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Mediating Effects of Innovation Capability on Market Orientation and Community Economic Enterprise Performance

Avianita Rachmawati[1], Surya[1]
[1]Universitas Flores, Indonesia
ibuavi@gmail.com *

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Abstract

Innovation is one of the important keys in improving the competitiveness and sustainability of community economic enterprises. This study aims to analyze the mediating effect of innovation capability on market orientation and community economic business performance. This research uses a quantitative method with a survey type. Data sources were taken using a questionnaire with a total of 52 questionnaire items. Data from the questionnaire was taken from 150 respondents from a total population of 218. All data were correlation analyzed using SEM & PLS software version 3. The results showed that market orientation directly has a significant effect on innovation capability and community economic business performance. Indirectly, market orientation mediated by innovation capability has a significant influence on community economic enterprise performance. This study found that innovative capabilities and market focus have a real impact in determining the success of community economic enterprises. This finding is expected to contribute and information specifically to community economic businesses regarding the mediating role of innovation capabilities in the relationship between market orientation and community economic business performance.

INTRODUCTION

Community economic enterprises have a strategic role in the economy, especially in developing countries. Community enterprises are business entities that play an important role in the economy, especially in Indonesia. They contribute to increased productivity and can compete with large enterprises, although they often face constraints such as financial limitations and the need to develop marketing capabilities. Community economic enterprises have 4 to 9 employees while micro and medium enterprises employ 10 to 50 people. (Alhakimi & Mahmoud, 2020; D'souza et al., 2022).

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Community economic enterprises are critical to the economy as they account for about 40% of Gross Domestic Product (GDP), 80% of total business opportunities in many countries. They drive innovation, entrepreneurship and create 60-70% of jobs while being key to economic growth and market expansion through access to the right resources. The low productivity and value-added of community economic enterprises is due to several factors, including limited resources, the ability to adopt technology and innovation and the instability of market growth in their fields (Ahmad et al., 2020; Yaqub et al., 2024). This is due to the lack of understanding of market information provided by the government and other parties about which industries have high market potential, where the industry is located, when the industry has high market potential, and how long the saturation point period or life cycle of the industry or product is. The vast majority of national economic actors are small community enterprises. The performance of community economic enterprises has four indicators, namely profit growth, growth in the number of customers, growth in the number of sales, and growth in the number of assets (Dewi et al., 2022; Tampi, 2015).

Small businesses in Indonesia are often associated with government efforts to reduce unemployment, fight poverty, and equalize income because Micro, Small, and Medium Enterprises (MSMEs) can help the government reduce unemployment. Many products made by Micro, Small, and Medium Enterprises (MSMEs) can currently compete in the domestic market before reaching the international market (Sumiati, 2015). Some community economic enterprises have external and internal weaknesses, such as limited resources, limitations in innovating, intense business competition, changes in regulations, and community economic enterprises have difficulty in entering new markets or expanding the reach of their businesses due to limited networks and resources (Alnawas & Abu Farha, 2020).

Empowerment and development of community economic enterprises is an effort taken by the Indonesian government to overcome the problems of poverty and unemployment. The facts that occur in the field show that most community economic business actors have the same problems, namely lack of resources, limited product innovation, intense competition, not adapting to technology and limited access to markets or lack of knowledge about marketing (Bahta et al., 2020; Wahyudi & Laksana, 2024).

Similarly, community economic enterprises in various regions have their own weaknesses and challenges. There are several challenges faced in obtaining financing or capital that can hinder business growth. Among them are the lack of involvement of the millennial generation or generation Z, making businesses dominated by the older generation, and having various difficulties, one of which has not maximized technology so that community economic businesses have not optimally utilized technology and information in the end they have difficulty in marketing products.

Some of the challenges faced by community economic enterprises are difficulties in obtaining raw materials at affordable prices, lack of innovation in making products so that community economic enterprises lose market share, lack of assistance and training in terms of technology adaptation to increase the capacity and productivity of community economic enterprises, and experiencing limited knowledge to understand and use digital technology for marketing and financing, thus hampering the potential of community economic enterprises to develop. The problems of community economic enterprises are similar to those of small and medium enterprises (SMEs) (Sultoni et al., 2022; Udriyah et al.,

2019).

