

# ELEVATING FINANCIAL PERFORMANCE IN MUSLIM CLOTHING SMEs BY LEVERAGING HUMAN RESOURCE CAPABILITIES AND CORPORATE STRATEGY

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**Abstract:** This research investigates the impact of external dynamics, human capital, business strategy, and innovation capability on the financial outcomes of Muslim clothing SMEs in East Java, Indonesia. Utilizing a quantitative approach with a descriptive research design, the study employs Structural Equation modelling (SEM) for data analysis. Data were gathered through surveys targeting managers of Muslim clothing SMEs in five regions of East Java, selecting 200 managers with at least two years of managerial experience using judgment sampling. The survey collected information on demographics, organisational experience, and perceptions regarding key variables. The results indicate that human capital positively affects financial outcomes but does not directly influence innovation capability. Business strategy significantly impacts both financial outcomes and innovation capability. Furthermore, a positive correlation is observed between financial outcomes and innovation capability. These findings highlight the necessity of enhancing human capital and implementing effective strategies to boost performance and innovation within SMEs. This study contributes to the academic literature by establishing financial outcomes as a mediator and external dynamics as a moderator in these interactions. However, the study's emphasis on a specific region and industry may limit its generalizability. Future research should explore additional factors that affect innovation and performance and broaden the analysis to different sectors for a more extensive understanding.

**Abstrak:** Penelitian ini meneliti dampak dari dinamika eksternal, sumber daya manusia, strategi bisnis, dan kemampuan inovasi terhadap hasil keuangan UKM pakaian Muslim di Jawa Timur, Indonesia. Menggunakan pendekatan kuantitatif

dengan desain penelitian deskriptif, penelitian ini menggunakan Structural Equation Modelling (SEM) untuk analisis data. Data dikumpulkan melalui survei yang menargetkan manajer UKM pakaian Muslim di lima wilayah di Jawa Timur, dengan memilih 200 manajer dengan setidaknya dua tahun pengalaman manajerial menggunakan judgement sampling. Survei ini mengumpulkan informasi tentang demografi, pengalaman manajerial, dan persepsi mengenai variabel-variabel kunci. Hasil penelitian menunjukkan bahwa sumber daya manusia secara positif mempengaruhi hasil keuangan tetapi tidak secara langsung mempengaruhi kemampuan inovasi. Strategi bisnis secara signifikan mempengaruhi hasil keuangan dan kemampuan inovasi. Selain itu, korelasi positif diamati antara hasil keuangan dan kemampuan inovasi. Temuan ini menyoroti perlunya meningkatkan sumber daya manusia dan menerapkan strategi yang efektif untuk meningkatkan kinerja dan inovasi di UKM. Studi ini berkontribusi pada literatur akademis dengan menetapkan hasil keuangan sebagai mediator dan dinamika eksternal sebagai moderator dalam interaksi ini. Namun, penekanan studi ini pada wilayah dan industri tertentu dapat membatasi kemampuan generalisasinya. Penelitian di masa depan harus mengeksplorasi faktor-faktor tambahan yang memengaruhi inovasi dan kinerja dan memperluas analisis ke berbagai sektor untuk pemahaman yang lebih luas.

**Keywords:** business strategy, financial outcomes, human capital, innovation capability, Muslim clothing SMEs.

## A. INTRODUCTION

Innovation is crucial for maintaining competitiveness in dynamic industries, particularly for Muslim Clothing SMEs, which face rapid growth and global competition. These businesses must innovate continually to adapt to changing market demands and consumer preferences, which helps improve product appeal, customization, and brand loyalty.<sup>12</sup> Success in innovation depends not only on creativity but also on strategic planning and human capital, as they contribute to developing human capital.<sup>34</sup> Despite the sector's potential, challenges like limited financial resources and unstable external dynamics often hinder innovation. Financial outcomes can mediate the link between business strategy and innovation capability, while external conditions, such as regulations, can influence this relationship.<sup>56</sup> This study investigates the impact of business strategy and human capital on innovation capability in Muslim Clothing SMEs, using financial outcomes as a mediator and external dynamics as a moderator. Data from 200 managers will be analyzed through PLS-SEM. The research aims to offer practical insights for business strategies and highlight the importance of external support for fostering innovation in the Muslim Clothing sector, contributing to the theoretical understanding of these dynamics in the industry.

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<sup>1</sup> E. Rinaldi and S. Riyanto, "The effect of work motivation, work environment, and job satisfaction on organizational citizenship behavior and their impact on employees performance of RSU Menteng Mitra Afia during the Covid-19 pandemic," *Int. J. Res. Bus. Soc. Sci.* (2147- 4478), vol. 10, no. 6, pp. 101–110, 2021, doi: 10.20525/ijrbs.v10i6.1293.

<sup>2</sup> H. Batista, X. Suzana, and C. De Barros, *From the table to the sofa: The remote work revolution attitudes and behaviors*, no. 0123456789. Springer US, 2024. doi: 10.1007/s10639-024-12684-1.

<sup>3</sup> J. Wongsansukcharoen and J. Thaweepaiboonwong, "Effect of innovations in human resource practices, innovation capabilities, and competitive advantage on small and medium enterprises' performance in Thailand," *Eur. Res. Manag. Bus. Econ.*, vol. 29, no. 1, p. 100210, 2023, doi: 10.1016/j.iemeen.2022.100210.

