Effect of Ethical Leadership on Employee Performance and Innovation with Internal Motivation as Intervening Variable

(Empirical Study of Small and Medium Industries (IKM) in Klaten Regency)

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ABSTRACT
Leadership is a mechanism to support or motivate a group of people to work towards a common goal, which can direct employees and workers with strategies to achieve a vision. In a company, in addition to having a leader, of course there are also employees. Employee performance is one indicator that keeps the company productive in running its business. Incremental innovation is also very important for the development of components in a company because with the development of the times there must also be a desire to develop products by adding each new innovation. Someone in work must also have motivation. Internal motivation or internal motivation is something that must be owned by individuals in the company. Internal motivation is an urge that comes from within a person to do something. Leaders must also have ethics because leaders must be role models for their subordinates. This study aims to analyze the effect of ethical leadership on employee performance and incremental innovation with internal motivation as an intervening variable. The population in this study is the Small and Medium Industry (IKM) in Klaten Regency with a sample of 192 respondents. In accordance with the theoretical framework that was built, the analytical tool used is Smart PLS. The results of this study, among others. Ethical leadership has a positive and significant effect on employee performance. Ethical leadership has a positive and significant effect on internal motivation. Ethical leadership has a significant effect on internal motivation. Internal motivation has a positive and significant effect on employee performance. Internal motivation has a positive and significant effect on incremental innovation. Internal motivation can mediate positively and significantly between leadership ethics on employee performance. Internal motivation can mediate positively and significantly between ethical leadership and incremental innovation. The limitation of this research is that it only uses 2 dependent variables so that the scope of the research is not wide enough. Future researchers are expected to be able to use other variables such as radical innovation which add to the varied research results and find out changes in innovation on a large scale in a company. Internal motivation can mediate positively and significantly between ethical leadership and incremental innovation. The limitation of this research is that it only uses 2 dependent variables so that the scope of the research is not wide enough. Future researchers are expected to be able to use other variables such as radical innovation which will add to the varied research results and find out changes in innovation on a large scale in a company.

Keywords: Ethical Leadership, Employee Performance, Incremental Innovation, Internal Motivation
1. INTRODUCTION

Leadership is a manner for motivating a set of humans to paintings collectively to attain a shared objective, wherein a pacesetter can offer personnel and employees with techniques to attain a vision. (Tajedini, 2015). A leader can plan matters in lots of approaches to reap his or her objectives. Leaders take diverse moves including having a clean imaginative and prescient of the future, particular and clean dreams that inspire subordinates to set their very own dreams, and a long-time period imaginative and prescient [2]. In this sense, leadership is a manner of inspiring others particularly affecting people with the intention of growing their competencies for organizational success [16].

Ethical leadership is an increasing number of being promoted as a manner for leaders to capitalize on their employees’ high-quality attitudes in the direction of their each day work, consisting of job satisfaction. Employee satisfaction with their work is not only a managerial issue, but also an ethical issue, given the extent to which leadership influences employee functions, attitudes, and behaviour[18]. Handling job satisfaction through ethical leadership, on the other hand, is a never-ending challenge [19].

Leaders must have ethics because leaders must be role models for subordinates. The attitude of the leader can also affect the performance of members in the organization or the company. Therefore, leaders must be kind and fair to all employees [3]. Ethical leadership is defined by [27] as “demonstrating normatively appropriate behavior through personal actions and interpersonal relationships, and promoting that behavior to followers through two-way communication, reinforcement, and decision making.” In a business, ethical leadership is critical. There will be a bad relationship between leaders and elements in a company if there is no ethical leadership. Ethical leadership increases employee efficacy and evolves employees’ potential to resolve workplace conflict[30], decreases employee negative behavior [30] and decreases the workforce’s social laziness while increasing their performance [30]. It should be noted that ethical leadership also has honesty, integrity, trustworthiness, caring, openness to information, respect, and decision-making principles [30].

The present day financial surroundings is closely inspired with the aid of using technological advancements, globalization, and the opposition level, and innovation has surfaced as a crucial answer for corporations striving to boom corporation overall performance and benefit a long-time period competitive edge [20]. Innovation is the spearhead of the creation of a country’s competitiveness and economic growth [4]. Incremental innovation, also known as incremental innovation, is the process of improving existing components. Incremental Innovation is the process by which supply chain members add value by increasing existing products and services or improving how they serve customers [21]. Maybe the innovation has long been found, but if there are individuals who still perceive the innovation as a something new, then that “something” can still be called an innovation for they [5]. Furthermore, [31] explains in his theory of entrepreneurship that incremental innovation provides entrepreneurs with the opportunity to achieve higher profits by using the same basic product in a new setting. Incremental innovations that improve performance are formed through the use of knowledge and technological solutions [22]. Moreover, incremental innovations contribute to providing solutions to existing problems [22]. However, innovation also includes the implementation of ideas [6]. Through collaboration incremental innovations can improve the quality of pre-existing products. Incremental innovations involve a low level of novelty according to relatively small transformation in improvement products [23], [24] stated that the most improvements are incremental and constitute line extensions or adjustments of current products.

