

CHAPTER I

INTRODUCTION

1.1 Background to the Research

Small and Medium Enterprises (SMEs) are important avenues for job creation and a powerful source for innovation (Daudda & Akingbade, 2010; Shehu & Mahmoud, 2014). SMEs play a significant role in the sustainable socio-economic development of a given country in terms of contribution to GDP, provision of employment, generation of wealth, poverty reduction, competence building and enriching the welfare of people through the provision of goods and services including education (Kanyabi & Devi, 2011). SMEs are important engines for innovation and technological advancement (Mulhern, 1995).

Handicrafts are mostly handled by SMEs. Yet nowadays Small Medium Enterprises such as handicrafts contribute more than the other sub-sectors in the creative industry. SMEs can be said as one of the instruments in the rotation of the Indonesian economy. A number of SMEs help various sectors of the country's economy to grow. Here are the roles of SMEs in the West Sumatra economy:

Table 1.1

SMEs contribution to West Sumatra in 2011-2013

No	Contribution to	2011	2012	2013
1	GDP (current price)	57.94	59.08	60.34
2	GDP (constant price)	57.83	57.48	57.56

3	Non-oil and gas exports	16.44	14.06	15.68
4	Level of labor	97.24	97.16	96.99
5	National investation (current price)	50.04	54.77	63.42
6	National investation (constant price)	49.11	51.45	56.15

The table indicates SMEs contribution in West Sumatra is increasing yearly.

It increases in every part possible.



In Indonesia, creative industry is growing rapidly. Experts and economists claimed that the creative industries contribute partly to the state income continue to grow and develop at any time. Also, creative industries grow into a new base in the industrial sector. There are a lot of sub-sectors in the creative industry. According to Weckerle, Gerig, and Sonderman (2007), creative industries have 13 sub-sectors. Such as music industry, book market, art market, film industry, radio industry, performing arts market, design industry, architecture market, the advertising industry, software and games industry, audiovisual equipment market, press industry and handicrafts.

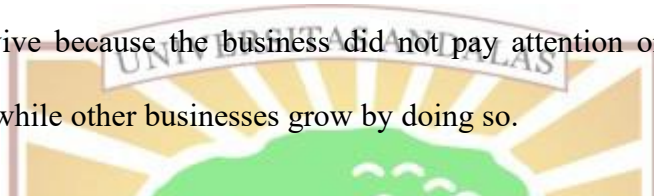
One sector that plays an important role in Indonesia is able to enhance Indonesian reputation in the eye of other countries. According to creative economy agency (2015), Craft is the dominant sub-sector i such contribution economically. Craft industries categorized as the third largest contribution to Indonesian GDP. Craft industries become the locomotives in the development of the national creative industry. This sector contributes do, to in value-added, labor, the number of companies, as well as exports more than other types of SMEs. Craft

industries have shown a significant increase in GDP. Many regions in Indonesia are making this sector as one of their regional incomes because of its large number of production. According to the Director General of the Ministry of Industry (2015), Added value generated by the craft sub-sector amounts to 24.8 percent of the total contribution of the creative industry sector. The employment of these small industries reached 31.13 percent with 35.7 percent of business. Furthermore, craft industries are the most valuable sector that West Sumatra had and if this sector increased significantly it can drive West Sumatra into one of the famous craft sectors in Indonesia.

The dominance of craft sub-sector dominates is due to the spread population throughout Indonesia and the richness of ethnic culture in each region. According to Indonesian creative economy agency (2017), the most known crafts in Indonesia are embroidery and handicrafts. This sector contributes 15,70% for Indonesian GDP in 2017. In Indonesia, crafts sector dominates the province income for the recent years, including West Sumatra.

The government of West Sumatra has paid serious attention on the development of handicrafts sectors. Yet these sectors are not so concerned about the future business. There are some weaknesses faced by handicrafts sectors. Based on the initial interview with the owner of businesses, from the obtained information, Innovation is one of the many problems faced by the owners of SMEs in West Sumatra in order to increase their organizational performances. Many of the businesses claimed that innovating their products and their way of doing things is not necessary and it is not useful for the business to survive. Hence, some organization could not compete and survive in order to last in this industry.

Deciding to innovate a product is really important for the owners of SMEs because innovation will be enable the business to compete with other businesses in the same sector. According to Hafeez *et al* (2012), Innovation is regarded as an engine for driving economic growth. Innovation is considered equally important for large enterprises as well as the small and medium ones. The role of innovation becomes even more important in the context of the business environment of developing countries than that of the developed ones. Moreover, some businesses could not survive because the business did not pay attention on the businesses surroundings, while other businesses grow by doing so.



Some business owners do not really know how to improve their business for better future. Based on the interview, the owners claim that their problem in business are not only innovation. But also, culture. The weaknesses of handicraft sectors in West Sumatra is not only innovation but also organizational culture. In handicraft sectors, the owner of this sector does not have a strong values and behavior pattern that represent the organization to the potential customers. The organizations tend to let the organization the way it is and just running the business the way their ancestor did. We can define culture in an easier term as personality. It is a hidden culture which unifies forces that provide meaning and direction. It is also a system of shared systems of beliefs and values that ultimately shapes employee behaviors (Van *et al.*, 1998).

Furthermore, in an organization or a business, culture determines where the business is heading to. It leads the business to what it is going to be in the future. Organization culture is everything that people have, think and do as members of the society (Ferraro, 1998). Organizational culture represents the characteristics of

the organization, which directs its employees in day-to-day working relationships and guides them on how to behave and communicate within the organization. Finally, the researcher recognizes why this sector makes the organization difficult to expand.

