

# SMEs' Strategies for Improving Financial Performance Through Competitive Advantages

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**Abstract.** This study aims to examine the direct effect of entrepreneurial orientation and innovation on competitive advantage and the impact of competitive advantage on the performance of SMEs. Furthermore, this study will also examine the indirect influence of entrepreneurial orientation and innovation variables on financial performance through competitive advantage. This is quantitative research using a survey method. The respondents are SMEs owners in the field of cultivation industry in Jember regency, Indonesia. This study uses the Structural Equation Model (SEM) as a data analysis technique, which is assisted by Warp PLS software. Statistical results show that entrepreneurial orientation and innovation have a direct effect on competitive advantage. Other results show that there is a direct effect of competitive advantage on financial performance. A company is said to have a competitive advantage if it can outperform other companies to create higher economic value. The results of the indirect effect test show that entrepreneurial orientation also has an indirect effect on financial performance through competitive advantage. Furthermore, the results of this study also prove that innovation affects financial performance through competitive advantage.

**Keywords:** Entrepreneurial Orientation, Competitive Advantage, Financial Performance.

## Introduction

Small and Medium Enterprises (SMEs) refer to enterprises run by an individual or a group of people productively or commercially whose total assets and sales are regulated by law. In the Indonesian economy, this kind of business plays a very important role, especially since the economic crisis where its role and number has been significantly increased. Therefore, it becomes the backbone of Indonesian economic development and at the same time provides the main source of income for everyone, particularly in terms of employment. In addition, SMEs are the main helpers to revive the regional economy, especially since some SMEs have been able to break through the export market (Widyani, 2014).

Mutegi et al., (2015) explained that the performance of SMEs is the result of a company program achieved by a person or group of people with the division of tasks during a certain period with predetermined standards. Some opinions state that the performance of SMEs is often related to the company's ability to deal with problems in its business environment (Birley and Westhead, 1993) and personality traits or talents (Baron and Markman, 2003; Littunen, 2000). However, Small and Medium Enterprises (SMEs) have so far faced various weaknesses, such as weak ability to adapt to strategic environmental changes, lack of skill in responding to business opportunities, lack of creativity in innovation that is dealing with imported products. This is reinforced by

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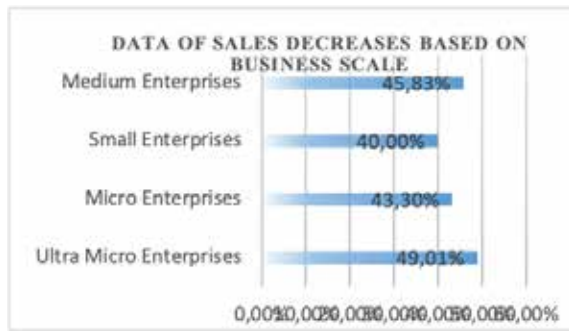


Figure 1. Data Of Sales

Source: Prepared by the authors (2021)

survey data in Figure 1 showing that 94.69% of businesses experienced a decline in sales. The decline in sales of greater than 75% was identified in 49.01% of ultra micro, 43.3% of micro, 40% of small, and 45.83% of medium businesses (Nugroho, 2020)

Based on this background, it can be argued that there is a phenomenon of decreasing performance of SMEs due to competitive advantage impairment. Whereas, SMEs have turned to be the backbone of the economy by contributing to the gross domestic product. In addition, the rapidly increasing number of SMEs has become the main source of income for the community as well as a source of employment in Jember Regency. Therefore, it is important to examine and analyze the determinants of competitive advantage to improve the financial performance of SMEs.

Lumpkin and Dess (1996) explain that entrepreneurial orientation is related to the decision-making processes, practices, and activities used by entrepreneurs to set up companies. Ahimbisibwe and Abaho (2015) mentioned when companies have a well-determined entrepreneurial orientation; they tend to be more open to risks, and at the same time, no longer rely on past strategies. In addition, Lee and Chu (2011) define entrepreneurial orientation as that principle which identifies and exploits opportunities. Patel and D'Souza (2009) defined it as a desire to be first in the market in terms of innovation, a willingness to take risks, and a willingness to respond quickly to market changes. To support this definition, Hafeez et al., (2012) added that companies with a determined orientation may be more capable to be innovative.

