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Innovation Capability and Financial Performance of Fashion Small and Medium Enterprises: The Role of Dynamic Relational Capability

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ABSTRACT

This study examined how innovation capability improves financial performance in fashion small and medium enterprises (SME) in Central Java, Indonesia, with a focus on the mediating role of dynamic relational capability. Although innovation capability has been widely investigated, the interaction with dynamic customer relationships remains understudied. Data were collected through online questionnaires and face-to-face interviews with 308 fashion SME owners/managers, purposively selected based on comprehensive business knowledge. The results showed that, based on PLS-SEM analysis, innovation capability significantly strengthened dynamic relational capability, leading to improvement in networking capapability and financial performance. In conclusion, dynamic relational capability directly improves financial performance and mediates the relationship between innovation capability and financial performance. The results underscore the essence of enhancing dynamic relational capability in fashion SME, providing practical details for owners/managers to build strategies that foster innovation and competitiveness.

JEL Classification: L14, M31, O31

Keywords: Innovation capability; Dynamic relational capability; Networking capapability; SME

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INTRODUCTION

Innovation capability is crucial for achieving competitive advantage and adapting to market changes (Ferreira et al., 2020), particularly for small and medium enterprises (SME), where it contributes to growth, profitability, and financial performance (Agyapong et al., 2017; Alenezi and Isa, 2024; Ruiz-Ortega et al., 2021; Saunila, 2014). Some studies have confirmed the positive effect of innovation capability on financial outcomes (Agyapong et al., 2017; Bahta et al., 2020; Maldonado-Guzmán et al., 2018; Zhang and Hartley, 2018), while others reported insignificant effects (Aljuboori et al., 2021; Pascual-Fern´andez et al., 2021; YuSheng and Ibrahim, 2020; Yusr, 2016). The inconsistencies observed in previous studies are particularly evident in the fashion industry, where SMEs encounter unique challenges such as rapidly changing demand and intense global competition (Gereffi and Frederick, 2010).

To address this gap, the present study introduces dynamic relational capability as a mediating factor that may help clarify the innovation–performance linkage. By doing so, the study not only contributes to theoretical advancement but also aims to offer actionable insights for managers seeking to enhance financial performance through innovation and relationship-oriented strategies. This capability refers to a firm's ability to adjust its customer relationships in response to environmental changes to enhance overall performance (Akkaya and Qaisar, 2021) and it is especially crucial in creative industries like fashion, where flexible and adaptive partnerships have a significant impact on financial performance (Chuang, 2020). In contrast to previous approaches which were limited to dynamic capability theory, this study uses the Resource Advantage Theory of Competition (hereafter R-A theory), which views competition as an evolutionary process with diverse and non-transferable resources and emphasizes distribution over ownership (Hunt and Morgan, 1995). In this theory, innovation and learning are assumed to be endogenous and market information is imperfect (Hunt and Morgan, 1995). R-A theory also emphasizes the importance of relational resource management in creating competitive advantage and improving business performance (Hunt and Morgan, 1995, 1996), making it relevant to fashion SMEs where implementation remains limited.

From the R-A theory perspective, relational resources are dynamic and can create competitive advantage through unique, hard-to-replicate relationship-building abilities (Hunt and Morgan, 1996). Companies can leverage these relational dynamics in rapidly changing markets (Hunt et al., 2012). This study addresses a gap in the literature, as prior research on fashion SMEs has primarily emphasized product innovation as a driver of performance (Kang, 2019), while overlooking the relational perspective advocated by R-A theory. It explores the link between dynamic relational capability and innovation as a source of networking capapability and financial performance.

This study formulates an empirical model and examines how dynamic relational capability bridges the gap between innovation and SMEs financial performance in fashion industry in Central Java. As a core industry with adaptive retail networks (Tao and Xu, 2018), fashion SMEs have unique flexibility in responding to market shifts (Kang, 2019; Rienda et al., 2020; Scuotto et al., 2020), with owner/managers providing critical operational insights. The findings reveal that dynamic relational capability critically enhances both innovation capacity and financial outcomes. These results provide practical insights for owners and managers of fashion SMEs, highlighting the importance of cultivating strong, flexible partnerships and continuously evolving relationship strategies. By doing so, firms can refine their innovation processes, respond more effectively to changing consumer demands, and ultimately strengthen their competitiveness in fast-paced and dynamic markets.

THEORETICAL BACKGROUND AND HYPOTHESIS DEVELOPMENT

Dynamic Relational Capability in the R-A Theory Perspective

R-A theory states that competitive advantage originates from a company unique differentiators, driving financial performance (Hunt and Morgan, 1995, 1996). It emphasizes dynamic market competition where strategic resources such as brand equity, corporate culture, and relationships determine success. Relational marketing significantly enhances both customer perspective and product development by fostering deeper, long-term connections between firms and their customers (Kim and Oh, 2017; O'Malley, 2014), while competitive agility fosters adaptive strategies (Silverman and Baum, 2002).