<sup>4</sup> N. Alsadaan *et al.*, "Impact of Nurse Leaders Behaviors on Nursing Staff Performance: A Systematic Review of Literature," *Inq. (United States)*, vol. 60, 2023, doi: 10.1177/00469580231178528.

<sup>5</sup> S. Kraus, K. Vonmetz, L. Bullini Orlandi, A. Zardini, and C. Rossignoli, "Digital entrepreneurship: The role of entrepreneurial orientation and digitalization for disruptive innovation," *Technol. Forecast. Soc. Change*, vol. 193, no. July 2022, p. 122638, 2023, doi: 10.1016/j.techfore.2023.122638.

<sup>6</sup> L. E. Valdez-Juárez and M. Castillo-Vergara, "Technological capabilities, open innovation, and eco-innovation: Dynamic capabilities to increase corporate performance of smes," *J. Open Innov. Technol. Mark. Complex.*, vol. 7, no. 1, pp. 1–19, 2021, doi: 10.3390/joitmc7010008.

## B. THEORETICAL BASIS

### **Innovation Capability (IC)**

This refers to an organization's capacity to develop new products, services, or processes that bring value to customers or enhance efficiency. Innovation can take the form of product, process, or technological advancements, contributing to competitiveness and sustainability in a dynamic environment.<sup>7</sup> It is deeply rooted in creativity, knowledge, and support from both internal and external resources.<sup>8</sup> A company's culture, particularly one that promotes risk-taking and experimentation, significantly influences its innovation capability. Organizations with strong innovation capabilities usually have flexible structures and collaborative teams that support the creation of new ideas.<sup>9</sup> Key indicators of innovation capability include product development, technology adaptation, process efficiency, market responsiveness, r&d investment, digital innovation, customer feedback integration, and employee creativity.<sup>1011</sup>

### **Financial Outcomes (FO)**

Financial Outcomes measure the results achieved by a company over a certain period, including net income, return on assets (ROA), and return on

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<sup>7</sup> J. Kroh, D. Globocnik, C. Schultz, F. Holdhof, and S. Salomo, "Micro-foundations of digital innovation capability – A mixed method approach to develop and validate a multi-dimensional measurement instrument," *Technol. Forecast. Soc. Change*, vol. 198, no. November 2022, 2024, doi: 10.1016/j.techfore.2023.122942.

<sup>8</sup> A. Priyono and A. Hidayat, "Fostering innovation through learning from digital business ecosystem: A dynamic capability perspective," *J. Open Innov. Technol. Mark. Complex.*, vol. 10, no. 1, p. 100196, 2024, doi: 10.1016/j.joitmc.2023.100196.

<sup>9</sup> U. S. Choksy, J. Zeng, W. U. Rehman, Z. Mirza, and P. Puthusserry, "The role of peripheral vendors in enhancing the absorptive capacity of offshore software development teams in challenging institutional environments," *Eur. Manag. J.*, no. February, 2024, doi: 10.1016/j.emj.2024.03.004.

<sup>10</sup> K. Chirumalla, "Building digitally-enabled process innovation in the process industries: A dynamic capabilities approach," *Technovation*, vol. 105, p. 102256, 2021, doi: 10.1016/j.technovation.2021.102256.

<sup>11</sup> A. Shore, M. Tiwari, P. Tandon, and C. Foropon, "Building entrepreneurial resilience during crisis using generative AI: An empirical study on SMEs," *Technovation*, vol. 135, no. December 2023, p. 103063, 2024, doi: 10.1016/j.technovation.2024.103063.

equity (ROE).<sup>12</sup> It is often used to evaluate the success of a company's strategic decisions and resource management. Financial Outcomes play a mediating role between IC and business strategy.<sup>13</sup> Beyond traditional indicators, it can also be measured through market share growth, revenue growth, and cost savings. In competitive industries, strong financial results often reflect the successful execution of innovation strategies and market expansion.<sup>14</sup> Key indicators include revenue growth, net profit, profit margin, ROI, positive cash flow, financial stability, debt-to-equity ratio and ROA/ROE (EBIT).<sup>151617</sup>

### **Business Strategy (BS)**

This involves plans and actions taken by a company to achieve long-term goals like enhancing competitiveness, expanding into new markets, and securing its market position.<sup>18</sup> A well-crafted strategy integrates resource management, product development, and market expansion, playing a critical role in driving innovation and financial outcomes.<sup>19</sup> Effective business strategy aligns with internal resources and external market

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<sup>12</sup> I. Bautista-Bernal, C. Quintana-García, and M. Marchante-Lara, "Safety culture, safety performance and financial performance. A longitudinal study," *Saf. Sci.*, vol. 172, no. May 2023, p. 106409, 2024, doi: 10.1016/j.ssci.2023.106409.

<sup>13</sup> Y. Jeong *et al.*, "Synaptic plasticity-dependent competition rule influences memory formation," *Nat. Commun.*, vol. 12, no. 1, pp. 1–13, 2021, doi: 10.1038/s41467-021-24269-4.

<sup>14</sup> F.-M. Tseng, N. B. N. Jade, H.-H. R. Weng, and F.-Y. Lu, "Effects of team diversity, emergent leadership, and shared leadership on team performance in a multi-stage innovation and creativity crowdsourcing competition," *Int. J. Manag. Educ.*, vol. 22, no. 2, p. 100948, 2024.