In regards to the definition of product innovation, Atalay et al., (2013) posited that it is an initiation and development of goods or services that are distinct from those previously available and that address

the shortcomings of the previous invention by placing a greater emphasis on quality factors. While Prakoso (2005) defines it as a mechanism undergone by the company to respond to a dynamic environment.

This notion arises fundamentally from the value allowing the company to create a value for its customers beyond the costs incurred by the company to create it (Porter, 1985). Meanwhile, David (2011) added that competitive advantage is anything a company can do so that it is better than rival companies. Meanwhile, according to Gary (2001), competitive advantages are all the factors that an organization may have to differentiate products or services from competitors' products and services to increase the market percentage. Furthermore, Barney and Clark (2007) state that the ultimate importance of a business is to maintain the competitive advantage it has.

The concept of financial performance according to Basri and Gitosudarmo (2002) is a set of financial transactions that occur over a period of time and are reported in financial statements such as the income statement and balance sheet. Financial performance is an assessment of a company's ability to follow logical and coherent financial implementation regulations.

### Research Methodology

This type of research is quantitative research. The research method used is a survey method, namely collecting data using a questionnaire. The variables used to consist of exogenous variables, namely entrepreneurial orientation and innovation; intervening variables, namely competitive advantage; and endogenous variables, namely financial performance. All indicator variables are measured using an ordinal scale. The Questions are made using a five-point scale or called the Likert scale. Point 1 strongly disagrees and point 5 strongly agrees. Entrepreneurial orientation is measured using the dimensions of entrepreneur's achievement motivation, locus of control, self-reliance, extroversion, innovation, acting proactivity, and managing risks (Lee and Tsang, 2001; Lumpkin and Dess, 1996). Innovation is measured using the dimensions of product line expansion, copying competitors' products or packaging, and generating new products. Furthermore, competitive advantage is measured using the dimensions of competitive prices, product quality, and customer relationships (Lee and

Chu, 2011). Performance is measured using the dimensions of sales level, profit rate, return on capital, turnover rate, and market share achieved (Glueck and William, 1988).

The study population is SMEs in the cultivation industry in Jember district. To achieve the samples, a purposive sampling method was implemented, a method in which the sampling technique is based on certain considerations. The sample was selected based on the essential and relevant characteristics of the study. The criteria in this study are described as follows: respondents are owners or managers of business units, respondents have owned or managed a business unit for at least 3 years as an indicator that they are committed to running the business, and respondents have a workforce of more than 10 people.

This study uses the Structural Equation Model (SEM) in technical data analysis, which is operated with the help of Warp PLS software version 7.0. Research using SEM provides an opportunity for a researcher to obtain answers to both regression and dimensional research questions. That is,

researchers can measure the dimensions of a concept (Ferdinand, 2006).

In general, evaluation to test the outer model uses three criteria as mentioned by Sholihin and Ratmono (2013), such as convergent validity, discriminant validity, and composite reliability (Sholihin and Ratmono, 2013). A validity test is done by looking at the loading factor value and the average variance extract value. The loading factor value must be higher than 0.70 and the AVE value must be higher than 0.50 (Sholihin and Ratmono, 2013)

The outer model is evaluated by the reliability test, namely by looking at the composite reliability value and the Cronbach alpha value. If the value of composite reliability and Cronbach alpha is greater than 0.70, then a construct is said to be reliable. The inner model is tested by looking at the average path coefficient (APC), and for the average R-squared (ARS) if the value is less than 0.05 then the model is appropriate, while the AVIF value must be smaller than 5 (Sholihin and Ratmono, 2013).

