



Market Orientation, Innovation, and Business Performance: The Mediating Role of Product Innovation in MSMEs of Nganjuk Regency

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Abstract

Purpose – This study aims to examine the influence of market orientation on business performance, specifically testing product innovation as a mediating variable among culinary Micro, Small, and Medium Enterprises (MSMEs) in Nganjuk Regency, East Java, Indonesia.

Design/methodology/approach – A quantitative, cross-sectional survey approach was employed. Data were collected using structured questionnaires (measured on a 5-point Likert scale) from 96 culinary MSME owners selected through purposive sampling. The data were analyzed using Partial Least Squares Structural Equation Modeling (PLS-SEM) via SmartPLS software.

Findings/Results – The results demonstrate that market orientation has a positive and significant effect on product innovation ($\beta = 0.740$, $p = 0.000$) and business performance ($\beta = 0.362$, $p = 0.022$). Additionally, product innovation positively and significantly influences business performance ($\beta = 0.515$, $p = 0.001$) and fully mediates the relationship between market orientation and business performance ($\beta = 0.381$, $p = 0.000$). Strong market orientation encourages relevant product innovations, which subsequently enhance sales, profitability, and overall business growth.

Originality/Value – This study contributes to the literature on entrepreneurship and marketing management by empirically confirming the mediating role of product innovation specifically within the context of culinary MSMEs. It provides practical insights for MSME owners to boost competitiveness through market-driven innovation, and highlights the need for local governments to support these efforts through targeted training and development programs.



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INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) are the backbone of Indonesia's economy (A. N. Rahmadi et al., 2020; A. N. Rahmadi & Ruhamak, 2018; Schneider, 2022). This sector contributes more than 60% to the national Gross Domestic Product (GDP) and employs more than 97% of the workforce (BPS, 2024). The development of MSMEs has therefore become a key strategy for promoting inclusive economic growth, creating employment, and achieving more equitable welfare distribution. Nganjuk Regency in East Java Province has great potential for MSME development. (BPS, 2024) recorded 17,840 small industries and household crafts scattered across 20 sub-districts. In 2023, the regency's economic growth reached 0.56% compared with the previous year, with transportation and warehousing, other services, and accommodation and food services as the fastest-growing sectors (BPS, 2024). Despite these positive developments, MSMEs in the area still face challenges, particularly in innovation and competitiveness amid increasingly competitive markets.

Market orientation is a crucial factor for the sustainability of MSMEs in the global competition era (D'souza et al., 2022; Dalimunthe, 2017; A. N. Rahmadi et al., 2020; Yadav et al., 2019). It reflects an enterprise's ability to understand consumer needs and wants proactively, analyze competitor behavior, and respond quickly and accurately to market dynamics. MSMEs with strong market orientation are more adaptive to changing consumer preferences and better at identifying market opportunities. Innovation serves as the link between market orientation and business performance (Abbas, 2018; D'souza et al., 2022; Heru Marwanto et al., 2023; Jannah et al., 2019; Lorensa & Hidayah, 2022; A. N. Rahmadi et al., 2020). Innovation involves developing new products or refining existing ones to better meet market needs in terms of function, design, packaging, and added value. Through relevant innovation, MSMEs can increase customer satisfaction, expand market share, and differentiate themselves from competitors.

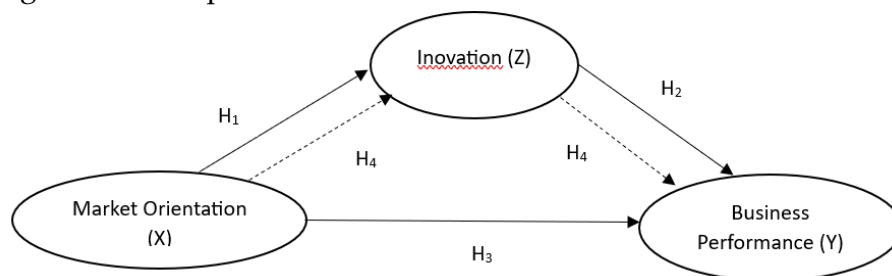
Previous research (Beliaeva et al., 2020; Cheng et al., 2025; Munfaqiroh et al., 2024) has shown inconsistent results regarding the relationship between these variables found that market orientation had no significant effect on business performance, although innovation mediated the influence of market orientation and entrepreneurial characteristics on performance. (Bekata & Kero, 2025; Reshid & Esmail, 2022) concluded that customer orientation had a significant positive effect on business performance, and innovation mediated the influence of competitor orientation on performance (Purwanto & Wijaya, 2024). emphasized the mediating role of innovation in linking market orientation to business performance (Hendriyeni & Pujani, 2024). Research specifically examining the mediating role of product innovation in the culinary sector of MSMEs at the district level is still limited, particularly in Nganjuk Regency.

