

IMPACT OF Innovation AND Market Orientation ON Msme Performance

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Abstract—The impact of Innovation Capability and Market Orientation on the Business Performance strategies of micro, small, and medium enterprises (MSMEs) in South Tangerang is examined in this research. Growing market rivalry and dynamic consumer expectations have made boosting innovation and market response absolutely necessary for MSMEs to stay alive and expand. With data gathered from 411 MSME owners or managers, a quantitative methodology was employed by this study using partial least squares structural equation modeling (PLS-SEM). Among the structures assessed are innovation capability, market orientation, and business performance. With average variance extracted (AVE), the model of measurement shows high reliability and validity because it is above the 0.5 threshold. According to the research results, it shows that Market Orientation is also very influential on business performance, while Innovation Capability also positively affects Business Performance. Moreover, Market Orientation indirectly affects business performance through innovation capability. These results imply that in improving MSME corporate plans and Market Orientation and Innovation Capability, both are really important. The practical results of this research show how crucial it is to invest in innovation and ongoing knowing market demands helps to guarantee sustainable business expansion.

Keywords—Innovation Capability, Market Orientation, Business Performance, MSMEs, South Tangerang, PLS-SEM.

I. INTRODUCTION

In South Tangerang, MSMEs contribute significantly to local income and employment. Amidst increasingly fierce market competition and dynamic changes in consumer preferences, MSMEs face major challenges to maintain and improve their competitiveness. A common phenomenon is that local MSME products often cannot compete with outside or imported products, even if they have the same or even better potential. This indicates that there is a problem with the business performance strategy that has not been optimized. The Tangerang City Government is obliged to develop the MSME sector to promote the city's economy [1]. Without strong innovation capabilities and a high focus on the market, SMEs will face difficulties in competing and improving their business performance [2]. Innovation is a key element that differentiates SMEs from their competitors. In the culinary industry, SMEs need to come up with more innovative products to stay competitive [2]. The development of SMEs is generally in line with the level of innovation owned by the company, where SMEs with high innovation capacity tend to be more adaptive in facing changes in market demand [2].

In 2023, the number of MSMEs in the city of South Tangerang, according to data from the ministry of tradi reached 92,783 units. Of this number, around 63,000 MSMEs already have a Business Identification Number (NIB), indicating a fairly high level of business legality in the area [3]. Based on data on the number of MSMEs by sub-district in South Tangerang City in 2023, Pamulang Sub-district has the highest number of micro MSMEs, with 2,876 units, followed by Ciputat Sub-district with 2,403 units. Meanwhile, Setu Sub-district has the least number of micro MSMEs, with 918 units. For the small MSME category, Serpong Sub-district has the highest number with 208 units, followed by Pondok Aren Sub-district with 198 units. Meanwhile, Setu Sub-district also recorded the least number of small MSMEs, with 91 units. This data shows that in South Tangerang City is dominated by micro enterprises, with an even distribution in various sub-districts. This indicates the large role of small-scale businesses in supporting the regional economy [4].

By improving people's well-being, creating jobs and facilitating income distribution, MSMEs contribute significantly to economic growth. The capacity of South Tangerang's product development strategy for innovation and market orientation is also very important. The ability of a business to develop new or improved products that ultimately improve market competitiveness is referred to as innovation capability. Improving performance largely depends on the capacity of MSMEs to innovate. However, this is highly dependent on the knowledge of resources possessed by MSMEs [5]. Without strong innovative skills and a strong market focus, MSMEs will find it difficult to remain competitive and improve business performance [6]. Three main variables are explained by this study: business performance, market orientation, and innovative capability. The development and survival of a business is greatly influenced by strategy. An important step that can be applied to MSMEs is business performance to ensure sustainable business growth. [7][7].

Small and medium-sized enterprises can benefit greatly from the findings of this study, especially when it comes to supporting their business development. The main objectives of this study are to examine the extent to which these variables affect business performance, provide strategies that similar companies can use to improve their competitiveness, and provide practical recommendations for SMEs in South Tangerang. In addition, the purpose of this study is to analyze and test the impact of innovation skills on business performance strategies of SMEs in South Tangerang, and to test how market orientation contributes to these strategy decisions. Therefore, the results of this study are expected to provide insights and recommendations for SME businesses to improve business competitiveness and sustainability.

