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Sme Business Performance Measurement in Agriculture; The Role of Innovation and Risk Assessment

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Abstract

The aims of this study was to analyze the effects of innovation, risk assessment and business strategic toward business performance in SME. Innovation and risk measurement in SMEs has become the concern of the Indonesian government in developing this institution, however, this policy has not been supported by detailed studies. This research closes this gap by measuring these two factors' role in Indonesian SMEs' business performance. We conducted a survey involving 206 SME in agriculture in Indonesia. Variables in this study are innovation and risk assessment as independent variables, business strategy as an intervening variable and business performance as the dependent variable. We use the Structural Equation Model with Partially Least Square (PLS) to test hypotheses. Our findings show that innovation related with new product development and marketing strategy are important for SME's business performance. In this study, we conclude that innovation and risk assessment have a positive effect to business strategy and business strategy has a positive effect to business performance. The policy implication of this study is that Indonesia's government should facilitate SME to improve their capacity to conduct innovation and risk measurement.

Keywords: innovation, risk assessment, business strategy, business performance, SME

INTRODUCTION

SME business performance related to how the organization achieved their goals. Discussions on SME business performance is vital for Indonesia's economic development since this type of business dominates this country's economy. Le *et al.,* (2023) found that the business performance of SMEs is affected determined by innovation. Begonja et al., (2016) identify SMEs should strengthen their innovation capability in their business processes. We can conclude that innovation in SMEs could lead to an increase their business performance.

SME as a business organization has many limitations. The limitations of SMEs include not having sufficient mastery of technological know-how to develop products and business processes, quality human resources and financial capital (Kabange & Simatele, 2022; Prasetya & Purwono, 2022). On the other hand, innovation in a business organization requires the support of good quality human resources and financial support (Arshi & Burns, 2019; Riadi et al., 2022). Does it factor that SME cannot innovate?

What should SME does, when these institutions have limited resources while they have to innovate to improve their business performance? Tuan and Rajagopal (2022) found that SMEs need to carry out business planning to improve their business performance. Specifically, business planning that is relevant to SME resource limitations is budget control and risk analysis. Mat *et al*., (2022) explained the conditions of uncertainty experienced by SMEs related to their business. This uncertainty causes SMEs to have to carry out business planning to mitigate emerging business risks. Business innovation for SMEs is a source of business risk. This will happen if the business innovations carried out related to product development or business process improvements are not accepted by the market.

The aim of this study was to analyze the effect of innovation, risk assessment and business strategy carried out by SMEs on their business performance. This research tests the MSME innovation and risk analysis model adopted

and developed by Begonja et al., (2016); Bek *et al*., (2013) and Block *et al*., (2015). In this research, business innovation developed by SMEs and business risk measurement are independent variables. Business strategy related to the selection and optimization of resources is an intervening variable and business performance is a dependent variable.

This study has focused on achieving SME business performance which is explained by innovation and risk measurement. Research on SME business performance and innovation has been widely conducted, however business strategy formulation variables and SME risk measurement variables are rarely discussed. Business strategy for MSMEs is related to short-term business operational planning, because SMEs rarely formulate long-term business strategies (Mufashih et al., 2023; Pusung et al., 2023). In this research, risk calculation is one of the antecedents for SME business strategy and business performance. Block et al., (2015) explained that SMEs' attitudes towards risk vary greatly with their tendency not to properly calculate and anticipate business risks. This research analyzes SME behavior in measuring emerging business risks. Testing risk measurement variables and business strategy is offered to close the research gap while offering novelty for research in SME strategic management.

SMEs in Indonesia are the backbone of the national economy because of their resilience to economic crises. They are praised as a type of business that contributes to the economy in terms of workforce absorption. SMEs in Indonesia face many challenges in managing their business. Some of these challenges include business uncertainty, level of competition, limited technical competence and capital problems (Hutahayan, 2019; Tambunan, 2022). On the other hand, Indonesian SME business performance still needs to be developed. Technological developments and business competition are challenges for SMEs in Indonesia to strengthen their competitiveness. Hutahayan (2021) in his research on textile product SMEs in Java and Bali, Indonesia, found that knowledge competency regarding production and product innovation as well as business processes had an effect on SME business performance. In the Indonesian context, strategy development in the form of business planning is also important to improve SME business performance. This research develops a model in order to strengthen Indonesian SME business performance with innovation antecedent variables and risk measurement. This research also proposes the preparation of business strategy as an intervening variable.

