

# KNOWLEDGE MANAGEMENT, ABSORPTIVE CAPACITY, AND SME PERFORMANCE: THE MEDIATING ROLE OF INNOVATION IN THE CRAFT SECTOR

## *Manajemen Pengetahuan, Kapasitas Absorptif, dan Kinerja UMKM: Peran Mediasi Inovasi pada Sektor Kerajinan*

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### Abstract

This study aims to examine the influence of knowledge management and absorptive capacity on organizational performance, with innovation as a mediating variable, in the handicraft SME sector. Craft-based SMEs play a strategic role in enhancing economic value and strengthening the competitiveness of the creative industry. However, many of these enterprises still face significant challenges related to limited knowledge management practices, low absorptive capacity, and weak innovation capability. This study adopts a quantitative approach using a survey method. Data were collected from 225 craft SME owners and managers in Bekasi, Indonesia, through structured questionnaires. The collected data were analyzed using Structural Equation Modeling based on Partial Least Squares (SEM-PLS) to examine the relationships among variables and test the proposed hypotheses. The results show that knowledge management and absorptive capacity have positive and significant effects on innovation. Furthermore, innovation has a strong positive effect on organizational performance. The findings also reveal that innovation plays a significant mediating role in the relationship between knowledge management and absorptive capacity on performance.

These results indicate that SMEs that are capable of effectively managing internal knowledge and absorbing external knowledge are more likely to develop innovative capabilities, which in turn enhance their performance. This study contributes to the knowledge-based view by emphasizing the critical role of innovation as a linking mechanism between knowledge resources and organizational performance, particularly in the context of craft SMEs.

**Keywords:** Knowledge Management, Absorptive Capacity, Innovation, Performance, Strategic Management

### Abstrak

Penelitian ini bertujuan untuk menguji pengaruh manajemen pengetahuan dan kapasitas absorptif terhadap kinerja organisasi, dengan inovasi sebagai variabel mediasi, pada sektor UMKM kerajinan. UMKM berbasis kerajinan memiliki peran strategis dalam meningkatkan nilai ekonomi serta memperkuat daya saing industri kreatif. Namun, banyak pelaku usaha ini masih menghadapi berbagai tantangan, seperti keterbatasan dalam praktik manajemen pengetahuan, rendahnya kapasitas absorptif, serta lemahnya kemampuan inovasi. Penelitian ini menggunakan pendekatan kuantitatif dengan metode survei. Data dikumpulkan dari 225 pemilik dan manajer UMKM kerajinan di Bekasi, Indonesia, melalui kuesioner terstruktur. Data yang diperoleh dianalisis menggunakan Structural Equation Modeling berbasis Partial Least Squares (SEM-PLS) untuk menguji hubungan antar variabel serta menguji hipotesis yang diajukan. Hasil penelitian menunjukkan bahwa manajemen pengetahuan dan kapasitas absorptif memiliki pengaruh positif dan signifikan terhadap inovasi. Selain itu, inovasi juga memiliki pengaruh positif yang kuat terhadap kinerja organisasi. Temuan penelitian ini juga mengungkapkan bahwa inovasi berperan sebagai variabel mediasi yang signifikan dalam hubungan antara manajemen pengetahuan dan kapasitas absorptif terhadap kinerja. Hasil ini menunjukkan bahwa UMKM yang mampu mengelola pengetahuan internal secara efektif serta menyerap pengetahuan

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*eksternal dengan baik cenderung lebih mampu mengembangkan inovasi, yang pada akhirnya meningkatkan kinerja mereka. Penelitian ini berkontribusi pada perspektif berbasis pengetahuan dengan menekankan peran penting inovasi sebagai mekanisme penghubung antara sumber daya pengetahuan dan kinerja organisasi, khususnya dalam konteks UMKM sektor kerajinan.*

**Kata Kunci:** *Manajemen Pengetahuan, Kapasitas Absorptif, Inovasi, Kinerja, Manajemen Strategis*

## Introduction

MSMEs play a vital role in the Indonesian economy, contributing more than 60% to the national Gross Domestic Product (GDP) and absorbing approximately 97% of the total workforce. They also support job creation, increase community income, and foster the development of the creative economy (Ministry of Cooperatives and SMEs, 2023; BPS, 2023). One sub-sector with significant potential is the craft MSME sector, which produces a variety of products rooted in creativity and local wisdom, such as handicrafts, home decor, and culturally significant art products. In recent years, the craft MSME sector has grown steadily in response to rising market demand for creative and unique products.

