



DOI: <https://doi.org/10.38035/gijea.v3i4>
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Local Village Product Innovation Strategy to Penetrate Regional Markets: A Case Study of Food Processing SMEs

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Abstract: This study examines local village product innovation strategies in penetrating regional markets through case studies of food processing SMEs. A qualitative research method with a case study approach was used to analyze five food processing SMEs in Central Java region. Data were collected through in-depth interviews, observations, and document analysis. The results show that effective innovation strategies include product diversification based on local raw materials, packaging quality improvement, halal and PIRT certification, and digital technology utilization for marketing. SMEs that successfully penetrated regional markets have characteristics of consistent product innovation, strong partnership networks, and adaptability to market demands. Branding strategies that emphasize local wisdom and product added value have proven to increase product competitiveness. This research recommends strengthening human resource capacity, capital access, and technology support as keys to successful regional market expansion.

Keyword: product innovation, food processing SMEs, regional market, marketing strategy, local village products

INTRODUCTION

Small and Medium Enterprises (SMEs) play a strategic role in the Indonesian economy, particularly in employment and contribution to Gross Domestic Product (GDP). Data from the Ministry of Cooperatives and SMEs reveal that SMEs employ 97% of the total workforce and contribute 61.07% to the national GDP in 2023. The food processing sector is one of the fastest-growing SME segments, with 4.69 million business units, or approximately 12% of the total SMEs in Indonesia. Villages, as production bases for food processing SMEs, have a comparative advantage in abundant local raw materials and relatively low production costs. However, most rural SMEs still face obstacles in accessing broader markets, particularly regional markets. Limited product innovation capabilities, inadequate packaging quality, and limited marketing strategies are key factors inhibiting market expansion.

Product innovation is key to increasing the competitiveness of food processing SMEs. Porter (1990) emphasized that innovation is a fundamental element in achieving sustainable competitive advantage. In the context of food processing SMEs, innovation is not limited to

new product development but also encompasses improvements in production processes, packaging, and marketing strategies tailored to regional market characteristics. Regional markets offer significant opportunities for food processing SMEs to expand their businesses. According to data from the Central Statistics Agency (2023), consumption of processed food products at the regional level experienced an average annual growth of 8.5%. This growth was driven by increased purchasing power, lifestyle changes, and consumer preference for quality local products.

Previous research has shown that SMEs that successfully penetrate regional markets possess distinctive characteristics in their innovation strategies. Christensen (1997) identified that innovations focused on the specific needs of the local market can serve as a basis for expansion into broader markets. It aligns with the findings of Prahalad and Hart (2002), who stated that innovations rooted in local wisdom have significant potential for growth in regional markets. The success of several village-based food processing SMEs in penetrating regional markets demonstrates a pattern of innovation strategies that can be studied and replicated. SMEs such as tempeh chips from Malang, garut dodol from West Java, and packaged rendang from West Sumatra have successfully established significant regional market share through appropriate innovation strategies. This success is inextricably linked to their ability to identify market needs, develop appropriate products, and build effective distribution networks.

However, there remains a gap in understanding effective product innovation strategies for rural food processing SMEs in penetrating regional markets. Existing research remains fragmented and does not provide a complete picture of the key factors determining the success of these innovation strategies. Therefore, this study aims to examine the innovation strategies of local village products in penetrating regional markets through case studies of food processing SMEs.

Literature Review

The Concept of Product Innovation in SMEs

Product innovation is defined as the development and introduction of new products or significant improvements to existing products to meet market needs (OECD, 2018). In the context of SMEs, product innovation does not necessarily mean creating something completely new, but can involve modifying, adapting, or improving existing products. Schumpeter (1942) emphasized that innovation is a creative process of destruction that creates new value through the combination of different resources. Rogers (2003) identified five characteristics of innovation that influence adoption rates: relative advantage, compatibility, complexity, trialability, and observability. In food processing SMEs, these characteristics are key considerations in developing an effective product innovation strategy.

