

The Effect Of Entrepreneurial Orientation, Product Innovation, And Dynamic Capabilities On Business Performance In Small And Medium-Sized Enterprises In Malang City

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ABSTRACT

This research investigates how entrepreneurial orientation, product innovation, and dynamic capabilities influence the business performance of MSMEs in Malang City. A quantitative design was applied, involving 208 MSME participants chosen through purposive sampling. Data were obtained using a Likert-scale questionnaire ranging from 1 to 5, then examined through validity and reliability testing, classical assumption checks, and multiple linear regression using SPSS 26. The findings indicate that the three predictors collectively contribute significantly to the performance of MSMEs ($\text{Sig.} = 0.000 < 0.05$). Individually, entrepreneurial orientation and dynamic capabilities were found to positively and significantly strengthen business performance, whereas product innovation did not show a meaningful influence. The determination value of 97.1% indicates that the model has a very high explanatory power for the variation in MSME performance. This finding confirms that the success of MSMEs in Malang City is largely determined by the ability of business actors to adapt, take risks, and develop robust business strategies.

Keywords: entrepreneurial orientation, product innovation, dynamic capabilities, business performance.

INTRODUCTION

MSMEs play a vital role in the national economy as the largest employer and driver of regional economic growth. In Malang City, the MSME sector is growing rapidly with a total of 21,270 MSMEs curated and a target of 4,000 MSMEs moving up the ladder by 2025 (Antara, 2025). Additionally, Malang Regency recorded a turnover of IDR 181.05 billion and assets of IDR 716.48 billion, with employment reaching 4.7 million people (Balaikota News, 2024). Although this growth shows great economic potential, most MSMEs still face serious challenges in maintaining sustainable business performance amid increasingly competitive market competition and rapid changes in the business environment.

Entrepreneurial orientation is one of the strategic factors in improving the competitiveness and performance of MSMEs. This concept reflects an innovative, proactive, and risk-taking attitude in creating new opportunities (Corrêa et al., 2022). Entrepreneurial orientation plays a crucial role for MSMEs, as it fosters the creativity and flexibility needed to respond to shifting market demands. By cultivating a proactive and innovative mindset, MSMEs are better equipped to adjust their strategies, explore new opportunities, and remain competitive in dynamic business environments (Zighan et al., 2022). However, Makhoulfi et al. (2021) show that entrepreneurial orientation is only effective when accompanied by product innovation capabilities and dynamic organizational capabilities.

Product innovation is an important aspect in maintaining business relevance, especially for MSMEs competing in local and national markets. Innovation enables companies to create added value through product updates, quality improvements, and differentiation that sets them apart from competitors (Sarii, 2024; Azhari & Ali, 2024). In the digital era, innovation is not only related to the physical form of products, but also involves the digitization of production and marketing processes (Tanjung et al., 2025). However, many MSMEs in Malang still face limitations in terms of resources, technology, and capital to innovate sustainably.

Moreover, dynamic capabilities serve as a key determinant in helping businesses cope with fast-paced changes in their external environment. According to Zahra et al. (2022), dynamic capabilities refer to an organization's capacity to combine, develop, and realign both internal and external resources in response to evolving conditions. For MSMEs, these capabilities support organizational agility, enhance learning mechanisms, and enable the continual adjustment of strategies to keep pace with market shifts (Munandar & Witjaksono, 2025). Without dynamic capabilities, MSMEs tend to stagnate and find it difficult to maintain their competitive advantage in the long term.

Given these circumstances, it is essential to conduct a thorough investigation into how entrepreneurial orientation, product innovation, and dynamic capabilities collectively influence the business performance of MSMEs in Malang City. This research is relevant considering that Malang City is currently striving to create a creative economy ecosystem based on MSMEs that is resilient, adaptive, and innovative towards the target of "MSMEs Moving Up a Class by 2025."

