

# **THE INFLUENCE OF LEADERSHIP AND PRODUCT INNOVATION ON RURAL BANK PERFORMANCE IN THE PROVINCE OF WEST JAVA, INDONESIA**

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## **Abstract**

*The performance of Rural Bank (Bank Perkreditan Rakyat) in West Java is still below the performance of rural banks in Indonesia, which is reflected in some financial ratios ROA and BOPO as well as credit portfolio that is still below the national's ratio. There was also a decrease in the number of branch offices of rural bank operates in West Java. The condition is assumed to be caused by the problems related to the weak implementation of leadership and product innovation. Thus, this study aims to examine the influence of Leadership and Product Innovation on Rural Bank Performance in West Java Province. The study is conducted through verification research on the unit of analysis Rural Banks in West Java Province, which the*

observation unit is the management of those Rural Bank. Time horizon of this study is the cross section / one shoot, which the hypothesis is examined using the Structural Equation Modeling (SEM). The results show that product innovation has a greater contributions than leadership in influencing the performance of Rural Bank. Then, to improve the performance of Rural Bank in West Java Province, it is needed to support by a better implementation of product innovation and leadership.

**Keywords:** Leadership, Product Innovation, Company Performance, Rural Bank, SEM

## INTRODUCTION

The performance of Rural Bank in West Java Province is still below the National, which is viewed from two components: The ratio of profit to average assets in the last 12 months (ROA). This ratio indicates the ability of the management of bank assets to generate earnings. And, the ratio of operating expenses to operating income in the last 12 months (BOPO). This ratio shows the level of efficiency in the management of bank operations

Data shows that from 2008 until November 2014, despite the improvement, however ROA and BOPO of Rural Bank in West Java is always under the National with ROA is 2.75% and 2.16% in 2014 and BOPO is 85.72% and 80.16 %. This shows that in that period, the Rural Bank management capabilities in West Java province in conducting financial management remains below the national. In addition, the credit portfolio in West Java is still below the national, this is reflected in the high non-performing loan (NPL) from 2009 until the end of November 2014, with the NPL of 6.71% (November, 2014). From the above data is suppose there is a problem in the performance of the Rural Bank in West Java province. Data on the performance of Rural Bank in West Java related to finance, is figured out below :

Table 1: Financial Performance of the Rural Bank in West Java Province and National

<b>Periode 2008 s.d November 2014</b>							
	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>Nov. 2014</b>
	%	%	%	%	%	%	%
<b>JAWA BARAT</b>							
LDR	79.29%	72.42%	73.43%	76.04%	74.11%	81.70%	80.27%
BOPO	86.92%	87.01%	85.51%	85.79%	84.67%	83.65%	85.72%
ROA	2.58%	2.75%	2.93%	2.73%	2.83%	2.88%	2.75%
NPL	9.24%	8.68%	7.28%	6.46%	6.36%	5.69%	6.71%
<b>NASIONAL</b>							
LDR	82.58%	79.61%	79.02%	78.54%	78.63%	84.26%	82.96%
BOPO	82.82%	81.82%	80.97%	79.47%	77.77%	77.65%	80.16%
ROA	2.62%	3.09%	3.16%	3.32%	3.46%	3.38%	3.16%
NPL	9.88%	6.90%	6.12%	5.22%	4.75%	4.45%	5.40%

Source: Financial Statistical Data of Indonesian Bank (2015)

Although Rural Bank's financial performance generally tends to improve, but this is not in line with growth in the number of Rural Bank which showed a downward trend from year to year, both nationally and in West Java. This is due to merger / consolidation of the Rural Bank and also because of liquidation. Total Rural Bank liquidated from 2006 until 2015, based on data from the Deposit Insurance Agency (LPS) of all Rural Banks liquidated (61 Rural Bank) in each of the province, 21 of which are in West Java, 11 are in West Sumatra, and the rest 29 spread in other provinces. If related to population in West Java increased high enough, should it give rise to the Rural Bank in West Java province to be successful is higher, given the broader market share.