In the face of increasing competition and rapid technological advances, data company products have reached a point where the difference between one product and another becomes difficult to recognize. This requires companies to innovate and develop their innovation capacity to remain competitive. Innovation is the key to creating sustainable competitive advantage in a highly competitive market (Sawaean & Ali, 2020; Zehir et al., 2015). In today's competition, manufacturers must consider more than just product quality. The implementation of appropriate strategies, including a market-oriented corporate culture is essential for establishing a competitive advantage. A market-oriented culture enables companies to understand and fulfill customer needs, which in turn can improve the performance and competitiveness of community economic enterprises in the market (Gangwani & Bhatia, 2024).

Market orientation is a corporate approach that focuses on understanding customer needs, analyzing competitors, and coordinating across functions to create superior value. Market orientation involves processing market intelligence, learning behavior, and innovation capabilities to proactively meet customer needs. This orientation is a global business evolution that focuses on core capabilities outsourcing non-core functions (Racela & Thoumrungroje, 2020). A market-oriented company is a company that makes customers the top priority for the company to run its business (Rahadhini & Lamidi, 2020). There are three indicators of market orientation measurement, namely customer orientation, competitor orientation, and inter-functional coordination (Ali et al., 2020; Didonet & Diaz-Villavicencio, 2020; Fang et al., 2022).

In addition to market orientation, the company's ability to innovate can also be used as one of the strategies in achieving competitive advantage. Product innovation is a process by which a business can improve its performance compared to its competitors by modifying existing products or introducing new products to the market that provide greater benefits to customers (De Toni et al., 2022; Durmaz & Eren, 2018).Technological innovation is the acceptance of new ideas that drive the creation and development of new products and improved outcomes in the global market.

Technological innovation plays an important role in improving operational efficiency, optimizing marketing, and adapting to changing business trends. Technological innovation requires strategies that can change corporate culture, encourage creativity, and generate new ideas driven by opportunities in the global environment (Kolbe et al., 2022). Therefore, as businesses that want to grow we also need to apply this technological innovation to achieve growth and ensure long-term success. Innovation capability has four indicators, namely product innovation, market innovation, process innovation, and strategic innovation (Zhang et al., 2016).

The use of Artificial Intelligence (AI) technology in marketing can improve the efficiency and effectiveness of marketing strategies. One example is the activity of sellers promoting products through live streaming on digital platforms, known as live selling. This method enables direct interaction with consumers, increases engagement, and provides a more engaging shopping experience. In addition, digital marketing through affiliate methods also utilizes technology to reach a wider audience and increase product sales online (Sohrabpour et al., 2021).

Currently there are 52 community economic businesses that have become partners and office BUMN Ende has also held various trainings for partner community economic businesses in Ende Regency. in this house, selling a variety of community economic business products, there are weaving, coffee, food

products, oil and so on. The first role of the BUMN house is to foster community economic businesses starting from Go Modern, Go Digital, Go Online (market place) and Go Global (ready to export). This role can be abbreviated as 4G.

Based on information from the Office of Micro and Small Enterprises Cooperatives, the number of companies in a region in 2023 is 4,665 companies, and the development of community economic businesses that are increasing in terms of quantity has not been matched by an adequate increase in the quality of community economic businesses, including community economic businesses engaged in the food and beverage business. The problem that is still faced is the low productivity that creates a gap between small and medium and large economic enterprises. Reserach gap in this study is that there is a weak influence between basic orientation on performance, there is no clear evidence when orientation has a positive impact on performance, and market orientation has no effect on marketing performance. Mediating innovation capability, market orientation has a positive and significant effect on marketing performance.

METHODS

This study uses quantitative research with a survey type (Munawaroh et al., 2025; Mutathahirin et al., 2020; Saisa et al., 2025; Sarmiah & Rahman, 2023; Yaumas et al., 2023). The data source was taken using a questionnaire with a total of 52 questionnaire items. Data from the questionnaire were taken 150 respondents from a total population of 218 The instruments used to collect data in this study used structured questionnaires, interviews, and observations (Engkizar et al., 2024). All data were analyzed in correlation using Structural Equation Modeling (SEM) & Partial Least Square (PLS) software version 3 (Asril et al., 2023; Engkizar et al., 2023). PLS has the ability to explain the relationship between variables and the ability to perform analyses in one test. The purpose of PLS is to help researchers confirm the theory and to explain whether or not there is a relationship between latent variables (Ghozali, 2016).

