
The Role of Strategic Planning and Flexibility in Shaping SMEs Market Orientation in Turbulence Business Environment

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Abstract:

This study aims to investigate the impact of environmental turbulence, strategic planning and strategic flexibility toward market orientation. One hundred and eighty-six managers of Small and Medium Enterprises in Malang City, Indonesia were surveyed by using purposive sampling technique.

Data was analysed by using Partial Least Squares. Internal environment has positive significant effects on both strategic planning and strategic flexibility. This study also found a significant effect of external environment on strategic flexibility and strategic planning.

The study determined that strategic planning played an important role in mediating the effect of business performance on market orientation. The model is considered a comprehensive model because it was not only analysing important constructs namely external and internal environment, strategic planning and strategic flexibility, but also tested the interrelationships among these constructs in predicting market orientation.

The study also provides empirical evident about the mediation role of strategic planning on the effect of external environment on market orientation and also on the mediating role of strategic planning on the relationship between internal environment on market orientation.

Keywords: *Internal environment, external environment, strategic planning, strategic flexibility, market orientation.*

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1. Introduction

Small and Medium Enterprises (SMEs) have been recognized as an important part in the national economy, especially in the developing countries. SMEs are proven to have strategic roles in national economy because its resilience in facing the various kind of crisis and its labour-intensive characteristic. The ability of SMEs to absorb labour is very useful in providing employment opportunities (Hapsari *et al.*, 2014). From the statistical data obtained from BPS, in 2012 SMEs absorbed 97.16% of the total industrial workforce in Indonesia or equal to 107.66 million people. Furthermore, SMEs in Indonesia, are considered as the largest contributors to Indonesia's GDP.

Although it has been acknowledged that SMEs have an important role in the national economy, research and experts mentioned that SMEs in Indonesia have various problems (Fatimah & Darna, 2011) that might affect SMEs' performance. Hapsari (2014) explains that capital, marketing and operations are the problems that are usually SMEs faced in Indonesia. In the domain of marketing studies, market driven strategy is believed to have an impact on overall business performance. Scholars (Javalgi, Whipple, Ghosh, & Young, 2005; Mandhachitara & Allapach, 2017; Montiel-Campos, 2018) explained that the more a company is market-oriented, the higher the company's performance will be. Thus, every business organization needs to put their market orientation on the top priority.

The study of Becherer, Halstead, and Haynes (2001) showed that business organizations can be more focused to market orientation when they are fully supported by internal environment especially from the employees. Similar to Becherer *et al.* (2001), Kohli and Jaworski (1990) explained that internal environment consisting senior management, interaction among departments and organizational system played essential roles in affecting market orientation. Apart from internal environment, external environment is also found to have an essential effect in shaping market-driven strategy. Scholars (Dobscha, Mentzer, & Littlefield, 2015; Jabeen, Aliyu, & Mahmood, 2016) noted that by having force from external factors, business organization would be more market oriented. Other scholars suggested the important of both internal (Becherer *et al.*, 2001; Kohli & Jaworski, 1990) and external (Dobscha *et al.*, 2015; Jabeen *et al.*, 2016) environment have significant effects on market orientation, a theoretical gap was found in the existing literature. The gap is about the unclear relationship between environment and market orientation. Reflecting system paradigm stating that a system consists of input – process – output, there is a missing link between business environment and business performance. In this circumstance, business environment was considered as an input while market orientation is recognized as an output.

Thus, there is a need to integrate other variables that can be regarded as a 'process' variable that will explain about how the environment can be a booster to strengthening SMEs market orientation. To fill this gap, this study proposed that the

notion of strategic flexibility and strategic planning can explain the process on how internal and external environment can affect market orientation. The notion of strategic flexibility and strategic planning are based on resource advantage theory of competition (Hunt & Morgan, 1996) explaining that management has a role to recognize, understand, create, select, implement and modify strategies. In accord to this theory, scholars (Nadkarni & Narayanan, 2007; Worren, Moore, & Cardona, 2002) empirically found that the flexibility of strategy plays a huge role in improving business performance through the enhancement of market-driven strategy. Similar to strategic flexibility, scholars such as Dibrell, Down, and Bull (2007) and Pulendran, Speed, and Widing (2003) showed the significant effect of strategic planning on market orientation. These studies claimed that the better strategic planning created by the firms were, the more firms will be market oriented.

