

Improving Performance of Small and Medium-Sized Enterprises of Processed Food through Competitive Strategy, Industry Environment, Innovation Capability, and Macroeconomic Factors

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Abstract

Small and medium-sized enterprises (SMEs) processed foods play a major role in the national economy but its performance is still low. The poor performance is due to many factors, but research results are still partial. This study fills the gap, with the aim of analyzing the influence of the industry environment, innovation capabilities, and macroeconomic factors on competitive strategy and the performance of SMEs of processed foods in Malang, Indonesia. Data were collected using a questionnaire of 65 SMEs of processed foods then analyzed using WarpPLS software version 5.0. The study found that the competitive strategy positively influences the performance of SMEs processed foods and competitive strategy is positively influenced by the capabilities of innovation and macroeconomic factors. Industry environment does not significantly affect the competitive strategy and macroeconomic factors do not significantly affect the performance of SMEs of processed foods.

Keywords: small and medium-sized enterprises; innovation capabilities; competitive strategy; performance

JEL Classification: E33; E51; E62; L15; O32; J31

Introduction

Processed foods are part of the processing industry and creative industry. The creative industries play an important role in the national economy because most of the enterprises are included a category for Micro, Small and Medium-Sized Enterprises (MSMEs). Data of the Ministry of Cooperatives and SMEs (2016) showed SMEs in Indonesia in 2013 as many as 57.9 million or 99.9% of total business units, absorbing 114.1 million people or about 97 percent of the workforce, accounted for about Rp5.440.007, 9 billion, or about 60% of Gross Domestic Product (GDP). One of the creative industries is culinary subsector. Culinary industry is defined as an activity related to the manufacture of foods that have characteristics such as a characteristic of a region (Departemen Perdagangan 2012). These regional characteristics make the culinary industry has a great potential as a tourism industry.

In according with tourism industry, Malang municipality has its mission as the city of industry and tourism. Malang is also famous for a city of education where there are more than 50 higher educational institutions in which college students come from various regions in Indonesia. Industry includes a wide range of small and medium industries include food processing. In the field of tourism, Malang became one of tourism destination in East Java. Tourists visiting Malang buying processed food products as souvenirs to their home areas. In 2014 as

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many as 5.8 million domestic and foreign tourists visiting Malang, then it increased to 6.4 million in 2015 and mostly to Kota Batu—the nearest tourist town with Malang (Surya Daily Online - Suryamalang.com 2016). Thus, the performance of processed foods needs to be increased.

Unfortunately, research on the performance of processed foods is limited and partial analysis. For example, Sunaryo *et al.* (2014) concerning the clusters of micro, small, and medium-sized food and drink; Kusumastuti and Nur (2014) on competency-based learning for culinary entrepreneurs; Sancoko (2015) on the business development strategy of business meals and drinks at the depot time to eat Surabaya; Wulandari and Zubaidah (2016) about culinary innovation in Malang but it is a case study on Meatballs Kebab Grill. Ramadan *et al.* (2014) formulate a model of agent-based simulation system for the culinary industry, but based on data and assumptions hypothetical so it is advisable to further research using real data to make it more accurate. Studies on the food business has not revealed a more comprehensive analysis covering competition within the industry, the ability to innovate on the existing resources and competitive strategies that can be applied to improve the performance of small and medium enterprises of the food.

This study is intended to fill this gap by analyzing the relationship between industry environment, innovation capabilities, macroeconomic factors and competitive strategy and performance of SMEs of processed foods in Malang. The results are expected to provide information on efforts to improve the business performance of processed foods.

1. Literature review

1.1. Performance of Small and Medium-Sized Enterprises of food

Small and Medium-Sized Enterprises (SMEs) in this study refers to Law No. 20 of 2008 which saw the size of the business according to net worth and annual sales revenue. However, in practice, it more easily uses criterion from the Central Statistics Agency based on the number of workers, *i.e.* 5-19 workforce categorized as small enterprises and 20-99 workers is included in medium-sized enterprises.

