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## Empowerment of Small and Medium Businesses (SMES) Based On Regional Potential in an Effort to Increase Competitive Advantage and Business Performance

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### Abstract

Empowerment of SMEs based on regional potential through local economic development, local governments and community groups are required to take initiative and instead of passive roles. Various strategic roles are owned by the SME sector, but this sector is also faced with various problems, including in terms of capital, business management capabilities, and the quality of human resources. **The objectives of this study are:** (1) To analyze the influence of innovation ability, innovation culture, human resource capability, and customer orientation on competitive advantage in SMEs in Malang Regency. (2) Analyzing the influence of innovation ability, innovation culture, human resource capability, customer orientation, and competitive advantage on business performance of SMEs in Malang Regency. (3) Analyzing the influence of innovation ability, innovation culture, human resource capability, customer orientation on business performance through competitive advantage in SMEs in Malang Regency. **This research method** uses a quantitative descriptive approach. The population in this study was 232 SME business unit and a sample of 115 SMEs assisted businesses Cooperatives and SME Malang and products featured in Malang Regency. The sampling technique is purposive sampling. The data analysis technique used Structural Equation Modeling (SEM). **The results of the study are** (1) the ability of innovation, innovation culture, human resource capabilities, and customer orientation have a significant effect on competitive advantage in SMEs in Malang Regency. (2) The ability of innovation, innovation culture, human resource capabilities, customer orientation, and competitive advantage have a significant effect on business performance in SMEs in Malang Regency. (3) The ability to innovate, the culture of innovation, the ability of human resources, customer orientation in SMEs in Malang Regency and competitive advantage as intervening variables.

**Keywords:** Empowerment, Small and Medium Enterprises, regional potential, competitive advantage, business performance.

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### I. Introduction

Small and Medium Enterprises (SMEs) is a business unit managed by community groups and families as the majority of Indonesian businesses. The role of Small and Medium Enterprises (SMEs) in the national economy is very large. The economic crisis that began with the monetary crisis that occurred in Indonesia showed that SMEs were relatively more resilient in the face of the crisis, than large-scale businesses that went bankrupt. Micro, Small and Medium Enterprises (MSMEs) have a contribution of 60.3% of the total Gross Domestic Product (GDP) of Indonesia, in addition to the MSMEs absorb 117 million workers or 97% of the total workforce and 99% of the total employment. Indonesia in 2018 had 64.2 million business units (BPS, 2018). According to Nuret *et al.*, (2014) SMEs can play a role in increasing employment, country development, and it is important to distribute development results. SMEs in Indonesia have an important role in the movement of the country's economy (Pramestiet *et al.*, 2016). According to Suryana (2013) SMEs have the advantage of not being easily shaken, because most of the raw materials and other resources come from within the country.

The performance of MSMEs in Indonesia has not shown good results, the family-based management system is one of the causes. Business management is still traditional and prioritizes family relationships over professional relationships (Alimudin *et al.*, 2019; Mangantaret *et al.*, 2017). Company performance is the level of achievement of the implementation of an activity to achieve predetermined targets or criteria that have been mutually agreed upon (Elisa, 2020). Increasing the performance of MSMEs will also increase the growth of the country's Gross Domestic Product (Laily, 2016; Hapsari *et al.*, 2014). The performance of MSMEs often experiences obstacles, such as the ability to survive, grow and develop, some of the causes include problems with human resource capabilities, product ownership, financing, marketing and other problems that make

MSMEs unable to compete, especially with large companies (Aribawa, 2016; Sudiarta, 2014). The business performance of SMEs can increase if the company is able to compete with competitors, competitive advantage is the ability of top management to understand the process by which the capabilities of SMEs are converted into core competencies to create opportunities for the company (Chelliah *et al.*, 2010).

