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ROLE OF INNOVATION CAPABILITY IN INCREASING SHAREHOLDER VALUE (SALES GROWTH AS INTERVENING VARIABLE)

Masmira Kurniawati
Faculty of Economics and Business, UniversitasAirlangga, masmira_k@yahoo.com

Abstract

This study aims to demonstrate that innovation capability as one of companies' marketing capabilities has an important role in increasing shareholder value through superior market performance, i.e. the sales growth. Recently, there has been increasing number of researches conducted in investigating the link between marketing performance and stock market performance in Indonesia. These are very important especially for companies listed in Indonesia Stock Exchange. In general, this study tries to develop, test, and find empirical support the relationship between innovation capabilities and shareholder value. The data used are secondary data from the financial statements of Unilever Company. Data were analyzed using mediation analysis suggested by Baron and Kenny (1986). The results of this study provide insight about the relationship between innovation capability and shareholder value. Managerial implications and suggestions for future research will then be delivered.

Keywords: Innovation capability, Sales growth, Shareholder value.

Abstrak

Penelitian ini bertujuan untuk menunjukkan bahwa kapabilitas di bidang pemasaran yang dimiliki oleh perusahaan seperti kapabilitas inovasi memiliki peran penting dalam meningkatkan nilai yang diterima oleh para pemegangsaham (*shareholder value*/SHV) melaluikinerjapasar yang superior, yakni pertumbuhanpenjualan. Selamaini, terutama di Indonesia, belum banyak penelitian yang menghubungkan kinerja pemasaran dengan kinerja pasar modal padahal hal ini sangat penting terutama bagi perusahaan yang telah terdaftar pada Bursa Efek Indonesia. Secara umum, penelitian ini mencoba untuk mengembangkan, menguji, dan berusaha untuk menemukan dukungan empiris bahwa terdapat hubungan positif antara kapabilitas inovasi dengan *shareholder value*. Data yang digunakan adalah data sekunder berupa laporankeuangan perusahaan PT Unilever.Analisis data menggunakan metode Baron dan Kenny (1986). Hasil penelitian ini memberikan dukungan terhadap hubungan antara kapabilitas inovasi dan *shareholder value*. Pada akhir artikel ini disampaikan implikasi manajerial dan saran penelitian di masa mendatang.

Kata kunci: Kapabilitas inovasi, Pertumbuhan penjualan, *Shareholder value*.

JEL Classification : G30, G32

1. Research Background

Innovation capability is one of the key success components in the company. Innovation capability is related to the company's capacity to engage in innovation activities, i.e.: the processes, products, or new ideas development in the organization. This innovation capability is one of the important factors that affect the company's business performance (Hurley, Hult, and Thomas, 1998; Porter, 1990). Through this innovation capability, companies can then search for a solution to the problems and challenges they face as well as a basis for the company to survive and excel in competition today and in the future. The logical consequence of this innovation capability, naturally,is a positive sales growth.

Eventhough profit will follow the new products development which come from innovation, some challenges and risks also accompany this activity. But in general, many scholars agree that the company's ability to innovate will improve the company'sperformance, whether it is measured objectively through financial side, efficiency, or subjectively by the company manager (Vincent et al. 2004).

Most researches on innovation link innovation activities with marketing performance (Aydin, Cetin, and Ozer, 2007; Calantone, Cavusgil, and Zhao, 2002; Hult, Hurley, and Knight, 2004; Rhee et al. 2009; Thornhil, 2006). However, only few studies linking company's performance with shareholder value (SHV). Determining the relationship between marketing performance (in thisstudyismeasuredthrough sales growth) and its contribution to the SHV is important because marketing academics and practitioners have long been challenged to demonstrate the contribution of marketing to SHV. In particular, Rust et al. (2004) stated that there is an urgent need to show how marketing cancontribute to SHV, because the perception of the lack of accountability of marketing has reduced the credibility of marketing, threaten marketing function in the company, and even threaten the existence of marketing as a unique capability in the company.

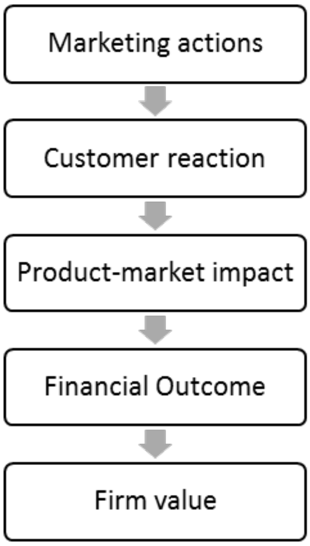

Figure 1. Marketing Prouctivity Chain

Source: Lehmann (2004)

Srivastava, Shervani, and Fahey (1998) in their classic article stated that SHV will be affected by market performance. Lehmann (2004) also stated his opinion on the marketing productivity chain that now marketing is more focus on first levels of marketing productivity chain. This was shown by the considerable attention given by the marketers in the field to market products (such as sales or marketshare). The relationship between marketing activity and SHV rarely gets attention whereas current market phenomena show a link between product market and capital market (Figure 1).

