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Implementation of Digital Transformation in HIPSI SMEs: A Qualitative Analysis of Strengthening Local Community Digital Capabilities

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ABSTRACT

Purpose: *The increasing importance of digital innovation as a driver of business transformation across various industries remains underexplored in the context of SMEs. This study aims to address this gap by examining the direct effects of digital orientation and digital capability on digital innovation and assessing the mediating role of digital innovation in the relationship between organizational performance and these driving factors.*

Design/methodology/approach: *This qualitative study analyzes data collected from 20 HIPSI SMEs in Pasuruan, Indonesia. Data were obtained through interviews and document reviews and analyzed using thematic analysis and structural modeling techniques with SmartPLS.*

Findings: *The findings reveal that digital orientation and digital capability significantly influence digital innovation. Furthermore, digital innovation mediates the effect of digital orientation and digital capability on financial and non-financial performance. This demonstrates the critical role of digital innovation in enhancing organizational performance by leveraging digital resources effectively.*

Practical implications: *This study highlights the need for SMEs to adopt a digital-oriented mindset and invest in developing digital capabilities to harness the potential of emerging digital technologies. This strategic alignment can foster innovation, improve competitiveness, and strengthen community digital empowerment.*

Originality/value: *This research provides a novel framework that links digital orientation, digital capability, and innovation to organizational performance within the SME sector. It fills a critical gap in the literature by emphasizing the mediating role of digital innovation and offering insights into the digital transformation of local business communities.*

Keyword: *Indonesia, Digital innovation, Organizational performance, Digital capability, SMEs*

A. INTRODUCTION

Digital transformation in SMEs across various sectors, driven by the latest digital technologies such as IoT, big data analytics, artificial intelligence (AI), and cloud computing, is a rapidly growing phenomenon (Maisaroh et al., 2024). SMEs need to adopt digital technologies to drive significant business growth, such as enhancing customer experience and engagement, streamlining operations, and creating new business models (Nengyanti et al., 2023). Otherwise, they risk falling behind competitors who are already leveraging

digitalization to their advantage (Ramadhan & Farida, 2023). To digitalize their products, services, or business functions, SMEs must integrate innovative digital solutions, such as AI-based market intelligence software that helps identify trends among target customers, enabling better product customization. Other digital solutions, like mobile applications that allow consumers to shop in virtual stores or scan products while waiting for public transportation, can optimize customer experience and boost sales (Rianingtyas & Wardani, 2019). These innovative digital solutions play a crucial role in driving digitalization across various SME sectors, including marketing, customer service, and operational management. Therefore, without adopting appropriate digital solutions and support from the technological ecosystem, SMEs will face challenges in undergoing an effective digital transformation process.

In this context, digital innovation can be understood as an information technology solution that integrates the latest digital technologies to support business digitalization in non-technology sectors such as banking, healthcare, manufacturing, and retail (Atmojo & Wijayanti, 2022). Along with the increasing role of digitalization, digital innovation has become a primary focus in research, driven by the growing need for new digital solutions. Although interest in research on digital innovation is increasing, the related literature remains in its early stages. Most studies on digital innovation focus on technical, architectural, or information systems perspectives (Li et al., 2022; Mouelhi & Bellakhal, 2021), while fewer address it from a managerial perspective. Moreover, much of this research emphasizes general management rather than the information technology context (Alves et al., 2015; Eidhoff et al., 2016). Hence, this study takes a different approach by focusing on the context of SMEs and information technology to explore how IT products or solutions can evolve into innovative digital solutions that not only transform traditional products and services but also create new business models. Furthermore, limited research examines how digital technologies can be utilized by SMEs to create innovative digital products and services. While many studies investigate the driving factors of innovation across various industries, the literature on factors driving product innovation in the SME sector remains scarce. This study aims to fill this gap by addressing the first research question:

1. What are the factors driving digital innovation in the context of SMEs and local communities?

We employ the resource-based theory, specifically the dynamic capability theory, to answer this research question by developing and testing a conceptual framework (Barney et al., 2021). In the context of Indonesian SMEs, a study by Zahroh, (2022) highlights that many SMEs face challenges related to a lack of commitment and limited capabilities as inhibiting factors in their digital transformation journey. While digital technologies offer new opportunities for SMEs, achieving digital innovation is not possible without a strong commitment to adopting emerging technologies. Putri & Arif, (2023) note that SMEs aiming to develop superior innovation must possess a robust technology orientation, defined as a company's commitment to adopting new technologies and responding to technological changes. Given the rapid advancement of digital technology, SMEs must be oriented toward embracing digital technologies and transforming them into innovative digital solutions.

