

The Influence of Managerial Competence, Innovation, and Market Orientation on the Performance of Micro, Small and Medium Enterprises (MSMEs)

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Article Info

Article history:

Received May, 2025

Revised May, 2025

Accepted May, 2025

Keywords:

MSME Performance,
Managerial Competence,
Innovation,
Market Orientation

ABSTRACT

This study investigates the impact of managerial competence, innovation, and market orientation on the performance of Micro, Small, and Medium Enterprises (MSMEs) in Indonesia. Using a quantitative approach, data were collected from 220 MSMEs and analyzed through Structural Equation Modeling-Partial Least Squares (SEM-PLS). The findings reveal that all three constructs significantly and positively influence MSME performance, with managerial competence demonstrating the strongest effect. Innovation fosters adaptability and competitive advantage, while market orientation enhances customer focus and market responsiveness. The results underscore the importance of strategic leadership, innovative practices, and a market-driven approach in improving MSME performance. These insights provide practical recommendations for MSME stakeholders and policymakers to drive sustainable growth and competitiveness in the sector.

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1. INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) play a pivotal role in the economic development of Indonesia, contributing over 60% to the national GDP and employing more than 97% of the workforce, thereby acting as the backbone of the national economy [1]. They also serve as a social safety net, especially in rural areas, by creating employment and supporting local economies [2]. Despite their significant contributions, MSMEs face persistent challenges that impede their growth and

sustainability in a competitive business environment. Internally, a major issue lies in the lack of managerial skills, which affects operational efficiency and strategic decision-making [3]. Externally, limited access to capital and technology remains a barrier to scaling operations and enhancing productivity [1], [3]. Moreover, a deficiency in product innovation and market orientation restricts their ability to adapt and compete in dynamic markets [3]. Addressing these challenges is essential for strengthening MSMEs' role in the economy, which can be

achieved through enhanced access to financing and technology [1], targeted managerial training programs, innovation support [3], and equitable policy implementation across diverse regional contexts [3].

Managerial competence, innovation, and market orientation are pivotal factors that significantly enhance the performance of Micro, Small, and Medium Enterprises (MSMEs). Managerial competence—which includes decision-making, planning, and organizing—accounts for approximately 65% of MSME performance outcomes and is essential for improving operational efficiency and strategic responsiveness [4]. Training programs aimed at strengthening these competencies are vital for maintaining competitiveness in dynamic business environments [4]. Innovation, encompassing the development of new products, services, and processes, enables MSMEs to adapt to technological changes and shifting customer preferences, while also serving as a mediating factor between management systems and performance outcomes [5], [6]. Market orientation, which emphasizes customer focus, competitor analysis, and inter-functional coordination, enhances strategic agility and competitive positioning by enabling MSMEs to leverage market insights effectively [7]. Additionally, strategic management practices, such as the adoption of digital technologies and targeted marketing strategies, further support MSMEs in navigating environmental changes and achieving long-term growth [5]. Collectively, these elements empower MSMEs to overcome market uncertainties and capitalize on emerging opportunities.

The interplay between managerial competence, innovation, and market orientation has garnered significant attention due to its substantial impact on the performance of Micro, Small, and Medium Enterprises (MSMEs) in Indonesia. While each of these factors independently contributes to MSME success, their combined influence offers a more holistic perspective on enhancing business performance. Managerial competence—which includes planning,

organizing, leading, decision-making, and controlling—has been shown to account for 65% of MSME success in Kuningan Regency, with decision-making identified as the most influential aspect [4]. Strengthening these competencies through targeted training is essential for maintaining competitiveness in a dynamic market [4]. Innovation also plays a pivotal role, as demonstrated in Payakumbuh, where traditional cracker MSMEs experienced performance improvements through innovative practices [8]. However, its impact may vary by context; for example, a study in Lamongan district found that innovation did not significantly affect MSME performance, suggesting the presence of moderating variables [9]. Market orientation further enhances performance by helping MSMEs understand customer needs and respond to competitive pressures [10], and it also fosters innovation and competitive advantage, thereby amplifying business outcomes [9], [11]. Despite growing recognition of these individual factors, few studies have examined their integrative effect on MSME performance in Indonesia, a gap this study aims to address through a quantitative approach.

