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## INTERNAL CAPABILITIES AND ORGANISATIONAL PERFORMANCE OF TRADITIONAL WEAVING MICRO, SMALL, AND MEDIUM ENTERPRISES (MSMEs): EVIDENCE FROM INDONESIA

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### ABSTRACT

This study investigates the effects of internal organisational capabilities on organisational performance among traditional Lurik weaving micro, small, and medium enterprises (MSMEs) in Indonesia, drawing on the dynamic capabilities perspective. A quantitative, cross-sectional design was employed using survey data collected from 30 owners or managers of Lurik weaving MSMEs in Klaten, Central Java. Data were analysed using Partial Least Squares Structural Equation Modeling (PLS-SEM), which is suitable for exploratory research with relatively small sample sizes. The findings reveal that financial literacy has a positive and statistically significant effect on organisational performance, indicating that effective financial management plays a crucial role in improving business outcomes. In contrast, however, human resource readiness and innovation capability do not show significant direct effects on organisational performance, suggesting that these capabilities may not immediately translate into measurable performance improvements in traditional cultural MSMEs. From a theoretical perspective, this study extends the application of dynamic capabilities theory to a culturally embedded MSMEs context and demonstrates that internal capabilities do not uniformly influence performance outcomes across different organisational settings. Practically, the findings highlight the importance of prioritising financial management capabilities to enhance performance in micro-scale traditional enterprises. This study is limited by its cross-sectional design, small sample size, and reliance on perceptual performance measures within a single regional context. Despite these limitations, the study offers original insights by focusing on traditional weaving MSMEs and identifying financial literacy as a dominant driver of organisational performance.

**KEYWORDS:** TRADITIONAL LURIK WEAVING MSMEs; ORGANISATIONAL PERFORMANCE; HUMAN RESOURCE READINESS; INNOVATION CAPABILITY; FINANCIAL LITERACY.

### ABSTRAK

Kajian ini meneliti pengaruh keupayaan organisasi dalaman terhadap prestasi organisasi dalam kalangan perusahaan mikro, kecil, dan sederhana (MSMEs) tenunan tradisional Lurik di Indonesia dengan menggunakan perspektif keupayaan dinamik. Kajian ini menggunakan reka bentuk kuantitatif keratan rentas melalui data tinjauan yang dikumpulkan daripada 30 pemilik atau pengurus MSMEs

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tenunan Lurik di Klaten, Jawa Tengah. Analisis data dijalankan menggunakan Partial Least Squares Structural Equation Modeling (PLS-SEM), yang sesuai untuk kajian penerokaan dengan saiz sampel yang kecil. Dapatan kajian menunjukkan bahawa literasi kewangan mempunyai pengaruh positif dan signifikan terhadap prestasi organisasi, yang menandakan bahawa pengurusan kewangan yang berkesan memainkan peranan penting dalam meningkatkan prestasi perniagaan. Sebaliknya, kesiapsiagaan sumber manusia dan keupayaan inovasi tidak menunjukkan kesan langsung yang signifikan terhadap prestasi organisasi, yang menunjukkan bahawa keupayaan tersebut tidak semestinya menghasilkan peningkatan prestasi dalam jangka pendek bagi MSMEs berasaskan budaya tradisional. Dari sudut teori, kajian ini memperluas aplikasi teori keupayaan dinamik dalam konteks MSMEs berteraskan budaya dan menunjukkan bahawa kesan keupayaan dalaman terhadap prestasi adalah bergantung kepada konteks organisasi. Dari sudut praktikal, dapatan kajian menekankan kepentingan memperkukuh literasi kewangan sebagai keutamaan bagi meningkatkan prestasi perusahaan mikro tradisional. Kajian ini terhad kepada reka bentuk keratan rentas, saiz sampel yang kecil, serta penggunaan ukuran prestasi berasaskan persepsi dalam satu konteks geografi tertentu. Walau bagaimanapun, kajian ini menawarkan sumbangan asli dengan memfokuskan kepada MSMEs tenunan tradisional yang masih kurang dikaji.