LITERATURE REVIEW

Business Performance and Competitiveness of MSMEs

The debate regarding SME business performance is generally related to the limited resources owned by the business organization. Modern business organizations measure organizational performance based on achievements related to long-term goals and organizational sustainability. On the scale of small and medium businesses, in practice what they do is survive, so that business performance is associated with short-term achievements, such as income per period and number of sales (Anggraeni et al., 2023; Kabange & Simatele, 2022). Hutahayan (2021) offers the concept of measuring SME business performance with long-term indicators such as business growth and asset growth.

SME business performance with measurements related to the organization's long-term goals guarantees the realization of the competitiveness of this business organization. At the company level, competitiveness is the ability to produce quality products and services and become a consistent and profitable consumer purchase choice in a better way than competitors (Gracia et al., 2011; Kussudyarsana et al., 2020). The concept of competitiveness that is more popular and easy to understand in the context of companies, namely competitiveness is understood as an effort to build uniqueness that increases the value of products and services compared to competitors (Porter & Linde, 1995; Sawitri et al., 2022). In the context of SMEs, realizing company competitiveness is not an easy thing. The limited resources of SMEs give rise to the idea that they must carry out business strategy planning and calculate risks in detail.

Innovation, Risk and Business Strategy Formulation of MSMEs

Innovation for SMEs is a strategic but expensive policy. Large companies usually carry out Innovation in the pattern starts from a research and development process that requires expensive investment and a long time. Innovation is also related to the quality of human resources from business organizations (Waskito & Linansya,

2023). However, in practice SMEs in Indonesia innovate as part of their business activities. Hutahayan (2019) in his research on culinary SMEs in East Java found that culinary SMEs innovated their dishes by periodically varying and diversifying their products due to the demands of business competition. The research mechanism is carried out only through observing customers and competitors. In general, innovation carried out by SMEs is related to periodic product development with practical considerations (Ngo, 2023).

Business innovation in the context of SME companies has two sides, namely successful innovation and producing a product that is accepted by the market or failed innovation, which means producing a failed product and being rejected by the market. In the context of SMEs, failed innovation means that the investment they make does not produce anything. This requires SMEs to carefully calculate business risks before investing in innovation. SMEs minimize the risk of failure in investing for innovation as much as possible (Ngo, 2023). Tuan and Rajagopal (2022) explain that the calculation of SME business risk is reflected in their financial planning. Financial planning in this business organization must be done because they have limitations in terms of capital. The challenge is to estimate the rate of return on investment from innovations that are difficult to predict over time.

Business innovation and risk calculation in terms of financial planning are an integral part of business strategy. Lo and Sugiarto (2021) found in their research that SMEs in tourism in Indonesia developed a core business strategy to help them develop learning processes within the organization. Pusung et al., (2023) explained that a competitive strategy consisting of cost efficiency, focus and differentiation is an important part of business planning. In the SME context, innovation and risk measurement have an impact on developing business strategies.

H1: Innovation carried out by SMEs has a positive effect on their business strategy

H2: Risk calculations carried out by SMEs have a positive effect on their business strategy.

Business Strategy and Improving Business Performance of MSME

SME business strategy formulation is a process for determining policy options to achieve organizational goals. Lovfing et al., (2014) explained that business strategy formulation for MSMEs must ensure that the planned strategy can be implemented within the company. Determining a business strategy in SMEs has several challenges including limited resources which are the basis for choosing a business strategy, consistency of SMEs in implementing business plans and changes in external conditions which can cause changes to business plans (Bismala, 2022; Mat et al., 2022).

Further, the business strategy that is planned, implemented and evaluated by SMEs, it has an impact on the business performance of the business organization. SME business performance is generally measured by short-term achievements, namely increasing sales, increasing production output and company profits (Raymond & Bergeron, 2008). Conceptually, the business strategy of a company influences business performance and ensures the business continuity of the company.

H3: SME's business strategy has a positive effect on their business performance.