LITERATURE REVIEW

Micro, Small, and Medium Enterprises (MSMEs)

MSMEs are an economic sector that contributes significantly to national development, both in terms of job creation, income distribution, and regional economic growth. MSMEs in Indonesia function as a vital pillar of the national economy, largely because of their resilience during periods of crisis and their capacity to adjust quickly to shifts in market conditions (Sirait et al., 2025). In the context of Malang City, the role of MSMEs is not only focused on improving the welfare of the community, but also as a driver of the creative economy and local tourism.

In broad terms, MSMEs refer to productive enterprises operated by individuals or small business entities that meet specific capital and revenue criteria as outlined in Law Number 20 of 2008. The main characteristics of MSMEs include limited human resources, capital, and managerial capabilities, but they have high flexibility in innovation and market strategy (Muttaqin & Apriadi, 2025). In the digital era, MSMEs face new challenges such as marketing digitalization, supply chain integration, and global competition, which require business actors to improve their entrepreneurial and innovation capabilities (Veiga et al., 2024). Therefore, the success of SMEs is not only determined by external factors such as government policies, but also internal factors such as entrepreneurial orientation, product innovation, and dynamic capabilities.

MSME Business Performance

Business performance reflects the extent to which an organization achieves its established goals, both financially and non-financially (Sundari et al., 2024). In the context of MSMEs, business performance is often measured through indicators of sales growth, profit increase, operational efficiency, customer satisfaction, and business sustainability (Mulyani & Hapsari, 2020). Business performance is influenced not only by financial outcomes but also by how effectively a company implements its strategies, innovates, and adjusts to shifts in its external environment. Rusli and Sujardi (2021) explain that performance can be assessed more holistically using the four dimensions of the Balanced Scorecard, which include financial results, customer perspectives, internal business processes, and learning and growth. In the MSME scale, business performance measurement tends to be simpler but still emphasizes survivability, market expansion, and increased customer satisfaction (Saad et al., 2022). Therefore, good business performance reflects the effectiveness of resource management and the innovative capabilities of business actors in facing market dynamics.

Entrepreneurial Orientation

Entrepreneurial orientation describes an organization's pattern of behavior in innovating, taking risks, and acting proactively on opportunities in the market (Chowdhury & Audretsch, 2021). This orientation reflects entrepreneurial values and culture that guide companies to continuously seek new opportunities and act quickly (Estede et al., 2025). Al-Mamary & Alshallaqi (2022) argue that entrepreneurial orientation consists of five main dimensions:

1. Innovativeness, which is the tendency to generate new ideas, conduct experiments, and develop new products or services.
2. Risk taking, which is the courage to make strategic decisions under uncertainty.
3. Proactiveness, which is the orientation to be the first to identify and respond to market opportunities.
4. Competitive aggressiveness, which is the ability and willingness to compete offensively against competitors.
5. Autonomy, which is the freedom of individuals or teams to make decisions and implement innovative ideas.

Product Innovation

Roberts et al. (2022) define product innovation as an integrated process involving creativity, development, and commercialization of new products that are valuable to consumers. Innovation encompasses not only the creation of new products, but also the improvement, adaptation, or development of existing products (Bouschery et al., 2025). Salma et al. (2023) classify product innovation into three main categories, namely:

1. Product extensions – new products for the market, but still related to the company's existing line.
2. Me-too products – products that imitate existing market concepts, but are modified to suit customer needs.
3. New-to-the-world products – products that are completely new to both the company and the market.

For MSMEs, product innovation plays an important role in strengthening market position, attracting new customers, and adapting to rapidly changing consumer trends (Sari, 2024). Good product innovation quality can increase brand value, strengthen differentiation, and drive sustainable business performance.

