

# The Mediating Role of Strategy Flexibility at the Effects of Entrepreneurial Orientation and Market Orientation on Business Performance Small Medium Enterprise Craft Sector in Indonesia

Indra Kurniawan, Ubud Salim, Margono Setiawan, Mintarti Rahayu

**Abstract:** *The research intends to test the effects of entrepreneurship orientation and market orientation on business performance with strategic flexibility as mediator. Considering Indonesia has been even today eagerly support entrepreneurial, it intends to explore relationship between the three variables in small and medium enterprises context. The study takes place in Indonesia with 194 sampel. For questionnaire distribution, it makes use of online tool with google form. The unit of analysis is owners, managers or decision-makers at the SMEs. For data analysis, it applies structural equation model with WarpPLS approach. The results demonstrate that entrepreneurial orientation does not significant effect on business performance, but has a positive effect on strategic flexibility. While market orientation has a positive effect on business performance, but it does not have significant effect on strategic flexibility. It means that strategic flexibility mediate relationship between entrepreneurial orientation and performance, while it does not hold true for relationship between market orientation and business performance.*

**Index Terms:** *Entrepreneurial Orientation, Market Orientation, Strategic Flexibility, and Business Performance.*

## I. INTRODUCTION

The analyses of relationship between entrepreneurial and business performance have so far provided mixed results. It leaves question on the nature of relationship, and the possible effect of settings on the nature.

The settings could range from big enterprises to technology-based corporations, Small and medium enterprises, manufacturer and still many others, and the question remains whether it would lead to different results. Other variables are usually featured to accompany entrepreneurial orientation in exploration of the effects on

performance, one of which is market orientation. It is widely viewed as having strong relationship to entrepreneurial orientation.

Both variables of entrepreneurial orientation and market orientation have high relevance for developing countries, including Indonesia. The tests of various model

involving the two aforementioned variable are eagerly carried out in the context of Indonesia. .

In a more specific way, the present research intends to prove whether entrepreneurial orientation and market orientation have effects on SMEs' business performance with strategic flexibility as mediator. It inserts a mediating variable to deal with inconsistent results regarding to business performance.

## II. LITERATURE REVIEW

### A. Entrepreneurial Orientation

Basis for configuring concepts in this study is to use contingency theory, that argues that leader performance is determined from his understanding of the situation in which they lead. Puts forward entrepreneurial orientation variable with three dimensions, top managers are found to make strategic measures when facing uncertain business situations (Covin, & Slevin, 1988). They have capacity to make right strategies to deal with the situations, which are related to entrepreneurial orientation. Anderson, Covin, & Slevin (2009) find that entrepreneurial orientation has a direct effect on strategic learning capability.

In its further development, some researchers add two dimensions to entrepreneurial orientation, that is autonomy dan competitive aggressiveness (3). Thus, the variable are made up of five dimensions: autonomy, risk-taking, proactiveness, innovativeness and competitive aggressiveness. Other researchers attempt to make sure dimensions of the variable (Miller, 1983; J. G. Covin & Wales, 2012), to find out ways to increase entrepreneurial orientation (6), develop new related variables such as strategic entrepreneurial (Ireland, Hitt & Sirmon, 2003).

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The wave of development and tests brings up two different results, that is some research point to significant effect of entrepreneurial orientation on business performance, and some others point to otherwise. Different settings have potential to lead to different results, as research in technology based industry (8) by applying dimensions made by (3). The results bring up insignificant effect, which support those of (Frank, Kessler, & Fink, 2010; Messersmith & Wales, 2013).

Significant effect is revealed by (Wiklund & Shepherd, 2005; Wiklund, 1999; Y. Zhang & Zhang, 2012). Meta-analysis by (14) on 51 research also points to significant effect of entrepreneurial orientation on business performance.

Regardless of these mixed results, continuous attempt to see the nature of relationship is never interrupted. It is due to the relevance of entrepreneurial in business orientation. Some researchers even relate this concept to other variables such as market orientation (Atuahene-Gima & Ko, 2001; Matsuno, Mentzer, & Rentz, 2005; González-Benito, González-Benito, & Muñoz-Gallego, 2009; Ramaseshan, Caruana, & Soon Pang, 2002; Song, Susan, & Wang, 2015), multinational corporation (Qu & Zhang, 2015; Zahra & Garvis, 2000), large enterprises (Zehir, Can, & Karaboga, 2015; Zehir, Köle, & Yıldız, 2015), and small and medium enterprises (Kraus, 2009; Kraus, Rigtering, Hughes, & Hosman, 2012; Lans, Galen, Versteegen, Biemans, & Mulder, 2014).