Based on the identified research gap, this study aims to determine the relationships among business environment, strategic flexibility, strategic planning and market orientation; and to scrutinize the mediating role of strategic planning and flexibility in the relationship between business environment and market orientation. Upon the completion of these research objectives, this study provides both theoretical and practical contributions. For theoretical standpoint, this study creates a conceptual framework explaining the interrelationships among business environment, strategic flexibility, strategic planning and market orientation. For practical contribution, this study can be a guideline for business practitioners in enhancing market-driven strategy.

2. Literature Review

2.1 Market Orientation

Uncles (2000) noted that market orientation is a process and activity related to customer creation and satisfaction by continuing to assess customer needs and desires. Implementation of market orientation will bring improved performance for the company, with the existence of this information, the seller will understand who the potential customers are now and, in the future, and what they want for now and in the future. Even though market orientation is recognized as an essential factor determining firm performance (Wang, Chen, & Chen, 2012), the research in exploring the antecedents of market orientation is remain inconsistency (Verhees & Meulenbergh, 2004; Yen-Chun, Adriana Amaya, & Wann-Yih, 2017; Zaman, Javaid, Arshad, & Bibi, 2012).

2.2 External and Internal Environment

According to Kotler and Armstrong (2010) external environment defined as an indirect factor that is outside the control or market control. These factors make marketers or companies adjust to the environment in terms of maintaining products or finding solutions so that consumers become loyal to the company's products. The

success of the company does not escape from several chains of suppliers, companies, marketing or intermediaries; those customers are the core of a company's marketing system (external environment). While the Internal Environment is the company's internal activities that can be controlled. Thus, in order to achieve the objectives and implement a marketing strategy, marketers should be able to control or regulate the operations of these activities as desired by the company. The internal environment is universal covering all functions performed by each business.

According to Sun, Yao, Zhang, Chen, and Liu (2016) and Navarro-García, Arenas-Gaitán, and Rondán-Cataluña (2014) environmental uncertainty is positively related to strategic planning and market oriented. The environmental turbulence will lead to better market orientation and strategic planning. Furthermore, under the uncertainty condition of environment, business organizations must ensure that they have strategic flexibility. Strategic flexibility is essential in order to certify that the strategic is flexible enough to be implemented under various condition of environments. Thus, the hypotheses are formulated as follows:

- H1: External environment has positive and significant effect on strategic planning.*
- H2: Internal environment has positive and significant effect on strategic planning.*
- H3: External environment has positive and significant effect on strategic flexibility.*
- H4: Internal environment has positive and significant effect on strategic flexibility.*
- H5: External environment has positive and significant effect on market orientation.*
- H6: Internal environment has positive and significant effect on market orientation.*

2.3 Strategic Planning

Planning is defined as the selection of the set of activities and disconnections what to do, when, how and by whom (5 W + 1 H). Environmental factors, which connote that the strength of the external environment has a positive impact on organizational performance and thus, the use of strategic environmental scans in evaluating the strengths of the external environment (opportunities and threats) helps in seizing opportunities and avoiding threats and leading to organizational profitability. Therefore, because the findings show a positive signal, the researcher recommends that organizations must be strategic, periodic, and continuously involved in strategic environmental scans and pay attention to threats (to avoid) and opportunities (to seize) in the environment. Planning must consider the need for flexibility, in order to be able to adjust to new situations and conditions as quickly as possible (Stoner, 2006). Thus, the hypothesis is formulated as:

- H7: Strategic planning has positive and significant effect on market orientation.*

2.4 Strategic flexibility

Changes that occur in the business environment lead to changes in consumer needs, intensity of competition, crisis, and enhancing technological developments. In these

conditions, businesses must have several different strategies and policies to deal with uncertainty and change. Organizational flexibility includes three different levels: operational, tactical, and strategic levels. Strategy flexibility is defined as long-term flexibility that emphasizes the ability of a business to identify, formulate and manage various choices of strategies in the face of change and uncertainty (Evan, 1991; Johnson, Lee, Saini, & Grohmann, 2003).

According to Shimizu and Hitt (2004), the flexibility of strategy is the ability of an organization to recognize changes coming from the external environment and use resources to take steps in a timely and immediate manner. The flexibility of strategy not only affects the ability of a business to survive change, but will affect the performance of business innovation (Nadkarni and Herrmann, 2010) and knowledge management (Zhou & Wu, 2010). According to Dibrell, Craig, and Neubaum (2014) a company need to set a 'fix point' in order to evaluate if the chosen strategy can be implemented or it need to be improved. Strategic flexibility practice as a response of the dynamic environment (including the dynamic of consumer environment) will strengthen company's market orientation. Thus, the hypothesis is formulated:

H8: Strategic flexibility has positive and significant effect on market orientation.

