
2. Spread in East Java
3. Have been established for at least 5 years

Determination of the number of samples based on Hair et al., (2014), depends on the number of indicators. The number of indicators can be multiplied 5x to 10x. Researchers decided to use 6x, with the following calculations:

1. Sample = number of indicators
2. Sample = 30 indicators x 6 = 180 respondents

Based on the above calculation, the sample used is 180 respondents.

A variable is defined as a concept that can be measured and the measurement results vary. In this study, researchers used four variables as follows:

1. Exogenous Variables: Organizational Inertia (X1) and Customer Orientation (X2)
2. Mediation Variable: Incremental Innovation (Z).
3. Endogenous Variables: Organizational Performance (Y).

Based on Hair et al., (2017), mixing path analysis-based regression with a structural equation model is used in PLS-SEM which estimates the parameters of the set of equations in the structural equation model. This study uses an analytical tool in the form of Structural Equation Modelling (SEM) with a Partial Least Square (PLS) approach. SEM-PLS examines the causal relationship between research variables. (Guterres & Armanu, 2020).

In this study, the hypotheses taken are as follows:

1. Does Organizational Inertia have a negative and significant impact on MSME Incremental Innovation in East Java?
2. Does Customer Orientation have a positive and significant impact on MSME Incremental Innovation in East Java?
3. Does Organizational Inertia have a positive and significant effect on the Organizational Performance of SMEs in East Java?

Table 1 Conceptual Definition

Variable	Conceptual Definition	Indicator	Definition
Organizational Inertia (Independent Variable / X ₁)	Organizational inertia is a phenomenon where an organization adheres to past practices, past policies that are deemed correct and have brought the company to a better, more successful, (Huang et al., 2020)	<ol style="list-style-type: none"> 1. Insight inertia 2. Psychological inertia 3. Action inertia 4. Structural inertia 5. Economic inertia (Moradi et al., 2021) 	<ol style="list-style-type: none"> 1. Insight inertia is the company's lack of understanding of environmental changes 2. Psychological inertia is the rejection by members of the organization related to the psychological side. 3. Action inertia is the inertia associated with actions not taken by the company. This can be attributed to the company's slow response to environmental activities 4. Structural Inertia is related to the company's inability to make changes in organizational structures and processes 5. Economical Inertia is the company's reluctance to make changes because changes will definitely require funds

Customer Orientation (Independent Variable / X ₂)	Customer Orientation is an organizational culture that focuses on buyers, aiming to create sustainable customer value. (Narver & Slater, 1990).	<ol style="list-style-type: none"> 1. Customer satisfaction 2. Focus on customer experience 3. Creating competitive advantage 4. Measuring customer satisfaction 5. Conduct customer survey (Grawe et al., 2009) 	<ol style="list-style-type: none"> 1. Business goals are mainly driven by customer satisfaction 2. Companies communicate information about customer experience across all business functions 3. The company's strategy to gain a competitive advantage is based on an understanding of customer needs 4. Companies often measure customer satisfaction 5. The company regularly surveys end customers to assess the quality of products and services
Incremental Innovation (Mediation Variable / Z)	Incremental innovation is an innovation to improve the performance of products that have been established at this time by trying to satisfy the needs of existing customers through product improvements and enhancements which ultimately increase the company's efficiency (Zhou & Li 2012).	<ol style="list-style-type: none"> 1. Repairing the product 2. Make small adaptations 3. Improvements for local market 4. Product efficiency (Sheng & Chien, 2015) 	<ol style="list-style-type: none"> 1. Improve the provision of existing products and services. 2. Implement minor adaptations to existing products and services. 3. Improved products and services are readily available for the local market. 4. Improve the efficiency of service and product provision.
Organizational Performance (Dependent Variable / Y)	Organizational performance is reflected in how the organization uses all its resources to achieve the expected goals and objectives through the activities and processes carried out (Cho & Dansereau, 2010).	<ol style="list-style-type: none"> 1. Profitable 2. High sales volume 3. Experiencing growth 4. Global competitiveness increases 5. Strengthening strategic position 6. Market share increases (Abiodun, 2017) 	<ol style="list-style-type: none"> 1. This company is very profitable 2. The company has generated high sales volume 3. The company has achieved rapid growth 4. This company has increased our global competitiveness. 5. The company has strengthened our strategic position 6. This company has significantly increased our global market share

4. Does Customer Orientation have a positive and significant impact on the Organizational Performance of SMEs in East Java?
5. Does Incremental Innovation have a positive and significant impact on the Organizational Performance of SMEs in East Java?