II. LITERATURE REVIEW

Innovation Capability

The ability to innovate highlights a company's ability to transform ideas, knowledge and know how to into new products that meet customer demands and simultaneously provide benefits to the company [8]. It represents a company's ability to utilize innovative methods, processes, technologies, products, and services to adapt to changes in the environment and achieve its business objectives [9]. Innovation is divided into four main types: market, product, process, and behavioral innovation, all of which are vital for organizational success [10]. Previous studies on innovation capabilities investigated three main areas to foster innovation and sustain competitive advantage: knowledge-based approach, resource approach, resource approach, and process based approach [11]. A company's innovation is influenced by a number of factors, such as emerging trends, the level of risk, the entrepreneurial mindset of its founders, early experience in international markets, adaptability, as well as dynamic skills such as the speed of responding to market changes [11]. By expanding these dimensions to address innovation, market, and behavior, we can define innovative skills in five key dimensions. Product, Process, Technology, Market, and Behavioral Innovation. These are critical to promoting the growth and competitiveness of the company [10]. Indicators of innovative skills are, the ability to sense opportunities, capitalize on opportunities and manage threats [12].

A. Market Orientation

An increase in market orientation is currently important due to the increasingly fierce competition around the world and depending on the needs of each different customer and marketing states how important it is to connect with their market [13]. Competitor and client activities can serve as a measure of the company's capacity [14]. The corporate culture known as "market orientation" has committed to continuous innovation in order to bring more value to customers [14]. The only thing that can change the strategy and product in the market is the company trying to understand the needs and preferences of customers as a whole [15].

An understanding of market orientation is important to know the needs and meet customer expectations, competitors' weaknesses, recognize strengths and coordinate available resources. Previous research has shown that MSMEs with a strong market orientation will be better equipped to deal with market changes, innovation and sustain growth [16]. Providing great value to customers and achieving sustainable performance for the company as a result [17]. Three main dimensions are used in market orientation to gain competitive advantage: competitor orientation, client orientation, and coordination of strategic functions [17].

B. Business Performance

Business performance concentrates on assessing how well a company or entity reaches its strategic goals. It includes different aspects that describe how effectively and efficiently an organization operates and meets its desired outcomes. Analyzing business performance helps management make better decisions, identify areas of improvement, and maximize the company's growth and potential [18]. Business performance refers to a company's capability to efficiently manage its resources in order to accomplish its goals and achieve desired results. By primeum (2023), business performance is the capacity for an organization to make optimal financial returns on its human and material resources. Primeum's Theory (2023) states that indicators of business performance variables are relevant, measurable, and achievable [19].

Hypothesis Development

1) Market Orientation and Business Performance

Market orientation has gained increasing recognition as a key driver of success for micro, small, and medium enterprises (MSMEs). Studies have found that market orientation, along with innovation capability, significantly enhances business performance in South Tangerang [20]. A company will work to create high value for its clients by being a market-oriented business that comprehends their needs and analyzes, disseminates, and gathers all information pertaining to them [21]. An organization must gain a deeper understanding of customer expectations compared to its competitors [19]. If an institution fails to understand its competitor's strategy, it may struggle to adapt to the evolving market dynamics. Therefore, organizations must take careful and appropriate strategic actions to maximize competitor orientation [19]. The performance of businesses is positively and significantly impacted by market orientation. According to that, the hypothesis is as follows:

H1: Market Orientation has a positive effect on MSME Business Performance

2) Innovation Capability and Business Performance

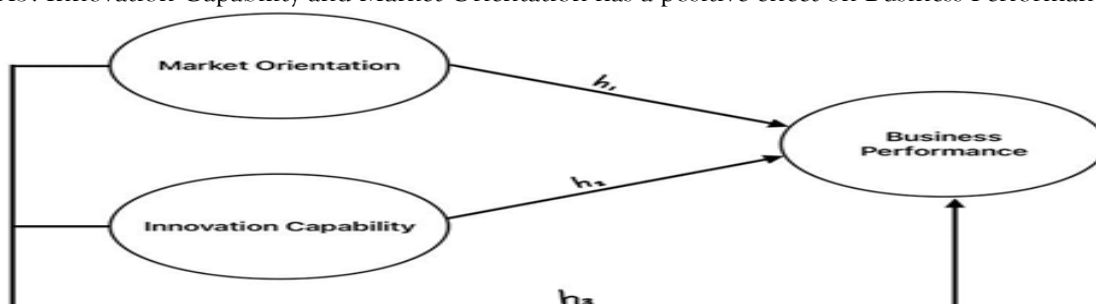
Activities carried out of the company that fundamentally change competitive behavior in the business sector to benefit from the implementation of strategies that are different from competitors are focused on innovation. When it comes to changing old mindsets across certain sectors, there's a link from Innovation to Success, and not just in terms of Development and Research to produce products of the future. This includes customer preferences, reformulation of target markets, and benefit delivery. There is a strong correlation of Innovation Capability and Business Performance has been established by empirical studies [22]. To fast respond to changing markets, technological developments, and consumer trends, companies need innovation [23].