With above description as background, we propose hypotheses as follows,

H<sub>1a</sub> : the higher the extent of entrepreneurial orientation is, the more it increases business performance

H<sub>1b</sub> : the higher the extent of entrepreneurial orientation is, the more it increases strategic flexibility

## **B. Market Orientation**

An entrepreneur should have an observant eyes to find breakthroughs in services, from which the corporation would gain recognition and trust from consumers. The breakthroughs are managed through innovation. Innovation implementation can be in the forms of product development, which is still tailored to market taste, or new product launching.

An entrepreneur should also have focus on market preferences. Entrepreneur or corporation with high extent of market orientation would have high business performance, because high market orientation would lead to competitive edge (27) and sustainability (28). (29) argue that corporation that has implemented market orientation would be able to provide better service, and accordingly would have better satisfied consumers with resulting increased profits. Put in another way, it has higher performance (Kohli & Jaworski, 1990; Narver & Slater, 1990) in providing service to consumers.

The existence of market orientation is always associated to business performance (Hult & Ketchen, 2001; Kara, Spillan, & DeShields Jr, 2005; Langerak, Hultink, & Robben, 2004; Panigyrakis & Theodoridis, 2007; Pelham,

1997), and innovation ability (Ferrell, 2000; Han, Kim, & Srivastava, 1998; Hurley, Hult, Abrahamson, & Maxwell, 1998; Mavondo, Chimhanzi, & Stewart, 2005; Sandvik & Sandvik, 2003), and SMEs profitability (42). Some researchers find relation between market orientation and performance (Bhuain, 1998; Harris & Ogbonna, 2001; Matsuno et al., 2005; Qu & Zhang, 2015a; Raju, Lonial, Gupta, & Ziegler, 2000), while others find otherwise (46). Still others consider the relationship is not necessarily positive (Jaworski and Kohli, 1993) (48).

Based on above clarification, we proposes the following hypotheses,

H<sub>2a</sub> : the higher the extent of market orientation is, the more it increases business performance

H<sub>2b</sub> : the higher the extent of market orientation is, the more it increases Strategic flexibility

## **C. Strategy Flexibility**

Organizational performance is not only measured from its capability to make innovation through new product, considering new product does not necessarily invite market response. Organizational performance is also related to its capability for strategic formulation that align internal resources to changing environment. This formulation might take the form of strategic flexibility, where an organization is able to adapt itself to market needs by looking into its resources.

Every organization faces dynamic and changing conditions, so it needs to remap its whole resources to increase innovation performance (49) (50) (51)

Previous research finds that strategic flexibility is a part of target achievement in a highly limited time mostly resulted from capability of organization owner, managers, and flexible human resources in making strategic decision (52). Strategic flexibility is a means for decision-makers and called as strategic flexibility framework (SFF) (52).

The goal of every organization is to obtain high profitability in effective and efficient manners (Bock et al., 2012; Sanchez, 2016; Yang, Zhang, Jiang, & Sun, 2015). It must be able to determine among strategic options available by aligning external conditions to internal resources and products life circle (56). Strategic flexibility leads organization to higher innovations which allow for organizational goal achievement. The size does not determine the capability of strategic flexibility. This flexibility enables organization to suit itself to external environment, to change strategy and make necessary changes (57), and to redefine and formulate strategies (54). It increases innovation capacity (57).

Strategic flexibility is also defined as capability to reformulate the available resources, its implementation, and strategy deemed appropriate to deal with changing environment (55). According to dynamic capability theory, ability to design strategies is related to ability to identify external environment (Yang et al., 2015; Zhou & Wu, 2010; Chakravarthy, 1982; Saebi, Lien, & Foss, 2017; Teece, Pisano, & Shuen, 1997).

Strategic flexibility paves the way to more dynamic performance and helps organization escape from the routine (62) (54) (55) (58).

