

## **Mediating Effect of Product Innovation on Market Orientation and Marketing Performance of SME'S During the COVID-19 Pandemic in Indonesia**



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### **ABSTRACT**

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The role of MSMEs is very large for Indonesia's economic growth, where the contribution of MSMEs to the gross domestic product (GDP) reaches 60.5% and to employment of 96.9% of the total national employment absorption. However, during the Covid-19 pandemic, the government imposed a semi-lockdown by limiting business operating hours, by limiting 50% of the capacity of arriving consumers and reducing operating hours to only 20.00 at night. This policy resulted in a decrease in product demand by 84.8%. However, the MSMEs coffee shop only had an impact of 16%. Based on this condition, researchers are interested in conducting research on MSMEs, especially coffee shops during a pandemic. The purpose of this study to analyze the Market Orientation effect of Product Innovation on Marketing Performance and to analyze the role of Product Innovation in mediating the influence of Market Orientation on Coffee Shop Marketing Performance in Medan City. The survey was conducted on 143 coffee shop entrepreneurs who still survived from the COVID-19 pandemic in the city of Medan. Data collection was carried out using a questionnaire with direct interview with the coffee shop owner. Data Analysis using the Partial Least Squares (PLS) analysis technique. The results indicate that market orientation has a positive and significant effect on product innovation at Coffee Shop in Medan. Market orientation has not significant effect on marketing performance at Coffee Shop in Medan City. Product innovation has a positive and significant effect on the marketing performance of the Coffee Shop in Medan City, and there is a role between product innovation in mediating the effect of market orientation on marketing performance at the Coffee Shop in Medan City. Coffee shop should establish mechanisms to obtain information about customer needs and expectations and to disseminate and effectively use this information among business functions.

## **1. INTRODUCTION**

The outbreak of the corona virus in the world, including in Indonesia since the beginning of 2020, has had an impact on business continuity, including Micro, Small and Medium Enterprises (MSMEs). China was forced to close 80% of existing MSMEs due to the impact of the virus. Meanwhile, in Indonesia, based on a survey conducted by UNDP, it was found that the income of MSMEs experienced a shortage of around 77% [1].

The impact of COVID-19 on the business world is very significant, as a result of declining purchasing power due to government policies implementing lockdown and other restriction scheme. The decline in people's purchasing power can have a direct impact on the decline in the economic growth of a country. In ASEAN countries, the impact of many countries experiencing economic contraction is that they are classified as countries facing an economic recession. Countries belonging to the Economic Recession during COVID-19 in ASEAN are Indonesia in 2020 with economic growth (-3.49%), Singapore in 2020 by -5.8%, Malaysia -2.7%, Philippines (-11.5), Thailand (-6.4%). Only Vietnam did not experience an economic recession, where its economic growth was (2.64%) (OECD, 2020). Impact of COVID-19 on MSMEs

in ASEAN, based on research by the OECD 2020, the effect of COVID-19 on business is 30% of SMEs expect to lay off 50% of their staff. It is estimated that 50% of SMEs have a month cash reserves or less.

MSME problems as the impact of COVID-19 in Indonesia, MSMEs lack resilience and flexibility in dealing with this Pandemic due to several things such as the low level of digitalization, difficulties in accessing technology and a lack of understanding of strategies to survive in business (OECD, 2020). The results of the survey on the impact of COVID-19 on Indonesian MSMEs on 722 MSME respondents starting from March 31 to April 20, it was found that 35.6% of MSME actors in the food processing sector were affected by COVID-19. Then followed by the handicraft sector 13.8%, fashion by 16% and the rest are other sectors such as restaurants, services, manufacturing, agriculture, coffee shop, pastries, trade and more [2].

