

# CHAPTER I

## INTRODUCTION

### 1.1 Background of the Study

Small and Medium Industries (SMI) are the majority sector of the industrial population which is widespread throughout Indonesia. This phenomenon can be seen from data from the Indonesian Ministry of Industry that the number of SMI units in the country in 2019 exceeding 4.4 million business units or reaching 99% of all industrial business units in Indonesia (Kementerian Perindustrian RI, 2019b). This condition have a positive effect in overcoming national problems such as high unemployment and poverty or slow export growth. According to Indonesian Ministry of Industry in 2016 the micro, small and medium industry sector has absorbed up to 11.68 million workers or contributed 60% of the overall industrial sector (Kementerian Perindustrian RI, 2019a). The Minister of Industry of the Republic of Indonesia revealed that the manufacturing industry is the largest contributor to Indonesia's Gross Domestic Product (GDP), which is 17.34% (Maulana, 2021). With this contribution, the successful performance of SMIs has an important role in promoting economic growth, social stability, and the development of a dynamic private sector.

In early 2020, Indonesia confirmed the case of the Covid-19 pandemic that has a negative impact on the country's economy and adversely affected human health. This also caused the government to impose a lockdown by closing schools, campuses, malls, offices, and public places. The impact of the pandemic caused the growth of the manufacturing industry sector in Indonesia to contract by 2.93% deeper than the Indonesian economy which contracted by 2.07%. Then, labor absorption by the processing industry in Indonesia also

decreased by 1.3% (BPS, 2021a). The performance of SMI experienced a significant decline as indicated by the weakening of the Manufacturing Purchasing Managers' Index (PMI) in the manufacturing sector from the level of 51.9 in February 2020 to 27.5 in April 2020 (Kusumah, 2020). Then, this was confirmed by an official government statement through the ministry of industry which states that several manufacturing industry sectors experienced a decline in production capacity by up to 50%, except for the medical device and drug industry.

The condition of SMIs throughout Indonesia is currently facing the same problems, including in West Sumatra. Before the Covid-19 pandemic, based on data from the Central Statistics Agency 2016, the manufacturing industry in West Sumatra is one of the largest businesses, amounting to 14.74% and also one of the largest distribution of workforce by category of business sector and business scale of 14.95% (BPS, 2017). The existence of the Covid-19 pandemic in 2020 caused the performance of SMI in West Sumatra Province experienced a decline. This decline has a direct impact on the economic turnover of SMI. This is due to the COVID-19 control policy that disrupts the operations of SMI. As a result, plenty of SMI experienced a decline in income, even without income (Preliminary Survey, 2021).

One of the manufacturing industries in West Sumatra Province that has experienced a decline in performance is the Small Medium food Industry. Evidence was found before the Covid-19 pandemic, the development of the food industry is growing well, as evidenced by the many food industries that have sprung up and are still developing in areas in West Sumatra Province. In addition, food is an industrial sector with the most variants and units in West Sumatra Province. Therefore, when the Covid-19 pandemic hit, the Small and Medium Food Industry sector was also directly affected. As a result, the Small and Medium Food

Industry reduces production capacity and reduces the workforce, this has a direct impact on the performance of the small and medium food industry.

One of the areas in West Sumatra Province that has experienced a decline in performance in the Small Medium Food Industry due to Covid-19 is the Payakumbuh City and Lima Puluh Kota Regency. This pandemic has made Small Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency as one of the groups in the manufacturing sector that has been severely affected (Preliminary survey, 2021). Enforcement of restrictions on community activities by closing public facilities and enforcing work from home as a way to contain the spread of the corona virus. Therefore, the impact on the Small and Medium Food Industry is especially severe, mainly due to the higher level of vulnerability and lower resilience associated with their size (OECD, 2020).

There are several impacts of the Covid-19 pandemic on the performance of the Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency. They are currently facing the problem of declining performance due to a sudden loss of demand and revenue which severely affects their ability to function (Meyer et al., 2021). Furthermore, supply chains are interrupted causing difficulties in obtaining raw materials, production and distribution constraints. During the pandemic, the knowledge-sharing experience will also become more fluid, due to many organizations start implementing collaboration technologies (Rao, 2020). However, many Small Medium Food Industry have difficulty accessing and adopting information technology, therefore, they are unable to adapt to this crisis. Small Medium Food Industry business actors who are unable to adapt to pandemic conditions will implement temporary policies to stop production or even be forced to close their business activities (Preliminary survey, 2021). This causes the development of Small Medium Food

Industry in Payakumbuh City and Lima Puluh Kota Regency experienced a decline in performance.