**KATA KUNCI:** *MSMES TENUNAN TRADISIONAL; PRESTASI ORGANISASI; KESIAPSIAGAAN SUMBER MANUSIA; KEUPAYAAN INOVASI; LITERASI KEWANGAN*

## 1. INTRODUCTION

Micro, small and medium enterprises (MSMEs) play a vital role in economic development, employment creation, and social resilience, particularly in emerging economies. Beyond their economic contributions, many MSMEs also function as custodians of local culture and heritage. In Indonesia, traditional weaving MSMEs such as Lurik enterprises represent not only productive economic units but also important carriers of cultural identity and indigenous knowledge (Mulyanto *et al.*, 2018; Setiyaning & Nugroho, 2017). Despite their significance, traditional cultural MSMEs continue to face persistent challenges, including limited resources, weak managerial capabilities, and declining competitiveness in increasingly modernized markets (Setyaningsih *et al.*, 2024).

Organisational performance has therefore become a central concern for MSMEs operating in highly competitive and rapidly changing environments. Prior research consistently emphasizes that internal organisational capabilities are critical determinants of performance, particularly for small firms with limited access to external resources and institutional support (Sutanto *et al.*, 2023; Tjahjadi *et al.*, 2024). From a dynamic capabilities perspective, firms that are able to effectively develop, integrate, and reconfigure internal resources are more likely to achieve superior performance outcomes and maintain competitiveness over time (Teece, 2007; Teece *et al.*, 2009; Teece, 2022).

Among the internal capabilities frequently highlighted in the literature are human resource readiness, innovation capability, and financial literacy. Human resource readiness enhances firms' adaptive capacity and productivity, innovation capability enables continuous value creation through incremental and process-based improvements, and financial literacy supports sound financial decision-making and efficient resource allocation (Mendoza-Silva, 2020; Masdupi *et al.*, 2024). Empirical evidence generally confirms the positive role of these capabilities in improving firm performance; however, such evidence is largely derived from studies focusing on modern, manufacturing-based, or technology-oriented MSMEs (Rajapathirana & Hui, 2018; Kim & Jin, 2022).

Despite the growing body of research on MSMEs performance, traditional cultural MSMEs remain under-represented in empirical investigations. Existing studies that address cultural or craft-based enterprises tend to prioritise sustainability, heritage preservation, or social outcomes, rather than organisational performance as an immediate strategic concern (Mulyanto *et al.*, 2018; Setyaningsih *et al.*, 2024). Moreover, the operational characteristics of traditional weaving MSMEs, such as family-based management, aging workforces, limited formal training, and incremental innovation practices,

differ substantially from those of contemporary MSMEs. As a result, there is limited empirical understanding of how internal organisational capabilities translate into performance outcomes within culturally embedded enterprises in emerging economies.

This gap constrains the applicability of dominant theoretical frameworks, particularly dynamic capabilities theory, to traditional MSMEs contexts and calls for empirical studies that explicitly examine capability, performance relationships beyond modern business settings. Therefore, this study seeks to address this gap by providing early empirical evidence on the relationship between human resource readiness, innovation capability, and financial literacy and organisational performance among traditional weaving MSMEs in Indonesia. By focusing on Lurik weaving enterprises in Klaten, Central Java, this research offers a contextual contribution that extends existing theories of internal capabilities and organisational performance to culturally embedded MSMEs setting.

## 2. LITERATURE REVIEW

### *Dynamic Capabilities Perspective and Organisational Performance*

Dynamic capabilities theory explains how firms sustain performance in changing environments. Teece, (2007) defines dynamic capabilities as the firm's ability to integrate, build, and reconfigure internal and external resources in response to environmental shifts. Unlike the traditional resource-based view, this perspective emphasizes adaptation, learning, and strategic renewal as drivers of performance (Teece *et al.*, 2009; Teece, 2022).

For MSMEs operating under resource constraints, internal capabilities become critical sources of advantage. Limited access to capital, technology, and institutional support increases reliance on internally developed competencies (Miles, 2012). Empirical studies show that stronger internal capabilities are associated with higher productivity, efficiency, and performance outcomes (Sutanto *et al.*, 2023; Tjahjadi *et al.*, 2024).

In traditional weaving enterprises, the need for adaptation is coupled with the preservation of cultural authenticity. These firms must respond to market changes while maintaining heritage-based production systems. However, empirical applications of dynamic capabilities theory in such contexts remain limited. This study, therefore, examines three internal capabilities, human resource readiness, innovation capability, and financial literacy, as potential drivers of organisational performance.

