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The effect of service quality, innovation towards competitive advantages and sustainable economic growth: Marketing mix strategy as mediating variable  
Srinita Syapsan,

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# The effect of service quality, innovation towards competitive advantages and sustainable economic growth

Sustainable  
economic  
growth

## Marketing mix strategy as mediating variable

Srinita Syapsan

*Universitas Syiah Kuala, Banda Aceh, Indonesia*

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### Abstract

**Purpose** – The purpose of this paper is to determine the effect of service quality and innovation on competitive advantage and sustainable local economy, with marketing mix strategy as the mediating variable (Study in small and medium enterprise (MSME) in Java and Sumatera).

**Design/methodology/approach** – The study population of this paper is the MSME in Sumatera and Java Islands in Indonesia, as the highest population in Indonesia in 2010–2016 (portion of MSME in Indonesia: Java 58.29 percent and Sumatera 22.22 percent, or total 80.51 percent), and total 16 province in Indonesia: Aceh, Sumatera Utara, Riau, Sumatera Barat, Jambi, Sumatera Selatan, Bengkulu, Lampung, Kep Riau, Kep Bangka Belitung (Sumatera Island), and Banten, DKI Jakarta, Jawa Barat, Jawa Tengah, Jawa Timur, DI Yogyakarta (Java Island). The analysis used in this study is a quantitative approach, namely, structural equation modeling based on variance, also known as the WarpPLS method.

**Findings** – The findings of this study are as follows: first, service quality has an influence on marketing mix strategies, meaning the application of service quality according to customer needs will create satisfaction. In other words, the better the quality of service provided, the higher the customer satisfaction will be. Second, the quality of service has a direct influence on creating a sustainable local economy, meaning that improving service quality to understand customer needs can enhance sustainable economic growth and competitive advantage through marketing mix strategies. This means that improving service quality in accordance with customer needs will improve the marketing mix strategy leading to a sustainable local economy. Third, the marketing mix strategy has a positive influence on the sustainable local economy, meaning that the higher the marketing mix strategy, the better the strategy for sustainable economic growth and competitive advantage will be.

**Originality/value** – The effect of marketing mix strategy as mediation (using the Sobel test) on the influence of service quality and product innovation on sustainable local economy and competitive advantage is shown in this study. No previous research studies this relationship at the research location: MSME in Indonesia, especially in Java and Sumatra Islands. Hence, this is one of few studies comprehensively evaluating the effect of service quality and innovation, toward competitive advantages and local sustainable economic: marketing mix strategy as mediating variable (study in MSME in Java and Sumatera).

**Keywords** Service quality, Product innovation

**Paper type** Research paper

### 1. Introduction

Over the last decades, few studies focusing on micro-, small and medium enterprises (MMSME) have attracted attention because this business sector has a fundamental contribution to the economy. In total, 90.0–99.0 percent companies throughout the world are small and medium enterprises (MSMEs), including majorly small or micro-business. Current business trends, such as flexible production, downsizing, outsourcing and franchise, are in favor of MSME, and, as the result, MMSME plays a more important role in stability, creating labor and economic development of a country (Gutierrez *et al.*, 2015).

Small enterprise is a terminology in Indonesian Economic Development which is pivotal for sustainability of national economic growth post-economic crisis. In addition to contributing to the economy, MSMEs also provide benefits to the domestic workforce in creating job, which reduces unemployment. The economic crisis has resulted in a sharp



decline in the monetary and financial sectors, especially those that have to deal with external and internal pressures such as the structure of the real economy. Before the crisis, the government emphasized the upstream industry. There is a statement that the downstream industry will simply follow the development of the upstream industry. As a matter of fact, developing a large industry is still an issue that does not have any authority to give input. Before introducing MSMEs as a program to develop downstream industries and large-scale businesses, the government had spent too much time. As the consequence, the downstream industry got the most severe affected by the economic crisis. Downstream industry would not have ended in such disadvantage position, had the government implemented MSMEs as solution to overcome issues taking place in the industry. MSME is the solution to solve crisis because MSMEs depend upon their competitive advantage (Bauchet and Morduch, 2013).

MSMEs have proven that the downstream industry is able to support the national economy because of collision taking place in the upstream industry. Every year, the number of MSMEs continues to increase. MSMEs act as the main economic activity that contributes to national income and creates vacancy in developing countries. Creating job vacancy in the downstream industry and strengthening the national economic stability, MSME acts as national economic activity with a significant contribution to the gross domestic income creating job vacancy in rural areas. It is expected that MSMEs help Indonesian citizen achieving financial stability.

MSME holds a strategic position for the economic sector in Aceh. MSMEs create job vacancy and empower local economy. The current number of MSMEs in Aceh is 55,783 units, consisting of 39,571 (71 percent) micro-scale industries, 13,728 (25 percent) small-scale industries and 2,484 (4 percent) middle-scale industries. It is estimated that these MSMEs have provided job for 275,000 labors. Their business activities involve trading, service, agriculture, industry, fisheries and aquaculture.

The role of MSMEs toward Aceh economy is in line to that toward the national economy. In 2015, data from the Ministry of Cooperatives and MSMEs showed that MSMEs had a significant contribution to the national economy. First, 99.9 percent of the national business consisted of MSMEs. Second, the MSMEs absorbed 97.04 percent of the national labor force. Third, MSMEs contributed 55.56 percent of the total gross domestic product (GDP). Considering the pivotal role of MSME, the government of Aceh should make serious effort to support this economic activity. The government should develop and carry out policy of which objective is to develop and maintain MSMEs effectively. The policy should be able to create supporting business climate, encourage growth of the local, regional and national economy, develop human resource and increase quality of MSMEs.