Based on data from the Central Bureau of Statistics is known that the Province of West Java is the most populous province in Indonesia, with a population of 43,227,100 inhabitants in 2010 and increased in 2015 to about 46.7096 million inhabitants. Rural Bank growth in West Java province should increase its performance, with the growth of population in the province. Given the market share of Rural Bank or SMEs in the region.

The problems of performance of Rural Bank in West Java province is reinforced by the data reduction in the number of Rural Bank's office in the province. The number of Rural Bank's office in West Java until 2014 as many as 300 rural banks, which decreased from the year 2008 as many as 105 units (25.93%). The percentage decline is far greater than the national decline are 134 Rural Bank (7.57%).

The phenomenon of other issues that could be assessed on the performance of BPR in West Java province is on the growth of third party fund that gradually experienced a slowing growth of 25.70% in 2009 to 14.50% in October 2014. It is also apparent decline assets owned by Rural Bank in West Java, which experienced a gradual decline in growth of 20.33% in 2009 to 13.18% in October 2014.

Rural Bank performance in West Java province which has not been optimal, presumably because the management has not had an effective leadership. Related to leadership, Robbins (2006) delivered three styles of leadership, consisting of: a) leader-member relations, b) task-structure, and c) leader's position power.

The indications of weak leadership of Rural Bank in West Java province is characterized by the findings of a BI stating poor management of Human Resources in Rural Bank. Especially for human resources in Rural Bank West Java province, where in 2015 the FSA (Financial Service Authority) still lend a hand in providing training to the Human resources of Rural Bank, in suppressing the low NPL. This confirms the weak leadership in human resources of Rural Bank in West Java province in leading HR.

Another indications alleged problem related to the performance of the company is the product innovation that is not high yet. The products of rural bank commonly offered are generally the same as the commercial banks include deposits and loans. However, this product has not been enough to attract people. Ar & Tray (2011, p.175) suggests some dimensions in product innovation, namely: 1) R & D Strategy, 2) Top Management Support, 3) Customer Focus, 4) Organizational Learning Capability, 5) Creative Capability, 6) Organizational Collaboration AND 7) Supplier Relationship.

Based on this background, this study intends to examine the influence of leadership and product innovation on the performance of Rural Bank in West Java.

## LITERATURE STUDIES

Leadership has an important role in creating product innovation (Birasnav, 2012). Birasnav (2014) in the latest journal stated that *“interpersonal influence exercised in situations and directed, through the communication process, toward the attainment of a specified goal or goals”*. Another statement comes from Hill (2013) in Leoveanu (2013, p.64) that leadership is *“The action of leading a group of people or an organization”* and *“process of social influence in which one person can enlist the aid and support of others in the accomplishment of a common task”*.

Fiedler in Robbins (2006) states that there are three key elements that will determine the leadership behavior or style of effective leadership, that can impact to the employee performance improvement, namely (1) the leader-member relations; (2) task-structure; and (3) the leader's position of power. Effective leadership behavior in support of these three elements, further explained that the required level of quality of the leadership relationship with a subordinate, how the attitude of subordinates on the personality, character, and proficiency superiors. In a work situation, required preparation tasks patterned, and how authority of leader formally in carrying out the task of leadership. (Robbins, 2006)

Related to the innovation, Reguia (2014) stated *“Innovation is considered as one of the success features in the economics companies, it's regard as the basic element to reach customer satisfaction and realize their desires”*. Reguia (2014) *“Product innovation is the development of new products, making changes in the current product design or using new techniques and means in the current production methods, it focuses on existing markets”*. Then Robbins et al. (2011, p. 36) defined *“Innovation is the process of taking a creative idea and turning it into a product or process that can be used or sold”*

