

Driving Structural Equation Modeling (SEM) Growth Innovation and Digital Capabilities

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General Background: In today's dynamic business environment, small and medium enterprises (SMEs) face increasing challenges that threaten their performance and sustainability. **Specific Background:** Business owners are compelled to adapt by leveraging innovation and digital transformation, yet the mechanisms linking these elements remain underexplored. **Knowledge Gap:** Previous studies have not sufficiently examined how digital capabilities mediate the relationship between innovation capability and entrepreneurial performance. **Aims:** This study aims to investigate the effect of innovation capability and entrepreneurial orientation on entrepreneurial performance, while assessing the mediating role of digital capability. **Results:** Using purposive sampling, data were collected from 205 SME stakeholders in Sidoarjo and Pasuruan, including shop heads, managers, and supervisors. Analysis with SmartPLS 4.0 revealed that both innovation capability and entrepreneurial orientation significantly enhance entrepreneurial performance. Furthermore, digital capability was found to significantly mediate the positive relationship between innovation capability and performance. **Novelty:** This research introduces a moderated mediation model that highlights the strategic importance of digital competence in strengthening innovation-led performance among SMEs. **Implications:** The findings provide practical insights for SMEs to prioritize innovation and digital development, enabling them to remain competitive in an increasingly digital economy.

Highlights:

- Highlights the mediating role of digital competence in SME innovation.
- Demonstrates positive impact of innovation and orientation on performance.
- Uses SmartPLS 4.0 to validate structural relationships in the model.

Keywords: Innovation Capability, Entrepreneurial Orientation, Digital Capability, Entrepreneurial Performance

Introduction

Many studies explain the relationship between entrepreneurial performance and other variables [6]. Research by Sariwulan et al., [7] shows that increasing innovation and digital capability has a positive effect on entrepreneurial performance. According to Hazem and Yunhong [8] entrepreneurial performance has a relationship with innovation capability in supporting business

performance. Relationship with innovation capability in supporting business performance. Supported by the study described by Nguyen et al., [9], that entrepreneurial performance can increase due to business innovation and entrepreneurial creativity. However, there are differences in research by Aulia et al., [10] that there is less entrepreneurial performance for business people. The discrepancy from previous research results reveals that entrepreneurial performance and innovation capability can be a strong driver of business development. When viewed from the methodological approach, previous studies used survey [11], SLR [12], qualitative [13], and mixed methods [14]. However, there is still a paradox that entrepreneurial performance and innovation ability can be strong drivers of business development. Most previous studies have focused on short-term attractiveness, without measuring how innovation acts as developing a vision that can increase business value [15]. In the RBV perspective, innovation has high potential that is difficult to imitate by competitors, thus providing sustainable superior value for the business [16]. Entrepreneurial performance can increase with innovation, because innovation allows businesses to create new value, increase efficiency, and compete more effectively in the market [17]. Zahara et al., [18] revealed that entrepreneurial performance in business actors can improve if they apply a business approach supported by digital capabilities. In the context of business, advanced entrepreneurial performance will affect the success of a business. So, entrepreneurial performance will be a factor in business improvement because it helps business cooperation and business entities. However, if the use of entrepreneurial performance is weak, it will experience business failure [19].

Previous research has not achieved results in improving business performance and business in the face of various obstacles [20]. The development of RBV theory starts from including invisible resources such as knowledge, capabilities, reputation, and brand. RBV theory has also progressed in considering the dynamics of resources and how companies can build and maintain their competitive advantage in a changing environment. Developments also involve understanding how firms can protect valuable resources from competitor imitation. In addition to resources, RBV also emphasizes the importance of capabilities, which is the company's ability to integrate and utilize resources effectively. This study uses RBV theory, Barney et al., [21] explains that entrepreneurial performance can achieve competitive advantage by utilizing internal resources in form innovation and digital capability. Innovation and digital capability must be able to adjust to the growing competition in the business world [22]. In essence, entrepreneurial performance can compete and gain an aggressive advantage in the business world [23]. Business actors must be able to adapt and transform in the face of dynamic external environmental changes [24]. This ability is in the form of developing performance capacity to recognize new opportunities, determine competitive resources, and apply innovation to entrepreneurial performance [25]. Therefore, this research is useful to complement previous research by adding digital capability as moderation. This study factually examines digital capability and entrepreneurial performance in the business environment.

To answer this research, this study analyzes innovation and entrepreneurial performance as successful performance. First, this study developed hypotheses based on relevant concepts from previous research conducted in the business context. Second, the researcher developed a questionnaire and distributed the questionnaire to respondents to collect data. Third, The intermediate level served as study's unit of analysis such as managers, store heads, decision makers, and SPVs. Fourth, a number of procedures were followed by the researcher to analyze the middle level data with Smart PLS 4.0 [26]. This research ultimately provides insights that relate to previous studies and offers guidance for future research.