The government should develop MSMEs empowerment program because this program supports the national economy more particularly amidst recent crisis. Supporting 90 percent of the national economy, the role of MSMEs is undeniable. This sector helps nearly the entire household that has low to middle income. According to him, there are four reasons responsible for the survival of the national MSMEs amidst the economic crisis. Some MSMEs produce a perishable item for daily consumption. Most of the MSMEs rely on financial institutions other than banks for funding. In general, MSMEs have selective product socialization, which means that they produce particular items only. New MSMEs are established after massive lay-off in the formal sectors. MSMEs play a pivotal role in supporting Indonesian economy because they are the main drive for the national economy.

One of the major roles of MSMEs for the national economy is to provide millions of job vacancy. The MSMEs also contribute to the GDP and foreign exchange since some of them export their products to foreign countries. However, the government has not paid serious attention to this sector yet. The government has yet to establish monetary policy to develop the real sector.

Similar to other companies, MSMEs should identify, understand and meet customers' expectation in order to survive the business competition. When these are fulfilled, MSMEs

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meet their customer's expectation. Comparing these expectations and performance in terms of goods services provided, we can determine whether or not customer satisfaction is met. Marketing strategy has become objective of most companies. Marketing strategy is implemented not only to gain profit, but also to survive competitive market. Furthermore, the quality of service, particularly for service company, is a vital element to get a high customer satisfaction and develop competitive advantage for the company itself.

MSMEs (which in this context is associated to company) should understand methods to create and increase quality of goods and service they offer. Instead of MSMEs or companies, customer is the one evaluating quality of service (Kotler, 2001, p. 9). Quality control is the major part of business strategy that allows company to develop sustainable competitive advantages, for instance as market leader or strategy for sustainable business. Quality refers to efforts to meet customer expectations, which include labor, products, processes, and the environment. Tjiptono (2005, p. 54) stated that good service allows service provider to create bond with customers helping the service provider to identify the customer's need and expectation. Thus, companies should keep improving their marketing strategy in order to provide better experience for their customers. In other words, marketing strategy helps developing re-purchase intention and customer loyalty.

Previous researchers have conducted studies on service quality because MSMEs are categorized as service company of which focus is effective service, customer loyalty and customer satisfaction. Service in this context refers to quality of service provided for customers. Personal service allows MMSME provide humane and respectful service. Personal service depends heavily upon human resource and therefore, companies should hire employees who have good communication skills and ability to handle customer's complains. In addition, service quality is also related to ability of company to create innovative products and access valid information in timely manner.

Customer purchase product based on its utility and favoritism (hedonism) (Batra and Athola, 1991). Hirschman and Holbrook (1982) state that happiness and pleasure are a result of experience, feeling, fantasy, or affective. Strahilevitz and Myers (1998) state that utility or functionality is influenced by customer cognition to act objectively. Trust and advantage customer gets from particular product will result in intention to re-purchase and purchase loyalty (Aaker, 1991).

Furthermore, in developing small and medium businesses in achieving a good innovation, it requires a service quality and innovation. Filippakopoulos *et al.* (2008) and Lena show that service quality has a positive influence on product innovation, innovation strategies, process innovation, and employee innovation performance, because companies have service-oriented quality, process, and product innovation, to increase internal innovation resource use (improve the ability of development and research), and to invest in technology to achieve better performance than companies that have no innovation strategy implementation at all or lower. Service quality has a positive influence on competitive advantage (Setyawati, 2003). This shows that the quality of service in managing a company has an influence on its ability to compete with other similar companies.

Throughout the world today, innovation has become the dominant factor in maintaining competitiveness. Gaynor (2002) confirms that innovation is the fuel of organizational growth; it brings future success and is a machine that enables businesses to maintain their survival in the global economy. For companies that pursue excellence, restructuring, reducing costs and improving the quality of products or services are no longer sufficient. Companies must be able to create and commercialize new product and process flows that expand technology boundaries, while at the same time keeping one or two steps ahead of their competitors (Porter and Stern, 2001). In summary, Peter Drucker states that every organization requires one core competency, which is innovation (Lin and Chen, 2007).

According to Vrakking and Cozijnsen (1997), in large companies as well as micro, small and medium enterprises (MSMEs) the pressure of innovation applies. Afuah (1998) confirms that experts have noted that MSMEs are often more prosperous than large companies in terms of innovation. Their comparative advantage over large companies in innovation is flexibility and speed of response (Acs and Audretsch, 1990; Dodgson, 1993). Therefore, MSMEs provide valuable social and economic contributions because of their innovations such as products, processes and administration. Maravelakis *et al.* (2006) measured organizational capacity over the past decade and achieved a large increase in the level of patents. The Center for Industry and Development and Investment supports this statement as stated in Lin and Chen (2007), that in 2003, Taiwan was ranked 4th globally in the number of US patent grants received, up from the 11th level a decade earlier and only surpassed by the United States, Japan, and Germany. In Indonesia, the practice of innovation by MSMEs has academic and practical values.