Based on the survey above, this study chose the MSME coffee shop to be researched because the coffee shop has become a place for business, social, and family activities. Facts on the ground show that coffee shops that have a wide and open location are more attractive to the public during the COVID-19 pandemic, so they do not have a significant impact are still operating during COVID-19 even though the

government makes a rule of 50% of the capacity of consumers who come and reduce operating hours only until 8.00 pm. Different/contrast things were experienced for coffee shop MSMEs during COVID-19, where the impact was very significant, especially for coffee shop MSMEs whose businesses were located in malls, hotels, office buildings and campuses as a result of the limited lock down policy and work from home. The research question is whether coffee shops can maintain their business performance in the midst of the economic crisis as a result of the COVID-19 pandemic due to product quality?

This study is important because the contribution of MSMEs to the economy is estimated to reach 60.4% [3]. Coffee Shop is one type of MSME that experienced rapid growth before the pandemic because coffee shops have become a trend for the lifestyle of urban people from all their activities.

There are only a few studies that focus on the MSME sector, especially on the Coffee Shop business. Therefore, Research is done for MSME coffee shops that have a stable marketing performance. Many studies have been conducted on the business sector affected by COVID-19, but research for coffee shop businesses that have survived during the COVID-19 pandemic is still rarely done. Based on this situation, researchers are interested in researching what business strategies are used by coffee shop SMEs to survive during COVID-19.

## **2. THEORETICAL REVIEW**

### **2.1 Market orientation**

Kohli and Jaworski defines Market orientation as a collection of processes, activities, and behaviors that stem from the implementation of the marketing concept [4]. In this definition, Kohli and Jaworski defines market orientation from a behavioral perspective that defines activities for a market-oriented business, which obtains information about the market regarding current and future customer needs, causing all departments of the organization to respond to this information [4]. On the other hand, Narver and Slater defines market orientation as an organizational culture based on three components, namely customer orientation, competitor orientation, and coordination [5].

Market orientation is the organization culture (ie, culture and climate, that most effectively and efficiently creates the necessary behaviors for the creation of superior value for buyers and, thus, continuous superior performance for the business [4, 6-10].

### **2.2 Product innovation**

This requires studying innovation with a broader scope and making the distinction between technology- and administration-related innovations. In organizational innovation literature, this distinction prevails as one of the most meaningful innovation dichotomies [11-13]. In Damanpour's conceptualization, "technical innovations pertain to products, services, and production process technology; they are related to basic work activities and can concern either product or process," whereas "administrative innovations involve organizational structure and administrative processes; they are indirectly related to the basic work activities of an organization." In the banking

industry, for example, the adoption of a point-of-sale versus a computerized bookkeeping system would illustrate technical and administrative innovations, respectively [13]. Product innovation aims to maintain the survival of the company, because existing ones are vulnerable to changes in consumer needs and tastes, technology, shorter product life cycles, as well as increasing domestic and foreign competition. Product innovation indicators include line expansion, new products, and completely new products.

### **2.3 Marketing performance**

According to Asashi & Sukaatmaja Marketing performance is a measure of the success that a company can achieve in marketing its products in the market [14]. According to Nasution Marketing performance is a concept used to measure company performance in the market for a product [15]. marketing performance as an effort made by the company to find out the needs, meet the needs, and tastes of consumers. Market performance indicators include sales growth, customer growth, market share, and profitability.

### **2.4 The relationship of market orientation with marketing performance**

Various studies related to market orientation and marketing performance have been carried out, where the results of the research have found that there is a positive and significant influence between market orientation and marketing performance [16-21]. In addition to market orientation, product innovation also affects marketing performance [22]. Meanwhile, the results of a different study were carried out by Greenley report no significant relationship, and Jaworski and Kohli encounter mixed results [4, 23].

### **2.5 The effect of intervening product innovation on the relationship of market orientation with marketing performance**

On the other hand, various studies also show indirectly product innovation also plays a role in mediating the effect of market orientation on marketing performance, which has been carried out by many researchers [14, 24-27].

## **3. RESEARCH METHODS**

### **3.1 Model development**

Market Orientation is defined as an independent variable, while Marketing Performance is classified as a dependent variable. Product Innovation is defined as intervening variable, which is they are dependent constructs because they are predicted by Market Orientation, but they are also independent constructs because they predict Marketing Performance.