RESULT AND DISCUSSION

Contruct reliability and validity

Market orientation is a strategic approach that prioritizes understanding and meeting customer needs as the main focus in making business decisions. Innovation capability is the ability of a company to develop and implement new ideas, products, or processes that can improve its performance and competitiveness. It includes managing the resources, knowledge and technology required to create effective innovations. Community business performance refers to the capabilities and results achieved by small and medium-sized enterprises in various aspects (Fatonah & Haryanto, 2022).

Table 1. Construct reliability and validity

	Cronbach's Alpha	Rho A	Composite Reliability	Average Variance Extracted (AVE)
Innovation Capability	0,976	0,977	0,978	0,691
UMKM Performance	0,986	0,987	0,987	0,793
Market Orientation	0,967	0,968	0,971	0,736

The AVE analysis generated in accordance with the tests carried out using Partial Least Square (PLS) shows that the Innovation Capability Variable is 0.691, the UMKM Performance Variable is 0.793, the Market Orientation Variable is 0.736. the results show that the variables as a whole are declared to

meet the validity, where the score is more than 0.5. Composite Reliability analysis shows the Innovation Capability variable of 0.978, the MSMEs Performance variable of 0.987 and the Market Orientation variable of 0.971. The results show that the variables as a whole are declared realizable, where the score is more than 0.5. Cronbach's Alpha analysis of the Innovation Capability variable is 0.976, the MSMEs Performance variable is 0.986, and the Market Orientation variable is 0.967. the results show the accuracy and reliability of all variables, where the score is more than 0.5.

The results of this study referring to innovation capability state that the data used in the study are considered reliable and valid constructs (Saunila, 2020). This study shows that various dimensions of innovation capability contribute to company performance, which indicates that the measurement tools used to assess innovation capability are reliable. The construct validity of innovation capability is also supported by findings that show that innovation as a process and outcome can be measured and has a significant impact on business performance. This suggests that the construct is valid in the context of small and medium-sized enterprises. market orientation which states that the data used in the study is considered a reliable and valid construct (Alnawas & Abu Farha, 2020).

R Square Analysis

R is obtained from calculating the PLS algorithm in the SmartPLS software. R-square is only found in latent variables that are influenced by other latent variables. The affected latent variable is also called the endogenous latent variable. The R Square value is the coefficient of determination on endogenous constructs. The criteria for the R square value are 0.75 (strong), 0.50 (moderate), and 0.25 (weak). The R-square value in this study can be seen in table 2 below.

Table 2. R Square value

	R Square	R Square Adjusted
Innovation capability	0,865	0,865
Community economic enterprise performance	0,802	0,799

With a focus on whole number operations, and involving 16 learners, the R-Square value of the innovation capability variable is 0.865 or in other words the innovation capability variable is influenced by other variables in the model by 86.5%. The R-Square value of the community economic business performance variable is 0.802 or in other words the performance variable is influenced by other variables in the model by 80.2%. The R Square value of 0.635 in the context of innovation capability shows that 63.5% of the variation in innovation performance can be explained by innovation capability (Gangwani & Bhatia, 2024). Shows that innovation capability has a significant effect on innovation performance, and most of the variation in innovation performance can be understood through the innovation capability of the company. However, another 36.5% of the variation is influenced by other factors that are not explained by this model. In other words, although innovation capability is a key factor in determining innovation performance, there are still other factors that also contribute.

Q Square Analysis

The R Square value is used to measure how well the test value is generated by and represented by a model and also its permanent estimate. Q2 range value of $0 < Q2 < 1$. The resulting Q2 value is closer to 1, it can be seen that the model is getting better. the resulting Q2 value of 0.973 indicates that

this research model is good. The following below is the value of Q Square.

Table 3. Q Square Value

Variable	Q^2 included	Q^2 excluded	q^2	Category
Market orientation	0,630	0,628	0,005	small effect
Innovation capability		0,577	0,143	small effect

From the Q-square table, the market orientation variable has a weak q2 effect size and the innovation capability variable has a weak q2 effect size. market orientation and capabilities have a strong influence on the performance of community economic enterprises. Market orientation allows firms to better recognize and respond to changes and opportunities in international markets, which is critical for export success. In addition, innovation capability is considered an important prerequisite for creating value, which includes developing new products and understanding customer needs. Both are mutually supportive in improving export performance, where market orientation can enhance innovation capabilities, which in turn has a positive impact on the performance of people's economic enterprises (Jäkel, 2019; Länsiluoto et al., 2019).

