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Research Articles

The Mediating Role of Innovation Capability to Improve Knowledge Sharing on Smess Performancce

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Abstract: This study aims to analyze the role of Knowledge sharing to improve SME Performance Small and Medium Enterprises (SMEs) in Sidoarjo by considering Innovation capability as a mediating variable. Using a quantitative method with an explanatory approach, data were collected from 31 respondents with a questionnaire and analyzed using Partial Least Square-Structural Equation Modeling (PLS-SEM). The findings show that knowledge sharing has a significant influence on improving SME performance. However, innovation capability does not contribute directly to improving performance, but rather acts as a supporting factor in the continuous innovation process. The findings underscore the importance of building an effective knowledge sharing culture as a key strategy in enhancing SME competitiveness amidst evolving market dynamics.

Keywords: Knowledge sharing, SME performance, Innovation capability

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1. INTRODUCTION

Small and Medium Enterprises (SMEs) play an important role in economic development globally, acting as a key driver of job creation, economic growth, and innovation (Lee et al., 2022). According to the Minister of Cooperatives and Small and Medium Enterprises (Menkop, dan UKM 2024), small and medium enterprises are a pillar of economic growth in Indonesia as an integral part of national development that cannot be ignored. Small and medium enterprises currently represent more than 97% of businesses in Indonesia and contribute 60% of Indonesia's GDP, with some SME sectors, especially those engaged in crafts and creative products, contributing to national exports.

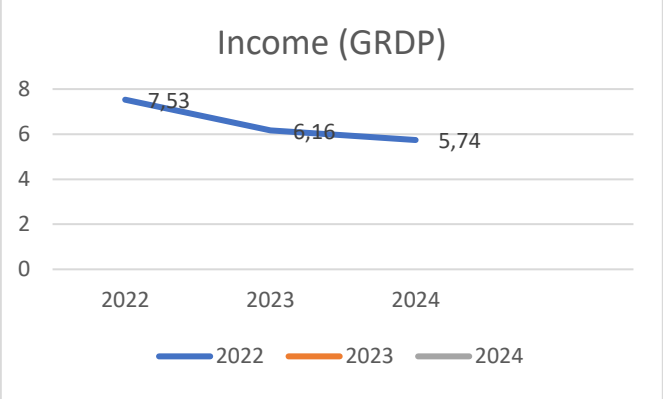
The competitiveness of SMEs is often hampered by the lack of innovation and effective knowledge sharing strategies. Knowledge sharing is an important key, because it allows SMEs to exchange information, experiences, and ideas to drive innovation in products, services, and operational processes (Akram et al ., 2020). The practice of knowledge sharing considers the motivations and preferences of individuals in conveying information or knowledge they have to other parties (Hon et al ., 2022).

Table 1. Number of SMEs Based on Business Scale 2024

Number of SMEs Based on Business Scale	
Small	26
Intermediate	5

Source: Data.diskopukm.jatimprov 2024

Based on Table 1, data from the East Java Cooperative and SME Service shows that the scale of small businesses is 26 and the scale of medium businesses is 5 in the Regency. Although the number of SMEs continues to grow, they face various obstacles that contribute to the high level of competition due to the rise in online sales making it difficult for SME product prices to compete with large companies or suppliers who offer lower prices. In addition , according to the Directorate General of Budget (2023), the decline in people's purchasing power, rising prices of raw materials, limited access to financing, and lack of innovation and digitalization have worsened the situation. To survive, SMEs need to adapt to technology, to increase product innovation, and utilize digital marketing to expand market reach.



Source: BPS Sidoarjo Regency

Figure 1 Market revenue

From Figure 1, it shows market income in 2022, 2023, 2024 with different results. As seen from Figure 1, in 2022 the income soared, while in 2023 and 2024 it decreased due to the weakening of commodities after the impact of Covid, all medium-large industries or SMEs did not produce many goods and had difficulty exporting goods.

