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ENHANCING SME COMPETITIVE ADVANTAGE: THE ROLE OF INNOVATION, STRATEGIC FLEXIBILITY, AND GOVERNMENT SUPPORT

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Abstract

This study develops an understanding of the competitive advantage factors in MSMEs located in the Berau Regency of East Kalimantan, Indonesia. Using an explanatory research design and a quantitative approach, this study examines whether intellectual capital, managerial competencies, and digital literacy predict competitive advantage, with the mediating role of innovation speed and strategic flexibility. In addition, government support is examined as a moderating variable. Data were collected through a sample of 165 owners and managers of MSMEs, selected through proportional area random sampling, and a Likert-scale questionnaire. The data analysis technique used is SEM-PLS. The results prove that intellectual capital, managerial competence, and digital literacy significantly enhance innovation speed and strategic flexibility, which have been the key factors that drive a firm to achieve the state of sustainable competitive advantage. However, further optimization is needed in government support for fully tapping the innovative potentials of MSMEs. Such findings offer useful insights to stakeholders while strategizing for strengthening MSME competitiveness by responding to globalization and digital transformation challenges and opportunities opened by regional economic growth. The present research will contribute to enhanced knowledge about MSMEs and their resilience in an increasingly dynamic and competitive business environment.

Keywords: Competitiveness, Digitalization, Innovation, Management, Strategy.

1. INTRODUCTION

SMEs play a very significant role in the economy of Indonesia, constituting about 60.3% of the Gross Domestic Product and employing 97% of the national labour force. In 2021, Indonesia had the highest number of SMEs among the ASEAN countries, amounting to 65.46 million units. The huge potential is scattered across the region, including East Kalimantan, which had 344,581 SMEs in 2024 and Samarinda and Balikpapan as the main contributors. In the regency of Berau, East Kalimantan, ranking fourth in the number of SMEs, there are 30,200 SMEs. Geographically, this region has the advantage of the development of marine tourism and rich natural resources in the mining, fishery, and ecotourism industries. The infrastructure and business ecology are relatively more developed when compared with other areas, such as Mahakam Ulu, which puts forward a strong economic foundation on which the development of SMEs is to be supported.

Despite this potential, the SMEs in Berau face a challenge in creating sustainable competitive advantages. The barriers are represented through limited technology, minimal innovation, and a lack of training for business actors, which make differentiation in products and business efficiency hard to achieve. This corresponds to the theory of Porter (1990), in which he

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mentioned that the competitive advantage is obtained by utilizing internal strengths to respond to external opportunities.

Intellectual capital acts as one of the crucial antecedents to enhance SME competitiveness. Human capital, structural capital, and relational capital enable innovation and competitive advantages (Beltramino et al., 2020; Todericiu & Stăniţ, 2015). Subramaniam & Youndt (2005) argued that some dimensions of intellectual capital related to incremental and radical innovations significantly influence company performance directly.

Managerial capability plays an important role in the integration and configuration of resources (Todericiu & Stăniţ, 2015; Adner & Helfat, 2003). According to Teece (2016), such a capability provides organizations with the ability to respond to dynamic environments, enhance innovation performance, and achieve sustainable competitive advantage.

While the contribution of SMEs to Indonesia has been widely recognized as the driver of the national economy, most studies are still focused on the Java Island region. Research related to SMEs in East Kalimantan, especially in Berau Regency, which has great potential in the tourism and natural resource sectors, is still very limited. Additionally, there is a lack of comprehensive research on how SMEs could achieve a competitive advantage by developing the nexus of management competence and intellectual capital. The ability of SMEs to innovate through technology and to exploit local resources is an important strategic issue that deserves more attention in the era of globalization and digital transformation. The study, therefore, adds to the existing material by examining how SMEs in Berau can become more competitive using the Resource-Based View framework and the role of unique resource management and intellectual capital in creating a sustainable competitive advantage.

2. METHODS

This study is an explanatory research that attempts to analyse complex conditions in the form of multifarious factors that determine competitive advantage in SMEs and its surroundings in Berau Regency, East Kalimantan, Indonesia. Therefore, this study uses a quantitative approach in testing the relationship by analysing an in-depth eight main interacting variable study.