Dynamic Capabilities

Dynamic capabilities describe an organization's capacity to adjust, renew, and reorganize both internal and external resources in order to respond effectively to shifts in its environment (Toyyibah & Kurniawan, 2025). Muliadi and Yuwono & Vaddhano (2025) explain that dynamic capabilities have three main dimensions: sensing opportunities and threats, learning to improve organizational capabilities, and reconfiguring resources to adjust strategies to market conditions. According to Safitri et al. (2024), dynamic capabilities reflect an organization's habit of updating its competencies and resources to remain relevant to evolving market needs. Meanwhile, Bari et al. (2022) emphasize that dynamic capabilities are the result of a stable collective process, in which organizations systematically improve their routines and business operations to achieve long-term effectiveness. In the context of MSMEs, dynamic capabilities are a determining factor for surviving increasingly fierce competition. Business actors who are able to develop dynamic capabilities can more quickly adjust their strategies, improve business processes, and take advantage of emerging opportunities, thereby positively impacting business performance.

Hypothesis Development

Entrepreneurial orientation reflects an organization's strategic mindset characterized by risk-taking, proactivity in seeking opportunities, and a drive for continuous innovation (Corrêa et al., 2022). In the MSME sector, entrepreneurial orientation functions as a key driver of growth, equipping business owners with the ability to navigate market fluctuations, build competitive strengths, and enhance overall productivity (Fahim & Indiran, 2024). MSMEs that exhibit strong entrepreneurial orientation are typically more willing to take strategic risks, pursue innovation in both products and processes, and respond swiftly to evolving customer preferences. These behaviors contribute to improved performance outcomes, not only in financial aspects such as profit and revenue expansion but also in non-financial areas including customer satisfaction and brand strength (Cheng et al., 2025). Research by Kamarudin et al. (2024) further confirms that entrepreneurial orientation positively influences performance because it supports the pursuit of new ideas and differentiation in the market. Therefore, higher levels of entrepreneurial orientation among MSME actors increase the likelihood of achieving strong and sustainable business performance within a dynamic competitive landscape. Based on this reasoning, the following hypothesis is formulated:

"H1: Entrepreneurial orientation has a positive and significant effect on the business performance of MSMEs in Malang City".

Product innovation is a key factor in determining business success and competitiveness, especially in the face of changing customer needs and technological developments (Florek-Paszkowska et al., 2021). The ability of MSMEs to continuously develop new products, improve existing quality, and adapt product design and functionality to market tastes is an important indicator of effective innovation (Purnomo et al., 1015). Hendrayanti and Nurauliya (2021) argue that innovation serves as a fundamental source of competitive advantage because it enables businesses to create new combinations within their production processes and the products they offer. Restrepo-Morales et al. (2024) further demonstrate that firms with strong product innovation capabilities tend to achieve higher customer satisfaction and experience substantial market expansion. For MSMEs, product innovation supports improvements in production efficiency, enhances product attractiveness in the marketplace, and strengthens customer loyalty factors that collectively contribute to better overall business performance (Sari et al., 2022). Ali et al. (2022) show that innovation not only expands market share but also strengthens the adaptive capacity of businesses to changes in consumer demand. Therefore, MSME actors who have consistent and market-oriented product innovation strategies tend to experience sustainable performance improvements. Based on this, the following hypothesis is proposed:

"H2: Product innovation has a positive and significant effect on the business performance of MSMEs in Malang City"