<sup>15</sup> M. Rahmah, C. Purnama, D. Fatmah, L. Hakim, and S. Hasani, "Self-efficacy , Innovative Work Behavior and Job Performance in Digital Printing," pp. 1–11.

<sup>16</sup> C. Duguleană, L. Duguleană, and K. D. Deszke, "Financial performance and capital structure – an econometric approach for Romanian e-commerce companies during the COVID-19 pandemic," *Econ. Anal. Policy*, vol. 83, pp. 786–812, 2024, doi: 10.1016/j.eap.2024.05.024.

<sup>17</sup> H. Tarighi, G. Zimon, M. J. Sheikh, and M. Sayrani, "The Impact of Firm Risk and the COVID-19 Crisis on Working Capital Management Strategies: Evidence from a Market Affected by Economic Uncertainty," *Risks*, vol. 12, no. 4, 2024, doi: 10.3390/risks12040072.

<sup>18</sup> L. Kolozsár, Á. Wimmer, K. Takácsné György, and A. Mitev, "Tournament rituals and experiential competence development in higher education: A case of a unique conference series," *Int. J. Manag. Educ.*, vol. 22, no. 1, 2024, doi: 10.1016/j.ijme.2023.100929.

<sup>19</sup> A. K. Samha, "Strategies for efficient resource management in federated cloud environments supporting Infrastructure as a Service (IaaS)," *J. Eng. Res.*, vol. 12, no. 2, pp. 101–114, 2024, doi: 10.1016/j.jer.2023.10.031.

conditions to achieve competitive advantages, focusing on strategic aspects such as diversification, alliances, and international expansion.<sup>20</sup> Key indicators include vision and mission, product differentiation, market penetration, pricing strategy, product diversification, strategic alliances, speed of execution, and trend adaptation.<sup>2122</sup>

### Human Capital (HC)

This refers to the skills and competencies of employees that support organizational goals like innovation and performance.<sup>23</sup> Building human capital can foster innovation and improve a company's responsiveness to environmental changes.<sup>24</sup> Human capital encompasses technical skills, creativity, and soft skills like leadership and communication. Companies that prioritize employee training and development are better positioned to drive innovation and operational excellence. Skilled employees play a crucial role in implementing business strategies.<sup>25</sup> Indicators include workforce skills, employee training, talent retention, leadership quality, employee motivation, collaborative culture, productivity, and diversity.<sup>2627</sup>

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<sup>20</sup> F. Tjiptono, G. Chandra, and D. Adriana, "Strategic marketing," *Yogyakarta Publ. Andi*, 2012.

<sup>21</sup> I. Mancuso, A. M. Petruzzelli, U. Panniello, F. Frattini, and M. Del Giudice, "Nurturing strategic agility through corporate venturing advisory: An exploratory analysis," *Ind. Mark. Manag.*, vol. 121, no. April, pp. 1–15, 2024, doi: 10.1016/j.indmarman.2024.06.012.

<sup>22</sup> I. Alkandi and M. A. Helmi, "The impact of strategic agility on organizational performance: the mediating role of market orientation and innovation capabilities in emerging industrial sector," *Cogent Bus. Manag.*, vol. 11, no. 1, p., 2024, doi: 10.1080/23311975.2024.2396528.

<sup>23</sup> S. Pahuja *et al.*, "Gaining competitive advantage status through human resource practices: A study of Indian banks," *Soc. Sci. Humanit. Open*, vol. 9, no. January, p. 100804, 2024, doi: 10.1016/j.ssaho.2024.100804.

<sup>24</sup> J. Saesen, C. Vera Hedwig Schmidt, and S. Strese, "The more, the better: The influence of overconfident CEOs on their firms' digital orientation," *J. Bus. Res.*, vol. 183, no. June, p. 114809, 2024, doi: 10.1016/j.jbusres.2024.114809.

<sup>25</sup> Z. Yan, N. Bai, Z. D. Mansor, and W. C. Choo, "Effects of Psychological Capital and Person-Job Fit on Hospitality Employees' Work-Family Conflict, Family-Work Conflict and Job Performance: The Moderating Role of Marital Status," *Front. Psychol.*, vol. 13, no. May, pp. 1–14, 2022, doi: 10.3389/fpsyg.2022.868971.

<sup>26</sup> N. Tusquellas, R. Palau, and R. Santiago, "Analysis of the potential of artificial intelligence for professional development and talent management: A systematic literature review," *Int. J. Inf. Manag. Data Insights*, vol. 4, no. 2, p. 100288, 2024, doi: 10.1016/j.jjimei.2024.100288.

## External Dynamics (ED)

This includes factors beyond a company's control that can impact its operations, such as economic conditions, regulations, market trends, and technology.<sup>28</sup> The external dynamics can create opportunities or threats depending on the company's ability to adapt.<sup>29</sup> Firms in rapidly changing environments must monitor regulatory changes, technological developments, and global market shifts to remain competitive.<sup>30</sup> Indicators of regulatory changes, industry competition, consumer preferences, economic stability, competitor technology, government support, and globalization.<sup>31,32,33</sup>

## Hypothesis Development

H1: Influence of Human Capital on Financial Outcomes. Effective human capital practices, such as talent management and employee

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<sup>27</sup> T. Ranasinghe, E. H. Grosse, C. H. Glock, and M. Y. Jaber, "Never too late to learn: Unlocking the potential of aging workforce in manufacturing and service industries," *Int. J. Prod. Econ.*, vol. 270, no. February, p. 109193, 2024, doi: 10.1016/j.ijpe.2024.109193.

