

Effect of Social Capital and Entrepreneurial Leadership on Company Performance Mediated by Innovation Capability in Fashion Industry MSMEs in Yogyakarta

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Abstract

This study aims to determine the effect of social capital and entrepreneurial leadership on business performance mediated by innovation capability in fashion industry MSMEs in Yogyakarta City. The main focus of this research is business competition in Indonesia, which continues to increase from year to year, which requires MSMEs to be able to maintain their existence and improve their performance. The method in this study uses descriptive and quantitative analysis. The population of this research is fashion MSMEs in Yogyakarta City. Data collection was carried out through distributing questionnaires face to face and through Google Forms which were distributed to 96 fashion MSMEs in Yogyakarta City. The method used to analyze the data used Partial Least Square (SEM-PLS). The results of the analysis in this study show that: 1) social capital has a positive and significant effect on business performance, 2) entrepreneurial leadership has a positive and significant effect on business performance, 3) social capital has a positive and significant effect on innovation capability, 4) entrepreneurial leadership has a positive and significant effect on innovation capability, 5) innovation capability has a positive and significant effect on business performance, 6) innovation capability successfully mediates the effect of social capital on business performance, 7) innovation capability successfully mediates the effect of entrepreneurial leadership on business performance.

Keywords: Social Capital, entrepreneurial leadership, innovation capability, business performance.

Introduction

Micro, Small, and Medium Enterprises (MSMEs) play a crucial role in various economic sectors, such as industry, trade, food, fashion, and education. MSMEs serve as significant providers of employment opportunities, contributing to income generation and economic growth. Their strategic role in reducing poverty and unemployment is vital, making MSMEs one of the most emphasized business sectors, especially since they can drive national economic growth (Ali & Iskandar, 2016).

However, MSMEs face numerous challenges, particularly in a volatile and uncertain market environment marked by rapid changes and intense competition (Irwansyah et al., 2021). In such dynamic conditions, innovation becomes a critical factor for MSMEs to remain competitive. As Bowen et al. (2010) assert, innovation plays a key role in MSME performance, compelling businesses to adapt quickly by devising new strategies to stay competitive.

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The Dynamic Capability (DC) theory explains how MSMEs can gain sustainable competitive advantages by configuring resources in flexible and dynamic ways to address both opportunities and risks (Teece et al., 1997). This adaptability is essential for MSMEs, enabling them to integrate and reconfigure both internal and external competencies to cope with a fast-changing environment.

In Indonesia, MSMEs represent the largest business sector, contributing significantly to the national GDP and employment. As of 2022, MSMEs accounted for 60.5% of the national GDP and provided 96.9% of total employment (Menko Perekonomian, 2022). MSMEs have proven resilient in the face of various economic dynamics and market competition, making them a key pillar in Indonesia's economy (Silviana Batubara et al., 2022).

Yogyakarta, a province with one of the highest concentrations of MSMEs, is also home to the rapidly growing creative economy sector. Among its most prominent subsectors are fashion, crafts, and culinary industries, with fashion holding substantial potential for continued growth. This sector plays a significant role in driving the local economy, contributing over 6% to Yogyakarta's GDP in 2023 (Kumparan, 2023). The government of Yogyakarta has prioritized the development of the fashion industry, as seen in initiatives like the Jogja Fashion Week, aimed at positioning the city as a global fashion hub (Event Nusantara, 2024).

To strengthen the fashion industry further, the local government has established the Jogja Fashion Dunia institution, which facilitates collaboration among stakeholders to overcome challenges and maximize opportunities (Yogyapos, 2024). Yogyakarta's unique cultural heritage has significantly influenced the local fashion trends, such as batik, jumputan, and ecoprint, which continue to thrive in the city.

Despite its promising potential, the fashion industry faces challenges that require a unique blend of creativity, innovation, and a deep understanding of market trends (Putri et al., 2021). The business performance in the fashion sector should not only be assessed through financial metrics but also by considering its artistic and cultural impacts (Sinaga et al., 2020).

In the era of Industry 4.0, businesses are interconnected globally, and digital technology plays a central role in shaping industry dynamics (Putri et al., 2020). To thrive in this rapidly evolving environment, MSMEs must enhance their creativity and innovation capabilities (Silalahi et al., 2020). Innovation is crucial for business expansion and sustainability, enabling companies to develop superior products and services to outperform competitors (Nababan et al., 2023).