This condition must be immediately addressed by the Small and Medium Food Industry in order to survive. This phenomenon will force the Small and Medium Food Industry to adapt to market conditions and be required to act quickly in determining and implementing competitive strategies (Preliminary survey, 2021). Therefore, it is necessary to measure performance to review the condition of the Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency which is still surviving during the Covid-19 pandemic. Performance measurement is carried out to measure implications and evaluate the quality of strategic decisions (Papulová et al., 2021). Thus, the use of performance measurement is useful to determine the extent to which the Small and Medium Food Industry has achieved its goals, especially in dealing with Covid-19.

Numerous studies discuss the factors that affect the business performance in the company. As explained by Usman et al., (2020), business performance is the end result of company goals or job achievement and related to sales, growth, and profitability that occur in the company within a certain period of time. Previous study conducted by (Udriyah et al., (2019) stated that market orientation and innovation contribute to providing performance benefits for companies. Meanwhile, another study conducted by Sentanu and Praharjo (2019) found that knowledge sharing has a positive effect on company performance. According to Sheikh et al., (2017) the use of electronic marketing will directly affect company performance.

Numerous studies discuss understanding of customers and competitors in market orientation research. Market orientation pays more attention to market information

processing activities based on customer and competitor observations; acquisition, dissemination, and response to market information (Correia et al., 2020). Therefore, market orientation is able to affect business performance even in the midst of a crisis. According to Shamsudin and Hassim, (2020), market orientation is an organizational culture that focuses on the understanding of the market condition in terms of customer and competitor to create superior value.

Basically, the inability of Small Medium Food Industries in Payakumbuh City and Lima Puluh Kota Regency to operate as they have in the past, due to changes in market conditions during the Covid-19 pandemic (Preliminary survey, 2021). Accordingly, the Covid-19 pandemic has significantly changed customer needs and the internal processes of the Small and Medium Food Industry (Haapio et al., 2021). Small Medium Food Industry are required to be able to recognize the various demands of market actors such as suppliers, customers and competitors (Mahmoud et al., 2016). However, not all Small Medium Food Industry can adapt to these market changes. Through market orientation the Small Medium Food Industry can learn to react efficiently to these market changes and strive to produce goods and services that match customer requirements then provide a competitive advantage for better performance (Bui et al., 2021). Therefore, market orientations is very relevant, especially in the era of the Covid-19 pandemic.

The Covid-19 pandemic has helped accelerate society's acceptance of remote work, knowledge-sharing frameworks, and empathetic design (Rao, 2020). The changing market conditions during the pandemic make the knowledge shared within an organization will be very useful for identifying market opportunities and creating new and superior values (Sentanu and Praharjo, 2019). To achieve organizational goals, knowledge sharing process

will be a key asset to identify market opportunities and threats using a network of knowledge. Knowledge sharing is the process of collecting, understanding, and conveying information obtained from internal and external organizations (Sentanu and Praharjo, 2020).

In addition, knowledge of human behavior during a pandemic is causing a reimagining of the customer experience, therefore knowledge could be an opportunity to solve problems through sharing information, experiences, and insights (McKinsey and Company, 2020). Companies that are able to mobilize their employee to share knowledge to members, groups, and companies will create and develop better opportunities (Sulistiyani and Harwiki, 2016). Individuals involved in knowledge sharing tend to accept and give each other in creating collaboration between employees, thus encouraging the ability to innovate (Sulistyo and Ayuni, 2018). Therefore, in order for the Small and Medium Food Industry to be able to survive in the midst of a crisis, it is necessary to make changes based on knowledge and help each other to create common goals (Tiawon and Supartha, 2021).

The reduced volume of transactions faced during the Covid-19 pandemic forced the Small and Medium Food Industry to respond quickly, learn fast, and innovative (Serbulova et al., 2020). Innovative activities can help Small Medium Food Industry to protect themselves from the impact of the crisis (Gupta, 2020). According to Suryani and Claudya (2021), innovation is the company's ability to deal with changes in the economy, technology, resources, and changes in company expectations for innovation and make efforts to utilize it to produce and develop new products or services to customers. Without innovation the company will not be able to survive because the demands, needs, and desires of customers are rapidly changing (Herman et al., 2018).

In the crisis context, innovation has been identified as a strong influence on the resilience of Small Medium Food Industry (Nah and Siau, 2020). The Small and Medium Food Industry must innovate in responding to changes that occur due to the Covid-19 pandemic. The implementation of lockdown and work from home which also has an impact on changing consumer behavior is the reason why innovation must be carried out. According to Clauss et al., (2021), concluded that an innovative stances would help Small Medium Food Industry survive the crisis. Therefore innovating means that the Small and Medium Food Industry conducted strategic renewal in responding to the crisis. Innovation activities will help Small and Medium Food Industries to improve their ability to create unique products that can increase their competitive advantage in the market, thereby improving company performance (Tarigan, 2018).