**Table 1**  
**Loading Factor**

<b>Variable</b>	<b>Indicator</b>	<b>Loading Factor</b>	<b>Notes</b>
Enterpreneurership Orientation	X1.1	0.841	Fulfilled The Validity
	X1.2	0.953	Fulfilled The Validity
	X1.3	0.949	Fulfilled The Validity
	X1.4	0.929	Fulfilled The Validity
	X1.5	0.930	Fulfilled The Validity
	X1.6	0.908	Fulfilled The Validity
	X1.7	0.911	Fulfilled The Validity
Innovation	X2.1	0.965	Fulfilled The Validity
	X2.2	0.941	Fulfilled The Validity
	X2.3	0.947	Fulfilled The Validity
	X2.4	0.977	Fulfilled The Validity
	X2.5	0.975	Fulfilled The Validity
	X2.6	0.972	Fulfilled The Validity
Competitive Advantage	Y1.1	0.988	Fulfilled The Validity
	Y1.2	0.983	Fulfilled The Validity
	Y1.3	0.993	Fulfilled The Validity
Financial Performance	Y2.1	0.933	Fulfilled The Validity
	Y2.2	0.933	Fulfilled The Validity
	Y2.3	0.963	Fulfilled The Validity
	Y2.4	0.965	Fulfilled The Validity
	Y2.5	0.969	Fulfilled The Validity

Source: authors' calculation

## Results and Discussions

This study used 112 respondents from SMEs in the cultivation industry sector in Jember district. According to Hair et al., (2006), a sample size determined for SEM ideally is between 100-200, with 5-10 observations for each indicator. Thus, if the estimated indicator is 21, then the minimum sample size is 105. This study used 112 respondents from SMEs in the processing industry sector consisting of 32 food processing industries, 12 beverages, 18 apparel, 5 footwear, 19 wooden items including woven bamboo, rattan, and the like, 10 paper, 11 furniture, and 5 rubber and plastic. The sampling method used is purposive sampling.

Based on Table 1, all indicators' variables are fulfilled the validity, which means the loading factor value of each variable is higher than 0,7. Furthermore, based on the table 2, it can be explained that variable entrepreneurship orientation has a value of 0,869 > 0,5, innovation has value of 0,984 > 0,5, competitive advantage has value of 0,988 > 0,5, and financial performance has value of 0,974 > 0,5. This result can explain that all variables fulfilled the validity.

Furthermore, the outer model was evaluated by reliability testing which is performed by observing the value of composite reliability and the value of Cronbach alpha. If the Cronbach alpha value

of a construct is greater than 0.70, then it is said to be reliable. Here are the results of the latent variable output. As seen in Table 3, the variable entrepreneurship orientation has a value of composite reliability of 0,974 > 0,7 and value of Cronbach alpha of 0,969 > 0,7; innovation has a value of composite reliability of 0,987 > 0,7 and value of Cronbach alpha of 0,984 > 0,7; competitive advantage has value of 0,992 > 0,7 and value of Cronbach alpha of 0,988 > 0,7; and financial performance has value of 0,980 > 0,7 and value of Cronbach alpha of 0,974 > 0,7. This result can be concluded that all variables fulfilled the reliability.

R Square is used to seek for a contributing influence of entrepreneurial orientation and innovation on competitive advantage and to find the strong influence of entrepreneurial orientation, innovation, and competitive advantage on financial performance. Based on table 4, it can be explained that the large influence of entrepreneurial orientation and innovation on competitive advantage is 77.1%; this value is categorized as strong. Furthermore, the influence of entrepreneurial orientation, innovation, and competitive advantage on financial performance is 76.7%, which is categorized as strong (Ghozali and Latan, 2015).

The evaluation of the inner or structural model is intended to test the suitability of the model. Three test indices are used,

**Table 2**  
**Average Variance Extracted**

Variable	AVE	Criteria	Notes
Entrepreneurship Orientation	0.969		Fulfilled The Validity
Innovation	0.984		Fulfilled The Validity
Competitive Advantage	0.988		Fulfilled The Validity
Financial Performance	0.974	> 0,5	Fulfilled The Validity

Source: authors' calculation

**Table 3**  
**Composite Reliability and Cronbach Alpha**

Variable	Composite Reliability	Cronbach Alpha	Notes
Entrepreneurship Orientation	0.974	0,969	Fulfilled The Reliability
Innovation	0.987	0,984	Fulfilled The Reliability
Competitive Advantage	0.992	0,988	Fulfilled The Reliability
Financial Performance	0.980	0,974	Fulfilled The Reliability

