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The Effect of Business Capital on Business Performance with Product Innovation as a Mediating Variable in Kendari City Micro Businesses

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Abstract. *Kendari City"s micro-enterprises struggle with limited capital and low product innovation, with 60% facing difficulties accessing capital. This study aims to examine the relationship between business capital and micro-enterprises" performance, with product innovation strengthening this relationship. Policy support is crucial for improving competitiveness and sustainability. This study investigates the effect of business capital on business performance in micro enterprises in Kendari City, focusing on product innovation as a moderating variable. Data was collected from 50 respondents using the Slovin formula and Structural Equation Modeling (SEM) method. The study validated and tested the data for reliability and validity, providing an overview of the relationship between business capital and performance. Business capital significantly influences business performance, product innovation, and overall performance. Its Path Coefficient is 0.011, with a T-Statistic value of 9.875, above the threshold of Z α 0.05. Product innovation also positively influences business performance, with a Path Coefficient of 0.004 and a T-Statistic value of 2.855. Business capital"s influence on product innovation is fairly large, exceeding the threshold. Business capital significantly impacts the performance of Micro, Small, and Medium Enterprises (MSMEs) in Kendari City, enhancing product innovation, competitiveness, and market competitiveness. A synergistic strategy utilizing sufficient capital fosters innovative capabilities, resulting in improved performance.*

Keywords: *Business Capital, Product Innovation, Business Performance.*

1. INTRODUCTION

Micro enterprises in Indonesia play a strategic role in supporting national economic growth. According to data from the Ministry of Cooperatives and Small and Medium Enterprises (Kemenkop UKM), by 2023, micro enterprises will contribute more than 60% to the Gross Domestic Product (GDP) and absorb around 97% of the national workforce. This role is crucial in reducing unemployment, increasing people's income, and promoting economic equality. However, micro businesses often face obstacles, such as limited capital, low innovation, and less than optimal product competitiveness. Research conducted by Tambunan (2019) shows that business capital has a significant influence on business performance, but its success is also influenced by the ability of business actors to innovate.

Therefore, it is important to identify factors that can improve micro business performance, one of which is business capital. Business capital is one aspect that greatly influences the ability of micro businesses to survive and thrive (Asmarida, 2023). Sufficient capital allows businesses to expand production capacity, purchase raw materials, and access technology and wider marketing. However, limited capital often hinders the development of micro enterprises, especially in areas such as Kendari City, which has its own challenges in terms of access to capital. This is in line with research conducted by Anggraeni & Pertiwi

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(2020), which shows that micro businesses with greater access to capital tend to have better performance and can overcome market challenges more effectively.

However, the effect of capital on business performance cannot be viewed unilaterally, because there are other factors that play a role, namely product innovation. Product innovation has the ability to increase the competitiveness of micro enterprises, change consumer preferences, and expand market share (Komariah et al., 2022). In the digital era and rapid market development, innovation is key for micro businesses to survive and thrive. Research by Solihin & Jannah (2018) found that micro businesses that are able to innovate products can significantly increase their sales volume and improve their market position, even with limited capital. Therefore, product innovation has the potential to be a mediating variable that can influence the direction or even the strength of the relationship between venture capital and business performance.

Product innovation plays an important role in creating added value and differentiation in the market. Based on research by Kotler & Keller (2016), product innovation allows businesses to fulfil evolving consumer needs and wants. In micro businesses, innovation does not always mean big changes, but it can be an improvement in quality, product variations, or more creative ways of marketing. Therefore, product innovation can influence the direction or even the strength of the relationship between venture capital and business performance, by increasing product competitiveness in the market and attracting consumer interest.