The focus of the study lies in how intellectual capital, managerial capabilities, and digital literacy act as independent variables influencing competitive advantage through intervening variables, which include innovation speed and strategic connectivity. Moreover, the addition of a moderating variable in the form of the role of the government certainly adds complexity to this research model. This study agrees with earlier findings that the ability to innovate and be more digital increases the competitiveness of SMEs (Yuleva–Chuchulayna, 2021).

This study involved a population of 303 SMEs registered in Berau Regency. Using the proportional area random sampling technique, a sample of 165 respondents was determined consisting of SME owners or managers. The selection of respondents was done purposively to understand the comprehensive scenario of their business environment and challenges, as suggested by the research on SME business strategies by (Raut et al., 2018).

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A Likert-type questionnaire was used to allow the respondents to give their opinions on a scale ranging from strongly disagree to strongly agree. Primary data were gathered directly from respondents, while secondary data were obtained from the Berau Regency Cooperatives, Industry, and Trade Service. The research instrument was tested for validity and reliability, and the results were very good, with a Cronbach's Alpha value of more than 0.7, as set by the measurement standards in quantitative research (Hair, 2009).

Data analysis was performed using the Partial Least Square method, which is a modern approach for testing complex structural models, and it is not necessary to assume that the data is normally distributed. The sequence was systematic in designing the structural model, drawing the path diagram, and testing hypotheses with the bootstrap method to discover how the mechanism underlying SME competitive advantage works. The basis for this approach has been that it has widely been applied in similar studies to decipher the complexity of business strategy (Sarstedt et al., 2014).

The described comprehensive approach will help the study to describe the phenomenon and further build an in-depth understanding of the dynamics of strategies influencing SME competitiveness in the Berau Regency area.

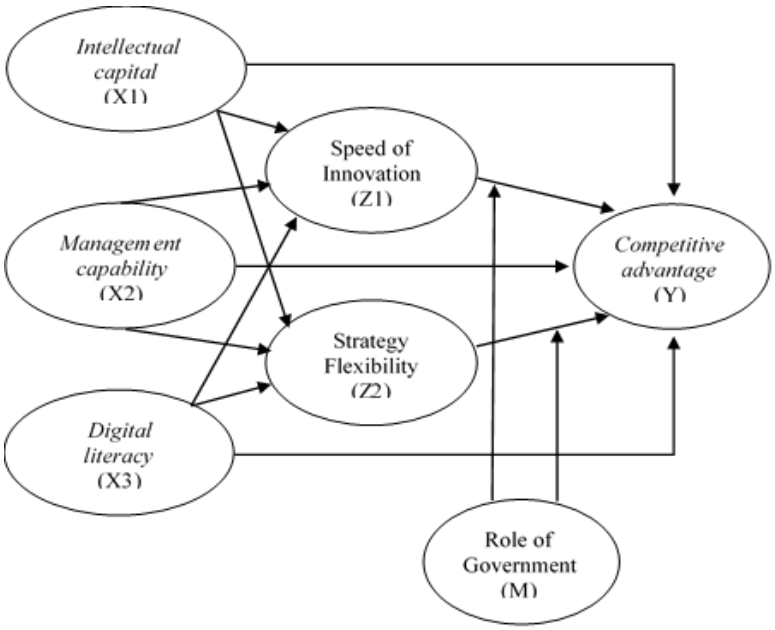

Figure 1: Conceptual Framework

Source: Researcher's results (2024)

3. RESULTS

Measurement Model Analysis (Outer Model)

The analysis of the measurement model seeks to assess the appropriateness of construct measurement, along with the validity and reliability of the indicators that represent the

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construct. Discriminant Validity is also a validity test of the research model with SmartPLS. Discriminant Validity explains the ability of each statement to distinguish between its constructs and other constructs. The model is said to be valid if the value of each statement in its construct has the largest factor loading value when connected to other constructs. The results of the discriminant validity test are obtained as follows:

Table 1: Discriminant Validity Value (Cross Loading)