The culinary subsector is one of the fastest-growing MSME segments in Nganjuk Regency and faces very intense competition. MSME actors in this sector are required to deeply understand the market and transform that understanding into competitive product innovation. Nevertheless, research that simultaneously integrates market orientation,

product innovation, and business performance in this specific local context remains scarce.

This study analyzes the effect of market orientation on the business performance of MSMEs in Nganjuk Regency, with innovation as the mediating variable. The research aims to provide a deeper understanding of the mechanism by which market orientation drives innovation and, ultimately, improves business performance. The findings are expected to offer practical implications for MSME actors in formulating marketing and product development strategies, as well as theoretical contributions to the literature on marketing management and entrepreneurship in the Indonesian MSME context

Figure 1. Conceptual Framework



To test the proposed relationships in the research model, the following hypotheses were formulated and examined using the path coefficient analysis in PLS-SEM:

H₁: Market orientation has a positive and significant effect on innovation among MSMEs in Nganjuk Regency.

H₂: Innovation has a positive and significant effect on business performance among MSMEs in Nganjuk Regency.

H₃: Market orientation has a positive and significant effect on business performance among MSMEs in Nganjuk Regency.

H₄: Innovation mediates the effect of market orientation on business performance among MSMEs in Nganjuk Regency.

LITERATURE REVIEW & HYPOTHESIS DEVELOPMENT

Market Orientation and Product Innovation

Market orientation reflects an enterprise's ability to proactively understand consumer needs and wants, analyze competitor behavior, and respond accurately to market dynamics. This orientation is considered a crucial factor for the sustainability of Micro, Small, and Medium Enterprises (MSMEs) in a highly competitive global era (D'souza et al., 2022; Dalimunthe, 2017; Rahmadi et al., 2020; Yadav et al., 2019). A strong orientation toward the market provides a significant drive for businesses to continuously innovate. Companies that are highly responsive to market demands tend to generate product and process innovations that are more adaptive and relevant to change, establishing a positive relationship between market orientation and innovation levels (Dalimunthe, 2017; Syukron & Ngatno, 2016).

H1: Market orientation has a positive and significant effect on innovation among MSMEs in Nganjuk Regency.

Product Innovation and Business Performance

Innovation serves as a vital link in improving business outcomes, which involves developing new products or refining existing ones to better meet market needs in terms of function, design, packaging, and added value (Abbas, 2018; D'souza et al., 2022; Marwanto et al., 2023; Jannah et al., 2019; Lorensa & Hidayah, 2022; Rahmadi et al., 2020). Innovation acts as a crucial catalyst for increasing business competitiveness, as companies that continuously innovate can better satisfy ever-changing market needs and tend to perform better overall (Kotler et al., 2021). Furthermore, MSMEs that consistently implement product innovation demonstrate improved business performance through enhanced operational efficiency, greater customer satisfaction, and a stronger competitive advantage (Jannah et al., 2019; Lorensa & Hidayah, 2022).

H2: Innovation has a positive and significant effect on business performance among MSMEs in Nganjuk Regency.

Market Orientation and Business Performance

Understanding consumer needs and market trends not only plays a key role in driving innovation but also exerts a direct impact on business performance. MSMEs equipped with a strong market orientation are capable of responding more quickly to market changes, which helps create more relevant products, increases customer loyalty, and improves operational efficiency. Empirical evidence indicates that strong market orientation is directly associated with superior performance, particularly concerning increased sales and profitability (Abbas, 2018; Darmawan et al., 2023). Additional research confirms that customer orientation yields a significant positive effect on overall business performance (Bekata & Kero, 2025; Reshid & Esmail, 2022).