Ar & Baki (2011, p.175) describes some of the dimensions that can be used in product innovation, including: R & D Strategy, with regard to the consistency of the R & D strategy, including expenditure, play and major, strategy, plan by connecting, resources, personnel, and clarity project; Top Management Support, deals with issues of internal association with an application that is set by the Top Management. Applications such as incentives, rewards, necessity funds and materials. And things that used to be measured from top management support including the new technologies Researches, Actively, encourages innovation, promotes the advantages, and regarding creative and innovative; Customer Focus, like listening to the voice of consumers through marketing research. Explore their desires now and later with reflection of customer feedback for the company's products. Things to consider the customer focus of which seek customer input, involve customers, maintain close relationship, research customer need, number new products, and used of customer complaints; Organizational Learning Capability, Includes a comprehensive program for training and education of employees, to improve the ability of the employee and the company, includes a comprehensive program, organizational-wide training, employee learning, investment, employee upgrades, and the ability to learn; Creative Capability, includes production of novelty and usefulness of the product in every dimension, such as provide time, open communication, rewarded, assess the innovative, and encourage our personnel; Organizational Collaboration, presents internal integration among individuals, groups or departments, with many behaviors such as sharing information, cross-functional team approach; Supplier Relationship, through collaboration with suppliers as a source of power outside the company. Some things into consideration at this stage are the supplier support, stable relationship and supplier Involved.

Jumingan (2009) describes that the performance of the bank is part of the bank's overall performance. Performance of bank as a whole is a picture of the achievements of the bank in its operations, both related to financial aspects, marketing, collection and distribution of funds, technology and human resources. The measurement of Rural Bank performance in this study uses *balanced scorecard*, considering able to study the problems of research on Rural Bank directly from four perspectives that can be analyzed by the method of balanced scorecard (Kaplan & Norton, 1996) which includes the perspective of financial, customer, internal business process, and learning and growth.

## Research Objective

The study aims to examine the influence of leadership and product innovation on Rural Bank Performance in the Province of West Java.

## METHODOLOGY

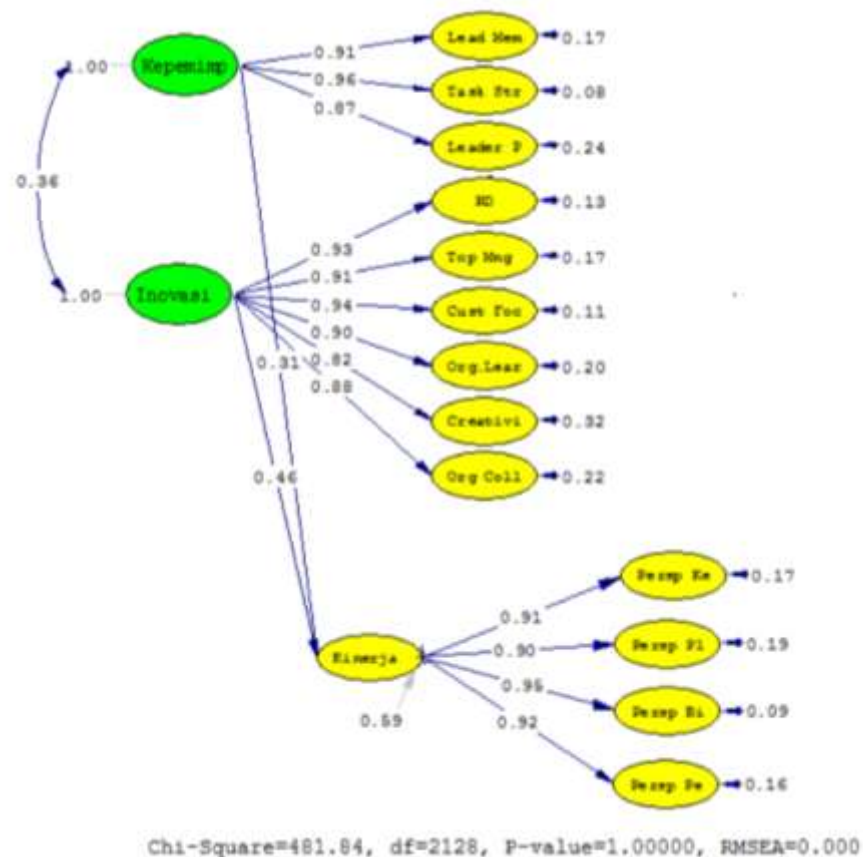
This is a verification study through observation in a cross section of time. The unit of analysis in this study is the Rural Bank in West Java province, the observation unit, namely the management of those Rural Bank. Based on the results of secondary data, there are 300 banks with different types of ownership. Random sampling method used to select units of analysis. Samples taken as many as 150 Rural Bank randomly based on the list of those registered at the Financial Services Authority. Data were analyzed through the Structural Equation Modeling (SEM) using LISREL 8.7.