F Square Analysis

The R value included is the R2 value of the dependent variable when all variables enter the model. This value is found in the last endogenous variable of the model, namely the UMKM Performance variable. The included R-square value or score is then compared with the excluded R-square value to find the f-square effect size (f2) value. The excluded R2 value is the R2 value of the endogenous latent variable (MSMEs Performance) when the variable whose effect size is to be known is removed from the model. The R2 included and excluded values and the results of the f2 calculation are presented in the following table.

Table 4. F Square Value

Variable	R^2 included	R^2 excluded	f^2	Category
Market orientation	0,802	0,747	0,277	moderate effect
Innovation capability		0,745	0,083	small effect

From the F-square table, the market orientation variable has a moderate effect size and the innovation capability variable has a weak effect size.

Testing the results of path coefficient (Bootstrapping)

The following below are the results of bootstrapping.

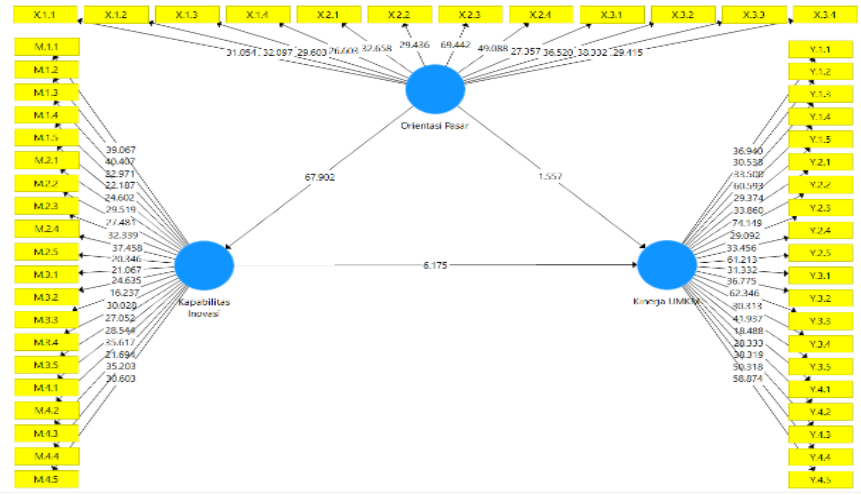

Fig 1. Direct effect test results

Table 5. Testing the direct effect

Variable	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values
Innovation Capability -> Performance MSMEs	0,719	0,726	0,116	6,175	0,000
Market Orientation -> Innovation Capability	0,930	0,930	0,014	67,902	0,000
Market Orientation -> Performance MSMEs	0,856	0,853	0,029	29,170	0,000

The first hypothesis examines the role of market orientation on innovation capability. The test results show that the T statistic of market orientation on innovation capability is 67.902. from the test results it is stated that the t-statistic is significant because the value is greater than 1.96 (t table) with a p value <0.05, which indicates a significant relationship between the market orientation variable and innovation capability so that the first hypothesis in this study can be accepted. The high t-statistic value indicates that market orientation has a very strong influence on innovation capability. The second hypothesis examines the role of market orientation on the performance of MSMEs. The test results show that the T statistic of market orientation on MSMEs performance is 29.170. from the test results it is stated that the t-statistic is significant because the value is greater than 1.96 (t table) with a p value <0.05 so that the second hypothesis in this study can be accepted. The results showing a very high t-statistic and a significant p-value indicate that market orientation is a very important factor in determining performance.

The third hypothesis examines the role of innovation capability on umkm performance. the test results show that the T statistic of innovation capability on umkm performance is 6.175. from the test results it is stated that the t-statistic is significant because the value is greater than 1.96 (t table) with a p value <0.05 so that the third hypothesis in this study can be accepted. It can be concluded that innovation capability has a significant effect on the performance of MSMEs, indicated by the t-statistic value of 6.175 which is greater than the t table value of 1.86 at the 5% significance level, indicating that innovation applied by MSMEs makes a real contribution to their performance, both in terms of growth, efficiency, and competitiveness.