Knowledge sharing between co-workers is considered normal and important to improve SME performance. (Damanik 2020). Fransiskus *et al* ., (2022) *Knowledge sharing* has a significant positive impact on SME performance, so that increasing the knowledge sharing process can improve business performance . *Innovation capability* has been shown to have a positive and significant impact on improving the quality of work of SME organizations (Muawanah & Pujianto 2024). High *innovation capability* tends to indicate better business performance, (Abimanyu and Prakasa 2022). *Innovation capability* acts as a link between knowledge sharing and company performance. However, poor interactions, such as knowledge that is irrelevant or not applied properly, can reduce performance effectiveness (Frontiers, 2022).

This study contributes to SMEs increasing innovation to be more competitive and encouraging a culture of knowledge sharing. Comite *et al* . (2021) emphasized that knowledge sharing must be supported by innovation capabilities so that ideas can be implemented in business strategies. Phung Anh Thu *et al* . (2021) added that innovation capabilities play a role in transforming knowledge into innovations that are in line with market needs, especially for SMEs with limited resources.

2. LITERATURE REVIEW

Theory Knowledge Based View (KBV)

Knowledge-Based View Theory is a modification of *the resource-based view* that suggests that various forms of knowledge are attractive resources (Grants, 1996). *The knowledge-based view* (KBV) is used to understand and examine how organizational knowledge and expertise can be a source of competitive advantage. The knowledge-based approach provides direction for organizational innovation and trends and has a broad impact on management practices (Grant, 1996). KBV helps understand how organizational knowledge and expertise drive innovation and influence management practices. Knowledge also increases the effectiveness of other resources, so that companies become more innovative and their performance improves (Maulana *et al* ., 2022).

Knowledge sharing

Knowledge sharing is defined as the behavior of receiving and sharing knowledge to benefit individuals or organizations (Muafi, 2020). *Knowledge sharing* plays a role in creating new knowledge, improving problem-solving skills, and supporting better decision-making, thereby strengthening the company's competitiveness (Liu *et al* ., 2020). In business and organizations, *Knowledge sharing* enables the transfer of valuable knowledge between individuals or work units, increasing effectiveness and collaboration (Widiyanto *et al* ., 2022). Based on the opinion above , *Knowledge sharing* (KS) is very important for companies because it encourages collaboration, creates new knowledge, and improves problem-solving and decision-making skills. According to Nham *et al* ., (2020) the dimensions or measurements of *Knowledge sharing* are, 1) *knowledge donating* , which is the activity of spreading personal intellectual capital to others. 2) *knowledge collecting* , refers to the process of collecting knowledge from others who share their intellectual capital.

Innovation capability

Innovation capability is defined as an organization's ability to apply knowledge, skills, and resources better than competitors (Muawanah & Pujianto, 2024). IC includes the complex process of creating and accepting new ideas to produce innovative products, services, or business models (Ferreira *et al* ., 2020). In addition, IC is recognized as a key element in building business competitiveness (Jordão *et al* ., 2022; Kim *et al* ., 2018). Based on the above opinion, it can be concluded that *Innovation capability* ensures that a business can apply various ideas or concepts to increase business effectiveness. According to Odoom and Mensah (2019), the dimensions or measurements of *Innovation capability* used in this study include:

1. Service Innovation, improving the quality of customer interactions to create long-term relationships and increase customer trust.
2. Technological innovation, improving business processes, competitive advantage, and increasing response to market changes.

3. Product innovation, Providing new solutions that are relevant to customer needs, increasing competitiveness and brand loyalty.
4. Market Innovation, The process of developing new strategies in marketing, market distribution in increasing business growth rates and competitiveness.

SME Performance

Referring to Law No. 20 of 2008, it explains that Micro, Small, and Medium Enterprises (SMEs) refer to productive businesses owned by business entities or individuals that have met certain criteria. Small businesses are part of the economic activities of the community that play an important role in the national economy, so they need protection from detrimental and unfair business competition practices (Maulani *et al* ., 2023). SME performance reflects the effectiveness and efficiency in achieving business goals (Aqida & Fitria, 2019). SME performance is defined as the company's ability to achieve predetermined goals using measurements of 1. financial performance and 2. non-financial (M. Ramdan, 2022. Tsou, H.-T *et al* . ,2015). Financial performance refers to a company's capability in generating revenue from several main sources of business, such as assets. Meanwhile, non-financial performance includes long-term goals highlighting the importance of building consumer loyalty, attracting new consumers, and increasing the level of the company's image and reputation (Tsou, H.-T *et al* . ,2015).

