International Review of Management and Marketing

ISSN: 2146-4405

available at http: www.econjournals.com

International Review of Management and Marketing, 2016, 6(S7) 355-360.

Special Issue for "International Soft Science Conference (ISSC 2016), 11-13 April 2016, Universiti Utara Malaysia, Malaysia"

The Effect of Social Capital on the Product Innovativeness and Marketing Performance in Indonesian Furniture Small and Medium-sized Enterprises

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ABSTRACT

The application of product innovativeness is considered to bring opportunities for product development, technological advances, and the earning of profit for the company. For certain products based on the rapidly changing mass-production technique and design such as small-scale traditional furniture, employees play a key role in generating innovative products. In such context, the relational quality among the employees in the form of social capital is considerably important to analyze the role of trust among internal stakeholders, and its impact on the innovativeness and performance. This study concluded that the internal structural relationship is more likely to improve the innovativeness and performance of furniture small and medium-sized enterprises. The novelty of this study lies on its focus on the extent that the innovative product can be produced by emphasizing on the establishment of internal social capital and stakeholder trust without involving external collaboration or network interaction.

Keywords: Social Capital, Trust, Product Innovativeness, Performance, Furniture Small and Medium-sized Enterprises, Indonesia
JEL Classifications: J24, M31

1. INTRODUCTION

Even though the company's main activity is basically to improve the performance of products, the most common facing problem, especially in the small and medium enterprises (SMEs), is how to create the innovative product by exploring the available limited resource. Some argue that creating innovation by utilizing company resource is easier to be captured in large-scale organizations (e.g. McAdam and Reid, 2001), than in smaller organizations that face limited innovation to compete, due to restricted resources owned (Lindermann et al., 2009). Hence, small enterprises will tend to create internal collaboration and networking development to face the competition.

Besides the limitation of internal tangible resources such as technology and physical equipment, empirical analysis of the relationship of traditional furniture SMEs, social capital and product innovativeness is highly attractive to examine, as the furniture industry is characterized by the high demands of decorative and functional elements to meet the aspect of utility, economy and fashion as the triggering factors of innovation. Various previous studies theoretically revealed different findings in the relationship between product innovativeness and social capital utilization, especially in terms of relationships and trust among employees, and between employees and companies. Dakhli and De Clercq (2004) find the negative relationship between social capital proxied by trust, associational activity, and norms of civic behaviour and innovation. Ellonen et al. (2009), however, state that the level of trust highly has a positive impact on the product innovativeness. Similarly, Tyler (2001) states that trust is more likely to be able to influence product innovation through increased efficiency and effectiveness of communication, cooperation and commitment between stakeholders.

Unlike most preceding studies that emphasize on the external business networking as determinant of innovation and performance (e.g. Cooke and Wills, 1999; Pittaway et al., 2004; Anderson and Jack, 2002; Street and Cameron, 2007; Zeng et al., 2010), this study attempts to analyze the quality of development and utilization of internal relationship among organizational resources of structural and cognitive social capital in creating innovative product and business performance in the traditional furniture SMEs in Jepara, a well-known export-oriented furniture center in Indonesia. Majority of furniture SMEs in Indonesia is traditional and handmade basis in which employee skill is the main determinant of innovation. Hence, the development of collaboration through social capital among employees is an important prerequisite of traditional organization to survive or grow its market share, sales and company growth.

This study focuses on the extent of innovativeness which can be achieved by such traditional organization by fully emphasizing on the establishment of internal social capital and stakeholder trust without involving external collaboration or network interaction. The result of this study is practically or theoretically expected to be useful to fulfill the above-mentioned gap, and analyse the development of traditional SMEs in creating innovativeness, which ultimately leads to improvement of business performance.

2. LITERATURE REVIEW AND HYPOTHESES

2.1. The Influence of Social Capital on Trust

Social capital focusing on the development of internal networking, utilizing reciprocal cooperation and trust between employees and management, is a very important factor as mean to establish cultural capital and achieve organizational performance. Social capital is developed by Bourdieu (1986), Coleman (1988), Putnam (2000), Fukuyama (1995), Narayan and Cassidy (2001) and Dasgupta and Serageldin (2000) as the theoretical basis to understand the relationships of social norms and structures. Putnam (2000) describes social capital as a set of horizontal associations between people which has an impact on the productivity of particular organization. This association includes trust, networking and social norms, all of which are associated empirically, and have social and economic consequences.

