





# “The role of innovation capability in mediating the effect of customer relationship management and market orientation on SME performance”

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# THE ROLE OF INNOVATION CAPABILITY IN MEDIATING THE EFFECT OF CUSTOMER RELATIONSHIP MANAGEMENT AND MARKET ORIENTATION ON SME PERFORMANCE

## Abstract

Every developing country, including Indonesia, relies on SMEs as an important part of its economic structure. However, SMEs encounter significant problems in terms of competition on the local and global markets. This study aims to examine the mediating role of innovation capability in the relationships between customer relationship management, market orientation, and SME performance. The survey targeted 103 SMEs in the food and beverage sector in East Java, Indonesia. This is quantitative research. SEM-PLS (SmartPLS software) was used to evaluate the study model. Empirically, customer relationship management has a marked influence on the performance ( $p = 0.000$ ) and innovation capability ( $p = 0.005$ ) of SMEs. Besides, market orientation has a significant impact on both SME's performance ( $p = 0.001$ ) and innovation capacity ( $p = 0.000$ ). The capability of innovation also has an influence on the performance of SMEs ( $p < 0.001$ ). Further, the study revealed that innovation capability partially mediates ( $p = 0.042$ ) the relationship between customer relationship management and SME performance, as well as the relationship between market orientation and SME performance ( $p = 0.002$ ). Therefore, the findings reveal that customer relationship management and market orientation in SMEs in East Java, Indonesia, have direct effects on SME performance and indirect effects through innovation capabilities.

## Keywords

customer relationship management, orientation, market, innovation, Indonesia, SME performance, capability

## JEL Classification

M31, L25, L26, O31

## INTRODUCTION

SMEs in the food and beverage industries located in East Java Province, Indonesia, are essential for economic development and job creation. This subsector not only determines the economic sector of East Java and its food security but also sustains regional production diversification. However, these companies are not exempt from the intense competition in both domestic and international markets, changes in consumer demand, or the growing demands of large companies. Workable mechanisms need to be put in place for national and international markets to make sense. In this context, in order to attain a competitive advantage with maximum effect on the market, each of these SMEs must find out what solutions are available to optimize the management process by determining ways of managing that anticipate market trends and produce innovative products corresponding to changes in consumer preferences (Nicolescu & Rîpa, 2024).

SMEs in the food and beverage sector must embrace digitalization and innovation to be viable in the future. The main factors for this tenden-

cy are expensive production and market requirements in terms of quality, which could maintain national and international market presence in the next several years. The next issue is the limited amount of funds, technology, or management capacity that are faced by almost all SMEs owned in East Java, Indonesia. To remain sustainable and grow in the near future, SMEs need to effectively plan on how they can make best use of available resources in a more strategic way, where effective customer relationship management utilization in their marketing efforts serves as one strategy to market products proactively with a user-friendly and easily deployable solution. This is necessary in order to produce more added value and improve a competitive position on a national and international scale (Aloqool et al., 2022).

SMEs in the food and beverage industry in East Java, Indonesia, face similar challenges in running their businesses. This is mostly because of systematic problems in entrepreneurship (especially in customer relations), a lack of knowledge about national and international markets, and a lack of ongoing innovation activities for the future. These SMEs face operational challenges because they use outdated, poorly developed technology systems that cannot keep up with market demand or retain customers as customer behavior changes. There is also a big gap in technology when it comes to using advanced solutions that are available all over the world, both at home and abroad. These problems are made worse by a general lack of people with the right skills, such as technical knowledge, financial savvy, and strong management skills, as well as help from the government. This kind of imbalance in relationship-based power creates a fundamental paradox for SMEs in the food and beverage industry, especially when it comes to marketing and innovation efforts to close the firm's competitive performance gap.

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## 1. LITERATURE REVIEW AND HYPOTHESES

To maintain their competitiveness, SMEs in East Java, Indonesia, are required to adopt adaptive management practices in response to market changes. A major success factor for SMEs is their ability to build strong relationships with customers and expand their understanding of market demand. Therefore, SMEs must critically assess the empirical effectiveness of various flexible strategies to enhance business performance. This paper focuses on two of the most common strategies: customer relationship management and market orientation. Both have been the subject of extensive academic investigation, highlighting their importance and their role in enabling firms to meet customer demand and adapt to market dynamics.

Every SME should make a priority of integrating customer relationship management as it highlights the importance of growing and maintaining profitable customer relationships as a fundamental driving force behind business. With customer relationship management systems, SMEs can have in-depth knowledge of what their customers want, prefer, and do, enabling better services to be delivered (Guerola-Navarro et al., 2024). Effective customer relationship management use is likely

to enable SMEs to increase customer satisfaction, loyalty, and retention over the long run. This is an opportunity for the SMEs to generate more income and grow their businesses in general (Kumar & Mokha, 2021). Customer relationship management is important in assisting SMEs to compete in dynamic and intense marketplaces (AlQershi et al., 2022). Such systems should also offer the instruments for increasing customer loyalty and lifetime value, even if SMEs have fewer resources compared to larger companies (Daulay & Saputra, 2020).

With regard to SMEs, customer relationship management has been an object of study for researchers as a method to promote performance, showing its strategic market orientation nature alongside both in parallel and separately (Guerola-Navarro et al., 2024). Customer relationship management refers to the technology and processes used by SMEs to collect and analyze information about customer communications and contacts, with the aim of retaining customers and maintaining customer relationships (Sofi et al., 2020). It is an amalgamation of technology, processes, and procedures that entail efforts to understand customers' preferences and ensure satisfaction (Kumar & Mokha, 2021; Barasa & Ahmad, 2025). The application of customer relationship management practices can

lead to improved customer retention; as a result, SME performance could be improved (Qalati et al., 2024; AlQershi et al., 2022).