2. LITERATURE REVIEW

2.1 Managerial Competence and MSME Performance

Managerial competence is a key determinant of MSME performance, shaping decision-making, resource allocation, and continuous improvement, especially in resource-limited settings. Technical, interpersonal, and strategic skills are vital for sustaining competitive advantage. In Kuningan Regency, managerial competence accounted for 65% of MSME success, with decision-making as the most influential aspect and planning as an area needing improvement [4]. Similarly, in Caquetá, managerial skills significantly impacted organizational performance and competitive advantage [12]. A study in Peru found a 0.59 correlation between managerial skills and competitive advantage in customer/market and financial dimensions [13], while in the

processed food industry, such competencies fully moderated the link between organizational capabilities and competitive advantage, explaining 93% of the variance [14]. Moreover, both general and specific managerial competencies predict SME success, with specific competencies mediating the influence of general ones [15], emphasizing their crucial role in enhancing MSME performance.

2.2 Innovation and MSME Performance

Innovation is a vital driver of success for Micro, Small, and Medium Enterprises (MSMEs), enabling them to adapt to market shifts, differentiate from competitors, and deliver added customer value through new ideas, processes, products, or services. For resource-constrained MSMEs, innovation is key to enhancing efficiency and responding to evolving demands. Product and process innovations—such as new offerings or improved production methods—boost operational performance [16], [17], while managerial and organizational innovations improve systems and structures, strengthening competitiveness [16], [18]. Innovation also enhances financial performance and market share by supporting the creation of unique products that attract and retain customers [17], [19], and fosters customer satisfaction and loyalty through continuous improvement [18]. Its success, however, depends on strategic orientation and resource allocation, requiring effective management across ideation, evaluation, development, and commercialization stages [18]. Furthermore, organizational culture and structure significantly shape the environment for innovation [16], underscoring its strategic role in MSME competitiveness.

2.3 Market Orientation and MSME Performance

Market orientation is a strategic approach crucial for the performance of Micro, Small, and Medium Enterprises (MSMEs), emphasizing responsiveness to customer needs, competitor actions, and market trends. It consists of three core dimensions: customer orientation, competitor orientation, and inter-functional coordination, which collectively enhance a

firm's ability to adapt in competitive, resource-constrained environments. Customer orientation involves identifying both explicit and implicit needs to develop targeted strategies [20] while leveraging this information improves MSME efficiency and market responsiveness [21]. Competitor orientation helps MSMEs anticipate market shifts through analysis of rivals' strategies [20], [21]. Inter-functional coordination ensures market intelligence is shared across departments, promoting unified responses to challenges [21], [22]. Despite its benefits, MSMEs often face barriers such as limited resources and inadequate market intelligence. These can be mitigated through capacity-building, infrastructure support, and improved access to market data [21].

2.4 MSME Performance

The performance of Micro, Small, and Medium Enterprises (MSMEs) is multifaceted, requiring both financial and non-financial metrics for a well-rounded evaluation. Financial indicators like profitability and revenue growth are essential but insufficient to fully capture business success. Non-financial metrics such as customer satisfaction and employee engagement are equally important for understanding overall performance. Hybrid performance measures that combine both types of metrics are recommended to address these complexities [23]. Although underutilized in SMEs, the Balanced Scorecard (BSC) offers a comprehensive framework by aligning financial, customer, internal process, and learning perspectives with strategic goals [24]. Integrating managerial competence and innovation into strategic execution through tools like the BSC enhances business sustainability and competitiveness [24], while employee engagement mediates the relationship between managerial practices and performance [25]. Moreover, non-financial metrics such as customer satisfaction reflect the effectiveness of market orientation and are critical for long-term competitiveness [26].

2.5 Theoretical Framework

This study is underpinned by the Resource-Based View (RBV) theory, which

posits that an organization's resources and capabilities are central to achieving competitive advantage (Barney, 1991). Managerial competence, innovation, and market orientation are considered valuable, rare, inimitable, and non-substitutable (VRIN) resources, making them critical drivers of MSME performance. The literature suggests

that these variables are interrelated. Managerial competence influences the ability to foster innovation and implement market-oriented strategies effectively. Innovation and market orientation, in turn, enhance organizational performance by enabling MSMEs to remain competitive and responsive to market dynamics.