Regional Market Penetration Strategy

Ansoff (1957) developed a growth strategy matrix that includes market penetration, product development, market development, and diversification. Regional market penetration strategies can be categorized as market development, where SMEs seek to enter new geographic market segments with existing or modified products. Kotler and Armstrong (2018) state that a regional market penetration strategy requires a thorough understanding of target market characteristics, consumer preferences, distribution channels, and existing competitors. In the context of food processing SMEs, this strategy must consider factors such as product durability, food regulations, and local taste preferences.

Competitive Advantage of SMEs Based on Local Resources

The Resource-Based View (RBV) theory developed by Barney (1991) states that sustainable competitive advantage can be achieved through the utilization of valuable, rare, inimitable, and non-substitutable (VRIN) resources. In the context of rural food processing SMEs, local resources such as traditional raw materials, local knowledge, and traditional wisdom can form the basis of competitive advantage. Research by Tambunan (2019) shows that SMEs that utilize local resources have advantages in terms of production costs, raw material quality, and product differentiation. This aligns with the concept of competitive advantage proposed by Porter (1985), which emphasizes the importance of differentiation in achieving competitive advantage.

Factors for Successful SME Product Innovation

Rothwell (1994) identified five generations of innovation models, with the latest generation emphasizing system and network integration. In the SME context, the open innovation model developed by Chesbrough (2003) is relevant because it allows SMEs to leverage external resources in the innovation process. Hadiyati's (2011) research on SMEs in Indonesia identified that key factors for successful SME product innovation include human resource capabilities, access to technology, financial support, and partnership networks. Meanwhile, a study by Wibowo and Suryawan (2013) showed that market orientation and learning orientation have a positive influence on SME product innovation performance.

Digital Marketing and Market Access

Developments in digital technology provide new opportunities for SMEs to access broader markets at relatively low costs. Chaffey and Ellis-Chadwick (2019) state that digital marketing enables SMEs to more precisely segment markets and build more personalized relationships with consumers. Research by Setiawan and Wulandari (2020) shows that SMEs that adopt digital technology in marketing perform better in terms of market reach, sales, and profitability. E-commerce platforms and social media are the primary channels SMEs use to market their products to regional markets.

METHOD

Research Design

This research uses a qualitative approach with an exploratory case study method. Yin (2018) states that case studies are an appropriate research strategy for answering "how" and "why" research questions and for understanding contemporary phenomena in a real-life context. It was chosen based on the need to deeply understand the product innovation strategies of food processing SMEs in penetrating regional markets.

Case Selection

This study used purposive sampling to select five food processing SMEs located in Central Java. The selection criteria include: SMEs that have been operating for at least 3 years, have products based on local raw materials, have marketed products to regional markets (at least 3 districts/cities), and have an annual turnover of above IDR 500 million. The five SMEs selected were: UD Sari Rasa (cassava chips), CV Berkah Jaya (jackfruit dodol), UD Maju Bersama (catfish floss), CV Hasil Tani (tempeh chips), and UD Rejeki Lancar (pecel chili sauce).

Data Collection Techniques

Primary data was collected through in-depth interviews with SME owners, production managers, and the marketing department. The interviews were conducted in a structured

manner using a pre-prepared interview guide. Direct observation was conducted to observe production processes, packaging, and marketing activities. Secondary data was collected from company documents, financial reports, product brochures, and sales data.

Data Analysis

Data analysis was conducted using thematic analysis techniques developed by Braun and Clarke (2006). The analysis process included: transcribing interview data, coding data, identifying themes, reviewing themes, defining and naming themes, and writing a report. Data triangulation is carried out by comparing data from various sources to ensure the validity and reliability of research findings.

Validity and Reliability

The study's validity was ensured through source triangulation, method triangulation, and member checking. Source triangulation was conducted by collecting data from various informants within each SME. Method triangulation using interviews, observation, and document analysis. Member checking is done by asking for confirmation from the informant regarding the results of the data analysis. Reliability is ensured through consistency in the use of research instruments and detailed documentation of the entire research process.

