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Research Article

The Influence of Entrepreneurial Orientation and Digital Transformation on Business Performance with Innovation Capability as a Mediating Variable in Fashion SMEs in Jakarta

Anetasya Angelica [1*], Hendra Wiyanto [2]

[1] Manajemen Bisnis, Fakultas Ekonomi dan Bisnis, Universitas Tarumanagara, Indonesia: anestasya.115220342@stu.untar.ac.id
[2] Manajemen Bisnis, Fakultas Ekonomi dan Bisnis, Universitas Tarumanagara, Indonesia: hendraw@fe.untar.ac.id
* Corresponding Author: Anetasya Angelica

Abstract: Micro, Small, and Medium Enterprises (MSMEs) fashion is one of the creative sectors that is experiencing rapid development in Jakarta. However, increasingly fierce competition, changing market trends, and digitalization require MSMEs to have an entrepreneurial orientation and adaptability through digital transformation. This study aims to analyze the effect of Entrepreneurial Orientation (EO) and Digital Transformation (DT) on Business Performance (BP) with Innovation Capability (IC) as a mediation variable. The study used a quantitative approach through a survey of 212 fashion MSME actors in Jakarta and analyzed using PLS-SEM. The results showed that EO and DT significantly positive effect on BP and IC. IC also has a significant positive effect on BP. However, IC does not mediate the relationship of EO to BP, but mediates the relationship of DT to BP. This finding confirms the importance of developing innovation and digital transformation capabilities in improving the performance of fashion MSMEs in Jakarta.

Keywords: Business Performance; Digital Transformation; Entrepreneurial Orientation; Innovation Capability; Micro.

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1. Introduction

Micro, Small, and Medium Enterprises (MSMEs) are one of the main pillars of the Indonesian economy. According to the latest data from the Ministry of Cooperatives and SMEs (2025), MSMEs contribute approximately 61.9% to the national Gross Domestic Product (GDP) and absorb more than 97% of the workforce across all economic sectors. By 2025, the number of MSMEs is expected to reach more than 65 million (OJK Institute, 2025). OJK data demonstrates the crucial role of MSMEs in maintaining national economic stability and serving as a key driver of economic activity in both urban and rural areas.

Figure 1. Contribution of MSMEs to GDP and National Workforce.

The figure above shows that the MSME sector has a significant contribution to the Indonesian economy in terms of economic growth and employment. The consistent increase in the number of MSMEs from year to year illustrates the enormous potential in supporting national economic development. Despite their significant contribution, MSMEs in Indonesia are now faced with the development of digital technology, changes in consumer behavior, and global competition, requiring business actors to adapt to new strategies. The KADIN graph shows that the high number of MSMEs does not fully reflect high business performance, as many MSMEs still face obstacles in productivity, innovation, and adaptation to digital technology developments. In other words, the competitiveness of MSMEs depends heavily on their ability to innovate, be entrepreneurial, and effectively carry out digital transformation.

Besides entrepreneurial orientation, innovation capability (IC) also plays a strategic role in building competitive advantage. Dahmiri et al. (2020) define innovation capability as a company's capacity to develop new ideas, improve production processes, and create added value for customers. Innovation capability in MSMEs is reflected not only in product design but also in the use of environmentally friendly materials, creative packaging, and the application of technology to improve efficiency and quality. MSMEs with high innovation capabilities tend to be able to maintain consumer loyalty and compete with market changes.

The next equally important factor is Digital Transformation (DT). Zhang et al. (2020) define digital transformation as the process of integrating digital technology into all aspects of a business to improve efficiency, expand market reach, and strengthen customer relationships. In the context of MSMEs, digital transformation can include the use of e-commerce, social media as a promotional tool, digital payment systems, and customer data analysis for strategic decision-making. However, many MSMEs still struggle to implement digital transformation due to limited capital, technological literacy, and inadequate human resources (Nugroho et al., 2022).