Performance is achievement of a company within a specific period which reflects the level of health of the company. The most widely used indicator to measure the performance of a company is the Return on Investment (ROI), which is simply the result of the income before tax to total assets (Wheelen and Hunger 2005, 286). Another view of corporate performance is expressed by Jauch and Glueck (2009), stating that the performance of a company can be seen from the quantitative and qualitative aspects. In quantitative terms, the performance of a company can be seen from the company's achievements compared to what was done in the past, or to its competitors in a number of factors such as net income, the return on capital, the return on equity, market share, and sales growth. While qualitative measures questions to determine whether or not the objectives, strategies and integrated and comprehensive plan of a company has been consistent, accurate and can run.

Performance of SMEs of food businesses in Indonesia is still low. The low performance of the food industry can be observed from the development of the food imports. Bernardo *et al.* (2012) reported the results of their analysis of the development of imports of food and beverages as follows: from 2006 to 2010, the import value of food and beverages grew at an average of 20% per year. In the period from January to September 2011, imports of food reached USD 4,948.2 (increased 59.2% from the previous year). During 2011, food and beverage products from Malaysia dominated the market for food and beverages in Indonesia (24%). The low performance of SMEs is closely related to the food industry environment, innovation capabilities, macro-economic conditions, and competitive strategy adopted by small and medium enterprises.

1.2. Industry environment, innovation capability, and competitive strategy

An industry competition concept proposed by Porter (1992) and known as the Porter Five Forces that shape the competition in an industry can be used to analyze the food industry environment. The conceptual framework explains that a company will have a competitive advantage if the company is in the favorable conditions of the five factors: suppliers, substitute products, buyers, potential competitors and competition among existing firms.

Suppliers are related to the procurement of raw materials or inputs for small businesses; replacement products are other small business products acting as substitutes; buyers made up of individuals and institutions;

potential competitor is the threat of new entrants in terms of economies of scale, differences in product, brand identity (brand), a cost advantage, and access to the entire distribution. The last factor is the competition among companies that already exists in terms of service, product attributes, distribution, and promotion.

Five competitive forces reflect the fact that competition in an industry is not limited to the number of existing companies. Customers, supplier of substitution products, as well as potential new entrants are all the company's competitors in the industry. These competitive forces jointly determine the intensity of competition and the profitability. The most powerful force will be decisive and very important in determining strategy. Therefore, Porter (1992) suggests a strategy in the face of competition which is referred to generic competitive strategies.

Generic competitive strategies are based on an analysis of a company's position in the industry, whether corporate profits are above or below the industry average. A good company will have a high level of income despite unfavorable industry structure and the average industry profit level was moderate. If so, the company was able to create a sustainable competitive advantage. To achieve this, the company could have two basic types of competitive advantage, namely low cost or differentiation. The strength or weakness that is significantly owned by a company in turn is a function of the relative cost impact and differentiation.

The two basic types of competitive advantage combined with the field of activity is sought to be achieved by a company headed toward three generic competitions to achieve the performance above the industry average, the cost leadership, differentiation, and focus. Focus strategy consists of the focus on cost and differentiation focus. The concept of generic strategy emphasizes that competitive advantage is the heart of any strategy and achieving competitive advantage requires a company to make a choice. If the company wants to achieve competitive advantage, the company must choose the desired type of competitive advantage and the scope or the field to be achieved. Selecting all types will result in the company's performance which was below the industry average. It means the company does not have a competitive advantage.

Implications of Porter generic strategy is how SMEs to operate at low cost or differentiation in terms of service. According to Craig and Grant (2010), sources of cost advantage is the saving knowledge (experience), economies of scale, cost of input, processing technology, product design, capacity utilization, and managerial factors.

The implementation of the operational strategy to compete through low cost or differentiation will largely depend on the capabilities of SMEs manage resources owned specifically (Makadok 2011). Resource management is done with the conceptual framework VRIO (value, rareness, imitability, and organization) in the Resource-Based Theory (Barney Clark 2007). This theory emphasizes the role of internal factors in the company such as strategy, structure, competence, capability to innovate, and the tangible and intangible resources for success in the competition. Innovation capabilities of companies can be done through technology innovation, product innovation, market innovation and service innovation (Sutapa 2014).