<sup>28</sup> R. M. S. Addin Al-Mawsheki, "Effect of working capital policies on firms' financial performance," *Cogent Econ. Financ.*, vol. 10, no. 1, 2022, doi: 10.1080/23322039.2022.2087289.

<sup>29</sup> C. Lynch and M. Ferasso, "The influence of a company's inherent values on its sustainability: Evidence from a born-sustainable SME in the footwear industry," *Clean. Responsible Consum.*, vol. 9, no. April, p. 100124, 2023, doi: 10.1016/j.clrc.2023.100124.

<sup>30</sup> D. L. Harrop *et al.*, "Effects of a culturally informed model of care for Aboriginal and Torres Strait Islander patients with acute coronary syndrome in a tertiary hospital in Australia: a pre-post, quasi-experimental, interventional study," *Lancet Glob. Heal.*, vol. 12, no. 4, pp. e623–e630, 2024, doi: 10.1016/S2214-109X(23)00601-0.

<sup>31</sup> C. Purnama and W. T. Subroto, "Competition intensity, uncertainty environmental on the use of information technology and its impact on business performance small and medium enterprises," *Int. Rev. Manag. Mark.*, vol. 6, no. 4, pp. 984–992, 2016.

<sup>32</sup> P. Jianing, K. Bai, Y. A. Solangi, C. Magazzino, and K. Ayaz, "Examining the role of digitalization and technological innovation in promoting sustainable natural resource exploitation," *Resour. Policy*, vol. 92, no. February, p. 105036, 2024, doi: 10.1016/j.resourpol.2024.105036.

<sup>33</sup> F. Ganda, "The interplay between technological innovation, financial development, energy consumption and natural resource rents in the BRICS economies: Evidence from GMM panel VAR," *Energy Strateg. Rev.*, vol. 51, no. July 2023, p. 101267, 2024, doi: 10.1016/j.esr.2023.101267.

development, lead to a skilled workforce that enhances financial metrics like revenue and profitability.<sup>34</sup>

H2: Influence of Business Strategy on Financial Outcomes. Strategic alignment with resources and market conditions improves positioning and profitability.<sup>35</sup>

H3: Influence of Human Capital on Innovation Capability. Strong human capital fosters a culture of creativity, significantly boosting a firm's innovation capacity.<sup>36</sup>

H4: Influence of Business Strategy on Innovation Capability. Strategies emphasizing flexibility and market alignment enhance innovation by enabling firms to adapt to new opportunities.<sup>37</sup>

H5: Influence of External Dynamics on Innovation Capability. Companies in volatile markets invest more in innovation to stay competitive.<sup>38</sup>

H6: Influence of Financial Outcomes on Innovation Capability. Better financial outcomes support R&D investments, promoting further innovation.<sup>39</sup>

H7: Influence of Human Capital on Innovation Capability Mediated by Financial Outcomes. Strong human resource strategies boost financial results, enabling resource allocation for innovation.<sup>40</sup>

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<sup>34</sup> Kellner et al., 2024

<sup>35</sup> X. Zhang, C. Cui, and D. Xie, "Are Dividends All for Rewarding Investors? Evidence from Payouts Induced by Return on Equity Targets," *China J. Account. Stud.*, vol. 8, no. 3, pp. 470–494, 2020, doi: 10.1080/21697213.2021.1926412.

<sup>36</sup> B. J. Adams, E. M. Gora, M. C. Donaldson-Matasci, E. J. H. Robinson, and S. Powell, "Competition and habitat availability interact to structure arboreal ant communities across scales of ecological organization," *Proc. R. Soc. B Biol. Sci.*, vol. 290, no. 2007, 2023, doi: 10.1098/rspb.2023.1290.

<sup>37</sup> K. Zhou, "The Influence of Creative Personality and Goal Orientation on Innovation Performance," *Front. Psychol.*, vol. 12, no. April, pp. 1–10, 2021, doi: 10.3389/fpsyg.2021.634951.

<sup>38</sup> N. Durrani, A. Raziq, T. Mahmood, and M. R. Khan, "Barriers to adaptation of environmental sustainability in SMEs: A qualitative study," *PLoS One*, vol. 19, no. 5 May, pp. 1–22, 2024, doi: 10.1371/journal.pone.0298580.

<sup>39</sup> C. Zehir, A. Üzmez, and H. Yıldız, "The Effect of SHRM Practices on Innovation Performance: The Mediating Role of Global Capabilities," *Procedia - Soc. Behav. Sci.*, vol. 235, no. October, pp. 797–806, 2016, doi: 10.1016/j.sbspro.2016.11.088.

<sup>40</sup> F. B. Zapkau, C. Schwens, and R. Kabst, "The Role of Prior Entrepreneurial Exposure in the Entrepreneurial Process: A Review and Future Research Implications," *J. Small Bus. Manag.*, vol. 55, no. 1, pp. 56–86, 2017, doi: 10.1111/jsbm.12232.