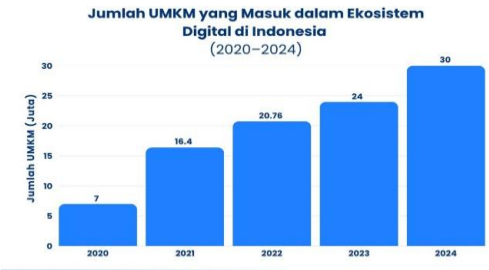

Figure 2. Number of MSMEs Entering the Digital Ecosystem in Indonesia (2020–2024)
Source: Ministry of Cooperatives and SMEs, 2024.

The increasing number of MSMEs integrated into the digital ecosystem demonstrates significant progress in the digital transformation process in Indonesia's small and medium-sized enterprise sector. According to data from the Ministry of Cooperatives and SMEs (2024), the

number of MSMEs integrated with digital platforms increased from 7 million in 2020 to 30 million in 2024. This trend indicates increased adoption of digital technology, particularly through the use of e-commerce, social media, and digital payment systems. However, not all MSMEs are able to maximize the potential of digitalization to improve business performance. Many businesses are still in the early adoption stage without a mature digital strategy, resulting in a less than optimal impact on sales growth, customer loyalty, and operational efficiency. This emphasizes that digital transformation requires not only access to technology but also human resource readiness and an entrepreneurial orientation that supports the sustainable implementation of innovation.

Various previous studies have shown that both internal factors (Entrepreneurial Orientation) and external factors (Digital Transformation) are equally important in improving Business Performance with the mediating role of Innovation Capability. Nguyen et al. (2023) in Vietnamese MSMEs found that DT has a positive influence on BP, which is partially mediated through IC, confirming the role of technology as an accelerator of innovation and performance. On the other hand, Nuryakin (2024) in Kuningan Boyolali MSMEs firmly proved that the influence of EO on BP must be through IC mediation because EO itself is not directly significant, indicating that IC is an inseparable bridge from entrepreneurial attitudes.

However, several studies have shown different results regarding each variable. Research by Putra and Yuniarti (2023) found that EO does not always have a significant impact on business performance, especially for MSMEs that are still in the survival stage and have not yet been able to consistently implement an entrepreneurial orientation. Meanwhile, regarding the Digital Transformation (DT) variable, a study by Sari et al. (2022) showed that digital transformation does not automatically improve business performance if it is not accompanied by human resource readiness and an organizational culture that supports technological change. On the other hand, research by Rahman and Dewi (2021) regarding Innovation Capability (IC) found that innovation capability does not always have a strong impact on business performance, especially for MSMEs with limited innovation capital and technology access, thus preventing the potential for innovation from being maximized to create added value for customers.

Furthermore, there are not many studies that specifically position Innovation Capability (IC) as a central mediating variable that integrates three variables: entrepreneurial orientation, digital transformation, and business performance in one complete research model. Specifically, studies are often separate. Therefore, there is a clear research gap in understanding how MSMEs can synergize entrepreneurial drive (EO) and the use of digital technology (DT) to produce optimal business performance, and how important the role of Innovation Capability (IC) as an essential mechanism that bridges this relationship. This study will address this gap by testing an integrated model that positions IC as a central mediator between EO, DT, and BP, particularly in the dynamic MSME fashion sector in Jakarta.

2. Preliminaries or Related Work or Literature Review

Entrepreneurial Orientation

Entrepreneurial orientation is a concept that is widely used to understand how business actors carry out entrepreneurial activities in facing changes in the modern business environment.Son and David (2022)explains that entrepreneurial orientation reflects strategies, processes, and behavioral patterns that encourage individuals and organizations to innovate,

take risks, and be proactive in responding to market opportunities.

Innovation Capability

Innovation capability can be understood as an organization's ability to create, develop, and implement new ideas into products, services, and processes that provide added value for consumers. According toRumanti et al. (2022), innovation capability is a combination of individual competencies, organizational systems, and leadership support that together create an environment conducive to the emergence of creative ideas.

Digital Transformation

Digital transformation is the process of adopting digital technology in every aspect of business activities with the goal of increasing efficiency, expanding market access, and providing added value for consumers. This transformation focuses not only on the implementation of new technologies but also includes fundamental changes in strategy, organizational culture, and business models to be more adaptive to the dynamics of the external environment.(Zhang, Li, & Zhao, 2025).According toMin and Qiao (2024),Digital transformation requires organizations to make comprehensive managerial changes, including in the way they make decisions, interact with customers, and manage resources to be more responsive and data-driven.