1.3. Macroeconomic factors and enterprises performance

One of the external factors within the framework of environmental analysis of companies according to Porter (1992) is the economic factor, which in this case is the macro economy. Several macroeconomic factors that determine the performance of the company is the inflation rate, the government policy on taxes, government policy on minimum wage, and the availability of credit (Mankiw 2007). A very high Inflation will increase production costs and reduce the purchasing power of consumers. As a result, the company's performance declined due to the revenue and corporate profits decline.

Taxes are a burden to the company. A tax for the government is a source of income that is used for the common good (Harmana 2013). If the tax is paid by large taxpayers, the state revenue will increase. But for some companies taxes are the costs and its benefits are not received directly, either in the form of goods, services or funds that tax expenditures should be calculated carefully.

The aims of government policy on the minimum wage is to protect workers but burdensome for employers, especially SMEs. Theoretically, the company will only pay wages in accordance with the productivity of labor, meaning that low labor productivity will receive low wages, and vice versa (Pyndick and Rubinfeld 2005). In fact, the minimum wage is much more determined by the increase in the price level compared to the increase in

productivity. In Indonesia, productivity has not become a major determinant in wage determination (Bappenas 2010, 61).

Many SMEs have difficulties in developing the business due to capital constraints. Therefore, the availability of credit with an easy procedure and the relatively small interest cost will help SMEs to develop business. One of the credit facilities provided by the government to SMEs is the People's Business Credit (KUR), a commitment of the government through Presidential Decree No. 6 Year 2007 on the Acceleration of Development of SME Sector and Empowerment.

The inflation rate, taxes, minimum wage, and the availability of credit at a certain level become a burden negatively affect the company's performance. Increased costs result in lower sales revenue and profit. Therefore, it needs the right competitive strategy. In addition, selection of cost leadership strategy, focus, or proper differentiation will improve company performance.

2. Methodology

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The study was conducted in Malang Municipality on consideration of Malang as one of the favorite tourist destinations including culinary tourism in East Java, Indonesia. Travelers typically buy processed food as souvenirs when returning to their home areas. Therefore, performance of the processed food industry needs to be improved. For that, they need information about factors that determine the performance of small and medium enterprises such as the food industry environment, innovation capabilities, and external economic factors.

Data were collected from SMEs food businesses registered in the Office of Industry and Trade Malang. The research follows criteria of the Statistic Central Agency, which is 5-19 manpower for small businesses and 20-99 workers to medium-sized businesses. Number of SMEs food listed in 2015 as many as 85 units so entirely sampled. However, in the collection of data, there were eight businesses no longer in operation, 5 entrepreneurs who move addresses so hard to find, 4 employers were not willing to share data, and 3 attempt to provide data but did not qualify for the analysis. Finally, 65 units of SMEs used in this study. Respondents are the owners and/or managers of SMEs of the food.

Data were collected using a questionnaire that contains items the statement of five variables, namely the environmental industry, innovation capabilities, macroeconomic factors, competitive strategy, and performance of small and medium-sized enterprises of processed foods. The variables and operational definitions, indicators, items, and the measurement scale are presented in Table 1. All items are measured with a Likert scale of five gradations from strongly disagree (score 1), disagree (score 2), neutral (score 3), agree (score 4), and strongly agree (score 5).