Social relationship is formed in a network to basically meet the needs of the organizational resource, which eventually provides organizational activity and collective capital, thus encourages economic improvement both for individuals and organization. In the development process of social capital within the company, Putnam (2000) emphasizes social capital as company's social feature in the forms of networking, norm, and trust that is able to beneficially support mutual cooperation and coordination among stakeholders. In contrast, Coleman (1988) and Melander and Nordqvist (2002) state that social capital is the basis for social networking and coordination within the community. The application of the social capital can be functioned as economic asset of organization which is likely able to minimize transaction costs. This is due to the fact that social capital is often addressed to non-economic goals, but has economic consequences. Nahapiet and Ghosal (1998) further state that construction of social capital within the company is a source of competitive advantage, as it strengthens the network of interpersonal relationships which becomes the foundation of company success. Social capital develops social structure which can be functioned as a resource for individuals to facilitate their certain activities within organization. In addition, social capital here is regarded as the assimilation of norms that form the basis of interpersonal behavior (Coleman, 1988).

Melander and Nordqvist (2002) consider structural and cognitive capital as two main dimensions of the capital. While Nahapiet and Ghosal (1998) reveal three main dimensions of social capital instead of two primary dimensions as stated by Melander and Nordqvist (2002), with the addition of relational capital. The structural social capital is a structural networks and relationships between people within organization in the form of harmonious relations. The relationship between members of the organization is highly influential on the transfer of information (Nahapiet and Ghosal, 1998), organizational learning (Fisher and White, 2000), and the implementation of organizational behavior (Bolino et al., 2002). Thus, the transfer of information and knowledge takes place when employees are mutually related. The activity of the company will be more efficient provided that the people in the company know each other well or going on interpersonal relationships. Accordingly, we propose the following hypothesis:

H1: Social capital significantly influences the development of trust.

The company activity is formed by sharing norms and values, while on the other side, the interaction and social ties within the company play an important role in influencing and establishing that norms. Liao and Welsch (2005) state that the three dimensions of social capital are interlinked. Structural social capital is the basic form of the capital that is able to bring relational and cognitive capital. Cognitive social capital relates to the ability of individuals within the company to understand one another. Understanding among employees can be achieved through transferring the ideas, sharing knowledge, discussing stories, and helping each other.

Baron and Markman (2003), Bolino et al. (2002) state that the cognitive aspect of social capital related to the level of proficiency to communicate effectively to other people. This thereby improving the level of understanding among organization's members that affect the individual ability to predict the activity of colleagues, facilitate the use of inputs from other members, adapt to changing conditions, increase efficiencies gained through mutual awareness, and decrease the undesirable behavior in the organization. The internal networking establishes the trust and sharing norms and values within company. In other words the higher the level of interaction is, the higher the trust is and the easier information and resources are exchanged within the network. Thus the following hypothesis is proposed:

H2: Cognitive social capital significantly influences the development of trust.

2.2. The Influence of Trust on the Product Innovation

Granovetter (1973) indicate relational capital by the level of high trust, which is characterized by trust, reciprocity and emotional intensity among individuals. Krackhard and Hanson (1993) define it as an interpersonal relationship that occurs naturally, that is measured by mutual cooperation and trust, affecting on the company performance. In other words, relational social capital is often identified with trust.

Ellonen et al. (2008) state that trust plays an important role in the development of company innovativeness. Furthermore, trust encourages products innovation by implementing the employee new ideas and enhancing the more closely relationship between management and employees (Oldham and Cummings, 1996). It can be regarded as the company special asset capable to improve openness and confidence among employees to find their ideas seriously and share them to solve the problem and achieve company goals in the future (Carolis and Saparito, 2006).

Moreover, trust in peers and in management are likely to contribute to team performance (Politis, 2003; Whitener, 1988). Employee product innovativeness will be able to improve performance when they get positive feedback from their colleagues. While trust in management is a basis for productive environment to create innovative products as trust leads employees to communicate and share their knowledge and information in the decision making without fear of failure or punishment (Mishra and Morrissey, 1990). Tanas and Saee (2007) state the trust has a positive role in the product innovation by more efficiently encouraging the resource exchange, although the company is under uncertainty and faces limited opportunities. Hence, it can be functioned to reduce the external costs and competition by internally improving collective activities.