However, the craft SME sector still faces various challenges, such as limitations in knowledge management, low utilization of digital technology, and limited product innovation capabilities, which impact business competitiveness (Siregar et al., 2024). In an increasingly competitive and dynamic business environment, SMEs are required to manage knowledge effectively to sustain their competitive advantage. Knowledge management enables organizations to create, store, share, and utilize knowledge, thereby enhancing their capacity to generate innovative ideas and improve organizational performance. Furthermore, absorptive capacity the ability to identify, assimilate, and apply external knowledge plays a crucial role in helping SMEs adapt to technological changes and evolving market demands (Pu & Liu, 2023).

These capabilities are essential for fostering product and process innovation that ultimately contributes to improved organizational performance. Recent studies highlight that knowledge management significantly enhances innovation and performance by integrating various knowledge resources within organizations (Bawa & Yongping, 2024; Santoro et al., 2021). Similarly, absorptive capacity has been recognized as a strategic capability that enables firms to leverage external knowledge to stimulate innovation and strengthen performance (Sancho-Zamora et al., 2022; Volberda et al., 2021). These findings underscore the importance of knowledge-based resources in achieving sustainable competitive advantage in SMEs.

## LITERATURE REVIEW AND HYPOTHESIS

### Knowledge Management

Knowledge management is a key concept in knowledge-based organizations. In the era of the knowledge based economy, organizations no longer rely solely on physical or financial resources, but also on their ability to create, manage, and utilize knowledge as a source of competitive advantage (Nonaka & Takeuchi, 1995; Santoro et al., 2021). Knowledge management encompasses the processes of creating, storing, sharing, and utilizing knowledge within an organization to enhance efficiency and innovation capabilities (Ferraris et al., 2020).

In the context of SMEs, particularly craft SMEs, knowledge management is crucial because most knowledge is tacit, stemming from the skills, experience, and creativity of artisans. The integration of tacit and explicit knowledge enables SME practitioners to develop new product ideas and improve the quality of the handicrafts produced (Secundo et al., 2021). Recent research indicates that the implementation of knowledge management in SMEs can enhance innovation capabilities and business competitiveness (Bawa & Yongping, 2024; Siregar et al., 2024).

## **Absorptive Capacity**

Absorptive capacity refers to an organization's ability to identify, absorb, and utilize knowledge derived from the external environment. In an increasingly dynamic business environment, organizations need to leverage knowledge from various sources such as customers, suppliers, and technological advancements to enhance their competitiveness (Zahra et al., 2020; Ferraris et al., 2020).

In craft SMEs, absorptive capacity plays a crucial role in helping entrepreneurs understand market trends, product design developments, and digital marketing opportunities. Organizations with high levels of absorptive capacity tend to be better able to identify innovation opportunities and develop products that align with market needs (Volberda et al., 2021). Recent research indicates that the ability to absorb external knowledge is a key factor supporting increased innovation and SME performance (Pu & Liu, 2023).

## **Innovation**

Innovation is an organization's ability to create new ideas, products, or processes that provide added value to the organization and its customers (Sulistiyowati, A., 2025). In the context of craft SMEs, innovation can take the form of product design development, the use of new materials, or more creative digital marketing strategies. Innovation enables SMEs to enhance product value and expand their market share (OECD, 2018; Santoro et al., 2021). Research shows that organizations with high levels of innovation tend to be better able to increase productivity and competitiveness in competitive markets (Ferraris et al., 2020; Rozak et al., 2024). Therefore, innovation is a critical factor in enhancing business sustainability within the craft SME sector.