Table 1. Operational definition and measurement of variables

Variable	Operational Definition	Indicator/item	Reference
Industry Environment (X ₁)	The industrial structure of similar business that influence the behavior of companies in competition to achieve superior performance	1. New entrant (X ₁₁) 2. Incumbent business (X ₁₂) 3. Buyer (X ₁₃) 4. Supplier (X ₁₄) 5. Product substitution (X ₁₅)	Porter, 2008; Porter, 1992
Innovation Capability (X ₂)	The ability to apply specific management of resources of the company to improve performance	1. Innovation technology (X ₂₁) 2. Product innovation (X ₂₂) 3. Market innovation (X ₂₃) 4. Service innovation (X ₂₄)	Devenport <i>et al.</i> , 2006; Teece, 2008
Macroeconomic Factor (X ₃)	Macroeconomic factors that influence the use of resources in business processes	1. Credit availability 2. Government policy on taxes 3. Inflation rate 4. Government policy on minimum wage	David, 2011

Variable	Operational Definition	Indicator/item	Reference
Competitive Strategy (Z)	The action taken by the company to excel over competitors by providing great customer value, through lower prices or by providing more benefits in accordance with the pricing higher	1. Cost leadership (Z ₁) 2. Focus (Z ₂) 3. Differentiation (Z ₃)	Porter, 2008; Porter, 1992
Performance of SMEs Food (Y)	The company's ability to control the market and goal oriented and finances	1. Growth of sales 2. Growth of profit 3. Growth of assets	Huber, 2010

Source: Compiled from various sources

The collected data were analyzed using the software program WarpPLS. According Vinzi *et al.* (2010), Sholihin and Ratmono (2013) and Hair *et al.* (2014), WarpPLS has the following advantages. First, WarpPLS is efficient on a small sample, complex model and practical because it does not require data normality. Second, WarpPLS can provide an output value of the indirect effect and the total effect along with the p value, standard error, and effect size. Output is very helpful in hypothesis testing mediating or intervening variable so it does not need to do manual counting as with Sobel test to test the significance of the indirect effect. Third, WarpPLS can provide coefficients and p-value results directly to a model with variable moderation, while others such as SmartPLS software PLS, PLS Graph, and Visual PLS should make the interaction between the variables of latent beforehand.

Evaluation of WarpPLS model consists of two phases, namely measurement model and structural model evaluation (Sholihin and Ratmono 2013). Evaluation of the measurement model is intended to evaluate the validity and reliability of the latent variables. Rules of thumb for reflective measurement model evaluation according to Hair *et al.* (2014, 107) are as follows: (1) consistency reliability of composite reliability is greater than .70; in the exploratory research of .60 up to .70 is acceptable; (2) reliability indicators: indicators outer loading greater than .70; (3) convergent validity: Average Variance Extracted (AVE) is greater than .50; (4) discriminant validity: a loading indicator is greater than the outer loading with other latent variables and the square root of the AVE is greater than the highest correlation with other latent variables.

Evaluation of structural model was conducted to evaluate the relationship among latent variables. Rules of thumb of WarpPLS structural model evaluation according to Hair *et al.* (2014, 186), among other things are (1) the coefficient of determination (R^2) for endogenous latent variables the higher the better, but generally .75; .50, or .25 respectively considered as substantial, moderate, and weak; (2) the effect size (f^2) of .02; .15; and .35 respectively indicating latent exogenous variables have the effect of small, medium, and large against endogenous latent variables; and (3) predictive relevance (Q^2) value is greater than 0 indicates that the exogenous latent variables have predictive relevance on the endogenous latent variables. In relative size, q^2 of .02; .15; and .35 respectively indicating that exogenous latent variables have small, medium, and large relevance predictive on the endogenous latent variables.

3. Results and discussion

3.1 Statistical Results

Most of the respondents (60 percent) are women who running a food business (Table 2). In addition to the nature of women take care of the food in the family, many food businesses to do at home so that women do not have to leave home. The reason is understandable because the majority of respondents (58.5 percent) aged 30-45 years, the age at which women are married and have children that need the attention of a mother. Food business is done at home can be done independently so that more flexibility in managing working time. This is shown by approximately 94 percent of respondents are business owner.

The education level of the most respondents (40%) is high school graduates. There is a tendency of college graduates running food business. Most enterprises (55.4%) aged 5-10 years and less than five years (30.8 percent), classified as a business that is still relatively young. Their experience in trying the food business is

almost the same age as these businesses was established by respondents. Entrepreneurs who pursue business with good management, 10 years are enough time to try and apply a wide variety of innovations in order to improve business performance.