Beyond the importance of technology adoption orientation, SMEs also need the ability to effectively manage and maximize digital technologies in the innovation process.

This capability is crucial for accelerating innovation by integrating and mobilizing human and technological resources. A study by Purnomo, (2021) emphasizes that managing digital transformation can be challenging, but readiness in terms of resources and capabilities is essential. A. K. Putri et al., (2020) argue that the dynamic capability approach provides a coherent framework for organizations to develop and manage capabilities, thereby building competitive advantage. In the context of digital innovation, digital capabilities are necessary to integrate digital technologies with professional digital skills within SMEs. According to the dynamic capability theory, digital capabilities can be regarded as dynamic capabilities, defined as an organization's ability to create new products and processes and respond to market changes Suryatiningsih et al., (2022). These digital capabilities complement a company's digital orientation, as only organizations with the skills to manage new technologies will be prepared to adopt and transform these technologies into innovative products. Thus, we propose that digital capabilities and digital orientation are complementary in driving product innovation, as innovation is proven to be stimulated by a strong technology orientation.

Previous literature has supported the relationship between technological capabilities and innovation, as well as between technology orientation and innovation (Maldonado-Guzmán et al., 2019; Wijaya & Simamora, 2022). On the other hand, many studies also demonstrate a positive relationship between innovation and organizational performance (Sherlin, 2016; Sukriani, 2022). However, in the context of digital transformation, evidence regarding the relationship between digital innovation and organizational performance remains limited. For instance, Chakti, (2017) found that companies that successfully maximized their digital potential achieved greater benefits and higher profits compared to others. They also highlighted that technology orientation and technological capabilities play a crucial role in achieving these outcomes. Thus, it is possible that digital orientation and digital capabilities have an indirect effect, through innovation, which ultimately enhances organizational performance. This leads to our second research question:

2. Can digital innovation translate digital orientation and digital capabilities into better organizational performance, particularly in the context of SMEs?

Furthermore, the substantial relationship between digital technology factors and performance has not been extensively studied empirically, especially in the context of SMEs that implement digital technology. For example, a study in Subang by Almaududi Ausat et al., (2022) shows that digital maturity has a weak and negative relationship with the company’s operational performance. Therefore, it is important to conduct further research to establish the relationship between digital capabilities, digital orientation, innovation, and performance in the context of SMEs, especially those involved in the digitization of products and services.

This study is conducted with two main objectives: first, to examine the direct effects of digital orientation and digital capabilities on innovation in HIPSI SMEs. Second, to test the mediating effect of digital innovation on the relationship between SME performance and digital orientation and digital capabilities. The focus of this research is on SMEs that adopt digital technology within the context of HIPSI, which often face challenges in implementing effective digital solutions. In this context, digital solutions such as e-commerce, digital

marketing, and technology-based applications are crucial to optimizing SME performance and competitiveness.

This research makes a significant contribution to the development of knowledge regarding digital innovation in the SME sector. First, the study offers a new conceptual framework that links digital innovation with driving factors and performance outcomes in SMEs. By testing this framework, the study fills a gap in the literature by providing empirical evidence on the relationship between the drivers of digitalization and the performance impact of digital innovation in the context of local SMEs. Second, this study is one of the first in Pasuruan Regency to explore factors related to digital innovation within the SME context, which is important for enhancing the understanding of how innovative digital solutions can accelerate business transformation in this sector. Third, the research introduces the new terms digital orientation and digital capabilities, which can be further expanded and conceptualized as essential elements of digital innovation. A deeper understanding of these concepts is crucial considering the disruptive and dynamic nature of ever-evolving digital technology.

