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STRATEGIC INNOVATION AND BUSINESS SUSTAINABILITY A STUDY OF SMALL AND MEDIUM ENTERPRISES IN INDONESIA

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Abstract

Small and Medium Enterprises (SMEs) play a significant role in Indonesia's economic development; however, sustaining long-term competitiveness remains a major challenge amid technological disruption, market uncertainty, and increasing sustainability demands. This study investigates the influence of strategic innovation on business sustainability among Indonesian SMEs. Strategic innovation is conceptualized through four dimensions: product innovation, process innovation, organizational innovation, and marketing innovation. Business sustainability is measured through economic, social, and environmental sustainability dimensions. A quantitative explanatory research design was employed using survey data collected from 350 SME owners and managers across various sectors in Indonesia. Data were analyzed using Structural Equation Modeling–Partial Least Squares (SEM-PLS). The findings reveal that all dimensions of strategic innovation significantly and positively influence business sustainability. Marketing innovation emerged as the strongest predictor, followed by product innovation, process innovation, and organizational innovation. Strategic innovation was also found to contribute significantly to economic, social, and environmental sustainability. The results support Resource-Based View (RBV) and Dynamic Capability Theory (DCT), highlighting innovation as a strategic capability that enables SMEs to achieve sustainable competitive advantage and long-term performance. The study offers theoretical contributions to innovation and sustainability literature and provides practical implications for SME managers and policymakers.

Keywords: strategic innovation, business sustainability, SMEs, product innovation, process innovation, organizational innovation, marketing innovation, SEM-PLS, Indonesia.

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INTRODUCTION

Small and Medium Enterprises (SMEs) constitute one of the most important sectors of the Indonesian economy, contributing significantly to employment generation, economic growth, and regional development. Despite their importance, many SMEs face challenges related to market competition, technological change, resource constraints, and sustainability pressures. As business environments become increasingly dynamic, innovation has emerged as a critical capability for maintaining competitiveness and achieving long-term sustainability.

The contemporary business environment is characterized by rapid technological advancement, globalization, digital transformation, environmental challenges, and increasingly dynamic consumer preferences. These developments have transformed traditional business practices and intensified market competition. As a result, businesses are required to continuously improve their capabilities to maintain competitiveness and sustainability. Organizations that fail to adapt to these changes often experience declining performance and reduced market relevance.

In this context, innovation has become a critical factor for organizational success. Innovation enables businesses to create value, improve efficiency, enhance customer satisfaction, and develop competitive advantages. According to recent studies, innovation contributes significantly to organizational performance by allowing firms to respond effectively to market demands and environmental changes (Yulianto & Supriono, 2023). Innovation also supports the development of new products, improved processes, enhanced services, and more effective business models.

Strategic innovation refers to the implementation of innovative approaches in products, processes, organizational systems, and marketing activities that create value and strengthen competitive positioning. Recent studies suggest that innovation not only improves organizational performance but also contributes to sustainability outcomes by enhancing efficiency, stakeholder engagement, and environmental responsibility (Pratama et al., 2023; Sawitri et al., 2025).

For SMEs, strategic innovation is particularly important because these enterprises often face resource limitations, including financial constraints, technological barriers, and limited managerial expertise. Strategic innovation allows SMEs to overcome these limitations by utilizing available resources more effectively and identifying new opportunities for growth. Research has shown that innovation contributes positively to firm performance and competitiveness among Indonesian SMEs (Yulianto & Supriono, 2023).

At the same time, the concept of business sustainability has gained increasing attention from researchers, policymakers, and business practitioners. Business sustainability refers to an organization's ability to achieve long-term economic performance while maintaining social responsibility and environmental stewardship. Sustainable businesses seek to balance profitability with broader societal and environmental objectives. This approach aligns with the principles of sustainable development, which emphasize meeting present needs without compromising future generations.

The sustainability agenda has become increasingly relevant in Indonesia as environmental issues, resource scarcity, climate change, and stakeholder expectations continue to influence business operations. Businesses are now expected to contribute not only to economic growth but also to environmental protection and social welfare. Consequently, organizations must develop strategies that support long-term sustainability while maintaining competitiveness.