### *Human Resource Readiness and Organisational Performance*

Human resource readiness refers to the extent to which employees possess the skills, knowledge, and adaptability required to perform effectively. In MSMEs, where organisational structures tend to be informal and employees often perform multiple roles, workforce readiness becomes particularly important for maintaining operational efficiency (Miles, 2012). Previous empirical studies show that human resource readiness contributes positively to firm performance. Sutanto *et al.* (2023) found that human capital readiness enhances business performance in MSMEs by strengthening innovation capability and improving firms' ability to adapt to market changes. Similarly, Tjahjadi *et al.* (2024) reported that human capital readiness significantly supports business performance and sustainability by improving employees' skills, knowledge, and adaptability in responding to organisational challenges. In traditional weaving MSMEs, workforce characteristics often involve inherited skills and limited formal training. While these characteristics support cultural continuity, improving human resource readiness may strengthen operational capabilities and enhance organisational performance. In this case, human resource readiness is expected to positively influence organisational performance. Hence,  $H_1$  was postulated as:

$H_1$ : Human resource readiness has a positive effect on organisational performance.

#### *Innovation Capability and Organisational Performance*

Innovation capability is a company's ability to generate and implement new ideas related to products, processes, or markets. In MSMEs, innovation generally takes the form of incremental improvements rather than radical technological change (Mendoza-Silva, 2020). Companies with stronger innovation capabilities are generally better able to adapt to market changes, improve operational processes, and maintain competitiveness. Previous research has shown that innovation capability plays a positive role in improving company performance. Rajapathirana & Hui (2018) found that innovation capability significantly impacts company performance through new product development, production process improvements, and the company's ability to respond effectively to market changes. This research indicates that companies with stronger innovation capabilities tend to achieve higher productivity, market performance, and competitive advantage. Similarly, Sahoo (2019) also demonstrated that innovation capability plays a crucial role in improving company performance, particularly through process improvements, the implementation of quality management practices, and sustainable operational development in small and medium enterprises. In the context of traditional weaving MSMEs, innovation is often manifested through design modifications, color combinations, and refinements in production techniques, or adjustments to marketing strategies. Although innovation is generally incremental, these changes can increase product appeal and strengthen market competitiveness without diminishing cultural authenticity. In view of this assertion, innovation capacity is thought to have a positive impact on organisational performance. Therefore, H<sub>2</sub> was hypothesised as:

H<sub>2</sub>: Innovation capability has a positive effect on organisational performance.

#### *Financial Literacy and Organisational Performance*

Financial literacy refers to the ability of business owners or managers to understand and apply financial knowledge in business decision-making. In MSMEs, where financial management is generally centralized in the owner or manager, financial literacy plays an important role in budgeting, investment decisions, and financial risk management (Masdupi *et al.*, 2024). Previous studies highlight the importance of financial literacy in improving MSME performance. Kurniasari *et al.*, (2025) found that financial literacy significantly enhances MSME performance by improving financial decision-making, encouraging the adoption of financial technology, and facilitating better access to finance. Similarly, Kyeyune and Ntayi (2024) reported that financial literacy strengthens business performance and sustainability by improving financial management practices, cost control, and long-term financial planning. In the context of traditional weaving MSMEs, financial management practices are often informal and rely more on the owner's personal experience rather than formal financial knowledge. Therefore, strengthening financial literacy may help business owners manage cash flows more effectively, allocate resources efficiently, and make strategic financial decisions that support business growth. Accordingly, financial literacy is expected to positively influence organisational performance. Henceforward, H<sub>3</sub> was suggested as:

H<sub>3</sub>: Financial literacy has a positive effect on organisational performance.

### **3. METHODOLOGY**

#### *Research Design*

This study used a quantitative, cross-sectional research design to examine the relationship between internal organisational capabilities and organisational performance among traditional Lurik weaving micro, small, and medium enterprises (MSMEs) in Klaten, Central Java, Indonesia. The initial data used in this study were 30 respondents. Primary data were collected through a structured questionnaire administered directly to MSMEs owners or managers, who served as the unit of analysis due to their direct involvement in operational and strategic decision-making. The sampling technique used was purposive non-probability sampling.