Apart from the direct effect among constructs there are also indirect effects. To be more focus on market, a business organization need to have understanding about the dynamic environment and good internal management process that will lead them to have a strong strategic planning. By having good strategic planning, the business organization can be more focus its consumers. In addition, when a company have a strong strategic planning process, it will enhance its strategic flexibility, and finally will enhance its market orientation Dibrell *et al.* (2014). Thus, the hypothesis is formulated as:

H9: Strategic Flexibility mediates the effect of external environment on market orientation.

H10: Strategic Flexibility mediates the effect of external environment on market orientation.

H11: Strategic Planning mediates the effect of external environment on market orientation.

H12: Strategic planning mediates the effect of internal environment on market orientation.

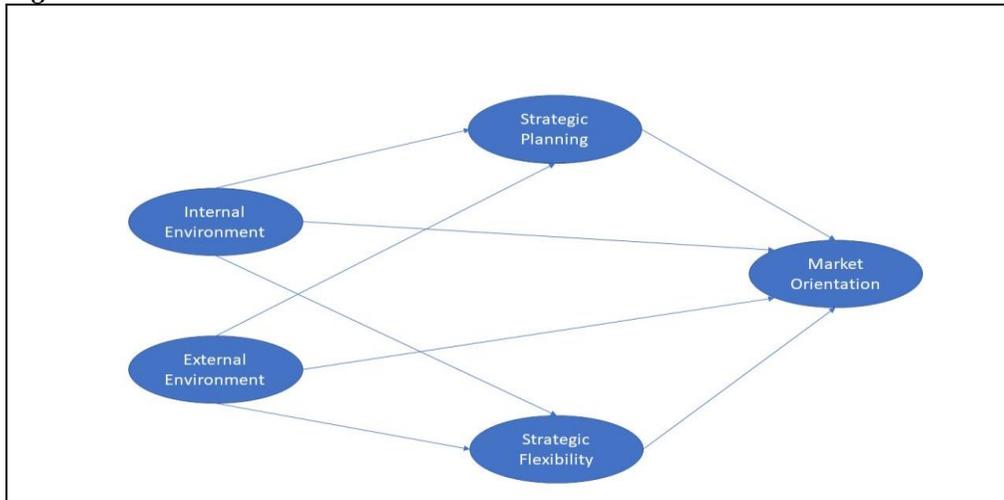
The research model is displayed by the figure below:

3. Research Method

3.1 Research Design

To answer the research objectives, this research was designed using a quantitative approach. Quantitative research design was chosen because this research is a basic research. This study aims to examine the causal effects of exogenous variables on endogenous variables.

Figure 1. Research Model



In determining the measurement, a literature review is conducted. After reviewing the literature, several hypotheses were formulated. As this study built a relatively complex model, Structural Equation Modelling (SEM) technique was used to analyse data. In using SEM techniques, three evaluation stages will be carried out in this study. The first step is to analyse the measurements used. The evaluations carried out included evaluating convergent validity, discriminant validity and the dimensionality of the construct. The second step is to evaluate the structural model. Structural model analysis is done by looking at the coefficient of total determination and goodness of fit model. The third step is testing the hypothesis of both direct and indirect effects. Indirect influence was tested using the Sobel test. For testing the hypothesis, alpha was determined at 5% level with $t = 1.960$ (Hair *et al.*, 2010).

3.2 Population and Sample

The unit of analysis of this study is the SME processing industry sector in the city of Malang. Therefore, the population of this study is all owners or managers of SMEs in the manufacturing industry in Malang. Based on this population, samples from this study can be categorized as nonprobability sampling. This is because there is no knowledge of the exact number of members of the population even though the data from related parties is known. Therefore, the sampling method used is purposive sampling. In using purposive sampling two criteria were employed. They are 1) The business surveyed has a minimum legal entity of an individual company and 2) in the last five years it has been operating for at least three consecutive years.

3.3 Measures

The questionnaire used in this study was divided into two sections. The first section asked about respondent demographic profiles and the second section asked about the variables measured in this study. For internal and external environment the items were adapted from Handriani (2011) and Wang *et al.* (2012), strategic planning was adapted from Eddleston, Kellermanns, and Sarathy (2008) and Nadkarni and Narayanan (2007), strategic flexibility was adapted from Feifei (2012) and market orientation was adapted from Lee, Kim, Seo, and Hight (2015). For the second section, five points Likert-scale anchored between strongly disagree (1) and strongly (5) agree was used to measure the variables.

