

# THE DIFFERENCES IMPACT OF PRODUCT AND PROCESS INNOVATION ON THE GROWTH OF SALES AND PROFIT OF SMES IN PALANGKARAYA

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**Abstract:** *This study aimed to analyze the differences in the impact of product innovation and process innovation on sales growth and profit growth. The study was conducted on SME in Palangkaraya. A total of 82 SMEs selected as the sample is determined by purposive sampling. Data were collected using a questionnaire prepared by the rating scale. We use multiple linear regression method to analyze the relationship between variables. We found that the positive impact of product innovation significantly to the increase in sales, however no significant effect on earnings growth. Mean while, Innovation in processes have a significant positive impact on earnings growth, but not significant to sales growth. Sales growth significantly positive impact on profit growth.*

**Keywords:** *Product Innovation, Process Innovation, Growth of sales, Growth of profit.*

## INTRODUCTION

In recent time, management experts believe that innovation is a must for a business to be able to survive and win the competition. Companies can do innovation in a variety of forms. Two types of innovation most often done is product innovation and process innovation.

Since long time ago, the SME is known as a business entity that is very flexible. Flexibility of SMEs is one of the main factors that make them able to survive in different situations of environmental change. The concrete evidence is when the economic crisis in 1998 in Indonesia, many large-scale enterprise sector bankruptcies. At the same time, the SME sector is still able to survive. One key to success is innovation carried out by SMEs.

In Palangkaraya, SME growth year-on-year rise quite sharply. The role of SMEs on local economic growth Palangkaraya also quite high. This condition is certainly a potential that must be developed by the local government to improve overall economic growth. One of the efforts that have been made is through training by

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local government focused on improving the ability of innovation, both product innovation and process innovation.

Characteristics of product innovation and process innovation is different. Therefore, the impact will also vary. This study aimed to analyze the differences in the impact of product innovation and process innovation carried out by SMEs in Palangkaraya on the growth of sales and profit growth.

## LITERATURE REVIEW

### 1. Definition Of Innovation

Innovation refers both to the output and the process of arriving at a technologically feasible solution to a problem triggered by a technological opportunity or customer need (Narayanan, 2001: 68). Innovation is the process of creating new ideas and putting them into practices. It is the means by which creative ideas find their way into everyday practices, ideally practices that contribute to improved customer service or organizational productivity (Schermerhorn et.al., 2006: 369).

Referring to the two definitions above, we conclude that the term innovation is often defined differently, although in general has a similar meaning. Innovation can be defined as a "process" or "outcome" and the development or utilization or mobilization of knowledge, skills (including technological skills) and experience to create or repair of products(goods and services), process, and or anew system, which gives mean values (especially the economic and social value).

Innovation as an "object" also mean a new product or practice that is available to applications, generally in a commercial context. Typically, different levels of novelty can be distinguished, depending on the context: an innovation may be new to a company (or "agent /actor"), new to the market, or country or region, or a new globally. Meanwhile, the innovation as an "activity" is the process of creating innovation, of ten identified with the commercialization of an invention.

Innovation is the specific function of entrepreneurship, whether it is in businesses that already exist, public service institution, or a new business undertaken by an individual. Innovation is a means used by employers to create new resources that produce wealth or utilize existing resources, to increase their potential, to increase wealth (Drucker in Hit, Ireland & Hoskisson, 2002:216).

Highly innovative organization have strategies and cultures that are built around a commitment to innovation. This includes tolerance for mistakes and respect for well-intentioned ideas that just do not work. Highly innovative organization have structures that support innovation. They emphasize creativity through teamwork and cross-functional integration. They also utilize decentralization and empowerment to overcome the limitations of great size Schermerhorn et.al (2005:370).

In highly innovative organization, staffing is done with a clear commitment to innovation. Special attention is given to critical innovation roles of idea generators, information gatekeeper, product champion, and project leader. Finally, innovative organization benefit from top management support. Senior manager provide good examples for others, eliminat obstacle to innovation, and try to get things done that make innovation easier.

Changes and market analysis, open up opportunities for the innovation. Demographic changes such as population growth, changes in the structure of age and gender, education etc. can push to the innovation. Changes in perception in the sense of changing the meaning of a product or service will encourage innovation.

Drucker (1995) explained, systematic innovation, aims to start with an analysis of the sources of new opportunities. Depending on the context, sources will be different at different times. Innovation because it involves the concept and perception, innovators must go outside, look, ask questions, and listen. Successful innovators use both left brain and right brain. Thus for effective, innovation must be simple, focused, accept what people say, specific, clear, starting small, and design applications carefully.