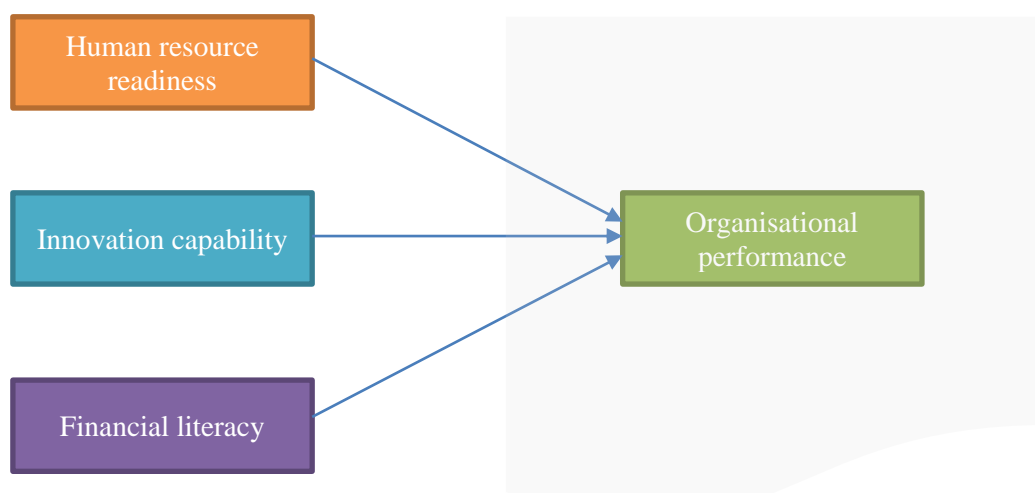
### *Measurement Scales Development*

All constructs in this study were measured using multi-item scales adapted from previous studies and contextualized to the setting of traditional weaving micro, small, and medium enterprises (MSMEs). Each item was measured using a five-point Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). The details are given as follows:

- The human resource readiness variable was adapted from Tjahjadi *et al.* (2024) and measured using seven questionnaire items, such as “Our employees understand how to carry out weaving or production activities according to proper and safe procedures” and “Our employees try to understand customers’ needs and preferences, even when they are not yet familiar with using digital media.” The innovation capability variable was adapted from Sutanto *et al.* (2023) and measured using seven questionnaire items, such as “Our Lurik weaving business has developed new products over the past three years” and “Our Lurik weaving business continuously changes or improves existing products.”;
- The financial literacy variable was adapted from Aripin and Zuhriyah (2025) and measured using six questionnaire items, such as “Our Lurik weaving business has a strong understanding of fundamental financial concepts, including interest rates, inflation, and potential investment risks” and “Our Lurik weaving business is capable of creating and managing business financial plans effectively.”; and
- Finally, the organisational performance variable was adapted from Tjahjadi *et al.* (2024) and measured using nine questionnaire items, such as “The quality of products produced by our Lurik weaving business meets the established standards” and “Our Lurik weaving products dominate the market.”

### *Data Analysis*

Data were analysed using Partial Least Squares Structural Equation Modeling (PLS-SEM), which is suitable for exploratory research, relatively small sample sizes, and non-normal data distributions (Kock and Hadaya, 2018). The analysis followed a two-stage procedure consisting of measurement model evaluation and structural model assessment (Hair *et al.*, 2021). In the first stage, the measurement model was assessed by examining indicator reliability, internal consistency reliability using Cronbach’s alpha and composite reliability (CR), and convergent validity using factor loading and the average variance extracted (AVE). Discriminant validity was evaluated using the Fornell–Larcker criterion to ensure that each construct was empirically distinct from other constructs in the model. In the second stage, the structural model was evaluated to test the hypothesized relationships among constructs. Path coefficients, t-statistics, and p-values were obtained through a bootstrapping procedure.



**FIGURE 1: CONCEPTUAL FRAMEWORK**

Source: Figure by Authors

#### 4. FINDINGS AND DISCUSSION

##### *Respondent Profile*

This preliminary study reveals findings obtained from initial data from 30 respondents of Lurik Weaving MSMEs in Klaten. The findings based on table 1, show that the respondent profile indicates that traditional Lurik weaving MSMEs are predominantly managed by women, with female respondents accounting for 80% of the sample, while male respondents represent 20%. In terms of educational background, most respondents have relatively low levels of formal education, with 53.3% completing elementary school, 40% junior high school, and only 6.7% senior high school. The length of business operation shows that these enterprises are generally well-established, as the majority have been operating for more than ten years, with business experience ranging from 10 to 35 years. Regarding firm size, most MSMEs operate on a micro scale, as 90% of respondents manage their businesses with only one employee and only a small proportion employ two workers. Overall, this profile reflects the characteristics of traditional weaving MSMEs as long-standing, micro-scale enterprises that rely heavily on female labour, family-based management, and limited formal organisational structures.