11 The performance of SMEs is not only influenced by competitive advantage, it is also important to have the ability to innovate. The ability to innovate is the company's capacity to develop new products through a combination of innovative behavior, strategic capabilities, and internal technological processes (Vicente *et al.* 2015). The innovation ability of companies belonging to the creative industry is able to positively affect the success of a product produced by the company. One of the prerequisites for being successful in a competitive environment is a culture of innovation or innovation culture (Aksoy, 2017). Culture becomes a supporter or a barrier to a company's innovation. Culture or innovation culture can improve company performance and enable the development of new products that require creativity, 15 teamwork, open communication, and good relations with employees (Klein & Gomes, 2016). Furthermore, SMEs can implement a culture of innovation as a strategic tool and facilitate the development of new products. The ability of Human Resource (HR) is a development that focuses on technology making human resources not only required to operate but also to utilize a large number of information technologies regarding consumer demand and production processes (Nuray, Terzi, 2011). Environmental changes, including information technology, really need good quality human resources in order to adapt to these changes (Dhamayantie *et al.*, 2017). is a development that focuses on technology making human resources not only required to operate but also to utilize a large number of information technologies regarding consumer demand and production processes (Nuray, Terzi, 2011). Environmental changes, including information technology, really need good quality human resources in order to adapt to these changes (Dhamayantie *et al.*, 2017).

In addition to innovation capabilities, innovation culture and human resource capabilities, customer orientation is also important to improve the competitive advantage and business performance of SMEs. Customer orientation is the process of finding information about customers, with customer information, the company will understand who its potential customers are, both now and in the future and what customers want now and in the future (Low *et al.* 2007). Customer orientation is a belief that places customer interests as the basis of product offerings, while all other stakeholders such as owners, managers and employees to develop a profitable company in the long term. Customer orientation is more relevant for SMEs, because it consists of all relevant stakeholders and the importance of customer orientation as a driver of the company's long-term profits. The potential of several regions in Indonesia makes it attractive for local and international tourists, thus creating a better business climate for SMEs and this condition can support the growth of SMEs.

Based on this background, this research is important to do to answer the following problems: (1) How does the influence of innovation ability, innovation culture, HR capability, and customer orientation affect the competitive advantage of SMEs in Malang Regency?, (2) How does the influence of innovation ability, culture innovation, human resource capabilities, customer orientation, and competitive advantage on the business performance of SMEs in Malang Regency? (3) How is the influence of innovation ability, innovation culture, human resource capability, customer orientation on business performance through the competitive advantage of SMEs in Malang Regency? 21

Based on the problems above, the objectives of this study are as follows: (1) To analyze the influence of innovation ability, innovation culture, human resource capability, and customer orientation on the competitive advantage of SMEs in Malang Regency. (2) Analyzing the influence of innovation ability, innovation culture, human resource capability, customer orientation, and competitive advantage on the business performance of SMEs in Malang Regency. (3) Analyzing the influence of innovation ability, innovation culture, human resource capability, customer orientation on business performance through the competitive advantage of SMEs in Malang Regency.

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## II. Literature Review

### Empowerment of SMEs

Micro, Small and Medium Enterprises (MSMEs) are productive economic businesses that stand alone and are carried out by individuals or business entities that are able to expand employment opportunities and provide broad economic services to the community. Empowering SMEs are the efforts made by the Government, local government, business world and society in synergy to shape the growth of the business climate, business development and financing to SMEs to be able to grow and develop into a business that is strong and 18 dependent (number 8 by Law No. 20 Th 2008). Some of the principles of SME empowerment include (1) Development of regional potential-based and market-oriented businesses in accordance with the competencies of Micro, Small, and Medium Enterprises. (2) Increasing the competitiveness of Micro, Small, and Medium Enterprises. (3) Implementation 16 integrated planning, implementation, and control. The purpose of empowering MSMEs is to increase the role of Micro, Small and Medium Enterprises in regional development,

job creation, income distribution, economic growth, and alleviating people from poverty. Empowerment of Micro, Small and Medium Enterprises (MSMEs) must be carried out comprehensively, optimally and continuously through the development of a conducive climate, providing business opportunities, support for protection and business development as widely as possible, in order to improve the position, role, and potential of Micro, Small and Medium Enterprises (MSMEs) in realizing economic growth, and can increase people's income, create jobs and reduce poverty.

