MARKET ORIENTATION, ENTREPRENEURIAL ORIENTATION, AND BUSINESS MODEL INNOVATION: DRIVING PRODUCT INNOVATION IN INDONESIAN MSMEs

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ABSTRACT

This study aims to examine business model innovation among Micro, Small, and Medium Enterprises (MSMEs) in Indonesia by analyzing the influence of market orientation and entrepreneurship on enhancing product innovation performance. MSMEs are encouraged to remain adaptive and innovative in responding to market dynamics, particularly during times of crisis. Data were collected by a questionnaire administered to MSME operators in the manufacturing and service sectors, and were analyzed using Structural Equation Modeling (SEM). The findings show that market orientation positively affects business model innovation ($\beta = 0.427$; $p < 0.001$), while entrepreneurial orientation also positively and significantly affects business model innovation ($\beta = 0.351$; $p < 0.001$). Furthermore, business model innovation positively affects product innovation performance ($\beta = 0.472$; $p < 0.001$). An R^2 value of 0.58 suggests that this model explains 58% of the variation in product innovation performance. These findings highlight the importance of strategic direction and business model innovation in strengthening the sustainability and competitiveness of MSMEs amid crises such as a pandemic or market uncertainty. This research has implications for MSME practitioners and regulators in fostering innovation, adaptive business strategies, and strengthening competitiveness. A limitation of this study is its sample scope, which is restricted to the manufacturing and service sectors.

Keywords: Entrepreneurial Orientation; Business Model Innovation; Market Orientation; Product Innovation; MSMEs.

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1. INTRODUCTION

Micro, small, and medium-sized Enterprises (MSMEs) play a key role in strengthening economic resilience, particularly in developing countries such as Indonesia. During times of crisis, including global pandemics and market disruptions, MSMEs are forced to remain adaptive and innovative despite their limited resources (Fatimah et al., 2024a; Purwaningsih et al., 2022a).

Amid this crisis, MSMEs must adapt and enhance their competitiveness to survive and remain resilient. Therefore, the ability to respond to crises through innovative strategies is a key factor in ensuring business sustainability. Several factors are believed to strengthen the competitiveness of MSMEs during the pandemic era, namely market orientation, entrepreneurial orientation, and business model innovation (Anwar, M., & Shah, 2021a; Arunachalam et al., 2018; Saunila, M., Pekkola, S., & Ukko, 2014).

Strategic orientations, particularly market orientation and entrepreneurial orientation, have been widely recognized as drivers of innovation performance. Most previous research has focused on large companies or adopted the perspective of developed countries. Hence, the understanding of how these orientations operate within MSMEs in developing countries facing uncertainty and resource constraints remains limited.

In situations often fraught with uncertainty, MSMEs need to understand the market, innovate, and develop adaptive business models. This can help MSMEs survive and even thrive, for example, by establishing a strategic direction and developing products that meet market needs.

From the perspective of MSMEs, market orientation can help them understand the market better and adapt the products or services offered according to customer needs. Market orientation can be realized through three main components, namely: (1) customer orientation, which includes an understanding of current customers and potential new customers; (2) competitor orientation, which includes monitoring competitors' strategies, capabilities, and actions; and (3) inter-functional coordination, which refers to efforts to integrate and leverage organizational resources to add value for customers (Narver, J. C., & Slater, 1990a; Ye et al., 2024a).

The capability of an organization or company to understand customer demands and preferences and adapt to market changes is referred to as market orientation (Narver, J. C., & Slater, 1990a; Ye et al., 2024b). Market orientation was measured through the infulence of market orientation on new product development performance, which helps MSMEs understand customer demands and preferences, and adapt to market changes quickly (Davidsson, P., & Gordon, 2021; Indomarco & Indradewa, 2023a; Ye et al., 2024a).

Entrepreneurial orientation can be realized through three main components, namely: (1) innovation, which involves the design and development of new products, processes or business models; (2) risk-taking, which includes a willingness to engage in high-risk projects with the potential for significant returns; and (3) proactivity, which refers to the initiative to get ahead of competitors and create change in the market (Covin, J. G., & Slevin, 1989; Indomarco & Indradewa, 2023b).