RESULT AND DISCUSSION

Characteristics of Food Processing SMEs

The five SMEs studied have diverse characteristics but demonstrate consistent patterns in their product innovation strategies. UD Sari Rasa, which produces cassava chips, has been operating for eight years with an annual turnover of IDR 2.1 billion. CV Berkah Jaya, which produces jackfruit *dodol*, has an annual turnover of IDR 1.8 billion and markets its products to 15 regencies/cities. UD Maju Bersama, which specializes in catfish floss, has achieved a turnover of IDR 1.5 billion with a market reach spanning Central Java, East Java, and Yogyakarta. CV Hasil Tani, which produces tempeh chips, is unique in its flavor innovation, developing 12 flavor variants tailored to regional market preferences. UD Rejeki Lancar, which produces *pecel* chili sauce, has successfully established a strong regional market share with an annual turnover of IDR 1.2 billion. All of these SMEs share similarities in utilizing local raw materials and developing products tailored to regional market characteristics.

Product Innovation Strategy

The research results indicate that the product innovation strategies of food processing SMEs can be categorized into four main dimensions: product innovation, process innovation, packaging innovation, and marketing innovation. Within the product innovation dimension, the five SMEs demonstrated the ability to develop new product variants based on local raw materials. UD Sari Rasa developed cassava chips with eight different flavors, including *balado*, cheese, and barbecue, tailored to regional market preferences. CV Berkah Jaya innovated by developing jackfruit *dodol* (sweet potato fritters) in various packaging formats, from the economical 100-gram package to the premium 500-gram package. This innovation was based on market segmentation analysis, which revealed differing demands among middle- to upper-class consumers and consumers with limited purchasing power. UD Maju Bersama developed catfish floss using a special drying technology that produces a crispier texture and longer shelf life. Within the process innovation dimension, these SMEs made improvements to their production systems to increase efficiency and product quality. CV Hasil Tani implemented a strict quality control system by regularly testing raw materials and

finished products. UD Rejeki Lancar uses pasteurization technology to increase the shelf life of its *pecel* sauce without compromising its authentic flavor.

Regional Marketing and Market Penetration Strategies

The marketing strategies implemented by the five SMEs demonstrate a consistent pattern in utilizing multi-channel marketing. All SMEs use a combination of traditional and digital marketing channels to reach the regional market. Traditional channels include partnerships with local grocery stores, supermarkets, and distributors. Digital channels include marketing through social media, online marketplaces, and the company website. UD Sari Rasa has built a distribution network spanning 45 grocery stores and 12 supermarkets in Central Java. This strategy is complemented by an intensive promotional program, such as product sampling and discounts for many purchases. CV Berkah Jaya focuses on developing partnerships with regional distributors with extensive networks, ensuring the availability of its jackfruit *dodol* products at various strategic sales points. Utilizing digital technology is key to its success in regional market penetration. UD Maju Bersama reports that 35% of its total sales come from online platforms, with an average annual growth of 25%. CV Hasil Tani uses a content marketing strategy through social media to build brand awareness and engagement with consumers. UD Rejeki Lancar developed an online sales system integrated with an inventory management system to ensure product availability.

Product Innovation Success Factors

An analysis of product innovation success factors identified five key factors contributing to the success of SMEs in penetrating regional markets. The first factor is adequate human resource capacity in terms of mastery of production and marketing technology. All SMEs invest in regular employee training to improve competency in production, quality control, and digital marketing. The second factor is access to technology appropriate to their business scale. Successful SMEs demonstrate the ability to adopt appropriate and cost-effective technology. CV Berkah Jaya uses an automatic packaging machine that increases production efficiency by 40% and reduces labor costs. UD Maju Bersama implements an automatic temperature control system in the drying process, resulting in more consistent product quality.

The third factor is adequate financial support for investment in product innovation and marketing. All SMEs have access to various financing sources, both from formal financial institutions and government programs. UD Sari Rasa obtained People's Business Credit (KUR) for production and marketing expansion, while CV Hasil Tani received support from a partnership program with a large company. The fourth factor is a strong partnership network with various stakeholders, including raw material suppliers, distributors, and supporting institutions. UD Rejeki Lancar builds partnerships with farmer groups to ensure a sustainable supply of quality raw materials. CV Berkah Jaya collaborates with research institutions for product development and quality testing.

