

# The Role of Innovation in Business Orientation and Performance of SMEs

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## Abstract

**Purpose:** This study aims to examine the effect of entrepreneurial orientation, customers and competitors on business performance mediated by innovation.

**Methodology/approach:** The population in this study was 3,945 small and medium-sized furniture businesses in Jepara district. The type of research data is primary with the data collection method using a questionnaire. The data were analyzed using the partial least square structural equation modeling technique which was processed with the smart-pls 3.0 tool.

**Results/findings:** The results showed that entrepreneurial orientation has a significant positive effect on business performance, as well as innovation. However, customer orientation and competitor orientation did not show a significant effect on business performance. In addition, innovation is proven to mediate the relationship between entrepreneurial orientation, customers, competitors, and business performance.

**Limitations:** This study is limited to SMEs in the furniture sector in Jepara Regency, so the results may not be generalizable to other sectors or regions.

**Contribution:** This research contributes to the understanding of the importance of innovation in improving business performance, particularly in the furniture SME sector. In addition, this study highlights the role of entrepreneurial orientation, customers, and competitors as key factors in driving innovation and business performance.

**Novelty:** This study offers novelty by exploring the role of innovation as a mediator in the relationship between entrepreneurial orientation, customers, competitors, and business performance, which has not been widely studied in the context of furniture SMEs in Indonesia.

**Keywords:** *business performance, smes, innovation, market orientation, entrepreneurial orientation*

## 1. Introduction

Small and Medium Enterprises (SMEs) are the main drivers of economic growth in Indonesia. Small and Medium Enterprises (SMEs) have very diverse characteristics, ranging from the scale of the business to the level of operational complexity (International Labor Organization (ILO), 2021). SMEs in Indonesia are vital for driving economic growth and generating employment opportunities. The year 2017 is proof that Small and Medium Enterprises (SMEs) are a very important economic sector in Indonesia, with a market share of 97.3%, a GDP contribution of 37%, and absorbing 66% of the workforce (Srimulyani et al., 2023). The success of SMEs has an involvement in the economic growth of a country, both in the context of developed and developing countries (Wajdi et al., 2018). This means that SMEs have a significant direct impact on economic development.

By 2022, a total of 8.71 million small, and medium-sized enterprises (SMEs) are operating in Indonesia, with Java as the largest concentration center. With the majority of Indonesia's population residing on the island of Java, which is also the country's main economic center, it is no wonder that the Small, and Medium Enterprises (SMEs) sector in Java, especially Central Java, has a very important role, especially in the furniture industry which has great potential for domestic and international markets (Srimulyani et al., 2023). Indonesian wood-based furniture products are highly favored in the international market due to their superior quality.

This creates vast business opportunities for furniture entrepreneurs and manufacturers in Indonesia. Indonesian furniture has a strong competitiveness in the global market, due to the uniqueness of its design and the use of distinctive materials such as rattan, bamboo, and teak wood, which distinguish it from other countries' furniture products (Arifin, 2022). According to data from the

Ministry of Industry in 2022, the furniture sector experienced a 2% decline, with an export value of USD 2.47 billion, a decrease compared to 2021, as illustrated in figure 1.

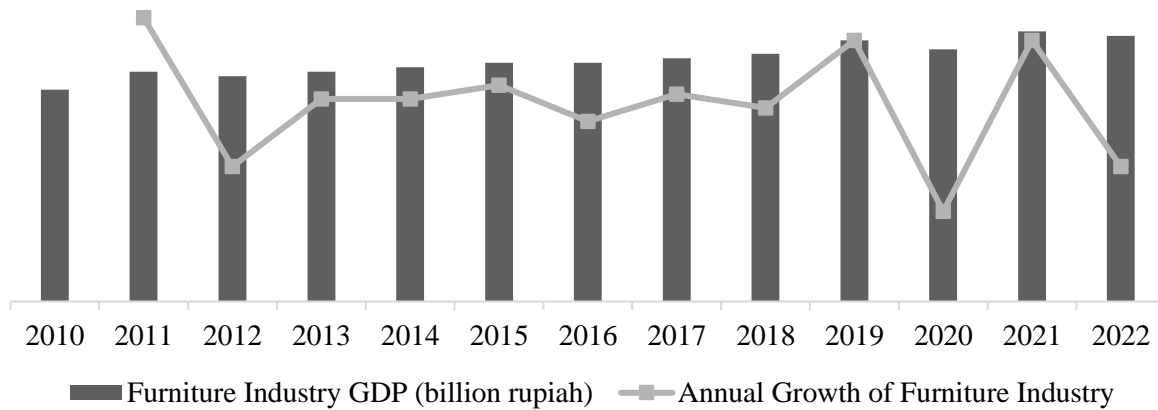


Figure 1. Trend Data of Furniture Industry Growth in Indonesia  
Source: industry data.com (2024)

The decline in the furniture industry's performance was due to various external factors affecting the global market. One of the main factors was the Russia-Ukraine war that caused an energy crisis in Europe and the United States. This crisis resulted in reduced demand for furniture exports from both regions. This geopolitical tension affected not only energy distribution but also consumer purchasing power, thus reducing furniture orders from manufacturers.