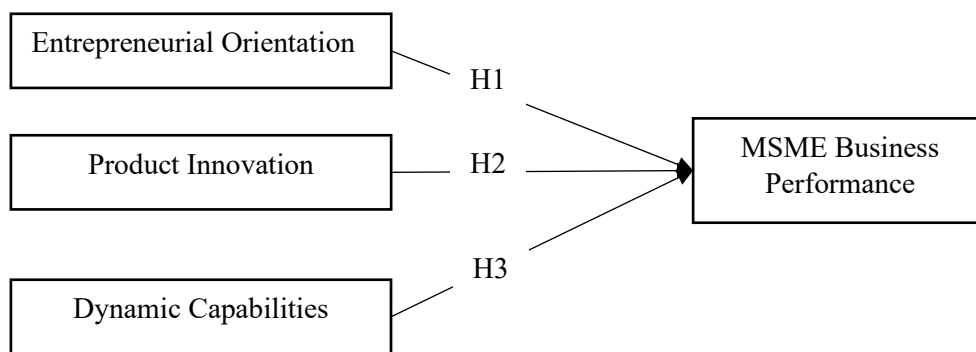
Dynamic capabilities are an organization's ability to integrate, reconfigure, and update internal and external resources in response to changes in the business environment (Teece et al., 1997). For MSMEs, dynamic capabilities are an important foundation for building resilience and strategic adaptation in a competitive market. Konlechner et al. (2018) emphasize that organizations with high dynamic capabilities are able to recognize opportunities (sensing), learn and adapt (learning), and reconfigure resources (reconfiguring) to create new value. Research by Triatmojo & Astuti (2025) shows that dynamic capabilities contribute significantly to increasing the effectiveness of innovation strategies and business sustainability. This is because business actors with good sensing and learning abilities can quickly read market changes and adjust their operational strategies to maintain competitive advantage (Yuwono & Vaddhano, 2025). Thus, dynamic capabilities not only strengthen competitiveness but also serve as a link between

organizational resources and optimal business performance results. In the context of MSMEs in Malang City, which face the pressures of digitalization and globalization, the ability to adapt and update strategies is key to success. Business actors with high dynamic capabilities tend to have better business performance because they are able to anticipate changes and take advantage of new opportunities. Based on this, the following hypothesis is proposed:

“H3: Dynamic capabilities have a positive and significant effect on the business performance of MSMEs in Malang City”

Based on the development of the hypothesis described above, the following is the conceptual framework of this study.

Figure 1. Conceptual Framework



RESEARCH METHODOLOGY

This research employs a quantitative approach to examine how Entrepreneurial Orientation, Product Innovation, and Dynamic Capabilities influence the business performance of MSMEs in Malang City. The study population includes all Micro, Small, and Medium Enterprises listed in the 2024 records of the Malang City Office of Cooperatives, Industry, and Trade. A total of 208 respondents were selected through purposive sampling, with the requirements that participants had operated their businesses for at least one year and employed permanent staff. Data were gathered using a closed-ended questionnaire with a 1–5 Likert scale, covering the four main variables of the study: entrepreneurial orientation, product innovation, dynamic capabilities, and MSME business performance.

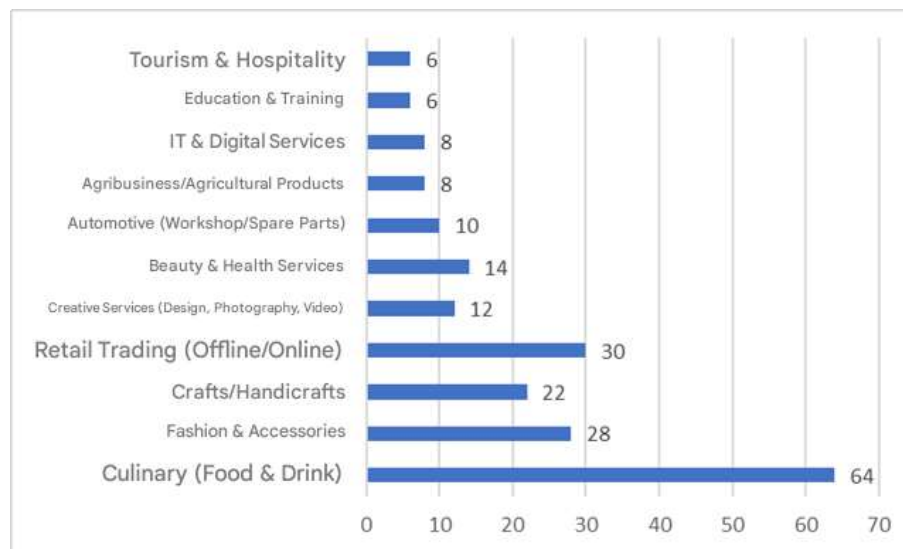
The collected data were processed using a series of statistical procedures with the assistance of SPSS version 26. The analysis began with validity and reliability testing to confirm that the research instruments produced consistent and dependable measurements. This was followed by classical assumption testing, which included: (1) a normality test using the Kolmogorov–Smirnov residual approach to verify that the data were normally distributed; (2) a multicollinearity test based on Variance Inflation Factor (VIF) and Tolerance values to identify potential correlations among the independent variables; and (3) a heteroscedasticity test using the Glejser method to check for unequal variance within the regression model. The final stage involved conducting multiple linear regression to assess both the simultaneous and partial influences of entrepreneurial orientation, product innovation, and dynamic capabilities on MSME business performance.