### Regional Potential

Regional potential is the ability that has the possibility to be developed, strength, ability, power and territory in this case means the regional environment (province, district, sub-district). Various economic activities encourage each district or city to develop its economic potential. Therefore, regional development is carried out in an integrated and harmonious manner and is directed so that development takes place in each region and is in accordance with regional priorities and potentials. Regional development is a process of local government and community managing existing resources in the form of a partnership pattern, between local governments, communities and the private sector, to develop existing potential by utilizing all existing potential. Regional competitiveness is the ability of the regional economy to achieve a high and sustainable level of welfare growth while remaining open to domestic and international competition. The development of the economic potential of the potential sector that provides the largest contribution to regional economic progress is a policy priority that must be implemented.

### Business Performance

Performance is the result or level of success of a person as a whole during a certain period in carrying out tasks compared to various possibilities, such as work standards, targets or targets or criteria that have been determined in advance and have been mutually agreed upon. Business performance is how well the company is managed and has value that can be distributed by the company to customers and other stakeholders (Moullin, 2009). The company's current overall performance relative to other companies in the industry in terms of product and service quality, employee morale, employee skills, labor productivity and efficiency, and profit levels are understood as the overall increase in profits based on the revenue generated from the sale of the product and services (Natasha, 2013). Company performance is something that is produced by the company in a certain period with reference to the standards set, so that the company's performance is also carried out to monitor the achievement of goals that have been set in a certain period. Business performance is an achievement that has been achieved by the company by taking into account various influencing indicators, namely: (1) Sales growth. (2) Capital growth. (3) Addition of manpower. (4) Market growth. (5) Profit growth (Munizu, 2010).

### Competitive Advantage

The concept of competitive advantage, cannot be understood by looking at a company as a whole, but must originate from the origin of competitive advantage, namely the various different activities carried out by companies in designing, producing, marketing, delivering and supporting their products. Competitive advantage is the ability of top management to understand the process by which the capabilities of SMEs are transformed into core competencies to create opportunities for companies (Chelliah *et al.*, 2010). Some of the indicators used to measure competitive advantage are (1) Product uniqueness: the resulting product combines artistic value with customer tastes. (2) Product quality: product quality and design. (3) Competitive price: the company's ability to adjust the price of its products to the general price in the market (Hasan, 2013). Product purchases will occur if the customer considers the price of the product according to the value it offers. Competitive advantage has a significant effect on company performance (Davicik & Sharma, 2016; Susana *et al.*, 2019).

### Innovation Ability

The ability of innovation is a process in the organization's ability that generates new ideas to create new product success with the development of the production process having an impact on increasing sales, profits and strength of competition. Innovation capability is a process that starts with ideas, findings from the development and introduction of new products, processes and new services in the market (Sulistyo & Siyamtinah 2016). A new invention that is different from existing or previously known, entrepreneurs who are able to innovate can be said to be innovative entrepreneurs, always trying to make improvements, promising something new that is different from what already exists. The ability to innovate is the company's capacity to develop new products through a combination of innovative behavior, strategic capabilities, and internal technological processes (Vicente, Abrantes, & Teixeira, 2015). Innovation ability is measured by three indicators, namely: (1) Organizational culture. (2) Knowledge. (3) Customer and employee engagement (Rajapathirana & Hui, 2017). Companies that are able to increase the ability to innovate are able to actively increase business growth or business performance (Huhtala, *et al.*, 2013). Innovation ability affects competitive advantage and business performance (Widyanti & Mahfudz, 2020; Sulistyo & Ayuni, 2020).



### Innovation Culture

An innovation culture can improve company performance and enable new product development which requires creativity, teamwork, open communication, good relations with employees (Klein & Gomes, 2016). Innovation culture is an organizational culture that exists within the company to always create new products (Kotler, 2016). Furthermore, SMEs can apply a culture of innovation as a strategic tool to improve performance and facilitate the development of new products. Organizational culture is a key determinant for corporate innovation. Culture becomes a supporter or a barrier to a company's innovation (Naranjo-Valencia et al., 2015). The culture of innovation in Small and Medium Enterprises (SMEs) is something that can build and sustain product innovation. The innovation culture consists of several indicators: (1) Managers have the courage to innovate and take risks. (2) Managers encourage creative ideas in the organization. (3) Companies value a willingness to experiment with new ideas. (4) Managers expect employees to work together to implement new processes. (5) The most important success factor in our business is innovation (Aksoy, 2017). A culture of innovation is a prerequisite for being successful in a competitive environment (Aksoy, 2017). Understanding innovation culture can help to drive product innovation, process innovation, and SME performance (Klein & Gomes, 2016). The culture of innovation affects competitive advantage and business performance (Arsawanet al., 2020).