Testing results of indirect influence

Table 6. Testing Indirect Influence

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values
Market Orientation -> Innovation Capability -> UMKM Performance	0,669	0,675	0,109	6,129	0,000

The fourth hypothesis examines the role of market orientation mediated by innovation capability on umkm performance. the results of the beta coefficient test or t statistic of the indirect effect of the role of market orientation mediated by innovation capability on umkm performance obtained a result of 6.129 and a p value <0.05, so that the fourth hypothesis in this study

can be accepted. With a t-statistic of 6.129, which is much greater than the t-table value of 1.96, it can be concluded that innovation capability has a significant mediating role in the relationship between market orientation and community economic business performance. This t-statistic value indicates that the role of innovation in mediating this relationship is strong and significant. The p-value <0.05 indicates that the indirect effect does not occur by chance and the relationship is statistically significant. This provides strong evidence that innovation capability mediates the effect of market orientation on community economic enterprise performance in a way that can be explained and measured.

The effect of market orientation on innovation capability

Market orientation (MO) is an approach that focuses on offering higher value to buyers and meeting market expectations. Market-oriented organizations pay attention to customers and competitors to drive innovation. Market orientation reflects the company's culture, beliefs, and shared values regarding customer needs (Krzakiewicz & Cyfert, 2019; Yaqub et al., 2024). Innovation capability refers to the ability of a firm to transform information and ideas into new products, procedures, and structures that benefit the business. It includes the capabilities and knowledge required to manage and improve existing technologies as well as add new innovative technologies. Innovation capability is recognized as the driver for creating, developing and implementing innovative design and production technologies (Elgarhy & Abou-Shouk, 2023).

The results of testing hypothesis 1 in table 5 show that the T statistic of market orientation on innovation capability is 67.902. from the test results it is stated that the t-statistic is significant because the value is greater than 1.96 (t table) with a p value <0.05, which indicates a significant relationship between market orientation variables on innovation capability so that the first hypothesis in this study can be accepted. This means that the greater the market orientation possessed by community economic enterprises, the more innovations that can be made by community economic enterprises. This significant positive relationship shows how important market orientation is in supporting innovation development. The very small p value indicates that the results obtained are not the result of mere coincidence, but reflect a real relationship between the two variables. This is in line with the theory that the market and consumers as a whole will help companies make relevant products or services according to their needs and improve their innovation capabilities.

Market orientation affects innovation capability. that market-oriented organizations tend to be more capable of innovation. This is due to greater attention to customer needs and expectations, which encourages companies to develop new, more relevant products and services. In addition, market orientation also contributes to competitive advantage through enhancing innovation capabilities, which in turn can improve marketing performance Market orientation has a positive effect on innovation capabilities because it supports companies in understanding customer needs, responding to market dynamics, and creating relevant and competitive solutions.

The effect of market orientation on community economic enterprise performance

Market orientation (MO) is an approach that focuses on offering higher value to buyers and meeting market expectations. Market-oriented organizations pay attention to customers and competitors to drive innovation. Market orientation reflects a company's culture, beliefs and shared values regarding customer needs and interests. Community economic enterprise

performance refers to the extent to which small and medium-sized enterprises achieve their goals and objectives, which can be measured through various indicators such as profitability, revenue growth, market share, and operational efficiency. This performance is often influenced by factors such as entrepreneurial orientation, innovation capabilities and marketing capabilities.

The results of testing hypothesis 2 in table 5 show that the T statistic of market orientation on the performance of community economic enterprises is 29.170. from the test results it is stated that the t-statistic is significant because the value is greater. The results of market orientation on the performance of small and medium enterprises show that companies that have a strong market orientation tend to have better performance. Market orientation helps small and medium enterprises understand customer needs and preferences, which in turn increases customer satisfaction and loyalty. In addition, market orientation also contributes to the development of more effective marketing strategies, which can improve the competitiveness and overall performance of the enterprise.

This means that community economic enterprises with good market orientation, including a deep understanding of customer needs and the ability to adapt to market dynamics, will be better able to compete and improve their performance. Therefore, the development of market orientation should be a key focus for community economic enterprises to achieve long-term success and sustainable performance improvement. Community economic enterprises with good market orientation will better understand the needs and wants of their customers and be able to adapt their products or services to dynamic market demands. As such, community economic enterprises will better meet customer expectations and gain customer loyalty, which will ultimately result in improved business performance.