Mishra and Morrissey (1990) state that trust arises from mutual belief, openness, and competence among individuals. Jones and George (1998) articulate that trust improves communication, social resource exchange and develops cooperation among members. Thus, it can be said that the high level of trust in the SMEs solidify team work, and improve the organizational function as a basis for innovation development. However, since trust and social networking are created through a process of interaction and learning within particular organization, this may lead to different result of social capital among different organizations (Melander and Nordqvist, 2002). Accordingly, the higher trust and the more extensive social networking, the higher the accumulation of social capital drives the economic capabilities for both the community and the company.

H3: Trust significantly influences the product innovativeness.

2.3. The Influence of Product Innovation on Marketing Performance

Having strong innovation, the company tends to be proactive to change regularly the company's activities to create a new supporting environment to innovation. Yamada (2003) states that product innovativeness is associated with the company ability to change activities and improve the structural knowledge mechanism. In this regard, the company's main role is not only to take the advantage of established networking, but also actively to search new business opportunities. Verhees and Meulenberg (2004) defined the innovativeness as the company owner's willingness to learn and to apply product innovativeness to produce the desired product by the customer by modifying and enhancing the quality of the existing product. Product innovativeness, which is seen as a strategic factor for improving product performance, is the basis for product excellence connected to the customer's perception of quality and functionality of particular product (Tien-Shang Lee, 2008).

Boettke and Coyne (2006) associated product innovativeness with the performance of the product as a result of the company's competitive skill. Product innovativeness is often broadly interpreted as the open culture of a company to new ideas. This culture leads organizational managers to learn and receive new ideas and to engage and support the creative process of new products. This willingness impacts on the company's ability to always find something new and the ability to more creatively manage the company's operations.

Ellonen et al. (2008) state that product innovativeness is a key early success of the company. Companies can achieve competitive advantage by continuously improving product innovation. The company is less able to survive without product innovation leading to the discovery of new products, markets and resources (Boettke and Coyne, 2006). In other words, with no influence of innovation, then, the company will not be able to improve the product and market performance. Product innovation leads the company to tend to master, implement and develop processes capable to improve the performance of the products, which is often resulted from internal mechanism, not necessarily from competitors.

The development of new ideas into a product, process, or service likely increases the company's market share and leads to improvement of product performance (Lilien et al., 2002). Li and Atuahene-Gima (2001), Langerak et al. (2004) revealed the influence of the product innovation on product performance. Companies that effectively apply the product innovativeness will get benefits from the increasing productivity and adaptability as the results of the improvement of process undertaken by the company.

H4: Product innovativeness significantly influences the product performance.

3. CONCEPTUAL FRAMEWORK

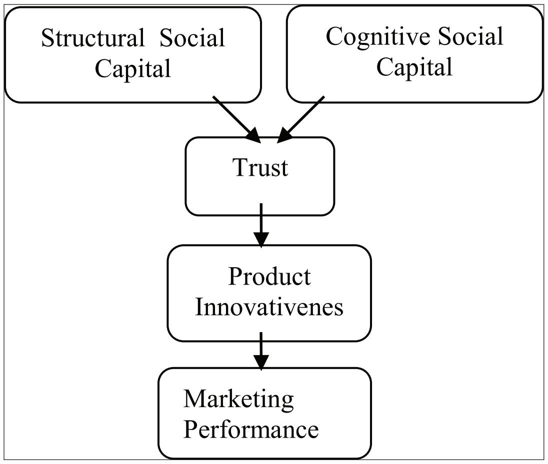
This study included the three variables of social capital as the main determinants whose influence on the product innovativeness and marketing performance need to be examined. By conducting field research in the furniture exporting SMEs in Jepara, Central Java, Indonesia, to examine those relationships, this study proposed the research model as the theoretical framework (Figure 1).

4. METHODOLOGY

4.1. Sampling

Indonesia, with its abundant natural resource of forestry products, has well-known reputation on export-oriented furniture and household equipment industry. The export value of this industry reached 2.2 billion USD in 2011 (ASMINDO, The Indonesia

Figure 1: Research model



Furniture Industry and Handicraft Association). Majority of about 4000 furniture companies in Indonesia is SMEs that primarily based on traditional hand crafting of wood and rattan. More specifically, the wooden furniture industry had 58.1% of total of industrial export in 2010, employed about 17 million workers that mainly concentrated in East Java, while Central Java, notably the regency of Jepara, is the central of export-oriented producers of high class furniture of teak and mahogany, and supplies the furniture for national and international market (www.gbgindonesia.com).