However, fostering innovation is no easy feat. It requires specific management knowledge and skills that go beyond day-to-day business operations (Halim et al., 2021). MSMEs need to leverage their networks and market opportunities to innovate and gain a competitive edge (Hurley et al., 1998). By continuously innovating, businesses can optimize their performance (Sherly et al., 2020).

As Mutegi et al. (2015) note, company performance is influenced by both internal and external factors. These include consumer demand, competition, and company structure, as well as leadership, strategy, social capital, innovation, and governance (Gavrea et al., 2011). In today's competitive landscape, businesses are compelled to maintain or improve their performance through resources such as social capital, entrepreneurial leadership, and innovation capabilities (Purwati et al., 2022).

Social capital, entrepreneurial leadership, and innovation capability are vital for MSMEs to stay competitive. Social capital refers to networks, social norms, and resources embedded in relationships between individuals or groups (Wan et al., 2012). It facilitates collaboration and resource mobilization, which directly impacts business performance (Hallam et al., 2018). Entrepreneurial leadership helps MSMEs navigate dynamic market shifts and promotes innovation to improve business outcomes (Purwati et al., 2021).

Innovation capability is crucial for MSMEs, enabling them to introduce new products, processes, and technologies that drive competitive advantage (Setini et al., 2020). Organizations that embrace innovation respond faster to business opportunities and market trends, leading to better performance (Purwati et al., 2021).

Given these factors, this study aims to examine the relationship between social capital, entrepreneurial leadership, and business performance, with innovation capability as a mediator, within the MSMEs of Yogyakarta's fashion industry. This research will provide valuable insights to MSME entrepreneurs on enhancing their social networks, leadership skills, and innovation capabilities to thrive amidst technological advancements and market uncertainties.

Literature Review

Dynamic Capability View (DCV)

Dynamic Capability View (DCV) posits that a company's ability to integrate, build, and reconfigure both internal and external competencies is crucial for responding to rapidly changing environments (Teece et al., 1997). This theory builds on the Resource-Based View, emphasizing the need for firms to adapt through innovation, technology adoption, and business model transformation (Teece, 2014). DCV consists of three processes: sensing opportunities and threats, seizing opportunities, and transforming resources to maintain competitiveness (Teece, 2018). In SMEs, particularly in the fashion industry, innovation capability is key to sustaining business amidst fluctuating trends. Warner and Wäger (2019) highlight that dynamic capabilities help SMEs proactively respond to environmental changes, ensuring long-term competitive advantage. Innovation capability, integrated with organizational knowledge, helps SMEs adapt and enhance competitiveness in creative industries.

Business Performance

Business performance is a multidimensional concept that encompasses not only financial outcomes but also sustainability, efficiency, and the ability to adapt to environmental changes (Pintea & Achim, 2010). It reflects the result of managerial and strategic processes that help evaluate and improve organizational performance over time (Masa'deh et al., 2018). Business performance includes both financial and non-financial outcomes, resulting from effective strategies and efficient operations (Lee et al., 2015). According to Jogaratnam (2017), good business performance is achieved through the effective use of organizational resources, creating value. Therefore, business performance is the outcome of resource utilization and effective strategy implementation, reflecting an organization's success in achieving long-term objectives and maintaining sustainability.

Social Capital

Social capital refers to intangible resources embedded in social networks, norms, and trust within a community or organization. It enables access to resources like information and collaboration, which are essential for innovation and business growth (Nahapiet & Ghoshal, 1998; Adler & Kwon, 2002). Bourdieu (1986) views social capital as a resource tied to social networks that individuals or groups can leverage to achieve goals. Coleman (1988) emphasizes that social capital facilitates collective action by offering communication channels and norms. Putnam (1995) sees social capital as a social glue that fosters coordination and cooperation for mutual benefit. Social capital, built on relationships based on trust and shared norms, facilitates access to opportunities and enhances organizational effectiveness.

Entrepreneurial Leadership

Entrepreneurial leadership connects innovation with the ability to exploit opportunities for business growth and sustainability (Darling et al., 2007). It involves creating an entrepreneurial culture and integrating entrepreneurial processes and initiatives to drive new ideas (Goossen, 2007). Entrepreneurial leadership is characterized by risk-taking, innovation, and the ability to manage change, creating value in dynamic environments (Renko, 2015). Esmer and Dayi (2017) argue that this leadership style fosters innovation, risk optimization, and motivates teams to achieve shared goals, enabling firms to thrive in changing markets.