**TABLE 1: DEMOGRAPHIC PROFILE OF RESPONDENTS**

Profile	Description	Frequency	Percentage (%)
Gender	Female	24	80
	Male	6	20
Educational	Elementary school	16	53.3
	Junior High School	12	40
	Senior High School	2	6.7
Length Of Business	10 - 15 years	7	23.3
	16 - 20 years	6	20
	21 - 25 years	6	20
	26 - 30 years	5	16.7
	31 - 35 years	6	20
Employee	1 employee	27	90
	2 employees	3	30

Source: Table by Authors

##### *Validity and Reliability*

Table 2 shows that all constructs exhibit satisfactory reliability and convergent validity. Cronbach's alpha values range from 0.906 to 0.967, and composite reliability values range from 0.926 to 0.972, exceeding the recommended thresholds and indicating strong internal consistency.

**TABLE 2: CONVERGENT VALIDITY AND RELIABILITY TESTING RESULTS**

Construct	N	Cronbach's Alpha	Factor Loading	CR	AVE
Human Resources Readiness	7	0.926	0.705 – 0.910	0.940	0.694
Financial Literacy	6	0.906	0.781 – 0.892	0.926	0.677
Innovation Capability	7	0.948	0.803 – 0.911	0.957	0.761
Organisational Performance	9	0.967	0.825 – 0.932	0.972	0.794

Source: Table by Authors

Convergent validity is further supported by factor loading values above 0.70 for all indicators, with loadings ranging from 0.705 to 0.932 across constructs. In addition, all average variance extracted (AVE) values exceed the minimum cutoff of 0.50, ranging from 0.677 to 0.794, confirming that each construct explains a substantial proportion of variance in its indicators. Overall, the measurement

model meets the required criteria for reliability and convergent validity and is suitable for structural model analysis (Hair *et al.*, 2021).

*Discriminant Validity*

Discriminant validity was assessed using the Fornell–Larcker criterion, where the square root of the average variance extracted (AVE) of each construct should be greater than its correlation with other constructs. As shown in Table 3, the diagonal values representing the square root of the AVE for human resource readiness (0.833), financial literacy (0.823), innovation capability (0.872), and organisational performance (0.891) were generally higher than the corresponding inter-construct correlations, indicating adequate discriminant validity (Hair *et al.*, 2021).

**TABLE 3: DISCRIMINANT VALIDITY USING FORNELL AND LACKER CRITERION**

Construct	Organisational Performance	Financial Literacy	Human Resource Readiness	Innovation Capability
Organisational performance	0.891			
Financial literacy	0.871	0.823		
Human resource readiness	0.778	0.802	0.833	
Innovation capability	0.624	0.744	0.448	0.872

Source: Table by Authors

*Hypothesis Testing*

The results of the hypothesis testing reveal differing effects of internal organisational capabilities on organisational performance among traditional Lurik weaving MSMEs. Human resource readiness shows a positive but statistically non-significant relationship with organisational performance ( $\beta = 0.235$ ,  $t = 1.241$ ,  $p = 0.215$ ), indicating that workforce readiness alone does not directly translate into improved performance outcomes. This finding suggests that, in traditional weaving enterprises characterized by family-based labor and inherited skills, human resource readiness may function as a foundational capability that supports operational continuity rather than as a direct driver of performance (Teece, 2007; Sutanto *et al.*, 2023). Similarly, innovation capability does not exhibit a significant direct effect on organisational performance ( $\beta = 0.026$ ,  $t = 0.182$ ,  $p = 0.856$ ), implying that innovation activities within these MSMEs are largely incremental and culturally oriented, and therefore insufficient to generate immediate performance gains (Rajapathirana & Hui, 2018; Mendoza-Silva, 2020). In contrast, financial literacy demonstrates a strong and statistically significant positive effect on organisational performance ( $\beta = 0.663$ ,  $t = 3.014$ ,  $p = 0.003$ ), highlighting its critical role in enhancing business outcomes. This result indicates that the ability of MSMEs owners to manage cash flows, control costs, and make informed financial decisions has a direct and substantial impact on performance, particularly in micro-scale enterprises with limited access to external resources (Masdupi *et al.*, 2024; Kyeyune & Ntayi, 2024). Overall, these findings suggest that, within traditional cultural MSMEs, managerial and financial capabilities play a more immediate role in driving organisational performance than human resource readiness or innovation capability, which may exert their influence through indirect or longer-term mechanisms (Teece, 2023).