H3: Market orientation has a positive and significant effect on business performance among MSMEs in Nganjuk Regency.

The Mediating Role of Product Innovation

While market orientation provides the foundational understanding of the market, product innovation transforms that understanding into competitive advantages. A strong market orientation encourages the development of relevant product innovations, which in turn are more readily accepted by consumers and lead to enhanced sales and financial performance. Multiple studies emphasize that product innovation acts as a key mediating variable that links market orientation with business performance (Fitri, 2021; Hendriyeni & Pujani, 2024; Purwanto & Wijaya, 2024; Rachmasari & Suprapti, 2022). Therefore, strong market-driven innovations serve as the mechanism to significantly boost MSME business outcomes.

H4: Innovation mediates the effect of market orientation on business performance among MSMEs in Nganjuk Regency.

METHODOLOGY

This study uses a quantitative approach with an explanatory survey design. The population consists of all MSME actors in Nganjuk Regency. Because the exact population size was unknown, the sample size was determined using the Lemeshow formula for infinite populations (Levy & Lemeshow, 2013). With a 95% confidence level ($Z = 1.96$), proportion

estimation of 0.5, and margin of error of 10%, the minimum sample size required was 96 respondents. The sampling technique used was purposive sampling, with the criteria that MSME actors had been operating for at least one year and were willing to participate.

Data were collected through primary and secondary sources. Primary data were obtained directly from respondents via structured closed-ended questionnaires using a 5-point Likert scale (1 = Strongly Disagree to 5 = Strongly Agree). Secondary data came from official documents, BPS Nganjuk reports, and relevant literature.

Variables were operationally defined as follows. Market orientation (X) was measured using three indicators: customer orientation, competitor orientation, and inter-functional coordination (Narver & Slater, 1990). Product innovation (Z) as the mediating variable was measured using four indicators: product innovation, process innovation, business system innovation, and marketing innovation (Rahmadi & Indrawijaya, 2024). Business performance (Y) was measured using three indicators: sales growth, profit growth, and business growth (Rahayu, 2013).

Data were analyzed using Partial Least Squares Structural Equation Modeling (PLS-SEM) with SmartPLS software (Ghozali, 2017; Hussein, 2015). This method was chosen because it is suitable for models involving mediating variables and a moderate sample size. Model evaluation was conducted in two stages. The first stage (outer model) included indicator reliability (outer loading > 0.70), internal consistency reliability (Cronbach's Alpha and Composite Reliability > 0.70), convergent validity (AVE \geq 0.50), and discriminant validity assessed through cross-loading, Fornell-Larcker criterion, and HTMT (< 0.90). The second stage (inner model) included multicollinearity assessment (VIF < 5), coefficient of determination (R^2), predictive relevance (Q^2), effect size (f^2), and path coefficient testing using bootstrapping (5,000 subsamples) at the 5% significance level (t-statistic > 1.96). Path analysis was used to examine direct effects, indirect effects, and the mediating role of product innovation in the relationship between market orientation and MSME business performance

RESULTS AND DISCUSSION

Result

Description of Research Respondents

Table 1. Description of Respondents' Answers on the Market Orientation Variable

Item	1 (F%)	2 (F%)	3 (F%)	4 (F%)	5 (F%)
Providing better customer experience than competitors	0 (0%)	0 (0%)	2 (2%)	37 (37%)	61 (61%)
Maintaining competitive advantage	0 (0%)	0 (0%)	2 (2%)	42 (42%)	56 (56%)
Effective inter-departmental coordination	0 (0%)	0 (0%)	2 (2%)	37 (37%)	61 (61%)

Source: primary data processed by researchers

The majority of respondents expressed strongly positive views on the market orientation variable. A high percentage (61%) strongly agreed that the company strives to provide better customer experience than competitors. Additionally, 56% strongly agreed that the company maintains a competitive advantage, and 61% strongly agreed that inter-

departmental coordination is effective. Overall, this indicates a strong commitment by the company to customer satisfaction, competitive strategy, and internal coordination.