3.4 Data Analysis

Partial Least Squares with smart PLS 3.2.7 was used to analyse the data. Prior testing the hypothesis, both outer and inner model evaluation were conducted to convince the robustness of measures used and the proposed model. For this study, outer model evaluation was conducted to the evaluation of convergent validity, discriminant validity and reliability. Inner model evaluation was evaluated through the score of GoF, Q^2 and f^2 . Hypothesis was tested by using alpha 5% ($t = 1.960$).

4. Findings

4.1 Demographic Characteristics

Two hundred self-administered questionnaires were distributed into the owners of small business in the sector of manufactures in Malang City. However, only 186 questionnaires were able to analyse yielded 93% response rate. The following demographic profiles were: 59% are male, 36% are aged between 46 and 55, 57% have tertiary education background and 42% have operated the business between 3 and 5 years. Table 1 showed the detail profile of respondents.

Table 1. Respondents Demographic

Variable	Indicator	F	Percentage
Gender	Male	110	59%
	Female	76	41%
Age	18-25	12	6%
	26-35	23	12%
	36-45	48	26%
	46-55	67	36%
	more than 55	36	19%
Education	High school	58	31%
	Diploma	88	47%
	Bachelor	19	10%
	Postgraduate	21	11%

	Doctoral	0	0%
Business period	3-5 years	79	42%
	6-10 years	45	24%
	11-15 years	27	15%
	>15 years	34	18%

4.2 Outer Model Evaluation

Outer model evaluation was conducted to examine the robustness of measures used. Three indicators were evaluated to examine the outer model. They are convergent validity, discriminant validity and uni-dimensionality. Following Chin (2010) suggestion, convergent validity was reflected by the score of outer loading. To be free from convergent validity problems, an item must have outer loading above 0.5 (Hair, Black, & Babin, 2010). For this study, the initial evaluation showed that item INT4, INT6, INT12, INT13, EXT6, SF1, SF2 and MO6 have outer loading below 0.5. Thus, these items were excluded from the model. The second evaluation showed that all items have outer loading above 0.5. Hence, there are no convergent validity problems faced by this study. Apart from the score of outer loading, to evaluate the convergent validity, this study refers into the score of Average Variance Extracted (AVE). Chin (2010) suggested that the score of AVE should be above 0.5. For this study, the score of AVE for each construct has been above 0.5 except the construct of internal environment (AVE = 0.417). However, as the score of outer loading for this construct has been more than 0.5, it is considered that there is no convergent validity problem. Table 2. Summarizes the score of convergent validity analysis.

Table 2. Convergent Validity Test

Code	Outer Loading	AVE	Composite Reliability
EXT1	0,821	0.510	0.836
EXT2	0,798		
EXT3	0,731		
EXT4	0,556		
EXT5	0,626		
INT1	0,669	0.417	0.864
INT2	0,647		
INT3	0,598		
INT5	0,535		
INT7	0,676		
INT8	0,715		
INT9	0,708		
INT10	0,568		
INT11	0,668		
MO1	0,601		
MO2	0,748		
MO3	0,845		
MO4	0,796		

MO5	0,778		
SF3	0,609	0.538	0.817
SF4	0,526		
SF5	0,872		
SF6	0,863		
SP1	0,869	0.749	0.922
SP2	0,914		
SP3	0,883		
SP4	0,790		

The second outer model evaluation was discriminant validity. To test the discriminant validity, this study followed Fornell and Larcker (1981) criterion. According to this criterion, the square root of AVE must be higher than the correlation among constructs. Refer to this criterion, there is no discriminant validity problem identified in this study. Uni-dimensionality test was conducted to ensure that the constructs used in this study are uni-dimension. To be uni-dimension, a construct must have composite reliability above 0.7. The PLS estimation showed that the score of composite reliability for this study varies between 0.817 and 0.922. Thus, all constructs are uni-dimension. Table 3 showed the discriminant validity.

Table 3. Discriminant Validity Test

Construct	Correlation and Discriminant Validity				
	External Environment	Internal Environment	Market Orientation	Strategic Flexibility	Strategic Planning
External Environment	(0,714)				
Internal Environment	0,644	(0,645)			
Market Orientation	0,591	0,530	(0,758)		
Strategic Flexibility	0,470	0,546	0,436	(0,734)	
Strategic Planning	0,551	0,636	0,624	0,707	(0,865)

4.3 Inner Model Evaluation

Inner model evaluation was tested through the score of coefficients of determination (R^2), predictive relevance (Q^2) and Goodness of Fit (GoF). Following Hair *et al.* (2010) the score of R^2 is categorized as strong ($R^2 = 0.75$), medium ($R^2 = 0.50$) and weak ($R^2 = 0.25$). In this study, the score of R^2 varies between 0.322 and 0.482.