## ANALYSIS

### Goodness of Fit

Goodness of fit is one of the uses of structural equation modeling (SEM), which aims to determine whether the research model has been in accordance with the empirical conditions. Here will be shown the overall test results of research model.

Figure 1: Diagram of Testing Model



The calculation of LISREL 8.7 results a structural model and measurement model as below :

Table 2: Goodness of Fit of Structural Model

No.	Degree of Fit	Value	Acceptable Degree of fit	Conclusion
1	<i>Chi Square</i>	481.84	$P\text{-value} > 0,05$	Close Fit
	<i>Normed Chi Square (x2/df)</i>	$P\text{-value} = 1.00$		
2	<i>Goodness of Fit Index (GFI)</i>	0,95	$> 0,8$	FIT
3	<i>Root Mean Square Error of Approximation (RMSEA)</i>	0,00	$RMSEA \leq 0,08$ (good fit) $RMSEA < 0,05$ (close-fit)	Close fit
4	<i>Adjusted Goodness of Fit Index (AGFI)</i>	0,94	$AGFI > 0,8$	FIT

Source: Proceeding data by LISREL 8.7

It is known that p-value for Chi-Square  $> 0.05$  and Goodness of Fit Indices (GFI)  $> 0.90$ , indicating that the model fit, it is supported by the RMSEA value  $< 0.05$ , so we concluded that the research model has been in accordance with the empirical conditions.

The following table shows the results of the measurement model that shows the validity of the indicators in measuring the each dimension.

Table 3: Measurement Model Goodness of Fit of Indicator on Dimensions

<i>Latent Variable / Manifest Variable</i>	<i>Loading factor</i>	<i>t</i>	<i>Conclusion</i>
<b>Leadership</b>	<i>Leader-member Relations</i>		
X1	0.74	--	valid
X2	0.71	5.53	valid
X3	0.69	5.40	valid
X4	0.69	5.42	valid
X5	0.67	5.32	valid
	<i>Task-structure</i>		
X6	0.69	- -	valid
X7	0.70	5.31	valid
X8	0.72	5.40	valid
X9	0.66	5.16	valid
X10	0.69	5.28	valid
	<i>Leader's Position Power</i>		
X11	0.67		valid
X12	0.72	5.07	valid
X13	0.70	5.02	valid
X14	0.74	5.16	valid
<b>Product Innovation</b>	<b>R&amp;D Strategy</b>		

Table 3...



	X15	0.73	--	valid
	X16	0.72	6.06	valid
	X17	0.72	6.06	valid
	X18	0.73	6.11	valid
	X19	0.72	6.04	valid
	X20	0.76	6.25	valid
	<i>Top Management Support</i>			
	X21	0.73	-	valid
	X22	0.77	6.21	valid
	X23	0.76	6.12	valid
	X24	0.78	6.27	valid
	X25	0.80	6.34	valid
	<i>Customer Focus</i>			
	X26	0.74	-	valid
	X27	0.74	6.23	valid
	X28	0.76	6.38	valid
	X29	0.76	6.37	valid
	X30	0.74	6.28	valid
	X31	0.77	6.41	valid
	<i>Organizational Learning Capability</i>			
	X32	0.78	--	valid
	X33	0.78	6.63	valid
	X34	0.80	6.71	valid
	X35	0.78	6.59	valid
	X36	0.75	6.45	valid
	X37	0.72	6.26	valid
	<i>Creative Capability</i>			
	X38	0.85	-	valid
	X39	0.85	7.21	valid
	X40	0.81	6.96	valid
	X41	0.82	7.05	valid
	X42	0.83	7.10	valid
	<i>Organizational Collaboration</i>			
	X43	0.82	-	valid
	X44	0.83	6.62	valid
<b>Rural Bank Performance</b>	<i>Financial Perspective</i>			
	Z1	0.75	-	valid
	Z2	0.77	6.20	valid
	Z3	0.73	6.02	valid
	Z4	0.76	6.16	valid
	<i>Customer Perspective</i>			
	Z5	0.74	-	valid
	Z6	0.74	5.98	valid
	Z7	0.73	5.95	valid
	Z8	0.77	6.13	valid
	Z9	0.77	6.14	valid
	<i>Internal Business Process Perspective</i>			

Table 3...