Table 2. Description of Respondents' Answers on the Product Innovation Variable

Item	1 (F%)	2 (F%)	3 (F%)	4 (F%)	5 (F%)
Creating unique and different products from competitors	0 (0%)	0 (0%)	2 (2%)	23 (23%)	75 (75%)
Regularly updating business processes	0 (0%)	0 (0%)	2 (2%)	25 (25%)	73 (73%)
Continuously improving management systems and workflow	0 (0%)	0 (0%)	2 (2%)	27 (27%)	71 (71%)

Source: primary data processed by researchers

The majority of respondents expressed strongly positive views on product innovation. A high percentage (75%) strongly agreed that the company creates unique and different products, while 73% strongly agreed that business processes are regularly updated for competitiveness. Additionally, 71% strongly agreed that management systems and workflows are continuously improved, and 70% strongly agreed that the latest digital marketing approaches are used. Overall, this shows a very high commitment to innovation across product, process, management, and digital marketing.

Table 3. Description of Respondents' Answers on the Business Performance Variable

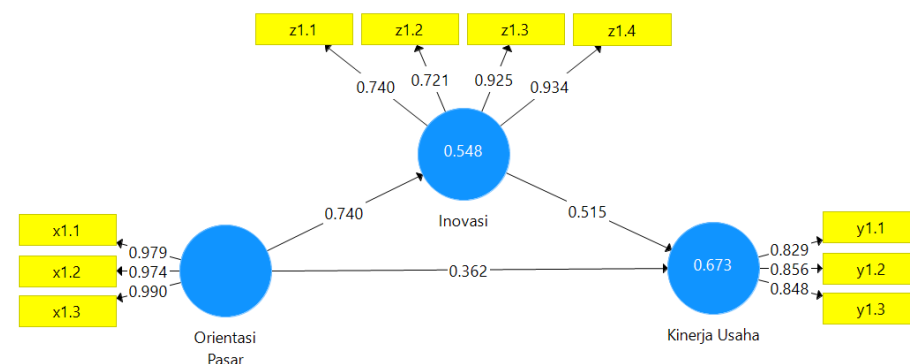
Item	1 (F%)	2 (F%)	3 (F%)	4 (F%)	5 (F%)
Marketing strategies successfully increase product sales volume	0 (0%)	0 (0%)	2 (2%)	27 (27%)	71 (71%)
Profits from product sales increase every year	0 (0%)	0 (0%)	2 (2%)	33 (33%)	65 (65%)
Growth reflects the success of implemented strategies	0 (0%)	0 (0%)	2 (2%)	41 (41%)	57 (57%)

Source: primary data processed by researchers

The majority of respondents expressed strongly positive views on business performance. A high percentage (71%) strongly agreed that marketing strategies successfully increase product sales volume, 65% strongly agreed that profits increase every year, and 57% strongly agreed that business growth reflects the success of the implemented strategies. Overall, this indicates stable and satisfactory business performance.

This study analyzes the structural model using Partial Least Squares Structural Equation Modeling (PLS-SEM) with the help of SmartPLS software. Model evaluation is carried out in two stages: evaluation of the measurement model (outer model) and evaluation of the structural model (inner model).

Figure 2. SEM Analysis Results



Evaluation of The Measurement Model (Outer Model)

Table 4. Outer Loading

	Innovation	Business performance	Market orientation
x1.1			0.979
x1.2			0.974
x1.3			0.990
y1.1		0.829	
y1.2		0.856	
y1.3		0.848	
z1.1	0.740		
z1.2	0.721		
z1.3	0.925		
z1.4	0.934		

Source: primary data processed by researchers

The results of the outer model test show that all indicators have outer loading values above the recommended threshold (0.70). Indicators in the Market Orientation variable show very high loadings (0.974–0.990), followed by Product Innovation (0.721–0.934) and Business Performance (0.829–0.856)..