The furniture industry in Central Java is concentrated in three areas, namely Jepara, Semarang, and Solo. Furniture-making skills have been passed down through generations and continue to develop today, making the furniture industry one of the mainstay sectors in the three cities. It is undeniable that the furniture industry has become the lifeblood of the Jepara community, providing jobs and sustaining regional economic growth.

The existence of the furniture industry is very important for the welfare of the people of Jepara (Arifin, 2022). Data on fluctuations in Jepara furniture sales during the 2018-2023 period provide a comprehensive picture of the dynamics of the furniture industry in the area. Significant fluctuations, especially due to the COVID-19 pandemic, open up opportunities for further research to understand the factors that affect industry performance, as well as formulate appropriate strategies to improve the competitiveness and sustainability of the Jepara furniture industry in the future.

Table.1 Furniture Sales in Jepara Regency in 2018-2023

Year	Number of Furniture Export SMEs	Number of Countries	Volume (Kg)	Sales Value		
				Sales Results		Fluctuations
				(Rupiah)	(Rupiah)	Percentage (%)
2018	413	117	84.451.876	5.033.432.092.875	-	-
2019	427	113	80.127.123	5.514.668.313.866	592.434.957.331	11,77%
2020	413	95	82.145.758	4.775.415.892.080	-805.141.573.824	-14,60%
2021	378	98	79.039.148	4.985.774.227.804	227.309.796.463	4,76%
2022	683	332	70.005.553	6.182.841.182.700	930.345.470.908	18,66%
2023	1.144	631	90.425.549	9.804.288.133.822	5.495.303.499.007	56,05%

Source: industry.com data (2024)

Based on table 1, the furniture industry experienced an 56.05% increase in sales in 2023 compared to the previous year. This increase reflects the potential for significant business growth amid global market competition and changing consumer preferences. However, despite the increase in sales, not all furniture SMEs in Jepara are able to maintain or improve their business performance consistently. This raises the question of what factors play a role in driving business performance, especially in the SME sector. Various studies have consistently shown that business performance is strongly influenced by three main factors: entrepreneurial orientation, customers, and competitors (Nursal et al., 2022; Gray et al., 2002; Hamel & Wijaya, 2020) Meanwhile, in an increasingly dynamic business environment, innovation acts as a significant mediating variable in strengthening the impact of entrepreneurial orientation, customer orientation, and competitor orientation on business performance (Wicaksono & Isa, 2023).

Business performance (SMEP) can be interpreted as the result of tasks performed by teams within the company due to various aspects, with the aim of achieving predetermined goals within a certain period (Abbas, 2018). According to Boohene et al., (2019), while financial metrics such as ROA and ROI are often used in evaluating SME performance, non-financial metrics such as product quality and customer service are equally important. While financial metrics focus more on the financial aspects of the company, non-financial metrics reflect more on the company's ability to meet customer needs and maintain product quality. For SMEs, it is important to combine these two types of metrics in evaluating company performance.

In addition to performance metrics, entrepreneurial orientation (EO) also plays an important role in business success. EO reflects an individual's disposition to be proactive in responding to market dynamics, tolerant of business risk, and adaptive to changes in the business environment (Feriyanayah, 2023). According to Zhang et al., (2020), entrepreneurial orientation makes organizations manage and restructure resources obtained through networking, then turn them into innovative results. In other words, entrepreneurial orientation is proven to be very effective in maximizing the utilization of all existing resources and encouraging the creation of new ideas or innovations. Based on various studies, a strong entrepreneurial orientation has proven to be very important in ensuring business sustainability and growth, especially in crisis situations.

Entrepreneurs who have a high entrepreneurial orientation tend to be more willing to try things that have never been done before, increase their business productivity, and ultimately be able to compete better and develop their business sustainably. This is supported by several studies, such as those conducted by (Kottika et al., 2020; Sabahi & Parast, 2020). Research conducted by Nursal et al., (2022) states that entrepreneurial orientation affects the performance of SMEs. In other words, when SMEs adopt and activate entrepreneurial principles well, this can lead to an increase in the quality of their performance results, which include revenue growth, profitability, and business sustainability.

While Setyawati, (2013) and Frank, Hermann, (2010) state that entrepreneurial orientation (EO) has no significant effect on business performance (SMEP). In other words, although the company has quite good characteristics of entrepreneurial spirit, the ability to innovate, be proactive and courageous in taking risks. In reality, this factor does not play a key role in determining the extent to which the company is successful or less successful in achieving its goals. Improved business performance caused by entrepreneurial orientation must be supported by customer orientation (CTO).