Source: authors' calculation

**Table 4**  
**R Square**

Variabel	R Square	Adj R Square
Competitive Advantage	0.771	0.767
Financial Performance	0.716	0.708

Source: authors' calculation

**Table 5**  
**P-Value Index Criteria Description**

	Index	P-Value	Criteria	Notes
APC	0.365	P<0.001	p < 0.001	Accepted
ARS	0.744	P<0.001	p < 0.001	Accepted
AVIF	3.360		acceptable if <= 5	Accepted

Source: authors' calculation

**Table 6.**  
**Direct Effects**

Criteria	Variable	Y1	Y2
Path coefficient	X1	0.451	0.170
	X2	0.477	0.237
	Y1		0.489
	Y2		
p-values	X1	<0.001	0.032
	X2	<0.001	0.004
	Y1		<0.001
	Y2		

Source: authors' calculation

namely the average path coefficient, average R-squared, and average variance factor. The criteria used including APC and ARS are Accepted if the p-value is less than 0.05 and AVIF is < 5 (Sholihin and Ratmono, 2013).

The results of output model fit indices are presented in the table 5. Table 5 indicates that the APC is 0.365 with a p-value of <0.001. Meanwhile, ARS value is 0.744 with a p-value of <0.001. The APC meets the criteria because the p-value is < 0.001. Likewise, ARS has a p-value of < 0.001. Furthermore, AVIF has a value of < 5, which is 3.360. In conclusion, the assumption of the inner model is accepted.

Hypothesis testing is done by looking for path coefficient value and p-value. Based on table 6, it can be concluded that entrepreneurial orientation (X1) has a direct effect on competitive advantage (Y1) of 0.451 with a significance value of p <0.001. Innovation (X2) has a direct effect on competitive advantage (Y1) of 0.477 with a significance value of p <0.001.

Entrepreneurial orientation (X1) has a direct effect on financial

performance (Y2) of 0.170 with a significance value of p <0.032. Innovation (X2) has a direct effect on performance (Y2) of 0.237 with a significance value of p <0.004. Competitive advantage has a direct effect (Y1) on financial performance (Y2) of 0.489 with a significance value of p <0.001.

Table 7 indicates that the indirect effect of entrepreneurial orientation variables on financial performance through competitive advantage is 0.220 with P<0.001 (significant). Meanwhile, the indirect effect of innovation on financial performance through competitive advantage is 0.233 with p <0.001 (significant).

The results of path analysis are presented in the figure 2.

Based on Figure 2, it can be explained that entrepreneurial orientation and innovation have a positive effect on competitive advantage, each path coefficient of 0.45 for entrepreneurial orientation and

**Table 7**  
**Indirect Effect for Paths with 2 Segments and P-Value**

	X1	X2
X1		
X2		
Y1		
Y2	0.220(p<0.001)	0.233 (p<0.001)

Source: authors' calculation

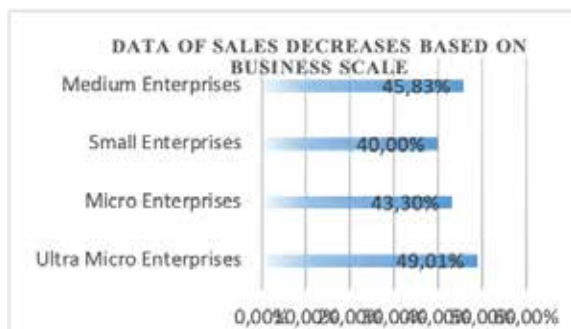


Figure 2. Path Analysis Result

0.48 for innovation with a significance value of < 0.01 and R-square of 0.77. It means that entrepreneurial orientation and innovation are able to explain the variation of changes in the competitive advantage of 77%. Furthermore, entrepreneurial orientation, innovation, and competitive advantage have a positive effect on financial performance. Path coefficient is 0.17 for entrepreneurial orientation with a significance value of 0.03; the competitive advantage is 0.49 with a significance value of <0.01, and innovation is 0.24 with a significance value of <0.01 and R-Square of 0.72. It means that entrepreneurial orientation, innovation, and competitive advantage are able to explain the variation of changes in the financial performance of 72%.

