

## MEASURING FINANCIAL PERFORMANCE THROUGH MANAGERIAL CAPABILITIES AND STRATEGIC INNOVATION IN THE ERA OF DIGITAL TECHNOLOGY

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Received: 14 November 2022; Revised: 16 January 2023; Published: 29 May 2023

### ABSTRACT

*The stretching of Indonesia's economic growth after Covid 19 shows conditions that are increasing, this can be seen from the business activities that have started to be carried out for people in villages and urban areas. This opportunity for the people of Rejoso village, Nganjuk Regency, is an opportunity that is very exploited so that traded products are able to penetrate big cities in East Java. The purpose of this study is to analyze the ability of businesses to create financial performance and to analyze the factors that influence the achievement of financial performance. This type of research is a quantitative research using primary data for the July 2022 period and distributing questionnaires to 110 MSMEs. The data source is from the Nganjuk Regency Cooperative and MSME Office. The analysis of this study uses the financial performance index and SEM PLS. The results show that managerial ability and innovation in achieving good financial performance have been achieved with an index of 96.91. These results are in line with the test results where the statistical T values and P values are in areas that are significant.*

**Key Words:** *Financial Performance, Managerial Capabilities, Strategic Innovation*

### INTRODUCTION

The Micro, Small and Medium Enterprises (MSMEs) sector is a business sector that is the backbone of national economic progress after the crisis that hit Indonesia as a result of Covid 19. MSMEs are part of the Indonesian economy that has independent insight and great potential in improving people's welfare. Therefore, the government is currently numbering the role of MSMEs in improving the condition of the national economy, which was slumped at minus in 2021.

Business capabilities in Indonesia are almost largely controlled by the MSME sector, this is in line with the statement of the 1945 Constitution article 33 paragraph 4 which reveals that the Indonesian national economy should have an independent perspective and have great potential in improving people's welfare. Given that the existence of MSMEs is able to absorb a lot of labor, prioritize their activities in rural areas by utilizing agricultural products, and are traditional. Independence in fund management and togetherness in an effort to create an innovative product is what makes MSMEs able to increase Indonesia's economic growth for the better.

To become a business actor who is able to generate income, MSMEs must innovate both in the stage of raw material processing, product packaging, to the product marketing stage. The involvement of technology must be included in it, so that the whole process can be carried out easily, quickly and achieve the desired expectations in a short time.

The change in the production process has brought a significant influence to MSMEs, in addition to being able to provide quality production results, it also gives certain characteristics to the regions that produce it. This difference is the main goal of local governments in an effort to improve the economy of their people while raising the standard of living of their regions.

Nganjuk Regency has 118,000 assisted MSMEs that have Home Industrial Food Production (PIRT), Business Identification Numbers (NIB), and permits for 20,000 people. Through the Office of Cooperatives and MSMEs (Diskopum), MSME businesses have been able to trade their products through Alfamart and Indomaret outlets in the Nganjuk area. So that future developments with the strategic innovations he has always carried out are expected to be able to penetrate foreign countries.

The increase in units produced and the increasing sales of micro-enterprises run by rural communities are desirable expectations when these businesses begin to run. To measure this success, research conducted by Khaira dan Jallaluddin (2021), Nurjanah et al. (2021), used an analysis of the financial ratio to income, costs and turnover of assets used during the business.

The role of technology is very important for the smooth running of micro-enterprises today. Considering that with technology, especially digital, all activities that will be carried out will become more practical and faster as well as being a tool for controlling the course of business. The development of this technology changed the business model that was originally done manually and took a long time, becoming faster and saving costs. This happens when the batik design that was originally drawn manually, currently the design can be done computerized with an attractive color display. This change is the result of strategic innovation that is always carried out by a micro-enterprise. To be able to find out this success, measurements are carried out using several financial ratios. These measurements have been carried out in Suhaeni (2018).