RESEARCH METHOD

Population and Sample

The population of this study was 300 SMEs engaged in fish farmings, 250 chilli farmings and 40 onion farmings in Central Java. We used a purposive sampling method with the criteria that SME respondents had to have been running a business for at least 3 years and had a stable profit level in the last 3 years.

Variable Measurement

The variables in this research were measured using research instruments developed by Thacker and Handscombe (2003), Bek et al., (2013) and Prajogo (2006). The variables in this study are innovation, business risk measurement, business strategy and business performance. SME business innovation and business risk calculation are the independent variables in this study. The SME business performance is the dependent variable and the SME business strategy in this study is the mediating variable.

Conceptual Model

We developed a conceptual model for this research based on models from Thacker and Handscombe (2003), Bek et al., (2013) and Prajogo (2006)(2006). The conceptual model in the research shows the relationship between research constructs, namely SME business innovation, SME business risk calculation, SME business strategy and SME business performance. Figure 1. shows the conceptual model of this research.

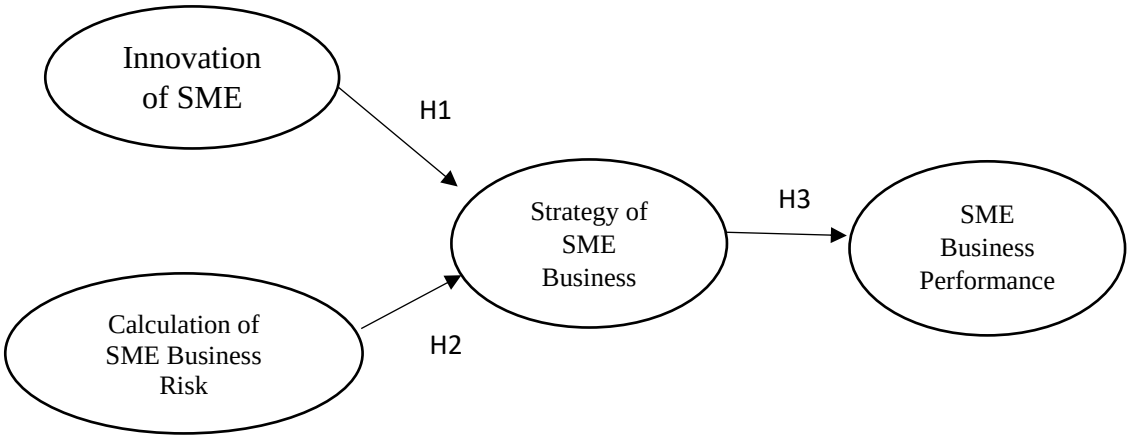

Figure 1. Conceptual Model of SME Business Performance

Description: it is developed from the research model Handscombe (2003), Bek et al., (2013) and Prajogo (2006)

RESULT AND DISCUSSION

Respondents Description

Table 1. shows the grouping of SME respondents based on business type. There are 3 types of business for respondents in this research, namely fish farmings, chili farmings and onion farmings.

Table 1. Type of Respondent's Business

No	SME Business Type	Number of SME
1.	Fish farmings	89
2.	Chili farmings	93
3.	Onion farmings	24
	Total	**206**

Source: Primary Data of MSME Innovation Survey

Regarding to the specified respondent criteria, namely the age of the business over 3 years and a stable profit rate for 3 years. We got 206 respondents consisting of 89 fish farmings SMEs, 93 chili farmings SMEs and 24 onion farming SMEs. Fish and chili farmings SMEs dominate the respondents in this study because the total population reaches 250 and 300 companies in the area that is the object of research. Meanwhile, onion farming was experiencing a decline in production when we conducted the research due to competition with imported onions, so the number of respondents that could be obtained was only 24 SMEs.

Table 2 shows the form of business entity from the SMEs that are the respondents in this study. There are 4 forms of business entities identified in this study, namely individuals, trading businesses (UD), limited partnerships (CV) and limited liability companies (PT). Table 2. shows the grouping of SME respondents based on the form of business entity.