The right customer orientation (CTO) plays an important role in supporting companies in decision making. A deep understanding of customers helps companies present superior value offerings, including the development of high-quality, imaginative, and leading-edge new products that can solve customer problems (Chen, 2022). Through customer orientation, it can also identify customer preferences and expectations that will motivate the company to strive to provide customer satisfaction (Syahira & Thamrin, 2023). In addition, the company's ability to analyze customer needs consistently and actively is also very important (Habel et al., 2020). Research on customer orientation generally proves that customer orientation will improve business performance (Munawaroh & Wibawanto, 2021).

However, research conducted by Rachmat, (2007) shows that customer orientation is unable to improve business performance. This is attributed to customer dissatisfaction, which arises from a lack of responsiveness to customer feedback or a slow processing time. Apart from the two factors

mentioned, increasingly fierce competition in the business world is also often the cause of business failure.

Competitor orientation (CPO) refers to the ability to analyze competitors and design marketing strategies accordingly (Suarkop, 2023). Companies must be able to analyze and evaluate information about competitors and utilize resources efficiently to collect relevant information. Competitor orientation is a business approach that proactively monitors and analyzes competitors' activities and strategies (Jamaludin et al., 2024). In this context, companies conduct continuous competitive monitoring to identify opportunities and threats, and optimize their business strategies.

According to Mubarak, (2019) in his research states that competitor orientation can strengthen SME performance. However, research conducted by Munawaroh & Wibawanto, (2021) competitor orientation did not succeed in proving that competitor orientation will improve business performance. So, the solution needed to overcome this obstacle is through innovation, namely the company's efforts to adapt to an ever-changing environment (Aulia & Hidayat, 2021).

Innovation gains importance as a tool to maintain existence and growth in the face of environmental uncertainty and increasingly fierce business competition (Zuliasanti et al., 2020). Innovation's success can be gauged by how effectively a company positions itself ahead of its competitors. Although many studies show a positive relationship between innovation and business performance such as Wicaksono & Isa, (2023), Putri et al., (2018), and Nursal et al., (2022), some other studies have found different results. For example, Karabulut, (2015) argues that innovation can hinder company growth.

This is in line with Laforet's view, (2011) which reminds us of the importance of considering the potential negative impact of innovation. This study aims to complement previous research on furniture SMEs by focusing on the local context of Jepara and considering the mediating role of innovation. Further research in this area may provide more in-depth and practical insights for entrepreneurs and managers in optimizing innovation strategies to achieve better performance in a competitive market. A conceptual framework can be constructed based on observed phenomena, theoretical foundations, and prior research findings to illustrate the relationships among these variables and research hypotheses. Figure 2 presents the conceptual framework scheme for this study.

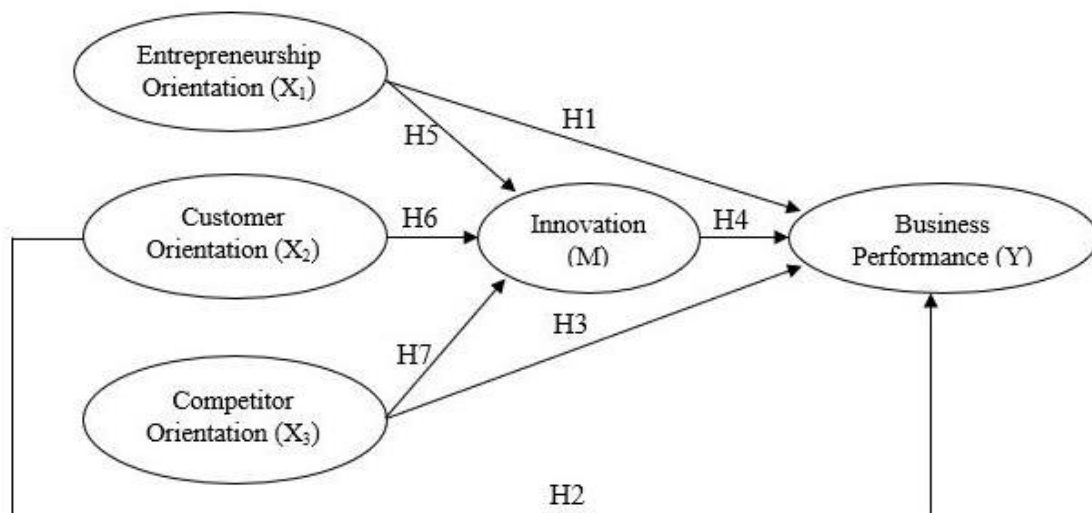


Figure 2. Conceptual Model

Based on the conceptual framework that has been presented, several hypotheses are formulated to be tested. Entrepreneurial orientation (EO) has a crucial role in integrating and developing capabilities from the external and internal environment to deal with rapid business changes in SMEs. Creative, innovative, proactive, and risk-taking abilities are the main foundation in identifying opportunities and achieving success Hibatullah, (2022). Research by Covin & Slevin, (1991) and