## **Performance**

Performance reflects an organization's level of success in achieving its established goals, which can be measured through indicators such as productivity, business growth, product quality, and customer satisfaction (Richard et al., 2009). In the context of craft MSMEs, improvements in business performance are significantly influenced by entrepreneurs' ability to manage knowledge and create valuable product innovations. Empirical research indicates that knowledge management and absorptive capacity have a positive influence on performance through increased innovation. Consequently, innovation is often viewed as a mediating variable linking knowledge management and the ability to absorb external knowledge with improved performance (Ferraris et al., 2020; Santoro et al., 2021; Pu & Liu, 2023).

## **Hypothesis Development**

Several previous studies have shown that Knowledge Management has a positive effect on Innovation. (Al-Khatib, 2022; Khan et al., 2021).

**H1:** Knowledge Management has a positive effect on Innovation.

Previous research has shown that Absorptive Capacity has a positive effect on Innovation. (Zhai et al., 2020; Ferraris et al., 2020)

**H2:** Absorptive Capacity has a positive effect on Innovation.

Previous research has shown the effect of Innovation on Performance. (Xie et al., 2018; Rajapathirana & Hui, 2018; Sulistyowati, A. (2025)

**H3:** The effect of Innovation on Performance.

Previous research indicates the effect of Knowledge Management on Performance. (Khan et al., 2021; Ferraris et al., 2020).

**H4:** The effect of Knowledge Management on Performance

Previous research results also indicate that Absorptive Capacity has a positive effect on performance. (Zhai et al., 2020; Al-Khatib, 2022)

**H5:** The Effect of Absorptive Capacity on Performance

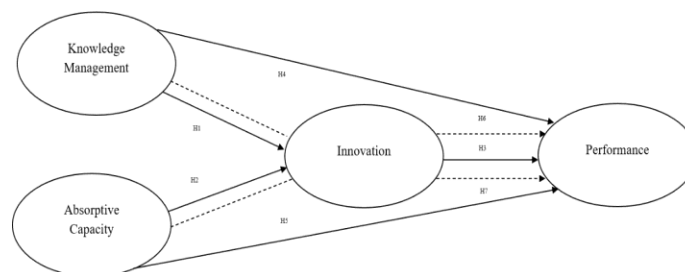
Previous research indicates that innovation can act as a mediating variable in the relationship between knowledge management and performance. (Khan et al., 2021; Al-Khatib, 2022).

**H6:** The effect of knowledge management on performance is mediated by innovation

Previous research has also shown that absorptive capacity can enhance innovation, which in turn leads to improved performance management. (Ferraris et al., 2020; Zhai et al., 2020)

**H7:** The effect of absorptive capacity on performance is mediated by innovation.

**Figure 1. Conceptual Framework**



Source: Data Processed by Researchers, 2026

## Operational Definitions of Research Variable

**Table 1. Research Variable**

No	Research Variable	Indicator	Reference
1.	Knowledge Management	a. Knowledge Creation b. Knowledge Storage c. Knowledge Sharing d. Knowledge Application e. Knowledge Transfer	Santoro et al. (2021); Secundo et al. (2021); Ferraris et al. (2020); Bawa & Yongping (2024)
2	Absorptive Capacity	a. The ability to acquire external knowledge b. The ability to understand new knowledge c. The ability to integrate new knowledge d. The ability to apply new knowledge e. Ability to apply knowledge to innovation	Volberda et al. (2021); Zahra et al. (2020); Pu & Liu (2023); Siregar et al. (2024)
3	Innovation	a. Product innovation b. Process innovation c. Marketing innovation d. Organizational innovation e. Ability to generate new ideas	OECD (2018); Santoro et al. (2021); Ferraris et al. (2020); Rozak et al. (2024)
4	Performance	a. Increased productivity b. Improved service quality c. Operational efficiency d. Organizational growth e. Customer satisfaction	Durst & Zieba (2020); Santoro et al. (2021); Bawa & Yongping (2024)

## Research Methods

### Research Design

This study employs a quantitative approach using a survey method to examine the relationships among knowledge management, absorptive capacity, innovation, and organizational performance. The research adopts an explanatory design to test causal relationships between independent variables, mediating variables, and dependent variables through systematic statistical analysis.