Based on above phenomenon, this study contributes to RBV theory by considering business conditions, business competitors, and future business goals, especially in achieving performance improvement. Second, this study develops entrepreneurial performance especially in the context of business that has been done by Pulka et al., [27] in Nigeria, Austria [28], Philippines [29], Australia [30], UK [31], and China [32]. In digital capability variables, Asian countries have been carried out, for example Australia [33], India [34], Japan [35], Korea [36], and Singapore [37] while this research is in Indonesia which has coverage of the Sidoarjo and Pasuruan areas. Specifically, this

study shows that empirical studies related to entrepreneurial performance in Asian countries such as Indonesia still need special attention [38]. Indonesia is the country with the largest number of businesses and according to WEF, Indonesia ranked 50 out of 141 countries surveyed in 2019 [39]. Therefore, the potential to create new ideas and the ability to compete by utilizing digital capabilities in improving entrepreneurial performance is needed. Understanding entrepreneurial performance is one of the important contributions of this research to the existing facts and specifically provides an overview by adding the role of digital capabilities as a moderator variable.

Resource Based View Theory: Resources based view emphasizes increasing competitive advantage derived from strategic organizational resources [40] RBV also highlights the company's unique capabilities and resources and adds significant value to the company [41]. Yuga and Widjaja [42] explain that RBV is about how companies use their resources and capabilities such as organizational routines, mechanisms, structures, and processes. The resource-based view (RBV), or resource-based theory, is a classic and influential classic and influential theory in the field of information systems. This theory originated from Edith Penrose's (1959) theory of corporate growth, introduced by Birger Wernerfelt (1984) who stated that companies that have unique and difficult-to-imitate resources will have a competitive advantage and popularized by Jay Barney (1991) developed the VRIO (Valuable, Rare, Inimitable, Organized) framework to analyze whether a company's resources can provide a sustainable competitive advantage. This resource-based view method examines the company's assets, expertise, capabilities, and intangible assets including the company's internal resources and determines its strategic advantage [43]. More specifically, RBV examines organizations from the inside out and examines what makes them successful and unsuccessful [40]. Some previous empirical findings on RBV have been listed in Table 1. Definition of RBV Theory.

Year	Authors	Definition er conceptual focus	Principle/Dimension	Fields
2001	Jay B. Barney	Competitive advantage can be maintained by utilizing resources that are valuable, rare, imperfectly imitable, and non-substitutable.	Knowledge resource based view	Economy
2016	Alexander J. Kull, Jeannette A. Mena, and Daniel Korschun	The RBV proposes that the internal resources of the firm primarily drive its sustainable competitive advantage. This perspective adopts an internally driven approach, as opposed to the externally driven perspective according to which a firm's competitive advantage stems from external market forces and a firm's ideal positioning in a market.	Stakeholder, Marketing strategy	Bussiness
2018	Yu, Wantao, Chavez, Roberto, Jacobs, Mark A. and Feng, Mengying	The resource-based view of the firm (RBV) suggests that firms that possess valuable, rare, inimitable, and irreplaceable resources can achieve sustainable competitive advantages by using them to implement strategies that are difficult for competitors to replicate.	Logistics and Transportation Review,	Business

2019	John Donnellan Wanda L. Rutledge	skills, capabilities, and other resources that organizations possess differ from one company to another.	competitive advantage in banking	Bussiness
2020	Hardeep Chahal, Mahesh Gupta, Namrita Bhan, and T.C.E. Cheng	RBV offers an attractive framework for integrating different resources to explain their synergistic and differential effects on performance, and similar contingencies.	Business performance in general, competitive performance, financial performance, and operational performance	Operations management
2021	R. Edward Freeman, Sergiy D. Dmytriiev, and Robert A. Phillips	RBV examines a firm's competitive advantage that arises from unique strategic resources at a time when "practicing managers were unaware of the arguments for a resource-based view". at a time when "practicing managers were not aware of the arguments for a resource-based view until 1990".	Resource-based view of the firm and stakeholder theory	Economy
2022	Nurul Wardani Lubis	A company's ability to access, control, and manage the company's resources determines how competitive the company is.	Company Strategic Capacity	Bussines
2023	Chalchissa Amentie Kero, Addisalem Tadesse Bogale	Wealth generated from exploitation of resources to generate economic value in a manner superior to that of their competitors with their competitors	A Systematic Review of Resource-Based View and Dynamic Capabilities	Economy and business
2024	Sheshadri Chatterjee, Nripendra P. Rana, and Yogesh K. Dwivedi	A managerial framework, which is used to determine the strategic resources an organization needs to exploit in order to achieve sustainable competitive advantage. organization to exploit in order to achieve sustainable competitive advantage.	Service sector and product based organisations	Bussiness
2025	Grace Yulianti and Mohammad Chaidir	Utilizing internal resources to create and capture value, and innovation in business models with the aim of adapting and optimizing the use of resources.	Managerial ties and external ecosystem,	Business

Table 1. Definition of RBV Theory.