In Kendari City, many micro enterprises face similar problems, namely limited capital and low levels of product innovation. Based on data from the Kendari City Cooperative and MSME Office (2023), around 60 per cent of micro enterprises in Kendari City experience difficulties in accessing capital, and only a small proportion focus on product innovation to improve competitiveness. This causes micro enterprises in this area to tend to stagnate, even difficult to grow in the face of increasingly fierce market competition, especially with the presence of digital technology that allows wider market access. Therefore, it is important to further investigate how venture capital and product innovation interact to influence the performance of micro enterprises in Kendari City.

Through this research, empirical evidence is expected to be found on how business capital affects micro business performance, with product innovation as a mediator factor that can influence the direction or strength of the variable relationship. This research is also expected to provide insights for policy makers, financial institutions, and businesses on the importance of innovation and access to capital to improve micro business performance. If the results of this study show that product innovation can strengthen the relationship between

business capital and business performance, then policies that support innovation and easy access to capital for micro businesses will be very important to improve the competitiveness and sustainability of micro businesses in Kendari City.

In addition, this research is also expected to contribute to the development of theory in the field of micro business management. Previous studies have discussed the effect of venture capital on business performance, but not many have explored how product innovation plays a role in mediating the relationship. Therefore, this study is expected to make a new contribution in understanding the dynamics that occur in micro businesses, as well as provide practical recommendations that can be applied by business actors and other related parties to encourage the growth and development of micro businesses in Kendari City.

2. METHODS

This research uses a quantitative design characterised by descriptive and causal methodologies. This design was chosen to determine the effect of business capital on business performance with product innovation as a mediating variable in Kendari City micro businesses. The sample size of 50 respondents was obtained using the Slovin formula with an error tolerance level of 10% in the sampling technique. Research respondents are actors or managers of MSMEs engaged in various business sectors in Kendari City. Structural Equation Modelling (SEM) method based on Partial Least Squares (PLS) was used to conduct data analysis. This method is considered suitable for assessing the relationship between latent variables (Anshori & Iswati, 2019).

The research instrument was a structured questionnaire prepared in accordance with the variable indicators of business capital, product innovation, and business performance. The amount of initial capital, funding sources, working capital management, and capital investment are indicators of business capital literacy. Product innovation indicators are: Revenue growth, Net profit, Growth in the number of customers, and Operational efficiency. Business performance is assessed through new product development, product quality improvement, product uniqueness, and product adjustment to market trends. To ensure the validity and reliability of the data obtained, all instruments were validated and tested for reliability before distribution. The magnitude of respondents' perceptions of each indicator was assessed using a five-point Likert scale (Agung & Yuesti, 2019).

The research process began with determining the population of MSMEs in Kendari City, followed by obtaining data through questionnaires. The questionnaire was distributed directly to respondents who met the inclusion criteria, namely having an active business for more than

one year. SmartPLS software was used to conduct statistical analyses of the collected data to evaluate direct and indirect relationships between variables (Saragih et al., 2023). The analysis process is carried out in stages, namely structural model evaluation, reliability test, and validity test. An overview of the Effect of Business Capital on Business Performance with Product Innovation as a Mediating Variable in Kendari City Micro Businesses is given through the analysis results. The following is a picture of the conceptual framework of the research.

