Financial Capital and Production Demand for Value-Added Innovations in SMEs

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ARTICLE INFORMATION

ABSTRACT

SMEs have characteristics and an important role in economy. Its independent characteristic makes it must be able to innovate. Innovation that has meaning with added value in innovation. Several influencing factors come from internal and external SMEs. Internal factors are believed to have a fundamental strength for SMEs to innovate. One of them that was used in this research was financial capital. In addition, external factors, also have meaning for innovation. In this research, production from demand was used as variable. This study aims to examine how financial capital and demand of production affect SME innovation. The research was conducted on one hundred SMEs in the Java region of Indonesia. The research was carried out post-pandemic, in first term of 2023. The research was conducted by analyzing the intervariable using the structural equation partial least square model. The research results that financial capital and demand for production influence innovation to create added value for SMEs. Through this research, it is hoped that SMEs will be able to find out that the financial capital factor needs to be strengthened to create innovation. Besides that, production demand also has a role in SMEs seeking innovation by providing added value to their production.

Keywords: Financial Capital, Innovation, Production Demand, SME, Value Added

INTRODUCTION

Innovation is needed to maintain the dynamics of SME businesses. SMEs with added value in innovation have the opportunity to survive longer and can develop their business better. Many factors influence SME innovation. However, the role of financial capital and production demand is a very important factor, considering that these two factors are strengths for MSMEs.

Previously, all sectors were affected by the pandemic covid-19 condition. Apart from the Covid-19 Pandemic, Indonesia had other natural calamities in different parts of the country. Furthermore, the data indicates that Indonesia is among the nation most susceptible to natural calamities (Asrofi, Pratomo, & Pangestuty, 2023). So that the SME condition were unstable and need some activities that support the economy. The dynamics condition was beginning from the time first term in 2023. That more relate for SMEs to rise up and made some innovation from previous condition. They already learned how to survive along the pandemic covid-19 and more creative after that. Innovation needed to support economy.

Previous research addressed competency management in innovative SMEs (Loufrani-Fedida & Aldebert, 2021). The most recent development is integrated studies on SMEs, innovation, and competency management. This promotes the growth of a multidimensional strategy in this area. This method offers a fresh viewpoint for examining competency management in cutting-edge SMEs. There is a need for additional theoretical and methodological improvement because the current literature on this issue still only provides tentative and insufficient explanations. The multilayer strategy results in three important contributions: it helps researchers position research at multiple levels, enables holistic understanding with access to multiple perspectives, and increases research reliability. In addition to inspiring HRM researchers to adopt a multilevel approach in understanding the reality of competency innovation of SMEs, this was the limitations of prior literature. This foundational work lays the groundwork for more pertinent and research in competency of innovation SMEs at any stage.

Previous research also combines two different streams of literature relating to reveal the impacts of strategic and responsive on technological innovation in SMEs. By using an institutional approach and a strategic view on corporate social responsibility, SMEs' attempts to manage diversity and their capacity for innovation may be impacted (Bocquet, Le Bas, Mothe, & Poussing, 2019). Company has to aware about the stakeholder, also for the impact of company activity and company interest of corporate policy (Sukhani & Hanif, 2023). SMEs were crucial to the growth of the economy in developing nations like India. In addition to having a beneficial impact on GDP, SMEs advance the nation's social and economic development by generating jobs that raise educational attainment and, eventually, the caliber of human capital (Kumar, Sureka, & Colombage, 2020).

According to research findings, financial capital is favorably and strongly connected with some success SMEs (Widnyana, Wijaya, & Almuntasir, 2021). Whether financial capital increases or shrinks will affect how well SMEs perform. The relationship is also moderated by financial constraints. Financial limitations act as a brake on the relationship, making it weaker as SMEs are subjected to greater restrictions. The foundation of is based on a thought that points to fathom social issues such as business, destitution, which utilizes the potential had by the town, so that's built up has it possess uniqueness as an exertion to make strides welfare for the community (Laksono, Handayati, & Winarno, 2023).