Strategic flexibility is the way to achieve goal by means of increased business performance (J. G. Covin & Slevin, 1989; Mu, Thomas, Peng, & Di, 2016; Mu & Di Benedetto, 2011; Theodosiou, Kehagias, & Katsikea, 2012; Venkatraman, 1989). Several scholars consider that there are two types of strategic flexibility, that is manufacturing flexibility (operational approach) and strategic flexibility (strategic approach) (68). Operational approach is defined as system ability to adapt to environmental conditions (De Toni & Tonchia, 2005; Q. Zhang, Vonderembse, & Lim, 2003). It lends support from (70) who say that *manufacturing flexibility* is fundamental instrument to deal with high uncertainty.

Strategic flexibility results from operational process and innovation (71). This concept is made up of three dimensions: cost, time and quality (72). Other scholars make five dimensions covering speed, consistency, sharpness, agility and innovativeness (Stalk et al., 1992).

Capability to adapt strategic flexibility is determined by the extent entrepreneurial orientation in the organization. The high extent of strategic flexibility would make it easier for corporate leader to adapt strategy suitable to handle situation on hand and thus increase the chance to win the competition. Adaptability is the key to achieve goal.

Based on above description, we put forward the following hypotheses:

H<sub>3a</sub> : the higher the extent of strategic business is, the more it increases business performance

H<sub>3b</sub> : the higher the extent of strategic business is, the more it mediates the relationship between entrepreneurial orientation and business performance.

H<sub>3c</sub> : the higher the extent of strategic flexibility is, the more it mediates the relationship between market orientation and business performance.

#### D. Business Performance

Performance reflects management effort to perform its duties and responsibilities in the form of successes and deficiencies. Performance is the function of motivation and ability, which are essential to perform duties. Knowledgeability is part of ability. Performance is an organizational achievement in a certain period reflecting the health of organization.

Corporate performance covers organization-wide activities including operational and financial. Business performance is consisted of market share, ROA (*Return On Assets*), whole product quality, services to consumers, and competitive position (73). It has four types of measurement (17):

1. Profitability/corporate economic performance, consisted of profit, margin, and *Return On Investment* (ROI)
2. Market Response, which is reaction on market demand, consisted of sale, growth of sale and market share.

3. Market position value, defined as attainment and advantaged position in the mind of consumers, consisted of consumer satisfaction, reputation, consumer loyalty, and *image*.
4. The success of new product.

According to (74) business performance falls into two categories, that is financial performance and operational performance. On financial performance, economical performance including sales, profit, and ROI are the representative of performance. On operational performance, factors such as consumer satisfaction, quality, and development phases of new product are the representative of performance (17).

*Sales growth, employment growth, income growth and Market share growth* are suggested to represent performance of small corporations (Hadjimanolis, 2000; Kim & Choi, 1994; Lee, Miller, & Hautes, 1996; Luo & Peng, 1999; Miles & Covin, 2000). Growth is considered as better and easier indicator than that of financial performance.

However, growth and financial performance carry its own unique and important information of corporate performance (3). Together, they provide a richer description of organization's actual performance.

#### E. Conceptual Model

The research intends to find out whether orientation and market orientation could increase performance through strategic flexibility, represented on the following Fig. 1

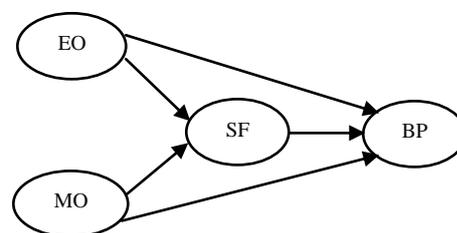


Fig. 1. Research's Conceptual Framework

### III. METHODOLOGY

Setting of the research is SMEs, with consideration that they are most able to adapt to strategic change thought its relative small size. The unit of analysis is the owners, managers or directors of SMEs who hold position as decision-maker. For data distribution, the research applies online questionnaire (*google form*). From 209 questionnaires distributed, the return and usable questionnaires is 194. It fulfills formula: 5 X parameter number (80). Analysis data is equipped by interview to make further confirmation and dig deeper information absent in questionnaire.

Measurement scale follows 7 point Likert scale. Validity test requires the value of each item of instrument is >0,70 (81) (Hair et al., 2014). For reliability test, the research applies Alpha Cronbach with minimal value is of >0,90. The results show that entrepreneur orientation variable is 0.916

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and Market Orientation 0,891, strategic flexibility 0,955 and business performance 0,947. These confirm that all instruments have met *rule of thumbs* (81).