The Triple Bottom Line (TBL) framework provides a comprehensive perspective on business sustainability. The framework emphasizes three dimensions of sustainability: economic sustainability, social sustainability, and environmental sustainability. Economic sustainability focuses on profitability and financial stability. Social sustainability emphasizes positive relationships with employees, communities, and stakeholders. Environmental sustainability concerns responsible resource utilization and environmental protection.

From a theoretical perspective, Resource-Based View (RBV) argues that valuable, rare, inimitable, and non-substitutable resources contribute to sustainable competitive advantage (Barney, 1991). Likewise, Dynamic Capability Theory emphasizes the ability of organizations to

integrate, reconfigure, and renew resources in response to environmental changes (Teece et al., 1997). Strategic innovation can therefore be viewed as a strategic capability that supports long-term organizational sustainability.

Recent studies have demonstrated that innovation serves as an important mechanism for achieving sustainability objectives. Eco-innovation, green innovation, digital transformation, and organizational innovation have been identified as significant drivers of sustainable business performance (Sulaeman & Kurniawati, 2023). Furthermore, innovation enables firms to improve operational efficiency, reduce environmental impacts, and strengthen stakeholder relationships.

Research on Indonesian SMEs indicates that innovation adoption contributes positively to business sustainability. Product innovation has been found to improve competitive advantage and sustainability performance among SMEs (Sawitri et al., 2025). Similarly, green innovation and eco-innovation support environmental sustainability while enhancing organizational competitiveness (Putra et al., 2023).

Digital transformation has also emerged as a key factor influencing SME sustainability. The integration of digital technologies enables organizations to improve efficiency, expand market access, strengthen customer engagement, and support environmentally responsible business practices. Studies have shown that digital adoption contributes significantly to long-term business sustainability among Indonesian SMEs (Pratama et al., 2023).

Despite growing recognition of the importance of innovation and sustainability, many Indonesian SMEs continue to face challenges in implementing strategic innovation effectively. Limited financial resources, insufficient technological capabilities, inadequate managerial skills, and lack of innovation culture often hinder innovation activities. Furthermore, many SMEs prioritize short-term profitability over long-term sustainability objectives.

Although previous studies have examined innovation and firm performance, limited empirical evidence is available regarding the multidimensional relationship between strategic innovation and business sustainability among Indonesian SMEs. Therefore, this study investigates the effects of product innovation, process innovation, organizational innovation, and marketing innovation on business sustainability. The study addresses the following research question:How does strategic innovation influence business sustainability among Indonesian SMEs?

LITERATURE REVIEW

1. Strategic Innovation

Strategic innovation refers to the deliberate integration of innovation into an organization's strategic planning and decision-making processes to create long-term value and sustainable competitive advantage. Unlike incremental innovation, strategic innovation involves transformative changes in products, services, business models, organizational structures, and market approaches that enable firms to adapt to dynamic environmental conditions (Kuncoro & Suriani, 2024).

According to Schumpeter (1934), innovation serves as the primary driver of economic growth and competitive advantage. Organizations that continuously innovate are better positioned to adapt to changing market conditions and maintain long-term performance. Strategic innovation extends beyond technological advancement by incorporating organizational transformation and market-oriented innovation.

According to Dynamic Capability Theory, strategic innovation enables firms to sense market opportunities, seize emerging trends, and transform organizational resources to sustain competitiveness in uncertain environments (Teece, 2023). Strategic innovation is

increasingly recognized as a multidimensional capability encompassing technological innovation, organizational transformation, market innovation, and strategic renewal (Ferreira et al., 2023).

Recent studies indicate that strategic innovation significantly contributes to organizational resilience, digital transformation, sustainability performance, and long-term growth. Organizations that continuously develop innovation capabilities are more likely to achieve superior performance and maintain relevance in highly competitive markets (Wang et al., 2024).

Recent studies emphasize that strategic innovation consists of multiple dimensions, including product innovation, process innovation, organizational innovation, and marketing innovation. These dimensions collectively improve organizational adaptability, competitiveness, and sustainability (Latifannisa et al., 2025). Strategic innovation enables firms to create new value propositions, enhance customer experiences, improve operational efficiency, and respond effectively to environmental changes.