The study was conducted among craft-based Micro, Small, and Medium Enterprises (MSMEs) in Bekasi, Indonesia. The population consisted of 225 SME owners and managers. A census sampling technique was applied, in which all members of the population were included as respondents. Data were collected through structured questionnaires using a five-point Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). The measurement indicators were adapted from validated studies to ensure content validity and reliability.

The collected data were analyzed using Structural Equation Modeling based on Partial Least Squares (SEM-PLS) with the assistance of SmartPLS software. The analysis involved two stages: evaluation of the measurement model (outer model) and evaluation of the structural model (inner model). The outer model assessment included tests of convergent validity, discriminant validity, composite reliability, and Cronbach's alpha. Meanwhile, the inner model was evaluated using the coefficient of determination ( $R^2$ ), path coefficients, effect size ( $f^2$ ), predictive relevance ( $Q^2$ ), and hypothesis testing through bootstrapping procedures.

### Research Population and Sample

The population in this study consists of craft-based MSMEs in the Bekasi region, which serve as the subject of the research. The study population comprises 225 respondents. The sampling technique employed was census sampling, a method in which all members of the population are included as the study sample. This technique was used because the population size is relatively small, allowing the entire population to be included as respondents in the study. Thus, the sample size in this study is 225 respondents who are considered to have met the criteria for providing relevant information regarding the variables under study.

### Analysis Results

Data analysis was conducted using Partial Least Squares based Structural Equation Modeling (SEMPLS) with the assistance of SmartPLS software. The analysis included respondent characteristics, measurement model evaluation, structural model evaluation, and hypothesis testing.

### Respondent Characteristics

**Table 2. Respondents by Gender**

No	Gender	Number	Percentage (%)
1	Female	128	56,9%
2	Male	97	43,1%
	Total	225	100%

Source: Data Processed by Researchers, 2026

Table 2 shows that the majority of respondents in this study were male, totaling 128 respondents (56.9%), while female respondents numbered 97 (43.1%). This indicates that the majority of organizational leaders or MSME owners in this study were male.

**Table 3. Length of Service of Respondents**

No	Length of Service	Number	Percentage (%)
1	<3 Year	52	23,1%
2	3-5 Year	74	32,9%
3	6-10 Year	63	28,0%
4	>10 Year	63	16%
	Total	225	100

Source: Data Processed by Researchers, 2026

Table 3 shows that the majority of respondents 74 respondents (32.9%) have 3–5 years of work experience. This indicates that most respondents have sufficient work experience within the organization to provide relevant insights regarding knowledge management, absorptive capacity, innovation, and performance.

### Uji Validity

The validity test was performed by evaluating the outer loading values of each indicator on the latent constructs. Indicators are considered valid when the outer loading value exceeds 0.70 (Hair et al., 2017). The results show that all indicators for the variables of income, financial literacy, lifestyle, social environment, consumptive behavior, and paylater usage exceeded the recommended threshold. Therefore, all indicators were deemed valid and capable of adequately representing the constructs in this study.

**Table 4. Outer Loading Results**

Variable	Indicator	Outer Loading	Description
Knowledge Management	KM1	0.79	valid
	KM2	0.82	valid
	KM3	0.77	valid
	KM4	0.77	valid
	KM5	0.78	valid
Absorptive Capacity	AC1	0.77	valid
	AC2	0.82	valid
	AC3	0.81	valid
	AC4	0.80	valid
	AC5	0.81	valid
Innovation	IN1	0.82	valid
	IN2	0.74	valid
	IN3	0.82	valid
	IN4	0.81	valid
	IN5	0.84	valid
Performance	PF1	0.82	valid
	PF2	0.79	valid
	PF3	0.78	valid
	PF4	0.83	valid
	PF5	0.83	valid

Source: Data Processed by Researchers, 2026

Based on Table 4, all indicators have loading factor values greater than 0.70, therefore, it can be concluded that all indicators in this study meet the convergent validity criteria. This finding indicates that each indicator is able to adequately represent the latent variables measured in this study.