Another study noted a strong positive relationship of financial capital to performance of small and medium-sized businesses. This was the result hypothesis, which contends that investing in human capital boosts productivity. The resource of theory of social capital suggests that a firm's success depends on external networks. There is a suggestion to use debt before external equity in the view of Modigliani and Miller, as well as Myers. SMEs' growth is limited by reliance on internal finance, so way to external source of fund debt financing can improve performance (Bocquet, Le Bas, Mothe, & Poussing, 2019). Government policies and regulations, which are linked to the financial system, are influenced by the government system. It also has an impact on the advancement of financial technology and operational procedures. Furthermore, the education system is determined by the government system, which also affects the advancement of the caliber of human resources. Information and technology are vital to human needs, economic expansion, and financing, and as such, they play a significant role in all aspects of human existence, including finance and the development of human resources (Priyanto, Sulisnaningrum, & Murniati, 2023).

This article analyzes the indirect effect of financial capital on firm performance through the concept of competitive advantage. The results show that financial capital have a positive influence toward competitive advantage and firm performance. In addition, it was revealed that financial capital had a positive and significant indirect effect on firm performance through competitive advantage. The results of this study are in line with previous studies stating that financial capital contribute significantly to Competitive Advantage and firm performance (Khattak & Shah, 2020).

Other study examined to analyze the influence of financial capital on the sustainability of SMEs. In addition, it also examines the interceding part of strategic variables. The results of research prove financial capital can increase the performance of sustainability in SME businesses. The effect of significance of the capital factor in maintaining the sustainability of SME businesses, and presently SMEs are passing a serious trouble of ruin due to the epidemic situation, nonstop improvements are demanded so that SMEs can pierce fresh finances, similar as soft loans, fintech or indeed rotating entitlement finances that allow SME actors to maintain their actuality (Pardiman, Susyanti, Heriyawati, Zakaria, & Masyhuri, 2022).

Another factor analyzed were demand of production. Production is a process of changing the combination of various inputs into outputs (Pracoyo & Pracoyo, 2006). Production can be defined as the efforts to create wealth by processing natural resources with four production factors owned, that were natural factors, capital, labor, system of management (Djazuli & Janwari, 2002). Thus, made the demand of production is fully supported the innovation especially for value added innovation.

LITERATURE REVIEW

Financial Capital

Fiscal capital is defined as the capability to acquire fiscal coffers to make, and maintain real capital, which enables enterprises to play a productive part in the frugality (Fama & Miller, 1972). Finance, money, and financial resources that belong to a company are referred to as financial capital. Financial capital is a major factor in the launch of a new company since during this phase, businesses encounter a number of unforeseen shocks, and finance can support them in these situations (Khan, Safdar, & Khan, 2019).

The important part of capital on the performance of SMEs has been extensively studied in colorful countries. Capital is appreciatively related to the performance of SMEs, where a capital increase will encourage better SME performance, and vice versa (Umar, Omar, Hamzah, & Hashim, 2018).

Previous study explored the relationship of structural capital, product and process invention, and organizational performance (Beltramino, García-Perez-de-Lema, & Valdez-Juárez, 2020). The exploration findings show that utmost structural capital factors have a positive effect to invention capabilities in SMEs. still, the factors of communication and cohesion didn't show a significant impact. A positive relationship was seen of invention in performance, while the same relationship with product invention couldn't be proven. Impalpable capital similar as firm has a positive and significant impact on process invention, but communication and group cohesion have no impact on product or process invention. Another important finding was innovation affects performance, in accordance with previous findings (Leitner, 2014).

SMEs Production
Production is the activity of processing raw materials into semi-finished materials and processing semi-finished materials into finished materials which aims to optimize production factors so that product output can facilitate the fulfillment of human needs (Utami, 2020).

The results of this study successfully linked, anatomized, and organized exploration around environmental operation in SMEs with the end of guiding unborn exploration and operation practices (Machado, Vivaldini, & de Oliveira, 2020). A descriptive analysis of the 68 papers collected in this literature study has been presented in detail, italicizing the applicability of this content in the scientific community. The counteraccusations for product and force chain in the development of environmental operation measures and practices in SMEs earn further attention in unborn exploration. This literature study confirms that both product and SC have a significant impact on environmental operation in SMEs.

Product in process is a process of changing the combination of various inputs into outputs, and is not only limited to the manufacturing process but also storage, distribution, transportation, repackaging and marketing that applies to goods and services (Pracoyo & Pracoyo, 2006). Production can be resulted of efforts to create wealth by utilizing resources, not except capital (Djazuli & Janwari, 2002).