	M	X1	X2	X3	Y	Z1	Z2	M x Z2	M x Z1
M_1	0.870	0.768	0.778	0.787	0.764	0.717	0.843	-0.652	-0.568
M_2	0.962	0.762	0.763	0.788	0.856	0.714	0.842	-0.525	-0.453
M_3	0.940	0.751	0.815	0.749	0.821	0.748	0.861	-0.529	-0.462
M_4	0.882	0.714	0.724	0.691	0.803	0.692	0.768	-0.548	-0.399
M_5	0.956	0.685	0.704	0.732	0.789	0.678	0.770	-0.529	-0.462
M_6	0.954	0.725	0.734	0.760	0.829	0.702	0.805	-0.538	-0.439
X1_1	0.564	0.773	0.615	0.669	0.639	0.643	0.680	-0.547	-0.449
X1_10	0.583	0.780	0.613	0.620	0.619	0.504	0.586	-0.256	-0.257
X1_11	0.634	0.863	0.688	0.768	0.671	0.634	0.734	-0.415	-0.425
X1_2	0.654	0.828	0.633	0.815	0.692	0.663	0.751	-0.620	-0.490
X1_3	0.639	0.786	0.627	0.645	0.751	0.653	0.703	-0.398	-0.298
X1_4	0.633	0.824	0.656	0.660	0.615	0.475	0.654	-0.500	-0.358
X1_5	0.618	0.888	0.672	0.748	0.695	0.673	0.716	-0.586	-0.478
X1_6	0.798	0.882	0.738	0.821	0.822	0.747	0.800	-0.603	-0.522
X1_7	0.778	0.922	0.728	0.801	0.859	0.732	0.828	-0.564	-0.433
X1_8	0.600	0.710	0.687	0.521	0.655	0.585	0.601	-0.039	-0.039
X1_9	0.637	0.803	0.753	0.649	0.626	0.613	0.677	-0.382	-0.283
X2_1	0.713	0.687	0.832	0.671	0.655	0.570	0.697	-0.393	-0.393
X2_2	0.525	0.571	0.744	0.548	0.528	0.426	0.559	-0.297	-0.271
X2_3	0.753	0.758	0.923	0.778	0.752	0.687	0.803	-0.515	-0.412
X2_4	0.725	0.716	0.898	0.783	0.770	0.706	0.774	-0.274	-0.178
X2_5	0.761	0.763	0.916	0.685	0.835	0.709	0.785	-0.406	-0.266
X2_6	0.686	0.745	0.888	0.719	0.768	0.704	0.755	-0.497	-0.356
X2_7	0.716	0.705	0.843	0.741	0.733	0.631	0.748	-0.195	-0.091
X2_8	0.745	0.725	0.913	0.786	0.820	0.751	0.807	-0.306	-0.204
X3_1	0.733	0.732	0.790	0.804	0.846	0.843	0.791	-0.413	-0.366
X3_2	0.833	0.803	0.800	0.879	0.856	0.692	0.837	-0.451	-0.332
X3_3	0.622	0.650	0.690	0.814	0.638	0.589	0.705	-0.282	-0.269
X3_4	0.762	0.829	0.740	0.922	0.814	0.722	0.811	-0.626	-0.533
X3_5	0.475	0.644	0.558	0.782	0.518	0.474	0.593	-0.553	-0.504
X3_6	0.432	0.530	0.447	0.715	0.500	0.474	0.554	-0.288	-0.213
X3_7	0.714	0.715	0.657	0.873	0.721	0.635	0.764	-0.552	-0.521
Y_1	0.850	0.769	0.819	0.776	0.971	0.819	0.856	-0.440	-0.337
Y_2	0.771	0.749	0.684	0.708	0.907	0.723	0.765	-0.530	-0.432
Y_3	0.792	0.806	0.756	0.830	0.930	0.747	0.833	-0.487	-0.375
Y_4	0.795	0.842	0.790	0.858	0.928	0.780	0.814	-0.505	-0.385
Y_5	0.818	0.754	0.808	0.795	0.916	0.753	0.846	-0.376	-0.282
Y_6	0.840	0.805	0.866	0.849	0.919	0.806	0.876	-0.511	-0.424
Z1_1	0.747	0.733	0.764	0.779	0.776	0.919	0.755	-0.493	-0.387
Z1_2	0.655	0.650	0.692	0.680	0.738	0.907	0.686	-0.284	-0.282