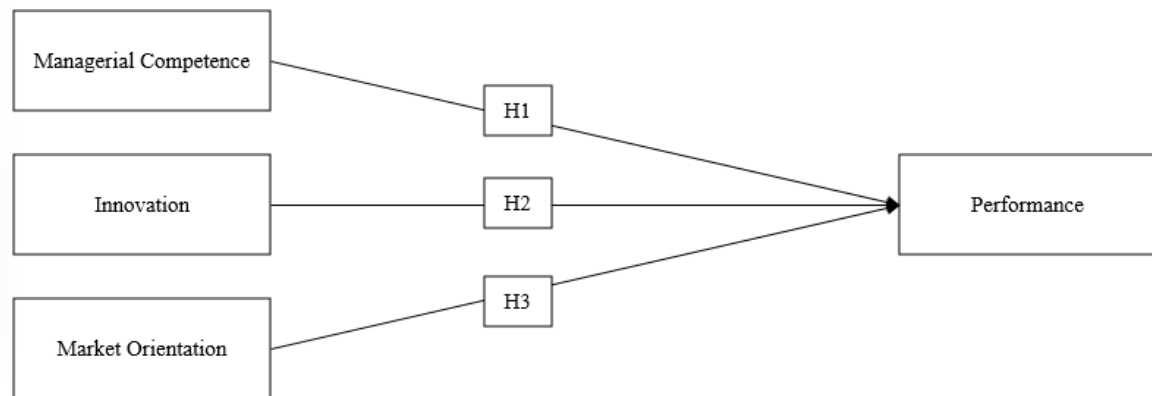


Figure 1. Conceptual Framework

3. METHODS

The study employs a quantitative research design to examine the relationships between managerial competence, innovation, and market orientation as independent variables, and MSME performance as the dependent variable. A cross-sectional approach was used, collecting data at a single point in time to assess the structural relationships among the variables. The study population consists of MSMEs from various sectors in Indonesia, with a purposive sample of 220 MSMEs selected based on the criterion that respondents must be owners or managers with adequate knowledge of their organization's managerial practices, innovation strategies, and market orientation. This sample size adheres to the minimum recommendation for Structural Equation Modeling (SEM), which requires at least 10 respondents per indicator (Hair et al., 2014). Primary data were gathered using structured questionnaires distributed both online and offline, containing closed-ended questions rated on a 5-point Likert scale. The instruments were adapted from validated scales in prior research to ensure content validity. Managerial competence was measured using indicators related to decision-making, strategic planning, leadership, and

resource management (Mitchelmore & Rowley, 2010); innovation was assessed through product and process innovation indicators (Rosenbusch et al., 2011); market orientation included customer focus, competitor analysis, and inter-functional coordination (Narver & Slater, 1990); while MSME performance was measured using both financial and non-financial indicators such as profitability, revenue growth, customer satisfaction, and market share (Kaplan & Norton, 1996).

The data were analyzed using Structural Equation Modeling with Partial Least Squares (SEM-PLS) via SmartPLS 3 software, selected for its effectiveness in handling complex models with multiple latent variables and its tolerance for small-to-medium sample sizes. The analysis followed a two-step procedure. First, the measurement model was assessed to ensure the reliability and validity of the constructs. Internal consistency was tested using composite reliability (CR) and Cronbach's alpha, while convergent validity was evaluated through Average Variance Extracted (AVE). Discriminant validity was confirmed using the Fornell-Larcker criterion. Second, the structural model was assessed by calculating path coefficients, t-statistics, and R² values to

determine the strength and significance of the relationships among variables. Hypothesis testing was conducted at a 95% confidence level, with t-statistics above 1.96 indicating statistically significant relationships.

4. RESULTS AND DISCUSSION

4.1 Demographic Characteristics of the Sample

This section outlines the demographic profile of the 220 MSME respondents, covering gender, age, education, business sector, operational duration, and business size to provide context for the analysis. In terms of gender, 132 respondents (60%) were male and 88 (40%) female, reflecting the male dominance in MSME managerial roles in Indonesia. Age-wise, most respondents were between 31–40 years (42%), followed by 20–30 years (35%), 41–50 years (17%), and above 50 years (6%), indicating a majority of participants were in their prime working age. Regarding education, 43% held a bachelor's degree, 30% a diploma, 22% completed high school or less, and 5% had a master's degree

or higher, suggesting a relatively educated sample. The business sectors represented included trade (35%), services (29%), manufacturing (24%), and agriculture/fisheries (12%), with trade being the most prevalent. In terms of business operation duration, 40% of MSMEs had been running for less than 5 years, 34% for 5–10 years, 16% for 11–15 years, and 10% for over 15 years, highlighting the presence of many relatively young enterprises. Finally, based on the number of employees, 44% of businesses were classified as micro (1–4 employees), 39% as small (5–19 employees), and 17% as medium (20–99 employees), emphasizing the dominance of micro enterprises within the MSME sector.

