*Jurnal Penelitian Ekonomi dan Akuntansi (JPENSI)*
http://jurnalekonomi.unisla.ac.id/index.php/jpensi
*e-ISSN 2621-3168*
*p-ISSN 2502 – 3764*

# Determinants of MSMEs Business Performance: The Role of Entrepreneurial Orientation, Business Management Capability, and Functional Business Capability

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**Article Info**

**Keywords:**
*Entrepreneurial Orientation; Business Management Capability; Functional Capability; Business Performance; MSMEs;*

**Abstract**

*This study examines the determinants of MSME business performance by investigating the roles of entrepreneurial orientation, business management capability, and functional capability. Using a quantitative associative approach, data were collected from 63 MSMEs in Mataram City, West Nusa Tenggara, Indonesia, and analyzed using PLS-SEM with SmartPLS. The results indicate that entrepreneurial orientation and business management capability have positive and significant effects on business performance, while functional capability has no significant effect. These findings highlight the importance of entrepreneurial orientation and managerial capability in improving MSME performance and competitiveness.*

## INTRODUCTION

The current business environment is characterized by increasing competition, technological advancement, and growing uncertainty in both global and local markets [1]. These conditions require businesses, particularly Micro, Small, and Medium Enterprises (MSMEs), to develop adaptive capabilities in order to sustain and improve their business performance [2]. Business performance is no longer determined solely by financial aspects but also by the ability of firms to create value through innovation, operational efficiency,

effective marketing strategies, and sound financial management. From the perspective of the Resource-Based View (RBV), competitive advantage and financial performance are generated through the combination of tangible and intangible resources owned by firms. These internal capabilities become key determinants of long-term performance, especially for MSMEs that often face limitations in accessing external resources [3], [4]. MSME business performance is influenced by various factors, one of which is entrepreneurial orientation.

Entrepreneurial orientation (EO) is considered one of the key drivers of MSME performance. EO reflects a firm's proactive behavior and willingness to take risks in exploring market opportunities and developing innovations that create added value [5], [6]. EO enables firms to mobilize internal resources and develop dynamic capabilities that enhance performance by encouraging organizations to explore new opportunities, allocate resources strategically, and build capabilities that support business improvement. From the RBV perspective, these capabilities represent valuable and difficult-to-imitate resources that contribute to achieving long-term competitive advantage [7], [8]. This argument is supported by Hidayatullah [9], who found that entrepreneurial orientation has a positive and significant relationship with MSME business performance.

Another factor that can improve MSME business performance is Business Management Capability. Business Management Capability refers to managerial abilities that encompass strategic planning practices, resource organization, operational control, and effective decision-making processes. Through strong managerial capabilities, MSMEs can achieve better business performance by optimizing resource allocation, improving strategy execution, and fostering a continuous performance evaluation culture. These capabilities enable MSMEs to manage internal resources more effectively, respond to environmental changes, and enhance operational efficiency, which ultimately contributes to sustainable business growth and competitiveness [10].

The business performance of MSMEs can also be enhanced through specific functional capabilities, particularly marketing and financial capabilities. From the Resource-Based View (RBV) perspective, functional capability in the marketing aspect is generally viewed as the ability to utilize knowledge and expertise to understand market needs, formulate marketing strategies, and strengthen