H8: Influence of Business Strategy on Innovation Capability Mediated by Financial Outcomes. Financial health allows companies to implement strategic initiatives that support innovation.<sup>41</sup>

H9: Influence of Human Capital on Innovation Capability Moderated by External Dynamics. In dynamic markets, human resource practices focusing on adaptability are crucial for sustaining innovation.<sup>42</sup>

H10: Influence of Financial Outcomes on Innovation Capability Moderated by External Dynamics. Firms with solid financial outcomes are better positioned to invest in innovation during market shifts.<sup>43</sup>

H11: Influence of Business Strategy on Innovation Capability Moderated by External Dynamics. Rapidly evolving markets necessitate frequent strategic adjustments to support ongoing innovation.<sup>44</sup>

### C. RESEARCH METHOD

This research adopts a quantitative approach to examine the effects of external dynamics, human capital, business strategy, and innovation capability on the financial outcomes of Muslim clothing SMEs in East Java, Indonesia. A descriptive research design was employed, and data were collected through surveys administered to 200 managers across five regions: Surabaya, Malang, Madiun, Bojonegoro, and Besuki. The survey used a five-point Likert scale, and a pre-test was conducted with 30 participants to ensure the validity and reliability of the instrument.

Judgment sampling was used to select respondents, requiring a minimum of two years of managerial experience. Data analysis was conducted using Partial Least Squares Structural Equation Modelling (PLS-SEM) with SmartPLS software, focusing on convergent and discriminant

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<sup>41</sup> O. Laaksonen and M. Peltoniemi, "The Essence of Dynamic Capabilities and their Measurement," *Int. J. Manag. Rev.*, vol. 20, no. 2, pp. 184–205, 2018, doi: 10.1111/ijmr.12122.

<sup>42</sup> C. R. Rossetto, C. E. Carvalho, G. Behling, and F. C. Lenzi, "O desenvolvimento da capacidade absorptiva de conhecimento a partir da incerteza ambiental," *Rev. Ibero-Americana Estrategia*, vol. 20, no. 1, p. e17393, 2021, doi: 10.5585/riae.v20i1.17393.

<sup>43</sup> M. Hughes, Y. Y. Chang, I. Hodgkinson, P. Hughes, and C. Y. Chang, "The multi-level effects of corporate entrepreneurial orientation on business unit radical innovation and financial performance," *Long Range Plann.*, vol. 54, no. 1, pp. 0–63, 2021, doi: 10.1016/j.lrp.2020.101989.

<sup>44</sup> J. E. Chung, Y. Huang, B. Jin, and B. Sternquist, "The impact of market orientation on Chinese retailers' channel relationships," *J. Bus. Ind. Mark.*, vol. 26, no. 1, pp. 14–25, 2011, doi: 10.1108/08858621111097175.

validity, as well as internal consistency through Composite Reliability and Cronbach's Alpha.

Ethical considerations included voluntary participation, informed consent, and strict confidentiality of respondents' data, with participants briefed on their rights and the study's purpose.

## **D. DISCUSSION**

### **Respondent Characteristics**

Based on data from table 1 Based on the characteristics of respondents in the study of Muslim Clothing SMEs, the majority of respondents are men (87.3%), while women make up only 12.7%. Most respondents fall within the age range of 35-52 years (62.8%), followed by those aged 17-34 years (28%), and the remaining are over 53 years old (9.2%). In terms of experience, the majority have been running their businesses for more than 10 years (63.3%), while the rest have 2-10 years of experience (36.7%). Regarding education, most respondents hold a bachelor's degree (50.1%), followed by those with a master's degree (29.3%), and high school graduates or lower (16.5%). Only 0.1% of respondents have a doctoral degree. This indicates that the Muslim Clothing SMEs are predominantly run by men, are middle-aged, experienced in business, and have a relatively high level of education.

### Measurement Model Testing

Table 2 and Figure 2 (attachment) show measurement model testing results indicate that the constructs of Human Capital, Business Strategy, Financial Outcomes, External Dynamics, and Innovation Capability have good convergent validity, as all factor loadings are above the threshold of 0.7. The constructs also exhibit high reliability, with Cronbach's alpha values ranging from 0.935 to 0.964, and Composite Reliability (CR) values exceeding 0.9, ensuring consistency in the measurements. Furthermore, the Average Variance Extracted (AVE) values for each construct are above 0.5, confirming that a substantial portion of variance is explained by the constructs rather than error. Additionally, the interaction terms between Human Capital, Business Strategy, and Financial Outcomes with External Dynamics have values of 1.000 for Cronbach's alpha, rho\_A, CR, and AVE, indicating perfect reliability for these moderating variables. These results demonstrate that the constructs are robust and suitable for further structural model analysis.

Table 3 shows the discriminant validity analysis, assessed using the Fornell-Larcker Criterion and the Heterotrait-Monotrait (HTMT) ratio, confirms that the constructs in the model are well-distinguished from each other. According to the Fornell-Larcker Criterion, the square roots of the Average Variance Extracted (AVE) for each construct are higher than their correlations with other constructs. For example, the square root of the AVE for Business Strategy is 0.848, which is greater than its correlation with External Dynamics (0.485) and Financial Outcomes (0.642). Similarly, External Dynamics has a square root AVE of 0.849, which is greater than its correlation with Human Capital (0.993) and Financial Outcomes (0.520). This indicates that each construct is more strongly related to its own indicators than to other variables in the model. Additionally, the HTMT values for all construct pairs are below the threshold of 0.85, further supporting the distinction between constructs. For instance, the HTMT between Business Strategy and External Dynamics is 0.510, and between Business Strategy and Financial Outcomes is 0.670. These results suggest that the constructs, including the moderating variables, have strong discriminant validity, ensuring accurate measurement of their unique roles in the analysis.