**Discussions**

Companies that have a good entrepreneurial orientation will be able to reach targets and market positions better than their competitors. The reason is that the company continuously observes market changes and at the same time responds quickly to the changes that occur. They are being proactive and risk-taking allows them to create more innovative products. As a result, companies can outperform their competitors so that they have a competitive advantage because they will be able to satisfy customers and identify the factors that affect customers. This is in accordance with research conducted by (Koh, 1996; Supranoto, 2009; Zulfida et al., 2016) which found that

companies with a proper entrepreneurial orientation can reach the target market and be in a forward market position compared to their competitors. Based on the results of the literature review and empirical evidence mentioned above, the proposed hypothesis is entrepreneurial orientation has a positive effect on competitive advantage.

Based on hypothesis testing, it is known that orientation has an effect on the competitive advantage of SMEs in Jember Regency. That is the ability of SMEs managers to be proactive and dare to take risks that enable SMEs to create innovative products ahead of competitors. The ability to innovate for SMEs in the processing industry requires new and unique business activities. The ability to innovate is important in the essence of entrepreneurial characteristics. SMEs managers are also willing to take risks in making uncertain decisions but provide opportunities for better results. The proactive nature of SMEs managers is intended to gain a wider market. This is in line with the results of research which states that entrepreneurial orientation has a significant effect on the competitive advantage of SMEs (Usvita, 2015). Furthermore, these results are also in line with research which states that the better the entrepreneurial orientation a business has, the better the achievement of competitive advantage from the business will be (Tahir et al., 2018).

Product innovation, according to Atalay et al., (2013) is the development and emergence of new types of products or services that are distinct from prior ones and address the shortcomings of past inventions. Companies that have high innovation power will have a competitive advantage. As explained by Wahyono (2001), a company's continuous innovation is a fundamental requirement that will, in turn, lead to the creation of competitive advantage. Song and Parry (1997) explained that the competitive advantage of a product is one of the decisive factors for the success of a new

product. Cooper (2000) stated it is vital for new products to possess advantages when entering the scope of an international market that has very tight competition. On the one hand, and organizational's advantage can be created through product development in the form of continuous innovation so that market advantages will be realized. Furthermore, Chen et al., (2009) suggest firms better maintain their advantage. In addition, Kuczarski (2003) also stated that to achieve a competitive advantage, innovation must always focus on creating something new in the world. A study performed by Omar et al., (2016) found that innovation ability has a positive effect on knowledge creation, while they also failed to prove that entrepreneurial orientation has it on the knowledge creation. Based on the results of the literature review and empirical evidence mentioned above, the proposed hypothesis is innovation has a positive effect on competitive advantage.

Based on hypothesis testing, it is known that innovation influences the competitive advantage of SMEs in Jember district. This shows that the main factor affecting competitive advantage is product innovation. Hills (1994) has formerly posited that innovation is a form of an idea, practice or object considered new by an individual. Product innovation, therefore, has the potential to lead to various designs, thereby giving more alternatives increase the utility or value perceived by the customer. Thus, innovation will have an impact on improving product quality as desired by customers (Prajogo and Sohal, 2003). SMEs managers in the processing industry sector in Jember Regency think that efforts to introduce innovation can lead and reduce the possibility of competitors to innovate earlier. The results of this study are in line with research conducted by (Sherlin, 2016; Tahir et al., 2018). These findings are also in line with the opinion of Poudel et al., (2012) which states that Entrepreneurial orientation is a strategic resource owned by an organization. The potential to create a competitive advantage can be created by organizations that have a good entrepreneurial orientation. Thus, competitive advantage will have an impact on the company's business performance. The results of this study are also in line with the results of previous studies, for example, research by (Wiklund, 1999; Wiklund and Shepherd, 2005).

Entrepreneurial orientation has the principle of identifying and exploiting opportunities (Lumpkin and Dess, 1996).