All variables and indicators/items have outer loading, Average Variance Extracted (AVE), composite reliability, and Cronbach Alpha greater than .60 (Table 3) and corrected item-total correlation was also greater than .60 so it can be concluded that the instrument used was valid and reliable. According to Sekaran (2003), Cronbach alpha is smaller than .60 less reliable; .70 is acceptable, and greater than .80 is good. Corrected item-total correlation is greater than 0.50 are said to be reliable or internal consistency between the indicator and items with variable (Hair *et al.* 2010).

Table 2. Characteristics of respondent of SMEs food in Malang

No.	Characteristics of Respondents		Number (person/unit)	Percentage (%)
1	Sex	a. Male	26	40.00
		b. Female	39	60.00
		Total	65	100.00
2	Age	a. Less than 30 year	5	7.7
		b. 30 up to 45 year	38	58.5
		c. 46 up to 65 year	20	30.8
		d. More than 65 year	2	3.1
		Total	65	100.00
3	Level of Education	a. Elementary School	7	10.8
		b. Junior High School	15	23.1
		c. Senior High School	26	40.0
		d. University/Vocational	17	26.1
		Total	65	100.0
4	Age of Business	a. Less than 5 year	20	30.8
		b. 5 up to 10 year	36	55.4
		c. 11 up to 20 year	5	7.7
		d. More than 20 year	4	6.1
		Total	65	100.0
5	Experience in food business	a. Less than 5 year	24	36.9
		b. 5 up to 10 year	32	49.3
		c. 11 up to 20 year	6	9.2
		d. More than 20 year	3	4.6
		Total	65	100.0
6	Ownership status	a. Private property	61	93.8
		b. Cooperation with other parties	4	6.2
		Total	65	100.0

Source: compiled from the survey

Table 3. Evaluation of Goodness of Fit Measurement model

Variable	Indicator	Validity		Reliability	
		Loading outer	AVE	Composite Reliability	Cronbach Alpha
Industry Environment (X ₁)	New Entrant (X ₁₁)	.899	.808	.944	.920
	Incumbent (X ₁₂)	.776	.602	.882	.832
	Buyer (X ₁₃)	.770	.694	.814	.657
	Supplier (X ₁₄)	.886	.785	.916	.862
	Product Substitute (X ₁₅)	.912	.832	.908	.798

Variable	Indicator	Validity		Reliability	
		Loading outer	AVE	Composite Reliability	Cronbach Alpha
Innovation Capability (X ₂)	Technology Innovation (X ₂₁)	.886	.785	.916	.863
	Product Innovation (X ₂₂)	.832	.692	.871	.777
	Market Innovation (X ₂₃)	.914	.835	.938	.901
	Service Innovation (X ₂₄)	.888	.788	.918	.865
External Economic Factors (X ₃)		.828	.685	.897	.846
Competitive Strategy (Z)	Cost leadership (Z ₁)	.917	.814	.815	.739
	Focus (Z ₂)	.890	.792	.856	.798
	Differentiation (Z ₃)	.976	.875	.891	.809
Performance of Food SMEs (Y)		.905	.819	.931	.884

Source: summarized the results of statistical analysis using WarpPLS

Table 4 shows that the structural model of goodness of fit qualifies as a good model to analyze the relationship between variables in this study, unless the average full collinearity (AFVIF). AFVIF greater than 3.3 because there are more than two latent variables were significant relationships.

