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The Role of Digital Innovation in Improving Financial Performance in MSMEs in Indonesia

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ABSTRACT

This study aims to fill the research gap that occurs between digital orientation and digital capability on financial performance. In previous research, there are still relatively few research models on financial performance that include digital innovation in the research model, on this basis, this study tries to examine the role of digital innovation, whether it can mediate the relationship between these two variables. This research uses descriptive method with associative research design. The data collection method used is the test technique to measure the knowledge of the respondents and by distributing a questionnaire with the lingkert's scale which is selected randomly in the population with certain criteria (purposive sampling), with a total of 200 MSMEs as respondents. The result of this research is that all hypotheses are accepted. For business managers, digital innovation is an important thing to do. The more innovated, the greater the opportunity to improve the financial performance of the business being run.

Keywords: Digital Innovation, Digital Orientation, Digital Capability, Financial Performance.

INTRODUCTION

This research is motivated by the development of promotional media that is carried out digitally. There are still relatively few research models that try to empirically test the direct influence between digital orientation and digital ability on financial performance, does it have a significant effect or not? So specifically, the purpose of this research is to find out whether the role of digital orientation and skills will have a significant influence on the financial performance of the business being undertaken.

Innovation in the current digital era is a crucial thing to do. The speed of change that has occurred, must be well adapted. The change from the conventional era to the digital era is one form of the dynamics of change that occurs (Brzozowska & Bubel, 2015). Innovation is the key to being able to improve and win today's competition. Innovation is a driving force for the operational activities of a business to be able to continue to grow and develop. Innovation, especially in the digital era, is a necessity that must always be done. Without innovation, consumers will be bored with various product offerings that are relatively the same. Innovation requires careful preparation and planning. With innovation, the potential for a business to able to progress and develop will be even greater.

Digital innovation is one form of effort to adapt to the dynamics of rapidly changing community needs (Ellström, Holtström, Berg, & Josefsson, 2021). Digital innovation provides a lot of conveniences and can keep operational costs to a minimum. Innovations carried out digitally will provide a wider range of benefits and impacts than conventional ones. Innovation in terms of marketing, bookkeeping, service, and reporting will provide various conveniences and conveniences, both from the side of business owners, employees, and the community or consumers. Innovations carried out digitally, will provide a wide exploration space to promote the various products and services that are owned so that they can be quickly recognized and known by the wider community.

The digital orientation and strategy will keep operational costs as low as possible, with much bigger and wider potential and promotional space, when compared to manual or conventional marketing.

The low financial performance as a result of the weak mastery of developing technology has limited the penetration of marketing and product promotion owned by a business. Innovations made through digital media are hampered, due to skills in using technology that they do not have. The use of digital technology on the platform from the efforts made has not been optimized properly (Rangaswamy et al., 2020), thus causing the involvement of micro or home-scale businesses to improve the digital economy to be constrained (Reuschke & Mason, 2020), transaction payments are still made in cash (Liao & Yang, 2020), which in turn cannot innovate digitally because the business model and skills they have are still traditional or conventional (Rachinger, Rauter, Müller, Vorraber, & Schirgi, 2019). Based on this problem, the authors are interested in trying to connect and test several variables such as digital orientation, digital capability, and digital innovation whether they have a significant impact on improving the financial performance of a business. Because it is often found that the application of online business models through digital media is difficult for some parties to implement (Kim, 2019).

In particular, this research aims to empirically examine the direct influence between Digital orientation and Digital Capability on financial performance. And, is Digital innovation able to mediate the relationship between Digital orientation and Digital

Capability on Financial performance? This study deserves to be researched because there are still relatively few researchers that try to analyze by compiling research models that include digital innovation variables as one of the determinants of the success of the business or business being run.

LITERATURE REVIEW

The study was conducted to test the role of mediation variables in the performance measurement system on the relationship between digital capabilities and financial performance (Nasiri, Ukko, Saunila, Rantala, & Rantanen, 2020). This research aims to see the types of digital capabilities that can affect performance measurement systems, which leads to an increase in financial performance. The findings in this study show that performance measurement systems are significantly able to mediate on the relationship between users related to digital and the ability to collaborate and financial performance. However, the significant mediation effect of performance measurement systems cannot be found between technical capabilities and digital innovation and financial performance. This research uses a structured survey questionnaire, where data is collected from MSMEs in Finland, which are engaged in the service and manufacturing sectors.