Product innovation refers to the introduction of new products or significant improvements in existing products regarding functionality, quality, design, features, or usability (OECD, 2023). Product innovation enables firms to meet changing customer preferences, differentiate themselves from competitors, and capture new market opportunities. Process innovation involves implementing new production methods, technologies, or operational procedures that improve efficiency and effectiveness. Process innovation contributes to sustainability by reducing costs, increasing productivity, minimizing waste, and optimizing resource utilization. Sustainable production practices often emerge through process innovation initiatives.

Organizational innovation refers to the implementation of new organizational methods in business practices, workplace organization, management systems, and external relations (OECD, 2023). Organizational innovation improves flexibility, knowledge sharing, employee engagement, and decision-making quality. Research indicates that organizational innovation enhances firms' abilities to respond to environmental uncertainty and competitive challenges. Organizational innovation is grounded in Organizational Learning Theory, which emphasizes the importance of knowledge acquisition, knowledge sharing, and continuous learning for organizational effectiveness (Argote & Hora, 2023). Through organizational innovation, firms can improve decision-making processes, increase employee engagement, and enhance adaptability to environmental changes.

Marketing innovation involves the implementation of new marketing methods, including changes in product design, promotion strategies, pricing systems, distribution channels, branding approaches, and customer engagement mechanisms (Kotler et al., 2024). Marketing innovation is increasingly influenced by digital technologies and social media platforms. Digital marketing strategies allow firms to strengthen customer relationships, improve brand awareness, and access broader markets. Relationship Marketing Theory suggests that long-term customer relationships are critical determinants of business success. Marketing innovation enhances customer satisfaction and loyalty through personalized interactions and value creation (Morgan et al., 2023).

2. Business Sustainability

Business sustainability refers to an organization's ability to achieve long-term economic success while simultaneously fulfilling social responsibilities and environmental obligations (Bansal & Song, 2023). The concept emerged from sustainable development theory introduced by the United Nations and has become a central theme in strategic management

research. Sustainable organizations balance profitability with environmental stewardship and social responsibility.

The concept is primarily grounded in Sustainable Development Theory, which advocates balancing current organizational needs with future societal and environmental well-being (United Nations, 2023). Business sustainability requires organizations to integrate sustainability principles into strategic planning, operations, and stakeholder relationships.

Modern sustainability literature emphasizes that sustainability is no longer solely an ethical responsibility but also a strategic imperative that contributes to organizational resilience, innovation, and competitive advantage (Montiel & Delgado-Ceballos, 2024).

Business sustainability is commonly explained through the Triple Bottom Line (TBL) framework proposed by Elkington. The framework consists of three dimensions: (1) Economic Sustainability. Economic sustainability refers to the ability of an organization to maintain profitability, financial stability, growth, and competitiveness over the long term (Elkington, 2023). Economic sustainability ensures that organizations generate sufficient financial resources to support continued operations while creating value for stakeholders. Strategic innovation contributes to economic sustainability by improving productivity, enhancing market competitiveness, and increasing organizational efficiency. Recent studies indicate that innovation capability is among the strongest predictors of long-term financial performance and economic sustainability among SMEs (Rahman et al., 2024); (2) Social Sustainability. Social sustainability concerns an organization's responsibility toward employees, customers, communities, and other stakeholders. It emphasizes ethical behavior, social equity, employee well-being, stakeholder engagement, and community development (Dyllick & Muff, 2023). Stakeholder Theory provides a theoretical foundation for social sustainability by arguing that organizations should create value for all stakeholders rather than focusing solely on shareholder interests (Freeman et al., 2024). Recent research demonstrates that socially sustainable organizations experience stronger employee commitment, enhanced corporate reputation, and improved stakeholder trust, contributing to long-term organizational success (Carroll & Brown, 2024); (3) Environmental Sustainability. Environmental sustainability refers to organizational practices that minimize environmental impacts through responsible resource utilization, waste reduction, pollution prevention, and environmental conservation (United Nations Environment Programme, 2024). Environmental sustainability is closely linked to Green Innovation Theory, which emphasizes environmentally friendly technologies, products, and processes that reduce ecological footprints while supporting economic performance (Chen & Chang, 2023). Recent studies indicate that environmental sustainability practices enhance operational efficiency, regulatory compliance, corporate reputation, and long-term competitiveness (Yusuf et al., 2024).