SME performance can be enhanced, and customer-related outcomes can be improved with the increasing adoption of customer relationship management within SMEs (Mokha & Kumar, 2022). Khan et al. (2022) argue that the adoption of customer relationship management systems by SMEs, such as those in the food and beverage industry in East Java, Indonesia, which often face financial constraints, can yield significant competitive benefits (Kumar & Mokha, 2021). A better understanding of and response to consumer needs strengthens a firm's competitive advantage. Improved customer relationship management performance leads to increased customer satisfaction, which positively influences SME performance (Sardjono et al., 2021).

In the strategic focus of SMEs, one important aspect is market orientation, which involves anticipating and striving to meet the needs of specific markets (Schulze et al., 2022). Market orientation emphasizes the importance of understanding consumers, competitors, and the broader market context (Sampaio et al., 2019). This approach enables SMEs to adapt to the external environment and develop offerings more effectively (Medrano et al., 2020). Moreover, SMEs with strong market orientation tend to be more innovative, are better able to retain customers, and become more competitive in both national and international markets.

Market orientation is one of the factors determining SME performance. Market-oriented SMEs can drive innovation by developing new products based on market information (Puspaningrum, 2020). Second, market orientation has a direct effect on SME performance (Fahmi et al., 2025). However, a market-oriented approach has demonstrated its ability to enable SMEs to respond to consumer needs and marketing challenges. The commercial standing of SMEs also gains a fillip in coping with external pressures and market forces, in which firms must conduct their business activities with a degree of market orientation (Randhawa et al., 2021).

Market orientation is a combination of three core dimensions: customer, competitor, and interfunc-

tional coordination (Alabsy, 2021). These characteristics allow SMEs to implement market intelligence and forecasting to gain the maximum possible competitive advantage and enhance performance. According to Gangwani and Bhatia (2024), market orientation is described as the understanding of and fulfillment of client needs. A robust market orientation empowers SMEs to understand market dynamics, hence incentivizing them to create more innovative goods (Pratono et al., 2019). As such, market orientation is not only a tool for understanding the market; it is also an important element in promoting innovation and performance, as well as strengthening competition across various industrial sectors.

Moreover, market responsiveness reflects an understanding of customer preferences and demands in the market, as well as the ability of SMEs to respond to changes occurring in the market (Taghvaei & Talebi, 2023). The market orientation of SMEs, which emphasizes customers, competitors, and coordination among internal departments, also significantly impacts SME performance (Yaskun et al., 2023). According to Falahat et al. (2022), a strong market orientation helps SMEs cope with market changes and improve their market position (Dahleez & Abdelfattah, 2022). The ability to adapt and respond to changes is crucial for SMEs in the food and beverage sector, requiring adjustments to ongoing shifts in customer preferences and continuously evolving industry dynamics (Fatonah & Haryanto, 2022).

SMEs are said to possess innovation capability when they can conceive, implement, and manage new ideas and concepts to create value for both the SME and its customers (Migdadi, 2022; Ali et al., 2020). As the market becomes increasingly dynamic and competitive, the ability to innovate has become one of the most crucial attributes for SMEs to sustain long-term competitive advantage (Ferreira et al., 2020). According to Najafi-Tavani et al. (2018), SMEs with greater innovation capacity tend to be more effective in meeting the ever-changing needs of their customers. This capability encompasses various elements, including the creation of new ideas, the launch of innovative products, and the implementation of effective strategies for marketing these products (Zhang et al., 2023). Beyond these key elements and definitional

boundaries, other variables such as a culture that fosters innovation within the SME, collaborative efforts in managing innovation, and flexibility to experiment play a significant role in enhancing the adaptive capacity of SMEs (Lam et al., 2021).

Innovation in SMEs is not solely an internal matter; it also requires external relationships to access more information and resources (Hameed et al., 2021). Therefore, the innovative capacity of an SME must include external linkages to attract additional resources and capabilities. For SMEs in this industrial sector, such capabilities are crucial to remaining competitive and relevant in ever-evolving markets (Jakhar et al., 2019). Innovative SMEs tend to be more competitive, efficient in resource utilization, and able to increase their market share (Qalati et al., 2024). Moreover, innovation serves as a significant mediator that links customer relationship management, market orientation, and SME performance (Cepeda & Arias-Pérez, 2019). Innovation capacity contributes to strengthening the relationship between marketing efforts and SME performance by generating new ideas that positively impact competitive advantage (Ferreira et al., 2020).

The diffusion of innovation can be facilitated by the integration effects of customer relationship management and market orientation (Gangwani & Bhatia, 2024). The integration of customer relationship management with market orientation and innovative capabilities is essential for achieving optimal business outcomes, especially for SMEs in the food sector that are rapidly growing and operate diversified businesses (Migdadi et al., 2017). This integration of customer relationship management and market orientation aims to enhance the innovation performance of SMEs (Qalati et al., 2024). The innovation performance of SMEs and, consequently, their overall performance, can be improved through the implementation of CRM and market orientation. However, most studies have focused on food SMEs, which face unique challenges and possess distinct characteristics that have largely been overlooked in the literature.