Method

Type of Research : This research method uses a quantitative approach. This study examines the relationship between innovation capability, entrepreneur orientation, digital capability and entrepreneurial performance in SMEs. This research is also considered descriptive because it explains how innovation capability and digital capability contribute to the increase in entrepreneurial or business performance.

Data Types and Sources : This type of research involves collecting numerical data through structured questionnaires, followed by statistical analysis to identify relationships, correlations, and patterns. Primary and secondary data sources were used in this investigation [44].

Data Collection Techniques : The data in this study were taken from SMEs in Sidoarjo and Pasuruan, which are engaged in food and beverages, fashion, furniture, textiles, electronics, beauty, motorcycle and cars and precious metals with a cross-sectional approach. The study began in November to December 2024. Several stages were carried out in this study, namely: First, the researcher sent a research permit to SMEs in Sidoarjo and Pasuruan cities. Second, the researcher compiled a questionnaire and ensured that the questionnaire statements were clear, simple, and easily understood by the respondents. Third, the researcher distributed the questionnaire offline to store heads, managers, and SPVs because they are directly involved in the management and decision-making process. The survey was conducted using a structured questionnaire designed to evaluate these four main variables, namely IC, EO, DC, and EP [45]. The sampling technique used was cluster sampling. The research population consists of SMEs in two districts, namely Pasuruan district with a population of 104,338 SMEs and Sidoarjo district with 106,745 SMEs. By using a margin of error of 10%, the sample size for Pasuruan district was 100 respondents and for Sidoarjo district was 100 respondents.

Data Validity Test : The measurement model and the structural model are two primary models used in the data validity test. A measurement model is considered to have strong validity if the factor loading is >0.7 and the Average Variance Extracted (AVE) is greater than 0.5. The structural model's capacity to account for variances in SME performance is evaluated using R^2 . Cronbach's Alpha and Composite dependability are used to measure dependability; values greater than 0.7 indicate strong consistency. The importance between variables was assessed by bootstrapping path coefficients. At the 5% level, a t-statistic result is deemed significant if it exceeds 1.96 [46]. A scale is the measurement tool utilized in this investigation that has been developed previously and adapted from existing literature. The relevant items in this study are presented in Table 2. The ability to convert knowledge and skills into a long-lasting innovation culture is known as innovation capability [47]. Innovation capability can be measured by four items adopted from [48]. Entrepreneur orientation is a company's ability to recognize market opportunities, act on existing opportunities, and reconfigure to maintain competitiveness [49]. The entrepreneur orientation items were developed based on several empirical studies involving entrepreneur orientation variables. This variable is measured by four items adopted from [50]. A collection of instruments that guarantee the transformation and integration of technical resources and maximize their potential is known as digital capability [51]. Digital capability is measured using four items adopted from [52]. Entrepreneurial performance is the ability to achieve goals by utilizing available business opportunities [53]. Entrepreneurial performance is measured by nine items adopted from [54].

Analysis Technique : This study uses a 5-point likert scale, ranging from 1 (strongly disagree) to 5 (strongly agree) [26]. This study's data analysis method made use of smartPLS 4.0 software. Partial Least Square is a very accurate data analysis method as it is not based on many assumptions [26]. PLS was used in this study because the analysis requires latent variable scores obtained from secondary data, because it does not have comprehensive evidence on the basis of measurement theory [55].

Results and Discussion

A. Results

Based on the results of the researcher's questionnaire that has been presented in Table 2. Respondent Distribution, it shows an overview of the 200 respondents. Most came from Pasuruan with a frequency of 52% and after that Sidoarjo by 48%. The distribution of food and beverage SMEs amounted to 34.5%, fashion 23.5%, furniture 9.5%, textiles 6.5%, electronics 15%, and beauty 11%. The duration of business was less than three years, 23%, and more than three years 77%. Respondents consisted of 60% owners, decision makers/managers by 40%.

Variables		Frequency	Percentage
Location	Sidoarjo	96	48%
	Pasuruan	104	52%
Type of SME	Food and Beverage	52	34,5%
	Fashion	30	23,5%
	Furniture	19	9,5%
	Textiles	13	6,5%
	Electronics	30	15%
	Beauty	22	11%
Length of Establishment	Less than 3 years	46	23%
	More than 3 years	154	77%
Position	Owner	120	60%
	Decision Maker/Manager	80	40%
Length of Service	0 to 5 years	56	28%
	5 to 10 years	86	43%
	10 to 15 years	37	18,5%
	15 to 20 years	21	10,5%

Table 2. Respondent Distribution

Outer Model: The nature of the data in this study uses the middle level, so the hypothesis of this study was tested using SmartPLS 4.0. To avoid data bias, this study uses a common method bias approach with a result of 27,145 (27%) or less than 50%, which means that there is no bias in this study. This study uses innovation capability with a reliability value of 0.810 and an AVE of 0.558; entrepreneurial orientation with a reliability value of 0.767 and an AVE of 0.583 independent variables; digital capability as a moderator with a reliability value of 0.742 and an AVE of 0.562; entrepreneurial performance as the dependent variable with a reliability value of 0.927 and an AVE of 0.624. As explained in Table 3. Item Measurement, Outer Loading, Reliability, and AVE.