competitiveness through the effective integration of marketing activities. Marketing capability enables MSMEs to create customer value, expand market reach, build strong customer relationships, and improve their competitive position. Furthermore, financial capability supports MSMEs in managing financial resources effectively through financial planning, budgeting, and decision-making processes, which are essential for maintaining business sustainability and improving performance. These functional capabilities represent valuable internal resources that can contribute to achieving competitive advantage and enhancing MSME business outcomes [11]. Marketing capability serves as a mechanism for understanding customer needs, expanding market reach, and optimizing marketing mix strategies, thereby contributing to improved MSME business performance. Meanwhile, functional capability in the financial aspect includes effective financial planning, control, and decision-making to manage financial resources efficiently. From the Resource-Based View (RBV) perspective, financial capability represents a valuable internal asset that enhances operational efficiency, supports financial sustainability, and improves access to external financing for MSMEs. Therefore, strong marketing and financial capabilities enable MSMEs to utilize their resources more effectively, strengthen competitiveness, and achieve better business performance [12]. Several studies have demonstrated that financial capability contributes positively to MSME performance through improved access to financing and more effective financial decision-making. Strong financial capability enables MSMEs to manage cash flows, allocate financial resources efficiently, prepare appropriate financial plans, and make strategic investment decisions. Within the Resource-Based View (RBV) framework, financial capability is considered a valuable internal resource that supports business sustainability and enhances competitive advantage. By strengthening financial management practices, MSMEs can improve operational efficiency, reduce financial risks, and achieve better business performance [13].

This study integrates various aspects encompassing entrepreneurial orientation, business management capability, and functional capability as strategic factors in improving MSME business performance. The research was conducted among MSMEs operating in Mataram City, West Nusa Tenggara, Indonesia, as one of the regions with growing economic activities driven by small and medium

enterprises. This area presents significant growth potential while also facing increasing competitiveness challenges, making it an important context for examining the internal capabilities that contribute to sustainable MSME performance.

## METHODS

This study employs a quantitative approach with an associative research design using primary data. The research respondents are Micro, Small, and Medium Enterprise (MSME) owners in Mataram City, West Nusa Tenggara, Indonesia. The research location was selected based on the consideration that Mataram City serves as the economic center of West Nusa Tenggara Province, with dynamic MSME development, making it a relevant context for examining the factors influencing business performance.

Data collection was conducted using a structured questionnaire distributed to MSME owners or managers as research respondents. A total of 63 MSMEs were selected as the research sample. Data analysis was performed using the Partial Least Squares Structural Equation Modeling (PLS-SEM) approach with the assistance of SmartPLS software. This method was applied to examine the relationships between entrepreneurial orientation, business management capability, functional capability, and MSME business performance.

**Definisi Operasional variabel**

| Variable | Definition | Dimention |
|---|---|---|
| Entrepreneurial orientation | Managerial behaviors and organizational practices in making strategic decisions to enter new markets, introduce new products or services, and respond to uncertainty through bold and proactive approaches. | 1. Independent<br>2. Proactive<br>3. Inovative<br>4. Risk Taking |
| Business Management Capability | Managerial abilities that encompass strategic planning practices, resource organization, operational control, and | 1. Operational<br>2. Human Resorces |

| | | |
|---|---|---|
| | effective decision-making processes | |
| Functional Business Capability | The firm's ability to effectively utilize resources within specific functional areas to support business activities and achieve organizational objectives. | 1. Marketing Capability<br>2. Finance Capability |
| Business Performance | Overall outcomes achieved by a firm, encompassing both financial and non-financial aspects that reflect the extent to which an organization accomplishes its strategic objectives within a specific period. Business performance is measured through indicators such as financial growth, profitability, market development, customer satisfaction, operational effectiveness, and the achievement of organizational goals. | 1. Sales Growth<br>2. Production Growth<br>3. Increase in Number of Employee<br>4. Competitive Advantage |

## RESULTS AND DISCUSSION

### Respondent Characteristics

The data used in this study were collected through a questionnaire survey. The respondents consisted of Micro, Small, and Medium Enterprise (MSMEs) owners or managers operating in Mataram City, West Nusa Tenggara, Indonesia. The number of MSMEs respondents was determined based on various business categories, including food, beverage, clothing, and other business sectors. The characteristics of respondents were analyzed based on several criteria to provide an overview of the research sample, as presented in Table 1. These characteristics include business category, business ownership profile, and other relevant demographic information that describe the background of the respondents involved in this study.