According to Hair et al. (2017), to measure convergent validity, there are two measurement. First is the outer loading and the second one is average variance extracted or AVE. To be considered as valid, the outer loading of each indicators should be above 0.7, while the amount

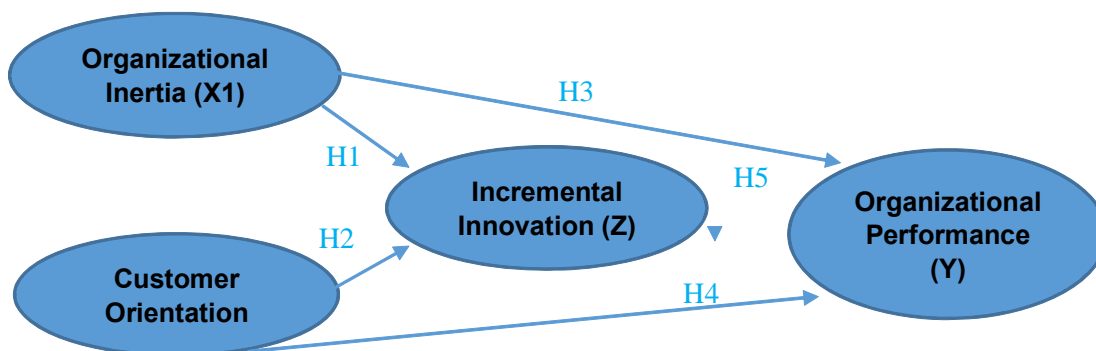


Figure 1 Research Model

of AVE or average variance extracted must be > 0.5. If the outer loading is above 0.7 and the average variance extracted exceed 0.5, it can be considered as valid. If the amount of outer loading is below 0.7 and the average variance extracted is below 0.5, then some indicators will need to be deleted to increase the value of the average variance extracted and to meet the criteria of the validation.

However, in special cases, researcher can consider not to delete the indicators if the

result of the outer loading is within 0.4 and 0.7. If the AVE is above 0.5 already, indicators with outer loading within the range of 0.4 until 0.7 will not need to be deleted. The result of the convergent validity, which consist of outer loading and average variance extracted (AVE) have been gathered and can be seen in Table 2 and Table 3. Table 2 indicates that there are several outer loadings with a value below 0.7 that will not be deleted because the value of the AVE has exceeded 0.5.

Table 2 Outer Loading Value Second Testing

Indicator	X1 Organizational Inertia	X2 Customer Orientation	Z Incremental Innovation	Y Organizational Performance
OI.4	0.999			
OI.5	0.564			
CO.1		0.929		
CO.3		0.789		
II.1			0.535	
II.3			0.956	
OP.1				0.715
OP.2				0.801

Table 3 Average Variance Extracted (AVE) Second Testing

	Average Variance Extracted (AVE)
X1 (Organizational Inertia)	0.606
X2 (Customer Orientation)	0.743
Z (Incremental Innovation)	0.601
Y (Organizational Performance)	0.576

RESULT

All outer loading values of each indicator are well exceeding the value of 0.70, which suggests sufficient levels of indicator reliability. Hair et al. (2017) suggests that the reliability test can be carried out by evaluating composite reliability assessment. The assessments are acceptable when the value is within 0.60 to 0.70, and are considered as satisfactory when the value is 0.70–0.90. Table shows the result of reliability test using composite reliability.

R² (R-squared) or usually called as coefficient of determination was used to explain the mediation variable and the dependent variable. Table 5 shows the result of the R-Squared testing of this research.