The study used purposive sampling method. Some respondent characteristics are highly considered in this study; they were selected based on their experience in operating an independent company - not a subsidiary company - for more than 1 year; and actively involved in the development of product innovativeness. Based on the opinion of Hair et al. (1998), the sample were taken from respondents of 100 furniture exporting SMEs in Jepara. By using questionnaires to collect data, the structural equation modeling/AMOS statistical analysis was used to examine the aforementioned hypotheses.

4.2. Measurement of Variables

Structural social capital was described as horizontal relationships among employees of furniture SMEs and that of vertical between employees and the management. These adopted from measurements developed by Krackhardt and Hanson (1993), and Levin and Cross (2004) including the close relationship among employees, communication among employees, the close relationship between employees and the managers, and learning of employee of the relational leadership.

Cognitive social capital was defined as a sense of solidarity among employees of furniture SMEs that subordinates the personal interests by sharing knowledge and ideas. The variable adopted the items of Adler and Kwon (2002) including need for achieving organizational goal, implementation of joint decision making, joint problem solving, and efficient internal communication.

Trust was operationally defined as structural relationship formed by a sense of solidarity, which was divided into three basic forms of trust i.e., benevolence, integrity and trust capability. The items were adopted from Bakker et al. (2006), and Ellonen et al. (2008), each of which was measured by two items, including beneficial trust in management and peers that fulfills employee expectation, and develops the continuous learning capability, technological and expertise competence.

Product innovativeness was measured based on the capability of product, process, behavior, and strategic innovativeness of the furniture exporting SMEs. These items was adopted from Wang and Ahmed (2004), Ellonen et al. (2008), including the ability of producing new products, of accepting differences in individual work assignments, of trying new methods, and willingness to take risks in getting new opportunities.

Marketing performance is measured based on the performance of exporting furniture SMEs products in terms of growth of sales volume, customer, and profitability. The items was adopted from Politis (2003) including the ability of the product to increase sales as of its superior brand, uniqueness, classic and elegant design, and meeting the customer requirements.

5. FINDINGS

5.1. Validity and Reliability Testing

Validity test by using Pearson showed that the correlation of each indicator with the total value of the latent variables showed significant result below the significancy level <0.05 (Table 1). This indicates that the data obtained in the field fits to be used in testing the model developed in this study. Similarly, reliability test resulted in the variable indicators tested is reliable for each indicator with the value of Cronbach alpha more than 0.60 (Table 2).

5.2. Goodness of Fit Testing

The result of the testing of feasibility parameter estimates showed that there was no negative variance or the correlation value more than 0.9; and, that the value of loading factor of each indicator is >0.6. Thus it can be said that all parameters used in this study produce good estimation and all indicators have good feasibility. The testing of goodness of fit indicated that the value of CMIN/DF is 1.533 (<2); of goodness-of-fit index is 0.791 (<0.90); and of root mean square error of approximation is 0.073 (<0.08). Thus, the model has a goodness of fit (Table 3).

5.3. Hypothesis Testing

5.3.1. The influence of structural and cognitive social capital on trust

Table 4 explains the results of hypothesis testing. As shown in the table, the first hypothesis examines the influence of structural social capital on the development of trust, while the second tests the effect of the cognitive on trust development. The testing shows that both hypotheses were accepted, as indicated by the value of construct reliability (C.R) of 0.282, and 0.105, for these hypotheses, respectively. The findings is in line with Nahapiet and Ghosal (1998) emphasizing on the use of all three dimensions of social capital, and Liao and Welsch (2005), stating that the dimensions are interlinked. The higher the level of interaction between stakeholders is, the easier the trust to build, and the easier the information and resources exchanged within the network. The findings emphasize the importance of trust that is more likely