The potential relationship between religious beliefs, management practices, and organizational outcomes has been ignored in key management research to date. Despite the fact that more than 80 percent of the population around the world believes that religion is an important part of their daily lives, many studies assume that the business and management environment in an organization is a religiously neutral environment, and as a result religion is not considered a study worthy. According to Mellahi and Budhwar (2010), this is due in part to skepticism that religion has a significant impact on how individuals behave in the workplace. Matiaske and Grözinger (2010) state that by considering the organization as a neutral environment, organizational members are expected to give up their religious ideas after passing through the factory gates or at least outside the organization. In addition to skepticism about the role of religion in organizational management, researchers have examined the practice of cross-cultural management, where there is a greater diversity of religions, including religion as part of national culture. Hofstede (1997) argues that culture precedes religion. According to Batra and Athola (1991), a customer will choose a product based on the value of utility and the value of pleasure (hedonist). Hirschman and Holbrook (1982) add that the value of pleasure and happiness is a result of experience, feeling, fantasy, or affective. Strahilevitz and Myers (1998) confirm that utility or functional values are more influenced by the cognitive aspects of customers to act objectively. As a result, the trust and effect of the product will encourage a customer to be loyal to a product reflected in repurchase (loyalty) and attitude to keep using the product (Aaker, 1991).

Continuous stagnation and a decline in economic growth have been accompanied by chronic unemployment and poverty, and the resulting problems have become the global spotlight, leading to an increasing search for strategies that can stimulate economic activities in many countries. Now the development of small businesses has become the center of community welfare efforts based on the idea that the businesses form the context in which entrepreneurial activities takes place. Besides that, MSMEs have a higher potential for job creation because of lower costs per job made. The researcher considers factors that influence the sustainable growth in Indonesia. Given the challenging target that the government has to achieve vision 2030 and MSMEs are one of the most promising sectors in job creation in the country, it is expected that MSMEs adopt management perspectives and strategies that will enable a sustainable culture of growth in business.

To encourage customer trust, a product must build sustainable economic growth through two utilitarian and hedonic values as mentioned above. Thus, this study aims to determine the effect of Service Quality and Innovation on Competitive Advantage and Sustainable Local Economy, with Marketing Mix Strategy as a mediating variable (Study in MSME in Indonesia, especially in Java and Sumatra). The originality of this research are: first, the effect of marketing mix strategy as mediation (using the Sobel test) on the influence of service quality and product innovation on a sustainable local economy and competitive advantage; second, no previous research has discussed this relationship in MSMEs in

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Indonesia, especially in Java and Sumatra Island. Third, this is one of few study comprehensively effect of service quality, innovation, toward competitive advantages and local sustainable economic: marketing mix strategy as mediating variable (study in MSME in Java and Sumatera). Several previous study has been separately investigate the effect between service quality, innovation toward marketing mix strategy, and marketing mix strategy toward competitive advantage and local sustainable economic.

## 2. Literature review

### 2.1 Service quality

The service sector is important in the economies of countries around the world and services will continue to be the dominant force in the world economy in the future. Therefore, service quality has become a field of research for almost the past three decades (Stafford *et al.*, 1999). Some authors have defined service quality from different perspectives such as the perspective of customers, companies, marketers and so on. Kannan *et al.* (2012) define service quality as “a function of what consumers really accept (technical quality) and how this service is delivered (functional quality).” Service quality consists of personnel skills (technical quality), coordination between different parts of the service system (integrative quality), the way these services are delivered to customers (functional quality), and the extent to which product services meet customer expectations (quality of results).

### 2.2 Innovation and benchmarking

Benchmarking is a reference point where various measurements can be made. The process of observation and imitation is a very important cognitive process that goes beyond the only activity of imitating the practice of others. The benchmarking process is a learning process that involves observing external performance and practice, comparing with internal, identifying knowledge gaps, and finally decision-making. This decision bridges the gap to obtain new resources or utilize internally and invest in improvements. The result of this learning process is something new, deriving both from the integration of external inputs with internal previous knowledge as well as from bridging knowledge gaps. Besides, the importance of outside sources of knowledge to the innovation process is widely recognized in literature. At the organizational level, March and Simon in Massa and Testa (2004) argue that most innovations originate from loans rather than creating something new.

### 2.3 Marketing mix strategy

The central concept in business discourse is also called marketing mix strategy. In discussions about service satisfaction and quality, the main focus is customers, because customers have an important role to measure satisfaction from a product and service provided by the company. Satisfaction is taken from the Latin word, namely “satis” and “facio.” “Satis” means good or sufficient and memadai “facio” means to do or make something. Rambat Lupiyoadi (2001) citing Kotler (1997) defines satisfaction as a level of feeling when someone describes the results of a comparison on the performance of products and or services received and expected.

In Webster dictionary (1928), as quoted by Lupiyoadi (2001), a customer is someone who comes several times to buy a product or tool. In other words, a customer is someone who comes constantly to the same place to fulfill his or her demand for a product or service and pay for the product or goods or service. The marketing mix strategy provides enormous benefits, but lately the marketing mix strategy is no longer the ultimate goal in business processes, because it is disappointed in the end as customers buy products from competitors without hesitation.

Regardless of the stage of economic development, the value of the small business sector is recognized in economies throughout the world. Its contribution to economic growth, job creation, and social progresses are highly valued. The World Bank (2007) reported that the contribution of MSMEs in India reached 66.9 percent for job creation, besides that India occupied the fourth level in economic development. In China, the MSME sector contributed 78 percent to total employment, as the highest figure, while the lowest is South Africa at 39.6 percent. The contribution of MSMEs to economic development is very large compared to other economic sectors. The role of MSMEs in investment, job creation, exports, industrial production, GDP, and so forth in each field is very significant. The MSME sector itself has a very high growth rate because of its advantages compared to other sectors. In India, the economy is closer to the MSME environment, such as cheap local resources, local talent, high demand and so on. In addition, India's socio-economic policies were adopted since the industry developed and the 1951 Act had determined the MSME sector as a vehicle to develop the Indian economy. Investment and production are closely related, where more investment indicates the amount of production, or the amount of production requires more investment.