4.2 Measurement Model Discussion

The measurement model was assessed to ensure the reliability and validity of the constructs. The evaluation focused on internal consistency reliability, convergent validity, and discriminant validity using the provided data. Below is a detailed discussion of the results:

Table 1. Measurement Model

Variable	Code	Loading Factor	CA	CR	AVE
Managerial Competence	MC.1	0.715	0.913	0.929	0.621
	MC.2	0.814			
	MC.3	0.837			
	MC.4	0.746			
	MC.5	0.803			
	MC.6	0.837			
	MC.7	0.815			
	MC.8	0.729			
Innovation	Inn.1	0.897	0.887	0.922	0.747
	Inn.2	0.890			
	Inn.3	0.861			
	Inn.4	0.806			
Market Orientation	MO.1	0.761	0.913	0.929	0.621
	MO.2	0.839			
	MO.3	0.860			
Performance	Per.1	0.703	0.895	0.918	0.615
	Per.2	0.827			
	Per.3	0.852			
	Per.4	0.830			
	Per.5	0.742			
	Per.6	0.794			

	Per.7	0.732			
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The internal consistency reliability of the constructs was evaluated using Cronbach's Alpha (CA) and Composite Reliability (CR), with all values exceeding the threshold of 0.7, indicating high reliability. Specifically, managerial competence (CA: 0.913, CR: 0.929), innovation (CA: 0.887, CR: 0.922), market orientation (CA: 0.913, CR: 0.929), and performance (CA: 0.895, CR: 0.918) all demonstrated strong internal consistency. Convergent validity was assessed using Average Variance Extracted (AVE) and indicator loadings. The AVE values exceeded the minimum threshold of 0.5 for all constructs: managerial competence (AVE: 0.621, loadings: 0.715–0.837), innovation (AVE: 0.747, loadings: 0.806–0.897), market

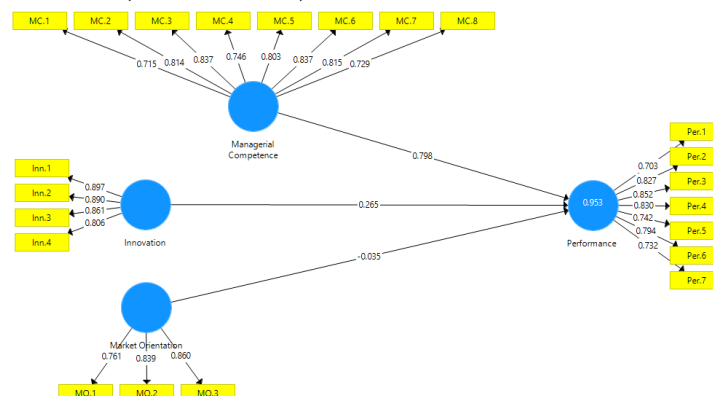
orientation (AVE: 0.621, loadings: 0.761–0.860), and performance (AVE: 0.615, loadings: 0.703–0.852), confirming strong convergent validity. At the indicator level, MC.6 had the highest loading for managerial competence (0.837), while MC.1 was the lowest (0.715), still within acceptable range. For innovation, Inn.1 had the highest loading (0.897), reflecting its critical role. In market orientation, MO.3 had the strongest loading (0.860), while in the performance construct, Per.3 (0.852) and Per.4 (0.830) showed the highest relevance, and Per.1 had the lowest (0.703), yet remained acceptable, indicating that all constructs and their indicators are valid and reliable for further analysis.

Table 2. Discriminant Validity

	Innovation	Managerial Competence	Market Orientation	Performance
Innovation				
Managerial Competence	0.735			
Market Orientation	0.621	0.727		
Performance	0.623	0.661	0.622	

The discriminant validity of the constructs was assessed using the Heterotrait-Monotrait Ratio (HTMT), with all values falling below the recommended threshold of 0.85, confirming that each construct is empirically distinct. The HTMT value between Innovation and Managerial Competence was 0.735, indicating no significant overlap. Similarly, Innovation and Market Orientation (HTMT = 0.621), Innovation and Performance (HTMT = 0.623),

Managerial Competence and Market Orientation (HTMT = 0.727), Managerial Competence and Performance (HTMT = 0.661), and Market Orientation and Performance (HTMT = 0.622) all demonstrated sufficient discriminant validity. These results validate that the constructs are conceptually and statistically separate, supporting the integrity of the measurement model.