The effect of innovation capability on community economic enterprise performance

Innovation capability refers to the ability of a company to transform information and ideas into new products, procedures and structures that provide benefits to the business. It includes the capabilities and knowledge required to manage and improve existing technologies and add new innovative technologies. Innovation capability is recognized as the driver for creating, developing and implementing innovative production designs and technologies. Community economic enterprise performance refers to the extent to which small and medium-sized enterprises achieve their goals and objectives, which can be measured through various indicators such as profitability, revenue growth, market share and operational efficiency. This performance is often influenced by factors such as entrepreneurial orientation, innovation capabilities, and marketing capabilities.

The results of testing hypothesis 3 in table 5 show that the T statistic of innovation capability on the performance of community economic enterprises is 6.175. from the test results it is stated that the t-statistic is significant because the value is greater than 1.96 (t table) with a p value <0.05 so that the third hypothesis in this study can be accepted.

This means that innovations in various aspects-products, processes, and marketing-play an important role in improving the competitiveness of community economic enterprises, optimizing efficiency, and promoting sustainable growth. Community economic enterprises that are able to create new products or update existing products will be able to meet market needs. Product innovations that are relevant to market trends or that can provide better solutions for consumers will strengthen the competitive position of

UMKM. Community economic enterprises can also increase efficiency and reduce costs. Community economic enterprises that can utilize technological advances in production, distribution and marketing are more likely to survive and thrive in an increasingly competitive market.

The effect of market orientation on community economic enterprise performance mediated by innovation capability

Market orientation (MO) is an approach that focuses on offering higher value to buyers and meeting market expectations. Market-oriented organizations pay attention to customers and competitors to drive innovation. Market orientation reflects a company's culture, beliefs, and shared values regarding customer needs and interests. Community economic enterprise performance refers to the extent to which small and medium-sized enterprises achieve their goals and objectives, which can be measured through various indicators such as profitability, revenue growth, market share, and operational efficiency. This performance is often influenced by factors such as entrepreneurial orientation, innovation capability and marketability Innovation capability refers to the ability of a firm to transform information and ideas into new products, procedures and structures that benefit the business. It includes the capabilities and knowledge required to manage and improve existing technologies as well as add new innovative technologies. Innovation capability is recognized as the driver for creating, developing and implementing innovative design and production technologies.

The results of testing hypothesis 4 in table 6 show that the results of the beta coefficient test or t statistic of the indirect effect of the role of market orientation mediated by innovation capability on the performance of umkm obtained a result of 6.129 and a p value <0.05, so that the fourth hypothesis in this study can be accepted. In other words, good market orientation allows small and medium enterprises to better understand and respond to customer needs, which in turn improves their innovation capabilities. These innovation capabilities then contribute to improved performance, especially in the context of exporting. Research shows that both market orientation and innovation capabilities are important factors in improving the performance of SMEs in international markets. That is, a good market orientation can encourage community economic enterprises to innovate, and effective innovation will strengthen the influence of market orientation on improving the performance of community economic enterprises.

Therefore, the development of market orientation and innovation capabilities are two key factors that support each other and should be prioritized by community economic enterprises to achieve better performance and higher competitiveness in the market. Good market orientation, which involves a deep understanding of customer needs and market dynamics, encourages community economic enterprises to innovate. When community economic enterprises are more sensitive to customer changes and needs, they are more motivated to make innovations in products, processes and services that better match market demand. Den Innovation capacity also helps community economic enterprises adjust to rapid market changes, such as changes in consumer trends, technology, or market regulations. In other words, while market orientation encourages community economic enterprises to learn more about the market, innovation capability enables them to adapt more effectively and be responsive to such changes. Thus, good market orientation will improve the competitiveness and performance of community economic enterprises.

CONCLUSION

This study reveals several research results, the first is that there is a direct influence of the market orientation variable on innovation capability. That is, the better the market orientation, the innovation capability increases, on the contrary, the worse the market orientation, the innovation capability will decrease. Second, there is a direct influence of the market orientation variable on the performance of community economic enterprises. That is, the better the market orientation, the performance of community economic enterprises increases, otherwise the worse the market orientation, the innovation capability will decrease. Third, there is a direct influence of market orientation variables on the performance of community economic enterprises. Fourth, there is an indirect effect of market orientation variables mediated by innovation capability on community economic business performance, the coefficient on this relationship is positive. This research provides benefits to enrich the literature on the relationship between market orientation, innovation capability, and community economic business performance and community economic businesses can focus more on understanding customer needs and adapting to market dynamics as a strategic step to encourage innovation and by implementing market orientation consistently, community economic businesses can achieve competitive advantage and improve their financial and operational results.

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