### The ability of Human Resources (HR)

E-Commerce is the process of carrying out business transactions, such as distribution, purchasing, sales, and services that are carried out electronically through computer networks, especially the internet and also external networks (I Gede, 2014). One of the important things that must be considered in e-commerce is the ability of Human Resources (HR). Human resource capabilities are developments that focus on technology, making human resources not only required to operate but also to utilize a large number of information technologies regarding consumer demand and production processes (NurayTerzi, 2011). HR capability indicators consist of: (1) Knowledge: knowing and understanding knowledge in their respective fields concerning duties and responsibilities at work. (2) Skills: the ability to complete tasks well and the ability to solve problems. (3) Attitude: having creativity at work and high morale (Hutapea and Nuriana, 2010). HR capabilities have a significant effect on competitive advantage (Azhadet al, 2018; Adi Putra and Mandala, 2017). The ability of human resources has a significant effect on the business performance of SMEs (Ardianaet al., 2010). HR capabilities have a significant effect on competitive advantage and business performance (Murtadlo, 2018).

### Customer Orientation

Companies are required to have more value to customers, to maintain them so that customers do not easily move to others because they feel comfortable with the values created by the company. Customer orientation is the process of finding information about customers, with customer information the company will understand who its potential customers are, both now and in the future and what customers want now and in the future (Low et al., 2007). Indicators of customer orientation according to Jalilvand (2017): (1) Customer focus: providing maximum service in meeting customer needs is an important thing that must be done by the company. Paying attention to what customers need and knowing what customers don't like. Customers' expectations are very diverse and conflicting with each other, so customer focus is one of the important parts that must be done by companies. (2) Competitors: is one of the things that must be known by the company. Strategies in retaining customers and increasing the number of customers applied by competitors can be an alternative for companies to adopt and implement within their own company. (3) Customer value: the difference between a prospective customer's assessment of all the benefits and costs of an offering against its alternatives (Kotler and Keller, 2016). Small and Medium Enterprises (SMEs) tend to be closer to customers to meet demands and can easily process customer data because of this proximity (Mauryaet al., 2015). Customer orientation is a strategy that stands out for small companies as a medium of competitive advantage that can separate them from larger companies (Brockman et al., 2012). Customer orientation also has a significant effect on business performance (Pekovic& Rolland, 2012). Customer orientation affects competitive advantage and business performance (Tarabih and Ahmad, 2015).

### Hypothesis

1. Innovation ability, innovation culture, human resource capability, and customer orientation have a significant effect on the competitive advantage of SMEs in Malang Regency.
2. Innovation ability, innovation culture, human resource capability, customer orientation, and competitive advantage have a significant effect on the business performance of SMEs in Malang Regency.

3. Innovation ability, innovation culture, human resources capability, customer orientation have a significant effect on business performance through the competitive advantage of SMEs in Malang Regency.

### III. Research Methods

This research method uses a quantitative descriptive approach. The population in this study were 232 SME entrepreneurs and a sample of 115 SME entrepreneurs who were assisted by the Malang Regency Cooperative and UKM Office and a superior product in Malang Regency. The questionnaire used was designed in the form of a closed questionnaire with Likert Scale, used to measure the indicators of the variables forming the empowerment of SMEs in an effort to improve competitive advantage and business performance of SMEs. The sampling technique is purposive sampling. Data analysis techniques using Structural Equation Modeling (SEM).

### IV. Results and Discussion

#### a. Results

##### i. Evaluation of the Goodness of Fit Model

Use Structural Equation Modeling (SEM) to test various relationships in a model. To analyze, evaluate the validity, and causality between variables of this model, AMOS 20 software is used.