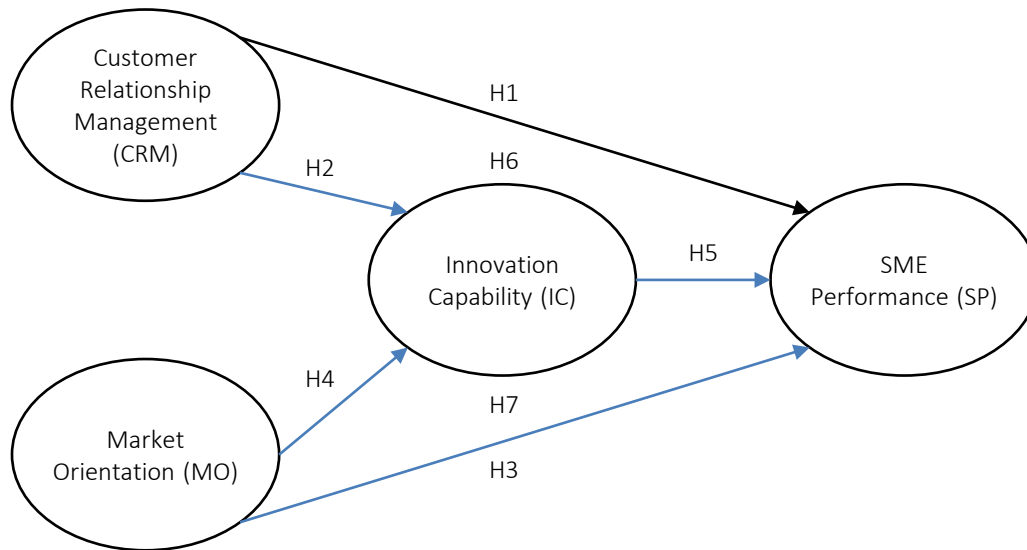
Within the academic community, knowledge of the operation dynamics of SMEs is a relatively new phenomenon. Although there is a significant

body of literature that focuses on these effects of customer relationship management and market orientation on the performance of SMEs, studies about SMEs from the food and beverage sector concerning their innovation capacity are quite few in number. To the best of our knowledge, however, there is scant literature discussing food and beverage SMEs' innovation capabilities in relation to the relationships among customer relationship management, market orientation, and SME performance. To address this gap, the current study investigates SMEs operating in the food and beverage industry in East Java, Indonesia, as the question is influenced by the unique characteristics and challenges faced by SMEs in this sector.

This paper aims to reveal the relationship between customer relationship management, continuing entrepreneurship, and innovative capability of SMEs in the food and beverage industry in East Java, Indonesia. This paper aims to examine the extent of innovation capability, primarily in terms of customer relationship management, market orientation, and SME performance.

As Figure 1 illustrates, the theoretical framework of this study describes the perceived requirement to investigate innovation capability as a mediator of performance and to validate the effects of customer relationship management and market orientation. By concentrating on the SME sector in this study, which is dominated by resource constraints and intense competition, it is expected that contributions can also be made to the academic community of SME practitioners. Furthermore, the study seeks to add a new perspective on how the innovation capability mediates the relationship between customer relationship management, market orientation, and SME performance as well as fill in a research gap (Gangwani & Bhatia, 2024). Accordingly, we offer the following hypotheses:

- H1: Customer relationship management has a positive and significant effect on SME performance.*
- H2: Customer relationship management positively influences innovation capability.*
- H3: Market orientation has a positive and significant effect on SME performance.*



**Figure 1.** Research framework

- H4: Market orientation has a positive and significant effect on innovation capability.*
- H5: SME performance can be positively and significantly influenced by the innovation capability and its mediating effect.*
- H6: SME performance can be positively and significantly influenced by customer relationship management through innovation capability as a mediator.*
- H7: Market orientation may significantly improve SME performance through a mediating role of innovation capability.*

fostered participation through digital means and with a description of our study goals, utilizing social media, emails, and other means. A small sample of 30 people was recruited to test the reliability of the tools prior to collecting the main study data.

This paper deals with customer relationship management metrics, which include several performance indicators, namely: competitive benchmarking, retention of new customers, satisfaction rate of customers, retention rate of existing customers, and involvement of customers in new product development initiatives (Guerola-Navarro et al., 2024; Li et al., 2023).

## 2. METHODOLOGY

With innovation capability acting as a mediating variable, this study uses a quantitative survey approach to evaluate the effects of customer relationship management and market orientation on SME performance in East Java, Indonesia. This approach makes thorough statistical analysis possible and speeds up data acquisition.

We analyzed food and beverage production manufacturers in Gresik, East Java. East Java, Indonesia, has 537 food and beverage manufacturing SMEs. The 103 respondents were selected using random sampling, consistent with Isaac et al. (2009), at a 5 percent significance level. We

There are various indicators to gauge market orientation, including grasping customer needs, gathering customer data, technological advancement, comprehension of competitors, strategic analysis of competitors, and the capacity to respond to shifts in the market (Habib et al., 2020).

Various indicators can be utilized to measure innovative capabilities. They include improvements that can be made to the existing product portfolio, the synchronization of the skills and knowledge of the workforce with that of the market, the nurturing of competitive and creative ability to innovatively approach the innovation of new value to the customer, the organizational articulation and their abilities in the field of technologies (Donate et al., 2022).

From the perspective of SMEs, key performance indicators (KPIs) include the degree of completion regarding the company's sustainable development goals, improvements in the quality of the products/services, the quality of customer satisfaction, the volume of sales over the period of the previous year, the increase of sales and profit, the profit goal realization, the acquisition of customers in the previous year, the increase of customers in the previous year, and the attainment of new customers, the diversification of the product/service (Ramdan et al., 2022).

Multivariate analyses describe the relations and inter-relations as well as the simultaneous effects between multiple variables. Data were evaluated through the SEM-PLS method in SmartPLS 3.0 to investigate the independent, mediating, and dependent variables. Prior to the analysis, instruments were rigorously tested for validity and reliability to guarantee excellent quality. The validity checks demonstrate that for all characteristics, all individual items reached the established level of performance as well as a sufficient inter-item reliability in the surveys.

The study technique balances ethical norms by taking into account participant data protection and gaining informed consent. The objectives of the study, potential outcomes, and the significance of their involvement were all thoroughly explained to the participants. There were no fees associated with the study, and participation was voluntarily.

According to Table 1, the majority of respondents are men, 67%. The predominant age group is 41–50 years old (39%), followed by 31–40 years (25%), 51–60 years (24%), 20–30 years (10%), and 61–70 years (5%). In terms of education, the largest number of respondents are high school graduates or the equivalent education (40%), followed by bachelor graduates (22%), elementary school graduates (16%), junior high school graduates (15%), and diploma graduates (10%). About length of business, the majority are in business for 6–10 years (34%), followed by those with 11–15 years (24%), 16–20 years (22%), over 20 years (13%), and 1–5 years (10%).