Schemermerhorn et. al (2006: 370) states that innovation process will not be complete until the achievement of the final application. Basic stages in the innovation process is as follows: 1). Idea creation: create ideas through spontaneous creativity, investigation and processing of information; 2). Initial experimentation: embody and implement the idea of potential value; 3). Feasibility determination: identify the benefits and cost anticipated; 4). Final application: manufactures and markets products and services or implementing new approaches to the operation.

Based on the process, Hubeis (2005: 77) distinguish the process of innovation in terms of the company on the following:1). Radical, when the reduction of the costs incurred by the innovation may monopolize the price and take the largest part of the market share. 2). Gradually when monopoly prices only happen on a competitive level. In practice, the innovation is based on the stages of introduction, persuasion, decision, implementation and confirmation in accordance with good ability to adopt active (innovators, early adopters and early majority) and passive (late majority and laggard).

Innovation involves the development of a core competency in the process of generating technology. Thus the innovation process more easily measured. In contrast to the knowledge generated through the process of innovation more tangible, tacit and depend son the context, among others, such as knowledge related to changes in working practices, changes in roles and responsibilities, and a change in values and attitudes. This knowledge is difficult to achieve in the form of an explicit, at least not in away that is understand able when it is transferred to the new context.

Innovation is the result of hard work that requires knowledge and purity (ingenuity). When Talent, purity, knowledge is already available, which is required in innovation is hard work that is focused and purposeful. It is known that the original purpose of innovation is to become a standard setter (maker of the norm), determine the direction of technological or industrial (newera). Often surfaced that if a result of innovation from the beginning is not intended as a leader, do not change the environment, an innovation seems to say not innovative enough. In the business world, it is often said to be effective when a simple innovation and focus in doing or making something, because innovation that has the power to transform the whole industry and put an end to business strategy usually is often not successful (Grovein Bataris Gorat, 2003).

Innovation must have a purpose and systematic, which begins with analyzing opportunities. It is intended that all sources of innovative opportunities is not enough just to pay attention to it, but the search need to be organized and carried out. Innovation also must be conceptual and perceptual. In principle, to innovate must be able to search for information by looking, watching, listening and studying the customer in terms of expectations, values and needs. Effective innovation starting small. An innovation is not grandiose, and trying to do something unique, because the general idea too grandiose as leading to the industrial revolution may not be able to run and difficult to realize. Later that innovation does not need to lead to the ultimate goal to be a big business (Drucker, 1995:149)

Drucker (1995) argues, that most of the innovative ideas emerge through methodological analysis of the opportunities that exist, both contained within and outside the company. According to Drucker, these opportunities may be events that are not expected (unexpected occurrences), the peculiarity of the various form (incongruities of various kinds), the needs of the process (process needs), changes in industry or market (change in an industry or market), demographic changes (demographic change), changes in perception (change in perception) and their new knowledge (new knowledge).

## **2. Types of Innovation**

The company is engaged in three types of innovation activity, ie, Invention, Innovation, and Imitation (Schumpeter in Hit, Ireland & Hoskisson, 2002: 218). Invention is the act of creating or developing a new product or process. Innovation is a commercial product creation process of the invention. Innovation may be necessary to maintain or achieve a competitive balance, more or less as a competitive advantage in many world markets. In addition, the success of innovation is influenced by the company's ability to absorb and evaluate information about the external environment. Therefore, it is usually built by bringing together knowledge and expertise from many sources, each innovation creates additional

sources of innovation. Therefore an invention brings something new into being, while innovation to make something new that to be used. Imitation is the use of an innovation by companies alike. Imitation usually leads to the standardization of products or processes, and products that are based on imitation is usually offered at a lower price, but with features that are not entirely the same. If a company produces goods or services, or to use a new system or procedure, then it is an innovation. In view of this invention is part of innovation.

Innovation used in two forms: (1) Innovation Process. In this sense, innovation is the process by which an individual or organization to the technical solution. (2) Innovation Output. In this sense, the output is the output of the innovation process (Narayanan, 2001:68).

According to Schermer hornet al, (2006: 369), there are two types of innovation, the innovation of product and process innovation. Product innovation is introducing or improving new products or services to better suit customer needs. Process innovation, is introducing new operations and methods is better to do something.