From Table 5, the value of R-square on *variable organizational performance* (Y) is 0.363 and the value of R-square of *incremental innovation* (Z) is 0.336. It can be interpreted that *organizational performance* can be explained from 36.3% of *organizational inertia*, *customer orientation* and *incremental innovation* while the rest 63.7% are explained by other variables outside this research. Variable *incremental innovation* (Z) can be explained by 36.6% of

organizational inertia, customer orientation while the other 63.4% are being explained by other variables outside of this research. The R-square are quite low because there are only three variables studied in this research, which are organizational inertia, customer orientation and incremental innovation as mediation. If the amount of variables used is higher, the R-square value can increase as well. According to Moralesa et al. (2007), the organizational learning can also influence organizational performance. Researcher think, this variable can be used to add more variable for the upcoming research in the future.

Path coefficient is the method used to show the relationship between the variable, whether the variable has a positive or negative effect and usually fall between -1 until +1 (Hair et al., 2017). T-statistic is the method used to measure the mediation variable, whether the mediation variable act as a partial mediation, full mediation, or no mediation at all. If the value of T-statistic is > 1.96, then it can be considered as significant. Tables 6 and 7 show the results of the path coefficient and t-statistic testing.

Table 4 Composite Reliability Assessment

Composite Reliability Value	
Variable	Composite Reliability
X1 (Organizational Inertia)	0.731
X2 (Customer Orientation)	0.851
Z (Incremental Innovation)	0.736
Y (Organizational Performance)	0.731

Table 5 R-Square

	R-Square
Z (Incremental Innovation)	0.366
Y(Organizational Performance)	0.363

Table 6 Path Coefficient

	Original Sample	Sample Mean	Standard Deviation	T-Statistic	P-Value
X1 → Y	-0.128	0.092	0.329	0.389	0.697
X1 → Z	0.626	0.493	0.269	2.330	0.020
X2 → Y	0.650	0.458	0.325	2.000	0.046
X2 → Z	-0.049	0.005	0.155	0.317	0.751
Z → Y	-0.092	-0.018	0.339	0.272	0.786

Table 7 T-Statistic

	Original Sample	Sample Mean	Standard Deviation	T-Statistic	P-Value
X1 → Z → Y	0.012	0.068	0.160	0.074	0.941
X2 → Z → Y	-0.060	-0.073	0.103	0.581	0.561

Tables 6 and 7 describe the relationship between the variables in this study. Variable X1 organizational inertia has a negative relationship with organizational performance because it has a T-Statistic of 0.389 lower than 1.96 which indicates that there is no significant relationship between the two variables. Variable X1 organizational inertia also has a positive T-Statistic value of 2.330 and greater than 1.96 so that the relationship between organizational inertia and incremental innovation is positive and significant. However, if you look at the T-Statistic value between the X1 organizational inertia variable through the Z incremental innovation variable to the Y organizational performance variable which is only 0.074 below 1.96, then although the relationship is positive but not significant. It means that incremental innovation cannot be a media variable between organizational inertia and organizational performance.

Variable X2 customer orientation has a positive and significant relationship with organizational performance because it has a T-Statistic value of 2, higher than 1.96. The variable X2 customer orientation also has a positive

relationship with the variable Z incremental innovation but it is not significant because the T-Statistic value is 0.317, smaller than 1.96. In addition, if we compare the T-Statistic value between X2 customer orientation towards variable Y organizational performance through variable z incremental innovation is 0.581, below 1.96 which means the relationship is positive but not significant. This means that incremental innovation is not a mediating variable between customer orientation and organizational performance.

DISCUSSION

Relationship between Organizational Inertia and Organizational Performance

As previously explained, organizational inertia is expected to have a negative relationship with organizational performance because conceptually the existence of inertia causes companies not to adapt to environmental changes so that in the end the company's performance will be poor. In this study, according to the T-Statistic value, there is a unidirectional but not significant relationship, this means that the first

hypothesis is rejected. The results of this study are in accordance with the research of Amiripour et al., (2017) which states that there is a negative relationship between organizational inertia and organizational performance, but the results of this study are not significant. Research from Carvalho et al., (2018) in accordance with the results of this study that the existence of organizational inertia can give various results to the company, sometimes it can have a positive relationship, sometimes it can be negative and sometimes it is not significant. In the context of this study, although there is a negative relationship between organizational inertia and organizational performance, it is not significant. Researchers feel that one of the causes of the insignificant relationship is because it is related to the Covid-19 pandemic. Currently, the negative effects of this pandemic are massively attacking almost all sectors in the nation's economy and almost all companies are feeling the negative effects. Therefore, whether a company has inertia or not, in general the company's performance remains poor.

