

# Enhancing MSME Performance through Digital Marketing and Innovation with Government Policy as Moderating Effect

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## Abstract

Indonesian MSMEs currently have very serious challenges and problems that are different from the previous economic crises that occurred in Indonesia. MSME performance has decreased during the Covid-19 pandemic by 30%. However, the Bungo Regency MSME Business Performance has decreased with a smaller percentage of 20% when compared to the percentage decline at the national level. There are still many MSME actors who are reluctant to innovate even though innovation is very important and only 10% of MSMEs use digital marketing even though government policies lead to an increase in the use of technology, at least 17.2% of MSMEs must be technology-based. The purpose of this study is to analyze the influence of innovation and digital marketing on the performance of MSMEs directly and indirectly and to analyze the effect of government policy as a moderating variable. The sample in this study amounted to 85 MSME actors. Data were analyzed using SEM PLS. From the test results, it is found that innovation does not directly affect the performance of MSMEs, but has an indirect effect on the performance of MSMEs through digital marketing. Meanwhile, digital marketing variables and government policies directly affect the performance of MSMEs. Government policy variables are not able to moderate the influence of innovation and digital marketing variables on MSME performance. MSME actors will innovate and use digital marketing at the pressure of the environment that requires them to adapt and not because of policies from the government.

## Keywords:

MSME Performance, Innovation, Digital Marketing, Policy

## 1. Introduction

Indonesia's Micro, Small and Medium Enterprises (MSMEs) currently have very serious challenges and problems that are different from the previous economic crises that occurred in Indonesia. In 1998, when the financial crisis occurred due to the drop in the rupiah exchange rate and the loss of market and public confidence, Akatiga (1999), conducted a study on the impact of the economic crisis by conducting a survey of 800 MSME actors in West Java, Central Java, Yogyakarta, North Sulawesi, and North Sumatra. . This study found that export market-oriented SMEs with locally sourced raw materials actually experienced an increase in profits.

In 2008 there was another crisis in Indonesia and in the world. In 2008 global financial crisis triggered by the collapse of the property market in the United States (US). Findings from several studies state that MSMEs are relatively unaffected. This is due to the limited linkage of MSMEs to the global market, the absence of foreign debt taken by MSMEs, and the orientation of MSMEs to the local market. Only MSMEs related to the export market are relatively affected.

This is different from the two previous crises where MSMEs were still relatively able to operate normally. The crisis that occurred in 2020 until now started from the health sector. The instructions to comply with the health protocol to maintain social distancing and not to gather that the government has implemented to reduce the spread of the corona virus have narrowed the opportunity for MSME actors to operate. Business performance, especially for MSMEs, has decreased during the Covid-19 pandemic. Many business industries that have good business performance are unable to survive, especially those engaged in services and manufacturing. Data shows that there has been a 30% decrease in MSME performance during the Covid-19 pandemic (Amri, 2020). However, Bungo Regency's MSME Business Performance has decreased with a smaller percentage of 20% when compared to the percentage of decline at the national level (Cooperative Office, UMKM, Bungo Regency Industry and Trade, 2021).

One of the causes of the decline in the performance of MSMEs is that there are still many MSMEs who are reluctant to innovate. Though innovation is very important to do (Harel, Schwartz and Kaufmann, 2020) (Indartono, 2018). And in Bungo Regency there are not many MSMEs that use Digital Marketing, data in Bungo Regency of 4283 MSME units is only 10% or around 428 MSME units that use digital marketing (Cooperative Office, MSMEs, Bungo Regency Industry and Trade, 2021). Whereas government policies lead to an increase in the use of technology, at least 17.2% of MSMEs must be technology-based.