Research Hypothesis

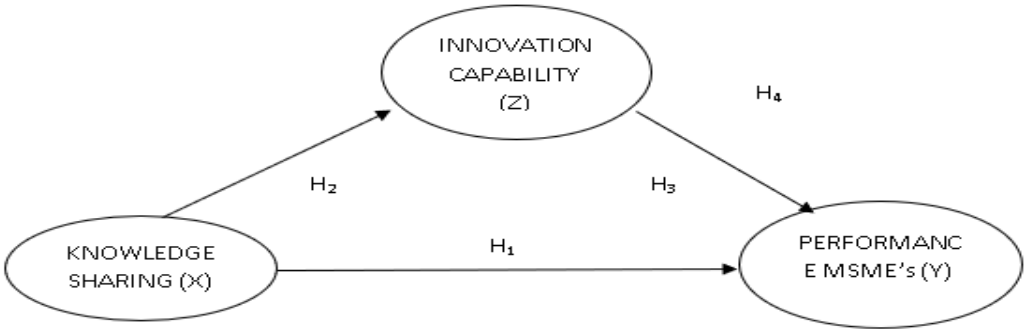


Figure 2. Conceptual Framework

Knowledge Sharing and Performance SME

Implementation of *Knowledge sharing* increases the level of process innovation and product quality with the latest technology, which has a positive impact on company performance (Azadehdel, 2021). *Knowledge sharing* also has a significant impact on SME performance because it allows the transfer of knowledge and skills between members of the organization (Rochma & Pujianto, 2024). In addition, sharing new ideas and knowledge increases creativity and efficiency, helping SMEs achieve goals and improve performance (Hanifah *et al* ., 2019). Overall, *Knowledge sharing* can encourage businesses to excel over their competitors.

H1: *Knowledge sharing* has an effect on *SMEs performance*

Innovaton capability and SME performance

Innovation capability (IC) is very important for SMEs to maintain performance and prevent bankruptcy (Kristinae *et al* ., 2020). Resource management for product innovation can increase sales and business performance (Sukri *et al* ., 2023). Empirical studies show a positive relationship between innovation and business performance (Awoleye *et al* ., 2020; Imran *et al* ., 2019). Saunila (2019) emphasized that *Innovation capability* distinguishes SMEs from large companies, where high levels of innovation

have a direct impact on business performance. By continuing to develop innovation, SMEs can increase their competitiveness and business growth (Abimanyu & Prakasa, 2022).

H2: *Innovation capability* has an impact on *SMEs performance*

Knowledge sharing and Innovation capability

Knowledge sharing (KS) contributes significantly to *Innovation capability* (IC) by accelerating problem solving and responding to business changes (Le & Lei, 2019). KS also has a positive impact on increasing corporate innovation, producing better products and services (Abimanyu *et al* ., 2022). However, a study in South Korea showed that KS has a weak impact on IC, because limited resources and technological infrastructure are the main obstacles (Lee & Park, 2021).

H3: *Knowledge sharing* has an impact on *Innovation Capability*

Knowledge sharing* and *SME Performance* through *Innovation Capability

Innovation capability (IC) acts as a link between *Knowledge sharing* (KS) and SME performance, especially for organizations that are adaptive to change. However, poor interactions, such as irrelevant or poorly implemented knowledge, can reduce performance effectiveness (Marjerison *et al* ., 2022). KS plays an important role in creating innovation and improving the sustainability of SMEs, which is influenced by internal and external support (Nurhayati *et al* ., 2021). SMEs with a good *Knowledge sharing system* tend to be more innovative and have higher performance (Martinez *et al* ., 2023). However, this impact depends on the maturity of the *Knowledge sharing system* and *Innovation capability* if it is not yet mature, the relationship becomes insignificant (Zhang *et al* ., 2020).