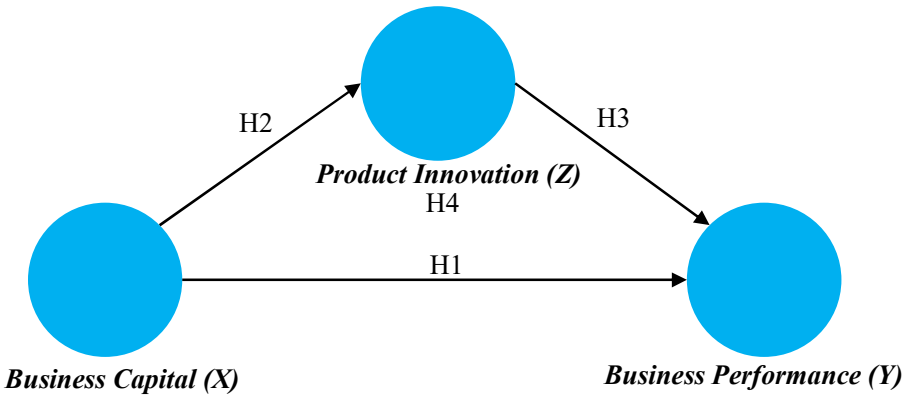


Image 1. ***Framework***

3. RESULTS AND DISCUSSION

Convergent Validity

This study assesses the validity of indicators based on the factor loading value on the outer loading which describes the relationship between the indicator and the variable under study. An indicator is considered valid if the correlation value between the indicator and the latent variable is ≥ 0.7.

Table 1. ***Outer Loadings***

	Product Innovation (Z)	Business Performance (Y)	Business Capital (X)
X1.1			0,896
X1.2			0,895
X1.3			0,920
X1.4			0,817
Y1.1		0,962	
Y1.2		0,952	
Y1.3		0,961	
Y1.4		0,759	
Z1.1	0,857		

Z1.2	0,887
Z1.3	0,759
Z1.4	0,928

Source: Primary Data SEM PLS (2024)

Table 1 shows that all indicators have a value of more than 0.7, thus confirming that all indicators in this study are valid and meet the requirements of convergent validity.

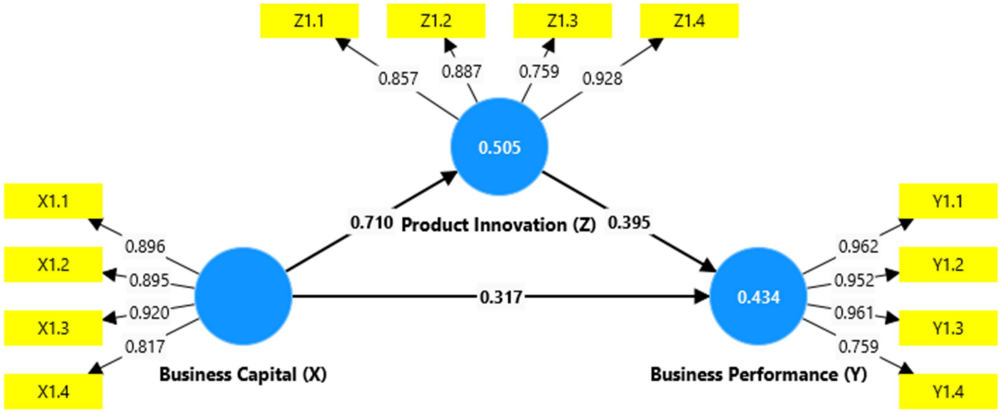


Image 2. ***Graphical Output Outer Model***

The AVE value indicates the extent to which the indicator variation is explained by the hidden variables. AVE values above 0.5 indicate strong convergent validity.

Table 2. ***Results Average Variance Extracted (AVE)***

	Average variance extracted (AVE)
Product Innovation (Z)	0,740
Business Performance (Y)	0,833
Business Capital (X)	0,780

Source: Primary Data SEM PLS (2024)

The data shows that the AVE value for the Product Innovation variable is 0.740, Business Performance is 0.833, and Business Capital is 0.780. The validity of the research is considered satisfactory if the AVE value exceeds 0.5.

Discriminant Validity

Refers to the extent to which a latent variable is empirically different from other latent variables in the model. Discriminant validity ensures that indicators of a construct are not overly correlated with indicators of other constructs, so that each construct is truly unique in measuring the phenomenon under study.

The Fornell-Larcker Criterion is the square root of the Average Variance Extracted (AVE) value for each latent variable must be greater than the correlation between other latent variables.