Innovation Capability

Innovation capability reflects an organization's ability to create value through the development of new products, services, processes, or business models (Dobni, 2010). It is a strategic process embedded in the organizational culture, focused on readiness to adapt and execute new ideas. Innovation capability must be integrated into strategy, structure, and management processes. According to Francis & Bessant (2005), it involves managing innovation systematically across technical and non-technical dimensions, including product, process, market positioning, and paradigm innovation. Innovation capability is crucial for long-term survival and competitiveness, enabling organizations to respond to market changes and introduce high-value offerings (Yang, Lee, & Cheng, 2009).

Hypothesis

The hypothesis is written as follow:

- H1.** Social Capital is positively and significantly related to Business Performance
- H2.** Entrepreneurial Leadership is positively and significantly related to Business Performance.
- H3.** Social Capital is positively and significantly related to Innovation Capability.
- H4.** Entrepreneurial Leadership is positively and significantly related to Innovation Capability.
- H5.** Innovation Capability is positively and significantly related to Business Performance.

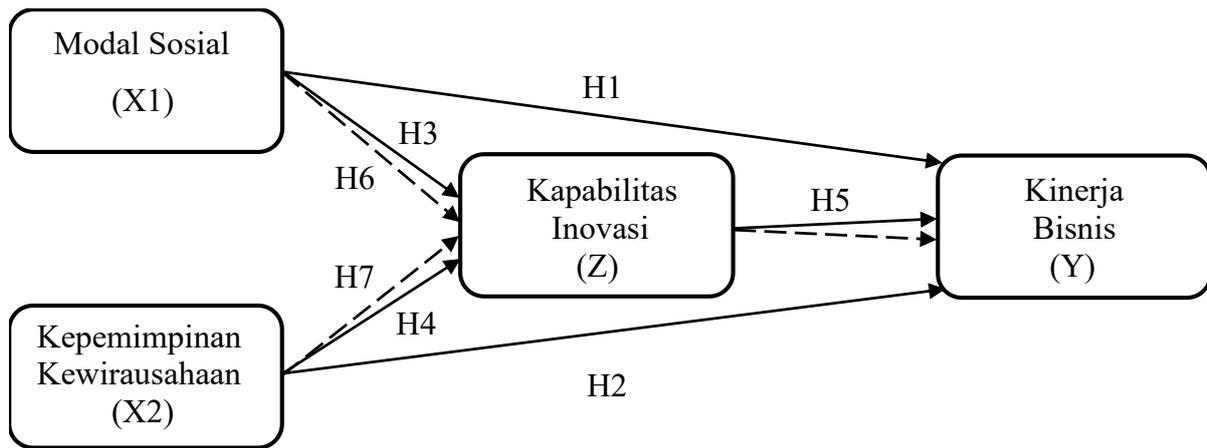


Figure 1. Research Model

H6. Innovation Capability can influence the relationship between Social Capital and Business Performance as a mediator.

H7. Innovation Capability can influence the relationship of Entrepreneurial Leadership to Business Performance as a mediator.

Methods

Sampling and Procedures

The population in this research were 96 fashion MSMEs in Yogyakarta City (Yogyakarta Special Region Government, 2022). The sample in this research is Owner/Manager of fashion MSMEs in Yogyakarta City are located in the Yogyakarta City area and MSMEs that have been operating for at least 1 year. which is 65 respondents chosen using purposive sampling method. Data is collected using questionnaire

Measures

Business Performance measured using 4 statements. All the statements are valid with the value of alpha is 0,963 (reliable).

Social Capital measured using 3 statements. All the statements are valid with the value of alpha is 0,987 (reliable).

Entrepreneurial Leadership measured using 5 statements. All the statements are valid with the value of alpha is 0,985 (reliable).

Innovation capability measured using 7 statements. All the statements are valid with the value of alpha is 0,933 (reliable).

Data Analysis

The data analysis technique in this research uses PLS-SEM (*Partial Least Square-Structural Equation Model*) with Smart-PLS.