**IV. RESULTS AND FINDINGS**

For data analysis, it applies partial least square with software WarpPLS to test model concerning variables that are thought to be able to increase business performance. Before proceeding to data analysis, the fulfillment of validity and reliability should be confirmed, which is represented on the following Table 1:

**Table 1.** Combined Loading and Cross-Loadings

Indicators	EO	MO	SF	BP	p-value
eo1	0.880	-0.172	0.031	-0.043	<0.001
eo2	0.816	0.358	0.132	0.005	<0.001
eo3	0.866	-0.175	0.030	0.041	<0.001
eo4	0.808	0.063	-0.068	-0.052	<0.001
eo5	0.868	-0.047	-0.123	0.047	<0.001
mo1	0.579	0.694	0.123	-0.006	<0.001
mo2	-0.148	0.906	-0.032	0.004	<0.001
mo3	-0.163	0.905	0.003	-0.021	<0.001
mo4	-0.141	0.853	-0.068	0.023	<0.001
sf1	-0.120	0.338	0.649	-0.146	<0.001
sf2	-0.079	0.027	0.830	0.165	<0.001
sf3	0.222	-0.176	0.838	0.044	<0.001
sf4	0.012	-0.109	0.821	-0.059	<0.001
sf5	-0.064	-0.006	0.828	-0.037	<0.001
bp1	-0.056	-0.138	0.433	0.771	<0.001
bp2	-0.096	0.128	-0.015	0.880	<0.001
bp3	-0.167	0.257	-0.244	0.808	<0.001
bp4	0.374	-0.304	-0.176	0.702	<0.001

**Note:** EO= Entrepreneurial Orientation, MO= Market Orientation, SF= Strategic Flexibility, BP= Business Performance

Table 1 reveals that loading factor value for each item is > 0.60 and p-value is <0.001 that fulfill convergent validity.

**Table 2.** The roots of AVE and Correlation Coefficients

	EO	MO	SF	BP
EO	<b>0.848</b>	0.695	0.519	0.259
MO	0.695	<b>0.844</b>	0.385	0.303
SF	0.519	0.385	<b>0.796</b>	0.579
BP	0.259	0.303	0.579	<b>0.793</b>

Table 2 displays that all indicators of instruments have fulfilled discriminant validity, which can be seen from the values of AVE roots with correlation coefficient of variable is larger than the values of AVE roots of other variables.

**Table 3.** Composite reliability dan Cronbach's alpha

No	Variables	Composite reliability coefficients	Cronbach's alpha coefficients
1	EO	0.927	0.902
2	MO	0.908	0.862
3	SF	0.896	0.853
4	BP	0.871	0.800

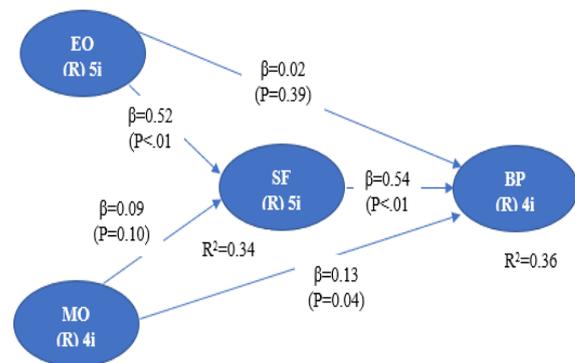
Table 3 displays that composite reliability is fulfilled with value of > 0.70 and consistency internal reliability with value

of > 0.60.

The following is representation of values to make sure of the criteria fulfilment of model fit and quality indices. It is important to make sure before research proceeds into model structural analysis.

**Table 4.** Rule of Thumb for Model Fit and Quality Indices

No	Model Fit and Quality Indices	Result	p-Value	Criteria
1	Average Path Coefficient (APC)	0.258	0.001	p < 0.05
2	Average R-Squared (ARS)	0.350	0.001	p < 0.05
3	Average Adjusted R-Squared (AARS)	0.341	0.001	p < 0.05
4	Average Block VIF (AVIF)	1.663	Ideal	Accepted if < = 5, ideally <= 3.3
5	Average Full Collinearity VIF (AFVIF)	1.955	Ideal	Accepted if < = 5, ideally <= 3.3
6	Tenenhaus (GoF)	GoF 0.485	Ideal	Small >= 0.1 medium >= 0.25 large >= 0.36
7	Sympson's Paradox Ratio (SPR)	1.000	Accepted	Acceptable if >= 0.7 ideally = 1
8	R-Squared Contribution Ratio (RSCR)	1.000	Ideal	Acceptable if >= 0.7 ideally = 1
9	Statistical Suppression Ratio (SSR)	1.000	Accepted	Acceptable if >= 0.7
10	Nonlinear Bivariate Causality Direction Ratio (NLBCDR)	1.000	Accepted	Acceptable if >= 0.7