Research written by Malchenko, Gogua, Golovacheva, Smirnova, and Alkanova (2020), shows the opportunity for businesses to not only consider consumers as recipients and adopters of digital technology but also aim to understand how to proactively engage consumers in the creation of shared value or benefits. Besides helping consumers to become more educated and have a comprehensive understanding of the digital economy, it will have a significant impact on improving financial performance.

Research written by Luo and Zeng (2020), demonstrate the impact of digital financial capabilities on home business ownership and business innovation. Using data from the 2015 China Household Finance Survey (CHFS), this study compiles a strong ability score and finds a positive relationship between digital financial ability and entrepreneurship in households. This study also compares the impact of digital financial capabilities on business ownership and business innovation. Moreover, this research adds the terms digital capability and financial capability interaction, which describes their role in improving model fit and further discusses the interaction effect both in general and at each capability score level.

This study tries to summarize the 10 latest research (2021) around digital innovations that have developed to have an impact on productivity. Its development started from an effort to make observations about the importance of digital transformation (Talafidaryani, Jalali, & Moro, 2021), an industry undergoing digital transformation, to drive change and create greater opportunities (Sraml Gonzalez & Gulbrandsen, 2021), the evolution of knowledge as a result of digital innovations carried out (Malhotra & Majchrzak, 2021), digital transformation that helps businesses stay competitive to be able to compete in the market (Kraus et al., 2021), the formation of risks and opportunities as a result of technological developments (Imran, Shahzad, Butt, & Kantola, 2021), the impact of digital transformation on the effectiveness of the planning carried out (Datta & Nwankpa, 2021), accelerate product development through digital transformation (Cooper, 2021), digital innovation in the field of e-commerce has made significant progress (Che, Peng, Lai, & Luo, 2021), and digital innovation gives birth to unprecedented opportunities (Bogers, Garud, Thomas, Tuertscher, & Yoo, 2021).

Next, the author will briefly explain the development of the 7 latest research (2021) related to digital capability. Starting from content design with digital in children (Yadav & Chakraborty, 2021), then digital transformation in a family company (Soluk & Kammerlander, 2021), the role of digital capabilities, digital culture, and digital strategy in increasing business digitization (Proksch, Rosin, Stubner, & Pinkwart, 2021), digital capabilities that play a role in the productivity of SMEs (Owoseni, Hatsu, & Tolani, 2021), the capabilities needed to digitize the business model you have (Menchini, Russo, Slavov, & Souza, 2021), digital transformation to support business productivity (Cannas, 2021), and the wave of industrial digitization (Bzhalava, Hassan, Kaivo-oja, Köping Olsson, & Imran, 2021).

Furthermore, the development of 7 latest research (2021) related to Digital Orientation. Beginning with research on the role of digital technology in providing well-documented operational and economic benefits (Cardinali & De Giovanni, 2022), the role of digital transformation in increasing sales volume (Wengler, Hildmann, & Vossebein, 2021), digital orientation plays a role in the development of business innovation in start-up companies (Visvizi, Troisi, Grimaldi, & Loia, 2021), digital transformation can help businesses stay competitive (Kraus et al., 2021), digital orientation can find a variety of new strategies (Kindermann et al., 2021), digital orientation encourages the development of SME services for the better (Fretschner, Clauss, Hagenau, & Lüthje, 2021), and strategic orientation based on Big Data on international marketing (Akter, Hossain, Lu, & Shams, 2021).

This study attempts to relate the variables of digital innovation, digital capability, and digital orientation to the financial performance of MSMEs in Indonesia. The concept that is tried to be tested in this research is the direct relationship between digital orientation and digital capability on financial performance. Will focusing on digital orientation have a significant impact on financial performance? Will applying the concept of digital capabilities contribute to improving financial performance? Previous studies Khin and Ho (2019) this relationship must pass through the digital innovation variable first, then lead to financial performance.