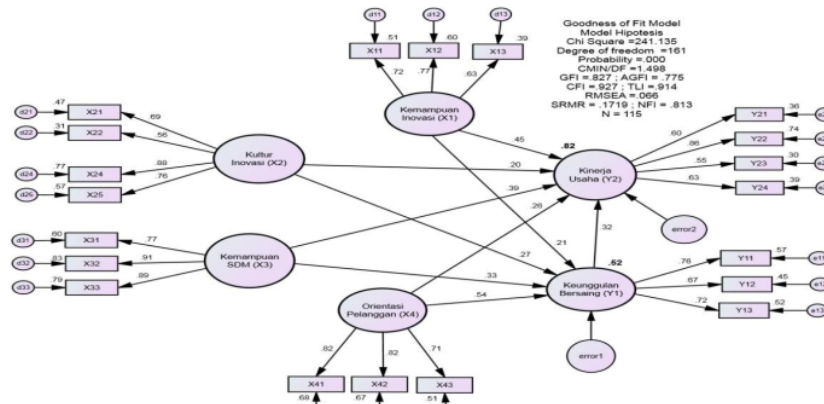


Figure 1: Structural Model Results

The results of the model feasibility test on the evaluation model are presented in Table 1.

Table 1: Evaluation of the Criteria for Conformance Index of Structural Models

Criteria	Results	Critical Value	Model Evaluation
<b>Absolute fit</b>			
Chi-square ( $\chi^2$ )	182.527	$\leq 185.05$	Good
Probability	0.065	$\geq 0.05$	Good
Degrees of Freedom	155	-	
GFI	0.869	$\geq 0.90$	Marginal
RMSEA	0.040	$\leq 0.08$	Good
<b>Parsimony fit</b>			
CMIN/DF	1.178	$\leq 2.00$	Good
AGFI	0.823	$\geq 0.90$	Marginal
<b>Incremental fit</b>			
CFI	0.975	$\geq 0.95$	Good
TLI	0.969	$\geq 0.95$	Good

Table 1 shows a summary of the results obtained in the analysis and recommended values for measuring the feasibility of the model. The results of the analysis related to the model feasibility index explained that the evaluation of the model produced a good feasibility value. The feasibility of the model has fulfilled all the eligibility requirements including the Chi Square test results, p-chi-square value greater than 0,05 at a significant level of 0,05, so that the evaluation model in this study can be accepted as the final model for interpretation and hypothesis testing.

## ii. Structural Equation

The causality relationship developed in the hypothesis in this model is tested with the null hypothesis which states that the regression coefficient between the relations of the constructs is no different from zero through the t-test as in the regression analysis. Hypothesis testing in the structural model is related to the results of the regression coefficient tests on each path produced which are described in table 2.

**Table 2.** Regression Coefficient Test Results Influence Between Variables

Influence	Standard Coefficient	C.R.	Value of p	Information
Innovation Ability -->Competitive Advantage	,208	1,974	,048	Significant
Innovation Culture -->Competitive Advantage	,270	2,622	,009	Significant
HR Capability -->Competitive Advantage	,333	3,337	***	Significant
Customer Orientation -->Competitive Advantage	,538	4,529	***	Significant
Innovation Ability -->Business Performance	,446	3,955	***	Significant
Innovation Culture -->Business Performance	,195	2,194	,028	Significant
HR Capability -->Business Performance	,388	3,863	***	Significant
Customer Orientation -->Business Performance	,259	2,243	,025	Significant
Competitive Advantage -->Business Performance	,320	2,197	,028	Significant

The structural model results (structural models) of each research variable are as follows:

$$Y_1 = 0,208X_1 + 0,270X_2 + 0,333X_3 + 0,538X_4 \dots\dots\dots (1)$$

$$Y_2 = 0,446X_1 + 0,195X_2 + 0,388X_3 + 0,259X_4 + 0,320Y_1 \dots\dots\dots (2)$$

**The first equation (1)**, there are four determinants of Competitive Advantage, namely Innovation Capability, Innovation Culture, HR Capability, and Customer Orientation. These four determinants are positive, meaning that good Innovation Capability, good Innovation Culture, good HR Capability, and good Customer Orientation will encourage high Competitive Advantage.

**The second equation (2)**, there are five determinants of Business Performance, namely Innovation Capability, Innovation Culture, HR Capability, Customer Orientation and Competitive Advantage. These five determinants are positive, meaning that good Innovation Ability, Good Innovation Culture, Good Human Resources Capability, Good Customer Orientation and Good Competitive Advantage will encourage high Business Performance.