H4: Knowledge sharing impacts SMEs Performance through Innovation Capability

3. RESEARCH METHODS

A quantitative approach through the explanatory method was applied in this study to analyze the relationship between variables. This research was conducted in Sidoarjo Regency with SMEs as the object of research because in terms of territory, Sidoarjo Regency has the largest contribution to the formation of gross value with the order of number 2. The population used in this study was Sidoarjo Regency SMEs based on the scale of small and medium businesses. The non-probability sampling technique through the saturated sampling sample selection technique because the population is relatively small. The sample of this study amounted to 31 respondents with the criteria of a Small business scale generating income of approximately 2M-15M and a Medium business scale generating income of 15M-50M . Primary data collection was carried out online through a questionnaire based on *a Likert scale* (1 to 5) which was distributed via *Google Form* . Data analysis in this study applied the *Partial Least Square* (PLS) approach. The selection of the PLS method was based on the research needs for latent variable score estimation to support further analysis. In addition, the characteristics of data sourced from secondary data, which tend to have limitations in terms of theoretical validity of measurement, make PLS the right method to use (Hair *et al* ., 2021).

4. RESULTS AND DISCUSSION

Results

Respondent Characteristics

Table 2. Overview of respondents

Respondent Distribution		Frequency	Presentation
Types of SMEs	Food and Drink	14	45.2%
	Fashion	6	19.4%
	Furniture	3	9.7%
	School Supplies	3	9.7%
	Electronic	1	3.2%
	Building materials or materials	2	6.5%
	Etc	2	6.5%
Long Standing	Less than 3 years	6	19.4%
	More than 3 years	25	80.6%
Position	Owner/Owner	19	61.3%
	Manager/decision maker	12	38.7%
Annual Turnover	>Rp.50,000,000 - Rp.500,000,000	12	38.7%
	> Rp.500,000,000 - Rp.10,000,000,000	17	54.8%
	Rp.10,000,000,000	2	6.5%

Table 2 shows the demographic characteristics of respondents based on the type of SME , length of business establishment, position, and length of service. The majority of respondents are Owners and Managers, 19 Owners (61.3 %), while the rest are Managers 12 (38.7%).

Measurement Model Analysis

Convergent Validity Test

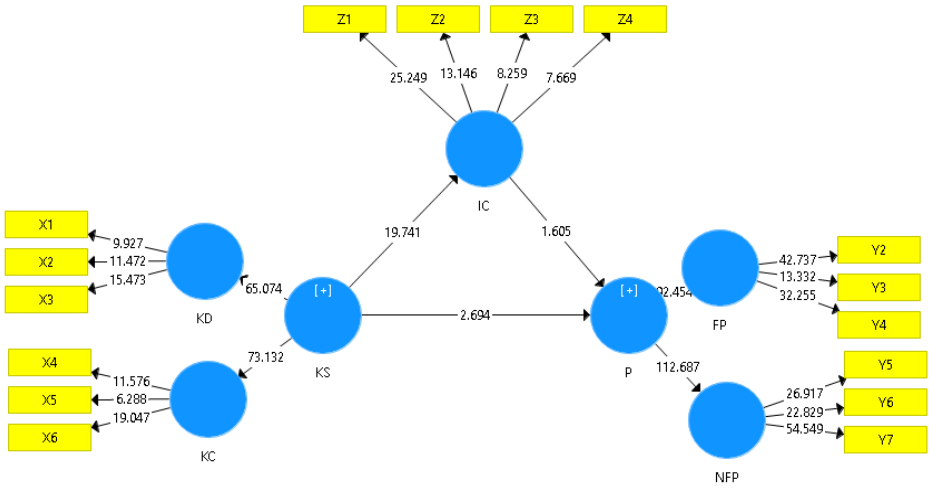


Figure 3 *Loading Factor*

The purpose of the convergent validity test is to verify that each research instrument actually measures the intended variable by looking at the *outer loading value* . The minimum limit that must be met in measuring convergent validity is that *the outer loading* exceeds 0.70 and the AVE exceeds 0.50 (Hair *et al.,* 2021) **.**