Managerial ability and entrepreneurial spirit are two things that are very decisive in achieving the financial performance of an MSME. For research conducted by Komaludin and Nisa (2017), these two things do not have an influence on the performance of MSMEs. This opinion is very different in the research of Muttaqien et al (2019) that these two factors are very influential in achieving financial performance added again by the existence of business strategy factors.

The performance measurement used in several previous studies used several ratios, but in this study used an index in performance assessment (Financial Performance Index / FPI) which was measured by managerial ability and innovation of its products. This assessment has been carried out previously in Korean SMEs from 1999 to 2004 (Sohn et al., 2007). From the results of his research, it was found that to advance a small business, the ability and experience of a business owner are the determining and most important factors.

## **THEORITICAL BASIS and HIPHOTESIS**

### **Micro, Small and Medium Enterprises (MSMEs)**

The definition of micro, small and medium enterprises according to Azis and Samad (2016) in Setiawardani (2021), that "SMEs are business struggling with various barriers to improve their business units through innovative tasks such as lack of internal funds and labor

skills". Meanwhile, in Indonesia, MSMEs have been regulated in Law number 20 of 2008 which contains that MSMEs are grouped based on the value of assets owned and the turnover they obtain.

### **Financial Performances**

As one of the measuring tools for the success of a business for small and independent businesses is the achievement of sales and production that occurs during one period. This achievement for a business that is managed individually may require a process that must be managed professionally. The managerial ability of the business owner is very much needed, because by using these abilities the business he has can be managed and controlled properly. Through the measurement of the Financial Performance Index (FPI), this study measures the managerial ability of business owners, the use of technology, marketing capabilities, and the ability of the external environment to respond to the sale of these products and other financial meters (Sohn, et al, 2007).

### **Strategy Innovation**

The step to get an increase from the sale of a product is one of the results of innovation made for a business. Rosli and Sidek (2013) in Suhaeni (2018) revealed that innovation is the creation of ideas, the expansion of a novelty, the introduction of new products and services to the community. The ways that will be done in achieving the realization of these innovations are through strategy.

The ability to develop a business in a more advanced direction by involving aspects of digital technology is very important today. The modernity of the process demanded today is not only guided by the ability to manage production into more attractive products, but also considers packaging techniques and delivery to customers in a short time. This is what makes companies often make various changes and even have to create new business models so that their business can be accepted by the public at large, even penetrate foreign countries (Chan et al., 2008).

Business activities carried out for small businesses with limited assets owned, require various strategic innovations to be able to survive in conditions of uncertainty due to the pandemic. Innovations that are carried out with the right strategy are not only related to product quality but also the right shape, packaging, price and marketing steps to suit the wishes of buyers. In a certain period of time the innovations carried out will provide results in the form of an increase in sales which will later produce new products with different variants and an increase in assets for the business. To measure success in implementing innovation with the right strategy, it is necessary to measure using financial and non-financial analysis.

Strategies related to business innovation carried out in a micro, small and medium enterprise are things that must often be done, for the purpose that the products produced can be accepted both in quality and price. Innovation is not only based on the ability to produce a product that is acceptable to buyers, but also must consider the purchasing power of the public or buyers to the price of the product itself. For this reason, in determining the selling price, the

manager of a small and medium-sized business must consider its financial capabilities (Mustikowati and Tysari, 2014).

### **Managerial Skills**

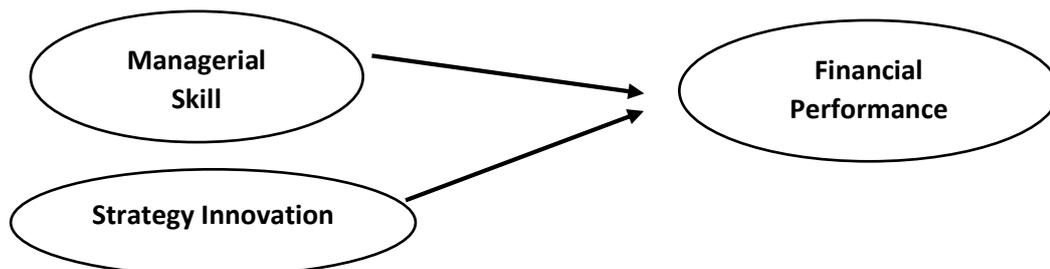
The success of a business achieved in a business is certainly influenced by the steps taken by the business owner in realizing his desire so that the products produced can be accepted in a business environment. This ability is not only related to managing products, managing emerging information, and determining policies related to business operationalization. According to Isnugrahadi & Kusuma in Abdillah et. all. (2019) that a manager who is able to manage his business well if the manager has expertise in managing his business operations well, has the ability to face the presence of competitors around him, and high intelligence.