H2: Innovation Capability has a positive effect on MSME Business Performance.

3) Innovation Capability and Market Orientation on Business Performance

Market orientation is the company's effort to apply marketing concepts to achieve superior company performance. Organizational efforts are focused on meeting consumer needs and wants [24]. Meanwhile, innovation capability describes the capacity of businesses to generate, develop, and realize innovative ideas in the form of products, services, or systems that provide added value [25]. Companies can strengthen customer loyalty and maximize market share by incorporating market orientation into the innovation process [25]. The combination of the two variables creates a strong synergy so that consumer-oriented innovations can be better accommodated and have a greater impact on business performance. With that said, here is the hypothesis:

H3: Innovation Capability and Market Orientation has a positive effect on Business Performance



- H₁:** The Influence of Market Orientation on MSME Business Performance.
H₂: The Influence of Innovation Capability on MSME Business Performance.
H₃: The Influence of Innovation Capability and Market Orientation on Business Performance.

III. RESEARCH METHODOLOGY

Based on the data from the distribution of questionnaires starting from March 28, 2025 - April 20, 2025, a total of 459 data were obtained and of these 459 data that met our respondent criteria were 411. Respondents of this study are someone who owns an MSME business in South Tangerang, who owns an MSME business in South Tangerang out of a total of 411 respondents, 44.8% are female, 55.2% are male, and 48.4% are 17-24 years old, 32.8% are 25-34 years old, 13.6% are 35-44 years old, and 5.1% are over 44 years old. Most of them owned a culinary business (47%). Most business types are dominated by culinary business types at 47%, Fashion 22.1%, Services 13.1%, Manufacturing 5.4%, Retail Trade 11.4%, Pork, Crafts, Frozen Meat, and Agriculture 0.2%. Most of the business lengths are dominated by 1-3 years, at 62%, 4-7 years at 25.3% and more than 7 years at 12.7%. Most of the average annual business revenue was below 300 million (50.9%), above 300 million-2.5 billion (38.2%), and above 2.5 billion-50 billion (10.9%).

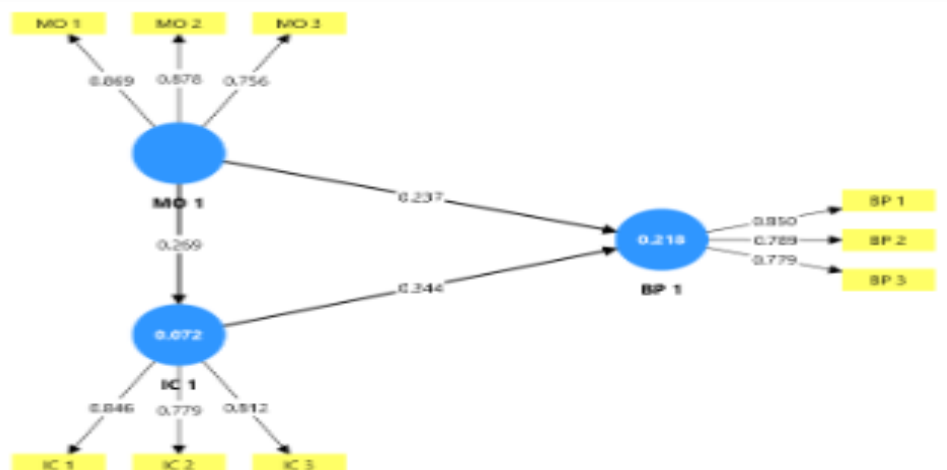


Fig. 1 Framework Models

Measurement Model

To measure the reliability of the constructs in this study's scope, two types of evaluative experiments were conducted. This assessment aims at two main forms of validity, namely Convergent Validity and Discriminant Validity. Convergent Validity aims to determine that the indicators in a study have the same correlation. This check is intended to confirm the extent to which the relationship between the variables falls within the framework of the construct being analyzed. Meanwhile, discriminant validity is tested to prove that items from different constructs are not significantly related. In other words, this test aims to ensure that each variable truly represents a different dimension or concept, and does not reflect the same aspect.