In addition to the initial interview, some owners of the organizations/SME were happy to listen to their employees' ideas and suggestions but most were not. The owners were stuck on the way they thought and would not want anyone to change the way of thinking about running organizations. It is actually really important for SME owners to listen to their employee's suggestions. Many owners tend to undergo the same procedure of running organizations with their ancestors, the owners would not want to change any of the procedures. Referring to the style of leadership, according to Webb (2009), claims there are three leadership styles, which are transactional, transformational and laizze-faire. Transformational leadership behavior is very effective to improve organizational performance during uncertain environment and to achieve competitive advantage (Nemanich & Keller, 2007). According to Bass & Bass (2008), transformational leadership is a style of leadership geared towards change and towards improving individual and collective performance. More specifically, transformational leadership is one of the emerging topics in innovation that many scholars have increasingly paid attention to (Di Benedetto, 2013). Hence, it is also necessary for the owner of the organizations to acknowledge the importance of applying this leadership style.

In order to produce handicrafts, the business owners had to have certain skills. Without such skills, the owner could not randomly produce quality products. The products must have values to represent culture of where they come from. The

owners should also be able to know the possibilities and difficulties in order to stay in the industry. Moreover, the owners need to create organizations which have a character of leadership style by listening to what employees suggest. Finally, the conclusion of the interview, there are still some problems that this industry faces.

In line with this phenomenon, the researcher would like to analyze the influence of Transformational Leadership and Organizational Culture on Organizational Innovation on Handicraft Industry in West Sumatra.

1.2 Research Problems

1. How will transformational leadership influence organizational culture in handicrafts sector in West Sumatra?
2. How will organizational culture influence organizational innovation in handicrafts sector in West Sumatra?
3. How will transformational leadership influence organizational innovation in handicrafts sector in West Sumatra?
4. How will organizational culture mediate the influence between transformational leadership and organizational innovation in handicrafts sector in West Sumatra?

1.3 Objectives of the Research

The research is intended to analyze whether all possible weaknesses faced by SMEs in West Sumatera are relevant to the reality. Clearly, it is:

1. To analyze the influence of transformational leadership towards organizational culture.
2. To analyze the influence of organizational culture towards organizational innovation.
3. To analyze the influence of transformational leadership towards organizational innovation.
4. To analyze the influence of organizational culture, mediate between transformational leadership and organizational innovation

1.4 Significance of the Research

This research hopefully will give a significant contribution to:

1. Theoretical advantages

This research will hopefully be presenting the advantages of the study for Small Medium Enterprises if they would like to know what could possibly happen in the future. Furthermore, the result of this research can be a reference for other researchers if they want to conduct similar research.

2. Practical advantages

The result of this research will have an impact and provide knowledge for the SMEs in West Sumatra. The owners will be able to improve their businesses in order for the business survive and compete with other SMEs. Finally, it can also be used as a discussion between the owner and the employees. Also, can take advantages of the result as topics of discussion.

1.5 Research Scope

During the research, there are some limitations faced:

1. Theoretical scope

This research only focused on three variables to be tested, including organizational innovation, organizational culture, and organizational performance.

2. Practical scope

Biased answers from the owner of the organization cannot be avoided during the research.

1.6 The Organization of Study

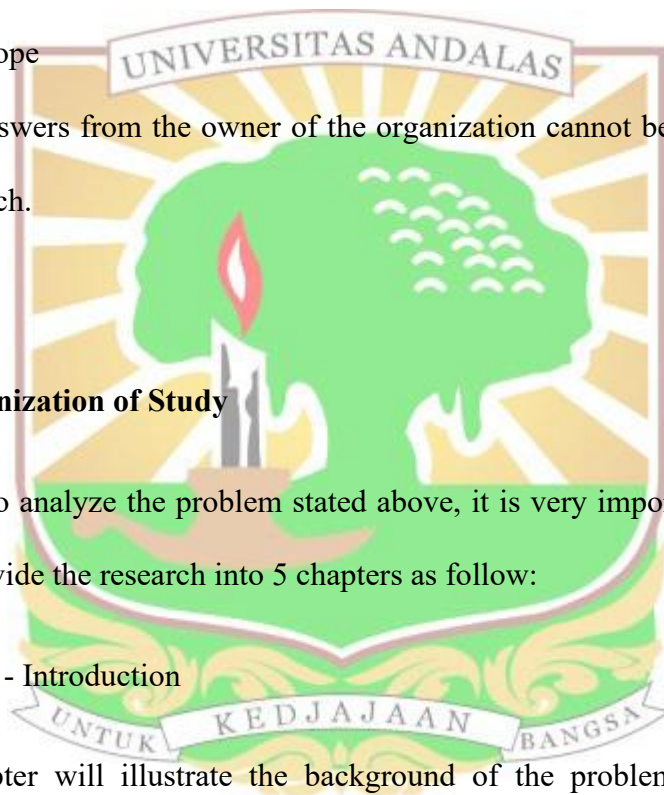
In order to analyze the problem stated above, it is very important to organize and divide the research into 5 chapters as follow:

Chapter 1 - Introduction

This chapter will illustrate the background of the problems, the problem statements, the purpose of the study, the significance of the study, the research framework and the organization of the study.

Chapter II - Literature Review

This chapter will amplify this study with previous studies that are related to the problem statements. The previous studies will be used to support the possible hypothesis on conducting this research.



Chapter III - Research Method

This chapter will elaborate what kind of method used in this research and how much sample and population needed for this research in order to achieve a positive relationship between dependent and independent variables.

Chapter IV - Analysis and Discussion

This chapter contains the result of the analysis, the characteristic of the respondent, and descriptive analysis.

Chapter V - Conclusion and Suggestion

This chapter is the conclusion of the analysis and research that was conducted previously, about whether all the variables are related and have positive association with each other. This chapter will also give some advice for the future research.