The results from Table 4 of the hypothesis testing highlight the key relationships between human capital (HC), business strategy (BS), financial

outcomes (FO), innovation capability (IC), and external dynamics (ED) within Muslim clothing SMEs. The direct effects indicate that human capital has a significant positive impact on financial outcomes ( $\beta = 0.293$ ,  $p = 0.000$ ), and business strategy also positively influences financial outcomes with an even stronger effect ( $\beta = 0.499$ ,  $p = 0.000$ ). However, human capital does not directly affect innovation capability ( $\beta = 0.326$ ,  $p = 0.613$ ), while business strategy significantly enhances innovation capability ( $\beta = 0.335$ ,  $p = 0.000$ ). Financial outcomes are positively associated with innovation capability ( $\beta = 0.243$ ,  $p = 0.006$ ), suggesting that financially healthy firms tend to have higher levels of innovation.

The indirect effects show that both human capital and business strategy influence innovation capability through financial outcomes, with significant mediation effects ( $\beta = 0.071$ ,  $p = 0.018$  and  $\beta = 0.121$ ,  $p = 0.009$ , respectively). These findings emphasize the role of financial outcomes as an important mediator, enabling innovation within the firms.

Additionally, the moderating effects of external dynamics are significant. External dynamics positively moderate the relationship between human capital and innovation capability ( $\beta = 0.292$ ,  $p = 0.001$ ) as well as between business strategy and innovation capability ( $\beta = 0.292$ ,  $p = 0.000$ ). This suggests that favorable external conditions can enhance the impact of internal capabilities on innovation. Conversely, external dynamics negatively moderate the relationship between financial outcomes and innovation capability ( $\beta = -0.444$ ,  $p = 0.000$ ), indicating that in certain external conditions, strong financial performance might not always lead to increased innovation.

These insights demonstrate the complex interplay between internal capabilities, financial health, external factors, and innovation within the Muslim clothing SME sector. They align with previous research emphasizing the critical roles of human capital, business strategy, and external conditions in shaping innovation outcomes in competitive environments.

### **Human Capital and Financial Outcomes**

Demonstrated that enhancing human capital significantly boosts a company's financial outcomes.<sup>45</sup> Their findings indicated that organizations with effective HR development initiatives tend to achieve greater operational efficiency and competitiveness, leading to improved financial results. This aligns with the observation from this study that human capital positively impacts financial outcomes in Muslim clothing SMEs ( $\beta = 0.293$ ,  $p = 0.000$ ).

### **Business Strategy and Financial Outcomes**

The study's results further corroborate the research on the effect of business strategy on financial performance, revealing that well-planned and adaptable strategies enhance competitiveness and financial outcomes.<sup>46</sup> The finding in this study that business strategy positively influences financial outcomes ( $\beta = 0.499$ ,  $p = 0.000$ ) is consistent with their conclusions, highlighting the strategic role in driving financial success.

### **The Role of Innovation in Enhancing Performance**

Innovation is crucial in strengthening the competitive position and financial outcomes of small and medium-sized enterprises<sup>47</sup>. This supports the finding from the current study that financial outcomes positively influence innovation capability ( $\beta = 0.243$ ,  $p = 0.006$ ), indicating that SMEs with better financial health can more readily invest in innovation initiatives to enhance competitiveness.

### **External Dynamics Moderation**

Examined how external dynamics moderate firm performance, finding that a dynamic external context can influence the relationship between

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<sup>45</sup> S. Pahuja *et al.*, "Gaining competitive advantage status through human resource practices: A study of Indian banks," *Soc. Sci. Humanit. Open*, vol. 9, no. January, p. 100804, 2024, doi: 10.1016/j.ssaho.2024.100804.

<sup>46</sup> U. Abdullahi, S. Usman Kunya, A. Umar Raji, and W. Emmanuel Dsazu, "Influence of Entrepreneurship Orientation on Financial Performance of Construction SMEs in Nigeria," *J. Sustain. Cities Built Environ.*, vol. 01, no. 02, 2023, doi: 10.58757/jscbe.ieofpcsn.02.

<sup>47</sup> J. P. Diáñez-González, C. Camelo-Ordaz, and M. Fernández-Alles, "Drivers and implications of entrepreneurial orientation for academic spin-offs," *Int. Entrep. Manag. J.*, vol. 17, no. 2, pp. 1007–1035, 2021, doi: 10.1007/s11365-020-00652-3.

business strategy and innovation capability.<sup>48</sup> This supports the finding from this study that external dynamics positively moderate the relationship between business strategy and innovation capability ( $\beta = 0.292$ ,  $p = 0.000$ ) and between human capital and innovation capability ( $\beta = 0.292$ ,  $p = 0.001$ ). These results suggest that favourable external conditions can amplify the positive effects of internal capabilities on innovation.

### **Financial Outcomes as a Mediator**

The study also identified that financial outcomes serve as a vital mediator in the relationship between human capital and innovation capability, consistent with research, which indicated that financially stable companies are better positioned to invest in innovation programs.<sup>49</sup> This underscores the significance of financial health in linking internal capabilities to innovation potential, as shown by the significant mediation effects in this study ( $\beta = 0.071$ ,  $p = 0.018$  for human capital and  $\beta = 0.121$ ,  $p = 0.009$  for business strategy).