Many SMEs fail in the short term due to pre-existing problems such as little or no investment in market improvements and knowledge, lack of formal planning and demand forecasting, lack of managerial and technical skills, and limited economic resources (García-Vidal *et al.*, 2020). These features make SMEs more vulnerable to internal and external events such as: crises of employees leaving their jobs, decreased financing options, and reduced demand as competitors enter the market (most SMEs are in highly competitive markets) (Eggers, 2020). In the context of the crisis, innovation has been identified as a strong driver for the resilience of small business organizations and economic development in the manufacturing and service sectors (Choi and Chandler, 2020)(Ali, Khan and Miah, 2017). Coincidentally, these are the sectors most affected during the COVID-19 pandemic (Ben Amara and Chen, 2020) (Fernandes, 2020; Hamilton, 2020). Innovation in SMEs can be measured through three indicators: product innovation, process innovation, and management system innovation (Dwivedi *et al.*, 2020). As part of the strategy, digital marketing aims to inform customers that the company has developed a communication strategy to increase customer attention regarding the company and its products, to help attract purchase options and make them loyal to the company's products. Moreover, digital marketing mainly involves building trust and loyalty relationships with customers and inbound marketing is becoming a key component of digital marketing (Nazir *et al.*, 2018) (Mason *et al.*, 2021). Innovation in SMEs can be measured through three indicators: product innovation, process innovation, and management system innovation (MaldonadoGuzman *et al.*). As part of the strategy, digital marketing aims to inform customers that the company has developed a communication strategy to increase customer attention regarding the company and its products, to help attract purchase options and make them loyal to the company's products. Moreover, digital marketing mainly involves building trust and loyalty relationships with customers and inbound marketing is becoming a key component of digital marketing (Mason *et al.*, 2021).

In the 2020-2024 RPJMN, the government is committed to strengthening entrepreneurship and MSMEs in order to increase economic value added, employment, investment, exports, and economic competitiveness through five priority areas, namely developing human resources (HR), increasing access to financial services, increase the added value of MSME products in domestic and international markets, strengthen partnerships, and improve regulations and policies that affect the sustainability of MSMEs.

The government has long rolled out an empowerment or development program for MSMEs. The program is implemented by various ministries/agencies (K/L) with several focus areas, namely increasing access to markets; improve access to financial services; improve the quality of human resources through competency training and mentoring; and improve policies to create a conducive business ecosystem such as ease of licensing. However, the implementation of the MSME program is seen as still not supporting the development of MSMEs.

Based on the description above, the researcher wants to conduct research with the title "Enhancing MSME Performance through Digital Marketing and Innovation with Government Policy as Moderating Effect".

## 2. Methods

This type of research is associative, namely research that aims to see the relationship between variables (Hermawan and Amirullah, 2016). While the data used is primary data sourced from respondents. While the population in this study are all MSMEs in Bungo Regency that use Digital Marketing with an unknown number of people so that it is categorized as an unlimited population. The number of samples in this study was 5 times the number of indicators, namely 17 (seventeen) so that the number of samples was 85 SMEs.

Operational variables in this study contain indicators of a variable that allows researchers to collect relevant data so that each of these variables is more focused and in accordance with the planned measurement method. Operational variables in this study are illustrated in Table 1 below:

Table 1. Definition of Operational Variables

No	Variable	Indicator	Variable Type
1.	MSME Performance (Y)	1. Sales Volume 2. Customer Growth 3. Profit Achievement	Endogenous
2.	Innovation (X1)	1. Product Innovation, 2. Process Innovation, 3. Management System Innovation	Exogenous
3.	Digital Marketing (X2)	1. Transaction, 2. interactive, 3. Incentive Programs, and 4. Site Design	Exogenous and Mediation
4.	Government Policy (Z)	1. Effectiveness 2. Efficiency 3. Impact 4. Value Conformity	Moderation

The data analysis method used is SEM analysis with the help of Smart PLS 3.2.9. PLS (Partial Least Square) is: Structural equation analysis (SEM) based on variance that can simultaneously test the measurement model as well as test the structural model. The measurement model is used to test the validity and reliability, while the structural model is used to test causality (testing hypotheses with predictive models). Partial Least Squares (PLS) analysis is a multivariate statistical technique that performs comparisons between multiple dependent variables and multiple independent variables. PLS is a variant-based SEM statistical method designed to solve multiple regression when specific problems occur in the data (Harahap, 2020).

The conceptual framework scheme in this study is structured as follows (See Figure 1):

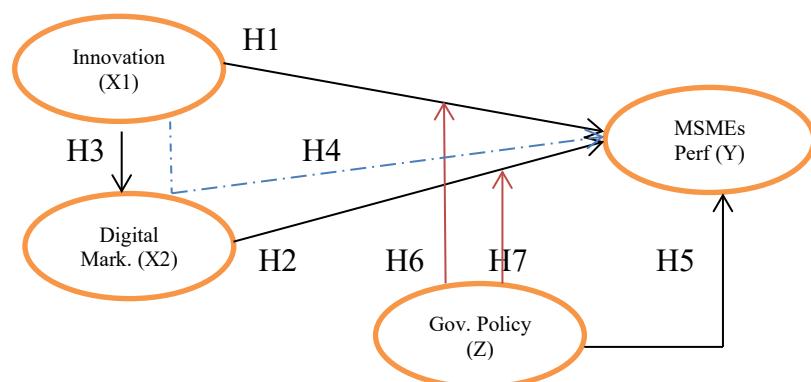


Figure 1. The conceptual framework

### 3. Results and Discussion

#### 3.1 Results

Characteristics of respondents

Characteristics of respondents in this study were classified into 4 categories, namely based on gender, age, last education and length of business. The description of these characteristics can be seen in the following graphic illustration as shown in the Figure 2:

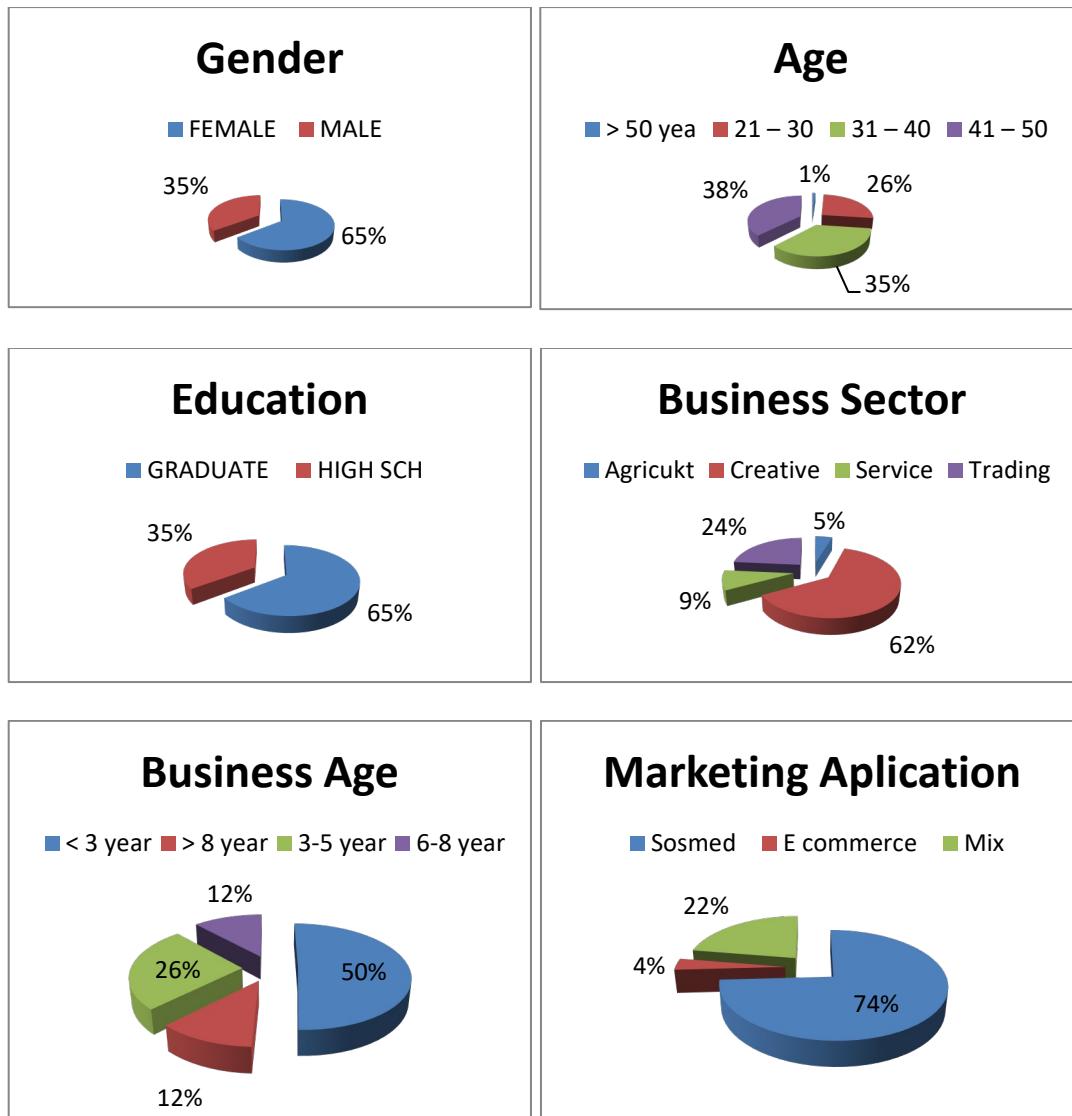


Figure 2. Respondent Description

#### A. Evaluation of the Measurement Model (Outer Model)

Evaluation of the measurement model (outer model) is carried out for each PLS scheme used, namely the path scheme, centroid scheme, and factor scheme. Evaluation of the measurement model for reflexive indicators includes evaluating the validity and reliability of each indicator on its latent variables. Validity is a measure that describes the correlation between reflexive indicator scores and latent variables. The evaluation begins by looking at the validity indicators indicated by the loading factor value ( $\lambda$ ), if the loading factor value ( $\lambda$ ) 0.6 then the indicator is said to be valid and vice versa (Sarstedt, Ringle and Hair, 2020). From the loading factor test, a structural image is obtained as shown in the following figure 3:

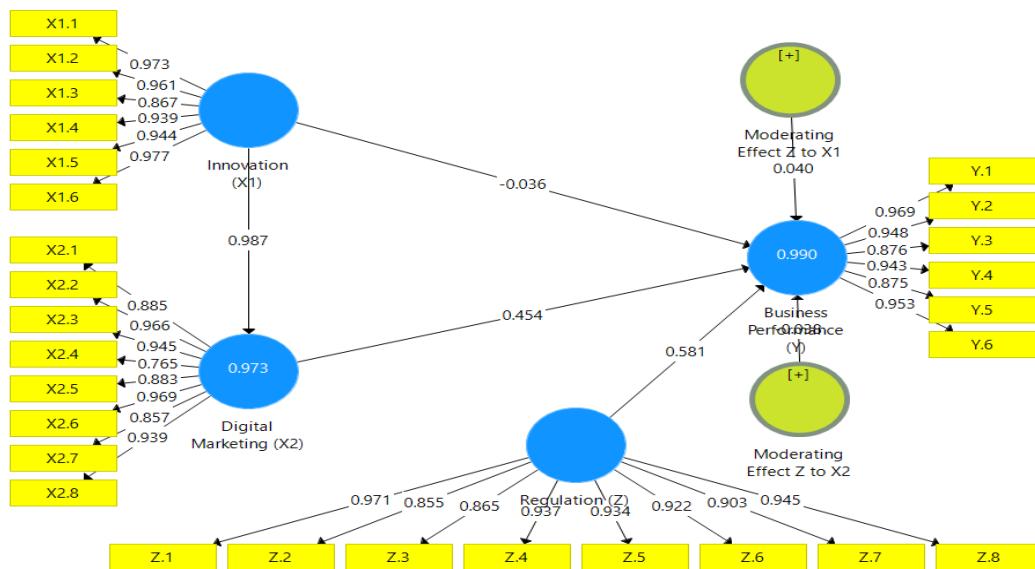


Figure 3. Outer Model

From the results of the processing of the loading factor, a value greater than 0.6 is obtained so that the indicator is concluded to be valid.

Next is testing the reliability of the research instrument. The reliability test was conducted to prove the accuracy, consistency, and accuracy of the instrument in measuring the construct. Construct reliability test using reflexive indicators in PLS-SEM can be done in two ways, namely; with