Table 3. *Fornell-Larcker Criterion*

	Business Business Capital (X)	Business Business Business Performance (Y)	Product Product Innovation (Z)
Business Capital (X)	0,883		
Business Performance (Y)	0,597	0,913	
Product Innovation (Z)	0,710	0,620	0,860

Source: Primary Data SEM PLS (2024)

The Fornell-Larcker Criterion table shows the results of the discriminant validity evaluation for the latent variables in the SEM model. The diagonal in the table contains the square root of the Average Variance Extracted (AVE) for each latent variable, which must be greater than the correlation with other latent variables to indicate discriminant validity. In this table, the AVE values for Business Capital (X), Business Performance (Y), and Product Innovation (Z) are 0.883, 0.913, and 0.860, respectively. All of these values are greater than the correlations between variables, which are 0.597, 0.710, and 0.620. This shows that each latent variable is able to distinguish themselves empirically from other variables, thus meeting the criteria for discriminant validity. Thus, the model used has unique and well-measured latent variables.

Composite Reliability

Composite Reliability is a construct that shows that the indicators used are considered stable and consistent in measurement if the value exceeds 0.7.

Table 4. *Composite Reliability*

	Cronbach's alpha	Composite reliability (rho_a)	Description
Product Innovation (Z)	0,881	0,890	Reliability
Business Performance (Y)	0,930	0,930	Reliability
Business Capital (X)	0,905	0,912	Reliability

Source: Primary Data SEM PLS (2024)

Tabel 4 Composite Reliability menunjukkan hasil evaluasi keandalan (reliability) dari variabel laten dalam model SEM. Composite Reliability (CR) dan Cronbach's Alpha (α) digunakan untuk mengukur sejauh mana indikator-indikator dari variabel laten saling

berkorelasi dan memberikan informasi yang konsisten. Hasil tabel menunjukkan bahwa semua variabel laten, yaitu Product Innovation (Z), Business Performance (Y), dan Business Capital (X), memiliki nilai CR dan Cronbach's Alpha di atas 0.7, yang merupakan kriteria minimum untuk keandalan yang memadai. Composite Reliability (CR) untuk Product Innovation adalah 0.890, untuk Business Performance adalah 0.930, dan untuk Business Capital adalah 0.912, menunjukkan keandalan yang tinggi pada semua variabel laten tersebut. Oleh karena itu, indikator-indikator yang digunakan dapat dipercaya dan menunjukkan konsistensi dalam mengukur variabel laten dalam model penelitian.

R-Square

Table 5. ***Results R-Square***

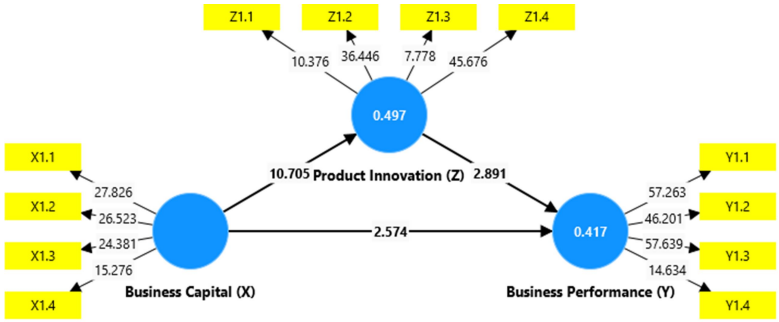
	R-square	R-square adjusted
Product Innovation (Z)	0,505	0,497
Business Performance (Y)	0,434	0,417

Source: Primary Data SEM PLS (2024)

The R-Square value of employee performance is 0.505, which indicates that the model explains 50.5% of the variance in employee performance caused by independent and intervening variables such as work discipline, career development, and work motivation, while 49.5% is caused by external factors. In addition, the R-Square value for work motivation is 0.434, which indicates that the model explains 43.4% of the variance in work motivation influenced by work discipline and career development, while the remaining 56.6% is influenced by other external variables.