**Table1. Respondent's Characteristics**

| Characteristics | Number (n) | Percentage (%) |
|---|---|---|
| Gender | | |
| Male | 38 | 60.32 |
| Female | 25 | 39.68 |
| Age (Years) | | |
| ≤30 | 20 | 31.75 |
| 31-40 | 18 | 28.57 |
| >40 | 25 | 39.68 |
| Highest Level of Education | | |
| Less Than High School | 6 | 9.53 |
| High Scool | 28 | 44.44 |
| Undergraduate | 26 | 41.27 |
| Master | 3 | 4.76 |
| Years of Business Operation | | |
| < 3 | 29 | 46.03 |
| 3 - 5 | 7 | 11.11 |
| 5 - 10 | 13 | 20.63 |
| > 10 | 14 | 22.22 |
| Sector | | |
| Food and Beverages | 47 | 74.60 |
| Fashion | 7 | 11.11 |
| Others | 9 | 14.29 |

Source: Processed Data (2026)

Table 1 indicates that MSME owners are predominantly male, accounting for 60.32 percent of the respondents, compared to female respondents at 39.68 percent. In terms of age characteristics, MSMEs operated by individuals aged 40 years and above represent the dominant group, indicating that business activities are largely managed by more experienced entrepreneurs. Furthermore, the majority of MSME owners have educational backgrounds at the senior high school and bachelor's degree levels, with proportions of 44.44 percent and 41.27 percent, respectively. These findings suggest that MSME operators in Mataram City are primarily managed by individuals with sufficient educational backgrounds and business experience, which may contribute to their ability to manage and develop business activities effectively.

**Validity and Reliability Testing**

Outer Loading

Outer loading represents the extent to which each indicator contributes to and reflects its corresponding latent construct in the Partial Least Squares

Structural Equation Modeling (PLS-SEM) approach. It indicates the strength of the relationship between observed indicators and the underlying construct being measured. A higher outer loading value demonstrates that the indicator has a stronger ability to explain the latent variable.

In PLS-SEM analysis, outer loading values are used to assess indicator reliability and convergent validity. An indicator is considered acceptable when its outer loading value is ≥ 0.70, indicating that the indicator adequately represents the construct. Therefore, higher outer loading values suggest that the measurement indicators provide a more accurate representation of the theoretical constructs examined in the research model.

**Table 2. Outer Loading Values of Measurement Model**

| | EO | BMC | FC | BP |
|---|---|---|---|---|
| X1.2 | 0.784 | | | |
| X1.4 | 0.735 | | | |
| X1.6 | 0.705 | | | |
| X1.7 | 0.783 | | | |
| X2.10 | | 0.77 | | |
| X2.2 | | 0.872 | | |
| X2.4 | | 0.88 | | |
| X2.8 | | 0.724 | | |
| X3.1 | | | 0.796 | |
| X3.2 | | | 0.79 | |
| X3.6 | | | 0.782 | |
| X3.7 | | | 0.808 | |
| Y.1 | | | | 0.782 |
| Y.2 | | | | 0.771 |
| Y.3 | | | | 0.763 |
| Y.4 | | | | 0.87 |

Source: Processed Data (2026)

Based on the outer loading results of the measurement model using Partial Least Squares Structural Equation Modeling (PLS-SEM), all indicators demonstrate loading factor values above the recommended threshold of 0.70. Outer loading values are used to assess convergent validity, which refers to the extent to which indicators are able to represent and measure their respective latent constructs. Indicators with outer loading values of ≥ 0.70 indicate that they have a strong ability to explain the underlying constructs. Therefore, the results confirm that all indicators used in this study adequately reflect their respective constructs

and meet the requirements for convergent validity. These findings indicate that the measurement model has good indicator reliability and can be used for further structural model analysis.

**Table 3. Construct Reliability and Convergent Validity Assessment**

| | Cronbach's Alpha | rho_A | Composite Reliability | Average Variance Extracted (AVE) |
|---|---|---|---|---|
| BMC | 0.831 | 0.855 | 0.886 | 0.663 |
| BP | 0.809 | 0.819 | 0.875 | 0.636 |
| EO | 0.748 | 0.762 | 0.839 | 0.566 |
| FC | 0.808 | 0.827 | 0.872 | 0.631 |

Source: Processed Data (2026)

Reliability testing was conducted using three indicators: Cronbach's Alpha, rho_A, and Composite Reliability, while convergent validity was assessed based on the Average Variance Extracted (AVE) value. A construct is considered to have good reliability when the values of Cronbach's Alpha, rho_A, and Composite Reliability exceed 0.70. Meanwhile, an AVE value greater than 0.50 indicates that the construct is able to explain the majority of the variance in its measurement indicators.