Internal motivation, also known as internal drive, is an internal drive from individuals to contribute to the company’s success. Internal motivation is the driving force that arises within a person to do something he desires in order to achieve a goal. Motivation encourages employees to think and take action with a specific purpose [7]. When employees are intrinsically motivated, they will feel positive creative stimulation which encourages them to access more information and in turn, encourages them to identify their ideas in a flexible way [25].

Internal motivation refers to doing an activity for inherent satisfaction rather than for some things that can be separated “consequences” [25]. If a person already has internal motivation, then perhaps the driving force of an individual as a force to carry out activities related to these needs and uses for the present and future. Internal motivation is a person’s major capital if they want to be productive and successful at work. According to [14] internal or intrinsic motivation (eg the work itself, achievement, recognition, responsibility, progress) has an immediate impact on man or woman or organizational overall performance. So, it could be stated that a person who’s happy with their paintings, achievements, responsibility, existence, and overall performance have a tendency to have excessive inner motivation.

Previous research stated that according to [19]ethical leadership has a positive and significant effect on employee performance. According to the study, ethical leadership has an impact on organizational commitment in addition to employee performance. That is, if ethical leadership improves or organizational commitment improves, employee performance tends to be higher or higher.
HYPOTHESES DEVELOPMENT

Social learning theory emphasizes an individual's ability to seek, interpret, and assign meaning and valence to contextual variables. Employee-leader relationships offer applicable contextual cues that may form worker behavior and attitudes [16]. According to [15] Ethical leadership (ethical leadership) as a leader who communicates ethical standards to his employees, a leader will ensure that employees follow these ethical standards by applying rewards and punishments. Ethical leaders will always practice ethical behavior not only at work but also in daily life[15]. Research conducted by[8] with the title Analysis of the influence of Ethical Leadership on Employee Performance, with Employee Engagement an Organizational Citizen Behavior (OCB) as a Mediation Variable for Four Star Hotel Employees in Batam City, it shows that the results of the study have provided findings that Ethical leadership also has a direct positive significant impact on employee performance.

H1: Ethical Leadership has an effect on Employee Performance

Ethical leadership is defined as a process in which predetermined goals within a company or organization are set and employees of the company or organization are directed to achieve these goals with the assistance of a leader role [20]. Research conducted by[9] with the title The Influence of Leadership and Organizational Culture on Innovative Work Behavior in Industry 4.0 shows the results of research on Leadership and organizational climate also have a positive and significant effect on partly and simultaneously innovative work behavior.

H2: Ethical Leadership affects Incremental Innovation

Intrinsic motivation is a main driver for work that originates within the worker as an individual, in the form of awareness of the significance or benefits of the work he performs [18]. Various literatures on leadership have emphasized the capacity and ethics of leaders to construct consider through developing task-primarily based totally relationships with employees [28]. Under ethical control, leaders emphasize honesty and integrity and display up their appropriate normative behavior through personal movements and interpersonal relationships [29]. Ethical leaders who're capable of offer consider and interpersonal relationships may be capable of growth worker morale in making extra improvements to provide new product services.

H3: Internal Motivation mediates Ethical Leadership with Employee Performance

According to Fatin (2019) Intrinsic motivation refers to things that inspire achievement that are intrinsic in nature, which means they originate within an individual. Research conducted by [11] with the title The impact of transformational leadership on innovative work behavior as influenced by job crafting and knowledge sharing shows that job crafting behavior (increasing job structural resources, increasing social resources, and increasing job challenges) mediates the impact of transformational leadership on employees' innovative workplace behavior. Furthermore, the connection among transformational leadership and innovative job involvement is altered by knowledge sharing.

H4: Internal Motivation mediates Ethical Leadership with Incremental Innovation

![Figure 1 Research Framework](image_url)
3. RESEARCH METHOD

This study uses a quantitative method. The sample of this study was 192 IKM that produce products with local cultural characteristics consisting of IKM Batik, IKM Lurik, and IKM Craft. The sample SMEs are businesses that have been passed down from generation to generation and become part of the conservation of local culture. In organizations with family-based relationships, the role of ethical leadership is more visible. So that the ethical behavior of the leader dominates in encouraging togetherness and more flexible relationships. Sampling used is simple random sampling. Measurement of variables using a Likert scale with a scale of 1-5, including strongly disagree to strongly agree (point 5).