SMEs Innovation
Small and medium sized enterprises are acknowledged as a driving force behind sustainable economic growth in both developed and developing nations. They are also seen as a vital sector for social inclusion and as a tool for addressing several development issues, particularly in developing nations: issues of poverty, inequality, and unemployment, especially for women and young people; limited industrial capacity; a lack of innovation in the economy; slow growth in rural economies; and a limited number of primary product items in the export basket in developing nations (Prasanna, 2019).

According to the opinion of Hills, Hultman, and Miles (2008), where invention is an idea, implement that's considered new by someone or new according to other stoner units (Dahmiri, Bhayangkari, & Khalik, 2021). Another exploration, delved the relationship between external and commercial invention in SMEs in Asia and Europe by evaluating the impact of external finance and invention. This impact is advanced for product invention (7-10) and process invention (3-4) in youthful enterprises than product invention (3-5) and process invention (2-3) in more mature enterprises (Wellalage & Fernandez, 2019).

Here the hypotheses for this research:
H1: Financial capital has positive effect towards innovation.
H2: Production demand has positive effect towards innovation.

RESEARCH METHOD

This research uses a survey method with a questionnaire. Questionnaires were distributed to as many as one hundred respondents, namely SME owners. The variables used are financial capital, production demand, and added innovation's value. The analysis was carried out using a partial least square model of structural equation model.

RESULTS

The research was carried out by distributing questionnaires to one hundred SMEs. Process data is carried out for analysis. With descriptive analysis and statistical analysis. The data presented as results, unfold as follows.

Figure 1. Age Profile
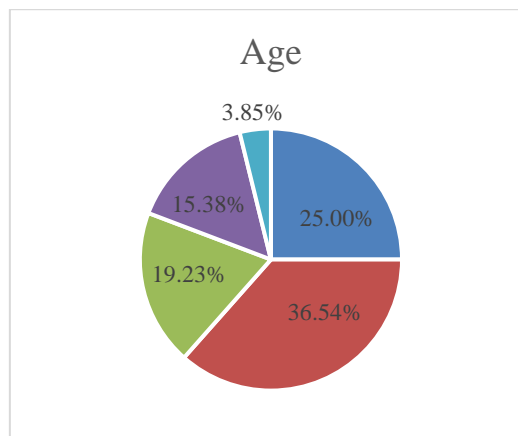
Blue   : 25,00%, age < 30 years
Red   : 36,54%, age 30 - 40 year
Green : 19,23%, age 41 - 50 year
Purple : 15, 38%, age 51 - 60 year
Tosca : 3,85%, age > 60 years

Entrepreneurs are predominantly in the age range of 30-40 years, comprising 36.54% of the total, while the smallest proportion is found among those above 60 years old, which is 3.85%. The age ranges below 30, and 41-50, also 51-60 years, percentage for 25%, 19.23%, and 15.38%.
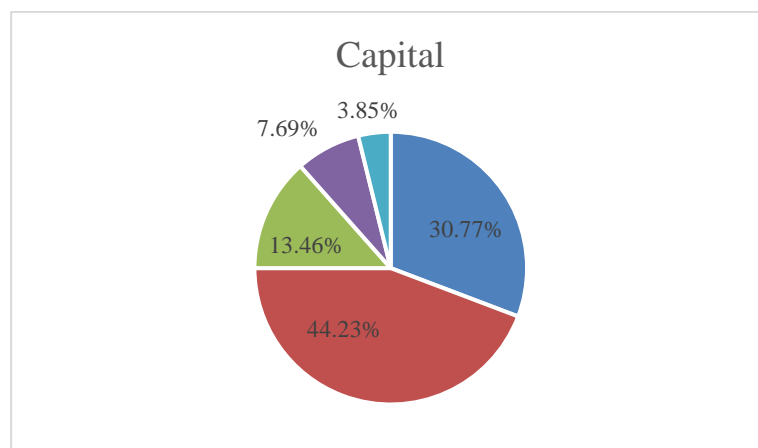
Figure 2. Gender Profile
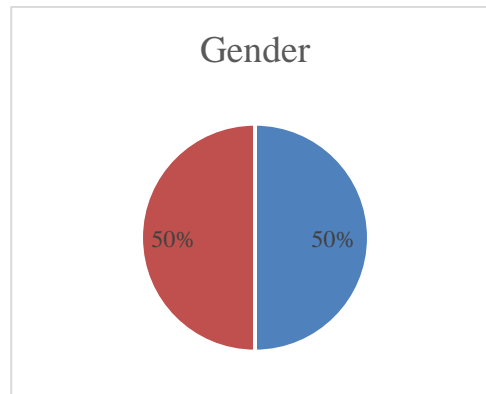
Blue : female, 50%
Red : male, 50%

The gender distribution among entrepreneurs is balanced, with an equal percentage of 50% for both women and men.