## iii. Hypothesis Testing

### 1. Hypothesis Testing 1

The value of the pathway of Innovation Ability ( $X_1$ ) → Competitive Advantage ( $Y_1$ ) is 0,208, meaning that the influence of Innovation Ability ( $X_1$ ) on Competitive Advantage ( $Y_1$ ) is 0,208. Probability value = 0,048 <significance level ( $\alpha$ ) 0,05, it can be concluded that there is a significant influence of Innovation Ability ( $X_1$ ) on Competitive Advantage ( $Y_1$ ).

The value of the pathway of Innovation Culture ( $X_2$ ) → Competitive Advantage ( $Y_1$ ) is 0,270, meaning that the influence of Innovation Culture ( $X_2$ ) on Competitive Advantage ( $Y_1$ ) is 0,270. Probability value = 0,009 <significance level ( $\alpha$ ) 0,05, it can be concluded that there is a significant influence of Innovation Culture ( $X_2$ ) on Competitive Advantage ( $Y_1$ ).

The value of the pathway of HR Capability ( $X_3$ ) → Competitive Advantage ( $Y_1$ ) is 0,333, meaning that the influence of HR Capability ( $X_3$ ) on Competitive Advantage ( $Y_1$ ) is 0,333. Probability value = 0,000 <significance level ( $\alpha$ ) 0,05, it can be concluded that there is a significant influence of HR Capability ( $X_3$ ) on Competitive Advantage ( $Y_1$ ).

The value of the pathway of Customer Orientation ( $X_4$ ) → Competitive Advantage ( $Y_1$ ) is 0,538, meaning that the influence of Customer Orientation ( $X_4$ ) on Competitive Advantage ( $Y_1$ ) is 0,538. Probability value = 0,000 <significance level ( $\alpha$ ) 0,05, it can be concluded that there is a significant influence of Customer Orientation ( $X_4$ ) on Competitive Advantage ( $Y_1$ ).

So: Innovation Ability, Innovation Culture, HR Capability, and Customer Orientation have a significant effect on Competitive Advantage in SMEs in Malang Regency.

### 2. Hypothesis Testing 2

The value of the pathway of Innovation Ability ( $X_1$ ) → Business Performance ( $Y_2$ ) is 0,446, meaning that the influence of Innovation Ability ( $X_1$ ) on Business Performance ( $Y_2$ ) is 0,446. Probability value = 0,000 <significance level ( $\alpha$ ) 0,05, it can be concluded that there is a significant influence of Innovation Ability ( $X_1$ ) on Business Performance ( $Y_2$ ).

The value of the pathway of Innovation Culture ( $X_2$ ) → Business Performance ( $Y_2$ ) is 0,195, meaning that the influence of Innovation Culture ( $X_2$ ) on Business Performance ( $Y_2$ ) is 0,195. Probability value = 0,028



<significance level ( $\alpha$ ) 0,05, it can be concluded that there is a significant influence of Innovation Culture ( $X_2$ ) on Business Performance ( $Y_2$ ).

The value of the pathway of HR Capability ( $X_3$ )  $\rightarrow$  Business Performance ( $Y_2$ ) is 0,388, meaning that the influence of HR Capability ( $X_3$ ) on Business Performance ( $Y_2$ ) is 0,388. Probability value = 0,000 <significance level ( $\alpha$ ) 0,05, it can be concluded that there is a significant influence of HR Capability ( $X_3$ ) on Business Performance ( $Y_2$ ).

The value of the pathway of Customer Orientation ( $X_4$ )  $\rightarrow$  Business Performance ( $Y_2$ ) is 0,259, meaning that the influence of Customer Orientation ( $X_4$ ) on Business Performance ( $Y_2$ ) is 0,259. Probability value = 0,025 <significance level ( $\alpha$ ) 0,05, it can be concluded that there is a significant influence of Customer Orientation ( $X_4$ ) on Business Performance ( $Y_2$ ).