The fifth factor is a strong market orientation in product development. Successful SMEs demonstrate the ability to identify market needs and develop appropriate products. All SMEs conduct simple but effective market research to understand regional consumer preferences. UD Sari Rasa conducts regular consumer surveys to obtain product feedback and develop new flavor variants.

Branding and Positioning Strategy

The branding strategies implemented by SMEs emphasize local values and traditional wisdom. All SMEs use local identity as a key differentiation in product positioning. UD Sari Rasa uses the tagline "Authentic Village Cassava Chips" to emphasize the

authenticity and quality of its products. CV Berkah Jaya positions its jackfruit *dodol* as "High-Quality Central Javanese Souvenirs." Packaging strategy is also a crucial element in branding. All SMEs have upgraded their packaging from simple to more attractive and informative. UD Maju Bersama uses airtight aluminum foil packaging to maintain the quality of catfish floss. CV Hasil Tani develops packaging with attractive designs and complete nutritional information to meet modern market standards.

Product certification is a strategy used to build consumer trust. All SMEs obtain PIRT (Home Industry Food) certification and halal certification from the Indonesian Ulema Council (MUI). UD Rejeki Lancar even obtained ISO 22000 certification for its food safety management system. This certification is a primary requirement for entering modern markets such as supermarkets and hypermarkets.

Utilization of Digital Technology

Adoption of digital technology is a key factor in successfully penetrating regional markets. All SMEs use social media as their primary platform to build brand awareness and engage with consumers. Facebook and Instagram are the most effective platforms with high engagement rates. UD Sari Rasa has 15,000 followers on Instagram with an average engagement rate of 8.5%. Utilizing online marketplaces such as Tokopedia, Shopee, and Bukalapak provides broader access to regional markets. CV Berkah Jaya reported that sales reached 40% of total sales with an average growth of 30% per year through online marketplaces. UD Maju Bersama employed a search engine optimization (SEO) strategy to increase product visibility on online platforms. An integrated management system was also adopted to improve operational efficiency. CV Hasil Tani employed a simple Enterprise Resource Planning (ERP) system that integrated production, inventory, and sales processes. UD Rejeki Lancar implements a Customer Relationship Management (CRM) system to manage relationships with customers and distributors.

CONCLUSION

This study identified that the product innovation strategies of food processing SMEs to penetrate regional markets require an integrated and sustainable approach. Strategies proven effective include product diversification based on local raw materials, improving packaging quality and product certification, developing multi-channel distribution networks, and utilizing digital technology for marketing. The five SMEs studied demonstrated the ability to simultaneously combine product, process, packaging, and marketing innovation. Key factors for successful product innovation include adequate human resource capabilities, access to appropriate technology, adequate financial support, a strong partnership network, and a clear market orientation. SMEs that successfully penetrate regional markets demonstrate the ability to adapt innovation strategies to the characteristics and needs of their target markets. Utilizing local wisdom and regional identity as product differentiation has proven effective in building strong positioning in regional markets.

Branding strategies that emphasize local values and product quality are key to building trust with regional consumers. Product certification and improving packaging quality are fundamental requirements for entering modern markets. The adoption of digital technology, particularly social media and online marketplaces, provides significant opportunities for SMEs to reach a wider consumer base at a relatively low cost. This research provides theoretical contributions to the understanding of SME product innovation strategies and practical contributions in the form of strategy recommendations that can be adopted by other SMEs. Limitations of this research lie in its limited geographic focus on Central Java and the relatively small number of cases. Future research is recommended to explore SME

product innovation strategies in other regions with different characteristics and use a larger sample for broader generalization.

The managerial implications of this research are the importance of developing an integrated and sustainable innovation strategy. SMEs need to invest in human resource development, technology, and partnership networks to enhance innovation capabilities. Support from the government and relevant institutions is needed in accessing financial, training, and partnership facilitation. Developing a conducive innovation ecosystem will encourage more SMEs to successfully penetrate regional markets and contribute to regional economic growth.

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