Item Measurement	Factor Loading	Reliability	AVE
Innovation capability [47].			
I am capable of produce products that excel in the market	0,778	0,810	0,558
I am able to provide satisfactory service to customers	0,742		
I developed new products through utilization of technology	0,779		
Entrepreneur orientation [49].			
Over the past 3 years my company has produced many new products/services	0,810	0,767	0,583
In general, I am often be the first party to introduce new	0,728		

products/services new service			
To achieve company goals, the impact of business on the environment encourages me to act decisive and courageous	0,764		
Changes in products or new services in my company I am quite significant	0,751		
Digital capability [51].			
My business can collaborate online on activities for our employees, such as training, coworking, etc.	0,775	0,742	0,562
My business is able to manage digital technology and utilize the various features that it offers, such as data analysis, networking, connection, visualization, and artificial intelligence	0,720		
My business is constantly looking for trends Technology	0,776		
My business is able to utilize digital knowledge digital knowledge from within the organization	0,725		
Entrepreneurial performance [53].			
My business has experienced increase in revenue in the last 3 years	0,803	0,927	0,624
My business adds new services	0,783		
My business is able to achieve production quantity and quality targeted	0,782		
My business has innovations new product	0,789		
My business has customers with good loyalty	0,755		
My business can fulfill consumer demand with inventory	0,810		
Many new customers who buy products from my business	0,821		
My business achieves annual sales target	0,751		
My business has experienced increase in revenue	0,814		

Table 3. *Item Measurement, Outer Loading, Reliability , dan AVE*

R Square: The R Square value can be classified as weak if >0.25 , moderate if >0.50 , and strong if >0.75 [56]. The findings of the R-Square values studied are as follows described in Table 4. R Square.

	R Square	R Square
		Adjusted
EP	0,464	0,450

Table 4. *R Square*

Table 4 above indicates that entrepreneurial performance has an R-Square value of 0.450, or 45.0%. In order for the outcomes derived from the entrepreneurial performance variable's R-Square value to fall into the moderate category.

Hypothesis Test: [26] explain that the path coefficient value is between -1 and 1. In contrast, the t-value or p-value statistics are used for hypothesis testing between variables; if the t-count (t-table) > 1.96 or p value < 0.05, then the variable is significantly affected. The results showed that the moderation of digital capability on innovation capability variable on entrepreneurial performance showed a P-value of 0.010 (accepted); entrepreneur orientation on entrepreneurial performance with a P-value of 0.000 (accepted); moderation of digital capability on innovation capability on entrepreneurial performance with a P-value of 0.874 (rejected); and moderation of digital capability on entrepreneur orientation on entrepreneurial performance with a P-value of 0.466 (rejected). As explained in Table 5. Patch Coefficient (mean, STDEV, T-Values, p values) and Effect Size.

	Original sample	Sampel Mean (M)	Standart Deviation	T Statistics (STDEV)	P- Values	Description
IC->EP	0,228	0,234	0,089	2,574	0,010	Retrieved
EO-> EP	0,325	0,325	0,076	4,308	0,000	Retrieved
DC x IC -> EP	0,009	0,004	0,058	0,158	0,874	Rejected
DC x EO -> EP	- 0,050	- 0,047	0,069	0,729	0,466	Rejected
Effect size	Alpha					
DC	0,168					
EO	0,031					
IC	0,115					
DC x EO	0,063					
DC x IC	0,000					

Table 5. *Patch Coefficient (mean, STDEV, T-Values, p values) and Effect Size*

Effect size: interpretation of F Square moderation path analysis shows that the effect of digital capabilities on entrepreneurial orientation is high (f square = 0.063) above 0.025. The effect between digital capabilities on innovation capabilities is stated not to moderate because the value (f square = 0.000). As explained in Table 5. Patch Coefficient (mean, STDEV, T-Values, p values) and Effect Size.

No		Mean	Std. Dev	1	2	3	4	5	6	7	8	9	10	11	12
1	Kota/Kabupaten	1.5171	0.50093	1											
2	Omset	2.1317	0.76519	0.039	1										
3	Tahun Berdiri	1.7707	0.42139	0.123	.383**	1									
4	Jenis UKM	4.0195	2.73675	-0.108	.259**	0.123	1								
5	Posisi	1.4	0.4911	0.052	.211**	-0.005	.311**	1							
6	Jenis Kelamin	1.522	0.50074	-0.006	-0.104	-.197**	-0.136	-0.036	1						
7	Usia	2.4829	1.13585	-.165*	.327**	.304**	.156*	-.172*	-.316**	1					
8	Pendidikan	2.3024	0.95293	0.010	.221**	.149*	0.026	-0.103	-0.045	.313**	1				