4. DATA ANALYSIS AND DISCUSSION

1. Outer Model

Table 1. Outer model analysis results

| Variable                  | Average Variance Extracted (AVE) | Composite reliability | Cronbach's alpha |
|---------------------------|----------------------------------|-----------------------|------------------|
| Ethical Leadership (X1)   | 0.774                            | 0.911                 | 0.854            |
| Employee performance (Y1) | 0.650                            | 0.881                 | 0.820            |
| Incremental Innovation(Y2)| 0.757                            | 0.949                 | 0.936            |
| Internal Motivation(Z1)   | 0.588                            | 0.895                 | 0.859            |

Source: Primary data processed, 2021

The first stage evaluates the measurement model to confirm the reliability, dimensions and construct validity (Hair, 2006). According to the results of the discriminant validity test using the Average Variance Extracted (AVE) value, the AVE value produced by each variable is greater than 0.5, indicating that it meets the requirements.

After testing the validity, continued with reliability testing. This test will show the consistency of respondents' answers in answering questions posed by the author. This reliability test uses composite reliability. A construct is shown to be accurate if its composite reliability value is > 0.70, but values as low as 0.6 are acceptable. When the magnitude of the composite reliability value for each variable exceeds 0.7, the overall variable is reliable.

The results of the reliability test were strengthened by the value of Cronbach's alpha with the assessment criteria if the Cronbach's Alpha value of each variable > 0.7 was said to be reliable. Based on the results of the analysis above, each research variable has met Cronbach's alpha value, it can be concluded that the overall level of reliability of the variables is high.

Table 2. Multicollinearity analysis results

| Inner VIF Values | VIF | Description       |
|------------------|-----|-------------------|
| X1→Y1            | 1.2 | Non multicollinearity |
| X1→Y2            | 1.2 | Non multicollinearity |
| X1→Z1            | 1.0 | Non multicollinearity |
| Z1→Y1            | 1.2 | Non multicollinearity |
| Z1→Y2            | 1.2 | Non multicollinearity |

Source: Primary data processed, 2021

After testing the validity and reliability, followed by multicollinearity analysis. This test aims to see whether each independent variable has a correlation between the independent variables or not as indicated by the VIF value <3.5-5. According to the results of the analysis of the independent variable on Employee Performance and the independent variable (Ethical Leadership) on Employee Performance, the independent variable on Internal Motivation, the Internal Motivation variable on Employee Performance, the Internal Motivation variable on Incremental Innovation has a VIF value <3.5-5, it can be stated that there is no multicollinearity.

2. Inner Model

Table 3. Value R Square

| Model             | R Square |
|-------------------|----------|
| Incremental Innovation | 0.298    |
| Internal Motivation   | 0.221    |
| Employee performance   | 0.313    |

Source: Primary data processed, 2021
The feasibility analysis of the model uses the Goodness of Fit. This test aims to determine the model that is worth researching or not by looking at the results of the research used using R Square value analysis. The value of R square above aims to see the effect of the Ethical Leadership variable on Employee Performance and Incremental Innovation.

### Table 4. Q Square analysis results

| Variable                      | Q2   |
|-------------------------------|------|
| Ethical Leadership (X1)       | 0.219|
| Incremental Innovation        | 0.129|
| Employee performance          | 0.198|

Source: Primary data processed, 2021

According to the test results within the desk above, the value of Q Square is used to see the level of diversity of the Ethical Leadership model on Incremental Innovation with a value of 0.219. The next Q Square value is to see the level of diversity of the Ethical Leadership model on Internal Motivation with a value of 0.129. The next Q Square value is to see the level of diversity of the Ethical Leadership model on Employee Performance with a value of 0.198. This means that the level of diversity of the model shown by the Ethical Leadership variable in explaining the Incremental Innovation variable is 21.9% and the remaining 78.1% is still influenced by other factors. The level of model diversity shown by the Ethical Leadership variable in explaining the Internal Motivation variable is 12.9% and the remaining 87.1% is still influenced by other factors. While the level of model diversity shown by the Ethical Leadership variable in explaining the Employee Performance variable is 19.8% and the remaining 80.2% is still influenced by other factors. The total value of Q square is 0.546 or 54.6% which meets the magnitude of the range 0 < Q<1, it can be concluded that this research model is declared to have predictive relevance.