Wiklund, (1999) shows that high entrepreneurial orientation contributes positively to better product marketing and business performance. It also facilitates the creation and exploitation of profit opportunities (Wiklund, 1999; Zhang et al., 2020; Okangi, 2019). Thus, entrepreneurial orientation not only improves the firm's adaptability to changes in the business environment, but also has the potential to improve SME business performance in terms of innovation, marketing, and profit opportunity creation (Maulana, 2023; Kusnadi & Utama, 2023; Feriyansyah, 2023; Nursal et al., 2022; Hibatullah, 2022; Puwardi, 2023). Therefore, the proposed hypotheses are:

H1: EO has a positive effect on SME performance (SMEP).

Customer orientation (CTO) is a belief that places the interests of customers as the top priority without putting aside the interests of other parties in the company, such as owners and employees, to achieve long-term profitability Safa & Ismail, (2013). Research shows that a strong customer orientation allows companies to develop products that are superior in terms of quality and innovation, which can solve customer problems and increase value benefits (Chen, 2022). This orientation also helps companies to actively identify customer preferences and expectations, which in turn drives the company's efforts in improving business performance (Syahira & Thamrin, 2023; Habel et al., 2020). Therefore, the proposed hypothesis is:

H2: CTO has a positive effect on SME performance (SMEP).

Competitor orientation (CPO) is the ability of a company to analyze and deeply understand its competitors, both in terms of strengths and short- and long-term strategies (Suarkop, 2023; Hartato & Handoyo, 2021). Research shows that this ability helps companies to anticipate competitors' moves and design marketing strategies that match market dynamics (Maisirata, 2022). Studies conducted by Mubarak, (2019) and Yulianthini & Dewanti, (2023) confirmed that competitor orientation has a positive and significant correlation with business performance, indicating that companies that have a deep understanding of competitive actions and are able to adjust their business strategies effectively will achieve better performance. Therefore, based on the literature review, the proposed hypothesis is:

H3: CPO has a positive effect on SME performance (SMEP).

Innovation (INV) has an increasingly important role in maintaining the existence and improving the performance of Small and Medium Enterprises (SMEP) in the midst of intense business competition and a dynamic environment (Zuliasanti et al., 2020). As mentioned by Zainul et al., (2016), innovation is not only about creating new ideas but also reflects a corporate culture that is open to new ideas, willing to take risks, and proactive in facing market challenges. Owners who have the ability to innovate can generate new ideas that support business continuity while the owner's proactive attitude in improving his managerial skills will provide additional benefits for the business (Ismanto & Irawan, 2018). Innovation allows companies to adapt to change and come up with creative solutions that can improve the consumer experience. In an ever-changing business environment, the ability to innovate is key to a company's survival.

Without innovation, companies will find it difficult to survive. Based on research by Ullah & Danish, (2020), innovation is proven to directly improve company performance and can even lead companies to achieve better performance than their competitors. In addition, innovation also acts as a way for SMEs to improve the quality of their products, which has a direct impact on their business success and performance in a competitive market Putri et al., (2018). Therefore, the proposed hypothesis is:

H4: Innovation positively impacts SMEs performance (SMEP).

H5: Innovation mediates the relationship between EO and SMEP.

H6: Innovation mediates the relationship between CTO and SMEP.

H7: Innovation mediates the relationship between CPO and SMEP.

### 3. Methodology

This study's population consisted of 3,945 small and medium-sized furniture entrepreneurs in Jepara District. A sample of 113 small and medium-sized entrepreneurs in the Jepara region involved in the furniture industry was selected using purposive sampling. Primary data was gathered from furniture entrepreneurs in Jepara Regency through a questionnaire. The research variables include

entrepreneurial orientation, customer orientation, competitor orientation, business performance, and innovation.

Measurement of business performance was adopted from Musran Munizu, (2010) and four questions representing the dependent variable. The entrepreneurial orientation variable is measured by indicators used by Hibatullah, (2022) which includes three indicators, namely innovativeness, proactiveness, and risk-taking. There are three questions in the questionnaire that represent this variable. Customer orientation is measured using 3 items from the measurement items (Frambach et al., 2016). Five questions related to customer orientation were asked, including customer satisfaction, customer needs and wants, and customer value.

Measurement of competitor orientation variables refers to (Sigey et al., 2023). There are two competitor orientation questions which include knowledge of competitors' strengths and information. Meanwhile, the measurement of innovation variables refers to (Okhtavia & Setiawan, 2022). There are three innovation questions which include knowledge of product features, design, and quality. The data analysis method employed in this study utilizes variance-based structural equation modeling techniques, specifically known as Partial Least Squares (PLS).