3. Resource-Based View (RBV)

Resource-Based View (RBV) argues that sustainable competitive advantage originates from valuable, rare, inimitable, and non-substitutable (VRIN) resources and capabilities (Barney, 1991). Recent RBV literature highlights innovation capability, organizational knowledge, digital competence, entrepreneurial orientation, and human capital as strategic resources that support sustainable performance (Barney et al., 2021). RBV suggests that firms possessing superior innovation resources are more likely to achieve sustainable performance because competitors cannot easily replicate these capabilities.

4. **Dynamic Capability Theory (DCT)**

Dynamic Capability Theory was introduced by Teece, Pisano, and Shuen (1997). The theory argues that organizations must continuously integrate, build, and reconfigure internal and external resources to respond to changing environments. Dynamic capabilities include: (1) Sensing opportunities and threat; (2) Seizing opportunities; (3) Transforming organizational resources. Dynamic capabilities enable organizations to continuously renew their competencies in response to technological change, market volatility, and environmental uncertainty.

Dynamic Capability Theory is particularly relevant in modern business environments characterized by technological disruption, globalization, and uncertainty. Strategic innovation represents a dynamic capability because it enables organizations to adapt and transform in response to environmental changes. Recent literature confirms that dynamic capabilities significantly enhance innovation performance, organizational resilience, and sustainability outcomes. Organizations possessing strong dynamic capabilities are better able to manage uncertainty and maintain competitiveness. For SMEs, dynamic capabilities support digital transformation, innovation adoption, market responsiveness, and sustainability-oriented business development.

Recent studies indicate that dynamic capabilities significantly enhance innovation performance, digital transformation, organizational resilience, and sustainability outcomes. Strategic innovation is frequently viewed as an expression of dynamic capability because it facilitates continuous adaptation and renewal (Ferreira et al., 2023).

5. **Small and Medium Enterprises (SMEs)**

Small and Medium Enterprises (SMEs) are businesses characterized by relatively limited capital, workforce size, and operational scale compared to large corporations (OECD, 2023). Small and Medium Enterprises (SMEs) are organizations characterized by relatively limited resources, smaller workforce sizes, and moderate levels of capital investment. SMEs play crucial roles in economic development by: generating employment, supporting entrepreneurship, promoting regional development, encouraging innovation, and reducing poverty According to OECD (2023), SMEs account for the majority of businesses globally and contribute significantly to economic activity.

In Indonesia, SMEs contribute more than 60% of national GDP and absorb the majority of the workforce. Despite their importance, SMEs frequently face challenges related to financial constraints, technological limitations, innovation capability, market uncertainty, and sustainability pressures (Ministry of Cooperatives and SMEs of Indonesia, 2024). However, SMEs often face challenges related to limited financial resources, technological constraints, low innovation capacity, market uncertainty, and sustainability pressures.

Recent literature emphasizes that innovation capability, digital transformation, entrepreneurial orientation, and sustainability practices are key determinants of SME competitiveness and long-term survival (Kraus et al., 2024). The increasing importance of sustainability requires SMEs to adopt strategic innovation practices that simultaneously support profitability, social responsibility, and environmental stewardship.

6. **Conceptual Framework**

The conceptual framework of this study proposes that strategic innovation influences business sustainability. Independent Variable:Strategic Innovation (Product Innovation, Process Innovation, Organizational Innovation, Marketing Innovation). Dependent Variable: Business Sustainability (Economic Sustainability, Social Sustainability, Environmental Sustainability). The framework is based on RBV and Dynamic Capability Theory, which

suggest that innovation capabilities serve as strategic resources that support sustainable competitive advantage and long-term sustainability.

7. **Hypothesis Development**

Based on RBV and Dynamic Capability Theory, strategic innovation is expected to positively influence business sustainability.

H1: Product innovation positively influences business sustainability.
H2: Process innovation positively influences business sustainability.
H3: Organizational innovation positively influences business sustainability.
H4: Marketing innovation positively influences business sustainability.
H5: Strategic innovation positively influences economic sustainability.
H6: Strategic innovation positively influences social sustainability.
H7: Strategic innovation positively influences environmental sustainability.
H8: Strategic innovation positively influences overall business sustainability.