Companies can do some form of innovate onto support business performance, namely product innovation, process innovation, service innovation, organizational innovation and business model innovation. Product innovation is innovation that is carried out on the products or services offered to consumers. Process Innovation, an innovation in the processes of production of goods and services to be more effective and efficient. Service innovation, an innovation in order provide more valuable services for customers. Organizational innovation, a change in the organizational structure and the division of roles within the company. Business model innovation is the change in the overall business system(Boone & Kurtz, 2014)

Innovation can take many forms but they can be reduced to four dimentions of change: 1). Product innovation, changes in the things (product/services) which an organization offers; 2). Process innovation, changes in the waya in which they are created and delivery; 3). Position innovation, changes in the context in which the product/services are introduced; 4). Paradigm innovation, change in the underlying mental models which frame what the organization does (Bessant & Tidd, 2011 : 19).

### **3. Impact of Innovation**

Nonaka & Takeuchi (1995) describes a competitive advantage based on their continuous innovation, creativity and innovation rooted in knowledge. That means that copy right knowledge has to do with innovation. For example, the prototype as a product of the justification used for the innovation conceptor model for the implementation of activities.

Innovation is a tool to exploit change as an opportunity for a different business or a different service. Innovation can be displayed as a science, can be learned and can be practiced. Innovation is also said to be a change of value and satisfaction, obtained consumers of resources. Usually the changes meant a change that has occurred or is in progress. Successful innovation, are capable of utilizing the change.

There are a number of innovations that lead to a major change, such as the great engineering innovation and is a remarkable thing. However, most successful innovation is much simpler and able to take advantage of ongoing changes. Successful innovation is also generally simple and focused and targeted at applications that are designed distinctive, clear and accurate. Innovation is more involving manual labor of the mind, but also innovation does not need to be technical and should not be objects altogether (Drucker, 1995).

Hubeis (2005: 72) argues, that efforts to enhance or improve existing resources, modify it to make something valuable, creating new things and different, change a value to the resource and incorporate these resources into a new configuration, which is more prolific, demonstrating the feasibility of innovations in generating an economic benefit.

At the macro level, process innovation tends to displace employment, compensation effects are revalent, and product innovation is associated with employment growth. (Harrison et. al, 2005).

Competition and hard budget constraints are complementary. Competitive pressure enhances the performance of old firms, which is suggestive of a role of agency effects and hence of policy substitutability and enhances the performance of new firms, which is consistent with complementarity (Aghion, Carlin, Schafer, 2002)

Empirically, several studies have shown the impact of innovation. Companies that do incremental innovation in advance, can reach a larger market share (Banburry & Mitchel, 1995). The analysis confirms a positive impact of product innovations on both revenue and profitability growth, whereas the profitability of an average industrial company remains unaffected by its service innovation activities, pointing to the challenge of managing the costs of service innovation in goods-centered environments (Eggert et.al, 2014). Product innovation, process innovations, and organizational innovations have a positive impact on organizational performance (Hassan et.al, 2013). Product innovations commercialized in the immediate past positively affect the corporate revenue streams of semiconductor companies (Corsino, 2008). Innovation is positive related to sales growth for small firms, but not for larger ones (Engel et.al, 2014).



However, research Boermans & Roelfsema (2015) resulted in findings that direct impact of innovation on firm performance is in significant. No significant relation appears between innovations and employment change (Engel et.al, 2014).

Based on the results of empirical studies, we will test two hypotheses as follows:

Hipotesis 1 : Product innovation and process innovation positive effect on sales growth, simultaneously and partially.

Hipotesis 2 : Product innovation, process innovation, and sales growth positive effect on earnings growth both simultaneously or partially.

## **RESEARCH METHODS**

This study uses the verification method, the test causality variable, the other variable. The unit of analysis is SMEs in Palangkaraya, Central Kalimantan. The sample is determined by purposive sampling method, with the following criteria: 1) Have their own products; 2) SMEs have been established for at least 5 years; 3) Employees have more than 10 people. Based on these criteria, selected as a sample of 82 SMEs.

Data was collected by questionnaire, which is designed to scale ratings (rating scale). The respondents are owners of SMEs. Variable product innovation is measured by three items of questions: number of product variants, different raw materials relative to competitors, the design is relatively unique compared to competitors. Process innovation, measured by the three items in question: always make innovations in production methods, always make innovations in service, do the division of labor among employees. Sales growth was measured with two items of questions: the number of new customers over the previous year, and the value of sales turn over the previous year. Profit growth was measured by one item question: the growth rate of net profit.

To analyze the relationship between variables, we used the method of Multiple Linear Regression. To test the significance of the partial effect, we used the t test. To test the significance of the simultaneous effect, we use f test.

## **RESULTS AND DISCUSSION**

### **1. Effect of Product And Process Innovation On Sales Growth**

The influence of product innovation and process innovation to sales growth simultaneously can be seen from R square values in Table 1, which amounted to 39.3%. This means that variations in sales growth changes, 39.3% is determined by the change in product innovation and process innovation. And, as much as 60.7% is determined by other variables not analyzed.