B. THEORETICAL REVIEW

1. Digital Innovation

In general, digital innovation is the process of creating new products, services, or business models that leverage digital technology (Nengyanti et al., 2023; Nizar et al., 2023). This innovation encompasses various outcomes, such as new products, platforms, services, and customer experiences, all supported by digital technology. In this study, digital innovation is defined as "The development of new products, services, or solutions using digital technology."

Technologies commonly used in digital innovation include Big Data, the Internet of Things (IoT), cloud computing, artificial intelligence, and cyber-physical systems (Sugihono et al., 2022). Yoo et al., (2010) explain that digital technologies have three unique characteristics: they are reprogrammable, have uniform data, and are self-referential. For example, IKEA has used augmented reality technology to create an app that helps customers visualize furniture in their homes. Many companies also utilize digital technology to increase productivity, reach broader audiences, and reduce operational costs (Fahmul Iltiham et al., 2022; Khan & Sarkar, 2024). In the context of HIPSI SMEs, adopting technologies such as e-commerce and social media can help enhance their competitiveness and business transformation. However, research on digital innovation is still limited, especially in the context of SMEs. This study aims to fill this gap in the literature by analyzing how digital orientation and digital capabilities can serve as key drivers of digital innovation.

2. Digital Orientation and Digital Innovation

Commitment to technology is crucial in responding to market changes (Dwi Lestari & Merthayasa, 2023). The resource-based view theory states that a company's performance heavily depends on unique, rare, and hard-to-imitate resources (Peteraf, 1993). In this study, digital orientation is defined as “a company’s commitment to using digital technology to create innovative products, services, or solutions.” Companies with a digital orientation are more likely to be open to new technologies and adopt them quickly. In the context of HIPSI SMEs, digital orientation includes the ability to leverage technologies such as digital marketing applications or business analytics. Companies with a digital orientation are

typically more prepared to generate innovations relevant to market needs. Based on this, the proposed hypothesis is:
H1. *Digital orientation positively affects digital innovation.*

3. Digital Capabilities and Digital Innovation

Digital capabilities encompass the skills, knowledge, and expertise of a company in managing digital technologies to support the development of new products (Suryatiningsih et al., 2022). In the context of HIPSI SMEs, digital capabilities include the community's ability to adopt technologies such as digital payment applications or cloud-based management systems. The dynamic capabilities theory explains that the ability to respond to market changes is a source of sustainable competitive advantage (Iltiham, 2022; Nugroho & Heykal, 2023). Developing innovative digital solutions requires effective technology management and competent professional personnel. Therefore, the better a company's digital capabilities, the greater its ability to produce digital innovation. The proposed hypothesis is:
H2. *Digital capabilities positively affect digital innovation.*

4. The Mediating Role of Digital Innovation

Digital innovation has become one of the main strategic tools for SMEs to enhance competitiveness and performance. Various previous studies have shown that innovation can have a positive impact on company performance (Firmansyah & Dede, 2022). However, there are also studies that reveal a negative impact of product innovation on performance (Laforet, 2011). In the context of digital technology, research findings have shown diverse results. Westerman et al., (2012) identified that companies with high levels of digital innovation tend to have greater profitability and revenue. Similarly, Weill & Woerner, (2015) reported that comprehensive adoption of digital technologies in the business ecosystem can enhance revenue growth and profit margins. Thus, the relationship between digital innovation and organizational performance heavily depends on the specific context.

However, some other studies have shown different results. For example, Chae et al., (2014) did not find a direct relationship between information technology (IT) capabilities and organizational performance. This research highlights the need to explore other variables that might influence this relationship. In response, we argue that digital innovation can be an important mediating factor linking a company's digital capabilities with business performance, especially in the context of digital transformation in HIPSI SMEs. Previous research has highlighted the mediating effect of product innovation in the relationship between technological orientation and performance (Lestari et al., 2013) as well as technological capabilities and performance (Al-Ansari et al., 2013). Al-Ansari et al., (2013) recommended that innovation be considered a factor that can enhance business performance through technological orientation. Additionally, the direct influence of technological orientation on innovation and technological capabilities on innovation has also been proven (Sainio et al., 2012). However, no research has specifically examined the mediating role of digital innovation in the relationship between digital orientation, digital capabilities, and performance, particularly in the SME sector.