The first step taken by researchers is to measure the model to assess its validity and reliability. Average Variance Extracted (AVE) is used as a tool to measure how strong the positive correlation is between indicators in one indicator. The AVE value is considered significant if it exceeds 0.5. In addition, the loading factor value is said to meet the criteria if it is more than 0.7. Although the AVE value above 0.5 indicates that the indicator is significant, the range of values between 0.5 to 0.7 is still acceptable and remains suitable for further analysis.

TABLE I CONSTRUCT RELIABILITY AND VALIDITY

	Cronbach's alpha	Composite reliability (rho_a)	Composite reliability (rho_c)	Average variance extracted (AVE)

Market Orientation	0.786	0.814	0.874	0.699
Innovation Capability	0.744	0.753	0.853	0.660
Business Performance	0.733	0.749	0.848	0.651

The Average Variance Extracted (AVE) values obtained in this study are 0.651, 0.660, and 0.699. All of these values exceed the minimum AVE limit that is generally accepted, which is 0.5. These results confirm that each construct being studied has successfully demonstrated convergent validity, which shows that the indicators used have a strong and reliable relationship with each other.

Discriminant Validity

The findings of the discriminant validity evaluation based on the Fornell-Larcker Criterion are shown in Table 2. This criterion states that a construct qualifies if the maximum correlation with other constructs is less than the square root of its AVE score.

TABLE II DISCRIMINANT VALIDITY

	Business Performance	Innovation Capability	Market Orientationsss
Business Performance	0.807		
Innovation Capability	0.408	0.813	
Market Orientation	0.330	0.269	0.836

An analysis of the results in Table 2 reveals that the square root of the AVE for each construct, Business Performance (0.807), Innovation Capability (0.813), and Market Orientation (0.836) is higher than its correlation with any other construct. For example, the correlation between Business Performance and Innovation Capability is 0.408, while its correlation with Market Orientation is 0.330, both of which are below 0.807. Similarly, the correlation between Innovation Capability and Market Orientation is 0.269, which is also lower than their respective AVE values. These findings suggest that each construct is clearly distinguishable from the others, indicating that the model satisfies the Fornell-Larcker criteria for discriminant validity.

Outer Model Evaluation

TABLE III R-SQUARE

	R-Square
BP	0.218
IC	0.072

See table 3, the R-Square values of the constructs Business Performance (BP) and Innovation Capability (IC). The R-square for BP is 0.218, meaning that the model explains about 21.8% of the changes or variations in Business Performance. Meanwhile, the R-square for IC is 0.072, indicating that only 7.2% of the changes in Innovation Capability are accounted for by the model.

TABLE IV R-STATISTICAL HYPOTHESIS TESTING RESULTS

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics	P Values	Decision
IC → BP	0.344	0.347	0.058	5.911	0.000	Significant
MO → BP	0.237	0.240	0.052	4.524	0.000	Significant

MO →	0.093	0.096	0.027	3.431	0.001	Significa
IC →						nt
BP						

The results of hypothesis testing from the smartPLS output show that all hypotheses have a significant effect because p-values < 0.05 and t-statistics > 1.96. Table 4. shows that each relationship studied (IC > BP, MO > BP, and MO > IC > BP) shows the significance of the statistics, as proven by the original values of the samples (between 0.344 and 0.093), the increased t-statistics (between 3.431 and 5.911), and the p-values of 0.000 and 0.001. However, each hypothesis shown on the table has a significant effect.

DISCUSSION

1. The Effect of Market Orientation on Business Performance

The research findings show that market orientation significantly and positively affects the operational performance of MSMEs in South Tangerang. This implication suggests that better firm success is achieved at higher levels of market orientation, such as understanding consumer desires, reacting to market changes, and keeping an eye on competitor activities. These results align with the research conducted by Yaskun et al. [25], which found that market orientation significantly enhances competitive advantage and business performance among Indonesian MSMEs.

In addition, a study by Dunga et al. [26] shows that MSMEs can respond to market demands more quickly and appropriately when customer information has been shared. The implementation of a market-oriented approach, however, requires high adaptability to external influences and strategic sustainability. MSMEs take the risk of losing their competitive advantage if they do not have a thorough awareness of market trends and the situation of rivals. Therefore, market orientation should be part of the long-term business objectives of MSME companies in South Tangerang.