Table 3. *Outer Loading*

	Knowledge sharing	***Innovation Capability***	***SME Performance***	**Information**
X.1	0.811			Valid
X.2	0.838			Valid
X.3	0.811			Valid
X.4	0.825			Valid
X.5	0.726			Valid
X.6	0.892			Valid
Z1		0.917		Valid
Z2		0.817		Valid
Z3		0.763		Valid
Z4		0.804		Valid
Y1			0.940	Valid
Y2			0.886	Valid
Y3			0.934	Valid
Y4			0.922	Valid
Y5			0.929	Valid
Y6			0.970	Valid

Smartpls Data Processing Results

Based on the outer loading data in Table 3, each indicator has a value exceeding 0.7 , so it meets the validity requirements and can be used for further testing. Indicator Y6 has the highest value, namely (0.970), on the other hand, indicator X5 has the lowest value, namely (0.726).

Reliability Test

Table 4. *Construct Reliability and Validity*

	Cronbach's Alpha	***rho_A***	***Composite Reliability***	**AVE**
Knowledge sharing (X)	0.879	0.881	0.908	0.623
Innovation capability (Z)	0.844	0.853	0.896	0.684
SME Performance (Y)	0.957	0.959	0.966	0.825

Smartpls Data Processing Results

Referring to table 4, Hair *et al* . (2021) the minimum standard for evaluating convergent validity is that the *outer loading value* must exceed 0.70 and the AVE value must exceed 0.50. The test results show that the Cronbach's Alpha value for all latent constructs is above the threshold of 0.70 , which indicates that the research instrument has adequate internal reliability. Meanwhile, the AVE value is used to assess the extent to which the indicator is able to explain the variation of its construct. The use of AVE is considered stricter than composite reliability because it emphasizes the convergent validity of the construct being tested. A minimum of 0.50 is recommended for the AVE value (Hair *et al* ., 2021). Based on Table 4, all AVE values are recorded as exceeding 0.50 . This indicates that each indicator has met the required convergent validity criteria and has a sufficient level of consistency to proceed to the next testing stage.

Discriminant Validity Test

Discriminant validity measures the difference between one construct and another, and the extent to which the indicator represents the intended construct. *Discriminant validity assessment* can be done using the *heterotrait-monotrait ratio* (HTMT). The acceptable HTMT limit value is <0.90 (Hair *et al* ., 2021)

Table 5. Discriminant Validity Test

	Innovation Capability	***Knowledge sharing***	***Performance of SMEs***
Innovation Capability	0. 827		
Knowledge sharing	0. 847	0. 789	
Performance of SMEs	0. 854	0. 889	0.908

Source: Smartpls Data Processing Results

From table 5, the results of the research data processing show that the HTMT value for each latent variable indicator is above 0.90 . Thus, it can be concluded that all latent variables do not meet the discriminant validity criteria.

Structural Model Analysis

R Square

The coefficient of determination or often called *R-Square,* is a statistical measure that indicates how far the variation that occurs to *the*

dependent variable can be explained by *the independent variable* in a model. The contribution that can be generated is proportional to the *R-Square value* . Based on (Hair *et al* ., 2021) , an *R-Squared value* of 0.75 or more indicates a very strong relationship, a value between 0.50 and 0.75 indicates a moderate relationship, and less than 0.50 indicates a weak relationship.

Table 6. *R Square*

	R Square	***R Square Adjusted***
SME's Performance	0. 827	0. 815
Innovation Capability	0. 717	0. 707

Smartpls Data Processing Results

The very strong relationship of *the independent variable* to *SMEs Performance* and *Innovation capability* is shown by the analysis of *the* R *Square* and *Adjusted* R *Square values* in table 6, where *the R Square values* are 0.827 and 0.717 respectively, both of which exceed the limit of 0.75. According to (Hair *et al* ., 2021) , most of the variations in *the dependent variable* can be explained by *the independent variables* in the model. The *R Square value* has a slightly lower value, namely 0.815 and 0.707. This shows that the research model has a strong fit and is able to predict the dependent variable accurately.