Thus, the coefficient determination for this study is considered weak to medium. Predictive relevance is the second indicator to examine inner model evaluation. A construct should have Q^2 greater than zero ($Q^2 > 0$) to have a predictive relevance. For this study, all constructs have predictive relevance greater than zero. Refer to Cohen (1988) suggestion about effect size, GoF value 0.10 is considered small, GoF score 0.25 is medium and GoF 0.36 is large. For this study, the value of GoF is 0.479 which is considered as large. Based on the inner model evaluation, it can be concluded that then structural model is robust, and the proposed hypotheses might be tested.

4.4 Hypothesis Test

Hypothesis 1 proposed that external environment has a positive significant effect on strategic flexibility. The statistical estimation showed that external environment has a positive significant effect on strategic flexibility ($\beta = 0.201$; $t = 2.611$). It means hypothesis 1 is supported. Similar to the effect of external environment on strategic flexibility, this study found the effect of internal environment on strategic flexibility ($\beta = 0.417$; $t = 6.028$). This finding means hypothesis 2 is supported. Those findings imply that environmental uncertainty that is faced by business organizations will force them to be more flexible in using the resources and be more flexible in applying the chosen strategies.

Apart from its effect on strategic flexibility, this study predicted the significant effect of external environment on strategic planning as proposed by hypothesis 3. The hypothesis test found that there is a positive significant effect of external environment on strategic planning ($\beta = 0.241$; $t = 3.765$). It supported hypothesis 3. Similar to external environment, this study showed that internal environment positively affected strategic planning ($\beta = 0.481$; $t = 7.508$) which means hypothesis 4 is supported.

Hypothesis 5 proposed the effect of strategic planning on market orientation. The estimation found that market orientation was significantly affected by strategic planning ($\beta = 0.451$; $t = 5.349$). It means hypothesis 5 is supported. While market orientation was affected by strategic planning, this study did not find the significant effect of strategic flexibility on market orientation as proposed by hypothesis 6. The effect of both external and internal environments on market orientation was predicted by hypothesis 7 and 8 respectively. Based on the statistical calculation, it was found that only external environment has a positive effect on market orientation ($\beta = 0.334$; $t = 4.429$) as suggested by hypothesis 7.

Hypothesis 9 and 10 proposed the mediating effect of strategic flexibility. However, the mediation test analysis showed that strategic flexibility does not mediate both external and internal environment on market orientation. Thus, hypothesis 9 and 10 were not supported. While strategic flexibility do not have mediating effects, this

study found that strategic planning significantly mediated the effect of external and internal environment on market orientation as proposed by hypothesis 11 ($\beta = 0.109$; $t = 3.115$) and 12 ($\beta = 0.217$; $t = 3.958$) respectively.

4.5 Theoretical and Practical Implications

Two research objectives were addressed by this study. The first objective determined the direct relationships among business environment, strategic flexibility, strategic planning and market orientation. The second objective identified the mediating role of both strategic flexibility and strategic planning in the relationship between business environment and market orientation. To answer these two objectives, this study developed 12 hypotheses. The following sections discuss the results of hypotheses tests.

As part of business environment, external environment was found to have a significant effect on strategic planning. This finding strengthens the previous studies (Boulton, Lindsay, Franklin, & Rue, 1982; Grant, 2003) declared the effect of external environment in formulating strategic planning. Practically, this finding means SME should be more focus on their strategic planning in the middle of market turbulence. As the external environment fluctuation has an essential effect in strategic planning formulation, this study also found the effect on internal environment on strategic planning process. The stronger internal organization is, the more focus strategic planning formulated by the SMEs will be. Theoretically, this finding supported the study of Calantone, Garcia, and Dröge (2003) and Hendrick (2003) who revealed the similar finding.

Apart from its effect on strategic planning process, external environment was found to have an important role in affecting business strategic flexibility. This result validates previous studies exposing similar finding (Abbott & Banerji, 2003; Pagell & Krause, 2004). The effect of external environment on strategic flexibility means the stronger market turbulence faced by a business organization is, the more flexible strategy generated will be.