#### *2.4 Competitive advantage*

Company resources and capabilities and external factors are referred to as sources of competitive advantage. There are two sources of competitive advantage, tangible and intangible. Tangible resources are financial resources and physical assets identified and valued in financial statements. Intangible assets are those not seen in tangible statements. In MSMEs, resources must work together to carry out their tasks. Included in the resource are organizational capabilities, i.e. the company's ability to disseminate resources for desired outcomes. Organizational capabilities can be classified based on the value chain because they are designed to create value for customers. New MSMEs that are made to survive can have slow growth and a new management system. According to Altenburg and Meyer-Stamer (1999), they formed what is called by emerging groups or surviving MSME groups. MSMEs that survive in developing countries are not clear in defining strategies to establish core competencies – they mix strategies with success factors; this is because they are based on intuition and experience that focuses on short-term and low formulations. Strategic factors are factors that result from mixing industry success factors with strategies. However, this type of MSME simplifies the process without developing core competencies. Jardon and Martos (2012) say that these strategic factors are used to produce better performance.

MSMEs by definition can use a smaller employee base, making it more difficult to maintain all the necessary in-house expertise. Also, fewer new employees enter small companies with knowledge of new techniques and theoretical approaches. Changing lost expertise in companies through external consultations is a realistic choice, yet very rarely, only for cases due to limited financial resources. Therefore, benchmarking efforts focus on financial indicators that are easily collected and widely known. As Taschner (2016) stated, this is true in cases where the object of comparison is difficult to define or the management of MSMEs is not aware of the importance of competitiveness of the company.

### **3. Research methodology**

This research is an explanatory study because it aims to explain the causal relationship between variables by testing the hypothesis. The research instrument used to collect data in this study is a questionnaire, which is filled in by respondents according to the characteristics of the population. Population is divided into two, sampling population and target population (Singarimbun, 1999). The target population in this study is all customers or service users who use MSME products. The sample was taken in accordance with the provisions set for the structural equation modeling (SEM) analysis tools. In determining

the sample size for SEM, several guidelines must be met, one of which is depending on the method of estimating the size of the sample used (Hair *et al.*, 2010). By using the estimated Maximum Likelihood (MLE) parameter method, the recommended sample size is between 100–200 samples.

Population of this study is the MSME in Sumatera and Java Island in Indonesia, as the highest population in Indonesia in 2010–2016 (portion of MSME in Indonesia: Java 58.29 percent, and Sumatera 22.22 percent, or total 80.51 percent), and total 16 province in Indonesia: Aceh, Sumatera Utara, Riau, Sumatera Barat, Jambi, Sumatera Selatan, Bengkulu, Lampung, Kep Riau, Kep Bangka Belitung (Sumatera Island), and Banten, DKI Jakarta, Jawa Barat, Jawa Tengah, Jawa Timur, DI Yogyakarta (Java Island).

After determining the sample (Solimun *et al.*, 2017), a 20-sampling indicator is determined as the basis for sampling. (service quality (X1) measured by five indicators, namely, tangible, reliability, assurance, empathy and responsiveness; product innovation (X2) measured by four indicators, namely, rewards for worker for new ideas, openness of new ideas, learning abilities and implementation ideas; marketing mix strategies using five indicators, namely, product, price, place, promotion, people; sustainable economic growth is measured by three indicators effectivity, efficiency and economics; competitive advantage using three indicators: valuable resources, not easily imitated and different from other) that are used with a ratio of 5–10 observations, for each indicator, the number of samples used is 10 observation  $\times$  20 parameter = minimum 200 samples for customer of MSME. Then the total number of samples used for 16 provinces  $\times$  20 = 320 respondents/samples (adequate for minimum 200 samples), consisting of 20 samples for each provinces. The sampling technique in this study is purposive sampling, in which the number of sample is determined based on the need. Determination of the sample in this study (questionnaire) is carried out with accidental sampling, so whoever met the researcher by chance could be chosen as respondents. Respondents' responses to each indicator of strategic leadership variables, entrepreneurial variables and hospital performance variables were measured using the Likert scale classified as interval data. The interval data scale used has range 1–5 that is: strongly disagree/never (score 1); disagree/never (score 2); neutral/rare (score 3); agree/often (score 4); and strongly agree/always (score 5). The primary data collection technique was conducted by giving questionnaires to the consumer of MSME.

The analysis used in this study is a quantitative approach, namely SEM based on variance, also known as the WarpPLS method (Solimun *et al.*, 2017). In addition, indicators are formed (as observable variables), because all variables included in measurements cannot be observed. Indicators are formed using first-order factor analysis (reflective indicators).

This research use SEM based on Variance or CB-SEM (WarpPLS), with several reason: the goal of this study is predicting key target construct (service quality, product characteristics and company performance), and identifying key driver construct (quality management system) (Hair *et al.*, 2018); robust with the invariant problem in measurement model (Dijkstra, 2014); this software (WarpPLS) provides several features that are not available from other SEM software; and this software (WarpPLS) provides a classic PLS algorithm along with a factor-based PLS algorithm for SEM. In CBSEM, the assumption based on linearity for each relationship (Kock, 2014) (Figure 1).

The hypothesis of this research are follow:

- (1) Service quality has positive and significance effect to marketing mix strategy. This hypothesis is supported from previous research by Aboyassin and Abood (2013), Dorson *et al.* (2017), Scapolan *et al.* (2017), Yuliansyah, *et al.* (2017), Alvinus *et al.* (2017), Qasrawi *et al.* (2017), Koohang *et al.* (2017), Wang *et al.* (2015), and Luu (2017).