In this context, the researchers argue that companies with strong digital orientation and digital capabilities are more likely to generate relevant digital innovations that add value

for customers and improve both financial and non-financial performance. Therefore, digital innovation serves as a mediator that connects digital orientation and digital capabilities with better performance. Based on this rationale, we propose the following hypotheses:

H3. *Digital orientation affects financial performance through the mediation of digital innovation.*

H4. *Digital orientation affects non-financial performance through the mediation of digital innovation.*

H5. Digital capabilities affect financial performance through the mediation of digital innovation.

H6. *Digital capabilities affect non-financial performance through the mediation of digital innovation.*

C. METHOD

This study aims to understand how digital transformation helps HIPSI SMEs strengthen the digital capabilities of the local community. The approach used is qualitative, analyzing interviews and related documents (Fitria, 2019; Nizar, 2018). The focus of the research is on SMEs that are part of HIPSI and have started using digital technology. The research data was collected from 20 HIPSI member SMEs in Pasuruan, representing various local business sectors. Pasuruan was chosen because it has great potential for the development of digital-based SMEs. There are two main reasons for selecting HIPSI SMEs. First, HIPSI SMEs are actively adopting digital technologies to support local economic growth. Second, this research aims to understand how digital innovation helps SMEs improve performance and support community empowerment.

The SMEs that are part of the sample must meet the following criteria: (1) owned by local entrepreneurs, (2) employing fewer than 10 permanent employees, and (3) already using digital technology in their operations. Data was collected through direct interviews with the owners or managers of the SMEs, as well as documents such as performance reports and digital training materials. Respondents were selected through the HIPSI network, and out of 30 SMEs contacted, 20 agreed to participate.

The research instruments were designed based on the literature review and interviews with digital technology experts. Some questions were modified to fit the context of HIPSI SMEs. To measure digital orientation, this study uses four indicators, such as the SME's commitment to using digital technology and their ability to recognize digital opportunities. All indicators are rated on a 1-5 scale, from 1 = "strongly disagree" to 5 = "strongly agree."

Digital capabilities are measured using five indicators, such as the ability of SMEs to apply digital technology in their operations (Dwi Lestari & Merthayasa, 2023). Digital innovation is also measured using six indicators that assess the SME's ability to create new digital-based solutions. SME performance is assessed from both financial and non-financial aspects (Khin & Ho, 2019). The financial aspects include satisfaction with sales, profits, and cash flow. The non-financial aspects include customer satisfaction, market share, and employee retention rates.

Table 1. Measurement Items

Questionnaire Items	Questionnaire Items
Digital Innovation	Digital Orientation
1. The quality of our digital solutions is superior to competitors 2. The features of our digital solutions are superior to competitors 3. The applications of our digital solutions are completely different from competitors 4. Our digital solutions are different from competitors in terms of product platform 5. Our new digital solutions are minor improvements to existing products 6. Some of our digital solutions are new to the market when launched	1. Please indicate your level of agreement or disagreement with the following statements 2. We are committed to using digital technology in developing our new solutions 3. Our solutions have superior digital technology 4. New digital technologies are readily accepted in our organization 5. We are always looking for opportunities to use digital technology in our innovations
Questionnaire Items	Questionnaire Items
Digital Capabilities	Financial Performance
1. Please specify your company's capability level in the following areas 2. Acquiring essential digital technologies 3. Identifying new digital opportunities 4. Responding to digital transformation 5. Mastering the latest digital technologies 6. Developing innovative products/ services/ processes using digital technologies	1. Please indicate your level of satisfaction with your company's performance 2. Sales 3. Net profit 4. Cash flow
Questionnaire Items	
Non-Financial Performance	
1. Objective Performance 2. Customer satisfaction 3. Market share 4. Employee turnover	

Sources: (Khin & Ho, 2019; Laub, 1999)

The sampled SMEs operate in various sectors, such as crafts, food and beverages, fashion, and digital services. Most SMEs (75%) have fewer than 10 employees, and the majority have been established for 3 to 10 years. The SMEs are spread across different areas of Pasuruan, one of the regions in East Java with community-based economic growth. The research respondents consist of business owners (50%), managers (30%), and senior staff. Most respondents have a sufficient educational background and have attended digital training organized by HIPSI. This training supports their digital capabilities in running their businesses.