Figure 3. **Capital Profile**

Blue : 30,77%, IDR < 50m
Red : 44,23%, IDR 5 - 10m
Green : 13,46%, IDR 11 - 20m
Purple : 15, 38%, IDR 21 - 50m
Tosca : 3,85%, IDR > 50m

Entrepreneurial capital is primarily concentrated in the range of 5 to 10 million, comprising 44.23% of the total, while the smallest proportion is observed among those with business capital exceeding 50 million, accounting for 3.85%. The capital ranges below 5 million, 11 to 20 million, and 21 to 50 million, follow with percentages of 30.77%, 13.46%, and 7.69% respectively.

Figure 4. Education Profile
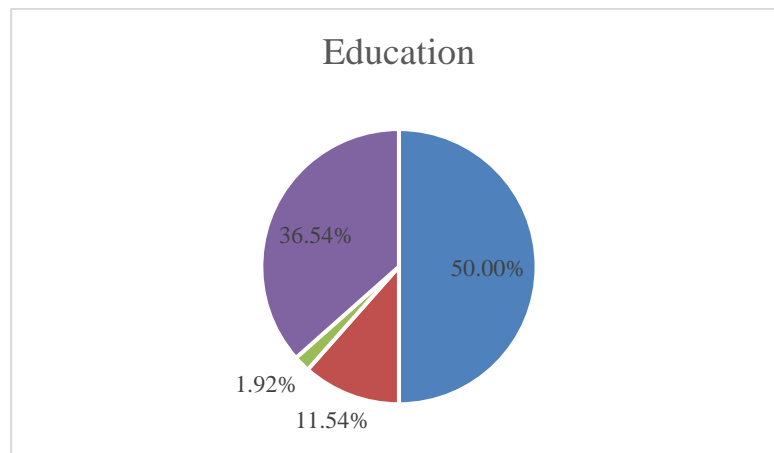
Blue   : 50,00%, Senior High School
Red   : 11,54%, Junior High School
Green : 1,92%, Elementary School
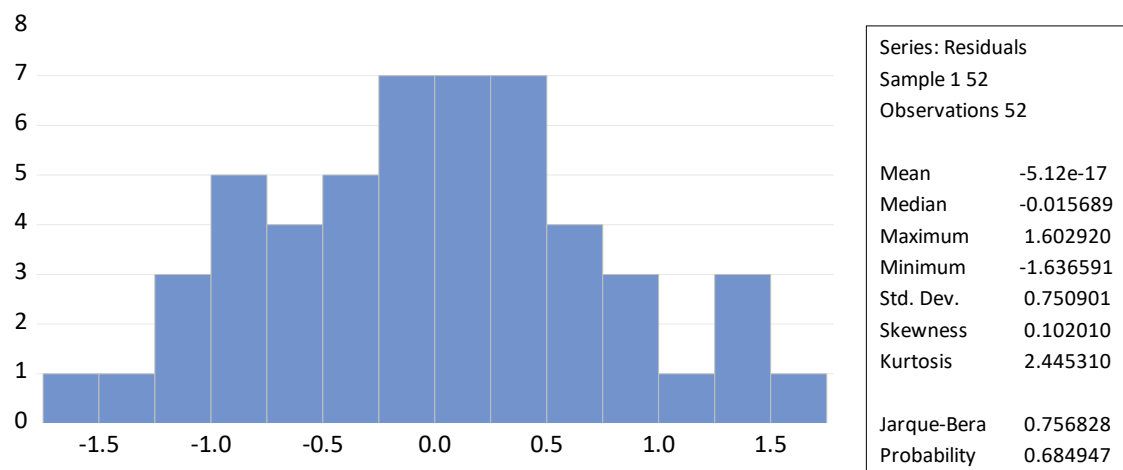Purple : 36,54%, University

The educational background of the entrepreneurs is predominantly from high school, accounting for 50%, while the lowest proportion comes from elementary school, which is 1.92%. For those with a university degree and junior high school, their percentages are 36.54% and 11.54%, respectively.