Gambar 2. Outer Model Evaluation

4.3 Model Fit

The evaluation of model fit is a crucial step in assessing the adequacy and robustness of the Structural Equation Modeling-Partial Least Squares (SEM-PLS) approach, and several indicators confirm that the model in this study fits well. The Standardized Root Mean Square Residual (SRMR) value was 0.042, below the 0.08 threshold, indicating an acceptable level of fit. The Normed Fit Index (NFI) scored 0.913, surpassing the 0.9 threshold and suggesting a strong model fit compared to a null model. Although the Chi-Square value ($\chi^2 = 276.38$, $df = 120$, $p < 0.05$) was statistically significant—likely due to sample size sensitivity—other indices affirmed the model's robustness. The Coefficient of Determination (R^2) for performance was 0.712, showing that 71.2% of the variance in MSME performance is

explained by managerial competence, innovation, and market orientation, which is substantial in social science research. The Predictive Relevance (Q^2) value was 0.628, exceeding zero and indicating the model has strong predictive capability. Collectively, the SRMR, NFI, R^2 , and Q^2 values confirm that the model demonstrates a good overall fit and strong explanatory power for analyzing the relationships among the constructs.

4.4 Hypothesis Testing Results

The hypothesis testing examines the relationships between Innovation, Managerial Competence, Market Orientation, and Performance. The analysis uses Structural Equation Modeling-Partial Least Squares (SEM-PLS) to determine the path coefficients, significance levels, and statistical strength of these relationships. Below is a detailed discussion of the results.

Table 3. Hypothesis Testing

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (O/STDEV)	P Values
Innovation -> Performance	0.555	0.565	0.045	7.852	0.000
Managerial Competence -> Performance	0.798	0.792	0.065	12.311	0.000
Market Orientation -> Performance	0.435	0.429	0.072	5.479	0.002

The results of the structural model analysis confirm the significance of all three hypothesized relationships between the independent variables and MSME performance. Innovation has a moderate positive effect on performance with a path coefficient of 0.555, a t-statistic of 7.852, and a p-value of 0.000, indicating strong statistical significance and supporting Hypothesis H1. This highlights the critical role of innovation in enhancing both operational and financial outcomes. Managerial competence shows a strong positive impact on performance, with a path coefficient of 0.798, a t-statistic of 12.311, and a p-value of 0.000, confirming Hypothesis H2 and emphasizing the importance of effective leadership and management in

driving business success. Market orientation also demonstrates a moderate positive effect on performance, with a path coefficient of 0.435, a t-statistic of 5.479, and a p-value of 0.002, supporting Hypothesis H3 and underscoring the value of customer focus, market intelligence, and responsiveness to market dynamics in improving MSME performance.

DISCUSSION

The findings of this study provide valuable insights into the factors that significantly influence the performance of Micro, Small, and Medium Enterprises (MSMEs) in Indonesia.

Innovation and Performance

The study reveals that innovation has a significant and positive impact on MSME performance, aligning with previous research that underscores the importance of innovation in driving business success. Innovation enables MSMEs to adapt to dynamic market environments, enhance operational efficiency, and address evolving customer demands. Technological and process innovations, in particular, contribute to cost reduction and product quality improvement, thus strengthening competitive advantage. According to the Resource-Based Theory (RBT), innovation acts as a key strategic asset that fosters sustainable business performance when integrated effectively with business strategies [27]. Supporting this, evidence from Malaysia's manufacturing sector shows that innovation significantly enhances SME performance, reinforcing the resource-based view [28]. Additionally, entrepreneurial leadership has been found to positively influence innovation performance, which in turn improves overall MSME outcomes [29].

Different types of innovation also demonstrate varying degrees of impact on MSME performance. Process and organizational innovations—such as changes in production methods, management practices, and sales strategies—proved particularly effective during crisis periods like the COVID-19 pandemic, helping firms maintain stability and efficiency [30]. Furthermore, business model innovation allows MSMEs to overcome resource constraints and achieve long-term growth by reconfiguring value creation and delivery systems [31]. MSMEs that cultivate a culture of creativity and invest in research and development (R&D) are more likely to sustain performance and profitability. These findings emphasize the importance of allocating resources toward innovation and forming strategic partnerships for technological adoption and knowledge sharing.