Table 4. Model of Fit and Quality Indices

Model of Fit	Coefficient (p-value)	Cut-off	Information
Average Path Coefficient (APC)	.303 (.002)	.05	Significant (good)
Average R-Squared (ARS)	.876 (.001)	.05	Significant (good)
Average Adjusted R-squared (AARS)	.871 (.001)	.05	Significant (good)
Average Block VIF (AVIF)	3.042	≤ 5: acceptable ≤ 3.3: ideal	Ideal
Average full collinearity VIF (AFVIF)	37883844904.234	≤ 5: Acceptable ≤ 3.3: ideal	Due to correlation among all latent variables are significant
Tenenhau GoF (GoF)	.800	≥ .1: Small ≥ .25: Medium ≥ .36 Big	Big
Sympson's paradox ratio (SPR)	.998	≥ .7: Acceptable 1: ideal	Ideal
R-squared contribution ratio (RSCR)	1.000	≥ .9: Acceptable 1: ideal	Ideal
Statistical suppression ratio (SSR)	1.000	≥ .7: Acceptable	Acceptable
Nonlinear bivariate causality direction ratio (NLBCDR)	1.000	≥ .7: Acceptable	Acceptable

Source: summarized the results of statistical analysis using WarpPLS

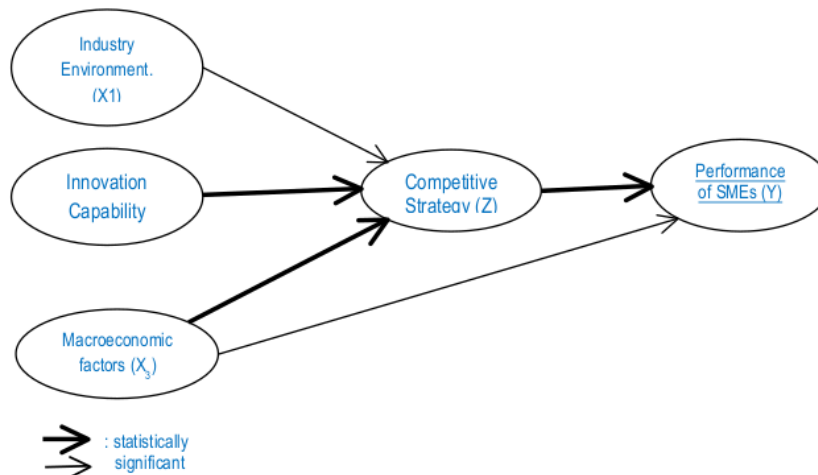
Relationships between variables in the analysis model are good in terms of the R-square (R²), the effect size (f²), and predictive relevance (q²) (Table 5). The coefficient of determination (R²) of all latent variables is greater than 80% means that the latent variables are well reflected by the indicator being used. Effect size (f²) of most indicators (77%) has the effect of medium and large, which means that the contribution of each latent variable predictor of the latent variable criterion is quite large. All latent variables has predictive relevance (q²) large (greater than .35) indicates each latent variable has great predictive power. Great predictive capability shown by the three significant path coefficient, namely the innovation capability on the competitive strategy, external economic factors on competitive strategy and competitive strategy on the performance of SMEs processed food (Figure 1).

Table 5. Evaluation of Structural Model

Goodness of Fit Indices	Coefficient	Cut-off	Information	
R-square (R ²) for endogenous latent variables:				
a. Industry environment	.965	The bigger the better	Good	
b. Innovation capability	.997			
c. Competitive strategy	.831			
Effect size (f ²):				
a. New entrant of industry environment	.364	.02: little effect	Great effect	
b. Incumbent of industry environment	.309	.15: medium effect	Great effect	
c. Buyer on industry environment	.197	.35: great effect	Medium effect	
d. Supplier on industry environment	.034	On endogenous latent variable	Little effect	
e. Substitute product on industry environment	.063		Little effect	
f. Technology innovation on innovation capability	.257		Medium effect	
g. Product innovation on innovation capability	.175		Medium effect	
h. Market innovation on innovation capability	.293		Medium effect	
i. Service innovation on innovation capability	.273		Medium effect	
j. Macroeconomic factors on competitive strategy	.180		Medium effect	
k. Macroeconomic factors on performance	.007		Little effect	
l. Industry environment of competitive strategy	.014		Little effect	
m. Innovation capability on competitive strategy	.664		Great effect	
n. Cost leadership on competitive strategy	.542		Great effect	
o. Focus on competitive strategy	.276		Medium effect	
p. Differentiation on competitive strategy	.341		Medium effect	
q. Competitive strategy on performance	.690		Medium effect	
Predictive Relevance (q ²):				
a. Industry environment	.965		.02: Little	Great
b. Innovation capability	.997	.15: Medium	Great	
c. Competitive strategy	.831	.35: Great	Great	
d. Performance	.699			