Table 5. Composite Reliability (CR)

	Composite Reliability
Innovation	0.901
Business performance	0.882
Market orientation	0.987

Source: primary data processed by researchers

Table 6. Cronbach's Alpha

	Cronbach's Alpha	Average Variance Extracted
Innovation	0.853	0.699
Business performance	0.818	0.714
Market orientation	0.981	0.963

Source: primary data processed by researchers

The Composite Reliability (CR) values for the three constructs were above 0.88, while the Cronbach's Alpha ranged from 0.818 to 0.981. Furthermore, the Average Variance Extracted (AVE) values reached 0.699 for Product Innovation, 0.714 for Business Performance, and 0.963 for Market Orientation. These results confirm that the measurement model meets the criteria of convergent validity, discriminant validity, and good reliability.

Evaluation of The Structural Model (Inner Model)

Table 7. R-Square (R²)

	R Square
Innovation	0.548
Business performance	0.673

Source: primary data processed by researchers

The structural model demonstrated adequate explanatory power. The R² value for the Product Innovation variable was 0.548, explaining 54.8% of the variance, while the R² for

Business Performance reached 0.673, or 67.3% of the variance.

Table 8. Q^2 (Stone-Geisser's Q^2)

	SSO	SSE	$Q^2 (=1-SSE/SSO)$
Innovation	300.000	199.120	0.336
Business performance	300.000	152.048	0.493
Market orientation	300.000	300.000	

Source: primary data processed by researchers

The Q^2 (predictive relevance) value shows positive results, namely 0.336 for Product innovation and 0.493 for Business performance, which indicates that the model has good predictive relevance.

Table 9. Effect Size

	Innovation	Business performance	Market orientation
Innovation		0.366	
Business performance			
Market orientation	1.212	0.181	

Source: primary data processed by researchers

The effect size (f^2) analysis shows that the influence of market orientation on product innovation is very large ($f^2 = 1.212$), the influence of product innovation on business performance is large ($f^2 = 0.366$), and the direct influence of market orientation on business performance is moderate ($f^2 = 0.181$).

Hypothesis Testing

Table 10. Result of Hypotesis

	Original Sample (O)	T Statistics (O/STDEV)	P Values
H ₁ Market orientation -> Innovation	0.740	12.451	0.000
H ₂ Innovation -> Business performance	0.515	3.376	0.001
H ₃ Market orientation -> Business performance	0.362	2.289	0.022
H ₄ Market orientation -> Innovation -> Business performance	0.743	15.002	0.000

Source: primary data processed by researchers

All research hypotheses were accepted at the 5% significance level. Market orientation had a positive and significant effect on product innovation ($\beta = 0.740$; $t = 12.451$; $p = 0.000$). Product innovation also had a positive and significant effect on business performance ($\beta = 0.515$; $t = 3.376$; $p = 0.001$). Furthermore, market orientation had a positive and significant direct effect on business performance ($\beta = 0.362$; $t = 2.289$; $p = 0.022$). The mediating effect of product innovation on the relationship between market orientation and business performance was also proven significant ($\beta = 0.743$; $t = 15.002$; $p = 0.000$), indicating a strong mediating role.

Overall, the analysis results support that market orientation is a significant factor driving product innovation, which in turn improves the business performance of MSMEs in Nganjuk Regency. This research model shows good suitability and provides empirical

evidence regarding the mediation mechanism of Product innovation in the context of MSMEs.

Discussion

The results of the structural model (inner model) test indicate that all hypotheses in this study are accepted, with the path coefficient (original sample), t-statistic, and p-value meeting significance criteria. These findings demonstrate a strong and relevant relationship between market orientation, innovation, and business performance.

The Effect of Market Orientation on Innovation

The first hypothesis (H1) proves that market orientation has a significant effect on innovation, with a coefficient value of 0.740, a t-statistic of 12.451, and a p-value of 0.000. This indicates that the higher a business's orientation toward consumer needs, desires, and behavior, the greater the drive to innovate. This finding aligns with the literature stating that companies that are responsive to the market tend to produce product innovation and processes that are more relevant and adaptive to change. (Dalimunthe, 2017; Syukron & Ngatno, 2016) found that a strong market orientation is positively related to the level of innovation. This supports the findings in this study, which show that market orientation significantly influences innovation.