Table 2. Respondent Business Entities

No	SME Business Entity	Number of SME
1.	Individual	181
2.	Trade Business	13
3.	Limited Partnership (CV)	11
3.	Limited Liability Company (PT)	1

	Total	**206**

Source: Primary Data of MSME Innovation Survey

Business entities from SMEs who were respondents in this study were dominated by individual ownership, namely 181 SMEs. This is also a characteristic of MSMEs in Indonesia, which are mostly owned by individuals (Tambunan, 2022). Business entities in the form of trading businesses total 13 SMEs. The form of trading business of the respondents of this research is a Joint Business Group (KUB) which was formed based on a decision letter from the village/district. The Limited Partnership (CV) form of business entity is the third most common business entity among respondents. This choice is made by SMEs that are already modern farming or already bankable. All 11 respondents with the CV business entity form are chili farmings SMEs.

Other characteristics of the SMEs who were respondents in this study were observed based on the average age of the business, length of education of the owner and working capital. Table 3 shows the characteristics of SME respondents based on average age of business, working capital and length of education of SME owners.

Table 3. Average age of business, working capital and length of education for SMEs

No	SME Characteristics	Average
1.	Business Age	13 years old
2.	Work Capital	IDR 219.363.325,2
3.	Year of Owner Education	9,3 years

Source: Data primer survey Inovasi UMKM

The business age of the SMEs who were respondents in this study was an average of 13 years. This shows that the respondents' business experience is long and their business is stable because it can last more than 5 years. The majority of fish and chili farmings SMEs have a business age of more than 5 years. The two SMEs are included in the type of modern farming with mastery of detailed technology and investment for high production technology so that they are not flexible to change businesses. The business age of the majority of onion farming SMEs is less than 5 years, because most of them were previously farmers of other food commodities besides onions. They become onion farmers for reasons of high commodity prices, high demand for their products and there are opportunities as substitutes when the price of imported onion is high.

The average working capital used by respondents in this study was IDR 219,363,325.2. Respondents with working capital above IDR 50,000,000 were mostly chili farmings SMEs. The SME respondents with the smallest working capital, namely IDR 50,000, came from the fish farming group. The average length of education of SME owners is 9.3 years. Based on this data, it means that the average education of these SME owners is only Junior High School (SMP). This explains that the majority of business entity choices from the respondents of this study were individual companies and trading businesses in the form of Joint Business Groups (KUB). These two forms of business entities do not require complicated administrative and legal procedures.

Validity and Reliability Test

Table 4 shows the results of testing the validity and reliability of this research construct.

Table 4. Results of Testing the Validity and Reliability of Research Instruments

Construct	Indicator	Cronbach Alpha	Factor Loadings 1	Factor Loadings 2	Factor Loadings 3	Factor Loadings 4
Innovation		0,855				
	1. Developing the new promotion strategy		0,722			
	2. Trying to find the new customer		0,864			

	3. Trying to find the new supplier		0,801		
	4. Trying to develop the new path and distribution method				
	5. Developing the new product and business process		0,851		
			0,735		
Risk Calculation		0,756			
	1. Fidning the mitigation way of business risk			0,478	
	2. Finding the method of minimizing the business risk			0,371	
	3. Finding the method to maximize the business opportunity			0,833	
	4. The business failure can be anticipated			0,859	
Business Strategy		0,910			
	1. The performance evaluation of each period.				0,887
	2. Arranging the target and achievement.				0,927
	3. Arranging the work plan.				0,946
Business Performance		0,902			
	1. Sale increase				0,842
	2. Increase in the number of customer				0,887
	3. The increase of company reputation				
	4. The increase of product quality				0,888
	5. The increase of production technology				
	6. The increase in the number of distribution network.				0,708
					0,744
					0,854

Source: Analysis of MSME innovation survey data

The results of the validity test show that all question indicators from the innovation construct, business strategy and business performance have a factor loading value above 0.5 according to the criteria of Hair et al., (2006). There are 2 question indicators of the risk calculation construct whose factor loading values are below 0.5. The two indicator questions are:

1. Look for ways to mitigate business risks.
2. Look for methods to minimize business risks.

These two question indicators are not removed in the next process, namely calculation or estimation, because these two questions provide important information about minimizing risk.

The results of construct reliability testing show that the Cronbach Alpha value of each construct in this study is above 0.6. This shows that the constructs of innovation, risk measurement, business strategy and business performance have good internal consistency.

Hypothesis test

The hypothesis in this study was tested using the structural equation model (SEM) analysis tool. Figure 2. shows the path coefficients from the SEM analysis of this research.