9	IC	4.2037	0.4240 6	.200**	0.121	0.002	-0.108	-.140*	-0.018	0.019	.174*	1			
10	EO	3.9301	0.4814 3	0.067	0.022	-0.031	-.188**	-.199**	0.010	0.023	.184**	.496**	.599**	1	
11	DC	4.0518	0.4523 4	.170*	0.008	-0.032	-.154*	-.156*	-0.024	-0.024	.173*	.680**	.778**	.735**	1
12	EP	4.1295	0.4373 8	.240**	0.123	0.039	-.215**	-.199**	0.034	-0.048	0.123	.673**	.626**	.595**	.798**
*. Correlation is significant at the 0.05 level (2-tailed).															
**. Correlation is significant at the 0.01 level (2-tailed).															

Table 6. Matrix Correlation

Matrix Correlation: correlation matrix in Table 6. Matrix Correlation on the variable innovation capability and entrepreneurial performance has a strong correlation (0.673), indicating that the two variables have a close relationship. The variable entrepreneur orientation and entrepreneurial performance has a moderate correlation (0.595), indicating that both variables have a significant influence. The variable digital capability and innovation capability has a strong correlation (0.680), indicating that digital capability has a significant moderating influence on innovation capability. Likewise, digital capability and entrepreneur orientation have a strong correlation (0.735), indicating that digital capability has a moderating influence on entrepreneur orientation.

H1 : 0,228 ; 0,010 H3 : 0,009 ; 0,874

H4 : -0,050 ; 0,466

H2 : 0,325 ; 0,000

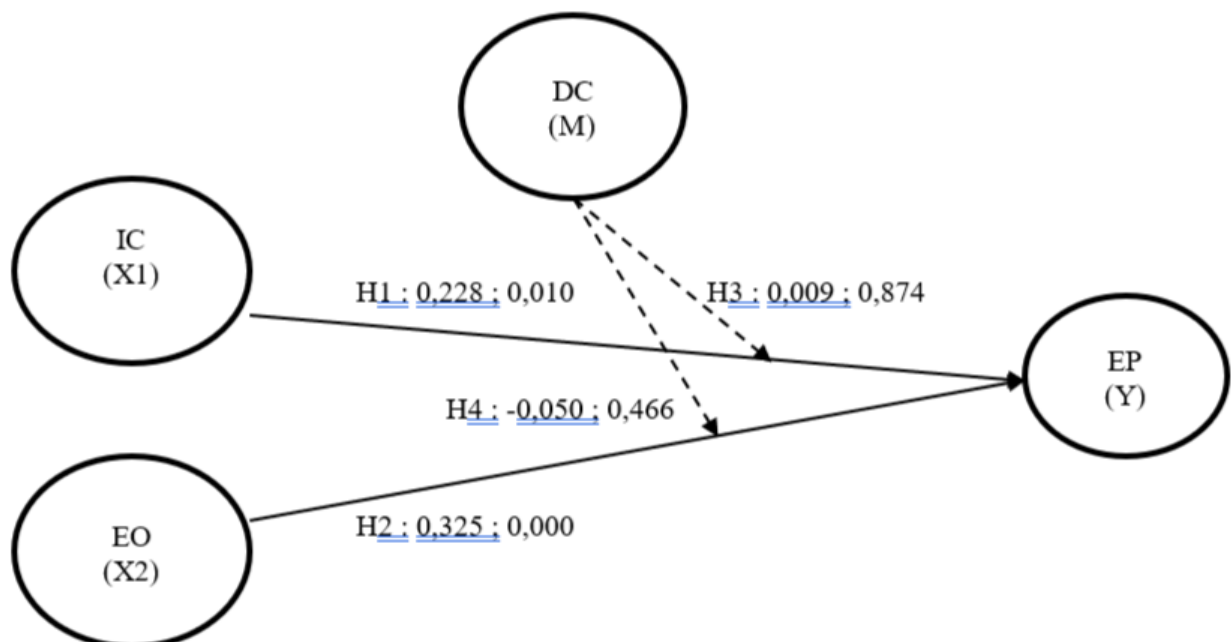


Figure 1. Hypothesis Testing

The results of the path coefficient analysis in Figure 1. Hypothesis Testing shows that, H1 shows IC

has a positive and significant influence with EP (0.228; 0.010); H1 is accepted, indicates that innovation capability can improve entrepreneurial performance. H2 shows EO has a positive and significant relationship with EP (0.325; 0.000); H2 is accepted, indicates that entrepreneur orientation can improve entrepreneurial performance. H3 shows that DC moderates the relationship between IC and EP positively and insignificantly (0.009; 0.874); H3 is rejected, meaning that a high level of digital capability can weaken the relationship between innovation capability and entrepreneurial performance. H4 shows that DC moderates the relationship between EO and EP negatively and insignificantly (-0.050; 0.466); H4 is rejected which means that too high a level of digital capability can make the relationship between entrepreneur orientation and entrepreneurial performance weak.