RESULTS AND DISCUSSION

Result

Distribution of industries engaged in by Micro, Small, and Medium Enterprises (MSMEs) in Malang City based on survey results from 208 respondents. The bar chart provides an overview of the proportion of MSME actors involved in various economic sectors that are developing in this region, including culinary, fashion, handicrafts, retail trade, creative services, beauty, automotive, agribusiness, information technology, education, and tourism and hospitality. This visualization aims to show the main concentration of MSME sectors that play a role in the local economy of Malang City.

Figure 1. Diagram of MSME Industries in Malang City



Based on Figure 1, the culinary sector (food and beverages) is the most dominant business field with 64 respondents or around 30.8% of the total, indicating that the food and beverage industry is the backbone of MSMEs in Malang City. Next, the retail trade sector ranks second with 30 businesses, followed by fashion & accessories (28) and handicrafts (22), indicating the strong creative economy base in this region. Service sectors such as beauty services (14), creative services (12), and automotive services (10) also show significant contributions, albeit on a smaller scale. Meanwhile, the agribusiness, IT & digital services, education, and tourism sectors have relatively few business actors.

Validity and reliability testing are important stages in ensuring that research instruments are able to measure the intended variables accurately and consistently (Ghozali, 2018). A significant calculated r value and Cronbach's Alpha above the minimum limit indicate that the research instrument has met the reliability criteria for use in further analysis.

Table 1. Validity and Reliability

Variable	Indicator	Calculated r	Table r (N=108)	Cronbach's Alpha	Description
Entrepreneurial Orientation	OK1	.888**	0.974	0.934	Valid and Reliable
	OK2	.903**			Valid and Reliable
	OK3	.897**			Valid and Reliable

	OK4	.882**			Valid and Reliable
	OK5	.879**			Valid and Reliable
Product Innovation	IP1	.820**		0.964	Valid and Reliable
	IP2	.815**			Valid and Reliable
	IP3	.789**			Valid and Reliable
	IP4	.796**			Valid and Reliable
	IP5	.775**			Valid and Reliable
Dynamic Capability	KD1	.358**		0.745	Valid and Reliable
	KD2	.604**			Valid and Reliable
	KD3	.366**			Valid and Reliable
	KD4	.600**			Valid and Reliable
	KD5	.264**			Valid and Reliable
MSME Business Performance	KB1	.266**		0.799	Valid and Reliable
	KB2	.626**			Valid and Reliable
	KB3	.596**			Valid and Reliable
	KB4	.642**			Valid and Reliable
	KB5	.255**			Valid and Reliable

Based on Table 1, all indicators in the four research variables have a calculated r value greater than the table r (0.1946) and are marked with two stars (**), indicating significance at the 0.01 level. Cronbach's Alpha values are also above 0.70 for all variables, namely 0.934 for entrepreneurial orientation, 0.964 for product innovation, 0.745 for dynamic capabilities, and 0.799 for MSME business performance. This shows that all questionnaire items have met the criteria for good validity and reliability. Thus, this research instrument is considered feasible and consistent in measuring the constructs of entrepreneurial orientation, product innovation, dynamic capabilities, and MSME business performance in Malang City.