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Z1_3	0.688	0.708	0.703	0.687	0.774	0.917	0.755	-0.463	-0.353
Z1_4	0.703	0.734	0.659	0.717	0.774	0.891	0.710	-0.496	-0.341
Z1_5	0.562	0.542	0.514	0.600	0.581	0.867	0.561	-0.401	-0.411
Z1_6	0.740	0.755	0.707	0.739	0.814	0.899	0.758	-0.446	-0.440
Z2_1	0.766	0.790	0.772	0.819	0.743	0.709	0.887	-0.666	-0.601
Z2_2	0.818	0.839	0.797	0.839	0.815	0.701	0.940	-0.589	-0.487
Z2_3	0.842	0.699	0.791	0.733	0.854	0.688	0.863	-0.372	-0.238
Z2_4	0.788	0.800	0.801	0.847	0.813	0.722	0.925	-0.600	-0.484
Z2_5	0.669	0.660	0.619	0.673	0.744	0.673	0.808	-0.416	-0.449
M x Z1	-0.499	-0.453	-0.307	-0.475	-0.401	-0.409	-0.510	0.867	1.000
M x Z2	-0.595	-0.552	-0.415	-0.550	-0.510	-0.481	-0.600	1.000	0.867

Source: Researcher's results (2024)

From Table 1, it can be seen that the value of each statement in its construct has the largest factor loading value when connected to other constructs. This means that each latent variable has good discriminant validity, or it can be said that the research model can be declared valid.

After all the output cross loadings values meet the validity test requirements (have the largest factor loading value), the next step is to conduct a Reliability Test on the research model. Reliability testing related to the outer model uses Composite Reliability. Composite reliability aims to test the reliability value of the indicators in a construct. A construct (latent variable and its manifest variables) is said to meet composite reliability if it has a composite reliability value > 0.7 and. the Average Variance Extracted (AVE) value of each construct is required > 0.50 (Maruf et al., 2021).

The following are the composite reliability and average variance extracted values of each construct:

Table 2: Composite Reliability and Average Variance Extracted

Variable	Composite Reliability	AVE	Remark
Intellectual capital (X1)	0.959	0.682	Reliable
Management capability (X2)	0.962	0.759	Reliable
Digital literacy (X3)	0.939	0.688	Reliable
Speed of innovation (Z1)	0.963	0.811	Reliable
Strategy flexibility (Z2)	0.948	0.785	Reliable
Role of Government (M)	0.974	0.861	Reliable
Competitive advantage (Y)	0.974	0.862	Reliable

Source: Researcher's results (2024)

Based on Table 2, it can be concluded that all constructs meet the reliable criteria. This is indicated by the composite reliability value above 0.70 as required criteria.

The AVE value for each construct has a value above 0.50, meaning that all variables have a composite reliability value that is sufficient to meet the reliable requirements (Cheung et al., 2024; Sarstedt et al., 2021).

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Structural Model (Inner Model)

In the simultaneous testing/assessment of the model using PLS, it is done by looking at the R-Square (R^2) which aims to test the influence of exogenous latent variables on endogenous latent variables.

The higher the R-Square (R^2) value means the stronger the influence of exogenous latent variables on endogenous latent variables, in the proposed research prediction model. The results of the R-square estimation using SmartPLS are presented in Table 3 below:

Table 3: R-Square Value

Variable	R^2	Remark
Speed of innovation (Z1)	0.660	The contribution of the influence of the variables intellectual capital, management capability, and digital literacy on the speed of innovation is 66.0%
Strategy flexibility (Z2)	0.819	The contribution of the influence of the variables intellectual capital, management capability, and digital literacy on strategic flexibility is 81.9%
Competitive advantage (Y)	0.879	The contribution of the influence of the variables intellectual capital, management capability, digital literacy, speed of innovation, strategic flexibility, and the role of government on competitive advantage is 87.9%.

Source: Researcher's results (2024)

Based on Table 3, it shows that the innovation speed variable is influenced by the intellectual capital, management capability and digital literacy variables by 60.0%. This means that the intellectual capital, management capability and digital literacy variables are able to influence the innovation speed by 60.0%, while the remaining 40.0% is influenced by other variables not examined in this study.

For the strategy flexibility variable, it is influenced by the intellectual capital, management capability and digital literacy variables by 81.9%. This means that the intellectual capital, management capability and digital literacy variables are able to influence the strategy flexibility variable by 81.9%, while the remaining 18.1% is influenced by other variables not examined in this study.

Meanwhile, the competitive advantage variable is influenced by the intellectual capital, management capability, digital literacy, innovation speed, strategy flexibility and government role variables by 87.9%.