Z10	0.72	-	valid
Z11	0.72	5.99	valid
Z12	0.71	5.96	valid
Z13	0.74	6.13	valid
Z14	0.70	5.91	valid
Z15	0.70	5.89	valid
Z16	0.77	6.26	valid
Learning and Growth Perspective			
Z17	0.72	-	valid
Z18	0.75	6.06	valid
Z19	0.75	6.06	valid
Z20	0.75	6.07	valid
Z21	0.72	5.93	valid
Z22	0.74	6.04	valid
Z23	0.79	6.27	valid

Source: Processing Data with LISREL 8.7

Variable research is a construct, each formed by multiple dimensions and each dimension is measured by several indicators / manifest (second order). Each indicator has loadings factors quite high ( $> 0.5$ ), so it can be concluded that these indicators could reflect the dimensions significantly ( $t > 1.97$ ). The following table shows the dimensions of the measurement model on the latent variables where each variable has a valid dimension in measuring the construct ( $t > t$  table).

Table 4: Measurement Model Goodness of Fit of Dimension on the Latent Variable

<i>Latent Variable / Manifest Variable</i>	<i>Loading Factor</i>	<i>t</i>	<i>Conclusion</i>
<b>Leadership</b>			
Leader-member Relations	0.91	7.04	valid
Task-structure	0.96	6.76	valid
Leader's Position Power	0.87	6.16	valid
<b>Product Innovation</b>			
R&D Strategy	0.93	7.83	valid
Top Management Support	0.91	7.60	valid
Customer Focus	0.94	8.03	valid
Organizational Learning Capability	0.90	8.21	valid
Creative Capability	0.82	8.32	valid
Organizational Collaboration	0.88	8.20	valid
<b>Rural Bank Performance</b>			
Financial Perspective	0.91	7.49	valid
Customer Perspective	0.90	7.28	valid
Business Process Perspective	0.95	7.46	valid
Learning and Growth Perspective	0.92	7.26	valid

Source: Processing Data with LISREL 8.7

Leadership and Innovation have the dimensions of high loadings factors value ( $> 0.5$ ). Likewise, the performance of Rural Bank with the value of factors loadings  $> 0.5$ , so that all variable have a good measurement model.

### Structural Model

$$\eta_1 = 0,31 \xi_1 + 0,46\xi_2 + \zeta_1$$

Which are:

$\xi_1$  = Leadership

$\xi_2$  = Product Innovation

$\eta_1$  = Rural Bank Performance

$\zeta_i$  = Residual factor

### Hypothesis Testing

The following shows the results of hypotheses testing simultaneously and partially:

#### *Simultaneous Hypothesis Testing*

The following shows the results of hypotheses testing simultaneously:

Table 5: Simultaneous Hypothesis Testing

Hypothesis	R <sup>2</sup>	F	Conclusion
Leadership and Product Innovation on Rural Bank Performance	0,41	85.82*	Hypothesis accepted

\* Significant at  $\alpha=0.05$  (F table =3,058)

The table show that in the degree of confidence of 95% ( $\alpha=0.05$ ), simultaneously there is the influence of leadership and Product Innovations on the the Performance of Rural Bank which is a variable effect by 41% while the rest of 59% influenced by other factors not examined.