The normality test is conducted to verify whether the residuals in the regression model follow a normal distribution, which is a key requirement in classical linear regression analysis (Ghozali, 2018). To assess this, the Kolmogorov-Smirnov test is employed to compare the observed data distribution with the expected normal distribution. If the resulting significance value (Asymp. Sig. 2-tailed) exceeds 0.05, the residuals are interpreted as normally distributed (Santoso, 2019). When this condition is met, it

indicates that the regression model satisfies the necessary statistical assumptions, thereby reinforcing the credibility of the regression findings.

Table 2. Residual Normality Assumption Test

One-Sample Kolmogorov-Smirnov Test	
	Unstandardized Residual
N	208
Test Statistic	0.555
Asymp. Sig. (2-tailed)	.200 ^c
a. Test distribution is Normal.	
b. Calculated from data.	
c. Lilliefors Significance Correction.	

Based on the Kolmogorov–Smirnov results presented in Table 2, the Asymp. Sig. (2-tailed) value is 0.200, which exceeds the 0.05 threshold. This confirms that the residuals follow a normal distribution. The test statistic of 0.555 with a sample size of 208 further reinforces that there is no violation of the normality assumption. Therefore, the regression model in this study satisfies the normality requirement, indicating that the data are appropriate for subsequent regression analysis.

Multicollinearity testing is carried out to identify whether strong correlations exist among the independent variables, as such relationships can distort the estimation of regression coefficients. The assessment is based on Tolerance and VIF values. Hair et al. (2019) explain that a model can be considered free from multicollinearity when the Tolerance value is greater than 0.10 and the VIF is below 10. In contrast, Tolerance values under 0.10 combined with VIF values above 10 signal the presence of substantial multicollinearity among the predictors.

Table 3. Multicollinearity Assumption Test

Variable	Collinearity Statistics	
	Tolerance	VIF
Entrepreneurial Orientation	0.26	2.189
Product Innovation	0.81	1.887
Dynamic Capabilities	0.19	2.350
a. Dependent Variable: MSME Business Performance		

Based on the multicollinearity test results shown in the table, all independent variables meet the required criteria, with Tolerance values greater than 0.10 and VIF values below 10. Specifically, entrepreneurial orientation has a Tolerance of 0.26 and a VIF of 2.189, product innovation has a Tolerance of 0.81 and a VIF of 1.887, and dynamic capability has a Tolerance of 0.19 and a VIF of 2.350. These values confirm that no strong linear relationships exist among the independent variables within the regression model. Therefore, the model is free from multicollinearity, ensuring that each predictor contributes independently in explaining variations in the business performance of MSMEs in Malang City.

The heteroscedasticity test is used to determine whether the residuals of the regression model exhibit constant variance across levels of the independent variables (Ghozali, 2018). The Glejser test is one of the commonly applied methods, where a significance value (Sig.) greater than 0.05 indicates the absence of heteroscedasticity. Conversely, a Sig.

value below 0.05 suggests that heteroscedasticity is present, which may compromise the accuracy and reliability of the regression estimates (Santoso, 2019).

Table 3. Heteroscedasticity Assumption Test (Glejser Test)

Model	Sig. (Glejser)
(Constant)	0
Entrepreneurial Orientation	0.223
Product Innovation	0.759
Dynamic Capabilities	0.196
a. Dependent Variable: residual	

Based on Table 4, the Glejser test results show that the significance values for the variables of Entrepreneurial Orientation (0.223), Product Innovation (0.759), and Dynamic Capabilities (0.196) are all greater than 0.05. This indicates that the regression model does not exhibit heteroscedasticity. Thus, the residual variance between observations is constant, and the regression model is considered to satisfy the assumption of homoscedasticity.

The F-test is employed to examine whether the independent variables, taken together, have a significant impact on the dependent variable within a regression model. According to Ghazali (2018), the model is considered statistically significant if the significance value (Sig.) is less than 0.05 or if the Fcount exceeds the Ftable value. If the Sig. value exceeds 0.05, the model is deemed not significant as a whole. Conducting this test is crucial to verify the overall validity of the regression model before proceeding to assess the individual effects of each variable through the t-test.