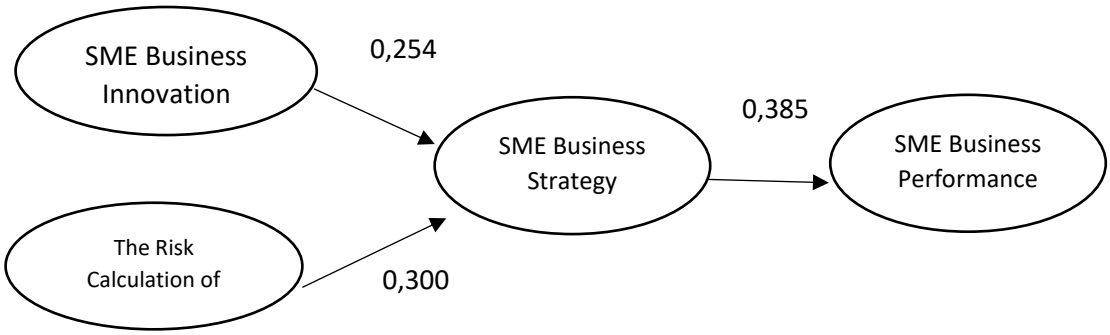

Figure 2. Estimation Results of the Research Model

Table 5. shows the results of testing the significance of the path coefficient of the relationship between constructs in this study.

Table 5. Results of the t statistical significance test for the path coefficient

The Correlation Among Construct	**Path Coefficient**	***t statistic***	***P value***	**Description**
Business Strategy-Innovation	0,254	4,912	0,000	Significant
The calculation of business risk-strategy	0,300	4,563	0,000	Significant
Business strategy – Business performance	O,385	6,625	0,000	Significant

Source: Primary Data of MSME Innovation Survey

Table 6 shows the results of testing the path coefficient for this study's indirect relationship between constructs.

Table 6. Results of the t-statistical significance test for path coefficients of indirect relationships between constructs

The Correlation Among Construct	Path Coefficient	*t statistic*	*P value*	Description
Innovation-Business Strategy-Business Performance	0,098	3,947	0,000	Significant
Risk Calculation – Business Strategy – Business Performance	0,116	3,647	0,000	Significant

Source: Primary Data of MSME Innovation Survey

The results of testing using SEM show that all relationships between constructs in this study are statistically significant. This test also includes estimation of the indirect effect between the innovation construct and risk calculation on business performance mediated by the business strategy construct. Table 6 shows that the analysis of the indirect effect of business innovation constructs and risk calculations on business performance mediated by business strategy is statistically significant. Table 7 shows the conclusions of the hypotheses in this research.

Table 7. Summary of Research Hypothesis Testing Results

Hypothesis	Description
H1 The Innovation carried out by SME positvely influence their business strategy	Supported
H2 The risk calculation carried out by SME positively influence their business strategy	Supported
H3 SME business strategy positively influences their business performance	Supported

Source: Primary Data of MSME Innovation Survey

DISCUSSION

The result indicated that innovation by SMEs had a positive effect on business strategy. These findings reinforce the results of research from Hutahayan (2021) regarding the importance of innovation as part of an SME business strategy in an empirical study of the textile industry in Indonesia. The textile industry is included in the manufacturing industry, as well as furniture and footwear SMEs who are the respondents in this study. This means that in the manufacturing industry the role of innovation is very crucial as part of a business strategy.

This study also strengthens research findings from Gracia et al (2011) regarding innovation as part of SME competitiveness. In innovation research conducted by SMEs related to continuous efforts to improve business processes and develop new products to strengthen their competitiveness. In general, the innovations carried out by SMEs within a strategic framework are finding new customers and exploring markets, finding new ways of distribution and improving relationships with suppliers. The link between innovation and business strategic planning which is the finding in this study strengthens the findings of Ngo (2023) who analyzed the effect of innovation on the choice of generic strategy in the culinary business of SMEs in Vietnam.

The risk calculation carried out by SMEs is an important finding in this study. SME perform risk calculations from the business decisions they make because business failures must be minimized. Limited financial resources from SMEs require them to take into account the risk of investment failure, especially related to business innovation. Block et al., (2015) in their research also found that anticipating risk behavior influences the choice of SME strategy.