The Effect of Product Innovation on Business Performance

The second hypothesis (H2) shows that innovation has a significant effect on business performance, with a path coefficient of 0.515, a t-statistic of 3.376, and a p-value of 0.001. This indicates that innovation by business actors has a positive impact on improving performance, both in terms of operational efficiency, customer satisfaction, and competitive advantage. Innovation is a crucial catalyst for increasing business competitiveness amidst competitive market dynamics. Innovation is one of the main factors that can increase company competitiveness. Companies that continuously innovate tend to perform better because innovation can meet ever-changing market needs (Kotler et al., 2021). In their research on product innovation, (Jannah et al., 2019; Lorensa & Hidayah, 2022) found that companies that consistently implement product innovation have better business performance. This aligns with the results of this study, which demonstrate the positive influence of product innovation on business performance.

The Effect of Market Orientation on Business Performance

The third hypothesis (H3) reveals that market orientation also has a significant direct effect on business performance, with a coefficient value of 0.362, a t-statistic of 2.289, and a p-value of 0.022. This indicates that market understanding and orientation not only play a role in driving innovation but also directly impact business performance. Businesses that understand consumer needs and market trends tend to be better able to adapt their products or services, resulting in more optimal results. Companies with a strong market orientation can respond more quickly to market changes, thereby improving efficiency and performance. Market orientation helps companies create more relevant products and increase customer loyalty, ultimately improving company performance. (Abbas, 2018; Darmawan et al., 2023) found that a strong market orientation is directly related to better performance, particularly in terms of sales and profits. This research is consistent with the

results found in this study, which shows that market orientation has a significant impact on business performance.

The Influence of Market Orientation on Business Performance through Product Innovation

The results of the fourth hypothesis (H4), which tests the mediating effect of Innovation in the relationship between Market Orientation and Business Performance, show a coefficient value of 0.743, a t-statistic of 15.002, and a p-value of 0.000, which is statistically highly significant. This strengthens the argument that Innovation is a crucial mediator in the influence of Market Orientation on improving Business Performance. In other words, a strong market orientation will encourage innovation, which will ultimately improve overall business performance.

Overall, the results of this study confirm that a market-based business strategy combined with consistent innovation is the key to creating superior and sustainable business performance. These findings provide theoretical and practical contributions to the development of business management models, particularly in the MSME sector and market-based entrepreneurship. Market orientation encourages product innovation, and product innovation, in turn, improves business performance. Product innovations developed based on strong market needs tend to be more accepted by consumers, which increases sales and financial performance. This demonstrates the important role of market orientation in encouraging relevant innovation that impacts business outcomes. (Fitri, 2021; Rachmasari & Suprapti, 2022)) show that a strong market orientation through product innovation can improve business performance. This aligns with the findings of this study, which show that the relationship between market orientation and business performance is mediated by product innovation.

These results support various theories and previous research findings that demonstrate that market orientation plays a key role in driving product innovation and improving business performance. Product innovation has been shown to have a positive and significant impact on business performance, both directly and through the mediating effect of market orientation. Therefore, companies that focus on a strong market orientation, relevant product innovation, and sound business performance management will be better able to compete and thrive in an increasingly competitive market.

CONCLUSION AND SUGGESTION

This study concludes that market orientation plays a critical role in improving the business performance of MSMEs in Nganjuk Regency. MSME actors with strong understanding of customer needs, competitor behavior, and internal coordination tend to create more relevant product innovations. These innovations serve as the primary driver of increased sales, profit, and business growth. Market orientation also exerts a direct positive effect on performance.

Based on the findings, MSME actors in Nganjuk Regency are recommended to continuously enhance market orientation through routine monitoring of consumer preferences and competitor activities, and to allocate resources for consistent product innovation across product, packaging, production processes, and marketing strategies. Local governments and relevant stakeholders are urged to provide training programs, mentoring, and financing access to strengthen MSME market orientation and

innovation capabilities. For future research, it is suggested to adopt a longitudinal design to examine causal relationships over time and to refine measurement instruments

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