**Figure 1.**  
Conceptual framework

- (2) Service quality has positive and significant effect on sustainable economic growth. This hypothesis is supported from previous research by Osorio *et al.* (2017), Vagnoni and Khoddami (2016), Gallouj (2017), Parakhina *et al.* (2017), Razak and Murray (2017), Ebrashi (2017), Jabeen *et al.* (2017), Mallon (2017), Ratten *et al.* (2017), and Henry (2017).
- (3) Service quality has positive and significant effect on competitive advantage. This hypothesis is supported from previous research by Dorson *et al.* (2017), Scapolan *et al.* (2017), Yuliansyah *et al.* (2017), Alvinus (2017), and Qasrawi *et al.* (2017).
- (4) Product innovation has positive and significant effect on marketing mix strategy. This hypothesis is supported from previous research by Watanabe and Senoo (2009), Bhatt (2001), Adams and Lamont (2003), and Edmonson (2010).
- (5) Product innovation has positive and significant effect on sustainable economic growth. This hypothesis is supported from previous research by Chatzoglou and Chatzoudes (2017), Johannessen and Olsen (2009), Watanabe and Senoo (2009), Bhatt (2001), Adams and Lamont (2003), Gebert *et al.* (2003), Awazu (2004), López *et al.* (2004), and Edmonson (2010).
- (6) Product innovation has positive and significant effect on competitive advantage. This hypothesis is supported from previous research by Al-Sa'di *et al.* (2017), Yang (2008), Ferrari and Toledo (2004), Chang and Ahn (2005), Fu *et al.* (2006), Pitt and MacVaugh (2008), Rahe (2009), Prieto *et al.* (2009), and Shani *et al.* (2003).
- (7) Marketing mix strategy has positive and significant effect on sustainable economic growth. This hypothesis is supported from previous research by Kohtamäki, M. *et al.* (2012), Nayyar and Naqvi (2013), Osorio *et al.* (2017), Scapolan *et al.* (2017), Arora *et al.* (2016), Yunis *et al.* (2017), Laforet (2016), Nielsen (2016), Secundo and Elia (2014), Kantur (2016).

- (8) Sustainable economic growth has positive and significant effect on competitive advantage. This hypothesis is supported from previous research by Chatzoglou and Chatzoudes (2017), Brem *et al.* (2016), Altıntaş *et al.* (2010), Minoja *et al.* (2010), Berawi (2004), Kamboj and Rahman (2017).

Sustainable economic growth

## 4. Result

### 4.1 Validity and reliability of instrument

The initial step of the analysis is to test the research instrument. The results of testing the validity and reliability of the instruments are presented in Table I. From the results, the correlation value  $> 0.3$  is obtained, meaning that all items are valid (80 items from 20 valid indicators). The reliability results obtained Cronbach's  $\alpha$  value  $> 0.6$ , meaning that all variables are reliable. Thus, the instruments used in this study are valid and reliable.

### 4.2 Assumption of model

Because PLS does not conform to distributional, the assumptions required by classical significance test must still be tested using the bootstrap method. According to Hair *et al.* (2011), PLS is strong in dealing with missing values, misspecification models, and violations of statistical assumptions from latent variable modeling. However, Fernandes *et al.* (2014) state that it is necessary to test linearity assumptions by using the Ramsey Reset Test. The linearity assumption test results are presented in Table II and linearity assumptions are not fulfilled if  $p$ -value  $> 0.05$ . The results presented show that linearity assumptions are fulfilled.

### 4.3 Goodness of fit model

The second step in the analysis is testing the goodness of the model. A research model is said to be appropriate if supported by empirical data. The Goodness of Fit in a structural analysis such as PLS-predictive value (Q<sup>2</sup>) is calculated based on the determination coefficient value (R<sup>2</sup>) of each endogenous variable. The resulting relevance predictive value (Q<sup>2</sup>) is 0.899 or 89.9 percent, meaning that 89.9 percent of employee performance can be

No.	Variable	Indicator	Correlation				Cronbach's $\alpha$
			Item 1	Item 2	Item 3	Item 4	
1	X1	X1.1	0.549	0.448	0.496	0.558	0.678
2		X1.2	0.638	0.497	0.465	0.455	
3		X1.3	0.539	0.641	0.473	0.673	
4		X1.4	0.436	0.572	0.495	0.461	
5		X1.5	0.471	0.495	0.663	0.450	
6	X2	X2.1	0.678	0.575	0.501	0.536	0.886
7		X2.2	0.558	0.666	0.471	0.495	
8		X2.3	0.440	0.689	0.696	0.619	
9		X2.4	0.698	0.652	0.488	0.541	
10	M	M1	0.520	0.593	0.425	0.534	0.861
11		M2	0.577	0.677	0.412	0.529	
12		M3	0.680	0.644	0.404	0.464	
13		M4	0.402	0.627	0.592	0.642	
14		M5	0.534	0.404	0.488	0.417	
15	Y1	Y1.1	0.537	0.626	0.620	0.620	0.829
16		Y1.2	0.609	0.642	0.512	0.627	
17		Y1.3	0.494	0.445	0.412	0.609	
18	Y2	Y2.1	0.461	0.431	0.640	0.576	0.876
19		Y2.2	0.416	0.459	0.558	0.515	
20		Y2.3	0.641	0.546	0.696	0.495	