#### 4. Results and discussion

##### Respondent Profile

Tabel 2. Respondent Demographics

<b>Variable</b>	<b>Unit</b>	<b>%</b>	<b>Variable</b>	<b>Unit</b>	<b>%</b>
<b>Age</b>			<b>Gender</b>		
<30 years	27	24%	Male	109	96%
30-40 years	43	38%	Female	4	4%
41-50 years	37	33%			
>50 years	6	5%	<b>Number of Employees</b>		
<b>Age of Company</b>			<6 employees		
5-10 years	25	22%	6-12 employees		
11-15 years	46	52%	13-19 employees		
16-20 years	29	26%	>19 employees		
>20 years	0	0%	<b>Education</b>		
<b>Total Monthly Income</b>			Elementary School		
<2 million	0	0%	Junior High School		
2-3 million	30	27%	Senior High School		
3-4 million	58	51%	Diploma/Bachelor's Degree (S1)		
>4 million	25	22%	Postgraduate/Master's Degree (S2)		

Source: processed by researchers, 2023

Table 2 presents respondent demographics categorized by gender, age, education, income, number of employees, and years of company operation. The majority of respondents are male (96%), a reflection of the industry characteristics; the furniture sector is largely male-dominated due to the physical and technical nature of the work. Age-wise, most respondents fall within the 30-40 age range (38%), followed by those aged 41-50 (33%). This indicates that this group is in the productive phase with sufficient experience.

Respondents under 30 years old accounted for 24%, while those over 50 years old were only 5%. In terms of education, 56% of respondents have a senior high school education, 33% junior high school, and 24% primary school, reflecting the variation in education levels that may affect the way they run their businesses.

Regarding total income, 51% of respondents had a turnover of between 3-4 million rupiah, indicating income stability. A total of 27% of respondents recorded a turnover of between 2-3 million, indicating the early phase of business development, and 22% had a turnover of more than 4 million, indicating good growth potential.

In terms of number of employees, 47% of respondents had 6-12 employees, indicating a small to medium organizational structure. A total of 20% reported having 13-19 employees, and 33% had more than 19 employees, indicating the presence of a larger company. In terms of length of operation, 52% of companies have been operating for 11-15 years, reflecting experience and stability. 26% have been operating for 16-20 years, indicating a good reputation in the market, while 22% have been operating for less than 5-10 years, indicating they are still in the early stages of development and face challenges in building a customer base and competitiveness.

Table 3 presents the results of calculations related to the validity test, reliability test, and inner model test, which are important steps in data analysis to ensure that the instruments used in this study are of good quality.

Table 3. Loading Factor, Cronbach's Alpha, Composite Reliability, AVE, dan R Square

Item	Loading Factor	Cronbach's Alpha	Composite Reliability	AVE	R-Square	R Square Adjusted
M1	0.840					
M2	0.800	0.767	0.865	0.681	0.339	0.321
M3	0.836					
X1.1	0.906					
X1.2	0.847	0.821	0.883	0.717		
X1.3	0.782					
X2.1	0.864					
X2.3	0.797	0.751	0.855	0.663		
X2.4	0.780					
X3.1	0.961	0.861	0.932	0.874		
X3.2	0.908					
Y1	0.859					
Y2	0.844	0.872	0.913	0.723	0.235	0.207
Y3	0.871					
Y4	0.827					

Source: processed by researchers, 2024

In Table 3, it is evident that all indicators display loading factors that meet the criteria for convergent validity, as each value exceeds the 0.7 threshold. However, two items, specifically X2.2 and X2.5, must be excluded since they fall short of the validity criteria. Thus, it can be concluded that the measurement instruments in this study are valid regarding convergent validity. Discriminant validity is assessed by comparing the square root of the Average Variance Extracted (AVE) with the correlations between constructs. This method ensures that each construct is unique, as the AVE square root exceeds the inter-construct correlations, indicating robust discriminant validity.

The test results are presented in Table 3, showing that all variables in this study have an AVE value that meets the minimum standard of above 0.50. This confirms that the constructs tested exhibit strong validity and effectively explain the variance of these variables. According to Table 3, the Cronbach's Alpha and Composite Reliability tests show values above 0.7 for each variable, indicating that all variables in this study are reliable, demonstrating consistency and stability in the measurements.

Additionally, Table 3 provides the inner model test results with the R-square parameter, showing adjusted R-square values of 0.321 for the Innovation (INV) variable and 0.207 for the PSMEs (Performance of Small and Medium Enterprises) variable. These findings suggest that the structural model in this study is relatively weak, as the independent variables explain only a limited proportion of the variance in the dependent variable. This implies that additional factors influencing the dependent variable may not have been captured in this model, warranting further research attention.