Table 4. F Test

ANOVA ^a						
	Model	Sum of Squares	df	Mean Square	F	Sig.
1	Regression	96.892	3	32,297	2,265.545	.000 ^b
	Residual	2,908	204	0.014		
	Total	99,800	207			
a. Dependent Variable: MSME Business Performance						
b. Predictors: (Constant), Dynamic Capabilities, Entrepreneurial Orientation, Product Innovation						

The F-test results in Table 4 show that the F-count value is 2265.545 with a significance value of 0.000, which is much smaller than 0.05. This means that the regression model involving the all variables simultaneously has a significant effect on MSME Business Performance. Thus, the model used in this study is declared fit and capable of explaining the strong relationship between the three independent variables and the dependent variable.

The t-test was conducted to test the partial effect of each independent variable on the dependent variable. According to Ghazali (2018), a variable is said to have a significant effect if the significance value (Sig.) < 0.05 and tcount > ttable (with df = n - k = 208 - 4 = 204, so that ttable ≈ 1.972 at a 95% confidence level). This test helps determine which variable has the most dominant effect on the dependent variable.

Table 5. t-test

Model	Variable	Coefficient	t	Sig.
1	(Constant)	0.122	2.522	0.012
	Entrepreneurial Orientation	0.388	5.658	0.000
	Product Innovation	0.153	1.167	0.245
	Dynamic Capabilities	1.205	14,145	0.000
a. Dependent Variable: MSME Business Performance				

Based on Table 5, the t-test results show the following:

1. Entrepreneurial Orientation has a t-value = 5.658 and Sig. = 0.000 < 0.05 → H1 is accepted, meaning that entrepreneurial orientation has a positive and significant effect on the business performance of MSMEs.
2. Product Innovation has a t-value of 1.167 and Sig. = 0.245 > 0.05 → H2 is rejected, meaning that product innovation does not have a significant effect on the business performance of MSMEs.
3. Dynamic Capabilities has a t-value of 14.145 and Sig. = 0.000 < 0.05 → H3 is accepted, meaning that dynamic capabilities have a positive and significant effect on the business performance of MSMEs.

Thus, it can be concluded that two variables, namely entrepreneurial orientation and dynamic capabilities, partially have a significant effect on the business performance of MSMEs, while product innovation has not shown a significant effect.

According to Sugiyono (2019), the R Square (R^2) value ranges from 0 to 1, where a value close to 1 indicates excellent model predictive ability. Meanwhile, Adjusted R Square is used to adjust the R^2 value to the number of independent variables, making it more accurate for complex models.

Table 6. Coefficient of Determination

Model	R	R Square	Adjusted R Square	Standard Error of the Estimate
1	.985 ^a	0.971	0.970	0.11940
a. Predictors: (Constant), Dynamic Capabilities, Entrepreneurial Orientation, Product Innovation				

Table 6 shows that the R value = 0.985 and R Square = 0.971, which means that 97.1% of the variation in MSME Business Performance can be explained by the combination of three independent variables, namely Entrepreneurial Orientation, Product Innovation, and Dynamic Capabilities. Meanwhile, the remaining 2.9% is explained by other factors outside this research model, such as marketing strategies, economic conditions, or other external factors. The Adjusted R Square value of 0.970 shows that the regression model used has a very high level of reliability and is able to explain the phenomenon well.

Discussion

The multiple linear regression results presented in Table 5 indicate that entrepreneurial orientation has a positive and significant impact on the business performance of MSMEs in Malang City, with a t-value of 5.658 and a significance level of 0.000 (< 0.05). This supports the view of Pulu et al. (2025), who emphasize that entrepreneurial traits such as innovativeness, proactivity, and risk-taking are key determinants of business success.

