Improving SME Performance in Salatiga City: Integrating Islamic Leadership and Innovation Models

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Abstract: This study aims to examine the relationship between Islamic leadership, innovation, and performance of small and medium enterprises (SMEs) in Indonesia, especially in the city of Salatiga. In this study, the main research is on innovation as a mediation between Islamic leadership and SME performance. The population in this study were all SMEs in the city of Salatiga with a sample of 100 respondents. The tool used to analyze the data in this study used SPSS version 24. Sobel test was used to test whether the variables could mediate or not. This study concludes that Islamic leadership has a direct effect on the performance of SMEs and innovation, innovation has a direct effect on the performance of SMEs, and innovation can mediate the relationship between Islamic leadership and SME performance. The originality of this study is the mediating effect of innovation in the relationship between Islamic leadership and the performance of SMEs in the location of the city of Salatiga does not yet exist for this relationship.

Keywords: Islamic leadership, innovation, SME performance

1. Introduction

It is common knowledge that small and medium enterprises play a very important role in economic development in both developing and developed countries (Chittithaworn et al., 2011). Small businesses are very important, not only absorbing employment but also having an important contribution to the growth of gross domestic product (GDP). The majority of Indonesian people are Muslim, a small business plays an important role in economic and social issues such as high poverty rates, unemployment, income inequality, urbanization with all its negative impacts, and uneven development in Indonesia. The development of small businesses is expected to make a significant contribution to efforts to resolve these problems.

The advantages of SMEs, among others, are that product development is facilitated by technological innovation, good relations between business people in a business, and easy to adapt to market conditions quickly compared to large companies that have to deal with bureaucracy both from the company and the local government (Chittithaworn et al., 2011).
These advantages are growing rapidly in SMEs in several cities in Indonesia. One of them is the city of Salatiga. In the city of Salatiga itself, there are 23,491 SME units in 2022. The biggest development is in the culinary sector. In general, this growth is good for economic growth in Salatiga.

Islamic leadership has a positive influence on innovation strategy, product innovation, process innovation, and employee innovation performance (Ahmad & Ogunsola, 2011; Nurdin & Mir'atun, 2018). Companies that have an orientation to Islamic leadership will increase the use of internal resources to innovate. Companies oriented towards Islamic leadership will also invest in technology.

In maintaining world competitiveness, the dominant factor is innovation. Innovation can drive organizational growth, drive future success, and is an enabling way for businesses to maintain their business. Crema et al., (2014) argue that companies must be able to create and be profit-oriented when some new processes and markets can expand technological boundaries. But at the same time step ahead of the company's competitors. Innovation is a core competency, this is clearly stated by Peter Drucker.

Large companies and small and medium enterprises (SMEs) are equally pressured to innovate. Many experts argue that SMEs are better than large companies in terms of innovation. Therefore, SMEs generally make more valuable economic and social contributions because their innovations are based on product innovation.

Until now, there are still many who consider religion and company organizational relationships to be less worthy of study. This is because many think that the company's organization is religiously neutral. More than 80% of people around the world state that religion has an important role in their lives.

African continent, to Southeast Asia and Australia, then to China and the Soviet Union, as well as to several parts of Europe, including North and South America. The population becomes a community that has the same beliefs, behaviors, and cultural heritage. Thus the management of diverse environments is often better in managing time, distance, culture, religion, language, social, and civilization. Management is not a simple thing (Ahmad & Ogunsola, 2011).

Islamic leadership has long been discussed by various groups in various fields of science. Leadership analysis is often associated with day-to-day organizational practices. An example is a difference in the title of head and king to express who is ruled and who is ruling (Marbun, 2013).

Based on this description, it can be seen that there is a partial relationship between leadership style variables and innovation (Amin et al., 2016; Chahal et al., 2016; Finoti et al., 2017; Franco et al., 2014; Fuchs & Köstner, 2016). Leadership style on performance (Amin et al., 2016; Chahal et al., 2016; Finkelstein & D'avenni, 1994; Finoti et al., 2017; Franco et al., 2014; Fuchs & Köstner, 2016; Mubarik et al., 2016; Navarro-García et al., 2016; Parakhina et al., 2017; Rodriguez-Gutiérrez et al., 2015) and innovation on performance (Amin et al., 2016; Bereket Mamo Buli, 2017; Crema et al., 2014; Finoti et al., 2017; Fuchs & Köstner, 2016; Gellynck et al., 2012; Hilmola & Lorentz, 2011; Mubarik et al., 2016). So far, no one has comprehensively examined the effect of mediating innovation on the relationship between Islamic leadership and the performance of SMEs, especially in the city of Salatiga.

2. Literature Review

In simple terms, the purpose of knowledge management is to improve the company's operations to gain profit and competitiveness. The concept of knowledge management in a company also aims to improve performance by instilling cultural knowledge which is an asset that can be managed so that it can be communicated and used together. Angkowo &
Kosasih, (2007) say that the application of knowledge management can provide tangible benefits for company performance, such as:

1. **People's Aspect** consists of the development, motivation, education, changes in corporate culture, job descriptions, and knowledge sharing to create value through social interaction.

2. **Process Aspect** consists of process innovation, reengineering, and continuous improvement.

3. **Technological aspects** include information systems and decision support, edge-based knowledge systems, and data mining systems.