Collectively, these studies reinforce the current research by demonstrating that the development of human capital and effective strategies significantly affects financial and innovation performance in SMEs. Moreover, the role of external dynamics as a moderating factor emphasizes the necessity of supportive market conditions for companies to leverage their internal strengths and foster innovation.

## **E. CONCLUSION**

The study highlights the critical role of internal resources, particularly human capital and business strategy, in enhancing financial outcomes and innovation capability within Muslim clothing SMEs, supporting the Resource-Based View (RBV) theory. The findings indicate that stronger financial outcomes serve as a mediator between these internal capabilities and innovation potential, suggesting that firms with better financial health

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<sup>48</sup> J. Liu, Y. Wu, and L. Liu, "Impact of Environmental Uncertainties and Strategic Flexibility in Innovation Activities on NEV Battery Recycling Firms in China," *Int. J. Environ. Res. Public Health*, vol. 20, no. 4, 2023, doi: 10.3390/ijerph20043497.

<sup>49</sup> T. Van Hiep, L. T. Tham, and L. M. Thong, "Analyzing economic performance and value added distribution in the Luong bamboo value chain: A case study of Thanh Hoa province, Vietnam," *Trees, For. People*, vol. 16, no. May, p. 100563, 2024, doi: 10.1016/j.tfp.2024.100563.

are more likely to invest in innovation. However, the research is limited to the Muslim clothing industry, which may restrict the generalizability of the results, and its cross-sectional design does not capture temporal changes in these relationships. Additionally, response bias could affect the accuracy of the findings. Future research should expand the scope to include diverse sectors and utilize longitudinal methods to observe dynamic changes. It is recommended that firms focus on enhancing human resource development through training, formulate adaptive strategies aligned with market conditions, and leverage financial resources for innovation. Engaging with stakeholders such as educational institutions can also foster collaborative innovation. Overall, this study provides valuable insights into the interplay of internal capabilities, financial outcomes, and innovation within a specific context, offering practical guidance for improving performance in dynamic market environments.

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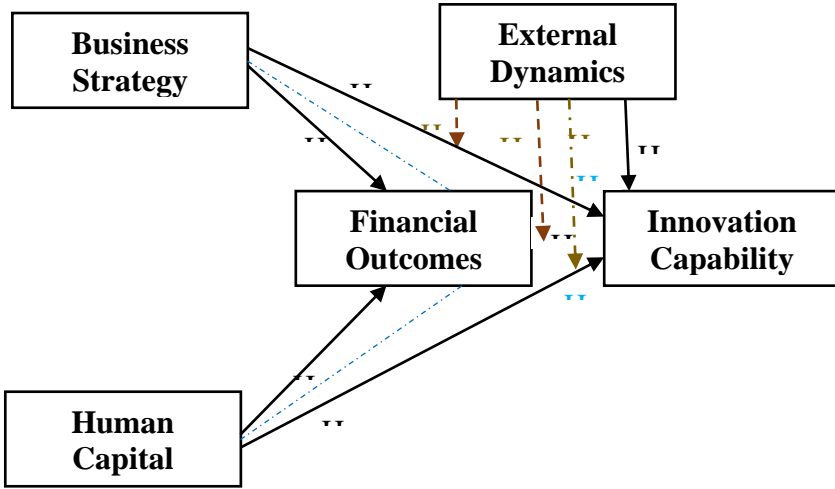
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ATTACHMENT

Figure 1. Conceptual Framework



Description:

- > Direct Effects
- - - - -> Indirect Effects (Mediating)
- - - - -> Moderating

Figure 2 Structural Model

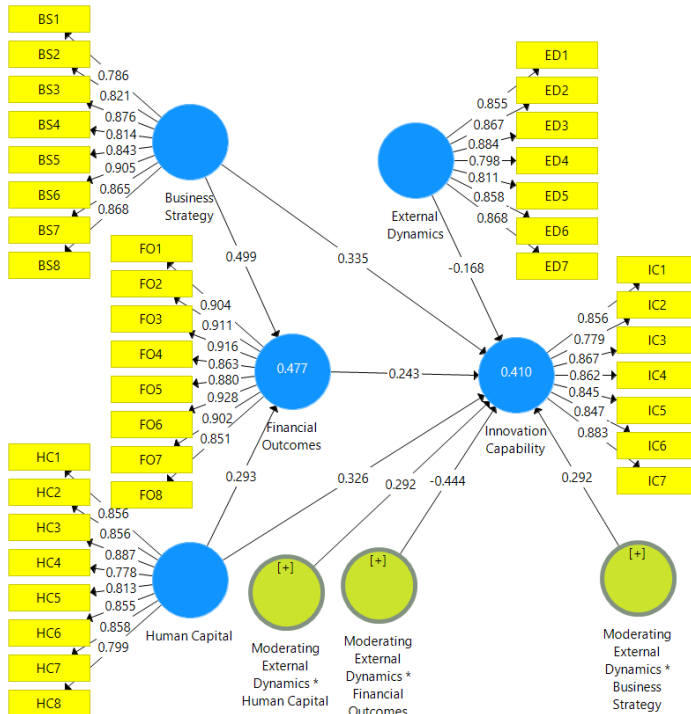


Table 1  
Characteristics of Respondents

Description	N	%	Description	N	%	Description	N	%
<b>Gender</b>			<b>Early Years</b>			<b>Education</b>		
Man	175	87.3				High school graduate or earlier	33	16.5
Woman	25	12.7	2-10 Years	73	36.7	Bachelor	100	50.1
Amount	200	100	>10 Years	127	63.3	Masters	59	29.3
<b>Age</b>			Amount	200	100	Doctor	8	0.1
17-34	56	28				Amount	200	100
35-52	126	62.8						
53>	18	9.2						
Amount	200	100						