**Table I.**  
Validity and reliability tests

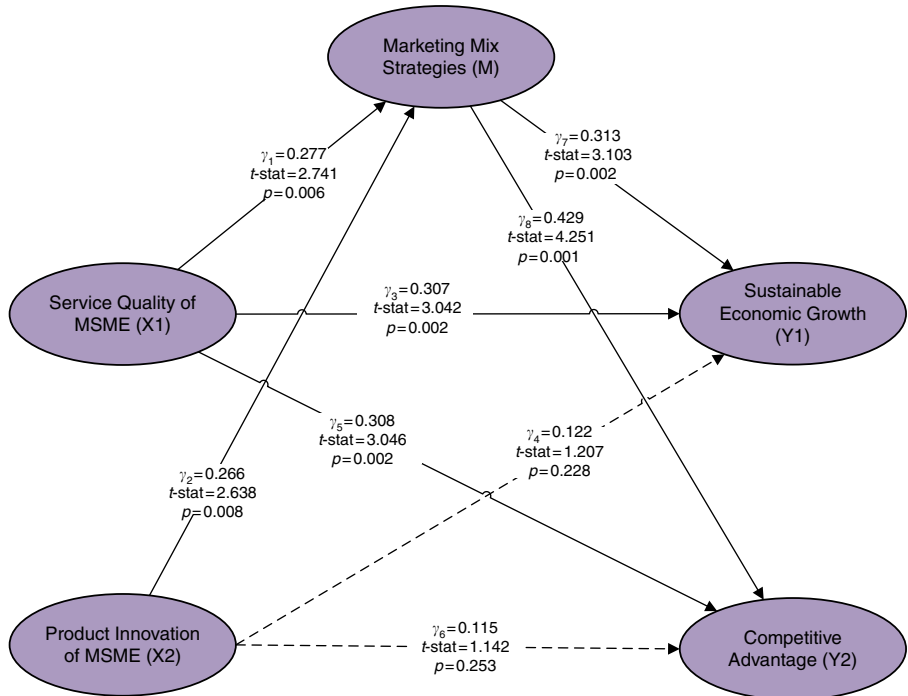
explained by the model formed, while the remaining 11.1 percent is explained by other variables outside the model. If the Q2 value is > 75 percent, the model used is suitable and can be used for further analysis (Hair *et al.*, 2011).

4.4 Structural model and hypothesis testing

The structural model shows the relationship between variables and other variables in the study through the coefficient of the structural model. Significant influence between one variable and another variable is indicated by the *t*-stat value > 1.96 (at the 5 percent significance level), or *p*-value < 0.05, and vice versa. In PLS, two effects are produced, namely direct effects and moderation effects (indirect). Figure 2 summarizes the results of the analysis.

No.	Effect	<i>p</i> -value	Conclusion
1	X1 → M	0.040	<i>p</i> -value < 0.05 linearity assumption met
2	X1 → Y1	0.025	
3	X1 → Y2	0.034	
4	X2 → M	0.018	
5	X2 → Y1	0.023	
6	X2 → Y2	0.036	
7	M → Y1	0.047	
8	M → Y2	0.017	

**Table II.**  
Linearity assumptions test



**Figure 2.**  
Analysis result: direct effect

—▶ Significant effect  
- - -▶ Not Significant effect

Based on Figure 2, it can be presented structural model test results, 6 from 8 relationship is significantly result. Service Quality of MSME has positive relationship to Marketing Mix Strategies, Sustainable Economic Growth and Competitive Advantage; Product Innovation of MSME has positive relationship to Marketing Mix Strategies; and Marketing Mix Strategies has positive relationship to Sustainable Economic Growth, and Competitive Advantage. In other hands, Product Innovations does not has significantly effect to Sustainable Economic Growth, and Competitive Advantage.

Based on Figure 3, mediation testing from several studies directly affects the form of the mediation. In Figure 3, the mediation test results are presented using the Sobel test. The Mixed Marketing Strategy (M) mediates the relationship between MSME Service Quality and MSME Product Innovation with Sustainable Economic Growth. In addition, the Mixed Marketing Strategy (M) also mediates the relationship between MSME Service Quality and MSME Product Innovation with Relative Advantages.

### 5. Discussion

From the results of the analysis, it has been confirmed that service quality and product innovation in MSMEs has a positive relationship and a significant effect on the marketing mix strategy. This happens because the quality of service and product innovation provided by the MSME sector to its customers has provided significant satisfaction. All dimensions of service quality and product innovation, which consist of responses (quick responses), reality (physical appearance), empathy (personal and sincere attention), reliability (service, timeliness, and accuracy), and guarantee (guaranteed ability from MSMEs) significantly meet the expectations, achievements, compatibility, and satisfaction requested by the customers. Service quality and product innovation in this study are defined as perceptions of customers on the quality of services and product innovations provided by MSMEs.

The results of this study indicate that customers feel the service quality and product innovation by MSMEs are as expected; their expectation meets their experience. MSMEs have provided service quality and product innovation to customers in accordance with what customers expect, so service quality and product innovation have created a marketing mix strategy. Thus, to evaluate whether the service quality and product innovation of the company or organization is good enough, the two must meet expectations and create customer satisfaction. Therefore, the quality of service and product innovation is in accordance with the expectation of customers.