### 3. Hypothesis testing

**Table 5. A Direct Effects analysis**

| Hypotheses | Relationship | t-value | p-value | Decision |
|------------|--------------|---------|---------|----------|
| H1         | EL → KK      | 4.324   | 0.000   | Accepted |
| H2         | EL → II      | 2.886   | 0.004   | Accepted |
| H3         | EL → IM      | 6.595   | 0.000   | Accepted |
| H4         | IM → KK      | 4.351   | 0.000   | Accepted |
| H5         | IM → II      | 6.525   | 0.000   | Accepted |

Source: Primary data processed, 2021

Based on the results of statistical tests, it's far recognised that H1. Ethical Leadership has an effective and considerable impact on worker performance (t-value 4.324, P-Values 0.000), H2. Ethical Leadership has an effective and considerable impact on Incremental Innovation (t-value 2.886, P Values 0.004), H3. Ethical Leadership has an effective and considerable impact on Internal Motivation (t-value 4.351, P-Values 0.000), H4. Internal Motivation has an effective and considerable impact on worker performance (t-value 4.351, P-Values 0.000). H5. Internal Motivation has an effective and considerable impact on Incremental Innovation (t-value 6.525, P-Values 0.000).

**Table 6. Indirect effect analysis**

| Variable                                      | Original Sample | P Values |
|-----------------------------------------------|-----------------|----------|
| Ethical Leadership -> Internal Motivation -> employee performance | 0.148           | 0.000    |
| Ethical Leadership -> Internal Motivation -> Incremental Innovation | 0.192           | 0.000    |

Source: Primary data processed, 2021

According to the findings of the indirect effect analysis, Internal Motivation can positively and substantially mediate the relationship among Ethical Leadership and job satisfaction, with P Values of 0.000. Furthermore, with P values of 0.000, Internal Motivation can mediate positively and significantly between Ethical Leadership and Incremental Innovation. This result is in line with research results by [11], [12].

The results of statistical analysis show that the hypothesis of all confirmed direct effects having a positive and significant effect is accepted. The indirect effect shows the same result that internal motivation mediates the influence between Ethical Leadership towards employee performance and also mediates the effect of Ethical Leadership on Incremental Innovation.

The exercise of Ethical Leadership within the business enterprise is capable of have a very good impact...
on employee performance and improve employee skills in Internal Motivation within the individual. The results show that ethical leadership has a massive and effective relationship with worker overall performance and incremental innovation. The findings of this study support the theoretical viewpoint that ethical leadership has a positive effect on individual behavior and attitudes [15]. Moreover, ethical leadership influences employees' innovative work behavior in a different way. The morals of ethical leadership in the workplace are implemented through open communication, employee respect, fairness, and trust.

5. THEORETICAL CONTRIBUTION
The result of this study builds on previous research on ethical leadership and contributes to the existing literature by providing empirical evidence that translating the effects of ethical leadership can improve employee performance. This finding addresses a literature gap where, even though social getting to know idea gives a broadly used framework to provide an explanation for the consequences of moral management, inner motivation, an crucial guiding principle of this idea, has obtained handiest constrained empirical attention. Enriched knowledge now no longer handiest gives proof for the explanatory cost of social getting to know idea within the moral area of worker management-performance, but also discusses the decision within the broader management literature for in addition studies at the underlying mechanisms via way of means of which leaders exert influence[13]. This study reinforces the probability view of leadership and offers a greater complicated realization of the connection among moral leadership and job performance. The most essential theoretical contribution of this studies examine underscores the mental procedures via way of means of which moral and ethical leaders inspire modern conduct among employees.

6. PRACTICAL IMPLICATIONS
The contribution of the study is to offer realistic implications for the control of human resources, mainly in a culturally diverse context. For starters, in order to improve employee performance, supervisors must cultivate the internal motivation of their employees and treat them with respect and consideration. They can achieve this through various support activities, such as constantly implementing new work models, communicating with moral standards and creating a safe environment.

7. LIMITATIONS OF RESEARCH AND SUGGESTIONS FOR FURTHER RESEARCH
This study has few limitations, namely that one must be cautious in generalizing the outcomes of this take a look at which become taken from a pattern of expert personnel in a single region or IKM center. Employee perceptions are used as a benchmark to measure ethical leadership in this study, which does not include measures of ethical leadership behavior. In some ways, this practice is consistent with [27] conceptual approach to defining ethical leadership and is broadly used within the leadership [13] literature. Future research could use a multi-level approach to study the complexities of ethical leadership at various organizational levels and in different cultural contexts.

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