### 3. RESULTS

SmartPLS was taken advantage of here because it can test mediation effects, handle small sample sizes, and analyze second-order constructs. In addition, it can test for validity, something SPSS cannot do (Laily et al., 2025). Table 2 presents more comprehensive descriptive statistics. The skewness and kurtosis statistics suggest that the distribution is normal, as all values fell within the range of  $\pm 2$  (Laily et al., 2025), considered to be acceptable.

From the statistical description, all variables have a mean of zero and a standard deviation of one, so we apply data centering. For each of the indi-

**Table 1.** Demographic profile of the participants

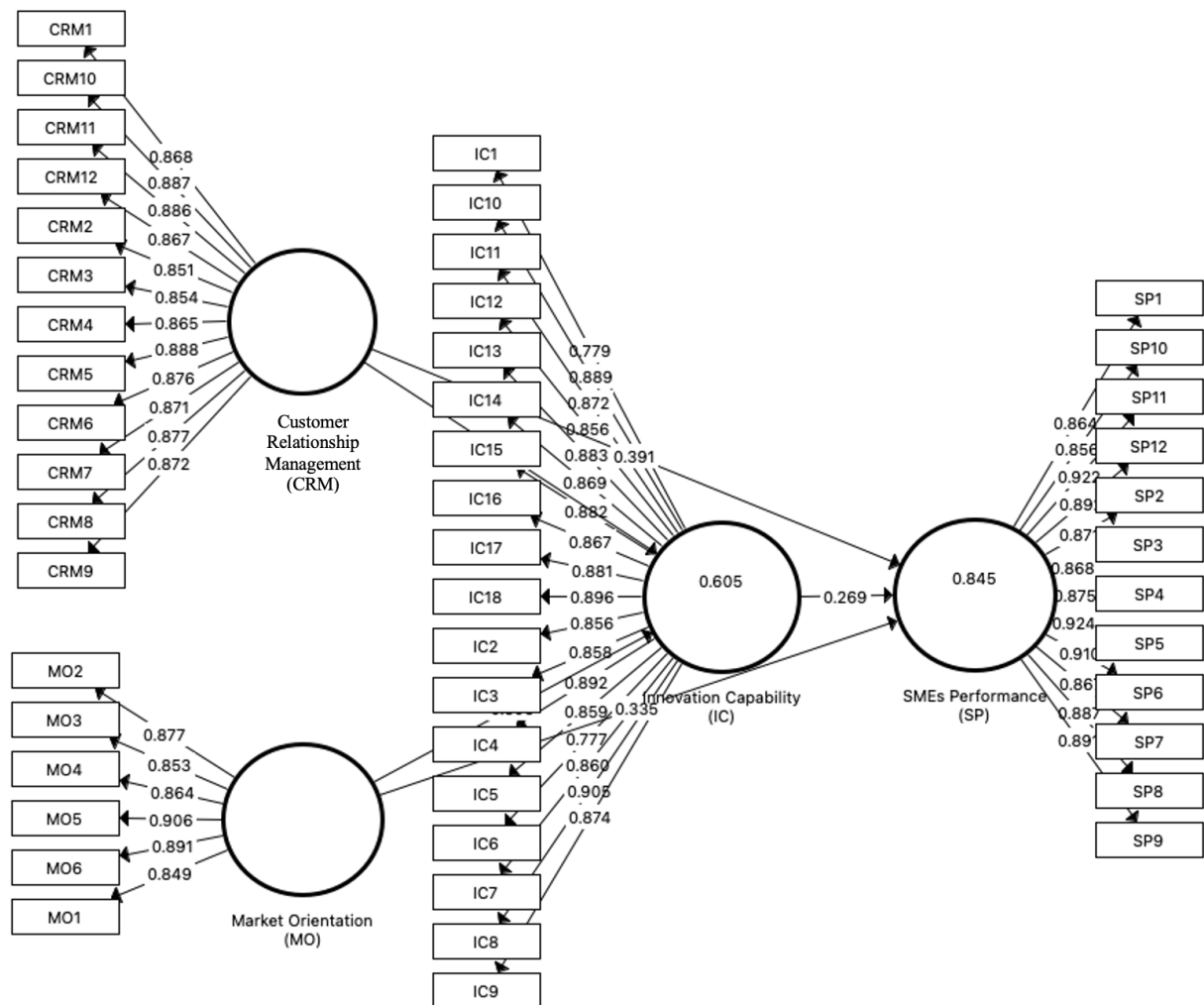
Characteristics	Category	Quantity (N = 103)	Percentage (100%)
Gender	Male	69	67%
	Female	34	33%
Age	20–30 years old	10	10%
	31–40 years old	25	25%
	41–50 years old	39	39%
	51–60 years old	24	24%
	61–70 years old	5	5%
Education	Elementary school	16	16%
	Junior high school	15	15%
	Senior high school	41	40%
	3-year diploma	10	10%
	Bachelor's degree	21	22%
Length of Business	1–5 years	10	10%
	6–10 years	35	34%
	11–15 years	24	24%
	16–20 years	22	22%
	> 20 years	12	13%

**Table 2.** Descriptive statistics

Variable	Obs	Mean	Min	Max	Standard Deviation	Kurtosis	Skewness
Customer Relationship Management	103	0.000	-3.136	1.445	1.000	0.125	-0.801
Innovation Capability	103	0.000	-2.889	1.333	1.000	-0.034	-0.799
Market Orientation	103	0.000	-3.114	1.456	1.000	0.127	-0.823
SME Performance	103	0.000	-2.974	1.361	1.000	-0.126	-0.727

vidual variables, negative skewness values imply a left-skewed distribution, and near-zero kurtosis values suggest an approximately normal distribution. This is indicative of a lack of extreme outliers and a fairly symmetric, unimodal data structure, with the implication that follow-up statistical procedures regression will be more valid (Hair et al., 2019). Therefore, these criteria justify the applicability of data to perform a sounder analysis about the relationships between customer relationship management, innovation capability, market orientation, and SME performance.