### Reliability Test

**Table 5. Reliability Test Results**

Variable	Cronbach Alpha	Composite Reliability	AVE
Knowledge Management	0.84	0.84	0.62
Absorptive Capacity	0.86	0.86	0.65
Innovation	0.86	0.86	0.65
Performance	0.87	0.87	0.66

Source: Data Processed by Researchers, 2026

Based on Table 5, all variables have Cronbach's Alpha and Composite Reliability values exceeding 0.70, and the Average Variance Extracted (AVE) values are above 0.50. These results indicate that all constructs in this study demonstrate good reliability and are appropriate for further analysis.

### Structural Model

#### R-Square Test

**Table 6. R-Square Test**

Variable	R-square	R-square adjusted
Performance	0.73	0.73
Innovation	0.75	0.75

Source: Data Processed by Researchers, 2026

Table 6 shows that the R-square value for Innovation is 0.73, indicating that 73% of the variance in Innovation can be explained by knowledge management and absorptive capacity, while the remaining 27% is explained by other variables outside the research model.

## Hypothesis Test

**Table 7. Hypothesis Test**

Relationship Between Variable	Path Coefficient	T-Statistic	P-Value	Result
Knowledge Management → Innovation	0,34	5,62	0,000	Significant
Absorptive Capacity → Innovation	0,56	9,92	0,000	Significant
Knowledge Management → Performance	0,11	3,91	0,000	Significant
Absorptive Capacity → Performance	0,26	8,19	0,000	Significant
Innovation → Performance	0,51	7,58	0,000	Significant

Source: Data Processed by Researchers, 2026

Based on Table 7, all relationships between variables show t-statistic values greater than 1.96 and p-values less than 0.05; therefore, all hypotheses in this study are supported. The results indicate that knowledge management has a positive and significant effect on Innovation, suggesting that organizations that manage knowledge effectively are more likely to enhance their Innovation capability. Furthermore, absorptive capacity also has a positive effect on Innovation, indicating that the organization's ability to absorb external knowledge can enhance its Innovation capability.

## Mediation Test

**Table 8. Mediation Test**

Relationship Variable	Indirect Effect	T-Statistic	P-Value
KM → Innovation → Performance	0,17	4,87	0,000
Absorptive Capacity → Innovation → Performance	0,28	5,66	0,000
Relationship Mediation	Indirect Effect	T-Statistic	P-Value

Table Source: Data Processed by Researchers, 2026

8 presents the results of the mediation analysis, showing that Innovation mediates the relationship between Knowledge Management and Performance, with an indirect effect value of 0.17, a t-statistic of 4.87, and a p-value of 0.000 ( $< 0.05$ ), indicating a significant mediation effect. In addition, Innovation also mediates the relationship between Absorptive Capacity and Performance, with an indirect effect value of 0.28, a t-statistic of 5.66, and a p-value of 0.000, indicating a significant mediation effect.

## Path Diagram

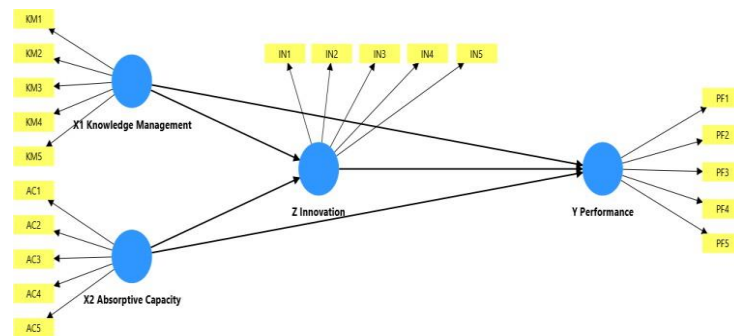
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## Results and Discussion

