

Chapter 13

The Mediating Role of Innovation in Financial Literacy and Financial Performance: An Implementation in SMEs

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ABSTRACT

The purpose of this study was to determine the relationship between financial literacy, innovation capability, and financial performance; and to determine the effect of mediators of innovation capability on the relationship between financial literacy and financial performance with implementation in small and medium enterprises (SMEs). To test the hypothesis in the research model, a field study was conducted using a survey method with a total of 189 owners and managers, out of 189 SMEs operating in the manufacturing sector of tempe chips and dinoyo ceramics. The data collected from 189 owners and managers were analyzed using correlation and regression analysis with the SEM Structural Equation Model. The analysis was carried out using SPSS and AMOS software. As a result of this study, it is evident that innovation capability has a partial mediator effect on the dimensions of market orientation and export performance. This empirical finding contributes to the achievement of the competitive advantage of SMEs through increasing market-based innovation capabilities.

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INTRODUCTION

Theories in the field of resource-based strategic management that focus on the internal dynamics of organizations suggest that competitive advantage and higher average returns to resources and innovation capabilities can reach the forefront of business. This can create their future strategy which is accepted as the basic management philosophy (Lailah & Soehari, 2020). Changes in the business world occur constantly and very quickly. This process of change is formed due to certain dynamic concepts such as globalization, relentless competition, shorter product life cycles, speed of technological innovation, and loss of market boundaries. SMEs must be able to produce products and services that have higher quality standards than the market. This factor forces SMEs to think and act with a broader perspective; customer oriented but still aiming to increase profits. The financial performance of SMEs is a measure of the success rate of SMEs in achieving their business which describes the sales, capital, the number of employees, market share, and profits that continue to increase. The COVID-19 pandemic has resulted in the financial performance of SMEs dropping drastically, this can be seen from the declining sales volume because business actors cannot work optimally with restrictions on their operational space, which has an impact on profit decline. Another factor that causes the financial performance of SMEs to decline in Malang is the decline in financial literacy and innovation. Financial literacy is the knowledge, behavior, and attitudes of a person in managing their finances (OJK Regulation No.76/POJK.07/2016). If financial knowledge is low and does not have clear financial goals, it will have an impact on the decline in the financial performance of SMEs.

Financial knowledge in understanding the basic concepts, benefits, and financial management supported by good financial behavior and attitudes will improve the financial performance of SMEs which includes increasing sales volume and profits (this is in line with the research of (Amri & Iramani, 2018); (Hilmawati & Kusumaningtias, 2021); (Susilo et al., 2022). Changes in external environmental conditions and increasing customer expectations require SMEs to develop innovations for sustainable business.

This situation occurs in Indonesia due to intense competition and the general dominance of SMEs in the economy. SMEs must develop organizational capabilities that enable their business continuity in the long term. Today's highly competitive business environment and innovation capabilities within this organization are critical to achieving a sustainable competitive advantage. However, intense competition and rapidly changing market structures in the context of consumer demand and expectations make this innovation capability important to develop that contributes to the financial performance of SMEs based on market dynamics (Ciampi et al., 2021). At this point, financial literacy offers an effective perspective to increase the

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