Moderation Test : The results of the moderation test in Figure 2. Simple Slope Analysis digital capability X innovation capability shows that the green line indicates the effect of high digital capability (+1 SD) on entrepreneurial performance on innovation capability, the blue line indicates the mean value, and the red line indicates low digital capability (-1 SD), The gradient of the three lines indicates that the impact of digital capacity on innovation capability value and entrepreneurial performance varies. Digital capability does not significantly moderate these relationships, with a strong effect at high levels of digital capability (+1 SD). This implies that the impact on entrepreneurial performance may not increase with the level of digital capacity.

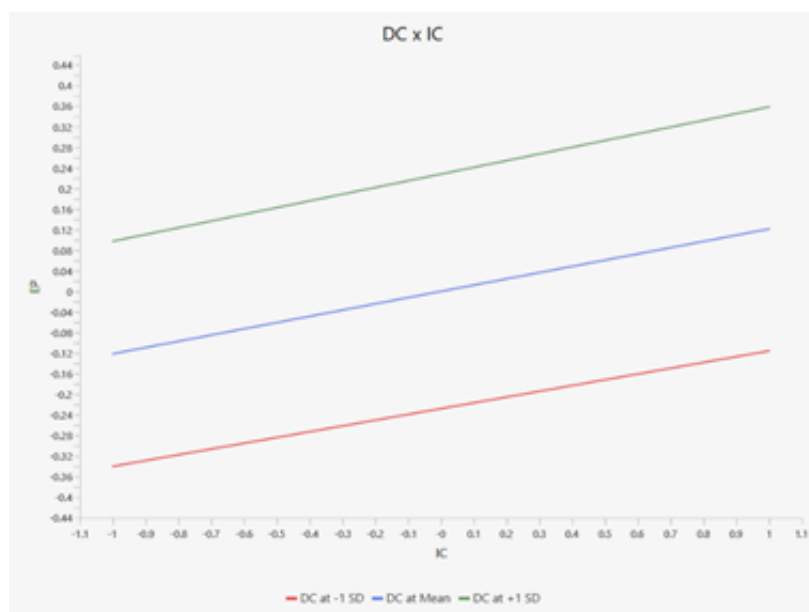


Figure 2. Simple Slope Analysis digital capability X innovation capability

The moderation test results in Figure 3. Simple Slope Analysis digital capability X entrepreneur orientation show that the green line represents the effect of high digital capability (+1 SD) on entrepreneurial performance in entrepreneur orientation, the red line represents low digital capability (-1 SD), and the blue line represents the average value. The difference in the gradient of the three lines shows that digital capability does not considerably mitigate the association between entrepreneurial performance and entrepreneur orientation, with the highest effect on digital capability (+ 1SD). This means that high digital capability cannot influence entrepreneurial performance on entrepreneur orientation.

