

PRODUCT INNOVATION CAPABILITY, COMPETITIVE ADVANTAGE AND BUSINESS PERFORMANCE IN MSMEs: A CONCEPTUAL PAPER

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Abstract. Micro, Small and Medium Enterprises (MSMEs) become a vital contributor to economic development and employment opportunities to all countries in the world. Despite of the significant contribution to the countries, MSMEs face challenges and difficulties in maintaining competitiveness in an increasingly dynamic and challenging business environment. Product innovation as a part of innovation capability, has been widely acknowledged as an essential determinant of competitive advantage and business performance regardless size of business. Furthermore, limited studies examining these relationships among MSMEs especially in the Klang Valley. Drawing upon the Resource-Based View (RBV) theory, this study seeks to analyse the influence of product innovation capability on competitive advantage and business performance among MSMEs in the Klang Valley, Malaysia. However, this paper only focuses on a conceptual paper as part of process a research on master study. For the future, questionnaire will be distributed via Google-Form to the owner of MSMEs in food and beverages (F&B) industry in Klang Valley.

Keywords: *product innovation capability, competitive advantage, business performance, small and medium enterprises (SMEs)*

Introduction

Micro, Small and Medium Enterprises (MSMEs) are significant contributors to economic growth and employment generation across both developed and developing countries including Malaysia (Sinha, et al., 2024; Jalil et al., 2022; Rosli and Sidek, 2013). Despite their importance, many MSMEs face challenges in maintaining competitiveness within an increasingly dynamic and competitive business environment. Apparently, the challenges among MSMEs are coming from the size, financial and ability to adapt with the technologies to compete in business market (Hendrawan et al., 2024; Loo et al., 2023). The organizations need to find out the strategies to enable in surviving in the competitive business. Therefore, product innovation capability has been widely recognised as an important factor influencing competitive advantage and business performance (Ali et al., 2016). There are a lot of researches regarding MSMEs in developing countries which cater in many perspectives such as technology capability (Hendarawan et al., 2024; Loo et al., 2023), and economy (Sinha, et al., 2024). However, a few studies has examined the relationship between product innovation capability, competitive advantage and business performance among Malaysian MSMEs (Sulistyo and Ayuni, 2020). Guided by the Resource-Based View (RBV) theory, this study intends to investigate the relationship of product innovation capability on competitive advantage and business performance among MSMEs in the Klang

Valley, Malaysia. In addition, the study tries to examine the mediating role of competitive advantage in the relationship between product innovation capability and business performance.

Even though, this paper only caters in the perspective of conceptual as part of master study, this research plans to adopt a quantitative survey approach involving MSME owners and managers in Klang Valley, Malaysia through Google-Form. The study is expected to provide preliminary research on how product innovation capability enhances competitive advantage and improves business performance among MSMEs. The literature found might assist researchers in examining the effective of product innovation capabilities to strengthen MSME competitiveness and business performance that finally can promote sustainable economic development in Malaysia. Micro, Small and Medium Enterprises (MSMEs) is significantly known as the backbone of national economies in term of employment, gross domestic product (GDP), innovation and entrepreneurial development (Hendarawan et al, 2024; Sinha, et al., 2024; Jalil et al., 2022; Farida et al., 2021; Rosli and Sidek, 2013). However, many MSMEs continue to experience challenges in achieving sustainable growth and maintaining competitiveness in increasingly dynamic business environments. Hendrawan et al. (2024) mentioned that the emergence of digital technologies, rapid technological change, shorter product life cycles, global competition and evolving consumer expectations have intensified competitive pressures, making it increasingly difficult for MSMEs to innovate and become more competitive in order to survive and sustain long-term business performance. Innovation is widely acknowledged as an important factor influencing competitiveness and business performance among MSMEs including in Malaysia (Rosli and Sidek, 2013). However, the level of innovation among MSMEs remains inconsistent due to challenges such as limited financial resources, inadequate technological capabilities and insufficient innovation-related skills (Hendrawan et al., 2024). These constraints hold MSMEs from effectively developing and commercialising new or improved products. Eventhough, there are many empirical studies regarding innovation capability with business performance, the results found are mixed. A few has positive and significant relationship (Farida et al., 2021), while some researches showed insignificantly (Kusuma et al., 2022). Thus, need more studies about product innovation capability among MSMEs especially in the context developing countries such as in Malaysia.