To have a flexible strategy, external environment is not the only business environment element having an essential role as this study also disclose the effect of internal environment on strategic flexibility. This finding showed that SMEs would have a flexible strategy upon the support of strong organization. It supports Gilaninia, Ganjinia, Karimi, and Review (2013) thought about the effect of organizational learning as part of internal environment on strategic flexibility.

As market orientation is considered as important notion in marketing field, some studies have tried to identify the determinants of this construct. This study found that external environment has a significant effect on market orientation. This significant effect means, SMEs will be more market oriented in the unpredictable situation. In this kind of circumstances, market and technology situation will be fluctuated and

change rapidly. Hence, business organization should be always focussed in serving the customers or market in order to win the competition in the industry. This result in accordance with the previous study which also found the effect of external environment on market orientation (Connor, 2007; Qureshi & Mian, 2010).

While the unpredictable situation leads to the market-based orientation, this study found that internal environment does not have any effects in shaping market orientation. This insignificant effect possibly happens as in affecting market orientation; internal environment must be mediated by other variables. Moreover, the other reason explaining this insignificant effect is about the scope of internal environment. The scope of internal environment is related to the internal business strengths and weaknesses. It does not discuss about the opportunities faced. To be market oriented, SMEs must be able to identify their market and opportunities provided by the market. Thus, it causes internal environment does not directly affect market orientation.

Theoretically, strategic planning process is crucial for a business organization (Hendrick, 2003). Strategic planning process will help business organization in directing the target market. In accord to the theory, this study showed that strategic planning process has a significant effect on market orientation. This finding strengthens previous studies (Pulendran, Widing, & Speed, 2003; Speed, 1996) which found the effect of strategic planning on market orientation. Although strategic planning plays an important role in shaping SMEs market orientation, this study did not find the effect of strategic flexibility on market orientation. Flexible strategy is essential for business organization especially in increasing business performance (Chan, Ngai, & Moon, 2017) and competitiveness (Kaur, Kumar, & Kumar, 2017). However, in determining market orientation, a business organization needs to have a fix plan. In this situation, strategic flexibility is needed to make a plan adjustment upon the implementation of the plan.

As an essential determinant of market orientation, this study indicated that strategic planning significantly mediate the effect of internal environment on market orientation. This mediating effect explains the insignificant effect of internal environment on market orientation. This finding indicates that in affecting market orientation, internal environment will affect strategic planning which finally lead to market orientation. This mediating effect is considered as full mediation.

Besides its mediating effect in the relationship between internal environment and market orientation, strategic planning also mediates the effect of external environment on market orientation. As external environment has a direct significant effect on market orientation, this effect is considered as partial mediation. Hence, the total effect of external environment on market orientation is the sum between the direct effect and indirect effect. Upon the completion of these research objectives, this study contributes both theoretical and practical standpoint. The first theoretical contribution is a comprehensive model explaining the relationship among external

environment, internal environment, strategic planning and strategic flexibility in shaping Indonesian SMEs market orientation. The model is considered a comprehensive model because this model was not only analysing important constructs namely external and internal environment, strategic planning and strategic flexibility, but also tested the interrelationships among these constructs in predicting market orientation. The second contribution regarding the mediating role of strategic planning in the relationship between business environment and market orientation.

This study indicates that strategic planning is not only having an important role in affecting market orientation, but also mediates the effect of both internal and external environments on market orientation. Specifically, strategic planning partially mediates the effect of external environment on market orientation as external environment has a direct effect in market orientation while strategic planning provides full mediation in the relationship between internal environment and market orientation. This full mediation occurs as internal environment does not have a direct effect on market orientation.

For practical implication, this study provides a guideline for Indonesian SMEs in shaping market orientation. This study validates that SMEs must give concern to the business environment as external and internal environment played important roles in enhancing strategic planning and strategic flexibility. In addition, practically, this study suggested to Indonesian SMEs to enhance their strategic planning since strategic planning is important in shaping market orientation.

4.6 Limitation and Direction for Future Research

This study employed convenience sampling technique that makes the results of this study cannot be easily generalized. Furthermore, this study focusses on SMEs in manufacture sector. The results between small and medium enterprises might be different, but this study did not analyse the data based on the firm size. Thus, comparison analyses of the impact of environmental turbulence, strategic planning and strategic flexibility toward market orientation based on the firm size is essential to be done. Business organization will get benefits by knowing the impact of strategic flexibility and strategic planning toward firm performance as proven by this research. However, this research only focusses on manufacture sector. As the characteristics of every industry is different, there might be a need to test the model on other settings or other industries.

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