This means that the intellectual capital, management capability, digital literacy, innovation speed, strategy flexibility and government role variables are able to influence the competitive advantage variable by 87.9%, while the remaining 12.1% is influenced by other variables not examined in this study.

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Based on the results of the relationship test in this study, it can be summarized as follows:

Table 4: Test Summary

Relationship		Weight of Influence	T Statistic	Sig	Remark
Influence					
1	The influence of intellectual capital (X1) on competitive advantage (Y)	0.119	1.240	0.215	Not Significant
2	The influence of intellectual capital (X1) on innovation speed (Z1)	0.272	2.500	0.012	Significant
3	The influence of intellectual capital (X1) on strategic flexibility (Z2)	0.242	3.208	0.001	Significant
4	The influence of management capability (X2) on competitive advantage (Y)	0.065	0.708	0.479	Not Significant
5	The influence of management capability (X2) on innovation speed (Z1)	0.245	2.449	0.014	Significant
6	The influence of management capability (X2) on strategic flexibility (Z2)	0.311	5.155	0.000	Significant
7	The influence of digital literacy (X3) on competitive advantage (Y)	0.149	1.178	0.239	Not Significant
8	The influence of digital literacy (X3) on the speed of innovation (Z1)	0.348	3.436	0.001	Significant
9	The influence of digital literacy (X3) on strategic flexibility (Z2)	0.422	5.424	0.000	Significant
10	The influence of innovation speed (Z1) on competitive advantage (Y)	0.204	3.702	0.000	Significant
11	The influence of strategic flexibility (Z2) on competitive advantage (Y)	0.247	1.888	0.059	Not Significant
12	The influence of intellectual capital (X1) is mediated by the speed of innovation (Z1) on competitive advantage (Y)	0.055	2.111	0.035	Significant
13	The influence of intellectual capital (X1) mediated by strategic flexibility (Z2) on competitive advantage (Y)	0.060	2.074	0.038	Significant
14	The influence of management capability (X2) mediated by innovation speed (Z1) on competitive advantage (Y)	0.050	1.882	0.060	Not Significant
15	The influence of management capability (X2) mediated by strategic flexibility (Z2) on competitive advantage (Y)	0.077	1.691	0.091	Not Significant
16	The influence of digital literacy (X3) is mediated by the speed of innovation (Z1) on competitive advantage (Y)	0.071	2.390	0.017	Significant
17	The influence of digital literacy (X3) mediated by strategic flexibility (Z2) on competitive advantage (Y)	0.104	1.512	0.130	Not Significant
18	The role of government moderates between strategic flexibility (Z2) and competitive advantage (Y)	0.084	2.292	0.022	Significant
19	The role of government is to moderate the speed of innovation (Z1) and competitive advantage (Y)	-0.013	0.304	0.761	Not Significant

Source: Researcher's results (2024)

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4. DISCUSSION

MSMEs are vital to the Indonesian economy, contributing 60.3% to the Gross Domestic Product and providing employment to about 97% of the workforce, thus acting as an economic backbone.

The projection of MSMEs in East Kalimantan until 2024 is 344,581 units, showing a great opportunity for economic development based on natural resources and ecotourism. In Berau Regency, approximately 30,200 MSMEs enjoy geographical advantages due to rich marine tourism and natural resource availability.

In reality, however, the potentials remain underutilized because of various constraints related to the limited access of the entrepreneur to technology, insufficient innovation, and a lack of training for entrepreneurs.

The Importance of Innovation and Managerial Capacity

The current research indicates that intellectual capital has a substantial impact on the pace of innovation and strategic adaptability. However, the direct effect of intellectual capital on competitive advantage appears to be minimal, as evidenced by a T-value of 1.240 and a p-value of 0.215.

These findings confirm the theory of Subramaniam & Youndt (2005), which mentions that intellectual capital dimensions, such as human capital, structural capital, and relational capital, significantly support both incremental and radical innovation, which then affects company performance.

By increasing the speed of innovation, MSMEs can create superior products or services and be competitive in the global market. According to Teece (2016), capability management is the crucial source of integration and configuration for organizational resources.