PLS Model Analysis

Image 3. ***Bootstraping Test Results***



Source: Primary Data SEM PLS (2024)

The PLS analysis model reveals P-values that exceed 0.05 as well as those below 0.05, along with T-statistics. As such, the following conclusions can be drawn:

1. Business Capital has a considerable positive influence on Business Performance, indicated by a Path Coefficient of 0.011 and a T-Statistic value of 9.875, which is above the Z threshold of α = 0.05 (5%) of 1.96, thus indicating (positive) significance.
2. Business Capital has a considerable positive influence on Product Innovation, indicated by a Path Coefficient of 0.000 and a T-Statistic value of 10.612, which is above the Z α = 0.05 (5%) threshold of 1.96, thus showing significance (positive).
3. Product Innovation has a considerable positive effect on Business Performance, indicated by a Path Coefficient of 0.004 and a T-Statistic value of 2.855, which is above the Z α = 0.05 (5%) threshold of 1.96, thus showing significance (positive).
4. Business Capital has a considerable positive influence on Business Performance through Product Innovation, indicated by a Path Coefficient of 0.010 and a T-Statistic value of 2.579 which exceeds the value of Z α = 0.05 (5%) = 1.96, thus showing significance (positive).

Table 6. *Specific indirect effects*

	Original sample (O)	T statistics (|O/STDEV|)	P values
Business Capital (X) -> Product Innovation (Z) -> Business Performance (Y)	0,280	2,626	0,004

Source: Primary Data SEM PLS (2024)

The specific indirect effects table shows the results of the analysis of direct and indirect relationships between Business Capital (X) and Business Performance (Y) variables through Product Innovation (Z) mediation. The results show the original sample value of 0.280, which means that 28% of the total relationship between Business Capital and Business Performance is mediated by Product Innovation. T statistics of 2.626 and a p-value of 0.004 indicate that this relationship is statistically significant at the 95% confidence level. Therefore, Product Innovation acts as an important mediating variable in the model, clarifying how Business Capital can influence business performance through product innovation.

The Effect of Business Capital on Business Performance

Researchers found that business capital affects the business performance of MSMEs in Kendari City. Business capital indicators in Kendari City MSMEs are the amount of initial capital, funding sources, working capital management, and capital investment. Business capital plays a crucial role in determining the performance of MSMEs. The availability of sufficient capital not only allows MSMEs to survive in the face of challenges, but also provides opportunities for innovation, expansion, and increased competitiveness. Government policies that support access to business capital, such as KUR and LPDB, are crucial in facilitating the growth and development of the MSME sector in Indonesia.

The results of this study are in line with research conducted by Thohari (2019) which consistently shows that business capital has a positive and significant influence on the performance of MSMEs. The higher the business capital owned by MSME business actors, the business performance tends to increase. The important role of venture capital Initial financial capital is strongly positively related to the performance and growth of SMEs. Adequate start-up capital serves as a buffer against common challenges such as slow business start-ups, slumps, or inadequate decision making, which is especially important for SMEs in the early stages (Bokhari, 2022). Meanwhile, according to Fadhilah (2024) Sufficient venture capital allows MSMEs to invest in innovation and expansion activities, which in turn can improve their performance and competitiveness.

The Effect of Business Capital on Product Innovation

Research shows that venture capital has a positive and substantial impact on product innovation by MSMEs. An increase in venture capital owned by MSME players increases their capacity to develop their product offerings. Capital as a Catalyst for Innovation The presence of sufficient venture capital is an important element that enables MSMEs to engage in research and development initiatives (Safitri, Mulyadi and Furqon, 2023). With sufficient capital, MSMEs can explore, evaluate new concepts, and introduce creative goods that are more competitive in the market.