For fashion SME, R-A theory offers a framework to leverage relational resources, including shared patents and technology as well as strategic agility for innovation (Chen and Miller, 2014; Weber and Tarba, 2014). Moreover, dynamic relationships yield unique advantages (Hussain et al., 2020), enhance innovation (Farzaneh et al., 2022), and improve customer portfolio management (Bednarek et al., 2016) while effective relational resource management improves product/service excellence and partnerships (Wang et al., 2018).

In general, relationship dynamics refer to interaction patterns that shape communication, and when managed effectively, they can build trust, reduce conflict, and enhance performance (Tjandra et al., 2020). Strong customer-company relationships create value (Barbieri et al., 2023), while dynamic capability helps meet customer needs through innovation (Kunanoppadol and Igel, 2023). Furthermore, agility - defined by attributes such as courage, focus, commitment, respect, and openness - is essential for sustaining competitiveness. In particular, supply chain agility provides a strategic advantage by enhancing an organization's ability to respond swiftly and effectively to changing demand (Manzoor et al., 2021);(Matahir et al., 2023), which ultimately influence firms' profitability (Zastempowski and Cyfert, 2023).

Innovation Capability and Dynamic Relational Capability

Companies that effectively leverage their innovation capability can positively influence both their intellectual capital and overall performance (Aljuboori et al., 2021). For SMEs in the fashion industry, innovation could be realized through creative design development, the use of local raw materials, and other media. According to Iddris et al. (2025), effective human resource management is critical in driving innovation, helping SMEs to obtain the economic and financial resources necessary for innovation (Maldonado-Guzmán et al., 2018). Strong innovation capability enables companies to capture new market opportunities and build extensive networks (Wang et al., 2023). This trait also facilitates strategic partnerships, enhances relational capability, and promotes growth (Pigola et al., 2023). Moreover, companies with high innovation capability can quickly adjust to market changes (Sabahi and Parast, 2020), while high levels of innovation amplify the positive effect of relational attachment on dynamic capability by means of ambidextrous learning (Zhang et al., 2022). This suggests that developing innovation capability will improve relational capability. Accordingly, the following hypothesis was proposed:

H1: Innovation capability has a positive effect on the dynamic relational capability of SMEs in the fashion industry

Dynamic Relational Capability and Networking Capability

The development of dynamic relational capability enables companies to quickly adapt to uncertain business conditions. For fashion SMEs, this capability also plays a strategic role in fostering long-term relationships with customers and partners. Relational capability is vital for building stronger customer relationships (Nyamrunda et al., 2021) and helps adapt to volatile environments (Batra, 2020). Sustaining relationships through this capability enhances adaptability (Mollet and Kaudela-Baum, 2022), while integrating external and internal resources strengthens competitive advantage (Dhewanto et al., 2021).

According to Kurniawan et al. (2021), effective networking enhances market orientation and company performance, enabling companies to quickly adapt to market changes (Batra, 2020). Therefore, developing relational skills improves networking capability (Chuang, 2020), aiding SMEs in dynamic markets (Manurung and Kurniawan, 2021). SMEs that effectively develop dynamic relational capability can expand networking capacity. Therefore, the following hypothesis is proposed:

H2: Dynamic relational capability positively affects the networking capability of SMEs in the fashion industry.

Networking Capability and Financial Performance

Networking capability is widely recognized as crucial for enhancing company performance by enabling effective and adaptable network management (Maghsoudi et al., 2021) and promoting an entrepreneurial orientation (Wegner, Santini, et al., 2023). For SMEs in the fashion industry, strong networks with local raw material suppliers, distribution partners, and customers can improve operational efficiency and expand the

markets. This practical networking skills are especially essential to overcome challenges and seize opportunities during crises (Wegner, Foguesatto, et al., 2023). It also facilitates the exchange of knowledge and resources, supporting innovation and business growth (Farida and Nuryakin, 2021). In addition, networking skills contribute to improved financial performance by facilitating the exchange of innovations (dos Santos et al., 2021) and enabling companies to create value through the renewal of effective network structure (Maghsoudi et al., 2021). These skills can also improve strategic flexibility and financial results, primarily through appropriate investments (Wang et al., 2021; Wegner, Santini, et al., 2023). Therefore, we hypothesis that:

H3: Networking capapability has a positive effect on the financial performance of SMEs in the fashion industry