Therefore, this study attempts to show that the marketing activities, such as innovation activities will ultimately contribute to SHV. It becomes more important, especially for companies that have listed their shares on the stock exchange to account for the use of funds raised from investors by showing that the activity of the company, especially marketing activities, can affect the wealth of shareholders.

1.1. Innovation Capability and Sales Growth

In order to survive in today's competitive environment, companies must have a high innovation capability for innovation will help the company to meet the needs of consumers better, develop new products to meet consumer demand, find new markets for theirproducts, diversify markets and products with superior quality in order to compete in the market (Aydin, Cetin, and Ozer, 2007; Sok, O'Cass, and Sok, 2013). Hence, innovation is a process in which the company will produce a product, service, or process in which they will contribute to the economy of the company while providing more value for customers. While O'cass and Sok (2012) defined innovation capability as the bundle of interrelated processes a firm has in place to facilitate and implement successful development, evolution, and execution of product innovation.

Furthermore, Choi and Williams (2014) stated that depth of innovation can drive sales growth in a number of ways. First and foremost, depth of innovation has been shown to have a positive influence on new product introductions (Katila and Ahuja, 2002). New product introductions are in turn an important driver of new sales and firm growth (Bayus, Erickson, and Jacobson, 2003). Second, through specialization, a firm can develop scale economies in learning by applying one innovation experience to another (Stuart and Podolny, 1996; Von Hippel, 1998). This specialized learning helps to lower the risk inherent in the innovation process and reduces technological defects in new products. Third, specialization enables the firm to develop and maintain a core competence in a specific domain. This focus on core competence is an important source of competitive advantage (Hamel and Prahalad, 1994).

Based on the arguments above, it can be concluded that innovation capabilities will enable company to produce better goods or services offered to consumers which are expected to provide a significant economic contribution to the company. Thus hypothesis 1:

H1 : Innovation capability affects sales growth.

1.2. Sales Growth and SHV

Marketing has a central role in any companies (Venkatesh and Penaloza, 2006) and from the standpoint of marketing, innovation is a very important research issue (Hauser, Tellisand Griffin, 2006). Thus, at the strategic level, marketing capabilities as the spearhead of the company should be able to sense, learn and act in anticipating trends and market dynamics that occur (De Luca and Atuahene-Gima, 2007).

Synergizing with the platform, marketing is required to be able to integrate the business processes management that is directly related to the process of value creation (Varadarajan, 1999). From a marketing perspective, innovation will be able to create a quantum leap in creating customer value. However, not only creating value for customers but the role of marketing in a company is also further challenged with accountability to create shareholder value (Lehmann, 2004). Moreover, business environment has also changed dramatically with the existence of connectivity between product market and capital markets/financial (Lovett and MacDonald, 2005).

As shown in Figure 1, Lehmann (2004) stated that the marketing activity will evoke a reaction from the consumer side where the consumer reaction to company's marketing activities will affect market performance and financial performance. In practice, innovation as marketing activity will produce new products, which are well accepted by consumers because of their superior value. Those good acceptances by customers will result in positive market performance indicated by increasing on sales growth. In the next stage, the company's market performance will contribute to the company's value as an indicator for the value received by the shareholders/investors (SHV). Srivastava et al. (1998) also stated previously that market performance will affect SHV.

Based on the arguments that have been submitted, it can be concluded that market performance, as a result of marketing activity, in turn, would then affect the value received by the shareholders (SHV). Thus H2 and H3:

H2 : Sales growth affects SHV.

H3 : Sales growth mediates the relationship between innovation capability and SHV.

2. Research Method

2.1. Variable Measurement

Innovation capability refers to company's ability and involvement in innovation activities within the company in order to produce value added products to consumers. Innovation capability is measured by R and D intensity as that used by Anderson, Fornell, and Mazvancheryl (2004) and Lue and Donthu (2006) through ratio of R and D expenditure to total assets of period of observation (*RandD expenditure/book value of total asset*$_{t-1}$). Sales growth is the sales movement on a certain period compared with the previous period, measured in percentages. This measurement is adapted from Rao et al. (2004), by comparing sales$_t$ with sales$_{t-1.}$Shareholder value is measured by company's stock price during the period of observation. Period of observation in this study is from 2007 to 2014, from quarter 1 to quarter 4, while the company of interest is Unilever Company. It was difficult to find ISX-listed-company that stated clearly about their RandD budget in annual report. To the author's knowledge, Unilever is the only manufacturing company explicitly declared their RandD budget discretion inannual report. as far as author could find. That is why Unilever Compay was chosen as object of the study.

This study also seeks to examine the mediating effect of a certain variable. To test the mediating variables, the commonly used method is estimating three equations using ordinary least squares regression (Baronand, 1986).