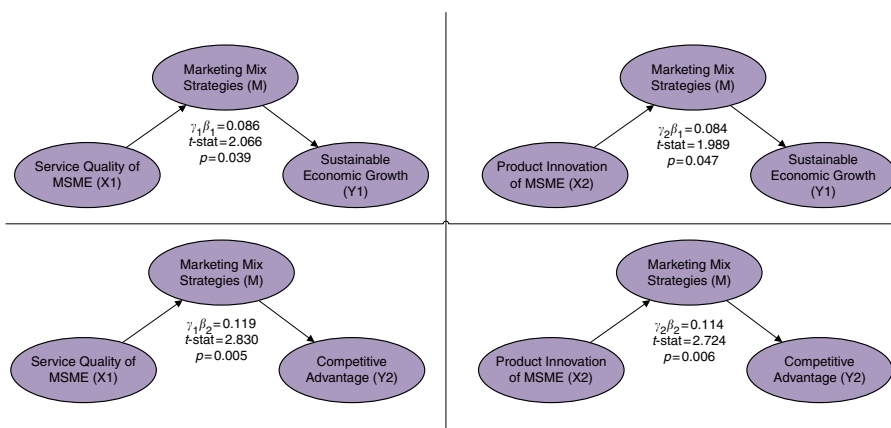


Figure 3. Analysis result: indirect effect

The marketing mix strategy and sustainable economic growth and competitive advantage in MSMEs in Indonesia have a positive and significant relationship, especially in Java and Sumatra. This shows the higher customer satisfaction, the higher the level of sustainable economic growth and the competitive advantage it creates, and this applies the vice versa. Fulfillment of expectations, compatibility, and services must create customer satisfaction to create sustainable economic growth and competitive advantage. Therefore, the marketing mix strategy greatly determines how a sustainable economic growth and competitive advantage is reflected in the attitude to consume MSME products as well as in the recommendation to other people or other parties about the MSME products or services.

The results of this study support several theories and some previous studies by Ostrowski *et al.* (1993), Bowen and Chen (2001), Kandampully and Suhartanto (2000) and Caruana and Malta (2002) that there is a significant relationship between marketing mix strategies for sustainable economic growth and competitive advantage. In addition, the finding that the marketing mix strategy has an effect on sustainable economic growth in the MSME sector supports Abadi (2006) and Utari (2004) confirming that there is a significant relationship between marketing mix strategies for sustainable economic growth and competitive advantage in MSMEs in Indonesia, especially in Java and Sumatra. This means that all service quality and product innovation must have a significant relationship to sustainable economic growth and competitive advantage if they have created customer satisfaction. These results are also supported by several theories and other studies such as Parasuraman *et al.* (1998), Caruana and Malta (2002) and Cronin and Taylor (1992) that marketing mix strategies tend to mediate the relationship of service quality and product innovation towards sustainable economic growth and competitive advantage. Thus, sustainable economic growth and competitive advantage are key successes, not only in the short term, but also sustainable competitive reliability. Sustainable economic growth and competitive advantage has a strategic value for MSMEs and other companies, and they cannot be separated because of the very strong relationship.

MSME activities in Indonesia, especially in Java and Sumatra, cover various sectors or sub-sectors with a variety of products or commodities. It is necessary to develop superior MSME products to increase the effectiveness of MSMEs and their contribution to the regional economy. MSME superior products uses criteria such as product effects on the absorption of the business units, labor, product marketing range, access to raw materials, product contributions to the local economy and other related aspects.

Through SKPA/SKPK related to the development of MSMEs, the provincial government and regency/city governments need to work closely with the MSME association, banks, chamber of commerce, and academics to determine and identify MSME superior products in each economic sector or sub-sector in each region. SKPA/SKPK here is not only direct MSME carrier institutions such as the Office of Cooperatives and MSMEs, but also other institutions related to sectors or sub-sectors where MSMEs have more activities such as the Office of Trade and Industry, the Office of Agriculture and Food Crops, Plantation Service, Forestry Service, Animal and Animal Health Service, the Office of Culture and Tourism and Marine and Fisheries Service.

Determination of superior MSME products can refer to the results of studies by credible agencies that are more objective and have a strong base, such as Bank Indonesia, universities and others. In addition, it is necessary to give legal weight (e.g. with local decisions) on the superior MSME products that have been determined at the provincial and regency/city level. This can be used as an official reference in the development of MSME products. With legal weight, related SKPA/SKPK will be more focused and comprehensive in carrying out or supporting development programs/activities of MSME superior products.

Efforts to develop superior MSME products in Indonesia need to be supported by a reliable database system. The database here is useful for collecting data related to MSME

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superior products, the value of investment, employment, and market share very important for business activities and investment plans. In addition, this database must be easily accessible to MSME business actors, SKPA/SKPK and other interested parties. To integrate activities, this database needs to facilitate coordination and cooperation from these institutions. It is also crucial to create a kind of MSME development forum involving stakeholders such as SKPA/SKPK, MSME association, banks, chamber of commerce, and academics to communicate, coordinate, and collaborate so the development of superior products can be carried out synergistically and effectively.

Through the dissemination of credit financing schemes, expansion of service networks, increased collaboration with various parties, the Bank needs to increase access to financing of superior MSME products as a form of SME development efforts and the development of credit distribution schemes. Flexibility in credit repayment needs to take into account the commodity characteristics, for example, differences in production cycles can be considered when paying credit for agricultural commodities.

The marketing expansion is also very much needed for the development of superior MSME products. The effort that will help may be like development of infrastructure in agricultural centers, especially in remote areas, which leads to marketing techniques. Improving port functions and services is also very important in addition to the construction of infrastructure, especially to increase exports of superior products.

Training and mentoring programs are also important for MSME entrepreneurs and institutional strengthening. The program is to improve product quality and packaging, to foster entrepreneurship and develop production technology and business management. In addition, it can also strengthen the MSME institutions such as cooperatives, associations, and others, for example by increasing institutional management capacity and expanding cooperation among business actors. Efforts to develop MSMEs need to be planned and integrated. By promoting MSMEs, we can also help mobilize the people's economy as a real step to overcome poverty and unemployment, and later to contribute to improving community welfare and regional economic growth and competitive advantage.