**Table 1**  
**Model Summary**

<i>Model</i>	<i>R</i>	<i>R Square</i>	<i>Adjusted R Square</i>	<i>Std. Error of the Estimate</i>
1	,627 <sup>a</sup>	,393	,378	,57402

a. Predictors: (Constant), X2, X1

Simultaneously, the effect is significant, as can be seen from Table 2 that the value of the F statistic of 25.566 that was significant at 1% level.

**Table 2**  
**ANOVA**

<i>Model</i>		<i>Sum of Squares</i>	<i>df</i>	<i>Mean Square</i>	<i>F</i>	<i>Sig.</i>
1	Regression	16,848	2	8,424	25,566	,000 <sup>a</sup>
	Residual	26,030	79	,329		
	Total	42,878	81			

a. Predictors: (Constant), X2, X1

b. Dependent Variable: Y

**Table 3**  
**Coefficients<sup>a</sup>**

<i>Model</i>		<i>Unstandardized Coefficients</i>		<i>Standardized Coefficients</i>	<i>t</i>	<i>Sig.</i>
		<i>B</i>	<i>Std. Error</i>	<i>Beta</i>		
1	(Constant)	4,556	,479		9,506	,000
	X1	,291	,061	,579	4,798	,000
	X2	,032	,058	,067	,558	,578

a. Dependent Variable: Y

In Table 3, we can see that, partially, product innovation have a positive impact on sales growth amounted to 0.291. That is, when the product innovations increased by one unit, then the sales growth will increase by 29.1%. Based on the level of significance, the coefficient is significant at the 1% level. It can be concluded that, product innovation, has a significant positive impact on sales growth in SMEs in Palangkaraya.

Meanwhile, the influence of the innovation process, to the sales growth was positive amounting to 0.032%. That is, if the innovation process is increased by one



unit, then growth in sales will increase by 3.2%. Based on the level of significance, the coefficient is not significant at the 5% level. It can be concluded that the innovation process has positive influence on sales growth in SMEs in Palangkaraya, but the effect is not significant.

## 2. Impact of Product Innovation, Process Innovation, and Sales Growth on Profit Growth

Simultaneously, product innovation, process innovation, and sales growth, influence the profit growth of 45.5% (see Table 4). This means that changes in earnings growth, 45.5% is determined by the variation of the change of product innovation, process innovation and sales growth. And about 54.5% is determined by other factors not analyzed in this study.

**Table 4**  
**Model Summary**

<i>Model</i>		<i>R</i>	<i>R Square</i>	<i>Adjusted R Square</i>	<i>Std. Error of the Estimate</i>
Dimension 0	1	,675 <sup>a</sup>	,455	,434	,76161

a. Predictors: (Constant), Y, X2, X1

Simultaneously the influence is significant. In Table 5 it can be seen that the value of the F statistic of 21.712 that was significant at the level of 1%.

**Table 5**  
**ANOVA<sup>b</sup>**

<i>Model</i>		<i>Sum of Squares</i>	<i>df</i>	<i>Mean Square</i>	<i>F</i>	<i>Sig.</i>
1	Regression	37,781	3	12,594	21,712	,000 <sup>a</sup>
	Residual	45,243	78	,580		
	Total	83,024	81			

a. Predictors: (Constant), Y, X2, X1

b. Dependent Variable: Z

Table 6, is the result of the test of the partial effect. It can be seen that product innovations positive effect on the growth of profit of 0.048. These effects are not significant, with a value of t-statistic of 0.528 which is above the 5% significance level. It can be concluded that the product innovations not provide a meaningful impact for profit growth.

Process innovation, positive impact on profit growth amounted to 0.269 with a value of t-statistic of 3.492, significant at the 1% level. This means that innovation processes provide means for increasing the impact on the profit growth of SMEs in Palangkaraya.

Meanwhile, sales growth is a positive impact on profit growth amounted to 0.446, with at-statistic value of 2.987, significant at the 1% level. That is, the increase in sales growth, provide significant impact for the improvement of profit growth.