Source: summarized the results of statistical analysis using WarpPLS

Figure 2. The Relationship between Exogenous and Endogenous Variables



Source: summarized the results of statistical analysis using WarpPLS

3.2 Discussion

The results showed that the industry environment does not significantly affect the competitive strategy. Environmental industry is well reflected by newcomers, existing companies, buyers, suppliers, and substitute product. Nearly 76% of the industry environment variation is explained by the five indicators. Explanatory most to the industry environment is new entrants and existing firm. It means that intensity of competition in the industry environment is determined by competition between existing firms in the processed food industry with new entrants companies.

No significant industry environment on the competitive strategy of SMEs of processed foods indicates that the intensity of competition in the processed food industry in Malang was not strong enough. Porter's five forces framework (1992) emphasizes that the greatest strength will be decisive and to be very important in determining strategy. Competitive strategy of SMEs of processed foods in Malang is more determined by the intensity of competition in a fast food restaurant or a cafe than a processed food in packaging. In other words, the competitive strategy of SMEs of processed foods in Malang is determined by factors other than the environmental industry.

The study found that innovation capabilities significantly influence competitive strategy of SMEs of processed foods in Malang. Innovation capabilities reflected through technological innovation, product innovation, market innovation and service innovation. Variations of innovation capabilities almost perfectly explained by the four indicators used in the analysis (R-square = 99.7%). To provide more value and satisfaction to customers than its competitors, the company must operate efficiently and effectively. Some researchers found a relationship between value and customer satisfaction with the marketing aspect (Corbett and Wassenhove 1993), information technology and product quality (Ross 1996), and innovation technology and innovation capabilities of companies (Grupp 1997). Other studies analyze the relationship between the types of innovation and business performance (Garcia and Calantone 2002) and competitiveness (Chen *et al.* 2006, Cho *et al.* 2008). The results of these studies found a positive correlation between the types of innovation with business performance and competitiveness of enterprises.

The data in Table 2 indicate that SMEs of processed food in Malang have a potential to develop innovation capabilities. A large portion of business owners (59%) aged between 30 and 45 years are in productive period of age, and quite a lot of them (26%) are college graduates so it is relatively easier to develop innovation (technology, product, market, and service). Age of business and business experience of the entrepreneurs were relatively long, between 5 to 10 years, with the status of property ownership business make it possible to develop innovation capabilities optimally.

Malang as one tourist destination has the potential to develop a traditional processed food. Research from past scholars indicated that hotel in Malaysia can be the one stop centre for the local and international tourists to get the first hand information about local food specialities (Ismail *et al.* 2013). On the hindsight, very limited efforts have been put into practice on the promotions of local food especially Malay cuisines in hotels. Promotion of traditional processed foods needs to pay attention to consumer behaviour. Kim *et al.* (2009) developed a model of local food consumption to understand the local food consumption patterns at tourist destinations. The model constitutes three categories: 'motivational factors' (*i.e.* exciting experience, escape from routine, health concern, learning knowledge, authentic experience, togetherness, prestige, sensory appeal, and physical environment); 'demographic factors' (*i.e.* gender, age, and education); and 'physiological factors' (*i.e.* food neophilia and food neophobia). In short, innovation capabilities can improve the quality of traditional processed food thus improving the performance of small and medium-sized enterprises.

Besides innovation capabilities, macroeconomic factors were also significantly affecting the competitive strategy of SMEs of processed food businesses in Malang. Macroeconomic factors reflected by the rate of inflation, credit availability, government policies on taxes, government policy on the minimum wage. However, macroeconomic factors had no significant effect on the performance of SMEs of the food. It is clear that competitive strategy is not as mediation or intervening variable between macroeconomic factors and the company's performance.