Hypothesis Testing

Table 7. *Path Coefficient*

	Original Sample	**T Statistics**	**P Values**
Knowledge sharing -> SME Performance	0. 585	2,577	0. 010
Knowledge sharing -> Innovation Capability	0. 847	21,638	0.000
Innovation capability -> SME Performance	0.3 59	1,545	0. 123

Smartpls Data Processing Results

The following are the results of the hypothesis test according to the table;

1) The Influence of *Knowledge Sharing* on *SME Performance*
   The Original Sample (O) value is 0.585 through T Statistics which is 2.577 and P Values of 0.010 indicate that *Knowledge sharing* has a significant impact on *SME performance* . Through the P value < 0.05 , it can be concluded that *Knowledge sharing* significantly increase the level of *SME performance* .
2) The Influence of *Knowledge Sharing* on *Innovation Capability*
   The Original Sample (O) value is 0.847 through T Statistics which is 21.638 and P Values 0.000 indicate that *Knowledge sharing* has a significant impact on *Innovation Capability* . Through the P value < 0.05 , it can be concluded that *Knowledge sharing* increases the level of *Innovation Capability* significantly.
3) The influence of *innovation capability* on *SME performance*
   The Original Sample (O) value of 0.359 through T Statistics 1.545 and P Values 0.123 indicates that *Innovation capability* does not have a significant

impact on *SME performance* . Through the P value> 0.05 , it can be concluded that *Innovation capability* cannot significantly improve *SME performance* .

Table 8. *Indirect Effect*

	Original Sample	***T Statistics***	***P Values***
Knowledge sharing -> Innovation capability -> SME Performance	0. 304	1,514	0. 131

Smartpls Data Processing Results

The Influence of *Knowledge Sharing* towards *SME Performance* with *Innovation capability*

knowledge sharing is not significant indirectly to SMEs Performance through Innovation Capability, with an initial sample value of 0.304. The T statistic value is 1.514 (less than 1.96) and the *P value is* 0.131 (exceeding 0.05) indicating statistical significance, it can be concluded that *Knowledge on SME Performance Innovation capability does not have a significant effect.*

5. DISCUSSION

The Influence of *Knowledge Sharing* on *SMEs Performance*

Knowledge sharing has a significant impact on SMEs performance. Sharing new knowledge can increase creativity and efficiency, thus helping to produce improved performance in SMEs. In line with research by Rochma & Pujianto (2024), *knowledge sharing* has a positive and significant impact on SME performance because it allows the transfer of knowledge and skills among members of the organization . *Theoretical* perspective *Knowledge-Based View* (KBV) places knowledge as an asset that can generate competitive advantage if managed and shared effectively (Grant, RM 1996). According to Abimanyu, A. *et al* ., (2022) SMEs that are able to manage the *knowledge sharing process* efficiently will be superior in facing business challenges. Therefore, *knowledge sharing* is not only an additional activity, but is a core element in the strategy to improve SME performance. Findings in the field show that by sharing knowledge, Sidoarjo SMEs can achieve sustainable business growth and adapt more quickly to market changes. The results are in line with the findings of (Muafi *et al* . 2021), which obtained the results that all *Knowledge sharing* has a positive and significant impact on SME performance.

The Influence of *Knowledge Sharing* on Innovation Capability

Knowledge sharing has a significant impact on innovation capability, where a high level of *knowledge sharing* coupled with the ability to innovate can certainly be used as a weapon that can make it easier for SMEs to achieve good performance. The ability to create innovation plays an important role in producing unique and value-added products, which ultimately can open up new market potential for SMEs (Anggraini et al ., 2022). This research is reinforced by research by Abimanyu *et al* ., (2022) which explains that *knowledge sharing* (KS) has a positive and significant impact on business *innovation capability* (IC), which contributes to increasing innovation in producing better products and services. In the perspective of *Knowledge-Based View* (KBV), knowledge is positioned as the main strategic resource which, if managed and shared effectively, will create a competitive advantage (Grant, RM 1996). Therefore, *knowledge sharing* not only

strengthens innovative capacity, but is also important in shaping the competitiveness of SMEs in a sustainable manner (Maulana *et al* ., 2022). High *knowledge sharing can increase its level of innovation.* This study is in line with the findings of Castaneda & Cuellar (2020) *Knowledge sharing* is the transfer of information, skills, and experience into practice, such as innovation. This is what triggers *Knowledge sharing* to play an important role for SMEs or businesses.