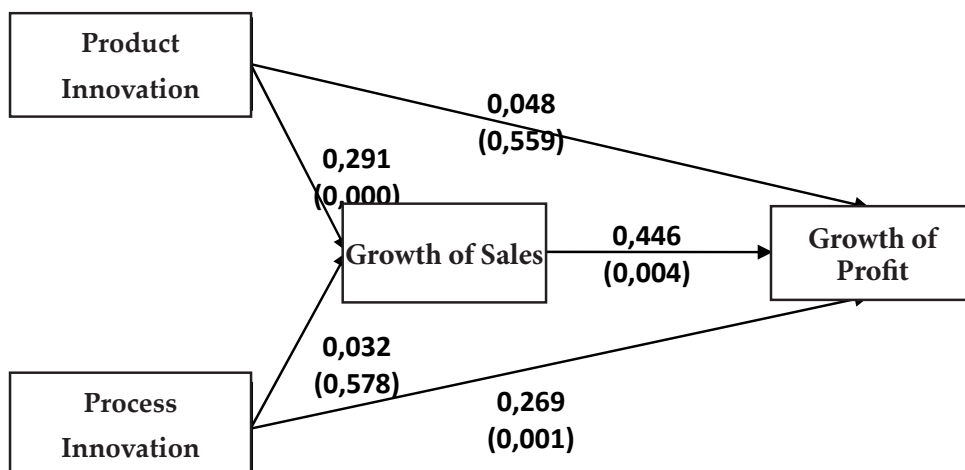
**Table 6**  
**Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-3,346	,931		-3,594	,001
	X1	,048	,092	,069	,528	,599
	X2	,269	,077	,402	3,492	,001
	Y	,446	,149	,320	2,987	,004

a. Dependent Variable: Z

Visually, the effect between variables can be seen in Figure 1 as follows:

**Figure 1. Research Model**



### 3. DISCUSSION

Based on the results of data processing, it can be seen that product innovations have a significant effect on sales growth, but not significant to the profit growth. This shows that sales growth is an intervening variable that connects between product innovation to profit growth. In other words, the impact of product innovation on earnings growth does not occur directly, but through sales growth.

Innovation processes are not significantly influence sales growth. However, a significant effect on profit growth. Thus, the impact of the process innovation to the profit growth can occur directly, without going through the sales growth as an intervening variable.

These findings are very interesting. We obtain empirical evidence that the impact of product innovation is on sales growth. The impact on profit growth occurs in directly, through growth customers. Yes, of course, because of product innovation focused more on the products to be offered to consumers. This is in accordance with the opinion of the experts that the Product innovation, changes in the things (products / services) roommates an organization offers (Bessant & Tidd, 2011). Product innovations made to the products or services offered to consumers (Boone & Kurtz, 2014). Product innovation introducing or improving new products or services to better suit the needs of customers (Schermerhorn et al, 2006:369).

Products and services are the main reasons customers to buy. High-value products, will certainly provide satisfaction for the customer. High value product is the result of product innovation. This in turn will cause a domino effect, where customers will tell their friends and colleagues about the advantages of the innovation results. The impact, of course, there will be growth in sales. The increasing number of new customers, and increased sales volume will increase earnings growth.

Another surprising findings, is that the process innovation is no significant impact on sales growth, but significant effect on earnings growth. Thus we can conclude, that the impact of the process innovation is more to the profitability.

Process innovation, it is more directed to improving the system and methods of production and management. The goal, is a working system, which is more effective and efficient. This is consistent with the statement of the experts, that the process innovation, is introducing new operations and methods is better to do something (Schermerhorn et al, 2006:369. Process innovation, an innovation in production processes goods and services to be more effective and efficient. (Boone & Kurtz, 2014). Process innovation, changes in the way in the which they are created and delivery (Bessant & Tidd, 2011:19).

What are the implications of this research? Of course, we commend that in order to increase sales growth for SMEs in Palangkaraya, innovation should be emphasized on product innovation. It can be done by improving their ability to create and offer more product variety, more unique design and combination of raw material more interesting and varied.

However, for SMEs in certain fields, it is often difficult to increase sales growth. One reason is that too narrow a niche market, or because the structure tends to monopoly. In such circumstances, SMEs should focus more on process innovation. The reason, the process innovation can increase earnings growth without having to increase sales growth. For SMEs, the characteristics of its business hard to innovate products (eg service sector), should focus on the process innovation.

## CONCLUSIONS AND SUGGESTIONS

There are three main results of this study: 1. Product Innovation have a significant positive impact on sales growth, but not significant on profit growth. 2. Process Innovation is no significant impact on sales growth, but significant impact on profit growth. 3. Sales growth significantly positive impact on profit growth.

The results showed that the impact of product innovation on profit growth can not occur directly, but must go through the intervening variables, the growth of sales. Meanwhile, the impact of the innovation process, to the profit growth, can occur directly, without going through an intervening variable.

The implication, to increase sales growth, SMEs in Palangkaraya can focus their efforts on product innovation. The sales growth will ultimately have an impact on profit growth. However, if the market is difficult to be improved, SMEs are still able to increase profit growth, by way of process innovation.

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