In Figure 2, the factor loading values were calculated by the algorithmic method as well as the first round of analysis conducted during validity and reliability test using SmartPLS. According to Laily et al. (2025), all items of the sample satisfied the validity criteria; factor loadings were large, no cross-loadings reached significance, as shown in Table 3. Discriminant validity and convergent validity were > 0.70 and > 0.50, respectively. In addition, internal consistency of all constructs was achieved (Laily et al., 2025), as CR values were above the minimum value of 0.70. The validity



**Figure 2.** Results of the first structural model

**Table 3.** Construct reliability and validity

Variable	Cronbach's Alpha	rho_A	Composite Reliability	AVE
Customer Relationship Management (CRM)	0.971	0.972	0.974	0.760
Innovation Capability (IC)	0.980	0.980	0.982	0.748
Market Orientation (MO)	0.938	0.939	0.951	0.763
SME Performance (SP)	0.975	0.975	0.978	0.784

and reliability test results for all constructs are reported in Table 3.

Table 3 demonstrates that Cronbach's Alpha, rho\_A, and CR of the constructs exceed 0.9, whereas AVE surpasses 0.7, indicating that all constructs exhibit excellent reliability and validity. It is, therefore, an indication that the study instruments adequately measure and validate the constructs. Besides, the high level of reliability and validity strengthens the credibility to explain mutual relationship between customer relationship management, innovation capability, market orientation, and SME performance (Hair et al., 2019).

Table 4 indicates that the R Squared value of innovation capability is 0.605 and for SME performance it is 0.845. Accordingly, the model predicts 60.5% of variance in innovation capability and 84.5% of variance in SME performance in light of independent variables used. The high R Squared values suggest that the model is relevant to serve as a policy blueprint for ensuring sustainable SME competitiveness and performance (Hair et al., 2019).

Table 5 presents the f Squared values, indicating the contribution of each variable to innovation

capability and SME performance. The correlation between SME performance the maximum values of f and customer relationship management are 0.283 (innovation capability shows 0.184 and market orientation shows 0.186). Regarding innovation capability, the highest contributor is market orientation (0.200). This implies that the customer relationship management and market orientation are among the most effective in enhancing innovation and SME performance; therefore, these variables should be placed at the forefront of SME development policies (Hair et al., 2019).

Innovation capability (0.443) and SME performance (0.657), as presented in Table 6, have reported good Q<sup>2</sup> values. These positive and high Q<sup>2</sup> values show that the model is of excellent predictive relevance for the dependent variables. The higher Q<sup>2</sup>, the more significant the model's relative contribution in explaining and predicting innovation and SME performance. This further confirms that the model is a reliable basis for strategic decisions in promoting sustainable SME performance (Hair et al., 2019).

All constructs are less than 0.90 for the heterotrait-monotrait ratio (HTMT) and correlations,

**Table 4.** R Squared

Variable	R Squared	R Squared Adjusted
Innovation Capability	0.605	0.597
SME Performance	0.845	0.840

**Table 5.** f Squared

Variable	Innovation Capability	SME Performance
Customer Relationship Management	0.073	0.283
Innovation Capability	0.184	0.184
Market Orientation	0.200	0.186

**Table 6.** Construct cross validated redundancy

Variable	Q <sup>2</sup>
Innovation Capability	0.443
SME Performance	0.657

**Table 7.** Heterotrait-monotrait ratio and correlation

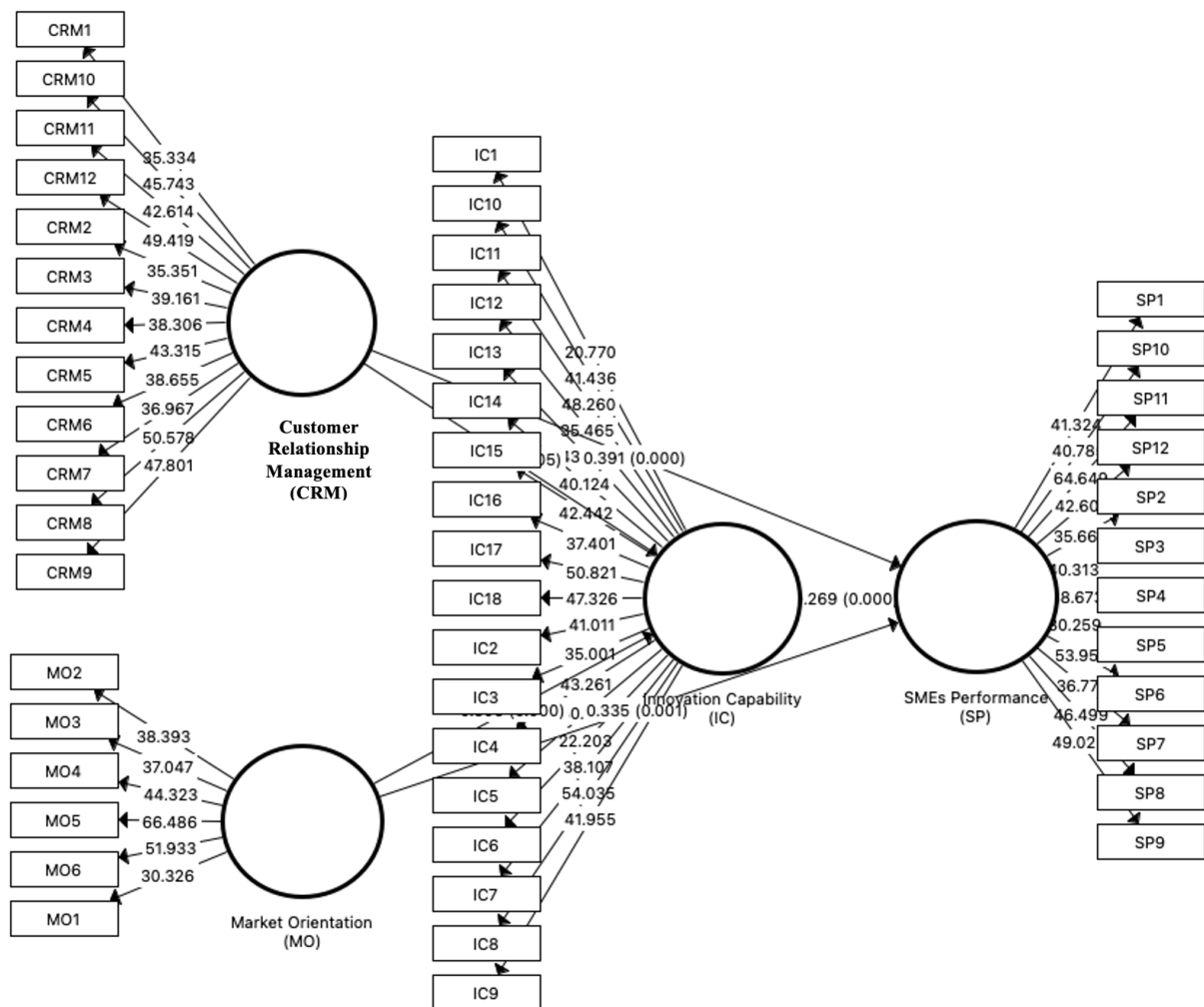
Variable	CRM	IC	MO	SP
Customer Relationship Management (CRM)	–	–	–	–
Innovation Capability (IC)	0.741	–	–	–
Market Orientation (MO)	0.871	0.789	–	–
SME Performance (SP)	0.887	0.825	0.903	–