Business strategy has a positive and significant effect on SME business performance. The findings in this research are that business strategy in the form of planning business activities and achievements as well as evaluating business planning has an effect on SME business performance. This finding strengthens the findings of Le et al.,

(2023) who found that one of the factors that influences SME business performance is the business strategy they execute.

CONCLUSION

This study indicated several important things related to SME business performance which are explained by innovation, risk calculation and business strategy. This study's estimation model also showed that business strategy is confirmed as a mediating variable for the influence of innovation and risk calculation on SME business performance.

In general, this research also found that innovation carried out by SMEs was carried out in an integrated manner with the production process or service process. SMEs do not carry out research and development activities separately because they have financial limitations to carry out research and development. Innovation carried out by SMEs not only develops new products, but also searches for new consumers and suppliers. However, all these activities are integrated with the production or service processes.

The risk calculations carried out by SMEs are related to their financial limitations. This research found that SMEs take risk into account by mitigating their business risks. SMEs have the perception that every investment they make to innovate cannot fail, because failure is too expensive for them. Business risks for SMEs are also related to business opportunities. Business opportunities for SMEs are a starting point for considering whether they need to innovate their products or business processes.

The business strategy for SMEs is carried out by evaluating previous performance, preparing work plans, targets and achievements. The process of determining a business strategy for SMEs in this study refers to a generic strategy with a choice of cost efficiency or product differentiation and business processes. Cost efficiency by SMEs is a response to rising production costs so that their product prices can remain competitive. The product differentiation is carried out by SMEs based on market demand. The business strategy in this study has a positive effect on SME business performance, so that this business organization needs to carry out periodic business strategy planning periodically.

Research Limitation

The research limitation is the problem of measuring the risk measurement construct. In this construct, 2 research indicators do not meet the required factor loading values. The research indicators are looking for mitigating business risks and minimizing business risks. The consequence of limitations in this measurement is that information about business risk perceptions is not as expected by researchers.

The next limitation is that the different types of business respondents cannot provide optimal information. In this study, SME respondents consisted of 3 different business fields, namely furniture, footwear and mushroom farming. However, the research estimation model does not accommodate differences in business types by making them a moderating variable. This was not done because the distribution of respondents in the 3 business fields had too wide a difference.

Implication

This research contributes to the development of an SME performance measurement model with innovation and risk measurement as independent variables. This research provides new information about the innovation process carried out by SMEs. SME innovates by expanding sales and distribution networks. SMEs also innovate by developing new products according to consumer demand and changing market conditions. However, innovation carried out by SMEs is not the result of a formal research and development process, but is part of the business activities of SMEs.

Calculation of SME business risk is an independent variable that shows the novelty of this study. Risk measurements carried out by SMEs include developing methods or ways to mitigate business risks, minimize business failures and calculate business opportunities in detail. Calculating business risk is also linked to the

decision to innovate, namely by setting investment limits for investment in accordance with the SME's financial capabilities. In particular, the measurement of the SME business risk calculation construct needs to go through a scale purification process to obtain indicators that have higher factor loading values.

Measurement of business strategy in this study is based on strategic planning activities carried out by SMEs. This is based on the finding that SMEs do not carry out formal business strategy planning. The business strategy planning process carried out by SMEs is based on short-term plans, when they experience losses or profits that exceed expectations. Strategic planning is also related to plans for cost efficiency or market development and investment expansion. SME strategic planning when they experience the benefits of the product is trying to develop new products or new business processes. This SME business strategy ultimately influences their business performance as measured by short-term performance, namely sales, increased profits and product quality. But there are also long-term performance measurements, namely increasing the company's reputation and increasing the number of distributions.

This research provides advice to practitioners, namely managers or SME owners to innovate products and business processes, according to their abilities. Product and business process development is part of new investment for SMEs. Strategic decisions, namely product and business process innovation, must be made by taking into account the possibility of business risks arising. SMEs must also carry out strategic planning related to their business activities. The choice of business strategy that can be done is to create unique products or business processes with innovation or to make production cost efficiencies.

In conditions of limited resources experienced by SMEs to innovate, the government can play a role in providing assistance and facilitation. Assistance in the innovation process can be provided by accompanying SMEs in developing new products and business processes. The government can also assist them in obtaining copyright protection for the new products and business processes they develop.

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