### Hypothesis Testing

The results of the hypothesis testing can be assessed through the t-statistic value and probability value obtained via the bootstrapping procedure. Variables are deemed to have a significant effect if the t-statistic value is  $\geq 1.96$  and the probability value is  $\leq 0.05$ . The direction of the variable relationships is analyzed using the path coefficient value, where a path coefficient value greater than 0 indicates a positive relationship (Ghozali & Latan, 2019).

Tabel 4. Path Coefficients

	<i>Original Sample (O)</i>	<i>T Statistics ( O/STDEV )</i>	<i>P Values</i>
INV -> SMEP	0.326	3.428	0.001
EO -> INV	0.259	2.803	0.005
EO -> SMEP	0.211	2.505	0.013
CTO -> INV	0.355	3.408	0.001
CTO -> SMEP	0.053	0.648	0.517
CPO -> INV	0.189	2.561	0.011
CPO -> SMEP	0.007	0.080	0.936

Source: processed by researchers, 2024

Table 4 shows that there are two hypotheses that have no effect, namely CTO and CPO on SME Performance. This is indicated by the t-statistic value which is less than 1.96, as well as the probability value which is greater than 0.05. A t-statistic value lower than 1.96 indicates that there is no significant relationship between these variables, so it can be concluded that CPO and CTO have no meaningful impact on the performance of SMEs in the context of this study. In contrast, the other hypothesis shows a significant positive influence on SMEP. The t-statistic value for this hypothesis exceeds 1.96, with a significance level below 0.05, indicating that these variables have a direct and significant impact on enhancing the performance of small and medium enterprises. This suggests that improvements in the tested variables are likely linked to enhancements in SME performance, offering solid support for the hypothesis in this study.

Tabel 5. Specific Indirect Effects

	<i>Original Sample (O)</i>	<i>T Statistics ( O/STDEV )</i>	<i>P Values</i>
EO -> INV -> SMEP	0.084	2.163	0.031
CTO -> INV -> SMEP	0.116	2.245	0.025
CPO -> INV -> SMEP	0.062	2.080	0.038

Source: processed by researchers, 2024

Table 5 indicates that EO, CTO, and CPO positively and significantly influence SME performance, with innovation serving as the mediating variable. This finding is validated by analysis results showing a t-statistic greater than 1.96 and a probability value below 0.05. A t-statistic above 1.96 confirms that the relationships between these variables and SME performance are statistically significant, meaning that changes in EO, CTO, and CPO positively impact SME performance improvement. In addition, the probability value being below 0.05 indicates that the results do not occur by chance, but rather reflect a real relationship. The mediating effect of innovation is also important to note, as it suggests that innovation acts as a bridge linking EO, CTO, and CPO to SME performance. In other words, improvements in the aspects of EO, CTO, and CPO not only directly impact SME performance, but also through the resulting increase in innovation. The complete results of the PLS analysis from this study are illustrated in Figure 3.