**Table 8.** Fornell-Larcker criterion

Variable	CRM	IC	MO	SP
Customer Relationship Management (CRM)	0.872	–	–	–
Innovation Capability (IC)	0.725	0.865	–	–
Market Orientation (MO)	0.831	0.759	0.874	–
SME Performance (SP)	0.865	0.807	0.864	0.886

which are reported in Table 7. This shows that every construct does possess discriminant validity and can be made to differentiate conceptually. The presence of discriminant validity promotes the robustness of the study in terms of its outcomes on customer relationship manage-

ment, innovation capability, market orientation, and SME performance, thus providing viable suppositions that could serve as sound knowledge for policy evolution to improve firm outcome persistency (Henseler et al., 2015).



**Figure 3.** Bootstrapping in the second structural model

The diagonal values (Table 8) show that the square root of AVE for each construct is greater than its correlation with other constructs. It suggests that each construct has discriminant validity according to the criteria of Fornell and Larcker. Good discriminant validity exists if customer relationship management, innovation capability, market orientation, and SME performance taken as measurements are (measured from the start of) not in common to each other and no economic-mismeasured result among variables occurs (Fornell & Larcker, 1981).

Table 9 demonstrates that all tested hypotheses have significant direct effects at the 1% and 5% confidence levels, with  $p$ -values  $< 0.05$ . Customer relationship management has a significant positive effect on SME performance (0.391) and innovation capability (0.305), emphasizing the importance of effective customer relationship management in promoting business growth and innovation. Market orientation also shows a significant positive effect on SME performance (0.315) and innovation capability (0.506), indicating that market understanding and adaptation to consumer needs are key to enhancing competitiveness and innovation. Innovation capability itself positively and significantly affects SME performance (0.269), suggesting that innovation plays a crucial role in improving productivity and business sustainability. These findings align with recent studies highlighting customer relationship management, market orientation, and innovation as primary determinants of SME performance and sustainability in the era of global competition (Agyapong et al., 2024).

Indirect effects of the relationship between customer relationship management and market orientation on SME performance through innovation capability are presented in Table 9. As  $p$ -values in both paths (0.042 and 0.002) are less than the significance level, these indirect effects are statistically significant and can be interpreted that customer relationship management and market orientation can enhance SME performance if accompanied by strong innovation capability. This result provides supporting evidence that innovation serves as a critical mediator to enhance the positive effects of customer relationship management and market orientation on SME performance. These findings are also in line with previous research claims, which has indicated that innovation capability acts as an enabler to convert business strategies into better performance results (Al Halbusi et al., 2023). Hence, as long as SMEs well-manage customer relationships and have market orientation with innovation, it in turn enables these firms to obtain competitive advantage and better performance of businesses within digital economy.

## 4. DISCUSSION

This study focuses on how customer relationship management and market orientation influence the performance of food and beverage SMEs in East Java, Indonesia, taking into account the mediating role of innovation capabilities. Thus, it offers valuable insights for enhancing competitiveness among these independent SMEs.

**Table 9.** Direct and indirect effects

Immediate Effects	Original sample	T statistics	P values	Information
<b>Direct Effects</b>				
H <sub>1</sub> : Customer Relationship Management (CRM) → SMEs Performance (SP)	0.391	4.218	0.000***	Accepted
H <sub>2</sub> : Customer Relationship Management (CRM) → Innovation Capability (IC)	0.305	2.834	0.005**	Accepted
H <sub>3</sub> : Market Orientation (MO) → SMEs Performance (SP)	0.315	3.229	0.001***	Accepted
H <sub>4</sub> : Market Orientation (MO) → Innovation Capability (IC)	0.506	4.785	0.000***	Accepted
H <sub>5</sub> : Innovation Capability (IC) → SMEs Performance (SP)	0.269	3.900	0.00***	Accepted
<b>Indirect Effects</b>				
H <sub>6</sub> : Customer Relationship Management (CRM) → Innovation Capability (IC) → SMEs Performance (SP)	0.068	2.039	0.042*	Accepted
H <sub>7</sub> : Market Orientation (MO) → Innovation Capability (IC) → SMEs Performance (SP)	0.113	3.165	0.002***	Accepted

Note: \*\*\* sig  $< 0.01$  (1%), \*\* sig  $< 0.05$  (5%), \* sig  $< 0.1$  (10%).