2. The Effect of Innovation Capability on Business Performance

Innovation capability reflects the extent to which companies are able to create new products or services that are able to meet market needs. The results of this study indicate that there is a positive correlation between innovation capability and business performance. However, not all MSMEs feel the significant impact of innovation. This study explains that there are other external factors, such as the quality of management and the availability of resources, which also affect the effectiveness of innovation results [20]. also concluded that the use of social platforms can make a positive contribution to the implementation of innovation and strengthen internal cooperation capabilities, which include important elements such as commitment, communication, and trust [20].

These results suggest that companies that can effectively develop and implement innovation tend to have better business performance in terms of revenue growth, operational efficiency, and competitive advantage. Innovation capabilities help companies adapt quickly to market changes, develop new products and services, and improve internal processes. Overall, the findings of this study reinforce the evidence that innovation capabilities play an important role in driving improved business performance.

3. The influence Between Market Orientation and Innovation Capability

This study successfully identified a significant and positive correlativity of Market Orientation and Innovation Capability of MSMEs in South Tangerang. Market orientation, which highlights the importance of customer focus, competitor intelligence, and response to market changes, provides a strategic foundation for growing innovation capabilities in organizations. Leading innovation capabilities in MSMEs can be enhanced through continuous integration of market intelligence and customer feedback. Their results show that MSMEs that have consistently synchronized their business strategies with market demands are better placed to carry out innovative processes, which in return leads to better performance results. This shows that a market-based approach acted as a catalyst to drive innovation, particularly when MSMEs were actively responding to external signs and consumer preferences [27].

Market orientation played a mediation role in improving innovation capabilities through strategic agility. Their research in developing industrial sectors shows that organizations with high strategic agility and a stronger Market Orientation is more likely to thrive an adaptive innovation capability. These

organizations can quickly feel and react to changes in the environment, which speeds up the innovation process [28] . Therefore, for MSMEs in South Tangerang, raising innovation capability needs to strengthen market orientation. MSMEs can develop more adapting and creative business plans by including their client knowledge and competition awareness into their business operations. Improving market orientation is crucial to enhancing innovation capability. By infusing customer understanding and competition awareness into their operational process, MSMEs can build more agile and innovative business models.

IV. CONCLUSIONS

The result shows that the Business Performance strategy of MSMEs in South Tangerang is significantly and positively influenced by Innovation Capability and Market Orientation. With a T-Statistic of 5.911 and a p-value of 0.000, smartpls analysis shows a strong and statistically significant direct effect of Innovation Capability on Business Performance. Business performance is also significantly and positively influenced by market orientation (T-Statistic of 4.524, p-value of 0.000). Furthermore, it is shown that Market Orientation has a significant indirect impact on business performance through innovation capability (T-Statistic of 3.431, p-value of 0.001). This affirms that in the relation between market orientation and business performance, innovation capability acts as a partial intermediary. From these findings it can be concluded that innovation capability and market orientation are factors that impact business performance. Innovation enables MSMEs to respond adaptively to changes in consumer needs and market dynamics, while market orientation ensures that MSMEs are aligned with customer preferences, competitor movements, and environmental shifts. Therefore, both variables are essential in building sustainable competitiveness for MSMEs in South Tangerang.

This study has several limitations. First, although the number of respondents exceeds the minimum required sample size (411 valid responses), the scope is limited to MSMEs in South Tangerang and may not represent the broader condition of MSMEs in Indonesia. Second, the study only uses three main variables (innovation capability, market orientation, and business performance), without considering other influencing factors such as digital adoption, access to financing, or government support. Third, the data collection method used was an online survey, which may introduce selection bias and limit the participation of MSME actors who are less digitally literate.

Future research is encouraged to expand the geographic coverage beyond South Tangerang to include other cities or regions to enhance the generalizability of the results. Increasing the number of research variables such as leadership style, digital transformation, or supply chain efficiency can also provide a more comprehensive picture of what drives business performance. In addition, mixed-method approaches (quantitative and qualitative) are recommended to capture deeper insights from MSME actors, particularly in exploring the practical implementation of innovation and market-oriented strategies. Researchers are also encouraged to consider longitudinal studies to observe changes over time and the long-term impact of strategic improvements. For MSME practitioners in South Tangerang, the findings suggest a strong need to invest in innovation whether in product development, process efficiency, or service improvement and to adopt a customer centric mindset by actively gathering market feedback and monitoring competitor activities. Local governments and related institutions are also encouraged to facilitate innovation training, market research support, and business incubation programs to strengthen MSME competitiveness. By strengthening both innovation capability and market orientation, MSMEs can enhance their business performance and ensure long-term sustainability in an increasingly competitive market environment.

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