Business success for small businesses is not only determined by the managerial ability of the business owner, but also determined by his ability to manage his human resources (Tangkilisan in Komaludin and Wahid, 2017). For companies that are inherited from parents, this ability is not very necessary because of its hereditary nature. As for a jointly formed business consisting of several people, the ability to manage human existence as a labor force is very important. Interest in labor regulation in a business venture will affect the level of productivity and the level of sales to be achieved in the business.

The ability to manage business operations and the ability to place human resources in a business are the most important parts of a business. This was revealed by Yuyun Wirasasmita and Suryana in Sembiring (2016). These abilities require further development processes through various forms of training, workshops and even education through various case studies in order to get a broader discourse.

### **Conceptual Framework**

Analysis of non-financial measurements is assessed based on managerial ability and business experience, the use of technology in its business and the role of technology in advancing its business. Meanwhile, financial measurement uses several questions related to the achievement of expected sales targets, the achievement of expected profits, the achievement of sales growth, all of which are related to the ability of the business being carried out (Sohn et. al., 2007). The relationship between the company's strategic innovation and the performance capabilities of MSMEs will be presented through the following frame of mind.



To find out the role of Strategy Innovation in the development of micro, small and medium enterprises in Rejoso district, the hypothesis in measuring the performance of this small business business is:

H1: The managerial skill of MSME players has a positive effect on Financial Performance.

H2: Strategic innovations related to the expansion of the resulting business have a positive effect on Financial Performance.

H3: Positive influence between Managerial Ability and Strategy Innovation on Financial Performance.

**Table 1. Operational Definition and Variable Mesuring Tool**

Variable	Dimention	Indicator	Scala
<b>Variable Exogen</b> Managerial Skill	Managerial Skill (KM)	The operational capability of MSMEs starting from the transaction of providing raw materials, the production process to the payment of salaries.	Ordinal
	Additional used Technology (Tech 1)	The ability of technology users starting from product design to packaging	Ordinal
	Digital Marketing (Tech 2)	Utilization of business opportunities related to digital marketing	Ordinal
Inovasi Strategi	Eksplorasi Product (IS 1)	The ability to process products directly	Ordinal
	Eksplotasi Product (IS 2)	The ability to develop products with the latest innovations	Ordinal
<b>Variable Endogenous</b> Financial Performance	Financial Performance 1 (FP 1)	The ability to achieve sales targets	Nominal & Rasio
	Financial Performance 2 (FP 2)	The ability to achieve sales growth	Nominal & Rasio

Source : Sohn et. al. (2007)

## METHODOLOGY

### Population and Sample

The study uses a population sample is all MSME actors in active conditions and business in rejos district, Nganjuk regency, East Java for the last five years, namely since 2017. As for the sampling, it is carried out using the Slovin formula  $n = N / (1 + Ne^2)$ . The Slovin formula is used with the intention that all types of businesses in the Rejoso district are represented as samples.

## Data

This study uses information in the form of data obtained from MSMEs in Rejoso village, Nganjuk Regency in August 2022. The data were obtained through interviews conducted several times. Based on the results of the interview, questions related to the research theme were then compiled. These questions are then sent to MSMEs in the form of a google form that is sent via e-mail and social media. The measurement scale used in this study is in the form of an ordinal scale with a range of values of 1 to 5. Specifically related to financial information using a nominal scale.