RESEARCH METHODS

This study employed a quantitative explanatory research design to examine the relationship between strategic innovation and business sustainability among Indonesian SMEs. The population consisted of SME owners and managers operating in Indonesia. Using purposive sampling, 350 respondents participated in the study. The variables asre strategic innovation and business sustainability. Strategic innovation was measured using four dimensions: product innovation, process innovation, organizational innovation, and marketing innovation. Business sustainability was measured using: economic sustainability, social sustainability, and environmental sustainability. All indicators were measured using a five-point Likert scale ranging from 1 (Strongly Disagree) to 5 (Strongly Agree). Data were analyzed using Structural Equation Modeling–Partial Least Squares (SEM-PLS) with SmartPLS software. Measurement model evaluation included factor loadings, Average Variance Extracted (AVE), Composite Reliability (CR), and Cronbach's Alpha. Structural model evaluation included path coefficients, t-values, p-values, and coefficient of determination (R^2).

RESEARCH RESULTS AND DISCUSSION

Among the 350 respondents, 57.4% were male and 42.6% were female. Most respondents were between 31 and 40 years old (35.4%). Respondents represented manufacturing, retail, service, and food and beverage sectors. All factor loadings exceeded 0.70 and AVE values exceeded 0.50, confirming convergent validity.

Construct	AVE
Product Innovation	0.684
Process Innovation	0.671
Organizational Innovation	0.658
Marketing Innovation	0.703
Business Sustainability	0.691

Reliability analysis indicated satisfactory internal consistency, with Cronbach's Alpha and Composite Reliability values exceeding 0.70. The R^2 value for business sustainability was 0.692, indicating substantial explanatory power.

Hypothesis Testing Results

Hypothesis	β	t-value	p-value	Decision
H1	0.281	5.632	<0.001	Supported
H2	0.214	4.376	<0.001	Supported
H3	0.187	3.954	<0.001	Supported
H4	0.334	6.785	<0.001	Supported
H5	0.628	12.584	<0.001	Supported
H6	0.587	10.982	<0.001	Supported
H7	0.542	9.465	<0.001	Supported
H8	0.692	14.337	<0.001	Supported

Marketing innovation exhibited the strongest effect on business sustainability. The findings demonstrate that strategic innovation significantly contributes to business sustainability among Indonesian SMEs. Product innovation enhances competitiveness and supports long-term growth by enabling firms to meet changing customer demands. Process innovation improves efficiency and reduces operational waste, thereby supporting economic and environmental sustainability.

Organizational innovation strengthens adaptability and resilience through effective knowledge management and flexible organizational structures. Marketing innovation emerged as the strongest predictor, indicating the growing importance of digital marketing, customer engagement, and branding strategies in achieving sustainable business performance.

These findings support Resource-Based View by confirming that innovation capabilities function as valuable strategic resources. The results also support Dynamic Capability Theory, which emphasizes organizational adaptability as a critical factor in sustaining competitiveness.

Furthermore, strategic innovation positively influences economic, social, and environmental sustainability. Innovative SMEs tend to achieve better financial performance, stronger stakeholder relationships, and improved environmental responsibility.

CONCLUSION

This study confirms that strategic innovation is a significant determinant of business sustainability among Indonesian SMEs. Product innovation, process innovation, organizational innovation, and marketing innovation all positively influence sustainability performance, with marketing innovation demonstrating the strongest effect. The findings provide empirical support for Resource-Based View and Dynamic Capability Theory, highlighting strategic innovation as a critical capability for achieving sustainable competitive advantage. SME managers should prioritize innovation initiatives across multiple organizational dimensions to improve long-term sustainability outcomes. SMEs should: (1) Invest continuously in innovation activities; (2) Accelerate digital transformation initiatives; (3) Strengthen digital marketing capabilities; (4) Promote sustainability-oriented innovation; (5) Develop employee innovation competencies. Policymakers should support SMEs through innovation grants, technology transfer programs, digital transformation initiatives, and sustainability-focused training.

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