Relationship between Organizational Inertia and Incremental Innovation

Many parties argue that innovation will require a lot of money so it is not suitable for companies on the MSME scale. Therefore, for MSMEs that will innovate, it is enough to carry out incremental innovation which does not require large costs (Christiansen, 1997). Related to this, most MSME companies are in the family business category so that the owner is the determinant of company policy. If the company is deemed to have been successful, the existing policies will be maintained, so that there is a perceived positive relationship between organizational inertia and incremental

innovation (Huang et al., 2012; Huang et al., 2013). This is proven in this study where organizational inertia has a positive and significant relationship with incremental innovation. If the company is reluctant to change, then the type of innovation carried out is incremental which does not require a lot of cost (Tetteh & Essegbey, 2014), does not use high technology and adapts to the circumstances and capabilities of the company.

Relationship between Customer Orientation and Organizational Performance

How the company carries out its activities depends on the choice of strategic orientation chosen by the company. If the company chooses customer orientation, the company will design strategies and policies that aim to satisfy customers. The company's focus will be to provide a pleasant experience for customers so that customers will be more satisfied and become loyal customers. Thus the company's performance will be good because many consumers have become loyal customers (Grawe et al., 2009; Voss & Voss (2000). This is also what happened in this study where customer orientation has a positive and significant relationship with organizational performance. If consumers satisfied, the company's performance will be good. The relationship between customer orientation and organizational performance moves in the same direction.

Relationship between Customer Orientation and Incremental Innovation

Grawe et al. (2009) in his research found that company orientation has a positive relationship with innovation by the company. However, in this study it was found that customer orienta-

tion and incremental innovation have a unidirectional but not significant relationship. This may be due to the wishes and hopes and dreams of consumers being difficult for the company to achieve, so the company will find it difficult to satisfy consumers by only using pre-existing resources. Assuming writer. Therefore, even though the T-Statistic value is positive, which means there is a unidirectional relationship between customer orientation and incremental innovation, the results are not significant.

The relationship between Incremental Innovation and Organizational Performance

Innovation is related to adjustments that must be made to be able to adapt to changes in the environment, especially with changes in consumer tastes. In accordance with the times, market tastes will also change. If companies can see this opportunity by innovating, where for SMEs the innovation is incremental innovation, the company's performance will be good (Abiodun, 2017; Oduro & Nyarku, 2018). However, in reality, this is not the case in this study. Although from the T-Statistic value the relationship is positive but not significant. According to researchers, this is related to the condition of the Covid-19 pandemic. When the negative effects of the pandemic hit all parts of the economy around the world, the majority of companies suffered losses and many even went

bankrupt. Therefore, the company's performance at that time was not too much influenced by the innovations made by the company.

In this study, it was found that only two hypotheses were accepted, namely the relationship between organizational inertia and incremental innovation and the relationship between customer orientation and organizational performance. In addition, incremental innovation is not a mediating variable that links organizational inertia and customer orientation with organizational inertia. The weakness in this research is that incremental innovation which is used as a mediating variable is not proven. This means that there are other factors that cause incremental innovation to not function properly. This can be attributed to the current conditions where the majority of companies experiencing losses are subject to the negative effects of the Covid-19 pandemic. Another thing that was found related to the respondents from this study, namely companies on the scale of SMEs so that the effects of organizational inertia and organizational performance are more affected. If possible, future research can be carried out when the effects of Covid-19 have ended so that the results of the research can be more independent. Beside that, if in this research incremental innovation is not performing as the mediation variable, other variables can be use to change it.

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