Inflation within one year is relatively stable at a level of about 5% compared to other macro-economic factors. People's Business Credit (Kredit Usaha Rakyat/KUR), which is aimed at SMEs, its distribution still facing various problems. According Pratomo (2014), KUR face five (5) problems: high interest rates, the distribution is uneven; socialization is not optimal for SMEs, KUR as a means of political campaigns, and lack of funding. KUR interest rate of 22% per year is considered still very burdensome. Through the Economic Policy Package has been lowered to 12% per year but just come into force in mid-2016. Since 2007 until now, KUR covers only 8.78 million micro and medium-sized businesses, with a total fund of Rp117 trillion. The condition is not comparable with the total SME businesses which reach 56.5 million units.

One of the factors causing the lack of participation of SMEs taxpayers in the compliance of paying taxes is a tax payment procedures and a high tariff (Atawodi and Ojeka 2012). The government is urged to provide lower tax rates to MSMEs, because tax policies taken by the government affects the growth of SMEs (Mungaya *et al.* 2012). Governments also need to consider the size of the company in determining tax policy (Adebisi and Gbegi 2013). In the Global Competitiveness Report 2011, the tax rules and the tax rate is one of the factors hampering the competitiveness of developing countries such as Indonesia.

Other macroeconomic factors related to competitive strategy and performance of SMEs is the minimum wage. Theoretically, wages proportional to productivity (Pyndick and Rubinfeld 2005). Sulistiawati (2012) found that wages have a significant effect and have a correspondingly negative on employment in Indonesia. This means that if there is an increase in wages, then it has the potential to reduce employment, especially low labor productivity. Productivity is closely related to education level. Nationally more than 45% of workforces are primary school educated, whereas in this study about 33% of business owners and managers of SMEs of food are primary and secondary school education (Table 2). In Indonesia, according to Badan Perencanaan Pembangunan Nasional (Bappenas 2010), productivity has not become a major determinant in the determination of wages. More minimum wage determined by the increase in the price level compared to the increase in productivity.

This study found that the competitive strategy has significant effect on the performance of SMEs of processed foods in Malang. The results in Table 5 show that competitive strategy has a profound effect on business performance. The right competitive strategy will boost the company's performance through growth in sales, profits, and assets. The study found that the cost leadership has the greatest effect on competitive strategy, while the two other indicators have a moderate effect. Thus, it can be concluded that the competitive strategy adopted by the processed food industry in Malang is cost leadership. This is in line with the framework of the five forces analysis Porter (1992). If the company wants to achieve competitive advantage, the company must choose the desired type of competitive advantage and the scope or field to be achieved. Companies that choose all types will result in the company's performance were below the industry average, which means the company does not have a competitive advantage.

By his research on the business development strategy of business food and beverage at the Depot Time to Eat in Surabaya, Sancoko (2015) found that this enterprise have changed the strategy of cost leadership strategy that has long been implemented into the strategy to focus on specific market niche. This proves that it is not profitable for the company to apply more than one strategy at a time.

Conclusion

The performance of SMEs of processed foods was affected by the competitive strategy. Competitive strategy was influenced by innovation capabilities and macroeconomic factors. Competitive strategy applied by SMEs was cost leadership, while the innovation capabilities reflected with relatively the same effect by technological innovation, product, market, and service innovation.

Industry environment has no significant influence on competitive strategy. Five forces framework analysis according to Porter that are new entrants, existing companies, buyers, suppliers, and substitute products yet or do not have a high intensity competition for influence competitive strategy of SMEs of processed foods. Likewise, macroeconomic factors do not significantly affect the performance of SMEs of processed foods.

Based on these findings it is suggested to the government in order to optimize the innovation capabilities through various means such as training for businesses, providing information and support infrastructure to support the technology implementation. In addition, the government can also manage macroeconomic factors to be optimized through tax policy and minimum wage, controlling inflation, and credit management for SMEs. For SMEs managers and/or owners to increase the capabilities of specific resources owned thus improving business performance. Subsequent studies can analyze the environmental industry and macroeconomic factors relationship with business performance using time series data.

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