D. RESULTS

In this study, SPSS Version 20 was used to process data, describe the respondent companies' profiles, and test for any variance issues caused by the measurement method. To test the hypotheses, SmartPLS software, developed by (Rakhmawati et al., 2019; Ringle et al., 2022), was utilized. This software applies the Partial Least Square (PLS) approach within

Structural Equation Modeling (SEM). One advantage of PLS is its ability to analyze the relationships between variables and latent constructs simultaneously, as well as its flexibility to work with small sample sizes and non-normally distributed data. Additionally, this method can be applied to complex structural models with multiple variables (Cheah et al., 2024). The study employed a two-step approach: first, analyzing the measurement model to ensure that the measurements used are valid and reliable; second, analyzing the structural model to test the relationships between variables or constructs. This approach follows the recommendations of (Anderson & Gerbing, 1988). Before analyzing the model, the study also evaluated whether there was any bias caused by the measurement method.

1. Evaluation of Measurement Method Bias

The first step was to examine whether there was common method variance (CMV). CMV refers to data variation that may occur because the same measurement method is used for multiple variables (Reio, 2010). This can lead to relationships between variables appearing stronger or weaker than they actually are (Bagozzi & Yi, 1990). To address this, the study used Harman's Single Factor Test, a technique that examines whether a single dominant factor accounts for the variance in the data. Results showed that five different factors explained 70% of the total data variance, with the first factor only accounting for 36%. Thus, it can be concluded that measurement method bias is not a significant issue in this study.

2. Measurement Model

The measurement model was validated by testing convergent validity and discriminant validity. Convergent validity ensures that each measure strongly correlates with other measures assessing the same construct (Hair et al., 2021). Discriminant validity ensures that each construct is unique and does not overlap with others (Hair et al., 2021). In this study, all constructs were measured using a reflective model, meaning their indicators should exhibit high variance. To assess convergent validity, analyses were conducted on indicator reliability (outer loadings), the average variance extracted (AVE), and composite reliability (CR), as presented in Table 2.

Table 2. Summary of construct validity and reliability

No.	Variables	No. Item	Item Cleared	*Factor loading*	AVEa	CRb
1	Digital Innovation	4	None	0,870; 0,847; 0,790; 0,810	0,686	0,897
2	Digital Orientation	5	1 (DC 5)	0,873; 0,841; 0,868; 0,785	0,706	0,906
3	Digital Capabilities	6	2 (Inno 5 and 6)	0,808; 0,855; 0,646; 0,693	0,567	0,838
4	Financial Performance	3	None	0,877; 0,920; 0,896	0,803	0,924
5	Non-Financial Performance	3	None	0,824; 0,865; 0,616	0,826	0,862

The results show that most indicators have loading values above 0.4. However, three indicators (DC5, Inno5, and Inno6) were excluded because their loading values were below 0.4 (Hair et al., 2021). All AVE values are greater than 0.5, indicating that convergent validity has been achieved. Furthermore, composite reliability (CR) was used to ensure the reliability of the measurements, with an emphasis on the reliability of each indicator. All CR values exceed 0.7, signifying that the measurements are reliable. According to Hair et al., (2021), Cronbach's alpha measures reliability based on the interrelationships among indicators, while composite reliability evaluates the reliability of each indicator individually. Discriminant validity was assessed by comparing the square root of AVE with the

correlations among latent variables. As shown in Table 3, the square root of the AVE for each construct is higher than its correlation with other constructs. This demonstrates that each construct in this study possesses good discriminant validity.