Impact on Competitiveness Product innovation supported by strong business financing can improve the competitiveness of MSMEs in the market. Innovative and high-quality goods can attract more consumers, increase satisfaction, and ultimately drive sales growth and profitability. Creativity and Innovation Function Alongside venture capital, creativity and innovation are important elements that can improve the

performance and success of MSME firms (Suriatna and Ardianti, 2013). The capacity of MSMEs to innovate new goods or improve existing goods can provide a long-lasting competitive advantage.

The Importance of a Cohesive Strategy To optimize the effectiveness of product innovation, MSMEs require sufficient venture capital and a supportive environment for innovation. A synergistic strategy that increases capital availability and fosters innovative capabilities will yield better results for MSME performance and competitiveness. In short, strong venture capital has a favorable and substantial impact on the product innovation capacity of MSMEs. With the right financial support, MSMEs can create more creative and competitive goods, thereby improving the performance and growth of their firms.

The Effect of Product Innovation on Business Performance

Product innovation is an important element that can improve the performance of MSMEs. Through the innovation of new goods or the improvement of existing goods, MSMEs can meet evolving consumer demands and preferences. This increases consumer satisfaction and loyalty, thereby increasing sales and profitability.

Successful product innovation can provide a competitive advantage for MSMEs. Innovative goods are often more appealing to customers, thereby attracting market attention and increasing market share. Research shows that MSMEs that engage in product innovation often have superior marketing success compared to those that do not innovate. Product innovation contributes significantly to improving marketing success. By offering superior and more relevant goods, MSMEs can increase the effectiveness of their marketing initiatives. Innovation in product design or the introduction of new features can serve as a powerful marketing instrument, allowing MSMEs to differentiate themselves in a competitive market.

Research shows a favorable correlation between product innovation and sales success. When MSMEs introduce a new item, they often see a spike in sales, especially if the product fulfills an unmet market need. This suggests that product innovation improves product quality and can also stimulate substantial sales growth. Product innovation is closely linked to market orientation. MSMEs that understand the requirements and desires of their clients are often more effective in implementing relevant innovations. By implementing a customer-centered strategy, MSMEs can develop goods that are creative and aligned with market demand, thereby increasing the

overall success of the company. Research conducted by Herlinawati and Machmud (2020) shows that innovation, particularly product innovation, positively and significantly affects the performance of MSMEs. Nevertheless, MSMEs in Indonesia's manufacturing sector experience difficulties stemming from a lacking level of product innovation, which weakens their competitiveness in local and global markets. Capital as a Catalyst for Innovation Adequate corporate capital is essential to drive innovation and maintain operational viability. Insufficient finance is often identified as a barrier to innovation and expansion for MSMEs (Herlinawati and Machmud, 2020).

The Effect of Business Capital on Business Performance through Product Innovation

Business capital plays an important role in supporting product innovation, which in turn can improve business performance. By providing the necessary resources for innovation, companies can create better products, increase competitiveness, and achieve better performance. Therefore, it is important for businesses to manage capital wisely and invest in product innovation as a strategy to achieve long-term success. The integration of venture capital and product innovation is key to creating added value and sustainable growth for companies.

4. CONCLUSIONS

Business capital plays an important role in the performance of Micro, Small and Medium Enterprises (MSMEs) in Kendari City. Enterprise capital has a positive impact on product innovation, as it increases the capacity of SMEs to develop their products. This capital enables SMEs to engage in research and development initiatives, explore new concepts, and introduce more competitive creative goods. Product innovation supported by strong business financing can increase SMEs' competitiveness in the market, attract more customers, increase satisfaction, and drive sales growth and profitability. Innovation is also an important element that can improve the performance and success of MSME firms. A cohesive strategy that optimizes the effectiveness of product innovation requires sufficient venture capital and a supportive environment for innovation. Synergistic strategies that increase capital availability and foster innovative capabilities will yield better results for MSME performance and competitiveness. In summary, venture capital plays an important role in supporting product innovation, which in turn can improve business performance. By managing capital wisely and

investing in product innovation, enterprises can create better products, improve competitiveness and achieve long-term success.

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