Miller (1983) defined this term as a desire to pioneer innovation in the market, to be risk-takers, and to well-respond to changes arising in the market. Companies with a good entrepreneurial orientation have better financial performance because those which possess a strong entrepreneurial orientation are more willing to take risks, not only stick to past strategies (Lumpkin and Dess, 1996). In a dynamic environment, entrepreneurial orientation is very important for the survival of a company. Entrepreneurial orientation that is formed by the dimensions of innovation, being proactive, risk-taking, competitive aggressiveness, and autonomy has an effect on SMEs business performance (Arsyad, 1999).

Based on hypothesis testing, it is known that entrepreneurial orientation has a positive effect on financial performance. This shows that improved financial performance is built by entrepreneurial orientation with indicators of innovation, courage to take risks and to act proactively. Therefore, SMEs managers in the processing industry in Jember Regency have the courage to take risks by trying new things or strategies that have the opportunity to improve financial performance. As a result, financial performance can be directed to transform it in facing long-term challenges. These findings indicate that SMEs managers in facing increasingly fierce competition need to continuously innovate. Innovation can be in the form of new product development or new product introductions. The innovation strategy, which includes the process of innovation, product innovation, and organizational innovation, can boost performance because the implementation of innovation is an important aspect that can add value to company competitiveness. Thus, the application of these four important aspects in business will improve financial performance. These findings are in line with Ellitan's (2006) study.

Studies on a similar topic have been carried out by previous scholars, including Fairoz et al., (2010) who examined the effect of entrepreneurial orientation on performance study on twenty-five SMEs in Hambantota District, Sri Lanka. This research found that there is an influence of entrepreneurial orientation on performance. Furthermore, Jasra et al., (2010) examine the key factors of the success of SMEs in Pakistan. The target population of this research is SMEs that operate in various business lines, ranging from service lines to manufacturing. Their study shows that financial resources

are an important factor in business success. Kraus et al., (2012), additionally, investigated the effect of entrepreneurial orientation on company performance during the period of economic crisis. The results show that although innovative SMEs perform better in a volatile environment, they must minimize the level of risk by avoiding risky projects. Other researchers, Mahmood and Hanafi (2013) examined the effect of entrepreneurial orientation on performance with a competitive advantage as a mediating variable in SMEs owned by women in Malaysia. Such research indicated that there is a significant influence of entrepreneurial orientation on performance. Moreover, other results show that competitive advantage mediates the effect of entrepreneurial orientation on performance.

Based on hypothesis testing, it is known that innovation has a positive effect on financial performance. These findings indicate that SMEs managers in the processing industry in Jember Regency have the company's endeavor that involves developing, producing, and marketing new products for the industry using technology and information. This is in accordance with Freeman (2002) who defined innovation as a company's endeavor to design, produce, and market new products for the industry using technology and information. In other words, it is the modification or discovery of ideas for continual improvement and development in order to suit the needs of customers. Thus, companies that have high innovation will be able to meet customer needs so that they can improve their financial performance, where performance is the desired result of the action. The results of this study support the research results of (Ferreira et al., 2020; Omar et al., 2016; Zehir et al., 2015). Research conducted by Zehir et al., (2015) focuses more on examining the role of innovation and differentiation strategies as mediating variables. The findings revealed that innovation and differentiation strategies mediate the relationship between entrepreneurial orientation and a company's performance. Furthermore, the research conducted by Ferreira et al., (2020) employed an empirical study of 387 companies in Portugal. The results of their study show that dynamic ability and creativity and innovation have a significant positive effect on performance. Cho and Lee (2018) in their research used both new entrepreneurs and those whose business has been operated for less than seven years in Korea. The research

indicated that entrepreneurial orientation and innovation affect non-financial business performance.