The influence of *innovation capability* on *SMEs performance*

Innovation capability does not have a significant impact on SME performance, not all innovations are well received by SMEs engaged in business sectors that are less sensitive to innovation. In addition, SMEs that are still in the early stages of development - especially those operating for less than three years tend to focus on business stabilization and achieving *break-even points* . In this phase, resources are usually still limited, so that the implementation of innovation does not immediately show real results on performance, even innovative efforts can be an additional burden if not supported by a mature system or strong market understanding (Giardino *et al* ,. 2022). In the *Knowledge-Based View* (KBV) Perspective, knowledge is indeed considered a strategic asset, but its effectiveness is highly dependent on the organization's ability to manage it adaptively and contextually (Grant, RM 1996). If the knowledge or innovation produced does not match market needs or cannot be optimally implemented due to limited resources, then the innovation will not have a significant impact on performance (Suaeb, Wijana 2024). In line with the findings of Cahyani *et. , Al* (2022) on SMEs found that innovation capability did not have a significant effect on the performance of these SMEs. that although there were efforts to innovate in products, this did not significantly improve the performance of SMEs in Sidoarjo. In practice, not all SMEs implement the latest technological innovations. However, the adoption of this technology does not necessarily have a direct impact on improving business performance, especially in terms of income because the implementation process generally requires a greater investment cost (Aristana *et. , Al* 2022). So the financial turnover that SMEs have becomes less healthy, and triggers an impact on the operations of SMEs.

The influence of *knowledge sharing* on *SMEs performance* through *innovation capability* .

This finding shows that *Knowledge sharing* has a positive and significant impact on *SMEs Performance* . However, this hypothesis indicates different results if mediated by innovation capability. *Knowledge sharing* has no significant impact on improving SME performance mediated by innovation capability. This shows that the implementation factor is weak and not optimal, because in SMEs not all information is used to carry out innovation. Although in the theoretical perspective, *the Knowledge-Based View* (KBV) states that knowledge is considered a primary resource in creating sustainable competitive advantage (Grant, 1996) to improve innovation capabilities and performance (Maulana *et al* ., 2022). In the field, many SMEs in Sidoarjo are more oriented towards fast production and sales than continuous innovation, so that *Innovation capability* is not the main factor in improving their performance, such as tight competition, and market fluctuations are more dominant in determining the success of SMEs, SMEs that have implemented innovation capabilities are fashion SMEs,

bag and suitcase industry, and electronics. However, SMEs that have implemented innovation capabilities but are not effective include furniture SMEs, school equipment, building materials, and food, so that *Knowledge sharing* through *Innovation Capability* cannot affect SME performance. This study can be strengthened by researchers Arman Hadi *et al* ., (2023) Competitive advantage may not be able to mediate the relationship between innovation capabilities and SME performance because innovation may not be the main goal of the results desired by business owners.

6. CONCLUSION

Based on the research conducted, it can be concluded that knowledge sharing has a significant positive effect on the performance of Small and Medium Enterprises (SMEs) in Sidoarjo. Although innovation capability does not show a significant direct effect on SME performance, this study confirms the importance of a knowledge sharing culture to improve SME competitiveness. In addition, this study shows that effective interaction in knowledge sharing can help SMEs adapt to market changes and create better innovations. However, challenges in implementing innovation capabilities are still obstacles that need to be overcome so that SMEs can maximize the potential of innovation in improving their performance. This study provides valuable insights for stakeholders in developing strategies to improve SME performance through improved knowledge sharing practices.

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