Tabel 1. Hasil R^2

	<i>R-square</i>	<i>Adjusted R-square</i>
Innovation Capability	0.685	0.675
Business Performance	0.917	0.913

Tabel 2. Hypothesis Test Results

	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics (O/STDEV)	P values
X1 -> Y	0.158	0.148	0.045	3.507	0.000
X2 -> Y	0.190	0.185	0.046	4.140	0.000
X1 -> Z	0.625	0.626	0.045	13.901	0.000
X2 -> Z	0.574	0.575	0.058	9.899	0.000
Z -> Y	0.750	0.762	0.052	14.508	0.000

Result and Discussion

Result

The Goodness of Fit the Model

The results of the in Table 1, it is known that the amount of adjusted R square of innovation capability is 0,685. It can be interpreted that 68.5% of the innovation capability variable can be explained by 2 independent variables (free), namely social capital, and entrepreneurial leadership. it is known that the amount of adjusted R square of innovation capability is 0,917. It can be interpreted that 91.7% of the innovation capability variable can be explained by 3 independent variables (free), namely social capital, entrepreneurial leadership and innovation capability.

Hypothesis Test

Hypothesis testing can be done by looking at the t-statistic value and p-value. Hypotheses that have a t-statistic value > 1.96 (t table) or if the p-value < 0.05, the hypothesis is accepted and there is a significant influence between the variables.

Direct Effect

Social Capital has a Positive and Significant Effect on Business Performance. The analysis results show that the p-value (0.000) < α (0.05) with a direct influence path coefficient of 0.158 or 15.8%. Therefore, it can be concluded that social capital has a positive and significant direct effect on business performance.

Entrepreneurial Leadership has a Positive and Significant Effect on Business Performance. The analysis results show that the p-value (0.000) < α (0.05) with a direct influence path coefficient of 0.190 or 19%. Therefore, it can be concluded that entrepreneurial leadership has a positive and significant direct effect on business performance.

Tabel 3. Hypothesis Test Results

	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics (O/STDEV)	P values
X1 -> Z -> Y	0.469	0.478	0.053	8.912	0.000
X2 -> Z -> Y	0.430	0.438	0.050	8.610	0.000

Social Capital has a Positive and Significant Effect on Innovation Capability. The analysis results show that the p-value (0.000) < α (0.05) with a direct influence path coefficient of 0.625 or 62.5%. Therefore, it can be concluded that social capital has a positive and significant direct effect on innovation capability.

Entrepreneurial Leadership has a Positive and Significant Effect on Innovation Capability. The analysis results show that the p-value (0.000) < α (0.05) with a direct influence path coefficient of 0.574 or 57.4%. Therefore, it can be concluded that entrepreneurial leadership has a positive and significant direct effect on innovation capability.

Innovation Capability has a Positive and Significant Effect on Business Performance. The analysis results show that the p-value (0.000) < α (0.05) with a direct influence path coefficient of 0.750 or 75%. Therefore, it can be concluded that innovation capability has a positive and significant direct effect on business performance.

Indirect Effect

Innovation Capability Mediates the Effect of Social Capital on Business Performance. The analysis results show that the p-value (0.000) < α (0.05) with a direct influence path coefficient of 0.469 or 46.9%. Therefore, it can be concluded that innovation capability mediates the effect of social capital on business performance.

Innovation Capability Mediates the Effect of Entrepreneurial Leadership on Business Performance. The analysis results show that the p-value (0.000) < α (0.05) with a direct influence path coefficient of 0.430 or 43%. Therefore, it can be concluded that innovation capability mediates the effect of entrepreneurial leadership on business performance.

Discussion

Social Capital has a Positive and Significant Effect on Business Performance

The study found that social capital significantly and positively impacts business performance in Yogyakarta's fashion SMEs. Networking, both formal and informal, plays a vital role in improving business outcomes by fostering information exchange and collaboration. This aligns with the structural and relational theories of social capital, emphasizing the role of trust and reciprocal norms in enhancing business productivity. Similar studies, like those by Coleman (1988) and Inkpen & Tsang (2005), confirm that social networks enable the sharing of valuable resources, improving competitiveness.

Entrepreneurial Leadership has a Positive and Significant Effect on Business Performance

Entrepreneurial leadership was found to positively and significantly affect business performance. Visionary leaders who embrace innovation and risk-taking contribute to business growth by introducing sustainable fashion products, thereby expanding market reach. The findings align with theories that link entrepreneurial leadership with competitive strategy (Bien & Arena, 2018; Zhang et al., 2015), showing that leadership orientation drives long-term business performance.