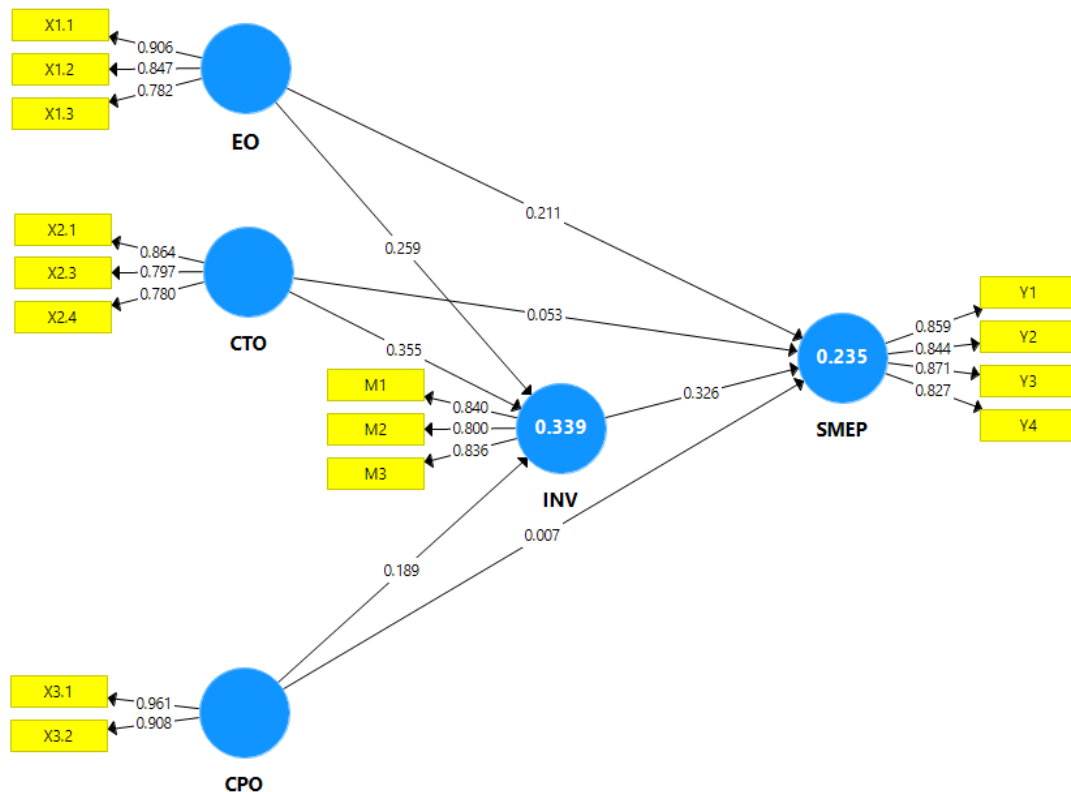


Figure 3. SEM-PLS Results  
Source: processed by researchers, 2024

The results demonstrate a positive and significant correlation between entrepreneurial orientation and SME performance. This is evident from the hypothesis test, where the t-statistic value of 2.505 exceeds 1.96. Furthermore, the impact of entrepreneurial orientation on SME performance is  $0.211 > 0$ , with a P-value below 0.05 at 0.013. Therefore, it can be concluded that entrepreneurial orientation positively and significantly influences SME performance. This finding is consistent with research conducted by Hibatullah, (2022), which also explained that SMEs that have a strong entrepreneurial orientation, characterized by innovative, proactive, and risk-taking traits, tend to perform better than SMEs that lack these traits.

Additionally, the results indicate that customer orientation does not influence SME performance. This is evident from the P-value, which is greater than 0.05 at 0.517, leading to the conclusion that customer orientation has no significant impact on business performance. Furthermore, hypothesis testing results show a t-statistic value of 0.648, which is less than 1.96. This study is apparently not in line with the results of previous research conducted by Syahira & Thamrin, (2023); Jalilvand, (2017); Munawaroh & Wibawanto, (2021) where they found that the customer orientation variable has a significant influence on SME performance. Customer orientation indicators such as customer satisfaction, customer needs and wants, and customer value, in this study did not show a significant contribution to improving the performance of SMEs in the furniture sector in Jepara. These results suggest that, although customer orientation is considered important in some previous studies, in the context of this study, customer orientation is not proven to have a significant impact on SME performance. In this case, the furniture SMEs in Jepara have not implemented customer orientation optimally. Although they have a basic understanding of the importance of recognizing customer needs and preferences, many furniture SMEs in Jepara have not been able to integrate this understanding into a comprehensive business strategy. This can be seen from the lack of product innovation in accordance with market desires and the lack of ability to present truly superior value offerings. Consequently,

customer orientation does not significantly impact their business performance, as the approach used remains conventional and is less responsive to the changing dynamics of customer needs.

Similarly, competitor orientation does not affect the performance of SMEs. This is shown by a P-value of 0.936, which exceeds 0.05, indicating that competitor orientation has no significant impact on business performance. Furthermore, the hypothesis testing results reveal a t-statistic value of 0.080, which is less than 1.96. This study shows that indicators of competitor orientation, such as competitor strength and competitor information, do not contribute significantly to improving the performance of SMEs in the furniture sector in Jepara. In this case, furniture SMEs in Jepara have not actively implemented competitor orientation in their business strategy. Many furniture SMEs in Jepara still pay little attention to competitor movements, both in terms of product innovation, marketing strategies, and prices. As a result, they are unable to take the right steps to face competition, making it difficult to adapt to changes made by competitors. This inability makes competitor orientation not have a significant influence on their business performance, because the information and analysis of competitors obtained are not utilized effectively in making business decisions. This finding is different from studies conducted by Mubarak, (2019) and Yulianthini & Dewanti, (2023), where they found that the competitor orientation variable has a significant influence on SME performance. The study highlights the relationship between competitor orientation and a company's ability to understand and respond to competitors' strategies, which in turn has a positive impact on business performance. However, in the context of this study, competitor orientation is not proven to have a significant impact on SMEs performance. Various contextual factors influence this, such as the dynamics of the local market, the business strategies employed by furniture SMEs in Jepara, as well as differences in the research approaches used. Thus, this result underlines the importance of understanding the specific context of each study and not generalizing the findings without considering the contextual variables that might affect the final results.