### **3.2 Data collection and processing**

After the construction of the research's conceptual model (Figure 1), the questionnaire for data collection was created. The questionnaire consists of four sections. Section 1 involves general data, such as personal. Section 2 deals with Market Orientation. Section 3 accommodates the questions on Product Innovation. Section 4 contains questions related to Marketing

Performance. Each question in the questionnaires uses a five-point Likert-scale. Cohen produced a table for researchers to determine the sample size of their research using partial least square (PLS) structural equation modeling (SEM). In this model, there are four arrows pointing at a construct, therefore, this research required 65 samples to reach an 80 percent statistical power [28]. The questionnaire was distributed to coffee shop owner in the Medan Area. A total of 143 responses were recorded. The data were then processed by using PLS-SEM. SEM is a powerful statistical approach for identifying the relationships between variables. PLS-SEM is a variance-based structural equation model estimation approach. The objective is to increase the amount of endogenous latent variables that can be described [28].

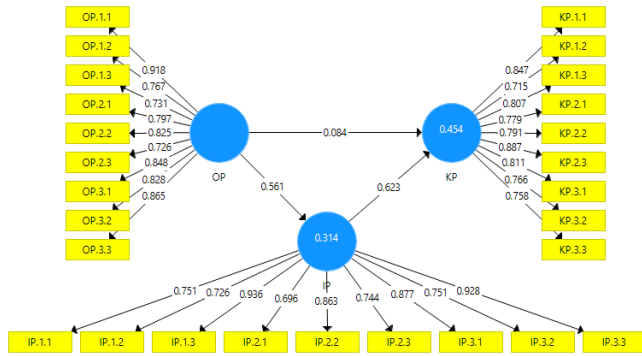


Figure 1. Result of structural model using SEM-PLS

### 3.3 Model testing

Composite reliability, individual indicator reliability, and average variance extracted (AVE) are all used to evaluate the

measurement model's internal consistency and convergent validity. Additionally, the Fornell–Larcker criterion and cross-loadings are used to assess discriminant validity. According to a common rule of thumb for indicator reliability, a latent variable should explain a significant part, usually at least 50% or 0.5 of each indicator's variance [28]. All the indicators for the four constructs in this work were well above the minimum acceptable level for outer loadings (Table 1). The composite reliability varied from 0 to 1, with greater values indicating greater levels of reliability. Specifically, the composite reliability values of 0.60–0.90 can be regard as satisfactory [28]. Hence, all four constructs in this work were satisfactory in terms of composite reliability (Table 1).

*Convergent Validity* of the measurement model by reflexive indicators is calculated based on the relationship between the recommended item scores and the PLS Program. The reflexive measure is said to be high if more than 0.70 is associated with the construct being measured. Outer loading value > 0.7 is the most expected / best value, but values > 0.4 to < 0.4 then the indicator must be removed from the variable [28]. The loading factor limit of 0.60 will be used in this study. From the results of data processing with SEM PLS shows that all items of the questionnaire statement are valid because they have a loading factor value above 0.60, thus the questionnaire can be used (Table 1).

Discriminant validity is carried out to ensure that each concept of each latent variable is different from other variables. The best new measurement criterion is to look at the Heretroit-Monotrait Ratio (HTMT) value. If the value of HTMT < 0.90 then a construct has good discriminant validity (Hair et.al. [28]). All variables have a Heretroit-Monotrait ratio value < 0.90 which means that the discriminant validity is good or completely different from other constructs (the construct is unique) (Table 1).