In simple logic, the stronger the digital orientation and digital capabilities, the higher the productivity of the business owned because the potential of the digital market share is very large and wide. On this basis, the author wants to test it empirically for the context of the Indonesian state.

RESEARCH METHOD

The quantitative descriptive method is chosen as a research model, the descriptive method means the method used for problem solving through describing the object of research at the present moment which refers to the facts obtained, then analyzed and then interpreted the results, the form can be in the form of surveys and research development studies. From the design side of the associative research design category, this design is useful to know the relationship between two or more variables in the research model, with the aim that a concept or theory can be built that can serve to explain, predict and control a symptom or phenomenon that is happening.

The independent variables in this study are Digital Orientation and Digital Ability, the dependent variable is financial performance and the mediating variable is Digital Innovation. Using the WarpPLS analysis tool. The data collection method used is the Test technique to measure the knowledge of the respondents and by distributing a questionnaire with the Linkert's scale selected randomly (proportionate stratified random sampling) in a population with certain criteria (purposive sampling), with a total

of 200 respondents. MSMEs. Distribution of questionnaires using postal services, direct visits to the addresses of each respondent, using electronic mail and social media. The following shows the questionnaire used with reference to the source and with personal modifications.

Digital innovation (Khin & Ho, 2019)

1. The business that I am currently running has been using digital media or online media
2. The menus that are available on the digital media that we use are superior
3. Digital media in our business is different from the others
4. Our digital media applications are unique compared to others

Digital orientation (Khin & Ho, 2019)

1. We are committed to using digital technology in developing our business
2. The solutions we have, refer to the application of superior digital technology.
3. Digital technology (latest) is ready to run in our business
4. We are always looking for opportunities to use digital technology in every innovation we do

Digital capabilities (Khin & Ho, 2019)

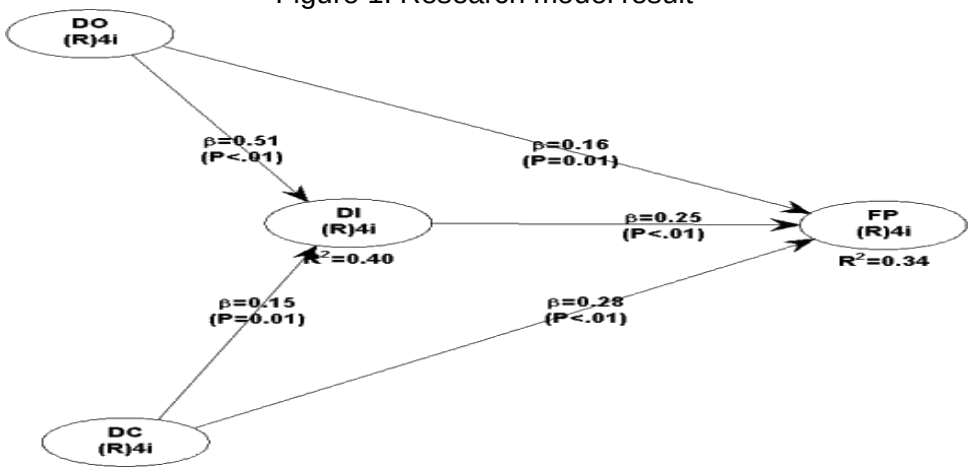
1. Having the ability to use technology digitally is important
2. We always try to identify every opportunity to apply new digital media
3. We develop products and services for consumers using digital technology
4. We understand well, every development in today's digital transformationAcquiring essential digital technology

Financial performance (Son, Phong, & Loan, 2020)

1. Our average operating profit is better than in the previous period
2. Our operating profit growth is better than the previous period
3. Our business sales growth is better than in the previous period
4. Our return on investment is better than in the previous period

RESULTS

Figure 1. Research model result



Note: DO: Digital Orientation, DI: Digital Innovation, DC: Digital Capability, FP: Financial Performance.