Competitive advantage has been identified as one of the most vital outcomes of innovation capability. Apparently, organizations with strong innovation capability able to position and differentiate their products and services, respond quickly to market changes, improve operational efficiency and create superior customer value to outperform competitors and have superior business performance (Jalil et.al, 2022; Rosli and Sidek, 2013). Furthermore, the mediating role of competitive advantage in explaining the relationship between innovation capability and business performance has received mix results. Ali et al., 2016, and Falahat et al., 2020 are among empirical studies found the positive mediating roles, while other finding shows differently (Ab Wahab et al., 2025; Yuen and Ng, 2021). Furthermore, existing studies often to test these constructs on large corporations and technology-intensive industries, while other studies refer to MSMEs (Ali et al., 2016). Thus, another reason to add more studies among MSMEs especially in developing countries. There are three main objectives of this research: (i) To examine the relationship between product innovation capability with competitive advantage among MSME; (ii) To examine the relationship between

competitive advantage with business performance in MSMEs; (iii) To determine either competitive advantage can mediate the relationship between product innovation capability and business performance among MSMEs.

Results and Discussion

Theoretical underpinning

This conceptual paper is underpinned by the Resource-Based View (RBV) in explaining how innovation capability enables Micro, Small and Medium Enterprises (MSMEs) to achieve competitive advantage and superior business performance. The Resource-Based View developed in detail by Barney (1991). This theory explains performance differences between organizations based on variations in the internal resources and capabilities they possess (Barney, 1991; Grant, 1991). According to this perspective, an organization can achieve sustainable competitive advantage when it can controls resources and capabilities that are valuable, rare, difficult to imitate and non-substitutable (Barney, 1991). In the context of this study, product innovation capability is suggested to become ultimate capabilities that can meet the RBV criteria for becoming a source of competitive advantage (Falahat et al., 2020; Rosli and Sidek, 2013). This capability stands from the combination of technical knowledge, market understanding, creativity and internal processes that are developed and refined over time within the firm (Yusr et al., 2022; Hanifah et al., 2019). When the competitors difficult to replicate the product innovation made by an organization, it can lead to competitive advantage in the form of superior products or differentiated value offerings, which finally generate better business performance (Sulistyo and Ayuni, 2020; Barney, 1991). RBV also supports competitive advantage as a mediating roles in the view that the relationship between capabilities and performance (Barney, 1991; Grant, 1991). Thus, product innovation capability influences business performance through the creation of distinctive competitive advantage that are recognised by customers as well as the market (Falahat et al., 2020; Jalil et al., 2022; Hanifah et al., 2019; Rosli and Sidek, 2013).

Product innovation capability

Innovation capability has become as one of the most important strategic capabilities that enable organizations to remain competitive in volatile business environments. Innovation could be defined as the creation or improvement of products, services, processes or business models that deliver new value to customers and organisations (Ab Wahab et al., 2025; Rosli and Sidek, 2013). Therefore, product innovation capability would be understand as an organization's ability to develop, introduce new products or modify it to become the newest products from the organization that meet market needs and preferences (Yusr et al., 2022; Falahat et al., 2020). The product innovation capability could not be refer in term of technical, product design and its functionality only, but it must cover about the understanding customers needs, market trends, and as well as competitors strategies and actions (Yusr et al., 2022; Rosli and Sidek, 2013). Empirical studies have shown that product innovation capability is a part of organization capabilities that can lead to a stronger competitive position and better overall performance (Jalil et.al, 2022; Rosli and Sidek, 2013). Proactive organizations in developing new or improvise existing products will have chances and opportunities to offer differentiated value, respond faster to changing demand as well as penetrate new

market segments (Yuen and Ng, 2021; Falahat et al., 2020). In the MSME context, product innovation capability often becomes a critical factor due to unable to compete solely on production scale with minimum cost (Rosli and Sidek, 2013; Khalil et al., 2022). For MSMEs in Malaysia including in the Klang Valley, the competition is intense and customers are exposed to diverse alternatives, thus the organizations must have product innovation capability to sustain the customer interest and market relevance (Hudi et al., 2024; Ali et al., 2016) (*Figure 1*).

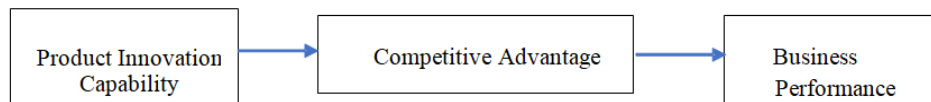


Figure 1. Conceptual framework.

Competitive advantage

Competitive advantage refers to a organization's ability to achieve better performance than its competitors in many areas in business such as cost, quality, product features, service or even business reputation (Barney, 1991; Porter, 1985). Therefore, competitive advantage can be achieved through many ways such as low-cost strategies, focus on specific market segments, differentiation strategies or a combination of these approaches (Porter, 1985). In fact, the fundamental of competitive advantage are difficult to imitate, durable and aligned with market needs so that an organization can have better performance to compare with other competitors over time (Barney, 1991; Grant, 1991). For MSMEs, competitive advantage could be part of the business strategies when the organizations have a combination of unique resources and capabilities such as specialised local market knowledge and innovation capability, close customer relationships as well as operational flexibility (Sulistyo and Ayuni, 2020). Therefore, with strong product innovation capability such as improve product quality, unique features and better alignment with specific customer needs with the new products offer will lead better market position (Falahat et al., 2020; Ali et al., 2016; Rosli and Sidek, 2013; Porter, 1985). Therefore, the hypothesis could be developed:

(H1): Product innovation capability has a positive relationship with competitive advantage.