### Respondent Characteristics

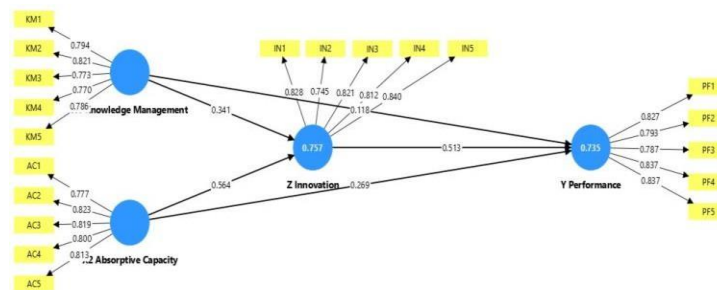
The path diagram was developed to illustrate the structural relationships among latent variables and their indicators based on the SEM-PLS model estimation results. The diagram presents the direction and strength of the relationships among variables in the research model, thereby facilitating a better understanding of the relationships between the inner model and the outer model specified in this study.

Figure 2. Research Model Test Results



Source: Data Processed by Researchers, 2026

Figure 3. SEM-PLS Data Analysis Results



Source: Data Processed by Researchers, 2026

The SEM-PLS analysis results show that all indicators have outer loading values greater than 0.70, indicating that the convergent validity criteria have been satisfied. The R-square values for Innovation (0.75) and Performance (0.73) suggest that the research model has strong explanatory power. The structural model results indicate that Knowledge Management and Absorptive Capacity have positive effects on Innovation, while Innovation has a positive effect on Performance. Furthermore, Knowledge Management and Absorptive Capacity also have direct effects on Performance. Therefore, Innovation serves as a mediating variable in the relationship between Knowledge Management and Absorptive Capacity and Performance.

### **Conclusion**

This study concludes that there are significant relationships among knowledge management, absorptive capacity, innovation, and performance in craft MSMEs. First, knowledge management has a positive and significant effect on innovation, indicating that more effective knowledge management practices enhance MSMEs' ability to generate new ideas and develop innovative products. Second, absorptive capacity also has a positive and significant effect on innovation. This finding highlights that MSMEs' ability to acquire, assimilate, and utilize external knowledge—such as market trends and production technologies—is a critical driver of innovation.

Third, both knowledge management and absorptive capacity have direct and significant effects on MSME performance. In addition, innovation plays a mediating role, strengthening the relationship between knowledge management and performance, as well as between absorptive capacity and performance. Therefore, to improve performance, craft MSMEs should strengthen their knowledge management practices and enhance their absorptive capacity in order to foster sustainable innovation.

### **Research Implications**

The findings of this study have theoretical and practical implications for the development of management science and organizational practice, particularly in the context of craft-based SMEs. Theoretically, this study reinforces the Knowledge-Based View (KBV) perspective, which emphasizes that knowledge is a strategic resource in creating competitive advantage. The findings indicate that knowledge management and absorptive capacity play a crucial role in enhancing innovation, which ultimately impacts performance improvement. Furthermore, this study underscores the role of innovation as a mechanism linking an organization's ability to manage and absorb knowledge with its performance.

Practically, the results of this study provide implications for craft SME practitioners to develop more effective knowledge management practices, such as through knowledge sharing, training, and the utilization of information technology. Furthermore, SMEs also need to enhance their ability to access and utilize external knowledge and create a business environment that fosters creativity and innovation to improve competitiveness and business performance sustainably.

### **Research Recommendations**

The results of this study have theoretical and practical implications for the development of management science and organizational practices in the craft sector of MSMEs. The findings indicate that knowledge management and absorptive capacity play a role in enhancing innovation, which ultimately leads to improved performance. Furthermore, innovation serves as a crucial mechanism linking an organization's ability to manage and absorb knowledge with performance improvement.

Practically, the results of this study provide implications for craft SME actors to develop more effective knowledge management practices through knowledge-sharing activities, training, and the utilization of information technology. Furthermore, SMEs also need to improve their ability to access and utilize external knowledge and create a business environment that supports creativity and innovation to enhance business competitiveness and performance sustainably.

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