Table 3. Discriminant Validity

Variables	1	2	3	4	5
Digital Innovation	0,898				
Digital Orientation	0,353	0,755			
Digital Capabilities	0,589	0,449	0,786		
Financial Performance	0,383	0,622	0,492	0,842	
Non-Financial Performance	0,465	0,595	0,518	0,582	0,830

3. Structural Model

In this study, business size and age were considered control variables as both might influence the relationships being tested. However, the analysis results indicate that neither business size nor age significantly affects digital innovation. Thus, the tested relationships remain valid without accounting for business size or age. To test the hypotheses, the structural model was analyzed to examine the relationships between variables. As shown in Table 4 and Figure 1, the results indicate that digital orientation ($\beta = 0.352$, $p < 0.01$) and digital capability ($\beta = 0.418$, $p < 0.01$) have a positive and significant influence on digital innovation. Therefore, hypotheses H1 and H2 are supported. The R^2 value of 0.465 suggests that 46.5% of the variation in digital innovation is explained by digital orientation and digital capability.

Table 4. Hypothesis Testing Results

Hypothesis	Direct Effect			Path coefficient	Standard error	t-value	Status
H1	Digital Orientation → Digital Innovation			0,352**	0,104	3,252	Accepted
H2	Digital Capabilities → Digital Innovation			0,418**	0,106	4,144	Accepted
	Efek Moderasi	Path coefficient A	Path coefficient B	Indirect effect	Standard Error	t-value	Status
H3	Digital Orientation → Digital Innovation → Financial Performance	0,353	0,353	0,126*	0,051	2,367	Accepted
H4	Digital Capabilities → Digital Innovation → Financial Performance	0,419	0,353	0,145**	0,048	3,178	Accepted
H5	Digital Orientation → Digital Innovation → Non-financial Performance	0,354	0,449	0,154*	0,065	2,337	Accepted
H6	Digital Capabilities → Digital Innovation → Non-financial Performance	0,418	0,448	0,183**	0,054	3,254	Accepted

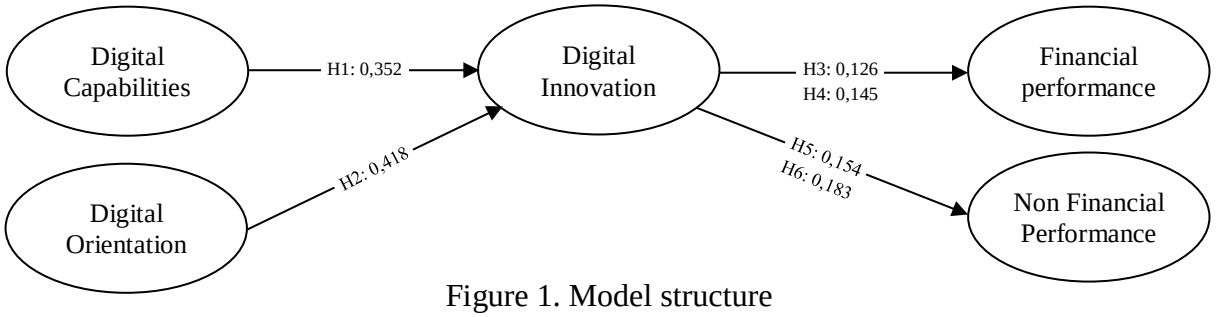

Figure 1. Model structure

Additionally, the mediation effect was also analyzed. To evaluate the mediation effect, the bootstrapping method was used as recommended Henseler et al., (2009) and Preacher & Hayes, (2008) with a PLS-SEM approach. The mediation effect was calculated using the formula: t-value = indirect effect / standard error. The t-value of the indirect effect was used to measure whether digital innovation serves as a significant mediator.

Table IV and Figure 1 show the beta values of the indirect effects of digital orientation and digital capabilities on financial and non-financial performance through digital innovation as a mediator. Based on the significant results, hypotheses H3 (b = 0.126; t-value = 2.367), H4 (b = 0.145; t-value = 3.178), H5 (b = 0.154; t-value = 2.337), and H6 (b = 0.183; t-value = 3.254) are accepted because the t-values are greater than 1.645 at the 95% significance level.

These results indicate that digital orientation and digital capabilities not only have a direct impact on digital innovation but also indirectly enhance financial and non-financial performance through digital innovation. This finding is relevant in supporting digital transformation and strengthening the digital capabilities of local communities in HIPSI enterprises.