**Fig 2.** The Results of Structural Model Analysis



Table 5. Structural Model

Hypothesis	Relations	Beta	p-value	Findings
H <sub>1a</sub>	EO → BP	0.020	0.392	Not Supported
H <sub>1b</sub>	EO → SF	0.520	0.001	Supported
H <sub>2a</sub>	MO → BP	0.126	0.037	Supported
H <sub>2b</sub>	MO → SF	0.090	0.102	Not Supported
H <sub>3a</sub>	SF → BP	0.536	0.001	Supported
H <sub>3b</sub>	EO →	0.278	0.001	Full
	SF →			Mediation
	BP			
H <sub>3c</sub>	MO →	0.048	0.170	Non
	SF →			Mediation

Note: EO: Entrepreneurial Orientation, SF: Strategic Flexibility, MO: Market Orientation, BP: Business Performance.

The results of hypothesis testings as shown on table 5 confirms that hypothesis 1a stating that entrepreneurial orientation has a significant effect on business performance is not proven, the  $\beta$  value of 0.020 and p-value of 0.392 make the hypothesis unsupported. While hypothesis 1b stating that entrepreneurial orientation has a significant effect on strategic flexibility is proven ( $\beta = 0.520$ , and  $p < 0.001$ ). Hypothesis 2a stating that market orientation has a significant effect on business performance is proven ( $\beta = 0.126$ , and  $p < 0.037$ ). Hypothesis 2b stating that market orientation has an effect on strategic flexibility is not proven ( $\beta = 0.090$ , and  $p < 0.102$ ). Hypothesis 3a stating that strategic flexibility has a significant effect on business performance is proven ( $\beta = 0.536$ , and  $p < 0.001$ ). Hypothesis 3b stating that strategic flexibility mediates relationship between entrepreneurial orientation and business performance is proven, by means of Sobel-test. Estimated coefficient value (a) is 0.520 and estimated coefficient (b) is 0.536 where standard error (a) is 0.065 while standard error (b) is 0.065. Estimated coefficient value (c) is 0.020 with 0.392 significance that points to *full mediation* (82). Hypothesis 3c stating that strategic flexibility mediates relationship between market orientation and business performance is not proven. Its estimated coefficient value (a) is 0.090 and coefficient value (b) is 0.536 where standard error (a) is 0.071 and standard error (b) is 0.065, coefficient value (c) is 0.126 with 0.037 significance that point to the absence of mediating effect of strategic flexibility on the relationship between market orientation and business performance.

## V. DISCUSSION

The research intends to test the effect of entrepreneurial orientation on business performance. The mixed results from previous research regarding to the relation between the two variables become the reason for the present research to include strategic flexibility as mediating variable.

The Effect Of Entrepreneurial Orientation On Business Performance

Table 5 displays that entrepreneurial orientation does not significantly affect business performance. The result is in line with the research of (83).

We see that most SME entrepreneurs does not exploit entrepreneurial orientation for increased performance, though they have entrepreneurial values in their soul. Many factors determine business success beside entrepreneurial orientation. Softskills play more important role for the success, which are required to build wide network, to sustain community development, and other marketing means. These conditions that help SMEs maintain its sustainability, even in the crisis time.

The Effect Of Entrepreneurial Orientation On Strategic Flexibility

The result reveals that entrepreneurial orientation has a significant effect on strategic Flexibility. It corresponds to previous research (J. G. Covin & Slevin, 1989; Mu et al., 2016; Mu & Di Benedetto, 2011; Theodosiou et al., 2012; Venkatraman, 1989). It shows that SME entrepreneurs have had strategic attitude in dealing with uncertain conditions in the market. They can reconfigure strategy to suit to changing demands. They also can modify products or services to incite positive market response. However, the lack of technological mastery mostly impede them from making technology-based innovation.