#### *Partial Hypothesis Testing*

The following shows the results of hypotheses testing partially:

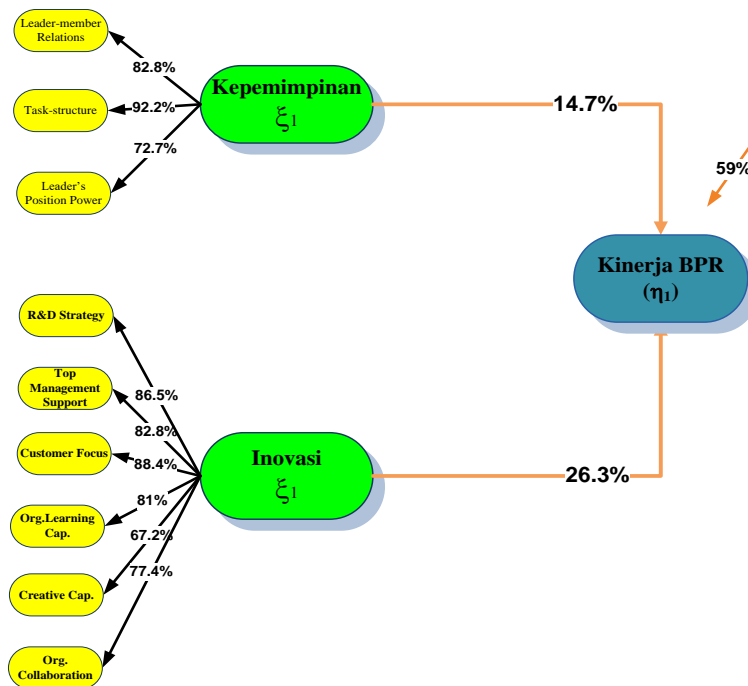
Table 6: Partial Hypothesis Testing

Hypothesis	$\gamma$	R <sup>2</sup>	T	Conclusion
Leadership on Rural Bank Performance	0,31	0.147	3.97*	Hypothesis accepted
Product Innovation on Rural Bank Performance	0,46	0.263	6.04*	Hypothesis accepted

\* Significant at  $\alpha=0.05$  (t table =1.99)

In the above table it is known that partially, there are influences of the variables of leadership and product innovation significantly to the performance of Rural Bank where the product innovation has a greater influence (26.3%). Based on the hypothesis testing, obtained a research finding as figure out below:

Figure 2. Final accepted model



## FINDINGS AND DISCUSSION

Based on the results of hypothesis testing it is known that the product innovation in rural banks in West Java, it turns out aspects of customer focus has the role of the highest in improving the performance, followed by R & D strategy, top management support, organizational learning capability, organizational learning collaboration, as well as creative capability. So we can say that the development of customer focus have a role in boosting the performance of Rural Bank in West Java. While in the leadership variable, Leader-member relations is an aspect that has the highest influence on the performance of Rural Bank, followed by the influence of the Task-structure, and the Leader's position of power.

The hypothesis testing results showed that the improvement in leadership and product innovation has implications for improving company performance of Rural Bank. Product innovation is a key factor in driving the increase in the performance of Rural Bank.

The test results demonstrate the role of product innovation in improving company performance, in line with the results of Ar & Tray (2011) that found the product and process innovation within the organization can directly affect the performance of the organization. The finding also in line with finding of Crema et al., (2014) which argues that innovation and strategy are two things that can create organizational performance. Hilman & Kaliappen (2014) shows the influence of the implementation of the strategy on organizational performance through innovation. In addition, Maier et al. (2014) produced a framework in order to develop innovation management both in theory and practice. Moghaddam et al. (2013) also found a significant positive relationship between innovation, market orientation and knowledge management in improving financial performance. As well as Barnes & Hinton (2012) who found that the lens of technological innovation, is a new understanding and a new potential that deserves to be investigated furthermore.

## CONCLUSION AND SUGGESTIONS

Leadership and product innovation able to improve the performance of Rural Bank in West Java province; Product innovation has contributed more than leadership in improving the performance of Rural Bank. Several factors that deliver the highest in improving the performance of Rural Bank are customer focus, followed by the implementation of R & D strategy, top management support, customer focus, organizational learning capability, creative capability, and organizational collaboration.

Expected future researchers who interested in conducting the research on rural banking industry with a different point of view to this research by reviewing the specificity in the field of marketing management, as well as by taking a broader analysis unit; i.e. the Rural Bank throughout Indonesia. There needs to be further research in addition to the variables that have been studied, the external factors that can affect the performance of Rural Bank.

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