Here was the result for the statistic's analysis.

Classical Assumption

Figure 5. Normality Test

Series: Residuals	
Sample 1 52	
Observations 52	
Mean	-5.12e-17
Median	-0.015689
Maximum	1.602920
Minimum	-1.636591
Std. Dev.	0.750901
Skewness	0.102010
Kurtosis	2.445310
Jarque-Bera	0.756828
Probability	0.684947

The result of the Kolmogorov-Smirnov normality test indicates that the p-value is 0.684947, which was mean greater than the level of significance of 0.05. This suggests that the data follows a normal distribution.

Table 1. Multicollinearity Test

Variance Inflation Factors
Date: 08/20/23   Time: 09:24
Sample: 1 52
Included observations: 52

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.394989	34.28416	NA
X1	0.011833	15.64350	1.051409
X2	0.012576	17.80143	1.001169
CONTROL	0.000126	1.785217	1.051921

The results of the multicollinearity test indicate that the Variance Inflation Factor (VIF) values for variable X1 are 1.051409, for X2 are 1.001169, and for the Control variable are 1.051921. All three values are below 10, leading to the conclusion that there is no presence of multicollinearity.

Table 2. Heteroscedasticity Test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.681185	0.356111	1.912845	0.0617
X1	-0.024132	0.061637	-0.391509	0.6972
X2	0.020728	0.063543	0.326195	0.7457
CONTROL	-0.007789	0.006361	-1.224455	0.2268

The results of the heteroskedasticity test using the Glejser test indicate that the probability values for variable X1 is 0.6972 (> 0.05), for variable X2 is 0.7457 (> 0.05), and for the control variable is 0.2268 (> 0.05). This implies the absence of heteroskedasticity.

Table 3. Autocorrelation Test

Breusch-Godfrey Serial Correlation LM Test:
Null hypothesis: No serial correlation at up to 2 lags

F-statistic	0.694688	Prob. F (2,46)	0.5044
Obs*R-squared	1.524551	Prob. Chi-Square (2)	0.4666

The results of the Breusch-Godfrey Serial Correlation LM Test indicate that the Probability value of the Chi-Square (2) statistic is 0.4666, which is greater than the significance level of 0.05. This suggests that there is no issue of autocorrelation.

Multiple Linear Regression Equation

Below is the linear equation of the ordinary least squares regression:

$$Y = 2.03330370309 + 0.267032551952*X1 + 0.137845623102*X2 + 0.0112961130806*CONTROL$$

The intercept value is 2.0333, implying that in the absence of the variables X1, X2, and the control variable, Y would undergo an increment of 2.0333 units. The coefficient for X1 is 0.2670, signifying that while keeping other variables constant, a 1% increase in the X1 variable would result in a Y increase of 26.70%. The coefficient for X2 is 0.1378, indicating that in a scenario where all other variables are held steady, a 1% elevation in the X2 variable would lead to a Y rise of 13.78%. The coefficient for the control variable is 0.0113, suggesting that assuming the constancy of other variables, a 1% elevation in the control variable would correspond to a Y increase of 1.13%.

Hypotheses Test

Table 4. Partial Effect (with Control)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.033304	0.628481	3.235265	0.0022
X1	0.267033	0.108781	2.454779	0.0178
X2	0.137846	0.112144	1.229182	0.2250
CONTROL	0.011296	0.011226	1.006225	0.3194

The t-test examines the partial influence of X1, X2, and the control variable on Y. Based on this examination, it is revealed that the p-value of X1 is 0.0178 (< 0.05) which exerts a positive and significant impact on Y. Conversely, the p-value of X2 and the control variable are 0.2250 (> 0 .05) and 0.3194 (> 0.05) respectively, which mean that X2 and the control variable do not hold significant influence over Y with positive coefficients.

Table 5. Partial Effect (without Control)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.228416	0.597897	3.727092	0.0005
X1	0.242937	0.106126	2.289142	0.0264
X2	0.134837	0.112119	1.202627	0.2349

After excluding the control variable from the regression analysis, the results indicate that X1 continues to have a significant and positive influence on Y (p-value is 0.0264, smaller than 0.05). However, its coefficient has changed from 0.2670 to 0.2429, representing a reduction of 0.0241 compared to the coefficient when the control variable was included. As for X2, it remains insignificant with a positive coefficient (p-value is 0.2349, larger than 0.05). The coefficient of X2 has changed from 0.1378 to 0.1348 after the control variable was removed, indicating a decrease of 0.003.