Dynamic Relational Capability and Financial Performance

Dynamic relational capability in fostering customer trust enhances a company's strategic agility, which in turn impacts overall effectiveness (Nyamrunda et al., 2021). For SMEs in the fashion industry, this capability can be achieved through effective communication with customers, responsive customer service, and loyalty programs. Business relationships create competitive advantages that influence financial performance (Ngo and Vu, 2021), while a company's dynamic capability, grounded in organizational agility to maintain customer relationships, also impacts financial performance (Li, 2022). Dynamic capability and organizational responsiveness differ based on the dynamics of the business environment and can influence marketing performance (Akkaya and Qaisar, 2021). Therefore, the following hypothesis was proposed:

H4: Dynamic relational capability has a positive effect on the financial performance of SMEs in the fashion industry

Dynamic Relational Capability As A Mediator of Innovation Capability and Financial Performance

Research on the link between innovation capability and financial performance has produced inconsistent findings. To address this gap, dynamic relational capability has been proposed as a mediating factor. Innovation capability encourages companies to develop strong networks which ultimately enhance performance (Aljuboori et al., 2021). For SMEs in the fashion industry, cultivating sustainable innovation capability is essential as it plays a crucial role in promoting overall company performance (Saunila, 2020). The ability to innovate through knowledge sharing supports the development of broader relationships (Pigola et al., 2023). Unique relational and innovation capability through social capital can enhance SMEs performance (Aljuboori et al., 2021). Moreover, companies that cultivate dynamic and innovative capabilities are more likely to gain customer recognition, which positively influences performance (Jiang et al., 2019). Based on this, the following hypothesis is proposed:

H5: Dynamic relational capability mediates innovation capability and financial performance of SMEs in the fashion industry

RESEARCH METHODOLOGY

Sample Design and Data Collection

This study focused on SMEs in the fashion industry of Central Java, Indonesia, encompassing businesses in clothing, batik, accessories, bags, and footwear (Mondol et al., 2021). The selection of this region was based on its significant contribution to national economic growth supported by strong business networks (Gonda et al., 2020), its demonstrated relational capability in fostering partnerships and driving innovation (Indriastuti, 2019), and its proven adaptability to evolving customer needs, which enhances overall performance (Rienda et al., 2020).

A quantitative research design was employed, involving a sample of 308 SMEs owners/managers. The sample size was determined in accordance with structural equation modeling (SEM) requirements, which recommend five to ten respondents per indicator (Hair et al., 2019). Respondents were selected using purposive sampling (Sekaran and Bougie, 2016) based on the criteria that they were owners or managers of fashion businesses operating in Central Java and had established cooperative relationships with partners. These criteria ensured that participants possessed relevant and comprehensive knowledge of their businesses. Data were collected through closed-ended questionnaires using a 10-point interval scale, which facilitates robust statistical analyses, including parametric tests and correlation measurements (Ferdinand, 2014; Nunnaly and Bernstein, 1994). The questionnaires were administered both online and through face-to-face interviews to improve response rates and data quality.

Measurements

The study employed measurement scales adapted from established literature to ensure validity and reliability. Innovation capability was measured using a five-item scale developed by Pascual-Fern´andez et al. (2021); Zhang and Hartley (2018). Dynamic relational capability was assessed through a six-item scale from Nyamrunda et al. (2021), while networking capability was measured using a three-item scale from Santos-Vijande et al. (2022). Financial performance was evaluated with a three-item scale from Pascual-Fern´andez et al. (2021). The detailed operational definitions and indicators for each construct are presented in Table 1.

Table 1 Operational variables and indicators

Construct	Indicator	References
Innovation Capability	Frequency of product innovation	(Pascual-Fern´andez et al., 2021; Zhang and Hartley, 2018)
	The ability to create creative ideas	
	The significance of generating new concepts	
	The liveliness of generating innovation	
	Developing new services	
Dynamic Relational Capability	Access partner information	(Nyamrunda et al., 2021)
	Knowledge sharing	
	Service development	
	Establishing effective communication	
	Social network learning	
	Collective team commitment	
Networking capapability	Ability to create network relationships	(Santos-Vijande et al., 2022)
	Ability to build collaboration with partners	
	Ability to manage and exploit partners	
Financial Performance	Sales growth	(Pascual-Fern´andez et al., 2021)
	Market share growth	
	Profits growth	

Data Analysis

Data analysis was performed using the partial least squares structural equation modeling (PLS-SEM) technique, which is well-suited for estimating causal relationships among latent variables and testing mediation effects within a single model (Tabachnick et al., 2013). The analysis was conducted using IBM SPSS Statistics version 25 and SmartPLS version 3. The PLS-SEM procedure consisted of two main stages: measurement model assessment, which evaluated the reliability and validity of the constructs, and structural model assessment, which examined the hypothesized relationships between variables. This approach prioritizes maximizing the explained variance of dependent variables while simultaneously predicting and testing the effects of independent variables (Benitez et al., 2020).