The value of the pathway of Competitive Advantage ( $Y_1$ )  $\rightarrow$  Business Performance ( $Y_2$ ) is 0,320, meaning that the influence of Competitive Advantage ( $Y_1$ ) on Business Performance ( $Y_2$ ) is 0,320. Probability value = 0,028 <significance level ( $\alpha$ ) 0,05, it can be concluded that there is a significant influence of Competitive Advantage ( $Y_1$ ) on Business Performance ( $Y_2$ ).

So: Innovation Ability, Innovation Culture, HR Capability, Customer Orientation and Competitive Advantage have a significant effect on Business Performance in SMEs in Malang Regency.

### 3. Hypothesis Testing 3

**Table 3.** Testing of Direct Effects, Indirect Effects and Total Influence

Effects	Direct	Indirect	Total
Innovation Ability $\rightarrow$ Competitive Advantage	0,208	-	0,208
Innovation Culture $\rightarrow$ Competitive Advantage	0,270	-	0,270
HR Capability $\rightarrow$ Competitive Advantage	0,333	-	0,333
Customer Orientation $\rightarrow$ Competitive Advantage	0,538	-	0,538
Competitive Advantage $\rightarrow$ Business Performance	0,320	-	0,320
Innovation Ability $\rightarrow$ Business Performance	0,446	0,067	0,512
Innovation Culture $\rightarrow$ Business Performance	0,195	0,086	0,281
HR Capability $\rightarrow$ Business Performance	0,388	0,107	0,494
Customer Orientation $\rightarrow$ Business Performance	0,259	0,172	0,431

The results of the analysis on the indirect influence section show that there is a fairly balanced proportion between direct and indirect influences. The indirect effect on Business Performance comes from Innovation Ability of 0,067, Innovation Culture of 0,086, HR Capability of 0,107, and Customer Orientation of 0,172. The comparison of the total effect of Innovation Ability, Innovation Culture, HR Capability and Customer Orientation on Business Performance is greater than the direct effect on Business Performance. The final modeling can be explained that the endogenous construct of Competitive Advantage is proven to function as a mediation between Innovation Ability, Innovation Culture, HR Capability and Customer Orientation on Business Performance. The total influence that is classified as large comes from two channels, namely: (1) the influence of each Innovation Ability, Innovation Culture, HR Capability and Customer Orientation on Business Performance, and (2) Competitive Advantage on Business Performance. Two relationships give the meaning that important pathways to business performance will start from the four exogenous variables. So it can be concluded that Competitive Advantage can mediate the influence of Innovation Ability, Innovation Culture, HR Capability and Customer Orientation on Business Performance in SMEs in Malang Regency.

## V. Discussion

### 5.1 Effect of Innovation Ability, Innovation Culture, HR Capability, and Customer Orientation on Competitive Advantage in SMEs in Malang Regency

Innovation Ability has a significant effect on competitive advantage. This means that if SMEs increasingly have the ability to innovate, which consists of organizational culture (the ability to innovate to increase customers and the business being run is always innovating), knowledge (knowing competitors' products and using knowledge from various sources), customer and employee involvement (making products according to customer desires and creating new ideas involving employees), it will lead to an increase in competitive advantage (products produced are preferred by consumers, product quality is better than competitors' products, prices are able to compete with competitors). The results of this study support research (Chamsuk *et al.*, 2017).

Innovation Culture has a significant effect on competitive advantage. This means that if SMEs always carry out a culture of innovation consisting of managers having the courage to innovate and take risks (having the courage to innovate and having the courage to take risks), encouraging creative ideas (encouraging creative ideas within the company and creating new products to meet consumer expectations), cooperate in implementing new processes (collaborating with employees in implementing new processes and working with employees in creating new products), success in business is innovative (always sensitive to changes that occur



and the most important success factor in business is innovative), then will increase competitive advantage. The results of this study support research (Aksoy, 2017).

HR Capability has a significant effect on competitive advantage. This means that if SMEs always have knowledge in their business activities which consist of (knowing how to use the internet as a means of finding information and knowledge and knowing the internet is a medium to promote products and market products), skills (able to communicate through digital technology media and be able to create products in various models with digital technology), attitude (having creativity at work and having high morale), it can increase competitive advantage. The results of this study support research (Azhad *et al.*, 2018).