Table 1. Result summary of models

Latent Variables	Indicators	Item	Covertgent Validity	Composite Reliability	AVE	Discriminant Validity
Market Orientation	Customer Orientation	1	0.930	0.949	0.676	Market Orientation x Product Innovation=0.598 Market Orientation x Marketing Performance=0.464 Product Innovation x Marketing Performance=0.691
		2	0.747			
		3	0.755			
	Competitor Orientation	4	0.841			
		5	0.821			
		6	0.688			
	Inter-functional Coordination	7	0.849			
		8	0.887			
		9	0.855			
Product Inovation	Product Quality	10	0.780	0.948	0.671	Market Orientation x Product Innovation=0.598 Market Orientation x Marketing Performance=0.464 Product Innovation x Marketing Performance=0.691
		11	0.711			
		12	0.956			
	Product Variants	13	0.742			
		14	0.851			
		15	0.738			
	Product Style and Design	16	0.883			
		17	0.736			
		18	0.932			
Marketing Performance	Sales Growth	19	0.842	0.943	0.649	Market Orientation x Product Innovation=0.598 Market Orientation x Marketing Performance=0.464 Product Innovation x Marketing Performance=0.691
		20	0.734			
		21	0.802			
	Customer Growth	22	0.792			
		23	0.770			
		24	0.876			
	Profit Growth	25	0.851			
		26	0.770			
		27	0.807			

**4. RESULTS**

Baseline characteristics of the study subjects are displayed in Table 2. Overall, the study sample (n=143) Participants were divided into four age groups: young aged <21 (n=18); young adult aged 21–40 (n=84) and adults aged over 40 (n=41). Participants were divided into three educational background groups: Primary + Elementary School(n=22); High School (n=95) and Bachelor + Graduate (n=26). Participants were divided into three Lengths of business groups: <1 years (n=29); 1-5 years (n=81) and >5 years (n=33).

The unit analysis of this study is a coffee shop that are still able to survive during the pandemic, therefore base on the respondent’s answers related to market orientation; all indicators have an average score above 3.5 on a scale of 5. Coffee shops that are able to survive because that are having orientation to customer satisfaction, builds good relationships with customers, observes and supervises and responds to

competitors, responsive in serving consumers, contributes to creating customer value and has a strategy in serving customers. However, the pandemic has an impact on the variety of coffee shop voters observing the developments made by competitors in marketing their products (Table 3).

**Table 2.** Characteristics of sample

		f	%
Age	<21	18	12.6
	21–40	84	58.7
	>40	41	28.7
Education	Primary+Elementary School	22	15.3
	High School	95	66.4
	Bachelor+Graduate	26	18.3
Lama Usaha	<1 years	29	20.3
	1-5 years	81	56.6
	>5 years	33	23.1

**Table 3.** Descriptions of respondents’ answers

Variabel	Indicators	Mean	SD
Market Orientation	Consumers are satisfied with always making repeat purchases	3,59	0.64982
	Products are sold in accordance with the wishes and needs of customers	3,79	0.55436
	Build good relationships with consumers for customer satisfaction	3,72	0.61539
	Supervise the steps and activities of competitors	3,64	0.61268
	Observing the developments are made by competitors in marketing their products	3,57	0.72818
	Responding to the development of other companies as a reference for making improvements	3,81	0.54473
	Everyone in charge of the company is quick to respond to customer requests	3,57	0.67829
	Everyone in charge of the company can contribute to create customer value	3,57	0.62442
	Everyone in charge of the company has a strategy in serving customers	3,64	0.69328
	Develop product quality to maintain product superiority with competing products	3,69	0.68073
Product Inovation	The resulting product is in accordance with product eligibility standards	3,28	0.81204
	The resulting product has been through an efficient and effective production process	3,52	0.84275
	Adding product variants in line with changing customer needs	3,50	0.62828
	Updating products created to compete with the market	3,50	0.77799
	The new product variants that I create always adjusting to the trends of the time	3,65	0.63665
	Displaying products in a different form from competitors	3,53	0.77721
	The resulting product has its own specialties	3,33	0.80324
	The products produced are in line with today's style	3,53	0.82111
	Annual sales target	3,10	0.83118
	Sales growth is compared to product development	2,91	0.84364
Marketing Performance	Increased sales are compared to customer growth	3,14	0.84704
	Customer growth is compared to last year	3,12	0.81816
	Market expansion is compared to consumers	3,28	0.89429
	The number of customers is done by the marketing system	3,09	0.90388
	The profit earned is compared with the results of the production	3,19	0.80474
	Sales volume is compared to company profit	3,05	0.86699
	Profit is earned every year	2,98	0.84794