Social Capital has a Positive and Significant Effect on Innovation Capability

Social capital also plays a key role in enhancing innovation capabilities. Strong networks facilitate the exchange of ideas and feedback, fostering continuous innovation. This supports the argument by Nahapiet & Ghoshal (1998) that social capital accelerates organizational learning and innovation, which are essential for competitive advantage in business.

Entrepreneurial Leadership has a Positive and Significant Effect on Innovation Capability

Entrepreneurial leadership directly influences innovation capabilities by creating a culture that supports new ideas and proactive risk-taking. Leaders foster an environment that promotes creativity, making innovation a competitive edge in business. This finding is consistent with research by Purwati et al. (2021), which demonstrated how leadership drives innovation in the face of market changes.

Innovation Capability has a Positive and Significant Effect on Business Performance

Innovation capability is crucial for enhancing business performance. SMEs in the Yogyakarta fashion industry that focus on product innovation—such as using natural dyes—have improved market competitiveness and customer satisfaction. The findings resonate with the Dynamic Capability View (Teece et al., 1997), which underscores innovation as a strategic response to environmental dynamics.

Innovation Capability Mediates the Effect of Social Capital on Business Performance

Innovation capability mediates the relationship between social capital and business performance. The ability to innovate, facilitated by social capital, enhances business efficiency and output, which subsequently improves financial and non-financial performance. This is supported by studies like those by Lin (2007) and Purwati et al. (2021), which highlight the importance of translating social capital into market-oriented innovation.

Innovation Capability Mediates the Effect of Entrepreneurial Leadership on Business Performance

Innovation capability mediates the impact of entrepreneurial leadership on business performance. Leaders who encourage innovation enhance the organization's capacity to adapt to market changes, leading to improved performance. This finding aligns with research by Al-Sharif et al. (2023), which demonstrates how entrepreneurial leadership drives innovation to improve business outcomes.

Conclusion

Based on the results of research and discussion regarding the effect of social capital and entrepreneurial leadership on company performance mediated by innovation capability in fashion industry MSMEs in Yogyakarta city conducted by researchers, it can be concluded as follows:

- ☑ Social Capital has a Positive and Significant Effect on Business Performance in Fashion industry MSMEs in Yogyakarta city. It can be concluded that hypothesis one in this study is proven.
- ☑ Entrepreneurial Leadership has a Positive and Significant Effect on Business Performance in Fashion industry MSMEs in Yogyakarta city. It can be concluded that hypothesis one in this study is proven.
- ☑ Social Capital has a Positive and Significant Effect on Innovation Capability in Fashion industry MSMEs in Yogyakarta city. It can be concluded that hypothesis one in this study is proven.
- ☑ Entrepreneurial Leadership has a Positive and Significant Effect on Innovation Capability in Fashion industry MSMEs in Yogyakarta city. It can be concluded that hypothesis one in this study is proven.
- ☑ Innovation Capability has a Positive and Significant Effect on Business Performance in Fashion industry MSMEs in Yogyakarta city. It can be concluded that hypothesis one in this study is proven.
- ☑ Innovation Capability Mediates the Effect of Social Capital on Business Performance in Fashion industry MSMEs in Yogyakarta city. It can be concluded that hypothesis one in this study is proven.
- ☑ Innovation Capability Mediates the Effect of Entrepreneurial Leadership on Business Performance in Fashion industry MSMEs in Yogyakarta city. It can be concluded that hypothesis one in this study is proven.

Limitation

This study is limited by its focus on fashion SMEs in Yogyakarta, which restricts the generalizability of the findings to other industries or regions. The dynamics of social networks and entrepreneurial leadership may differ across different sectors or cities. Furthermore, the research was constrained by time and scope, limiting the ability to explore additional variables. Future research should replicate the study in other regions or industries to verify the findings and incorporate a larger sample and longitudinal data.

Management Implication

The study emphasizes the importance of leveraging social networks for improved business performance. SME managers should strengthen relationships with stakeholders and participate in local fashion communities to enhance innovation. Entrepreneurial leadership is also key, and managers should encourage creativity and risk-taking to foster innovation. Collaborating with government agencies can provide valuable resources. These strategies can boost both operational performance and long-term competitiveness.

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