E. DISCUSSION

This study had two primary objectives: first, to analyze the direct effects of digital orientation and digital capabilities on innovation; and second, to assess the role of digital innovation as a mediator in the relationship between organizational performance and both digital orientation and digital capabilities in HIPSI SMEs. The research model was designed to achieve these objectives and address the research questions. The findings show that all hypotheses are supported, thereby validating the proposed conceptual model. These results align with the Resource-Based Theory and the Dynamic Capability Theory, which link digital orientation and digital capabilities to digital innovation.

To address the first research question, hypothesis testing for H1 and H2 reveals that digital orientation and digital capabilities have a positive and significant effect on digital innovation. This indicates that both are key drivers of digital innovation. These findings support previous studies, such as those by Dwi Lestari & Merthayasa, (2023), which found that technological orientation positively impacts product innovation. In the context of HIPSI SMEs, digital orientation enables entrepreneurs to focus more effectively on leveraging digital technologies to meet the needs of local communities. With this orientation, SMEs can create innovative digital solutions that enhance competitiveness and provide new experiences for customers. Therefore, SMEs need to cultivate a digital mindset by recognizing the transformative potential of technology for business growth and the empowerment of local communities.

Digital capabilities that significantly influence digital innovation highlight the importance of digital skills for HIPSI SMEs in developing new products or services that meet market demands. These findings align with the study by Khan & Sarkar, (2024), which asserts that technological orientation supports technology-based innovation. SMEs can enhance their digital capabilities by investing in training, establishing strategic partnerships, or collaborating with more experienced entities. These capabilities can be built through a combination of skills, knowledge, and experience in managing digital technologies. To

support this, SMEs should foster a workplace environment that attracts digital talent and encourages a digital culture. Additionally, government policies can assist these efforts through digital training programs for the current workforce and younger generations, including the introduction of digital education at an early stage.

To address the second research question, hypotheses H3, H4, H5, and H6 indicate that digital innovation mediates the influence of digital orientation and digital capabilities on financial and non-financial performance. This implies that digital innovation is the key to translating digital orientation and capabilities into improved organizational performance. In the context of HIPSI SMEs, digital innovation enables them to better respond to technological changes and remain competitive. These findings confirm that digital innovation plays a vital role in enhancing both financial and non-financial performance for SMEs. Overall, this study demonstrates that SMEs' digital strengths must be harnessed to create innovations that can boost competitiveness and business success.

Like other studies, this research has several limitations that should be considered when interpreting its results. The study focuses solely on two key factors: digital orientation and digital capabilities. This limitation opens opportunities for future research to delve deeper into other factors that might influence digital innovation, such as technology culture, organizational aspects that foster innovation, or market factors aligned with users' digital needs.

Additionally, the data for this study were collected from a single industry sector, which may restrict the applicability of the findings to other industries. Nevertheless, the results are robust enough to support the explanation of how digital orientation and digital capabilities directly impact digital innovation and how they indirectly influence organizational performance. This study also provides a solid foundation for future research, especially in exploring digital transformation in SMEs, including the role of such transformation in strengthening the digital capabilities of local communities.

F. CONCLUSION

This study emphasizes the importance of understanding the drivers and impacts of digital innovation for HIPSI SMEs, which play a crucial role in strengthening local community digital capabilities and fostering innovation. The findings reveal that digital orientation and digital capabilities directly contribute to innovation and organizational performance. Moreover, this research addresses gaps in previous literature by introducing a digital innovation model that can be utilized in future studies and providing a roadmap for SMEs to cultivate a digital culture and enhance their digital technology management skills.

Practically, the results offer guidance for HIPSI SMEs to leverage digital technologies to improve performance and competitiveness in both financial and non-financial aspects. The study highlights the significance of digital innovation as a bridge connecting digital orientation, digital capabilities, and organizational performance enhancement. HIPSI SMEs are expected to assist their communities and business partners in optimizing the use of digital solutions, accelerating digital transformation, and fostering a more advanced digital economy.

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