Cronbach's alpha and composite reliability or what is often referred to as Dillon-Golstein's. The use of cronbach's alpha to test the reliability of the construct will give a lower value (under estimate) so it is more advisable to use composite reliability in testing the reliability of a construct.

Table 2. Variable Reliability

	Cronbach's Alpha	rho_A	Composite Reliability	Average Variance Extracted (AVE)
Business Performance (Y2)	0.967	0.969	0.974	0.861
Innovations (X1)	0.967	0.972	0.973	0.816
Digital Marketing (X2)	0.975	0.978	0.980	0.892
Regulation (Z)	0.973	0.975	0.977	0.841

Source: Researchers, processed data (2021)

Rule of thumb which is usually used to assess construct reliability, namely the value of composite reliability must be greater than 0.7 for confirmatory research and a value of 0.6 - 0.7 for exploratory research (Wiyono, 2013)(Sarstedt, Ringle and Hair, 2020). The Table 2 above shows that the value of Cronbach's alpha and composite reliability of all variables is above 0.7 and so is the overall average variance extracted value above 0.5 so that it meets the reliability requirements.

#### B. Evaluation of the Structural Model (Inner Model)

Evaluation of the structural model is carried out to see the relationship between latent constructs that have been hypothesized previously. Measures that can be used to evaluate the structural model (inner model) are R-square.