Higher levels of entrepreneurial orientation among MSME actors enhance their ability to develop competitive strategies that are responsive to shifts in the business environment (Zighan et al., 2022). This is particularly relevant for MSMEs in Malang City, which are characterized by their dynamic nature and focus on the local creative market. The findings also align with research by Zoraifi and Arifin (2025), which shows that entrepreneurial orientation consistently drives improvements in sales growth, profitability, and customer loyalty. Thus, H1 is accepted, indicating that the entrepreneurial spirit of MSME actors plays an important role in increasing business competitiveness and performance.

Unlike the previous variable, product innovation did not have a significant effect on the business performance of MSMEs, with a t-value of 1.167 and a significance of $0.245 > 0.05$. Although Distanont (2020) emphasized that innovation is a major source of economic growth and competitive advantage, these results show that the innovations made by MSMEs in Malang City have not been able to have a real impact on performance. This may be due to innovations that are still incremental in nature, such as changes in product design or packaging without significant changes in value in the eyes of consumers (Maryam et al., 2025). In addition, technological and resource constraints are also obstacles for business actors in implementing sustainable innovations (Beyer, 2022). The research by Jiménez-Jiménez and Sanz-Valle (2011) even emphasizes that new innovations will affect performance if they are supported by organizational learning and effective resource management. Therefore, H2 is rejected, indicating that product innovation among MSMEs in Malang City has not been the main driver of business performance improvement.

Meanwhile, the dynamic capability variable has the strongest influence on MSME business performance with a t-value of 14.145 and a significance of $0.000 < 0.05$. These results confirm Zungu & Laryea (2025) that dynamic capabilities, which include sensing (detecting opportunities), learning (developing organizational learning), and reconfiguring (reorganizing resources), are central to a company's ability to survive and grow amid market changes. In the context of SMEs in Malang City, this adaptive capability is evident in the efforts of business actors to change their business strategies in line with digitalization trends and local consumer needs. The research by Muliadi and Noviaristanti (2021) also supports this finding, where dynamic capabilities play an important role in shaping long-term competitive advantage. Thus, H3 is accepted, which means that the success of MSMEs in Malang City is largely determined by their ability to adapt and renew organizational resources in accordance with the dynamics of the business environment.

CONCLUSION

The findings of this study reveal that entrepreneurial orientation and dynamic capabilities positively and significantly influence the business performance of MSMEs in Malang City, whereas product innovation does not show a significant effect. This suggests that the entrepreneurial mindset manifested through risk-taking, opportunity-seeking, and strategic innovation plays a crucial role in enhancing MSME performance. Meanwhile, dynamic capabilities emerge as the most influential factor, as they allow business owners to respond effectively to changes in the business environment and optimize resource management. Consequently, the competitiveness of MSMEs in Malang City is largely shaped by the adaptability and strategic flexibility of entrepreneurs in navigating market dynamics.

Theoretically, this study reinforces the theory of entrepreneurial orientation and dynamic capabilities in the context of MSMEs in developing regions. These results provide empirical evidence that a combination of entrepreneurial attitudes and organizational capabilities to react quickly to change can improve business performance. Practically, these findings have implications for the Malang City government to strengthen MSME

assistance programs based on adaptive entrepreneurship and organizational capability improvement. Training and mentoring programs on digitalization, risk management, and adaptive strategies can be key to enabling MSMEs to move up the ladder and survive global competition. In addition, it is important for MSME players to prioritize market-driven innovation so that product innovation can have a direct impact on business performance. This study has limitations in terms of the scope of the region and variables studied. Therefore, further research is recommended to expand the scope of the region to the regional or national level so that the results are more generalizable. Future researchers may also add other variables such as digital capability, marketing strategy, or government support as external factors that can strengthen the relationship between variables. In addition, a mixed methods approach can be used to explore in greater depth the dynamics of entrepreneurial behavior and organizational adaptation qualitatively. Thus, the results of subsequent studies can provide a more comprehensive understanding of strategies for improving the performance of MSMEs in the era of digital transformation.

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