Empirical findings demonstrate the important role of customer relationship management in the performance of SMEs. This result is consistent with previous research, which indicates that customer relationship management is key to building strong relationships between SMEs and their customers, as well as enhancing customer loyalty (Magatef et al., 2023). By effectively utilizing information technology, SMEs can collect all necessary data regarding customer needs, allowing them to respond more quickly to market demands (AlQershi et al., 2020). Strategically, customer relationship management implementation helps SMEs gather and analyze customer data to tailor products or services to specific consumer needs. Furthermore, a customer relationship management system enables the creation of a better customer experience, thereby increasing satisfaction and strengthening the relationship between SMEs and their customers. Customers can feel more appreciated and involved by using more targeted and individualized communication techniques (Guerola-Navarro et al., 2024). As a result, successful customer relationship management deployment enhances SMEs' competitiveness, business operations, and customer connections.

A higher level of customer intimacy increases customer advocacy, where satisfied customers recommend products to their peers. This provides broader access to expanding markets for SMEs without any acquisition costs. Such behavior drives sales growth and strengthens customer brand equity, which in turn can revitalize brand loyalty and market penetration (Kumar & Mokha, 2021). When SMEs focus on customer relationships, their market position improves, and their market value increases. Customer relationship management has a positive impact on the strategic planning of SMEs and encourages innovation in other products and services to meet the needs of target market customers. Integrating both static and dynamic customer feedback into products and services enhances the customer experience and helps maintain the SME's market position in the midst of rapid market changes. This process can also increase the profitability of SMEs. There is a favorable and statistically significant correlation between customer relationship management and innovation capability, as customer relationship management enables SMEs to understand

customer needs and preferences, which is crucial to the innovation process. Customer data acquired and processed by SMEs enable them to quickly and accurately identify market changes and develop new, valuable products (Khan et al., 2022; Migdadi, 2021).

Modern customer relationship management systems enable SMEs to establish and maintain favorable relationships with customers, collect feedback, and involve customers in the development of new products or services. This approach improves customer retention and provides critical insights into the strategic role in the innovation process (Barasa & Ahmad, 2025). Furthermore, the implementation of a customer relationship management system enhances intra-organizational collaboration, facilitating the free flow of information and ideas, which in turn improves team innovation and productivity (AlQershi et al., 2022). Today, in an intensely competitive environment, innovation serves as the distinguishing factor for the sustainability and growth of SMEs. By utilizing customer relationship management systems, SMEs are likely to achieve greater efficiency through task automation, process streamlining, and accelerated innovation to drive operational improvements. All these positive changes contribute to strengthening competitive positioning and sustaining market growth (Sofi et al., 2020). Therefore, ongoing innovation and the ability to adapt to changing market needs make the effective deployment of customer relationship management systems increasingly important.

The level of market orientation that SMEs possess has a favorable impact on their performance. Understanding consumer wants and preferences and being able to react to market shifts are two aspects of market orientation. Effective market orientation strategies enable SMEs to identify and respond to market demands (Crick et al., 2022). Puspaningrum (2020) and Hazem et al. (2020) support these findings. Moreover, evidence from various studies demonstrates that SMEs with strong market orientation can enhance their performance by tailoring products to target markets, thereby increasing customer satisfaction and building loyalty toward SMEs. Moreover, innovations that address market needs are customized as a result of understanding and embracing market

orientation. Knowing, gathering, and evaluating market data enable small businesses to identify what consumers require, as well as anticipate future needs. Small entrepreneurial firms are thus able to continuously innovate and develop new products to meet market demands (Kolbe et al., 2022). Therefore, entrepreneurial small firms with strong market orientation are able to introduce new products that satisfy consumer needs and enhance their competitiveness in the market. Hence, market orientation in the context of SMEs is one of the significant factors determining their success and competitiveness.

Previous research provides evidence that the degree of market orientation in SMEs influences the enhancement of their innovation capabilities (Schulze et al., 2022). The implementation of market orientation encourages SMEs to thoroughly understand customer desires and anticipate changes in the competitive landscape and the general market (Wahyono & Hutahayan, 2021). Effective mapping of customer desires and current market conditions enables SMEs to identify target areas that merit strategic innovative intervention (Aydin, 2021). Therefore, SMEs are in a better position to design new products and offerings that address unarticulated market needs and to increase the level of their innovative activities. Market orientation enhances coordination, the flow of information exchange, and collaboration within SMEs. SMEs can assimilate customer feedback and market information into their decision-making and product offerings, as they continuously gather information. The role of customers in the innovation process is crucial, as their feedback can positively influence the idea and concept generation stages of SMEs in the future. Thus, market orientation can address the innovation deficit in SMEs and ensure that the innovations produced are truly responsive to market needs. From this perspective, market orientation acts as a critical factor in driving innovation, as well as the progress and sustainability of SMEs in a highly competitive context (Julian et al., 2020). Improvements in product design and ideas largely depend on the integration of customer feedback into the innovation process. Therefore, market orientation enhances the innovation capabilities of SMEs and enables their innovations

to be more visionary regarding future market demand. Consequently, market orientation becomes an important factor that drives innovation and continuously enables growth in highly competitive markets.

Innovation positively influences the performance of small and medium-sized enterprises. Operational innovation denotes the development and execution of novel concepts, products, processes, and distribution channels to enhance results across all operational activities (Jalil et al., 2022). Innovative SMEs are able to produce superior products and build strong customer loyalty (Rumanti et al., 2022). Market-responsive innovation is one of the key factors contributing to superior SME performance (Fang et al., 2022). Strong SME performance and the ability to face competitive challenges are closely linked to productive innovation. Innovation enables SMEs to be more flexible in responding to changes in customer needs and industry sectors at the operational level. SMEs that foster an innovative culture demonstrate greater adaptability to market changes as well as the dissemination of research and development for improvement. This adaptability enhances positive outcomes in the short term and ensures the long-term sustainability of SMEs. Therefore, innovation is one of the core attributes of SMEs that guarantees their continuity and significance amidst dynamic changes (Haddad et al., 2020). Thus, innovation improves the overall performance of SMEs and ensures their long-term sustainability. Consequently, the innovative capacity of SMEs significantly determines their competitiveness and relevance in an ever-changing market.