Table 3. Value of R square Structural model

Latent Variable	R Square (R2)
Digital Marketing (X2)	0.990
Business Performance (Y)	0.970

Source: Researchers, processed data (2021)

Table 3 shows that the R2 value for the MSME performance variable is 0.970 or 97% and for the Digital Marketing variable, it is 0.990 or 99%. This value means that the Innovation variable and the moderating variable can explain the Digital marketing variable by 99%. While the Innovation, Digital marketing and moderating variables can explain the contribution to the performance of MSMEs by 97%, the R2 value in both variables is classified as a substantial or strong model.

#### C. Bootstrap Hypothesis Testing

The significance of the model parameters, both the measurement model and the structural model were evaluated through the bootstrap procedure. The decision to reject H0 if the t-count value is greater than t-Table 1.989 using 0.05. The iteration used is in accordance with the default of 500 iterations. Parameter testing for the measurement model is as follows:

Table 4 Testing the Measurement Model Hypothesis

X1 . indicator	t- Value	X2 . indicator	t- Value	Y . indicator	t- Value	Z . indicator	t- Value
X1.1	102.622	X2.1	24,816	Y.1	80,207	Z.1	82,428
X1.2	72.386	X2.2	88,777	Y.2	44,894	Z.2	18,664
X1.3	19,276	X2.3	41.305	Y.3	21,559	Z.3	18,571
X1.4	36,730	X2.4	8.140	Y.4	43,819	Z.4	35,363
X1.5	46,159	X2.5	25.545	Y.5	20,688	Z.5	33,982
X1.6	148,319	X2.6	98.486	Y.6	69,099	Z.6	34,012
		X2.7	19,171			Z.7	26,195
		X2.8	36,785			Z.8	53,099

Source: Researchers, processed data (2021)

Table 4 contains the t-value of each indicator. The t- value for all indicators has exceeded the t-table value of 1.989, so the conclusion is that H0 is rejected so that all indicators have a significant effect on the latent variable.

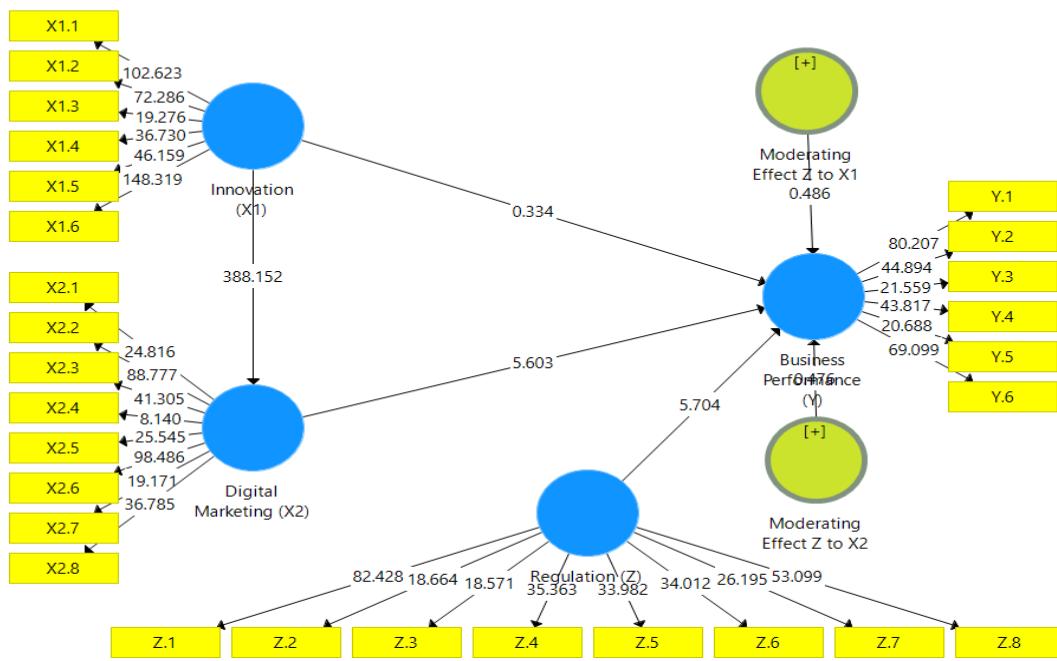


Figure 4. Bootstrap Structural Model

The next step is testing the parameters for the structural model with the hypotheses used are:

$$H_0: ij = 0 \quad H_1: ij \neq 0$$

Bootstrapping results for the structural model Figure 4 are as follows:

Table 5. Structural Model Hypothesis Testing

	Parameter Coefficient	t-value	Conclusion
H1. $X_1 \rightarrow Y$	-0.036	0.334	Rejected
H2. $X_2 \rightarrow Y$	0.454	5,603	Accepted
H3. $X_1 \rightarrow X_2$	0.987	388,152	Accepted
H4. $X_1 \rightarrow X_2 \rightarrow Y$	0.448	5,711	Accepted
H5. $Z \rightarrow Y$	0.581	5,704	Accepted

Source: Researchers, processed data(2021)

The results of Bootstrap on hypothesis testing from Table 5 concluded that H1 was rejected because the t-value was smaller than  $t_{\text{table}}$ , namely 1.989. This means that innovation does not affect the performance of SMEs. While H2, H3, H4 and H5 the results of t value are greater than  $t_{\text{table}}$  so that the hypothesis is accepted.

#### D. Moderated Structural Equation Modeling

The moderator variable used is the policy variable as a moderator with the exogenous variables being the innovation and digital marketing variables, while the endogenous variables that are affected are the MSME performance variables. The coefficient values for the structural model and their test statistics are as follows:

Table 6 Structural Test Results Moderating Effect

Hypothesis	Parameter Coefficient	t-value	Conclusion
H6. Moderating $Z^*X_1 \rightarrow Z$	0.040	0.519	Rejected
H7. Moderating $Z^*X_2 \rightarrow Z$	-0.038	0.507	Rejected

Source: Researchers, processed data (2021)

From the test results as shown in Table 6 above for the effect of the moderating variable, a smaller value is obtained than t table so that the conclusion is H6 and H7 are rejected. This means that government policies are not able to moderate the influence of innovation and digital marketing on the performance of MSMEs.

## Discussion

Testing the effect of the innovation variable on the performance of MSMEs in this study obtained insignificant results. This is because during the COVID-19 pandemic, MSME actors think that by innovating, they will increase spending because innovation requires additional costs. In addition, MSME actors are afraid of failure and do not dare to take risks to do something new. During a pandemic, surviving with old products is better than exploring, but it doesn't necessarily work. This is in line with previous research, namely the research of (Cucculelli and Peruzzi, 2020)(Oyedele et al., 2020) who said that innovation had no effect on business performance.

The results of the research on the influence of digital marketing on the performance of MSMEs obtained positive and significant results. The use of digital marketing has a positive impact on the performance of MSMEs. The existence of government policies that require social distancing and prohibition of gatherings, urges MSME actors to make changes in marketing so that they can still reach their consumers. Digital marketing has brought new insights and new markets for MSMEs to reach consumers wider than ever before. Some of the benefits that are felt directly from the use of digital marketing are the savings in promotional costs. With content sharing and electronic word of mouth that consumers do without being asked, it has strengthened the performance of MSMEs. This is in line with the research conducted by (Istianingsih, Harahap and Ali, 2020)(Melović et al., 2020)(Low et al., 2020).

Although innovation does not directly affect the performance of MSMEs, placing digital marketing as a mediating variable can change the influence of innovation on MSME performance through digital marketing. This is also in line with research conducted by (Kristina et al., 2020) that innovation does not directly affect business performance but has an indirect effect after being mediated by digital marketing.

Tests on the moderating effect of government policies, both the effect on innovation and digital marketing, do not have an effect on the performance of MSMEs. This means that there are or no government policies, to innovate and use digital marketing is a form of encouragement from the environment they feel for the progress of their business (Yuhertiana and Fatun, 2020). Although the government has launched policies to encourage MSMEs to innovate, such as training on the use of production equipment, packaging improvements or activities that encourage innovation, MSME actors are still reluctant to change. Meanwhile, the urge to use digital marketing is not an effect of government policies that direct marketing strategies through the Go digital MSME program that was echoed several years ago.

## 4. Conclusions and Recommendations

### 4.1 Conclusions

From the test results, it is found that innovation does not directly affect the performance of MSMEs, but has an indirect effect on the performance of MSMEs through digital marketing. Digital marketing and government policies have a direct effect on the performance of MSMEs. Government policy variables are not able to moderate the influence of innovation and digital marketing variables on MSME performance.

### 4.2 Recommendations

The government should better understand the condition of MSMEs and focus more on identifying what are the

main drivers of MSME performance so that the policies made can have an effect on better MSME performance. This study still has shortcomings such as the number of samples used is still relatively small. For future research, it is expected to increase the number of samples and add technical analysis such as the use of mix methods in order to obtain comprehensive conclusions.

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