The result of the study showed that managerial capabilities have a positive significant effect on innovation speed ($T = 2.449$; $p = 0.014$) and strategic flexibility ($T = 5.155$; $p < 0.001$), but it has an insignificant direct effect on competitive advantage ($T = 0.708$; $p = 0.479$). This proves that managerial abilities work as a leveraging mechanism and maximize the internal resources inducing competitive advantage indirectly via some mediating variables.

The Role of Digital Literacy in Driving Innovation

In the era of digital transformation, digital literacy is one of the important factors in driving the competitive advantage of MSMEs. This study indicated that digital literacy significantly influenced the speed of innovation, with $T = 3.436$; $p = 0.001$, and strategic flexibility, with $T = 5.424$; $p < 0.001$, although its direct influence on competitive advantage was not significant, with $T = 1.178$; $p = 0.239$.Digital literacy empowers micro, small, and medium enterprises (MSMEs) to embrace cutting-edge technology, improve their operational efficiency, and accelerate innovation in their business processes. These conclusions align with the research of Bharadwaj et al. (2013), which indicates that proficiency in information technology greatly strengthens a firm's capacity to adapt to changes in the business landscape.

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Speed of Innovation and Strategic Flexibility as Mediating Variables

Furthermore, it was proved that speed of innovation had a significant effect on competitive advantage at $T = 3.702$; $p < 0.001$. This attested that the speed of innovating allows MSMEs to respond to market needs with greater effectiveness and more efficiency.

This conclusion is reinforced by the Resource-Based View (RBV) theory, which posits that internal resources, including innovation, offer advantages that are challenging for competitors to replicate (Barney, 1991).

While strategic flexibility does not have a significant direct impact on competitive advantage ($T = 1.888$; $p = 0.059$), it serves a crucial function as a mediator. The findings of the study show that intellectual capital, managerial capabilities, and digital literacy significantly influence competitive advantage through strategic flexibility.

Strategic flexibility by Sanchez (1995) is the ability of MSMEs to adapt to the changing dynamic business environment. Through flexibility, the MSMEs are able to convert challenges into strategic opportunities.

Moderation of Government Role

The findings further indicate that the government's role plays a significant moderating effect on the relationship between strategic flexibility and competitive advantage, with $T = 2.292$; $p = 0.022$. In this context, the government has the capacity to assist micro, small, and medium enterprises (MSMEs) by implementing policies that promote innovation, technological advancement, and market accessibility.

Such a policy supportive environment will help MSMEs to use strategic flexibility in a more feasible business environment. However, government-moderating innovation speed and competitive advantage is insignificant ($T = 0.304$; $p = 0.761$), meaning the intervention of the government in support of innovation needs to be further improved by more focused policies.

Practical and Theoretical Implications

The research contributes both practically and theoretically. The practical contribution this study can provide is that MSMEs in Berau should improve their intellectual capital, managerial capabilities, and digital literacy to build sustainable competitive advantages.

Their support needs to be further enhanced through training, technology subsidies, and policies stimulating innovation by the government as well. Theoretically, this supports the concept of RBV by showing how internal resources in terms of intellectual capital and digital literacy are important for building competitive advantage.

5. CONCLUSION

This research indicates that intellectual capital, managerial competence, and digital literacy play significant roles in determining the pace of innovation and strategic flexibility, which in turn impacts the competitive advantage of micro, small, and medium enterprises (MSMEs) in Berau.

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The pace of innovation is identified as a critical factor in achieving sustainable competitive advantage, whereas strategic flexibility serves as a mechanism for adapting to the ever-changing business landscape. Government support, though important in its moderating role, has to be further improved in order to optimize the innovation potential of MSMEs.

The research is thus important to stakeholders in building more effective strategies to further support MSME growth. Through enhancing internal resources and making better use of government support, MSMEs in Berau can be much better prepared to face globalization challenges and digital transformation and be able to capitalize on regional economic potential.

This present study also has some limitations. First, the focus on the geographical area of MSMEs in Berau Regency, East Kalimantan, leads to doubts that the research results must be representative of the general conditions of MSMEs in other parts of Indonesia.

The second limitation of the given study is the investigation of just a few variables like intellectual capital, managerial capability, digital literacy, speed of innovation, and strategic flexibility, as long as there are so many others.

Further research needs to be done by covering more geographical areas and, importantly, adding other variables, such as sustainability, market orientation, and adoption of advanced technology, to be able to have a greater understanding of the factors that surround the competitiveness of MSMEs.

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