The influence of entrepreneurial orientation towards new product development performance is measured by looking at entrepreneurial orientation that encourages MSMEs to innovate, take risks, and be proactive in utilising opportunities (Anwar, M., & Shah, 2021b; Indomarco & Indradewa, 2023a). Previous research has shown that entrepreneurial orientation positively affects new product development performance (Arunachalam, D., Ramaswami, S.N., Herrmann, P., & Walker, 2018; Fatimah et al., 2024a; Hanaysha & Al-Shaikh, 2024a)

Business model innovation can be realised through three main components, namely: (1) value proposition, which includes the offering of unique and valuable products or services to customers; (2) value chain, which includes the activities and resources used to create and deliver the value proposition; and (3) revenue model, which refers to the way the organisation generates revenue from the value proposition offered (Motjolopane et al., 2023a; Narver, J. C., & Slater, 1990b; Teece, 2010a).

According to previous studies, business model innovations have made a significant

contribution to MSMEs during the pandemic. This has been achieved through efforts to create new value for customers and improve operational efficiency, which can help MSMEs remain competitive and sustainable in the face of various challenges (Ahmad, S., & Rosli, 2021; Motjolopane et al., 2023a; Ye, J., & Feng, 2023).

Business model innovation serves as an effort to integrate entrepreneurial activities with business performance, highlighting its importance in maintaining competitive advantage (Motjolopane et al., 2023b). Previously, most studies have focused on the direct link between strategic orientation and product innovation, yet the mediating role of business model innovation has not been thoroughly explored (Indomarco & Indradewa, 2023a; Purwaningsih et al., 2022a; Suhendah & Brigita, 2021a).

Efforts to drive new product development are becoming increasingly important for SMEs during the pandemic. Changes and shifts in customer needs and preferences require businesses to develop new products or services that align with evolving market conditions. This product development can positively impact organizational performance by aligning products with consumer preferences through effective market research and human resource training (Eshiett, I., & Eshiett, 2022; Ye et al., 2024a). Previous research has shown that business model innovation has a positive effect on new product development performance (Kawasaki et al., 2023; Saunila, M., Pekkola, S., & Ukko, 2014; Ye et al., 2024b).

The performance of new product development can serve as a significant indicator for assessing the competitiveness and adaptability of MSMEs in the face of market changes. New product development performance refers to an organization's ability to develop new products or services that succeed in the market (Kawasaki et al., 2023; Lopetcharat et al., 2022). The performance of new product development can be improved through the integration of digital technology implementation, innovative products, cross-functional coordination, user participation, peer competition, and environmental uncertainty (Eshiett, I., & Eshiett, 2022; Gu, A., Chen, S., Chen, B., & Liu, 2023a).

It can be concluded from several existing studies that a market-oriented approach enables MSMEs to understand customer needs and preferences and respond quickly to market changes (Davidsson, P., & Gordon, 2021; Purwaningsih et al., 2022b). Entrepreneurial orientation encourages MSMEs to innovate, take risks, and proactively exploit opportunities (Covin, J. G., & Slevin, 1989; Hanaysha & Al-Shaikh, 2024b). Meanwhile, business model innovation can help MSMEs create new customer value and increase operational efficiency (Motjolopane et al., 2023b; Teece, 2010b). These three factors are important in improving new product development performance for MSMEs in the pandemic era.

This paper aims to contribute to the existing literature by examining the impact of market orientation and entrepreneurial orientation on product innovation performance through business model innovation among Indonesian MSMEs. Through the Partial Least Squares–Structural Equation Modeling (PLS-SEM) method, this study provides empirical evidence regarding the mediating role of business model innovation in determining the relationship among variables.

The novelty of this study lies in its integration of strategic orientation and business model innovation within the context of MSMEs in developing countries, thereby offering a theoretical contribution to the innovation literature as well as practical implications for strengthening the competitiveness of MSMEs during times of crisis.

2. METHOD

This study integrates market orientation and entrepreneurial orientation as strategic factors influencing product innovation performance through business model innovation. Market orientation describes the ability of MSMEs to understand customer needs and market changes, while entrepreneurial orientation emphasizes adaptive, innovative, and risk-taking attitudes in exploring business opportunities.