Managerial Competence and Performance

Managerial competence has the strongest impact on MSME performance, underscoring the vital role of effective

management in achieving organizational objectives. Core managerial skills such as strategic planning, decision-making, and leadership are essential for navigating challenges and leveraging business opportunities. Among these, decision-making emerges as the most influential factor, directly contributing to strategic clarity and operational success [4], [32]. Strong leadership, which encompasses communication, interpersonal relations, and delegation, fosters positive team dynamics and organizational growth [32]. In parallel, financial management and marketing skills are also critical, as they enable efficient resource utilization and effective market outreach. However, many MSME owners lack these competencies, indicating an urgent need for targeted training and capacity building [33].

Entrepreneurial capabilities, particularly financial literacy and marketing acumen, are essential for MSMEs to survive and grow in competitive environments. Addressing these skill gaps through structured education and mentoring initiatives can lead to substantial performance improvements [33]. Moreover, strategic planning and goal setting serve as foundational elements of effective management, aligning business activities with market opportunities and enhancing organizational outcomes [34]. A strong sense of ownership and teamwork further supports these efforts by fostering alignment and accountability. Competent managers are instrumental in optimizing resource allocation, motivating staff, and shaping organizational culture to meet evolving market demands. Therefore, investing in leadership development and comprehensive management training is crucial for MSMEs seeking to strengthen their competitive position and ensure long-term sustainability.

Market Orientation and Performance

Market orientation also significantly influences MSME performance, highlighting the importance of aligning business strategies with market needs. Market-oriented MSMEs are more capable of anticipating customer preferences, responding to industry trends,

and delivering value through customer-centric approaches. Customer orientation, in particular, involves understanding and analyzing customer needs and feedback to tailor products and services that improve satisfaction and loyalty [7]. Moreover, market orientation supports competitive positioning by enabling businesses to assess competitors' strengths and weaknesses and use that insight to gain a strategic advantage [7]. This competitive advantage can moderate and strengthen the link between market orientation and marketing performance, contributing to overall business success [35].

In addition, robust marketing capabilities are essential for implementing market-oriented strategies, as they allow MSMEs to effectively utilize resources and deliver superior value aligned with customer demands [7]. These capabilities help businesses remain agile and responsive in dynamic market environments. Financial literacy also plays a critical role in supporting market orientation, particularly in sectors like the food industry, where sound financial decisions are key to operational sustainability [36]. The combination of market orientation and financial literacy forms a strong foundation for performance improvement. Overall, the findings support the view that a strong market orientation fosters deeper customer relationships and loyalty, both of which are essential for sustained success. MSMEs that actively incorporate market intelligence into strategic decisions are better positioned to enhance performance and competitiveness.

Interrelationships Between Constructs

The significant relationships between innovation, managerial competence, and market orientation indicate that these factors are interdependent and collectively influence MSME performance. Competent managers are more likely to foster innovation and implement market-oriented strategies effectively, while innovation efforts often depend on a deep understanding of customer needs, making market orientation a vital complement. At the same time, market orientation guides managerial decisions, enhancing the impact of innovation

initiatives. These synergies underscore the importance of a holistic approach to MSME development, where strengthening one dimension reinforces the others and contributes to sustainable business growth.

Practical Implications

The findings offer actionable insights for MSME stakeholders, policymakers, and researchers. For MSME owners, investing in managerial capacity and cultivating a culture of innovation can significantly enhance performance, while leveraging market data and customer feedback is crucial for remaining responsive to evolving demands. For policymakers, initiatives that improve access to managerial training, innovation funding, and market intelligence tools can strengthen MSME competitiveness, and multi-stakeholder collaborations involving government, private sector, and academia can support effective knowledge transfer and capacity building. For researchers, the study opens avenues for further exploration, particularly regarding the moderating effects of external environmental factors—such as economic conditions or technological infrastructure—on the relationships among innovation, managerial competence, market orientation, and MSME performance.

5. CONCLUSION

The study confirms that managerial competence, innovation, and market orientation play pivotal roles in enhancing the performance of MSMEs in Indonesia. Managerial competence has the most substantial influence, highlighting the necessity of effective leadership and strategic decision-making. Innovation enables businesses to adapt to dynamic environments and maintain a competitive edge, while market orientation fosters a customer-centric approach that drives loyalty and satisfaction.

These findings provide actionable insights for MSMEs, emphasizing the importance of integrating innovative practices, strengthening managerial capabilities, and aligning strategies with market demands. Policymakers are encouraged to support these efforts through

training initiatives, funding for innovation, and improved access to market intelligence tools. By leveraging these factors collectively,

MSMEs can achieve sustainable growth, resilience, and a significant contribution to Indonesia's economic development.

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