The business nature of SMEs requires high creativity, uniqueness, and artistic value which prevent imitation. Exatly these are ones that make Indonesian handicraft products invite special attention in international markets.

Strategic Flexibility Mediates Relationship Between Entrepreneurial Orientation And Business Performance

The result reveals that strategic flexibility mediates relationship between entrepreneurial orientation and business performance. Entrepreneurial orientation does not necessarily lead to increased performance, so the role of strategic flexibility is required to increase the performance. Particularly, it is relevant to market with changing demands. Non-manufacturing niche demands products with high uniqueness.

Strategic flexibility enables organization to maintain relevance. It also allows the business to uphold sustainability and increase performance.

The Effect Of Market Orientation On Business Performance

The results show that market orientation has no effect on business performance, it can be interpreted that the industry in its process is less able to adjust to consumer desires, and has not been able to identify competitors' strengths and weaknesses to be used as strategic planning to improve company performance, and low inter-functional coordination exists within the organization even though the organizational structure in the craft industry is limited.

Strategic Flexibility Does Not Mediate The Relationship Between Market Orientation And Business Performance

The research' result find that strategic flexibility does not mediate the relationship between market orientation and business performance. Most SME entrepreneurs have seen market orientation as important and performed this as part of their strategy to achieve organizational

objective. They see market orientation equals to consumer orientation. It is also viewed as the practice of continuous monitoring to environment (Raynor, 2007; Yawson & Greiman, 2017a), and refers to competitor orientation, that is organization always monitors the competitors, including their products and strategies. It means that strategic flexibility is commonly seen as already part of market orientation. It is further supported by short span of control in SMEs that large corporations commonly lack. The practice of market orientation directly leads to, and is required for, organization performance. The direct effect of market orientation on organizational performance negates mediating role of strategic flexibility.

## VI. CONCLUSIONS

The research provides interesting results. Entrepreneurial orientation does not lead to increased business performance. The insignificant effect of entrepreneurial orientation on business performance necessitates the inclusion of strategic flexibility as mediator. The inclusion is possible since the implementation is important and easy in terms of SMEs' small size. Flexibility refers to incessant adaptability to present development or dynamics in the market, based on resources available.

Second, strategic flexibility does not mediate the relationship between market orientation and business performance, as strategic flexibility is mostly seen as already a part of market orientation.

### A. Contributions And Implications

The results contribute greatly to development of entrepreneurial orientation, market orientation, and strategic flexibility theories, that eventually can increase business performance of SMEs in East Java, Indonesia. So far most SMEs' entrepreneurs only rely on intuition in developing their organizational performance. It is partly due to low educational background.

To them, strategic flexibility is the right way for SMEs to handle changing environment in terms of competitors, market needs, and technological development. However, the performance of strategic flexibility should be aligned to resources on hand, both human and financial resources that would support the strategy. It all depends on a strong will and capability of the SMEs' entrepreneurs to do so. This strategy provides unlimited room for continuous change and adaptation.

Most of SMEs entrepreneurs' behaviors so far are conventional, reactive, intuitive and tactical. They should move away from these behaviors to more strategic based ones in order to achieve superior corporate performance.

Implication of this research is that UKM's entrepreneurs could exploits more calculated strategy in order to compete with minimal costs. Strategic flexibility is the right and relevant choice for SME entrepreneurs in East Java, Indonesia, to perform as means to increase business performance.

### B. Limitations And Future Research

Like other research exploring entrepreneurial orientation, the present research also suffers some limitations. First, the limitations of respondents in understanding entrepreneurial orientation can be viewed differently from what is meant by this research, as entrepreneurial orientation is seen as a behavior but different views can be interpreted as attitudes. Second, *cross sectional* approach only covers one point of time, while condition quickly changes, from which consistence becomes main issue. Third, strategic flexibility is not for-all solution. The research's results show that strategic flexibility mediates relationship between entrepreneurial orientation and business performance, while it does not mediate relationship between market orientation and business performance.

We recommend for future research to include *absorptive capacity* as mediating or moderating variable in the relationship between market orientation and business performance. The inclusion is important, considering that absorptive variable is closely related to capability of SME entrepreneurs to transform information into new product suitable for market demand. The concept is relevant for business nature of SMEs which always entails high creativity.

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