Business Performance

Business performance essentially describes the extent to which a business is able to achieve its stated goals, both financially and non-financially. According to Rusliana et al. (2023), business performance is a crucial indicator for assessing the success of MSMEs in managing resources and strategies to survive in a competitive market. This performance is measured not only through profitability and sales growth but also includes non-financial aspects such as customer satisfaction, consumer loyalty, and a sustainable brand reputation

3. Materials and Method

The research design used was descriptive with a quantitative approach, utilizing a questionnaire as the data collection tool. All data was collected through questionnaires distributed through online platforms, particularly e-commerce platforms like Shopee and TikTok, as well as other social media platforms like Instagram and WhatsApp.

The population used in this study includes MSMEs in the fashion sector in Jakarta who have been running their businesses for at least two years.

4. Results and Discussion

Data Analysis Results

Multilinearity Analysis Results

Table 1. Results of Variance Inflation Factor Analysis in the Inner Model.

Variables	Business Performance	Innovation Capability
Entrepreneurial Orientation	2.106	1,715
Digital Transformation	2,066	1,715
Innovation Capability	2,220	

Source: Pls Data Processing Results (2024).

Table 1 shows the results of the multicollinearity test using the Variance Inflation Factor (VIF) values in the Inner Model. These results indicate that there is no multicollinearity problem among the predictor variables (Entrepreneurial Orientation, Digital Transformation, and Innovation Capability) because all VIF values obtained do not exceed 5 points (Hair et al., 2019). Specifically, the VIF values obtained ranged from 1.715 to 2.220.

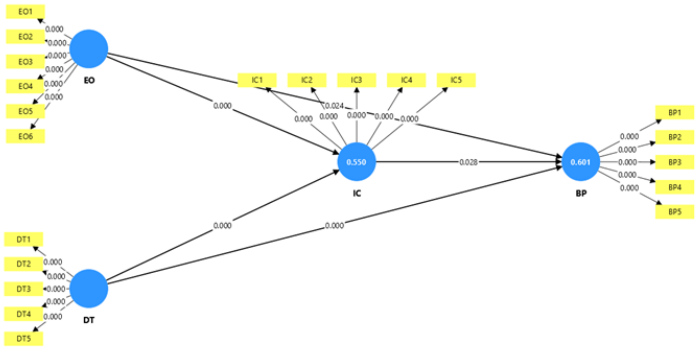

Figure 3. Bootstrapping Test Results.

Source: PLS Data Processing Results (2025).

Results of the Analysis of the Coefficient of Determination (R²)

Table 2. Results of the Analysis of the Coefficient of Determination (R²).

Variables	R-square	Information
Business Performance	0.601	Currently
Innovation Capability	0.550	Currently

Source: Pls Data Processing Results (2024).

Based on Table 2, the coefficient of determination (R²) for Business Performance is recorded at 0.601, meaning that 60.1% of the variation in Business Performance can be explained by the independent variables used in this study. Meanwhile, the remaining 39.9% is influenced by other factors not included in the research model. Meanwhile, for Innovation Capability, the R-square value obtained is 0.550. This indicates that 55% of changes or variations in Innovation Capability can be explained by the independent variables in the model, and the remaining 45% is influenced by other variables outside the scope of this study.

Effect Size (F²) Analysis Results

Table 3. Results of Effect Size (F²) Analysis.

Variables	F2	Information
Entrepreneurial Orientation→Business Performance	0.244	Moderate effect
Entrepreneurial Orientation→Innovation Capability	0.205	Moderate effect
Digital Transformation→Business Performance	0.049	Little effect
Digital Transformation→Innovation Capability	0.228	Moderate effect
Innovation Capability→Business Performance	0.056	Little effect

Source: Pls Data Processing Results (2024).