## Analytical Data

This research in data analysis uses two ways, first using SEM-PLS version 5.0 inferential statistical analysis and financial performance index analysis. The analysis tool for SEM-PLS has two models, namely Measurement Model (outer model) and Structural Model (inner model). Outer model is a measurement of the validity and reliability of the model built in this study, including Convergen Validity, AVE, Validity Discriminant and Reliability. Meanwhile, the inner model measurement was measured through the R-square value for the dependent construct, the Q-square test which describes the structural relevance match of the model, the T test and P-value to measure how much the model fits in this study.

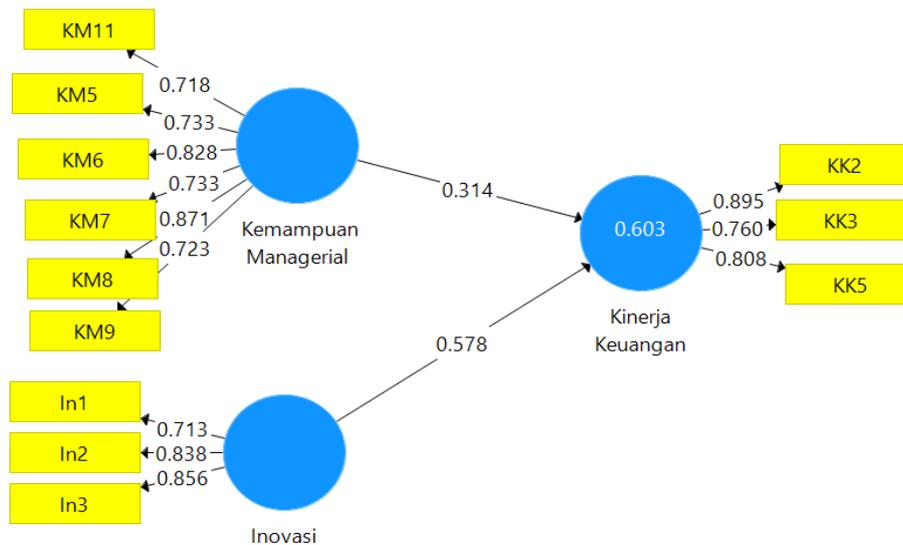
The second test, namely the analysis of the financial performance index, is calculated using a nominal and ratio scale. Based on these results, index calculations are carried out using the weighted average method, the following formulation. (Sohn, et al, 2007)

$$\frac{\text{Total Wiegth}}{\text{Total Elements}} = \text{Weighted average value}$$

To get the index value with the formula:

$$\frac{\text{Total of perceptual values per element}}{\text{Total elements filled}} \times \text{Basic Weigher Value} = \text{Financial Performance Indicator (FPI)}$$

Furthermore, the results of the Financial Performance Index are grouped into an assessment of quality standards used by the government according to MenpanRB regulation No. 14 of 2017 which is classified into 4 ratings, namely Not Good, Not Good, Good and Very Good.



Pictures 2 : Outer Model results

## RESULTS

### Responden Demography

The population of this study is MSMEs in Rejoso district, Nganjuk regency, as many as 110 business units. Based on this number, the types of businesses carried out include food, beverages, batik fabrics, woven fabrics, accessories made from cowhide and goat skin. The respondents who returned answers were 58 business units, while the rest did not give answers as many as 28 business units. The largest business actors are carried out by women 88.70% and men 11.30% with an age range of more than 35 years as much as 64.50%, 33.90% aged 25-35 years, while the rest are aged 20-25 years. The last education was the most highest school graduates 37.10% followed by higher education graduates at 32.30%, the remaining 17.70% were SMK graduates and finally elementary / junior high school graduates were 12.90%. Business ownership is dominated by people as much as 56.50%, which is managed in a familial manner as much as 58.10% with a business form in the form of food as much as 69.40%. MSMEs have generally run their business for 2-5 years as much as 53.20%, 5-10 years as much as 22.60, while those more than 10 years.