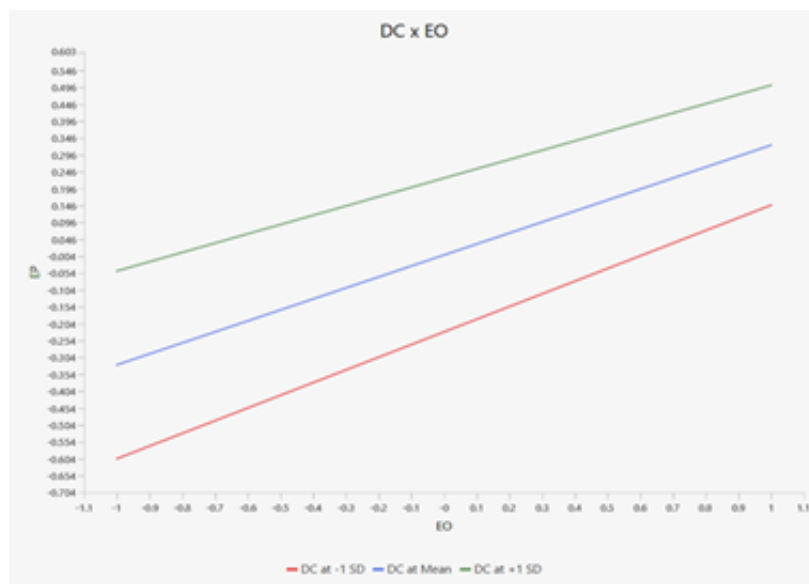


Figure 3. Simple Slope Analysis digital capability X entrepreneur orientation

B. Discussion

The impact of innovation capability on mid-level business performance is examined in this study. In general, innovation capability has a relationship with operational performance, if SMEs have innovation capability, their business performance will also be high [57]. In addition, the results of this study are in line with the research of [58], which shows a positive and significant relationship between innovation ability and entrepreneurial performance. This shows that innovation capabilities can improve entrepreneurial performance in businesses at the middle level. Effective implementation of innovation capabilities in business can improve entrepreneurs' ability to create new ideas. In Barney et al. , [21] resource-based view theory, proper application of internal resources in the form of innovation capabilities and digital capabilities will be a strong driver for business progress [59] . To create innovation, institutions must have the ability to do new and creative things and learn unique ways of working [60]. Innovation capabilities encourage business people to think creatively such as seeing business opportunities and innovative attitudes to continue to adapt sustainably [61]. In addition, the application of innovation capabilities can help businesses develop appropriate and targeted strategies compared to competitors [62] . For example, a coffee shop SME experienced business growth because it utilized technology applications for digital ordering and payment services. In addition, the SME implemented a data-driven marketing strategy to understand customer preferences. This study differs from previous studies on product diversity innovation and production process improvement [63]. This novelty is also found in several previous studies on how a business maximizes performance with various innovations implemented such as improving customer service through free shipping services and providing product warranties. By applying innovation capabilities, SMEs can experience improved performance and make it easier to see business opportunities.

This study is consistent with Putniņš [64] which demonstrates that entrepreneurial performance is significantly impacted by entrepreneur orientation. The success of business performance supported by entrepreneur orientation can create synergies that drive business growth [65]. Veleva[66] explains that the entrepreneur's ability to make decisions will create positive business policies that can improve business performance. In the resource-based view theory, Barney et al., [21] reveals that businesses must continue to adapt by integrating their entrepreneur orientation and implementing business management to identify potential market opportunities and strengthen business cooperation. Entrepreneurs who have good managerial skills will create a business vision that is beneficial in the long term [67]. For example, an SME in the field of premium hijab

production (Buttonsscarvess) managed to attract the attention of the global market. The SME applied proactivity to boldly enter the international market with digital marketing strategies on platforms such as Instagram, TikTok, and international e-commerce. This research has differences with previous research on the application of proactivity in various businesses, they take steps and are oriented on how to find suitable strategies for their business such as collaborating with other SMEs to create new products [68]. With an entrepreneurial orientation, SMEs will easily achieve a competitive advantage and maintain the vision and mission of the business.

Research by Benitez et al., [69] illustrates how the relationship between innovation capabilities and entrepreneurial performance is strengthened by digital capabilities. Innovation capabilities moderated by digital capabilities cannot significantly improve business performance. Business performance with innovation capability shows no relationship with digital capability. The term "digital capability" describes a firm's capacity to use digital technology to conduct operations in a more effective and efficient manner. Integrating innovation capabilities through digital capabilities can improve the competitiveness of businesses compared to competitors. Entrepreneurial performance and innovation capabilities are insignificantly correlated through digital capabilities will weaken entrepreneurial performance in achieving business goals [70]. Therefore, businesses can face increasingly fierce competitiveness between businesses. In the resource-based view theory, Barney et al., [21] explains that digital capability can strengthen the relationship between innovation capability and entrepreneurial performance by applying the characteristics possessed by the business. Thus, digital capability cannot act as a moderating variable that strengthens the relationship between innovation capability and entrepreneurial performance due to the lack of readiness of the owner in facing technological advances. For example, a cultural batik SME producing home-made batik is implementing digital transformation by using high-quality content and software for accounting management and market prediction. Lack of readiness and knowledge about digital transformation by business owners can lead to failure and decreased performance effectiveness. Therefore, digital capabilities in this context cannot improve business performance as expected. This study is different from the previous study on digital capabilities by implementing a customer relationship management system. In the end, communication with customers is stronger and increases customer loyalty [71]. Digital capabilities in business will increase the contribution of digital competencies in SMEs and deepen the relationship between innovation capabilities and entrepreneurial performance.

Finally, The study's findings indicate that the association between entrepreneur orientation and entrepreneurial performance in business performance is weakened by digital capacity. This is consistent with Tang et al., [72] which shows that digital capability cannot significantly strengthen businesses to achieve goals more effectively. Business courage in taking risks and supporting digital technology capabilities will weaken business performance and be less competitive. In Barney et al., [21] resource-based view theory, it reveals that entrepreneur orientation combined with digital capability can help businesses respond to potential opportunities that have a direct impact on business improvement. For example, owners of traditional culinary SMEs apply a proactive attitude to their subordinates. The employees in the business are asked by the owner to have the courage to take risks, act independently, and implement business strategies in order to achieve business goals in the long term. So, the owner's attitude in giving directions to subordinates does not require digital technology in carrying out his duties. Therefore, a business with entrepreneur orientation combined with digital capability in this context cannot increase the effectiveness of business performance. The relationship between entrepreneur orientation and entrepreneurial performance may deteriorate and not directly contribute when SMEs' digital capabilities increase.