Based on the test results (f²) in table 3, entrepreneurial orientation → business performance is 0.244, indicating a moderate influence. Entrepreneurial orientation → innovation capability is 0.205, indicating a moderate influence. Digital transformation → innovation capability is 0.228, indicating a moderate influence. Digital transformation → business performance is 0.049, indicating a small influence. Innovation capability → business performance is

0.056, also indicating a small influence.

Godness of Fit (GoF)

The results of the Goodness of Fit (GoF) test can be seen in the following table:

Table 4. Goodness of Fit (GoF) Test Results.

Variables	AVE	R2	Gof
Entrepreneurial Orientation	0.640		
Digital Transformation	0.659		√0.642 x 0.576
Innovation Capability	0.631	0.550	= √0.370
Business Performance	0.638	0.601	= 0.608
Average	0.642	0.576	

Source: Pls Data Processing Results (2024) (Attachment 3).

Predictive Relevance (Q^2) Analysis Results

The Predictive Relevance (Q^2) analysis results showed excellent values, namely 0.570 for business performance and 0.544 for innovation capability. Since all Q^2 values were above 0, this indicates that the model has adequate predictive ability and that there are relevant relationships between the constructs in this study.

a. First Hypothesis Test

The formulation of the first hypothesis (H1) is that Entrepreneurial Orientation has a positive effect on Business Performance. Based on the results of the hypothesis test in Table 4.10, it was found that Entrepreneurial Orientation has a positive and significant effect on Business Performance, indicated by a path coefficient value of 0.202 and p-values of 0.024. With a p-value <0.05, it can be concluded that the first hypothesis is accepted.

b. Second Hypothesis Test

The formulation of the second hypothesis (H2) is that Entrepreneurial Orientation has a positive effect on Innovation Capability. The test results in Table 4.10 show that Entrepreneurial Orientation has a positive and significant effect on Innovation Capability, with a path coefficient of 0.420 and a p-value of 0.000. Since the p-value is <0.05, the second hypothesis is accepted.

c. Third Hypothesis Test

The formulation of the third hypothesis (H3) is that Digital Transformation has a positive effect on Business Performance. The results of the hypothesis testing in Table 4.10 show that Digital Transformation has a positive and significant effect on Business Performance, indicated by a path coefficient of 0.448 and a p-value of 0.000. Thus, the third hypothesis is accepted.

d. Fourth Hypothesis Test

The formulation of the second hypothesis (H4) is that Digital Transformation has a positive effect on Innovation Capability. The test results show that Digital Transformation has a positive and significant effect on Innovation Capability. This is indicated by a path coefficient of 0.398 and a p-value of 0.000. Since $p < 0.05$, the fourth hypothesis is accepted.

e. Fifth Hypothesis Test

The fifth hypothesis (H5) is that Innovation Capability has a positive effect on Business Performance. Table 4.9 shows that Innovation Capability has a positive and significant effect on Business Performance. This is evident from the path coefficient of 0.222 and p-value of 0.028. Therefore, the fifth hypothesis is accepted.

f. Sixth Hypothesis Test

The sixth hypothesis (H6) is formulated as Innovation Capability mediating the influence of Entrepreneurial Orientation on Business Performance. The test results show that the mediation of Innovation Capability on the relationship between Entrepreneurial Orientation and Business Performance has a path coefficient value of 0.093 and a p-value of 0.052. Because the p-value > 0.05, the mediation effect is not significant, so the sixth hypothesis is rejected.

g. TestSeventh Hypothesis

The formulation of the seventh hypothesis (H7) is that Innovation Capability mediates the influence of Digital Transformation on Business Performance. The results of the hypothesis testing in Table 4.10 show that Innovation Capability mediates the relationship between Digital Transformation and Business Performance, with a path coefficient value of 0.088 and a p-value of 0.050. Because the p-value = 0.050 is still within the significance limit (≤ 0.05), the seventh hypothesis is accepted.

Discussion

In this study, researchers analyzed the influence of Entrepreneurial Orientation and Digital Transformation on Business Performance, mediated by Innovation Capability, in fashion MSMEs in Jakarta. Data collection was conducted through an online questionnaire distributed using Google Forms through the Line Group, Instagram, and TikTok platforms in November 2025. This approach was chosen to ensure that respondents who met the criteria could easily access the questionnaire and provide objective answers.