Business MSME scattered in all corners of the country in the archipelago fairly evenly. Indeed, the soul of "entrepreneurship" citizens of this nation attached long ago even long before the independent state. MSME has been proven throughout the nation's history to emerge as the driving force and savior of the Indonesian economy. MSME was able to support the joints of the nation's economy in the difficult times and economic crisis hit the country especially in 1997/1998. At that time large companies turned out helpless and shaky. A number of conglomerates obtained a loan facility from the government known as Bank Indonesia's liquidity assistance (BLBI). But the company was never saved even happened BLBI embezzlement. Trillions of rupiah disbursed by the government (BI) disappeared unclear rimbanya. Ironically, the government was forced to bite the fingers, there is no good faith tycoon that mengemplang BLBI. "Milk is rewarded with tubal water."

Now let us see factually the existence of MSME in the midst of the spread of network of capitalism in this nation's economy. MSME actually play a role not only to reduce the social unrest caused by the unemployment rate is getting bigger, but also macro participate to grow the economy of the country. In this context it is important to note the BPS data on MSME's contribution to the increase in GDP. Last year MSME accounted for 56 percent of total GDP in Indonesia. The government's concern over MSME's growth and development is appropriate and relevant, especially in the focus of development of the real sector. MSME is more "playing" in the real sector that fulfills the livelihood of the people so it is beneficial not only for economic growth but also the equity of people's welfare.

So much the MSME has long run its business and has a tremendous prospect, but because of lack of funds and understanding of management is still limited, then MSME rarely become large. For example, based on the experience of writers in Malang there are ice

sellers degan (young coconut) who sell their merchandise with simple rombong but have turnover reach 1 million rupiah per day. The spirit, determination and willingness of this true businessman to develop his business is quite large. But unfortunately they are less capital and less enlightened insight into business management. This role can actually be facilitated by our banking. In this context, the role of banking is required.

Today international donor agencies all support the development of MSME. Some see it as a vehicle for job creation (ILO), some see it as a translation of their commitments (IMF, World Bank, Asian Development Bank) to fight poverty in developing countries. In Asia, the development of the MSME sector is also seen as one way out of the economic crisis. Multilateral and bilateral donors (including Japan) will all provide funding and technical assistance for the development of the sector.

The role of Small and Medium Enterprises (MSME) in Indonesia is enormous and has been proven to save the economy of the nation at the time of the 1997 economic crisis, in the developing countries, in the United States, Japan, Germany, Italy, MSME which became the main pillar of the state economy. This situation is only possible because governments rather than those countries have policies that support the creation of conditions in which their small and medium-sized enterprises become very healthy and strong. "The policy in question is not only about capital access or funding issues, but also support for market access, educational and training support, and support to get the right technology."

The reasons for MSME survive and tend to increase in times of crisis are: Most MSME produce consumer goods and services with low demand elasticity of income, so the average income level of the public does not have much effect on the demand for the goods produced. Conversely, the increase in income levels also has no effect on demand; second, most MSME do not get capital from banks. The implications of the deterioration of the banking sector and rising interest rates do not significantly affect the sector. Unlike the troubled banking sector, the MSME participated in its business activities. While large business can survive. In Indonesia, MSME uses its own capital from savings and its access to banking is very low; third, MSME has limited capital and competitive market, its impact MSME has a strict production specialization. This allows MSME to move easily from one business to another, no inbound and outbound obstacles; fourth, reforms eliminate barriers in the market, upstream industry protection is eliminated, MSME has more choice in raw material procurement. As a result production costs decreased and efficiency increased. But because along with the economic crisis, the effect is not too big; fifth, with the prolonged economic crisis causing the formal sector to lay off many of its workers. The unemployed are entering the informal sector, doing business activities are generally small scale, consequently the number of MSME increases.

## 6. Conclusion and recommendation

Based on the results and discussion, the following conclusions can be presented. First, service quality has an influence on marketing mix strategies, meaning the application of service quality according to customer needs will create satisfaction. In other words, the better the quality of service provided, the higher the customer satisfaction will be. Second, quality of service provides a direct influence in creating a sustainable local economy, meaning that improving service quality to understand customer needs can enhance sustainable economic growth and competitive advantage through marketing mix strategies. This means that improving service quality in accordance with customer needs will improve the marketing mix strategy leading to a sustainable local economy. Third, the marketing mix strategy has a positive influence on the sustainable local economy, meaning that the higher the marketing mix strategy, the better the strategy for sustainable economic growth and competitive advantage will be.

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Some suggestions were submitted based on the results of this study. First, to increase satisfaction and loyalty of MSME customers in Indonesia, especially in Java and Sumatra, the quality of services provided by MSMEs must be improved. Second, in an effort to improve service quality, implementation of satisfaction, sustainable economic growth and competitive advantage must be done. Companies that have better prospects are those aware of their weak points and respond with immediate improvements. This means that in order to improve the marketing mix strategy, improving service quality is a very important effort. Third, management of MSMEs must pay attention to specific service processes that have relationships with customers to maintain and enhance sustainable economic growth through improving service quality, and to increase customer trust through programs offered by MSMEs, such as convenient administrative services, increased connection or increased mobility.

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**Corresponding author**

Srinita Syapsan can be contacted at: [srinita.unsyiah.jp@gmail.com](mailto:srinita.unsyiah.jp@gmail.com)

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