Table 1: Testing result of variance extracted

Item		Construct	Estimate	S.L	M.E	V.E
XX1	←	Structural	0.794	0.63	0.37	
XX2	←	Structural	0.905	0.82	0.18	
XX3	←	Structural	0.952	0.91	0.09	
XX4	←	Structural	0.935	0.87	0.13	
Structural social capital				3.23	0.77	0.81
XX5	←	Cognitive	0.893	0.80	0.20	
XX6	←	Cognitive	0.909	0.83	0.17	
XX7	←	Cognitive	0.918	0.84	0.16	
XX8	←	Cognitive	0.685	0.47	0.53	
Cognitive social capital				2.94	1.06	0.73
XX9	←	Trust	0.925	0.86	0.14	
XX10	←	Trust	0.937	0.88	0.12	
XX11	←	Trust	0.927	0.86	0.14	
XX12	←	Trust	0.938	0.88	0.12	
XX13	←	Trust	0.952	0.91	0.09	
XX14	←	Trust	0.957	0.92	0.08	
Trust				5.29	0.71	0.88
XX15	←	Innovativeness	0.887	0.79	0.21	
XX16	←	Innovativeness	0.948	0.90	0.10	
XX17	←	Innovativeness	0.928	0.86	0.14	
XX18	←	Innovativeness	0.95	0.90	0.10	
Innovativeness				3.45	0.55	0.86
XX19	←	Performance	0.918	0.84	0.16	
XX20	←	Performance	0.715	0.51	0.49	
XX21	←	Performance	0.877	0.77	0.23	
XX22	←	Performance	0.644	0.41	0.59	
Product performance				2.54	1.46	0.63

M.E: Measurement error, S.L: Standard loading, V.E: Variance extract

Table 2: Testing result of reliability

Construct	S.L	M.E	C.R
Structural social capital	3.23	0.77	0.93
Cognitive social capital	2.94	1.06	0.89
Trust	5.29	0.71	0.98
Innovativeness	3.45	0.55	0.96
Product performance	2.54	1.46	0.81

M.E: Measurement error, S.L: Standard loading, C.R: Construct reliability

Table 3: Results of the goodness of fit test

χ^2	P value	CMIN/DF	GFI	RMSEA
<0.09	<0.05	1.533	0.791	0.073

GFI: Goodness-of-fit index, RMSEA: Root mean square error of approximation

Table 4: Hypothesis testing results

Hypothesis			Estimate	SS.E	C.R	P value
Trust	←	Cognitive	0.376	0.121	3.105	0.002
Trust	←	Structural	0.220	0.096	2.282	0.022
Innovativeness	←	Trust	0.326	0.100	3.250	0.001
Performance	←	Innovativeness	0.171	0.069	2.483	0.013

C.R: Construct reliability, S.E: Standard estimate, P value: Significance level

to be improved through structural and cognitive social capital focusing on the building solidarity among employees and between employees and managers. In addition, knowledge sharing and the sense of commonality is more likely able to improve the trust, both among employees and between employees and management.

5.3.2. The effect of trust on product innovation

The testing reveals the positive and significant effect on product innovation influence with the value of C.R at 0.250 and P value at 0.001. The finding is consistent with Carolis and Saparito (2006) and Tanas and Saee (2007). This result shows that improving trust is considerably possible to promote product innovativeness. Product innovation that forms in term of company ability to produce unique, elegant and marketable products is more likely to improve the product performance measured by the product presence that is able to increase firm sales and market share.

5.3.3. The influence of product innovativeness on product performance

The testing reveals the positive and significant effect of product innovation on product performance, with the C.R value at 0.483 and P value at 0.013. The result is in accordance with Boettke and Coyne (2006), stating that the product innovativeness is able to bring economic growth of company as the result of the developed skill of company and ongoing product innovation. The product innovation is more likely to encourage the furniture SMEs performance by creating innovative product to improve the performance of the company as a whole.

6. CONCLUSION AND IMPLICATION

This study aims to explore the role of social capital in furniture SMEs producing a product characterized by high demand of innovation of design and product, in which utilization of organizational resource and internal relationship between employees and management is highly needed, to supplement the limitation in cooperation and interaction with external parties and resources that cannot be obtained at any time (Huggins and Johnston, 2009). This study reveals the importance of trust as mediating variable to improve the influence of social capital on product innovation in the creative industry of furniture SMEs in Indonesia. More specifically, the study found that the internal structural relationship through structural and cognitive social capital significantly improve the trust among stakeholders, thereby being more likely to promote the innovativeness and performance of furniture SMEs in Jepara, Indonesia. This relational ability encourages the communication and solidarity of stakeholders either vertically among employees, or horizontally between employees and company managers.

This study reveals the importance of social capital development of traditional SMEs in the light of improving product innovativeness and the firm performance. The utilization of social capital and trust help coordination within the organization and overcomes the company lack capability to develop external networks. This implies to the development of trust measured by abilities, kindness and integrity of Jepara's furniture SMEs. Thus, this is of significant effect in encouraging more communication and growth of vertical and horizontal trust, thereby eventually driving innovativeness of furniture SMEs in Indonesia.

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