Source: Data processed

Table 2  
Measurement Model Testing Convergent Validity, Composite Reliability and Cronbach's Alpha

Construct	$\lambda$	Cronbach's $\alpha$	$\rho_{A}$	CR	AVE
Human Capital		0.939	0.943	0.950	0.703
HC1; Workforce skills	0.856				
HC2; Employee training	0.856				
HC3; Talent retention	0.887				
HC4; Leadership quality	0.778				
HC5; Employee motivation	0.813				
HC6; Collaborative culture	0.855				
HC7; Productivity	0.858				
HC8; Diversity	0.799				
Business Strategy		0.944	0.946	0.953	0.719
BS1; Vision and mission	0.786				
BS2; Product differentiation	0.821				
BS3; Market penetration	0.876				
BS4; Pricing strategy	0.814				
BS5; Product diversification	0.843				
BS6; Strategic alliances	0.905				
BS7; Speed of execution	0.865				
BS8; Trend adaptation	0.868				
Financial Outcomes		0.964	0.966	0.970	0.800
FO1; Revenue growth	0.904				
FO2; Net profit	0.911				
FO3; Profit margin	0.916				
FO4; ROI	0.863				
FO5; Positive cash flow	0.880				
FO6; Financial stability	0.928				
FO7; Debt-to-Equity Ratio	0.902				
FO8; ROA	0.851				
External Dynamics		0.936	0.948	0.948	0.721
ED1; Regulatory changes	0.855				
ED2; Industry competition	0.867				

ELEVATING FINANCIAL PERFORMANCE IN MUSLIM CLOTHING SMES BY LEVERAGING HUMAN RESOURCE CAPABILITIES AND CORPORATE STRATEGY

ED3; Consumer preferences	0.884				
ED4; Economic stability	0.798				
ED5; Competitor technology	0.811				
ED6; Government support	0.858				
ED7; Globalization	0.868				
Innovation Capability		0.935	0.937	0.948	0.721
IC1; Product development	0.856				
IC2; Technology adaptation	0.779				
IC3; Process efficiency	0.867				
IC4; Market responsiveness	0.862				
IC5; R&D investment	0.845				
IC6; Digital innovation	0.847				
IC7; Employee creativity	0.883				
Human Capital * External Dynamics	1.026	1.000	1.000	1.000	1.000
Financial Outcomes * External Dynamics	1.053	1.000	1.000	1.000	1.000
Business Strategy * External Dynamics	1.022	1.000	1.000	1.000	1.000

Source: Data processed

Table 3  
Discriminant Validity

Variable	BS	ED	FO	HC	IC	Moderating ED * BS	Moderating ED * FO	Moderating ED * HC
<b>Fornell-Larcker Criterion</b>								
BS	.848							
ED	.485	0.849						
FO	.642	0.520	0.895					
HC	.487	0.993	0.536	0.838				
IC	.528	0.285	0.496	0.301	0.849			
Moderating ED * BS	0.038	-0.141	-0.025	-0.138	0.063	1.000		
Moderating ED * FO	0.025	-0.118	0.006	-0.127	-0.087	0.763	1.000	
Moderating ED * HC	0.137	-0.576	-0.131	-0.570	0.011	0.540	0.606	1.000
<b>Heterotrait-Monotrait Ratio (HTMT)</b>								
BS								
ED	0.510							
FO	0.670	0.546						
HC	0.512	0.661	0.559					
IC	0.558	0.295	0.520	0.315				
Moderating ED * BS	0.046	0.146	0.040	0.141	0.074			
Moderating ED * FO	0.047	0.120	0.040	0.128	0.092	0.763		
Moderating ED * HC	0.140	0.599	0.135	0.589	0.032	0.540	0.606	

Source: Data processed

**Table 4**  
**Hypothesis Testing**

Path Coefficients	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (O/STDEV)	P Values	Decision
<b>Direct Effects</b>						
HC -> FO	0.293	0.296	0.065	4.484	0.000	H1, Significant
BS -> FO	0.499	0.497	0.064	7.841	0.000	H2, Significant
HC -> IC	0.326	0.055	0.643	0.506	0.613	H3, Not Significant
BS -> IC	0.335	0.332	0.086	3.922	0.000	H4, Significant
ED -> IC	-0.168	0.108	0.635	0.264	0.792	H5, Not Significant
FO -> IC	0.243	0.254	0.088	2.770	0.006	H6, Significant
<b>Indirect Effects</b>						
HC -> FO -> IC	0.071	0.074	0.030	2.368	0.018	H7, Significant
BS -> FO -> IC	0.121	0.126	0.046	2.607	0.009	H8, Significant
<b>Moderating</b>						
Moderating ED * HC -> IC	0.292	0.306	0.091	3.209	0.001	H9, Significant
Moderating ED * FO -> IC	-0.444	-0.456	0.080	5.553	0.000	H10, Significant
Moderating ED * BS -> IC	0.292	0.294	0.078	3.729	0.000	H11, Significant

Source: Data processed