Customer Orientation has a significant effect on competitive advantage. This means that if SMEs always carry out customer orientation which consists of customer focus (always committed to satisfying and fulfilling customer desires), competitors (having a strategy to deal with competitors and making competitors a reference to always be better), customer value (improve what is customer complaints and pay attention to customer satisfaction), it can increase competitive advantage. The results of this study support research (Brockman *et al.*, 2012).

### **5.2 Effect of Innovation Ability, Innovation Culture, HR Capability, Customer Orientation and Competitive Advantage on Business Performance in SMEs in Malang Regency.**

Innovation Ability has a significant effect on business performance. This means that if SMEs increasingly have the ability to innovate, which consists of organizational culture (the ability to innovate to increase customers and the business being run is always innovating), knowledge (knowing competitors' products and using knowledge from various sources), customer and employee involvement (making products according to customer desires and creating new ideas involving employees), it will lead to an increase in business performance consisting of sales growth, capital growth, labor growth, market growth. The results of this study support research (Huhtala *et al.*, 2013).

Innovation Culture has a significant effect on business performance. This means that if SMEs always carry out a culture of innovation consisting of managers having the courage to innovate and take risks (having the courage to innovate and having the courage to take risks), encouraging creative ideas (encouraging creative ideas within the company and creating new products to meet consumer expectations), cooperate in implementing new processes (collaborating with employees in implementing new processes and working with employees in creating new products), success in business is innovative (always sensitive to changes that occur and the most important success factor in business is innovative), it can increase business performance. The results of this study support research (Klein & Gomes, 2016).

HR Capability has a significant effect on business performance. This means that if SMEs always have knowledge in their business activities which consist of (knowing how to use the internet as a means of finding information and knowledge and knowing the internet is a medium to promote products and market products), skills (able to communicate through digital technology media and be able to create products in various models with digital technology), attitude (having creativity at work and having high morale), it can increase business performance. The results of this study support research (Ardiana *et al.*, 2010).

Customer Orientation has a significant effect on business performance. This means that if SMEs always carry out customer orientation which consists of customer focus (always committed to satisfying and fulfilling customer desires), competitors (having a strategy to deal with competitors and making competitors a reference to always be better), customer value (improve what is customer complaints and pay attention to customer satisfaction), it can increase business performance. The results of this study support research (Pekovic & Rolland, 2012).

Competitive advantage has a significant effect on business performance. This means that if the SMEs always make excellence consisting of product uniqueness, product quality, and competitive prices, it can improve business performance. The results of this study support the research (Davick & Sharma, 2016).

### **5.3 Effect of Innovation Ability, Innovation Culture, HR Capability, and Customer Orientation on Business Performance in SMEs in Malang Regency and Competitive Advantage as variables between.**

Innovation ability, innovation culture, HR capability and customer orientation are significant and positive towards business performance and competitive advantage as intermediate variables. This causality shows that competitive advantage related to product uniqueness, product quality, and competitive prices can improve business performance in SMEs in Malang Regency.

The findings of this study indicate that the role of competitive advantage is needed to increase the effect of innovation ability, innovation culture, HR capability and customer orientation indirectly on business performance.

## VI. Conclusions and Recommendations

### 6.1 Conclusion

- (1) Innovation ability, innovation culture, HR capability and customer orientation plays an important role in providing competitive advantage to SMEs in Malang Regency. If SMEs always carry out an innovation ability, innovation culture, HR capability and customer orientation, then competitive advantage can increase.
- (2) The contribution of innovation ability, innovation culture, HR capability, customer orientation and competitive advantage to business performance in SMEs in Malang is stated to be very adequate. This is reflected in an increase in business performance if the innovation ability, innovation culture, HR capability and customer orientation also increase.
- (3) Competitive advantage plays an important role in mediating the effect of innovation ability, innovation culture, HR capability and customer orientation on business performance.

### 6.2 Recommendations

- (1) SMEs in Malang Regency should concentrate on their innovation ability, innovation culture, HR capability and customer orientation in improving business performance
- (2) Focus on competitive advantage is an action that must be taken by SMEs in Malang Regency, because it can enhance the role of innovation ability, innovation culture, HR capability and customer orientation towards business performance.

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