Based on hypothesis testing, it is known that competitive advantage has a positive effect on financial performance. Furthermore, the study findings indicated that a competitive company is likely to create greater economic values than other companies in the same industry. SMEs that have the ability to compete or have a market position can improve their financial performance. The same thing is explained by David (2011) who states that competitive advantage is an action taken by a company so that it is better than rival companies. The results of this study support the research results of (Widyaningdyah and Aryani, 2013). Competitive advantage is a company's ability to accomplish a much higher and superior performance compared to competitors in similar industries through outstandingly managed characteristics and resources. Day and Wensley (1988) stated that a competitive advantage is a form of strategy to help companies maintain their survival. The competitive market and the company's ability to achieve an outstanding performance are highly dependent on the degree of competitive advantage. Companies that have a competitive advantage will have better financial performance because they have a much higher and superior performance than their competitors. Research conducted by Lee and Chu (2011) showed that competitive advantage has a positive influence on company performance.

Again, as it is stated above, entrepreneurial orientation is an orientation that has the principle of identifying and exploiting opportunities (Lumpkin and Dess, 1996). Furthermore, Miller (1983) defined this term as a desire to pioneer innovation in the market, to be risk-takers, and to well- respond to changes arising in the market. Companies that have good entrepreneurial orientation will have better financial performance if their competitive advantages are also good. This is because companies that have a determined entrepreneurial orientation will be better risk-takers and rely less on past strategies (Lumpkin and Dess, 1996). In a dynamic environment, entrepreneurial orientation is very important for the survival of the company. Entrepreneurial orientation that is formed by the dimensions of innovation, being proactive, risk-taking, competitive aggressiveness, and autonomy has an effect



on SME's business performance (Arshad et al., 2014).

Based on hypothesis testing, it is known that entrepreneurial orientation has an effect on financial performance through competitive advantage. The present study further indicates that the entrepreneurial orientation of the creative industry sector has been maximally innovative that can produce a competitive advantage. Business actors have dared to take full advantage of existing business potentials or opportunities, such as entering new markets or producing new products. As a result, SMEs can provide better economic value than other companies within the same industry. Thus, this study supports several previous studies, namely (Frank et al., 2010; Wiklund, 1999; Wiklund and Shepherd, 2005) who have succeeded in proving empirically the positive effect of entrepreneurial orientation on business performance. In a similar vein, Zeebaree and Siron (2017), investigated SME managers in the Iraqi Kurdistan region. Statistical results show that entrepreneurial orientation has a significant effect on competitive advantage. Other results also show that financial support may constitute a moderating variable of the relationship between entrepreneurial orientation and competitive advantage.

Defined by Freeman (2002), innovation is a company endeavor that involves developing, producing, and marketing new products for industry using technology and information. In other words, innovation is the act of modifying or discovering ideas intended for continuous improvement and development to satisfy customer needs. Thus, companies that have high innovation will be able to meet customer needs so that they will improve financial performance, where performance is the desired result of behavior (Gibson, 2011). The increase in financial performance will be even higher if followed by a highly competitive advantage because the competitive advantage is the company's ability to have a much higher and superior performance compared to competitors. Based on hypothesis testing, it is known that entrepreneurial orientation has a direct influence on financial performance through the intervening variable of competitive advantage.

SMEs in the processing industry in Jember Regency continue to innovate by using IT to develop, produce and market new products for the industry (Freeman, 2002). In other words, innovation is the act of modifying or discovering ideas intended for

continuous improvement and development to satisfy customer needs so as to increase competitive advantage and have an impact on financial performance. SMEs processing industry considers that the increase in financial performance will be even higher if it is followed by a highly competitive advantage because it will enable them to have a much higher and superior performance compared to competitors.

### **Conclusions**

Entrepreneurial orientation and innovation have a direct effect on competitive advantage and financial performance. The results of this study indicate that the ability of SMEs managers to be proactive and dare to take risks enables them to create innovative products. Product innovation for the processing industry is important to increase alternative product choices and to intensify added value for customers. A company is said to have a competitive advantage if it can outperform other companies to create a higher economic value. Therefore, an increase in financial performance will be greatly influenced by customer response to a company's products.

The results of this study also prove that entrepreneurial orientation has an indirect effect on financial performance through competitive advantage. Furthermore, the results of this study found that innovation has an influence on financial performance through the intervening variable, namely competitive advantage.

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