Overall, all research constructs, namely Business Management Capability (BMC), Business Performance (BP), Entrepreneurial Orientation (EO), and Functional Capability (FC), show Cronbach's Alpha, rho_A, and Composite Reliability values above 0.70, as well as AVE values above 0.50. These results indicate that all constructs meet the criteria for internal consistency reliability and convergent validity. Therefore, the measurement instruments used in this study are considered reliable and valid, allowing the constructs to be further analyzed in the structural model assessment (inner model) and hypothesis testing stage.

Heterotrait-Monotrait Ratio (HTMT)

**Table 4. Heterotrait-Monotrait Ratio (HTMT) Results**

| | BMC | BP | EO | FC |
|---|---|---|---|---|
| BMC | | | | |
| BP | 0.657 | | | |
| EO | 0.674 | 0.714 | | |
| FC | 0.784 | 0.515 | 0.657 | |

Source: Processed Data (2026)

Based on the Heterotrait-Monotrait Ratio (HTMT) assessment presented in the table above, this test was conducted to evaluate discriminant validity within the measurement model of PLS-SEM. The HTMT criterion assesses the extent to which a construct is empirically distinct from other constructs in the research model. A construct is considered to have adequate discriminant validity when the HTMT value between constructs is below the recommended threshold.

The results indicate that all HTMT values among the constructs are below the threshold value of 0.90. Therefore, all constructs in this study meet the criteria for discriminant validity. These findings confirm that Business Management Capability (BMC), Business Performance (BP), Entrepreneurial Orientation (EO), and Functional Capability (FC) represent distinct concepts and that there is no excessive overlap among the constructs. Thus, the measurement model demonstrates adequate discriminant validity and is suitable for further structural model analysis.

Fornell-Larcker Criterion

Based on the Fornell-Larcker Criterion results, this test is used to assess discriminant validity in the measurement model (outer model) of the PLS-SEM approach. The criterion requires that the square root of Average Variance Extracted (√AVE) for each construct must be higher than its correlations with other constructs.

**Tabel 5. Fornell-Larcker Criterion Result**

| | BMC | BP | EO | FC |
|---|---|---|---|---|
| BMC | 0.814 | | | |
| BP | 0.561 | 0.797 | | |
| EO | 0.518 | 0.579 | 0.753 | |
| FC | 0.635 | 0.438 | 0.509 | 0.794 |

Source: Processed Data (2026)

Based on the table above, all research constructs have diagonal values (√AVE) that are higher than the correlation values with other constructs. This indicates that each construct has adequate discriminant validity, as each construct demonstrates distinct characteristics and is able to explain its own measurement indicators better than other constructs. Therefore, the results confirm that the constructs in this study are empirically distinct and meet the requirements for further structural model analysis.

## Structural Model Assessment

Path Analysis

The following presents the results of the structural model assessment (inner model) using the bootstrapping method in PLS-SEM.