This study obtained a total of 212 respondents, all of whom met the research criteria: fashion MSMEs located in Jakarta, operating for at least two years, having more than ten employees, and implementing digital activities in their business operations. The data obtained were then analyzed using the Partial Least Squares–Structural Equation Modeling (PLS-SEM) method with the assistance of SmartPLS 4 software.

Based on the respondent characteristics, the majority of MSMEs are of productive age and actively involved in fashion business management. All samples demonstrated a relatively high level of digital adoption, consistent with the characteristics of modern MSMEs that rely on technology for marketing, transaction management, and product innovation. This makes the data relevant for measuring the role of Entrepreneurial Orientation, Digital Transformation, and Innovation Capability in business performance.

Descriptive results of the research variables indicate that respondents gave high ratings to Entrepreneurial Orientation, particularly in terms of risk-taking, competitive response, and speed of new product introduction. Digital Transformation also received positive responses, particularly regarding the use of e-commerce and the ability to adapt to technological changes. Regarding Innovation Capability, the majority of respondents stated they were able to develop ideas, accelerate new offerings, and reduce costs through innovation. Meanwhile, Business Performance also showed a positive trend, particularly in terms of financial growth, budget management, and increasing market share.

Before conducting hypothesis testing, this study first conducted an outer model test to ensure the validity and reliability of the instrument. In the convergent validity test, all variables had an Average Variance Extracted (AVE) value above 0.50 and an outer loading value above 0.708, thus declared valid. In the discriminant validity test, which included Fornell-Larcker,

cross-loading, and HTMT, all indicators and constructs met the validity requirements. Reliability tests using Cronbach's Alpha and Composite Reliability also showed good results because all values met the minimum limits of 0.60 and 0.70. After all indicators were declared to have met the criteria, the analysis continued to the inner model testing stage to assess the relationship between variables through the path coefficient, F^2, Q^2, and R^2.

5. Conclusion

Research conducted on fashion MSMEs in Jakarta shows that Entrepreneurial Orientation and Digital Transformation play a crucial role in improving business performance. Entrepreneurial orientation has been shown to encourage MSMEs to be more innovative and bold in seizing opportunities, thus improving their business performance. Digital transformation also has a significant impact, particularly because businesses that utilize technology tend to be more efficient in running operations and are better able to develop new innovations. Furthermore, the ability to innovate itself has been shown to contribute positively to business performance, thus MSMEs that continue to innovate have a greater opportunity to grow.

However, this study also found that innovation capability did not act as a mediator in the relationship between Entrepreneurial Orientation and Business Performance. In other words, EO is already quite strong in influencing business performance without having to go through innovation as an intermediary. This is in contrast to the relationship between Digital Transformation and Business Performance, where innovation capability was proven to be a mediator that strengthens the influence of digital transformation on improving business performance. Overall, this study confirms that entrepreneurial orientation, digital technology utilization, and innovation capability are important, complementary elements in driving the progress of Jakarta's fashion MSMEs.

Suggestion

Referring to the results obtained, there are several suggestions that can be put forward, namely:

Practical Advice

1. For fashion MSMEs, it's crucial to begin utilizing digital technology in a more targeted manner. The use of e-commerce, social commerce, and data-driven marketing strategies can help businesses run more effectively. Furthermore, innovation capabilities must be continuously honed to maximize the benefits of digital transformation in improving business performance.
2. For MSMEs with a strong entrepreneurial orientation, it is recommended to strengthen the innovation process, both internally and through collaboration, so that its impact on business performance is more optimal.

Theoretical Suggestions

1. For future research, it would be beneficial to add other variables such as market orientation, digital readiness, creativity, or organizational agility as mediators or moderators. These additional variables could help provide a more comprehensive picture of the relationship between Entrepreneurial Orientation, Digital Transformation, and Business Performance.

2. Future studies should expand the research area, for example to Jabodetabek or the national level, and consider the use of mixed methods for more in-depth analysis.

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