The empirical findings indicate that customer relationship management and market orientation have a sustained positive impact on SMEs. Moreover, innovation capability clearly acts as a mediator in this context. Empirical evidence statistically and positively demonstrates that both customer relationship management and market orientation positively affect SME performance. Innovation capability also serves as a mediator, as described in the research findings. Customer relationship management helps retain customers, while market orientation is a

means to understand customer needs; they both contribute to the creation of positive customer value and ultimately enhance the operational effectiveness of SMEs. These findings are consistent with Sofi et al. (2020), who showed a positive relationship between customer relationship management and overall SME performance, as business outcomes improve with the development of customer relationships. Furthermore, innovation capability plays a significant role in the relationship between customer relationship management, market orientation, and SME performance. With the adoption of robust customer relationship management systems, SMEs can collect and analyze customer data necessary for the development of new products that have market appeal. Meanwhile, a market-oriented approach encourages SMEs to develop new value propositions in response to changing market trends and consumer demands. Innovation capacity not only increases the variety of offerings, both products and services, but also enhances overall SME performance. Thus, the influence of customer relationship management and market orientation on SME performance through innovation capacity highlights the importance of an integrated management approach. The relationship between customer relationship management and market orientation provides SMEs with the potential to adapt to changing market conditions and evolving customer needs. The contribution of this study is to help clarify the relationship between various marketing strategies and innovation in order to improve SME performance.

Furthermore, the practical outcomes offer SME actors opportunities to allocate resources more effectively, thereby improving performance. SMEs are able to build more meaningful relationships with clients and gain a broader understanding of their desires and behaviors (Yodchai et al., 2022). Understanding customer needs facilitates the development of new offerings tailored to client preferences. At the same time, in implementing a market-oriented approach, SMEs are required to actively conduct market surveys and adjust their strategies in a timely manner. Therefore, for SMEs aiming to enhance their competitiveness and achieve long-term sustainability in a competitive market, the

integrated adoption of these methods with an emphasis on innovation is essential. This is in line with the views of most scholars (Zhang et al., 2023). Many researchers conclude that mastering this approach constitutes a technical success, and that understanding consumer needs as well as the ability to adapt to desired changes are key factors. These findings further strengthen previous research demonstrating the positive impact of customer relationship management systems on SME performance, particularly in enhancing innovative skills. The development of SMEs' innovative capabilities also requires the integration of effective customer relationship management practices, not only in building relationships between SMEs and their customers (Tuamyil et al., 2022). Managing customer relationships enables SMEs to understand clients' needs and expectations, which can be utilized in developing new and improved products and services, thereby enhancing overall SME performance. These findings also support Fang et al. (2022). In addition, positive customer relationships and interactions have been proven to encourage innovation that is responsive to market needs.

Furthermore, strong innovation capacity resulting from improved SME performance is also a consequence of high market orientation. Market orientation enables SMEs to anticipate and respond to market developments and customer needs, thereby allowing them to lead in achieving various breakthroughs (Wahyono & Hutahayan, 2021). Specifically, the ability of SMEs to quickly identify and respond to market opportunities allows them to deliver products and services that meet consumer needs and ensure competitive advantage (Wahyono & Hutahayan, 2021). This is consistent with the perspectives of scholars in the field of SME performance (Nasution et al., 2020). Therefore, a high level of market orientation is expected to stimulate internal creative and collaborative activities, making innovation a future strategy. Finally, customer relationship management and a market-oriented approach are considered driving forces for innovations that enhance SME performance and enable the creation of a favorable innovation cycle, which ultimately leads to higher competitiveness in the market.

## CONCLUSION

This study aims to empirically examine the mediating role of innovation capability in the relationship between customer relationship management and market orientation on the performance of SMEs in East Java, Indonesia. The findings indicate that customer relationship management significantly influences both SME performance and innovation capability. Further results reveal that market orientation also has a significant effect on SME performance and innovation capability. Additionally, the study provides evidence that innovation capability significantly impacts SME performance. The paper establishes that customer relationship management has a positive relationship with SME success through innovation capability. Market orientation is also recognized as an indirect yet important determinant of SME performance, with innovation capability playing the most substantial mediating role.

The findings of this study provide academic recommendations for SMEs to integrate customer relationship management and market orientation in order to establish a synergistic effect between the two as factors that enhance innovation capability, thereby contributing to improved SME performance in East Java, Indonesia. Empirically, these results indicate that the creation of distinctive innovations can be influenced by strengthening customer relationships and understanding both national and international markets. The findings also offer practical implications for SMEs regarding how customer relationship management and market orientation can be implemented in strategic planning to enhance innovation and overall performance. Empirically, these findings offer implications for academics by suggesting new directions for managing and developing SME-focused businesses.

Future research should investigate the direct mediators of customer relationship management and market orientation's effects on innovation, especially in industries outside the SME sector. Furthermore, other characteristics that may mitigate or mediate the impact of innovation should be investigated. Expanding the research breadth yields clearer insights, enhancing the understanding of the factors that drive global SME success, particularly through developments in digital technology.

## AUTHOR CONTRIBUTIONS

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## AI USAGE STATEMENT

We use the QuillBot AI Chat to help us write better English grammar in our schoolwork so that it is more accurate and meets the most recent standards. QuillBot also helps us make our documents less similar, which makes our scientific work more original. Using this technology makes writing faster and more accurate, and it also follows the most up-to-date rules for academic writing.

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