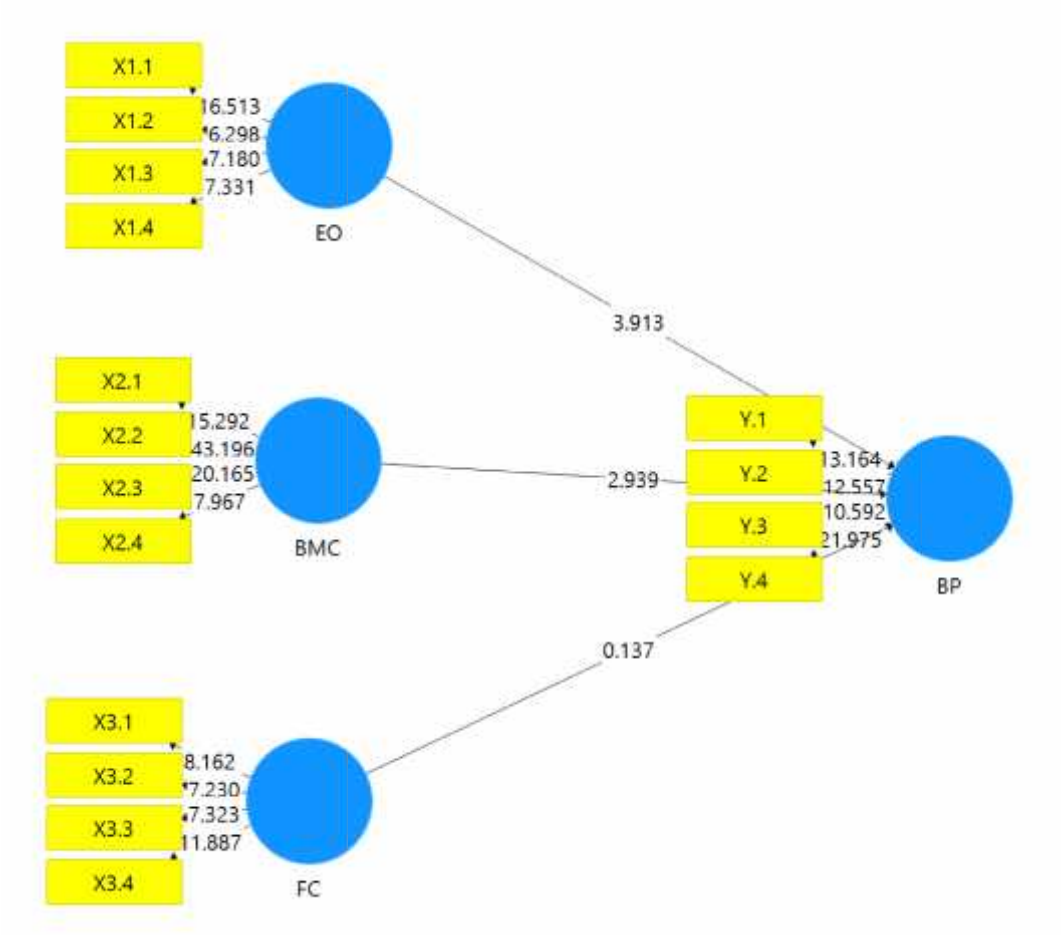



**Figure 1. Path Analysis**

**Table 6. Hypothesis Testing**

| | Original Sample (O) | Sample Mean (M) | Standard Deviation (STDEV) | T Statistics (\|O/STDEV\|) | P Values |
|---|---|---|---|---|---|
| BMC -> BP | 0.346 | 0.301 | 0.108 | 3.2 | 0.002** |
| EO -> BP | 0.39 | 0.403 | 0.111 | 3.508 | 0.001*** |
| FC -> BP | 0.02 | 0.079 | 0.141 | 0.141 | 0.889 |
| Adjusted R-Squared | 0.400 | | | | |

Source: Processed Data (2026)

Based on the R-Square assessment results, the Adjusted R-Square value of 0.40 indicates that Entrepreneurial Orientation (EO), Business Management Capability (BMC), and Functional Capability (FC) collectively explain 40% of

the variance in Business Performance (BP). Meanwhile, the remaining 60% of the variation in business performance is explained by other factors outside the research model. This finding indicates that the proposed model has a moderate explanatory power in explaining MSME business performance, while other external and internal factors may also contribute to variations in MSME performance.

Table 2 presents the results of hypothesis testing. The findings indicate that the relationship between Entrepreneurial Orientation (EO) and Business Performance (BP) has a P-value of 0.001, which is below the significance level of 0.05. Therefore, the relationship is considered positive and statistically significant. Similarly, Business Management Capability (BMC) has a P-value of 0.002 in relation to Business Performance (BP), which is also below 0.05, indicating a positive and significant relationship. Meanwhile, the relationship between Functional Capability (FC) and Business Performance (BP) shows a P-value of 0.889, which is greater than 0.05, indicating that the relationship is not statistically significant.