Business model innovation serves as a mediating variable, enabling MSMEs to translate strategic orientations into innovation

outcomes by enhancing value creation and business adaptability. The framework explains that market orientation The framework explains that market orientation positively impacts business model innovation, entrepreneurial orientation positively impacts business model innovation, and business model innovation positively impacts product innovation performance. Through PLS-SEM analysis, this framework offers a more comprehensive understanding of how MSMEs can strengthen innovation performance and competitiveness in a dynamic business environment.

This research employs a quantitative approach using a questionnaire-based survey method. The data were collected through questionnaires distributed to owners or managers of MSMEs in Indonesia, particularly in Yogyakarta. The sample population in this study consists of all MSMEs in Indonesia, particularly in Yogyakarta (appendix 1).

The sample was purposively selected based on the following criteria: (1) MSMEs operating in Indonesia, especially in Yogyakarta, (2) MSMEs that have developed new products in the last 2 years, and (3) MSMEs that are willing to participate in research.

Variable Measurement: 1) Market Orientation. Market orientation was measured by adapting a scale that has been developed (Narver, J. C., & Slater, 1990a). This scale consists of three (3) dimensions: customer orientation, competitor orientation, and inter-functional coordination; 2) Entrepreneurial Orientation. Entrepreneurial orientation was measured by adapting a scale that has been developed (Covin, J. G., & Slevin, 1989).

This scale has three dimensions: innovation, risk-taking, and proactivity; 3) Business Model Innovation. Business model innovation is measured by adapting a scale that has been developed (Teece, 2010b). This scale consists of 3 dimensions: value proposition, value chain, and revenue model; 4) New Product Development Performance. New product development performance was measured by adapting a scale that has been developed (Gima, 1995).

This scale consists of 3 indicators: success of new products on the market, product development efficiency, and product innovation.

Data analysis in this research used Structural Equation Modeling (SEM) with the help of AMOS software. SEM was chosen because it can comprehensively test the relationship between latent variables and their indicators, as well as the relationship between latent variables (Hair et al., 2014). Before testing the structural model, a validity and reliability test of the instrument was carried out, as well as a test of SEM assumptions (appendix 3).

The analysis was conducted using PLS-SEM with SmartPLS 4. Construct validity was assessed using factor loadings (>0.7), Average Variance Extracted (AVE >0.5), and Composite Reliability (CR >0.7). Discriminant validity was examined using the HTMT ratio (<0.85). Model fit was evaluated using SRMR (0.062), NFI (0.91), and the R^2 value for the endogenous variables. The findings show that the model meets the criteria for validity and reliability.

3. RESULTS AND DISCUSSION

Respondent Profile

This research involved 250 MSMEs in Indonesia's manufacturing and service sectors, especially in Yogyakarta. Most respondents (60%) are MSMEs operating for 5-10 years, with an average number of employees of around two people. Most MSMEs (70%) operate on the island of Java, especially in Yogyakarta (Appendix 1).

The results of the descriptive analysis show that the average scores for market orientation, entrepreneurial orientation, business model innovation and new product development performance are in the high category. This indicates that the sample MSMEs are capable of implementing market orientation and entrepreneurship, innovating business models, and achieving satisfactory new product development performance (Appendix 2).

The effect of market orientation on business model innovation is examined through the results of regression analysis, which shows that market orientation has a positive and significant effect on business model innovation. ($\beta = 0.427$, $p < 0.001$). This finding is consistent with previous research, which shows that market

orientation can encourage MSMEs to innovate business models (Arunachalam et al., 2018; Davidsson, P., & Gordon, 2021). By understanding customer needs and preferences, as well as monitoring competitors' movements, MSMEs can design business models that are more innovative and in line with market demands.

The effect of entrepreneurial orientation on business model innovation is examined through regression analysis, which shows that entrepreneurial orientation positively affects business model innovation ($\beta = 0.351$, $p < 0.001$). This finding aligns with previous studies, which found that entrepreneurial orientation can encourage MSMEs to innovate business models (Indomarco & Indradewa, 2023b; Saunila, M., Pekkola, S., & Ukko, 2014). An innovative attitude, daring to take risks, and being proactive in exploiting opportunities allow MSMEs to design business models that are more creative and adaptive to change.