In contrast, innovation has a positive and significant influence on the performance of SMEs. This is demonstrated by the results of the hypothesis test, where the t-statistic value is 3.428, exceeding the threshold of 1.96. In addition, the effect of innovation on the performance of small and medium enterprises was recorded at  $0.326 > 0$  with a P-value of less than 0.05. This finding is consistent with research conducted by Ullah & Danish, (2020), innovation is proven to directly improve company performance and can even lead companies to achieve better performance than their competitors. Additionally, entrepreneurial orientation has a positive and significant effect on SME performance, with innovation acting as a mediator. This is evidenced by a t-statistic value of 2.163, exceeding 1.96, an effect size of 0.084 (which is greater than 0), and a significant P-value of 0.031, which is less than 0.05. These results indicate that innovation plays a significant role as a mediator in the relationship between entrepreneurial orientation and SME performance. This finding is consistent with the results of previous research conducted by Wicaksono & Isa, (2023), which also found that entrepreneurial orientation has a positive effect on SME performance through innovation.

Furthermore, customer orientation has been demonstrated to have a positive and significant effect on the performance of SMEs, with innovation functioning as a mediator. The hypothesis test results show a t-statistic value of  $2.245 > 1.96$  with a significant effect of  $0.116 > 0$  and a P-value of less than 0.05 (0.025). Thus, it can be concluded that innovation plays a crucial role as a mediator in the relationship between customer orientation and SME performance. This finding is consistent with the results of previous research conducted by Christian, (2019) and Putri et al., (2019), which found that customer orientation has a positive effect on SME performance through innovation.

Finally, competitor orientation is also found to have a positive and significant impact on the performance of small and medium enterprises, with innovation serving as a mediator. The analysis shows a t-statistic value of  $2.080 > 1.96$  with an effect of  $0.062 > 0$  and a significant P-value of less than 0.05 (0.038). This confirms that innovation acts as an effective mediator in connecting competitor orientation with SME performance. This finding is in line with the results of research conducted by Antari & Widagda K, (2022), which also found that competitor orientation has a positive influence on SME performance through innovation. Overall, this study highlights the strategic importance of entrepreneurial orientation, customer orientation, and competitor orientation in optimizing SME

performance in the furniture sector in Jepara, with innovation serving as a crucial mediating factor. The practical implication of the findings is the need to focus on innovation development as a way to improve SMEs' business performance, by considering various aspects of the relevant orientations.

## **4. Conclusion**

### **4.1. Conclusion**

Based on the analytical findings presented in this study, it can be concluded that entrepreneurial orientation and innovation have a positive and significant impact on the business performance of SMEs in the furniture sector in Jepara. Conversely, customer orientation and competitor orientation do not demonstrate a significant direct impact on SMEs performance. However, entrepreneurial orientation, customer orientation, and competitor orientation collectively influence SME performance through the mediation of innovation. The implications of this study suggest that strategy development that focuses on internal resource mobilization and market utilization can optimize SME business performance. Entrepreneurial orientation needs to be prioritized to strengthen innovation as one of the fundamental elements in improving competitiveness and achieving sustainable business success.

Meanwhile, although customer orientation and competitor orientation do not directly affect SME performance, it is important for SMEs to still understand and adapt market needs and anticipate competitors' moves to create relevant and competitive innovations. For practitioners and stakeholders, it is important to consider approaches to developing innovation-focused products and services as a bridge to improving business performance. This can be done by optimizing internal processes and integrating feedback from the market and competitors into product development strategies. Thus, this study provides practical guidance for SMEs in the furniture sector and other industries to strengthen their position in the market through the utilization of innovation as an effective strategic tool.

### **4.2. Limitation**

This study has limitations in the scope that only covers SMEs in the furniture sector in Jepara Regency. This indicates that the data utilized and the analysis results only reflect the specific conditions and dynamics occurring within SMEs in this sector and region. The results of this study only apply to the context of the furniture industry in Jepara, as other sectors such as food and beverages, textiles, or services have unique business challenges and opportunities. In addition, the business environment in Jepara, including cultural factors, infrastructure, local government policies, and local market dynamics, may differ from other regions in Indonesia. Therefore, there is a need for further research in different industry sectors or in different regions to test whether or not these findings are consistent in a broader context. This is important to obtain more generalized and relevant conclusions for SMEs in Indonesia as a whole.

### **5.3. Suggestion**

Entrepreneurial orientation is proven to be an important factor in improving the performance of Jepara furniture SMEs through innovation development. It is important for businesses to focus on mobilizing internal resources, such as improving HR capacity and operational efficiency, which will support the creation of relevant and competitive innovations. Although customer orientation and competitor orientation did not show a direct influence on performance, SMEs still need to pay attention to market dynamics and competitor strategies to inspire innovations that can strengthen their position. In addition, the development of innovative products and services should be based on market understanding and customer feedback, so that business strategies are more focused and oriented to consumer needs. To obtain a deeper understanding and stronger generalization, further research needs to be conducted involving a more diverse sample from various sectors and regions.

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