Similarly, by market orientation, the survival of the existing coffee shop certainly cannot be separated from market orientation. Judging from the response of coffee shop owners related to market orientation, all market orientation indicators have an average score above 3 on a scale of 5. During the pandemic coffee shop owners continue to develop product quality to maintain product superiority with competing products, add product variants along with changing customer needs and new product variants that I create always adjusting to the trends of the time. However, there are still coffee shops that have not produced products that comply with product eligibility standards, the resulting products have not been through an efficient and effective production process yet, the resulting products do not have their own specialties and the products produced are not in accordance with today's styles. Despite surviving the pandemic with a market-oriented

strategy and carrying out various product innovations, there are still coffee shop owners who reveal that sales growth are not in line with product development and the profit earned every year are constant and even tends to decline.

The path coefficient in Table 4 above shows the path coefficient=0.561 and P-Value=0.000 (<0.05) meaning that the direct influence of Market Orientation on Product Innovation is positive and significant. The path coefficient=0.084 and P-Value=0.316 (>0.05) means that the direct influence of Market Orientation on Marketing Performance is positive and not significant and the path coefficient=0.623 and P-Value=0.000 (<0.05) means the direct effect of Product Innovation on Marketing Performance is positive and significant. The indirect effect of Market Orientation → Product Innovation → Product Innovation is 0.349, with P-Values 0.000<0.05 (significant), then Product Innovation mediates the effect of Market Orientation on

Marketing Performance.

**Table 4.** Direct, indirect and total effect

	Original Sample	P-Value
Direct Effect		
Market Orientation → Product Innovation	0.561	0.000
Market Orientation → Marketing Performance	0.084	0.316
Product Innovation → Marketing Performance	0.623	0.000
Indirect Effect		
Market Orientation → Product Innovation → Product Innovation	0.349	0.000
Total Effect		
Market Orientation → Product Innovation	0.561	0.000
Market Orientation → Marketing Performance	0.433	0.000
Product Innovation → Marketing Performance	0.623	0.000

The total effect for the relationship between Market Orientation and Market Innovation is 0.561 or 56.1% and is significant. The total effect for the relationship between Market Orientation and Marketing Performance is 0.433 or 43.3% and is significant, and the total effect for the relationship between Product Innovation and Marketing Performance is 0.623 or 62.3% and significant.

All variables have positive and significant values; the total effect is a combination of the direct effect and indirect effect values. In calculating the total effect of market orientation value on marketing performance, significant results are obtained, different from the value obtained through direct effects which produce insignificant values. This is because the acquisition of the total effect value has been through a combination of direct effects and indirect effects, resulting in a different value from the initial value.

**5. DISCUSSION**

From this study it is found that the effect of market orientation on product innovation is positive significant. This finding means that if the value of market orientation increases, then product innovation also increases and this significant value means that market orientation significantly affects product innovation at the Coffee Shop in Medan City. The better SMEs understand the market through customer orientation, competitor orientation, and inter-functional coordination; it will increase product innovation from the Coffee Shop in Medan City. Likewise, with what happened to the Coffee Shop in Medan City, in product innovation, stimulation from consumers and competitors are a factor that must be considered. Knowledge of consumer needs and market conditions, especially competitors in the same sector can encourage the continued growth of new innovations for SMEs in Medan City.

Previous studies have also examined how market orientation relates to product innovation. Obtained research results similar to previous researches are conducted by Slater et al. [4, 17, 29-32].