The effect of business model innovation on new product development performance is examined through the results of regression analysis, which shows that business model innovation positively affects new product development performance ($\beta = 0.472$, $p < 0.001$).

This finding is consistent with previous research, which shows that business model innovation can improve new product development performance in MSMEs (Gu, A., Chen, S., Chen, B., & Liu, 2023b; Saunila, M., Pekkola, S., & Ukko, 2014). By adding new value for customers through business model innovation, MSMEs can increase the competitiveness of their products and encourage the success of new product development.

The findings of this study explained that market orientation, entrepreneurial orientation, and business model innovation were important factors in improving the performance of new product development among MSMEs during the pandemic. Market orientation and entrepreneurial orientation have been shown to encourage MSMEs to adopt new business models, which, in time, will positively impact new product development performance.

Amid the pandemic, the ability of MSMEs to understand customer needs, monitor competitors' movements, and innovate proactively becomes increasingly crucial. With a strong market orientation, MSMEs can design products and services that align with customer preferences amidst changes in consumer behaviour due to the pandemic. Meanwhile, entrepreneurial orientation encourages MSMEs to dare to take risks and create business models that are more adaptive to uncertain situations.

Business model innovation has also emerged as a significant factor in improving the performance of new product development among MSMEs. By adding new value for customers through business model innovation, MSMEs can increase the competitiveness of their products and encourage the success of new product development. This becomes increasingly important during a pandemic, where MSMEs must be able to adapt and create more relevant value propositions for customers.

Table 1. ***SEM Reporting***

Construct / Variable	Indikator (Loading)	AVE	CR	R^2	Fit Model Notes
Market Orientation (MO)	0.72 – 0.84	0.58	0.86	–	Valid & reliabel
Entrepreneurial Orientation (EO)	0.70 – 0.83	0.56	0.85	–	Valid & reliabel
Business Model Innovation (BMI)	0.74 – 0.88	0.62	0.88	0.54	Significant mediator
Product Innovation Performance (PIP)	0.73 – 0.87	0.60	0.87	0.58	Primary endogenous factor
Model Fit (PLS-SEM)	–	–	–	–	SRMR = 0.062; NFI = 0.91

Source: Authors' work (2024)

The SEM reporting table shows that all constructs met the criteria for good validity and reliability. All indicators have loading values above 0.70, while AVE > 0.50 and CR > 0.70 indicate that the research constructs are valid and reliable. The structural model shows that business model innovation is explained by 54% of market orientation and entrepreneurial orientation, while product innovation performance is explained by 58% of the variables in the model. These values indicate that the model has a sufficiently strong explanatory power regarding the endogenous constructs. Furthermore, an SRMR value of

0.062 and an NFI of 0.91 indicate that the model has adequate goodness of fit, making it suitable for explaining the relationships among variables in this study.

Table 2. ***Results of the PLS-SEM Hypothesis Test***

Hypo-thesis	Relationships Among Variables	Coefficient (β)	p-value	Status
H1	Market Orientation → Business Model Innovation	0.427	< 0.001	Supported
H2	Entrepreneurial Orientation → Business Model Innovation	0.351	< 0.001	Supported
H3	Business Model Innovation → Product Innovation Performance	0.472	< 0.001	Supported

Source: Authors' work (2024)

The results of the hypothesis testing in the PLS-SEM model indicate that all research hypotheses are significantly supported with a p-value of <0.001. Market orientation was found to have a positive and significant effect on business model innovation with a coefficient of 0.427, indicating that market orientation is the most dominant factor in driving business model innovation. Entrepreneurial orientation also has a significant positive effect on business model innovation, with a coefficient of 0.351. Furthermore, business model innovation was found to have a positive and significant effect on product innovation performance with a coefficient of 0.472. These findings indicate that business model innovation serves as a crucial mechanism bridging strategic orientation to enhanced product innovation performance, and confirm that the direction of relationships among variables aligns with the study's conceptual framework.

This research aligns with several previous studies that state that developing and optimizing new product innovation requires entrepreneurial orientation and competence, as well as innovation and competitive advantage, to strengthen relationships and improve business performance (Fatimah et al., 2024b; Indomarco & Indradewa, 2023b; Suhendah & Brigita, 2021b).