Restrictions on community activities during the Covid-19 pandemic have changed almost every customer behavior, both the way customers choose or buy the products/services (Maryati, 2020). This policy to control the spread of Covid-19 forced Small Medium Food Industry to close their physical stores which could invite crowds (Preliminary survey, 2021). Due to the restrictions on direct activities, Small Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency have difficulty selling their products directly to the market. Therefore, production capacity and labor are reduced in order to survive. Thus, they must be able to manage digital technology as a strategy to increase online sales (Fernando, 2021).

The use of e-Marketing is becoming increasingly important for companies because it leads to a new era of business communication between players by following current market trends and needs by using digital communication channels for purchasing and decision making in the market (Sidek et al., 2020). Technology adoption such as e-marketing is

increased in order to achieve market share, cost efficiency, growth, new product development, information about competitors, and to retain customers in the long term (Sheikh et al., 2018). This implies that in the midst of the current Covid-19 pandemic, collaborative innovation and aggressive marketing through digital or online platforms are also very important things to be developed and implemented. Since the outbreak of Covid-19, consumer behavior has shifted to online transactions.

Small and Medium Food Industry need to be market oriented, due to the company's innovation process depends on the amount of information obtained from the market, such as changes on customer's behavior and needs, technological advances, then carefully monitoring what suppliers and competitors are doing (Yadav et al., 2019). Hence, market oriented companies are able to provide innovations that suit customer needs and demands than improve the performance (Rodriguez and Morant, 2016). Through the performance of Small Medium Food Industry, it will be able to support the Indonesian economy during the Covid-19 pandemic. Based on the explanation above, the author are interested in conducting further research with the title **"Factors Affecting the Performance of Small and Medium Food Industries in Payakumbuh City and Lima Puluh Kota Regency"**.

## **1.2 Problem Statement**

The problem statement of this study are below:

1. How is the influence of market orientation on SMI's Performance in Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency?
2. How is the influence of market orientation on Innovation in Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency?



3. How is the influence of knowledge sharing on SMI's Performance in the Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency?
4. How is the influence of knowledge sharing on innovation in the Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency?
5. How is the influence of innovation on SMI's Performance in Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency?
6. How is the influence of the use of electronic marketing on SMI's Performance in Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency?
7. How does innovation mediate the relationship between market orientation and business performance in Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency?

### **1.3 Objective of the Study**

The objective of this study are below:

1. To examine the effect of market orientation on SMI's Performance in Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency?
2. To examine the effect of market orientation on Innovation in Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency?
3. To examine the effect of knowledge sharing on SMI's Performance on Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency?
4. To examine the effect of knowledge sharing on innovation in Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency?

5. To examine the effect of innovation on SMI's Performance in Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency?
6. To examine the effect of the use of electronic marketing on SMI's Performance in Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency?
7. To examine the effect of innovation mediating the relationship between market orientation and business performance in Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency?

#### **1.4 Benefits of the Study**

The benefits of this study are below:

1. Academic Benefits

It is hoped that through this research it can develop insight and knowledge for researchers and become a reference in entrepreneurship and Small Medium Food Industry, especially regarding the factors that affect business performance.

2. Practitioner Benefits

Through this research it can provide benefits to Small Medium Food Industry which could make this research a reference and consideration in decision making.

#### **1.5 The Scope of Study**

The scope of the current study will be carried out with the research subject being the Small and Medium Food Industry in Payakumbuh City and Lima Puluh Kota Regency in the phase of the Covid-19 pandemic and the research sample is the owner and manager of Small and Medium Food Industry. The current study examines market orientation, innovation, knowledge sharing, and the use of electronic marketing as independent variables and

mediating role of innovation that cause changes in business performance as the dependent variable.

## **1.6 Systematic of Study**

The writing systematics of this study are below:

### Chapter I Introduction

Chapter I contains the background that explains the phenomenon of the research problem, research purpose, benefits of research, and the systematic of writing system.

### Chapter II Literature Review

In chapter II contains the theoretical basis regarding the variables discussed in the study, previous research, the relationship between variables and the conceptual framework.

### Chapter III Research Methods

In chapter III contains the form or research design, then how to operationalize the variables, how data collection techniques are used, how sampling techniques are used, how data analysis is carried out, and how to test hypotheses.

### Chapter IV Data Analysis and Discussion

In chapter IV contains a description of the object of research, results of data analysis using applications, discussion and implementation of research results, therefore the results of the analysis learned in hypothesis testing can be known.

### Chapter V Closing

In chapter V is the concluding chapter of the research which contains conclusions obtained from the research results, research implications, and research limitations, suggestions for companies, future researchers and the government.