From this study also found that the effect of market orientation on marketing performance is positive but not

significant. This finding means that if the value of market orientation increases, then marketing performance also increases and the insignificant value means that market orientation does not significantly affect marketing performance at the Coffee Shop in Medan City. The better Coffee Shop's efforts to understand the market through customer orientation approaches, competitor orientation, and inter-functional coordination will improve the marketing performance of Coffee Shop in Medan City. Market orientation is a tradition by businesses that can direct a business unit to improve marketing performance. The company will be able to determine what will be done for the company in the short and long term through market orientation. Companies and business units must try to identify the strengths and limitations of current competitors in the short term, while in the long-term companies must examine what businesses can do to maximize successful marketing performance in the future.

However, from the results of research is conducted by the author, the results show that market orientation has a positive and insignificant effect on marketing performance, because of the time this research is conducted; economic conditions and other sectors are experiencing an imbalance due to the Covid 19 pandemic. The whole order of life has changed as well as the marketing performance of Coffee Shop in Medan City. The value of market orientation has a very small percentage in influencing its marketing performance. The unstable economic situation affects consumer behavior and changes in the market situation, causing many coffee shops to experience a decline.

Consumer orientations have not always a positive influence on marketing performance in all situations and conditions, when the unstable technology situation can affect the relationship less significantly [4]. The importance of estimating the risks to be taken in decision making is emphasized in this study. The research by Han et al, suggests that there is no significant but positive effect of market orientation on company performance. Next, according to Greenley finds that the relationship between market orientation and marketing performance is not significant [23, 24].

In addition, this study shows that product innovation has a positive and significant effect on marketing performance. This finding shows that marketing performance also increases if product innovation increases, and it is significant that product innovation affects the marketing performance of Coffee Shop in Medan City. By designing and developing new concepts, designing more attractive designs, introducing new products at every opportunity, and continuing to develop the quality of their products, the better and more often Coffee Shop makes good innovations, it will improve the marketing performance of Coffee Shop in Medan City [24-26].

The role of product innovation in mediating the effect of market orientation on marketing performance substantially mediates the effect of market orientation on marketing performance. This means that the influence of market orientation on marketing performance at the Coffee Shop beverage in Medan City can be mediated by product innovation. The greater the product creativity, the greater the market interest to improve marketing performance. The findings of this study indicate that if the Coffee Shop in Medan City is market-oriented as well as the Coffee Shop which is able to choose strategic actions quickly, customer satisfaction commitments and all of its features will collaborate to be able

to put the customer first, then the market orientation attitude can increase product innovation and, in the end, it will be able to improve marketing performance at the Coffee Shop in Medan City. The findings of this study are in line with previous research conducted by Pardi et al. [14, 33].

## 6. CONCLUSIONS

Based on the research and data processing that have been carried out, several conclusions are obtained, as follows the market orientation has a positive and significant effect on product innovation at the Coffee Shop in Medan City. Market orientation has a positive and insignificant effect on marketing performance at Coffee Shop in Medan City. Product innovation has a positive and significant effect on marketing performance at the Coffee Shop in Medan City, and there is a role between Product Innovation in Mediating the Effect of Market Orientation on Marketing Performance at the Coffee Shop in Medan City. The results show that market orientation has not significant effect on marketing performance, because of the time this research is conducted; economic conditions and other sectors are experiencing an imbalance due to the COVID 19 pandemic. The whole order of life has changed as well as the marketing performance of Coffee Shop in Medan City. The value of market orientation has a very small percentage in influencing its marketing performance. The unstable economic situation affects consumer behavior and changes in the market situation, causing many coffee shops to experience a decline. Meanwhile, coffee shop owners in Medan City needs to improve customer orientation, competitor orientation, and inter-functional coordination in market orientation indicators, so that the influence of market orientation on marketing performance can be further enhanced in order to obtain significant results. Coffee shop owners in Medan City needs to pay more attention to the strengths and weaknesses of their competitors; these can be used as consideration for determining a strategy so that they can produce competitive advantages. To improve marketing performance, Coffee Shop owners in Medan City are advised to increase product innovation such as creating ideas in making attractive designs according to customer demand and developing distribution facilities such as having more than one business outlet. For future research the author suggests to other researchers to add another moderating variable such as Product differentiation, Competitive Advantage, Creativity.

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