**TABLE 4: HYPHOTESIS TESTING**

Hypothesis	$\beta$ (O)	$\beta$ (M)	$t$ -value	$p$ -value
H1: Human resource readiness -> Organisational Performance	0.235	0.268	1.241	0.215
H2: Innovation capability -> Organisational Performance	0.026	0.061	0.182	0.856
H3: Financial literacy -> Organisational Performance	0.663	0.609	3.014	0.003

Source: Table by Authors

## 5. CONCLUSION, LIMITATIONS AND FUTURE RESEARCH

This study examines the influence of internal organisational capabilities on organisational performance among traditional Lurik weaving micro, small, and medium enterprises (MSMEs) in Klaten, Central Java, using the dynamic capabilities perspective. Based on the analysis of preliminary survey data from 30 MSMEs owners or managers, the findings provide early empirical evidence that internal capabilities do not contribute equally to performance outcomes in culturally embedded and micro-scale enterprises. The results indicate that financial literacy has a significant and positive effect on organisational performance, highlighting the critical role of financial management skills in enhancing business outcomes. In contrast, human resource readiness and innovation capability do not show significant direct effects on organisational performance, suggesting that these capabilities may not immediately translate into measurable performance improvements in traditional weaving MSMEs. These findings reflect the unique characteristics of traditional Lurik weaving enterprises, which are predominantly micro-scale, family-based, and reliant on inherited skills and incremental innovation practices. In such contexts, financial literacy appears to function as a key operational capability that directly supports performance through better cash flow management, cost control, and financial decision-making. Overall, this study contributes to the MSMEs and dynamic capabilities literature by extending empirical evidence to traditional cultural enterprises and by demonstrating that performance drivers in these contexts differ from those commonly identified in modern or technology-oriented MSMEs.

This study offers a more nuanced understanding of dynamic capabilities theory in micro-scale, culturally embedded enterprises. The findings suggest that, in traditional MSMEs, managerial micro foundations, particularly financial literacy, may serve as more immediate drivers of performance than innovation or workforce-based capabilities. This refines Teece's framework by indicating that, under conditions of extreme resource constraints and cultural embeddedness, the reconfiguration of financial and managerial routines may precede sensing- and innovation-based capabilities in shaping short-term organisational performance.

Despite its contributions, as a preliminary study, this study has several limitations that should be acknowledged. First, the research employs a cross-sectional design, which limits the ability to capture changes in organisational capabilities and performance over time. Second, the sample size is relatively small and confined to traditional Lurik weaving MSMEs in a single geographical area, which may restrict the generalizability of the findings to other types of MSMEs or cultural industries. Third, organisational performance is measured using perceptual indicators reported by owners or managers, which may be subject to response bias despite their widespread use in MSMEs research. Finally, this study focuses solely on direct relationships between internal capabilities and organisational performance, without examining potential mediating or moderating variables that could further explain these relationships.

Future research may consider repositioning organisational performance as a mediating variable rather than a final outcome. Given that human resource readiness and innovation capability do not exhibit significant direct effects on organisational performance in this study, it is plausible that these capabilities influence broader outcomes, such as sustainability, competitiveness, or long-term resilience, through intermediate performance mechanisms. Adopting organisational performance as a mediator may provide deeper insights into the indirect pathways through which internal capabilities contribute to long-term outcomes in traditional cultural MSMEs, consistent with the dynamic capabilities perspective. Finally, future studies may expand the research model by including sustainability outcomes or external support mechanisms, such as government assistance, to develop a more comprehensive understanding of performance and resilience among traditional cultural MSMEs.

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