### Financial Performance

Financial performance measurement calculated using the Financial Performance Indicator (FPI) approach uses two indicators (Sochn et. al 2005), namely sales achievement and sales growth achievement. The ability to achieve performance for Rejoso MSMEs so far can only be calculated through the amount of income and the amount of expenditure, without using economic terms which of course require their own ability to understand them. Based on the calculation results of the Financial Performance index, the number 96.9175 is achieved, which illustrates a very good predicate.

**The Accuracy and Reliability of Research Instruments**

**The Outer Model**

Further data analysis uses SEM-PLS whose measurement is preceded by measurement model testing. In this measurement, there are three criteria that must be met, including the Convergen Validity, Validity Discriminant and Composite Reliability tests to obtain an outer loading value that exceeds 0.70 (Sofyani, 2016). Convergen Validity aims to determine the validity of the relationship of indicators with latent variables, which is measured through loading values  $\geq 0.50$ .

In discriminant validity tests that are estimated to be able to predict values more precisely, the measurement is based on Cross Loading on each construct variable. The result includes the discriminant validity value of the largest cross loading compared to other cross loading.

Composite Reliability testing is assessed based on square root of EVE values by comparing AVE root values with correlations between constructs. If the AVE value is higher than the correlation value between constructs, then the discriminant validity is rated successful or the AVE value exceeds 0.50.

**Table 2 : Reliability and Validity Test**

	Cronbach Alpha	Rho_A	Compositer Reliability	AVE	R <sup>2</sup>
<b>Managerial Skill</b>	0,861	0,870	0,897	0,592	--
<b>Strategy Innovation</b>	0,736	0,787	0,846	0,648	--
<b>Financial Performance</b>	0,761	0,773	0,862	0,677	0,603

Source : SEM PLS results

The results of the outer loading test of table 2 above for each variable have a number exceeding 0.50, it can be interpreted that all variables have met the requirements of convergent validity, discriminant validity, and composite reliability. So that these results show that in the initial stage of testing, the indicators and variables used are considered valid. Furthermore, inner model / structural model testing can be carried out.

**The Inner Model**

Inner model is a test that aims to measure the strength of correlation between exogenous variables to endogenous variables, called structural model testing. The results can be known from the R-square values for the dependent constructs (Good, moderate, and weak), the t-test as well as the significance test of the structural path parameter coefficient. The inner model can also be used to test hypotheses where the t-statistical value of  $\geq 1,960$  has a significant influence between variables. While the F-square the larger the number, the greater the influence between variables. For Q-square values close to 1 illustrate that the model can be used to predict future values (Syarifah, Mawardi, & Iqbal, 2020).

The R-square value in Financial Performance shown in table 3 obtained the number 0.603 explains that 60.30% of variable Y (Financial Performance) can be influenced by variables X1 (Managerial Ability) and X2 (Strategy Innovation). While the rest is influenced by other factors outside the study.

### Hypothesis Results

In this section, the measurement is carried out through bootstrapping calculations, with the aim of minimizing the problem of data abnormalities.

**Table 3: Path Coefficient**

Variabel	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics ( $\frac{O}{STDEV}$ )	P Values	Q Square
X1 → Y	0,314	0,316	0,090	3,483	0,001	--
X2 → Y	0,578	0,584	0,103	5,628	0,000	--
Financial Performance	---	---	---	---	---	0,367

Source: SEM PLS results

The measurement results above illustrate that the variables X1 (Managerial Ability) and X2 (Strategy Innovation) provide a directional and positive picture in shaping Y (Financial Performance). This can be seen from the numbers contained in the Original Sample where the numbers are above zero.

In testing the hypothesis between X1 (Managerial Ability) to Y (Financial Performance) can be seen from the t-statistical results which show the number 3.483 and P values 0.001 which illustrate the relationship of these variables is significant because the number  $> 1.96$  and  $< 0.05$  so it can be interpreted that H0 is rejected and H1 is accepted. For the hypothesis X2 (Strategy Innovation) against Y (Financial Performance) obtained the number 5.628 and P values 0.000 describe a significant relationship because it is at  $> 1.96$  and  $< 0.05$  illustrates that the relationship is significant so that H0 is rejected and H2 is accepted (F. Hair Joseph et al.2019).