Business performance

Business performance is a combination of financial and non-financial indicators whereby could be achieved through the resources and capabilities within the organizations such as sales growth, profitability, number of customers, market share and perceived competitiveness (Yuen and Ng, 2021). Business performance could been seen with not only short-term profit, but also with growth potential, long-term sustainability and resilience in the face of economic uncertainty. Many empirical studies in the context of MSMEs, performance is often assessed based on owners' or managers' perceptions, especially when refer to financial data which is hardly publish in public (Yuen and Ng, 2021; Rosli and Sidek, 2013). In the perspective of MSMEs' business performance,

there are a few factors that being analyzed such as access to finance, technological capability, managerial skills and innovation capacity (Loo et al., 2023; Yuen and Ng, 2021). For MSMEs in developing countries, performance is influenced by competitive advantage in the perspective of intense competition, high operating costs and evolving customer expectations (Falahat et al., 2020; Ali et al., 2016). Thus, for this study a hypothesis is developed:

(H2): Competitive advantage has a positive relationship with business performance.

Competitive advantage mediate between product innovation capability and business performance

Although there are many empirical studies have extensively examined the relationship between innovation capability including in the prospective of product innovation with business performance, the findings remain inconclusive (Ab Wahab et al., 2025; Yuen and Ng, 2021). A few researches report a positive relationship between innovation capability and organization performance (Farida et al., 2021), whereas other studies reveal weak, insignificant or context-dependent relationships (Kusuma et al., 2022). These inconsistencies indicate that the relationship may be more complex than a simple direct effect and that additional organizational mechanisms may influence how innovation capability translates into superior performance. Consequently, there is a need to examine the underlying processes through which innovation capability contributes to organizational success. Successful innovation might enhance many positive return and lead to better performance which based on the value offered to customers, strengthen brand image and ultimately improve business performance (Jalil et al., 2022; Rosli and Sidek, 2013). However, innovation has negative impact which involve costs, risks and uncertainty. Therefore, the actual impact of innovation on business performance may depend on the context, sector and strategic orientation of the organization (Ab Wahab et al., 2025; Yuen and Ng, 2021). For MSMEs in developing countries, effective use of innovation capabilities can influence competitive advantage that lead better business performance (Falahat et al., 2020; Ali et al., 2016). Therefore, the hypothesis is:

(H3): Competitive advantage positively mediate between product innovation capability and business performance.

This research will adopt a quantitative survey approach involving MSME owners and managers in Klang Valley, Malaysia whose businesses are formally registered and have operated for at least one year. Therefore, the population of MSMEs will be gathered from related government agencies such as Department of Statistics Malaysia (DOSM), Companies Commission of Malaysia (SSM) and SME Corporation of Malaysia (SME Corp. Malaysia). The survey will be collected by using structured questionnaires comprising multi-item 5-point Likert scales adapted from previous validated studies (Farida et al., 2021; Falahat et al., 2020; Likert, 1932). The questionnaires will be distributed to selected respondents via Google-Form. The selected respondents will be based on convenience sampling in Klang Valley. The collected data will be analyzed using descriptive statistics, reliability and validity analyses, as well as inferential techniques such as correlation, regression, and Partial Least Squares Structural Equation Modelling (PLS-SEM) (Bekata and Kero, 2025; Farida et al., 2021).

Conclusion

This conceptual paper intends to examine product innovation capability as a strategic source of competitive advantage and business performance among Micro, Small and Medium Enterprises (MSMEs) in Malaysia which will focus around Klang Valley. Based on the Resource-Based View Theory (RBV), the paper proposes that product innovation capability could be a valuable strategic resource and a dynamic organizational capability influence organization to develop distinctive competencies, adapt to changing business environments which lead better organizational performance. This study proposes competitive advantage as the critical mediating mechanism through which product innovation capability toward business performance. This perspective offers a meaningful explanation for more findings aligned with the previous studies by suggesting that product innovation capability alone may not automatically improve organizational performance unless it requires competitive advantages that create superior customer value and organizational differentiation which hardly being copied by other competitors. However, this research extends to investigate among MSMEs in developing country which is Malaysia. With the limited financial among MSMEs and other constraints, this study is expecting to have an interesting result which can contribute to existing findings.

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Conflict of interest

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this article.

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