Knowledge management is a series of activities to demonstrate organizational design along with business and management principles. This can help employees to demonstrate their ability and creativity with efficiency in creating business value. In other words, timeliness in receiving and conveying the right information to the right employees will result in a competitive advantage for the company.

A leader is a motivator, initiator, dynamist, stimulator, and innovator in an organization (Kartono, 2004). A leader is someone who influences people to work together to achieve certain goals (Winardi, 2000). In carrying out daily tasks, a leader must refer to a leadership orientation that is appropriate to the behavior applied. Islamic leadership is almost the same as conventional which differs only in its morals, religion, and humanity. From the Islamic perspective, the root of leadership is in the Qur'an and Sunnah. (Ahmad & Ogunsola, 2011) views leadership as a flexible person based on shared goals between leaders and followers. Leadership is the behavior of a leader in completing tasks, setting, managing the course, and monitoring and evaluating team performance. Meanwhile, on the other hand, it is the task of the leader who leads the preparation of work plans, setting organizational forms, networking, channels, methods, and clear work procedures to achieve goals.

Innovation is part of a person’s efforts to maintain his trademark. So far, some people have managed to do so by creating new solutions although some have turned into threats (Fonseca, 2001). Some experts state that innovation is one of the important roles for companies in increasing competitiveness. There are several definitions of innovation found in previous research such as research from (Gana, 2011) which found five types of innovation: (1) introduction of new products or changes to existing products, (2) innovation processes for the industry, (3) opening new markets, (4) development of raw material sources, and (5) changes in industrial organization.

### 3. Research Method

This research is a quantitative method as research that aims to explain phenomena or patterns of relationships between concepts (Fernandes, 2017). The focus of this research is SMEs in Salatiga City. The population in this study is all SMEs in Salatiga City, and the number of samples is 100 respondents, with simple random sampling. The hypothesis of this study is to determine the relationship between Islamic Leadership (X), Innovation (Z), and SME Performance (Y). In-depth examines the mediating effect of innovation between Islamic leadership (X) and SME performance (Y). Sobel test is used to test whether a variable is a variable that mediates the relationship between endogenous variables and exogenous variables. The analysis tool used is IBM Statistics SPSS version 24. The results of this analysis indicate that a variable is a mediating variable, but it is not necessarily true.

Decisions are analyzed by looking at the calculated P value or probability. The hypothesis
is accepted if the P value is less than 0.05 (with an error rate of 5%).

Figure 1 Research Framework

6. Discussion and Results

Primary data collection for this study used interview techniques and questionnaires. Interviews were conducted to obtain initial data and obtain more detailed information related to the subject and object of research. Because the data collection in this study used a survey method, a questionnaire was used.

In the first stage, the instrument was tested. In the test results, it can be seen that each variable has a validity value above 0.3 which means that the instrument is valid for research. As for the reliability test, Cronbach's alpha obtained is known to be above 0.6 so it can be said that all variables are reliable.

The second step is to test the coefficient of determination or $R^2$. In this test, tests were conducted on the variables used to measure how much influence the independent variable had on the dependent variable. In this study, the variables of Islamic Leadership and innovation have an influence of 45.6% on performance. While the remaining 54.4% is influenced by other variables that do not exist in this study.

The third stage is testing the structural model of the coefficient which states the magnitude of the relationship between one variable and another. It is said to have a significant influence between one variable and another if the significance value obtained is less than 0.05. Based on the correlation test, the relationship between Islamic Leadership and innovation gets a significance value of 0.000, which means it is smaller than 0.05. So that Islamic Leadership has a significant influence on innovation.

Testing on the relationship between the Islamic Leadership variable and performance is known to have a significant value of 0.000. Likewise, the innovation and performance variables get a significance value of 0.000. So it can be concluded from the two variables have a significant influence on performance.

The last stage, testing the effect of the mediating variable with the Sobel test. From Figure 1 it can be seen that the 2-way significance value obtained is 0.000 and the coefficient value is 0.958, so it can be said that innovation can mediate the relationship between Islamic Leadership and performance. This shows that the higher the Islamic Leadership, the higher the performance. This also applies if there is an innovation that bridges, namely if Islamic leadership is high, then innovation is high, and if innovation is high, then performance is also high.
7. Conclusion

Based on the analysis and testing that has been done, the influence of Islamic leadership on the performance of SMEs in Salatiga City. It can be concluded that Islamic leadership positive and significant effect on the performance of SMEs with innovation as a mediating variable. The results of this study are in line with research conducted by (Nurdin & Mir’atun, 2018) which says that Islamic leadership has a positive effect on innovation strategy, product innovation, process innovation, and employee innovation performance because the company is oriented toward Islamic leadership, has product innovation, and processes, increasing the use of internal innovation resources, and investing in technologies that will be able to achieve better performance than firms that have a low or no innovation strategy.

The results of this study also show that Islamic leadership shows a significant effect on the performance of SMEs. Islamic leadership competence is indispensable in the application of marketing strategies to generate a competitive advantage through market information on consumer needs. Islamic leadership will also influence the attitude of companies or SMEs to market needs and respond quickly to market trends.

The results of the study show that innovation affects the performance of SMEs, meaning that the performance of SMEs in Salatiga City increases with the application of good innovation. In line with research (Setyawati, 2013) innovation ability has a positive and significant effect on marketing performance. Innovation capabilities can improve marketing performance if Batik SMEs can make original and attractive products.

References


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