Therefore, the results support the hypotheses regarding the positive effects of Entrepreneurial Orientation (EO) and Business Management Capability (BMC) on Business Performance (BP), while the hypothesis proposing the effect of Functional Capability (FC) on Business Performance (BP) is not supported.

**Discussion**

Based on the hypothesis testing results, the relationship between Entrepreneurial Orientation (EO) and Business Performance (BP) shows a positive and significant effect, as indicated by the P-value below the 0.05 significance level. This finding demonstrates that higher levels of entrepreneurial orientation are associated with better business performance among MSMEs. The significant relationship is consistent with the findings of Ibarra-Cisneros and Hernandez-Perlines [14], who confirmed that entrepreneurial orientation has a positive effect on business performance. Furthermore, this finding highlights the importance of dynamic capabilities in supporting MSME performance. Entrepreneurially oriented firms tend to continuously adapt to changes, utilize knowledge and experience, and develop internal capabilities to respond to market opportunities. This result reinforces the argument that organizations that

incorporate change as a routine process are better able to leverage their resources and capabilities to achieve superior performance [15], [16]. From the Resource-Based View (RBV) perspective, EO represents a valuable internal capability that enables MSMEs to create competitive advantages and sustain long-term performance improvements [15], [16].

The Resource-Based View (RBV) perspective also emphasizes the importance of the context and dynamics of dynamic capabilities in transforming entrepreneurial orientation (EO) into sustainable improvements in business performance (BP). In a dynamic business environment, MSMEs are required to continuously adapt to emerging opportunities and market changes. Therefore, EO needs to be supported by dynamic capabilities that enable firms to integrate, develop, and reconfigure internal resources to achieve sustainable competitive advantage [16], [17]

Based on the findings, the relationship between Business Management Capability (BMC) and Business Performance (BP) is positive and significant. This indicates that stronger business management capabilities contribute significantly to improved business performance. This result is consistent with the RBV perspective, which views performance as the outcome of valuable, rare, inimitable, and non-substitutable internal resources and capabilities. BMC represents managerial capabilities that include strategic planning, cost control, risk management, and operational decision-making. These capabilities can enhance business performance when effectively implemented [18]. The combination of internal resources creates a unique organizational configuration; therefore, BMC functions as a resource coordinator that enables effective strategy execution. Consequently, improved operational efficiency, appropriate resource allocation, and reduced inefficiencies contribute to better business performance [19].

However, the results indicate that the relationship between Functional Capability (FC) and Business Performance (BP) is not statistically significant. This finding suggests that the presence of functional capabilities alone is insufficient to generate significant improvements in MSME performance.

## CONCLUSION

This study aims to examine the determinants of MSME business

performance by analyzing the roles of entrepreneurial orientation, business management capability, and functional capability among MSMEs in Mataram City, West Nusa Tenggara, Indonesia. Using the PLS-SEM approach with data collected from 63 SMEs, this study provides empirical evidence regarding the contribution of internal business factors in improving MSME performance.

The results indicate that entrepreneurial orientation has a positive and significant effect on business performance. This finding suggests that MSMEs with stronger entrepreneurial characteristics, including innovativeness, proactiveness, independence, and risk-taking ability, tend to achieve better business outcomes. Furthermore, business management capability has a positive and significant effect on business performance, confirming that effective managerial capabilities play an important role in enhancing MSME performance through better resource management, strategic planning, and decision-making. However, the findings show that functional capability does not have a significant effect on business performance.

Overall, this study concludes that entrepreneurial orientation and business management capability are key determinants of MSME business performance, while functional capability requires further optimization and integration with other strategic capabilities to generate a significant impact. These findings highlight the importance of strengthening entrepreneurial mindset and managerial competencies among MSME owners as strategic efforts to improve competitiveness and business sustainability.

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