Figure 2. Research Framework

3. Result and Discussion

Acceptance and rejection of hypothesis in this study is based or= 5%. To test the mediating effect of sales growth in the relationship between innovation capability and SHV, based on the method of Baron and Kenny (1986), the regression equations are as follows:

HARGA_SAHAM 01= C(10)+C(11)*R_D_BV_TA01 ……………........… (1)

SALES_GROWTH 01= C(20)+C(21)*R_D_BV_TA01 …....………….. (2)
HARGA_SAHAM 01= C(30)+C(31)*R_D_BV_TA01+C(32) *SALES_GROWTH01.. (3)

While to test hypothesis 2, the equation is as follows:
HARGA_SAHAM 01= C(40)+C(41)*SALES_GROWTH01 ………...... (4)

Where:

HARGA_SAHAM01 = stock price
R_D_BV_TA01 = innovation capability
SALES_GROWTH01 = sales growth
C = constanta

Table 1. Regression Result

	Coefficient	**Prob.**
C(10)	18929.60	0.0000
C(11)	21201.82	0.0463
C(20)	23.66590	0.3358
C(21)	349.6539	0.0241
C(30)	18810.14	0.0000
C(31)	23653.89	0.0009
C(32)	23.51702	0.0300
C(40)	15663.14	0.0000
C(41)	12.10130	0.0119

Based on Table 1, we can see that for the equation (2), the results show that Innovation Capability significantly affect Sales Growth with coefficient 349.65 and prob. 0.0241. Thus, Hypothesis 1: Capability of innovation affect the company's sales growth is supported. This result is in accordance with the opinion of Vincent et al. (2004) which states that innovation is a mechanism in which the organization transforms its core competencies into performance that is critical for success. Fontana (2009) also stated that innovation is the economic and social success due to the introduction of new ways or new combinations of old ways of transforming inputs into outputs that creates a major change in the relationship between value and the price offered to consumers and/or users, community, society, and the environment.

In equation (4), the results show that Sales Growth significantly affect SHV with coefficient 12.10 and prob. 0.0119. Thus, H2: Sales growth affects the SHV is supported. For H3, by using the method suggested by Baron and Kenny (1986), we can see that the effect of each independent variable on dependent variable in equation (1), (2), and (3) show the effect of the significant with coefficient and prob. value respectively: 21201.82 (0.0463); 349.65 (0.0241); 23653.89 (0.0009); 23.52 (0.0300). Thus, it can be concluded that the third hypothesis is supported. The acceptance of Hypothesis 2 and 3 support the idea about the presence of connectivity between product market and financial market, the company's innovation capability to produce new products will also be directly captured as a market signals that will influence the formation of expectations of financial market participants (analyst expectation) in shaping the market capitalization of the company (market value of the firm) (Lovett and MacDonald, 2005). Hence, innovation strategy is very important in transforming the marketing activities at the level of strategic marketing, especially for companies involved in strategic decisions regarding the level of profitability contribution of marketing activity (return on marketing) to the shareholders. This is a manifestation of marketing accountability at the top management level of the company.

4. Conclusion and Implication

Based on the analysis, it can be concluded that the innovation capability significantly affect the company's sales growth, while sales growth significantly affects shareholder value, and sales growth mediates the relationship between innovation capability and shareholder value. These findings confirm that marketing has crucial role in a company as the emergence of existence connectivity between product market and capital market (Lehman, 2004; (Lovett and MacDonald, 2005). These findings also answer challenges for marketing function to prove that marketing has significant contribution in creating shareholder value, not just customer value. Hence, evidently, the company's ability to innovate will help the company to improve its offerings to consumers in the form of better products, that meet consumer needs better, or products that have different characteristics, that are considered superior to consumer product companies. It is, then, in turn will contribute to the creation of SHV.

Recognizing the importance of innovation, managers should give more attention to innovation process in the company. But one thing needs to consider that every company has unique innovation challenge. So, another firm's best innovation practice could become one's worst nightmare (Hansen and Birkinshaw, 2007). On the other hand, managers need to encourage every company's member to come up with new ideas and not to kill them too early. This is the hardest task for managers to beautifully orchestrating innovation process. Hansen and Birkinshaw (2007) viewed innovation as a value chain comprising three phases: idea generation, conversion, and diffusion. Six linking tasks are performed across those phases: internal, external and cross unit collaboration; idea selection and development; and spread of developed ideas. Any weak link could break innovation efforts, so managers need to pinpoint and strengthening weaknesses. Hence, it is important for future research to investigate ways of reducing risks in new product development, i.e. through knowledge management or cross-functional collaboration.

As marketing plays an important role in a business process, future research should emphasize more on how marketing is integrated with other function. It will be interesting for future research to investigate whether the connectivity between product market and capital market has opposite direction that is whether capital market affects product market. For marketing managers, knowing that shareholder value is important, they should start considering cash flow for any decisions they make.

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