Policy Implications : The results of this study provide implications for the development and implementation of policies that support business progress. Government policy regulations in SMEs are listed in Government Regulation (PP) Number 7 of 2021, the central government is obliged to provide empowerment facilities to business people optimally so that business growth in Indonesia will increase. The government also needs to provide programs that can encourage the performance of business people, such as educating SME practitioners and increasing the number of SME

coaching centers that offer consulting services. This policy has been implemented in Malaysia to realize strong competitiveness and increase economic prosperity. Meanwhile, business development in Singapore implements four development areas, namely: First, Business support services include the development of a complete information network such as the community for entrepreneurship program to facilitate networking. Second, Develop key clusters consisting of information technology, life style, manufacturing and services including education, health, and logistics. Third, Technology Commercialization Scheme (TECS) which provides funding, connectivity for new knowledge-based businesses. Fourth, money, market, management and knowhow (MMK). These policies can enhance the development of SMEs at the national and international levels and offer great potential in improving business competitiveness in Indonesia.

Theoretical Implication : The conclusions of this study have significant theoretical consequences in several ways. First, this study contributes to the resource-based-view theory, particularly in terms of business. In the context of RBV by Barney et al., [21] states that first, businesses can become superior to competitors by applying innovation, proactive action, and digital technology [73]. Because, with it all, businesses are faster in responding to market changes and competition [74]. Second, this study advances knowledge about entrepreneur performance, digital capacity, entrepreneur orientation, and innovation capability. This study responds to Fang et al., [75] who stated that research on innovation capabilities in businesses in developing countries is still minimal and needs to align research for business adaptation in order to respond more quickly to business changes. Specifically, this study integrates digital capabilities as a moderating variable that can enhance the relationship between entrepreneurial performance and innovation capabilities for rapid firm adaptation. In essence, the proper implementation of innovation capabilities has the potential to increase the level of performance quality that leads to increased employment in the long run. Third, this study was conducted in Indonesia which still has a low level of business adaptation, which is ranked seventh in ASEAN. Various obstacles are faced such as lack of supporting infrastructure, digital network readiness, and ineffective government policies. The network sector in Indonesia is growing rapidly along with many businesses that utilize digital technology. However, digital access is still limited in Indonesia, making it difficult for businesses to find business opportunities [76]. Therefore, this research is of major concern for SMEs, owners, managers, shop heads, and SPVs to optimize business performance in Indonesia. Ultimately, this research offers a deep insight into the existing business developments in Indonesia. The theoretical approach and efficient utilization of technology, can have a direct influence on business progress and be able to compete with the global market at the ASEAN level.

Practical Implications : The discussion of this research provides practical implications that are relevant to business, particularly in Indonesia and East Java. First, the need to improve innovation capabilities and digital capabilities for SMEs through the provision of customized training and coaching. In addition, by adopting ideas, ideas, and information for business performance development. This step aims to increase superior competitiveness compared to competitors and become more competitive. Second, there is a need to establish an entrepreneurial community to make it easier to solve problems, share experiences, and more easily assist the professional use of digital technology by experienced entrepreneurs. The government also plays a role in providing incentives such as adequate infrastructure development, increased access to capital such as subsidies and incentives, and market development through promotional programs or cooperation with other countries. This step is taken to accelerate future business growth. Third, digital capabilities need to be analyzed first by ensuring the use of technology that is suitable for business effectiveness. Because, digital capabilities can provide great potential in improving business performance, for example, entrepreneurs who are able to use technological advances, will make it easier to analyze markets, respond to changes and improve production quality. This step is very useful for businesses in managing resources more efficiently and expanding business reach. Fourth, continuous evaluation is also needed to ensure entrepreneurial performance to be more effective and improve in the future. Because, business people ensure that the ability to innovate and use digital technology must be able to provide positive value for business growth. With evaluation, performance will be more significant and maximize the potential of the business. This step

contributes to sustainable growth and business success. Thus, SMEs are more advanced and ready to face various challenges in the digital era.

Conclusion

This study contributes to managerial practice by emphasizing the need for managers and business owners to create technological readiness and respond to change, integrating effective innovation and digital technologies to maximize their impact on business progress. This managerial contribution shows that a clear strategy is needed to develop a more effective approach to innovation and digital capabilities that is aligned with business objectives. This study has limitations that should be considered. First, the sample came from SMEs in two cities in East Java Province, Sidoarjo and Pasuruan, which may limit the generalizability of this study to the organizational context. Further research could conduct longitudinal surveys in industries across East Java and other provinces that could provide a more complex understanding of the context of performance improvement through innovation and orientation. Second, this study uses the RBV perspective as the basic theory. Furthermore, reliance on reported data may also introduce biases, such as social desirability or response bias, which affect the accuracy of responses. For future research, it is recommended that a business use the dynamic capability theory approach which can be used as a conceptual framework in supporting future research. This approach explains how SMEs can improve performance with creativity, and resource management that can respond to changes in the business environment. In addition, future research can develop the theoretical framework by examining the influence of external factors, such as the business environment and technological change so that it is possible to explore a broader and more nuanced understanding in a dynamic environment. With these steps, it is expected that SMEs can utilize digital technology for sustainable business growth.

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