Table 6. Goodness-of-Fit (with Control)

R-squared	0.140116
Adjusted R-squared	0.086374
S.E. of regression	0.774011
Sum squared resid	28.75650
Log likelihood	-58.38292
F-statistic	2.607167
Prob(F-statistic)	0.062372

The adjusted R-squared value from the regression results with the control variable is 0.086374, equivalent to 8.63%. This value indicates that the variables X1, X2, and the control variable collectively account for 8.63% of the variance in variable Y, while the remaining variance is explained by other variables not included in the study. The value of the prob(F-statistic) is 0.0624, which is less than 0.05. This implies that the variables X1, X2, and the control variable, when considered simultaneously, do not have a statistically significant impact on Y.

Table 7. Goodness-of-Fit (without Control)

R-squared	0.121978
Adjusted R-squared	0.086141
S.E. of regression	0.774110
Sum squared residual	29.36307
Log likelihood	-58.92565
F-statistic	3.403639
Prob(F-statistic)	0.041293

Upon removing the control variable from the regression analysis, the adjusted R-squared value becomes 0.086141. This value is slightly higher compared to the adjusted R-squared value when the control variable was included, with an increase of only 0.000233. Furthermore, the prob(F-statistic) value without the control variable decreases to 0.041293 (< 0.05). This suggests that after excluding the control variable, the regression model demonstrates a simultaneous influence of variables X1 and X2 on Y.

DISCUSSION

SMEs play a major role in driving economic growth and jobs. Therefore, by examining whether and to what degree the recent financial crisis has affected SMEs' capital structure and its drivers, this paper seeks to add to the body of literature. Due to the utilization of outside resources, SMEs are more interested in handling asymmetry information problems than in weighing the advantages and disadvantages of debt (D'Amato, 2020). As the catalyst for economic expansion, SMEs are vital to the nation's economy, according to World Bank reports from 2008. They are crucial for establishing efficient and competitive marketplaces as well as for reducing poverty (Widnyana, Wijaya, & Almuntasir, 2021).

The research results indicate that financial capital has a positive effect for innovation. Innovation requires support to be implemented into products. With financial strength, innovation can be carried out. Innovation requires funds because innovation requires something new to be designed, and requires the support of both new technology and equipment that the company does not yet have. Innovation in added value requires its own way of production, unlike what SMEs usually do. Therefore, the support of financial capital will have a positive influence on value-added innovation. Financial capital positively increases the sustainability of SME businesses in Indonesia. A high or low in financial capital will have an impact on increasing or decreasing the performance of SMEs. Financial capital has a positive relationship with performance of SMEs (Widnyana, Wijaya, & Almuntasir, 2021; Beltramino, García-Perez-de-Lema, & Valdez-Juárez, 2020; Khattak & Shah, 2020; Bocquet, Le Bas, Mothe, & Poussing, 2019).

Apart from innovation support, another thing that needs to be considered is support from production demand. Production is a process of changing the combination of various inputs into outputs, and is not only limited to the manufacturing process but also storage, distribution, transportation, repackaging and marketing that applies to goods and services (Pracoyo & Pracoyo, 2006). Production without demand will make added value unattractive to consumers. By carrying out market research first, value-added innovation will provide the full benefits that society and consumers need. Therefore, market demand will make value-added innovation in SMEs very important. This is what SMEs need to pay attention to when carrying out value-added innovation, where innovation is not just making a product, but value-added innovation.

CONCLUSION

The conclusion from this research is that many factors can influence how SMEs will innovate. Especially in value-added innovation, the factors in the research, financial capital and production demand, are very important. These two factors have been tested statistically and state that there is quite a large influence on SME innovation. Therefore, it is hoped that it will be taken into account by SMEs.

LIMITATION
Research limitations lie in the selection of factors used and are specific to value-added innovation. Apart from that, regional coverage is still relatively narrow. It is hoped that further research can expand the research area.

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DECLARATION OF CONFLICTING INTERESTS
There is no interest in this research, other than for research and publication of research results.

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