Table 1. Characteristics of respondents

LOCATION		
	F	%
Bangka Belitung	2	1
Banten	23	11.5
Bengkulu	1	0.5
DI Yogyakarta	9	4.5
DKI Jakarta	54	27
Jambi	2	1
West Java	59	29.5
Central Java	7	3.5
East Java	15	7.5
West Kalimantan	1	0.5
North Kalimantan	2	1
Riau islands	2	1
Lampung	1	0.5
Nanggroe Aceh Darussalam	1	0.5
West Nusa Tenggara	2	1
Papua	1	0.5
Riau	2	1
South Sulawesi	3	1.5
West Sumatera	3	1.5
South Sumatera	5	2.5
North Sumatera	5	2.5
TOTAL	**200**	**100**

CATEGORY	
F	%
Small	87	43.5
Medium	22	11
Micro	64	32
Ultra Micro	27	13.5
TOTAL	**200**	**100**

AGE (year)		
	F	%
0 - 1	75	37.5
1 - 2	74	37
10 >	6	3
3 - 5	33	16.5
5 - 10	12	6
TOTAL	**200**	**100**

TYPE		
	F	%
Automotive	2	1
Electronic	8	4
Fashion	45	22.5
Furniture	2	1
Information Technology (IT)	3	1.5
Daily needs	17	8.5
Health	4	2
Culinary	78	39
Other	21	10.5
Food and Drink	17	8.5
Agriculture	2	1
Property	1	0.5
TOTAL	**200**	**100**

DISCUSSION

Table 2. Latent variable coefficient

	DO	DC	DI	FP
R-squared			0.400	0.342
Adj. R-Squared			0.394	0.332
Composite Reliab.	0.861	0.831	0.876	0.898
Cronbach's Alpha	0.784	0.729	0.811	0.848
Avg. var. extrac	0.607	0.552	0.639	0.687
Full collin. VIF	2.376	2.092	1.657	1.451

By referring to table two, for R^2 in model one it is 40%, but in model two it has decreased to 34.2%, however, the R^2 figure is still in the moderate category (Latan & Ghozali, 2017, p. 92). The reliability test in PLS uses two methods, with composite reliability and Cronbach's alpha, if a number is found between 0.7 - 0.9 then it is very good (Hair et al., 2021, p. 77). For average variance extracted (AVE), it is said to be good if it has a value above 0.5 (Hair et al., 2021, p. 78). For the value of full collinearity (VIF) is said to be good if it has a value below the number 5 (Hair et al., 2021, p. 93).

Table 3. Regression Results

Hypothesis	Direction	Path-Coef.	P-Value	Results
H1	DO ➔ DI	0.514	<0.001***	Accepted
H2	DC ➔ DI	0.153	0.013**	Accepted
H3	DI ➔ FP	0.254	<0.001**	Accepted
H4	DO ➔ FP	0.160	0.010**	Accepted
H5	DC ➔ FP	0.280	<0.001**	Accepted
	DO ➔ DI ➔ FP	0.130	0.004***	Accepted
	DC ➔ DI ➔ FP	0.039	0.218	Rejected

Note: DO: Digital Orientation, DI: Digital Innovation, DC: Digital Capability, FP: Financial Performance, *** 1% significant, ** 5% significant.

Research hypothesis:

1. H1: Digital Orientation has a significant effect on Digital Innovation
2. H2: Digital Capability has a significant effect on Digital Innovation
3. H3: Digital Innovation has a significant effect on Financial Performance
4. H4: Digital Orientation has a significant effect on Financial Performance
5. H5: Digital Capability has a significant effect on Financial Performance

By referring to table three, it is found that all hypotheses are accepted. The variable that has the strongest relationship is the relationship between the digital orientation variable to Digital Innovation (0.514) and the variable that has the weakest relationship is digital capability to digital innovation (0.153). The digital innovation variable is able to significantly mediate the relationship between digital orientation and financial performance. Furthermore, the digital innovation variable cannot mediate the relationship between digital capability and financial performance.

CONCLUSION

The indirect effect on the relationship between digital orientation and financial performance is 0.130 with a significance of 0.004, which means that the digital innovation variable is able to significantly mediate the relationship between digital orientation and financial performance. However, digital innovation cannot mediate the relationship between digital capability and financial performance with a significance number of 0.218 which is greater than 0.05.

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DECLARATION OF CONFLICTING INTERESTS

I declare that there is no conflict of interest in certain parties related to the results of this research and I am responsible for various things that will happen in the future.

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