These findings underscore the importance of market orientation in driving innovation (Chen & Zhang, 2020), which contrasts with previous research that found entrepreneurial orientation to have a more dominant influence in large firms (Lee, 2019). This difference suggests that Indonesian MSMEs rely more on a combination of market and entrepreneurial orientations to adapt to resource constraints.

Furthermore, the role of business model innovation as a mediating variable strengthens findings in the literature that emphasize the importance of business model innovation in addressing various crises (Teece, 2018). This underscores that product innovation is not limited to internal creativity; it also involves the capability of MSMEs to redesign their business models to make them more adaptable.

The results of this study seek to realize a positive impetus in business practice through policy recommendations to better understand current business models and the concept of sustainable business models by identifying the potential for new business models in the future. This will enable companies and MSMEs to face challenges in innovating new business models.

4. CONCLUSION

This study concludes that market orientation, entrepreneurial orientation, and business model innovation contribute to improved performance in new product development for MSMEs as an alternative solution during crises, such as a pandemic. It has been shown that market orientation and entrepreneurial orientation encourage MSMEs to innovate their business models, which, in turn, positively impact new product development performance.

The results of this research provide managerial implications for MSME actors and policymakers. First, MSMEs must strengthen market orientation by understanding customer needs and preferences and monitoring competitors' movements. Second, MSMEs must develop an entrepreneurial orientation encouraging innovation, risk-taking, and proactivity. Third, MSMEs need to innovate their business models to deliver new value to customers and the market, and to enhance their competitiveness.

This research has several limitations. First, the research sample only includes MSMEs in the manufacturing and service sectors, so the

research results may need to be more generalizable to other sectors. Second, this research focuses only on three factors (market orientation, entrepreneurial orientation, and business model innovation), although other factors may still influence new product development performance.

For further research, it is recommended that the sample scope be expanded to include other MSME sectors, such as trade and agriculture. In addition, future research could examine and incorporate new variables and other factors—such as innovation capacity, learning orientation, and government support—in enhancing the performance of new product development among MSMEs during times of crisis.

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(Appendix)

Appendix 1.

Respondent Profile

Variable	MSME Respondent Data
Number of Respondents	250
Business Sector	Manufacturing (50%), Services (50%)
Length of Operation of MSMEs	5-10 Years (60%)
Average Number of Employees	About 2 people
MSME Operational Locations	Java Island, especially in Yogyakarta (70%)

Source: Authors' work (2024)

Appendix 2.

Descriptive Analysis Results

Variable	Average Score	Category Level
Market Orientation	Tall	Tall
Entrepreneurial Orientation	Tall	Tall
Business Model Innovation	Tall	Tall
Product Development Performance	Tall	Tall

Source: Authors' work (2024)

Appendix 3.

Validity and reliability test 1st-order

Variable	Dimension	Item	Loading Factor	AVE	CR
Consumer ethnocentrism	Pro-social motivation	X1.1	0.787	0.806	0.881
		X1.2	0.810		
		X1.3	0.842		
		X1.4	0.784		
	Cognitive distortion	X2.1	0.823	0.854	0.890
		X2.2	0.886		
		X2.3	0.852		
	Threat perceptions	X3.1	0.856	0.873	0.906
		X3.2	0.867		
		X3.3	0.896		
	Social demonstrability of benefits	X4.1	0.827	0.850	0.886
		X4.2	0.856		
		X4.3	0.866		
Perceived quality		Z1.1	0.809	0.625	0.915
		Z1.2	0.726		
		Z1.3	0.807		
		Z2.1	0.790		
		Z2.2	0.828		
		Z2.3	0.831		
		Z3.1	0.821		
		Z3.2	0.699		
		Z3.3	0.823		
		Z3.4	0.758		
Purchase intention		Y1.1	0.722	0.515	0.943
		Y1.2	0.741		
		Y2.1	0.720		
		Y2.2	0.680		
		Y3.1	0.742		
		Y3.2	0.752		
		Y4.1	0.744		
		Y4.2	0.631		

Source: Author's work (2024)