### The Effect of Managerial Ability on Financial Performance

Managerial ability has a significant influence on determining Financial Performance. This is evident from the results of the path coefficient value of 0.314 and the t-statistic of 3.483 and the p-value of 0.001. The conclusion is that the Managerial Capability variable has a direct influence on the acquisition of Financial Performance of 31.40%. This figure can be interpreted that if the Managerial Capability is increased once, the Financial Performance variable will increase by 31.40%. The Managerial Ability of MSMEs in Nganjuk is able to manage their business well, because this is supported by their local governments through various trainings, product competitions and direct arrangements from related agencies. This is in line with the wishes of their regional leaders, especially the Regent, in their efforts to accelerate regional economic growth. This is proven by its ability to reach Indomaret and Alfamaret mini markets in East Java.

### **The Effect of Strategy Innovation on Financial Performance**

The important role of strategic innovation in product development and its efforts to become a well-known product can be known through the results of the path coefficient value of 0.578 and the t-statistic of 5.628 and the p-value of 0.000. These figures illustrate a direct influence on the achievement of Financial Performance of 56.28%. The remaining 43.72% is determined by other factors. The conclusion that can be given from the relationship between the two variables is that Strategy Innovation has a significant influence on the achievement of Financial Performance.

This research is in line with Setiawardani (2021) which illustrates that after the Covid-19 disruption, MSMEs must make various changes to both packaging and types of food traded. The most important consideration of this result is that the role of strategic innovation is very necessary and not only to be acceptable but various strategies are carried out to strengthen the existence of the product so that it has a long product life. In addition, the manager's ability in financial management and technology is the main focus because the business is a source of family income.

### **Conclusion**

Technology has an important role in business development today, not only shortening the processing time of a product but also helping to increase the business growth of an MSME business in the Nganjuk area and its surroundings. This is certainly achieved through the Research & Development process from the efforts carried out by MSMEs in Nganjuk, East Java.

This study uses the calculation of the Financial Performance Index (FPI) which is measured through the relationship between the Managerial Ability of MSME owners and the Innovation Strategy carried out by Nganjuk MSMEs in their efforts to penetrate national and international markets. The results show that the ability of MSMEs to achieve very satisfactory results is shown from the index value of 96.9175. The figures are based on the results of their questionnaire answers which illustrate that it is the sense of family ownership and shared responsibility that keeps the business growing. On the other hand, the local government has also made various efforts to develop businesses, especially Nganjuk, into an economic center in East Java, both in the form of training, joint discussion forums, to markets that are only carried out for products from Nganjuk.

The next measurement is to conduct interviews and assessments of 58 questionnaires that are entered or received. The results were obtained that the feasibility of this research model has been achieved from the validity and reliability test. This model has also provided a significant picture of each hypothesis of this study. The level of significance achieved entirely is below 5%. Meanwhile, the relationship between independent variables and dependent variables reached 34.83% for Managerial Ability and 56.28% for Strategy Innovation, while the rest in influencing the financial performance of MSMEs was determined by other variables.

### **Suggestion**

Based on the results of this study, suggestions that can be submitted for the progress of Nganjuk MSMEs related to business development, especially small businesses, should be for local governments to deepen their understanding of financial literacy, business asset management, and understanding of digital literacy so that MSMEs are able to understand financial management and be able to take advantage of business opportunities that are always present at every opportunity. So that with this ability, Nganjuk MSMEs are able to penetrate a wider market through business innovations in the form of products with contemporary profiles, unique packaging, products with regional flavors made from Nganjuk nature, marketing capabilities in a more attractive way and open cooperation with companies abroad that have

well-known names so that cross-trade can be opened wider and wider. These opportunities will certainly be embryos for future business development.

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Volume 9 January JOURNAL OF SECURITY AND SUSTAINABILITY ISSUES ISSN 2029-  
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