RESULT

This study involved owners and managers of SMEs in the fashion industry located across six former Residency areas in Central Java, namely Pekalongan, Semarang, Surakarta, Pati, Kedu, and Banyumas. Data collection was conducted from February to June 2024 through direct interviews (Bolderston, 2012) and online questionnaires distributed via Google Forms (Gupta et al., 2020). A total of 325 responses were received, of which 308 met the inclusion criteria, while the remainder were excluded due to respondents not being owners

or managers of fashion businesses or providing incomplete responses. The demographic and business profiles of respondents are presented in Table 2.

Table 2 Demographic and business profiles of the respondents

	Quantity	%
Gender		
Male	111	36%
Female	197	64%
Age		
< 30 years	93	30%
30-50 years	215	70%
Position		
Owner	205	67%
Manager	103	33%
Type of business		
Fashion	308	100%
Non Fashion	0	0%
Revenue		
< IDR 300 million	113	37%
IDR 300million-IDR 2,5 Billion	175	57%
IDR 2,5 Billion - IDR 50 Billion	20	6%
Number of networks		
No network	0	0%
1-2 network	108	35%
> 3 networks	200	65%
Length of network		
< 1 year	95	31%
> 1 year	213	69%

The majority of respondents were women (64%, n = 197), reflecting the strong association between female entrepreneurship and the aesthetic orientation of the fashion industry (Al-Mutawa et al., 2023; Cavusoglu and Atik, 2022). Most were between 30 and 50 years old (70%, n = 215), and owners (67%, n = 205) outnumbered managers (33%, n = 103). In terms of annual revenue, 57% (n = 175) reported earnings between IDR 300 million and 2.5 billion, while 37% (n = 113) earned less than IDR 300 million, and 6% (n = 20) earned between IDR 2.5 billion and IDR 50 billion. A substantial proportion (65%) maintained more than three business networks, which supports the formation of cross-regional partnerships, trust building, and effective information exchange (Nyamrunda et al., 2021). The remaining 35% reported having one to two networks, and none operated without any networking caponnections, in line with the purposive sampling criteria emphasizing established business relationships.

Model Reliability and Validity

Convergent validity analysis indicated that all constructs achieved an Average Variance Extracted (AVE) value above 0.50, satisfying the threshold suggested by Hair et al. (2019). Reliability analysis further showed that all constructs met the criteria for Composite Reliability (CR) and Cronbach's alpha (CA), with values exceeding 0.70. While CA values of 0.60 can still be acceptable, all constructs in this study surpassed the higher standard, confirming the reliability of the measurement items. The Standardized Root Mean Residual (SRMR) value of 0.079 indicated a good model fit, and the Normed Fit Index (NFI) value of 0.786, which approaches 1, further supported the model's adequacy (Hair et al., 2019). Table 3 presents the outer loadings, CA, CR, and AVE values for all constructs.

Table 3 Convergent validity, CA, CR and AVE

Construct	Indicator	Outer Loading	CA	CR	AVE
Innovation	IC1	0.833	0.744	0.854	0.661
Capability	IC2	0.827			
	IC3	0.779			
Dynamic	DRC1	0.848	0.794	0.866	0.619
Relational	DRC2	0.821			
Capability	DRC4	0.745			
	DRC6	0.727			
Network	NC1	0.904	0.905	0.94	0.84
Capability	NC2	0.936			
	NC3	0.909			
Financial	FP1	0.864	0.822	0.894	0.737
Performance	FP2	0.875			
	FP3	0.836			

Discriminant validity was assessed using the Fornell–Larcker criterion, with results showing that the square root of AVE for each construct exceeded its correlations with other constructs. For example, the AVE square root for dynamic relational capability (0.787) was higher than its correlations with financial performance (0.583), innovation capability (0.681), and networking capapability (0.567). Table 4 summarizes these results.

Table 4 Fornell-Larcker Criterion

Variable	Dynamic Relational Capability	Financial Performance	Innovation Capability	Networking Capability
Dynamic relational Cap.	0.787			
Financial performance	0.583	0.859		
Innovation capability	0.681	0.594	0.813	
Networking capapability	0.567	0.441	0.487	0.917

Discriminant validity was also evaluated using the Heterotrait–Monotrait Ratio (HTMT). Initial analysis revealed high correlations for several indicators (IC4, IC5, DRC3, and DRC5) with HTMT values exceeding 0.90, leading to their removal. After refinement, all HTMT values fell below 0.90 (Table 5), confirming the absence of discriminant validity concerns.

Table 5 Heterotrait-Monotrait Ratio (HTMT) for Discriminant Validity

	DRC	FP	IC	NC
DRC				
FP	0.726			
IC	0.882	0.761		
NC	0.659	0.510	0.592	

Structural Model Assessment

The structural model was evaluated using SmartPLS 3, with outer loadings exceeding 0.70 for all retained items, indicating strong correlations between indicators and their respective constructs (Figure 1). Hypothesis testing results are presented in Table 6.

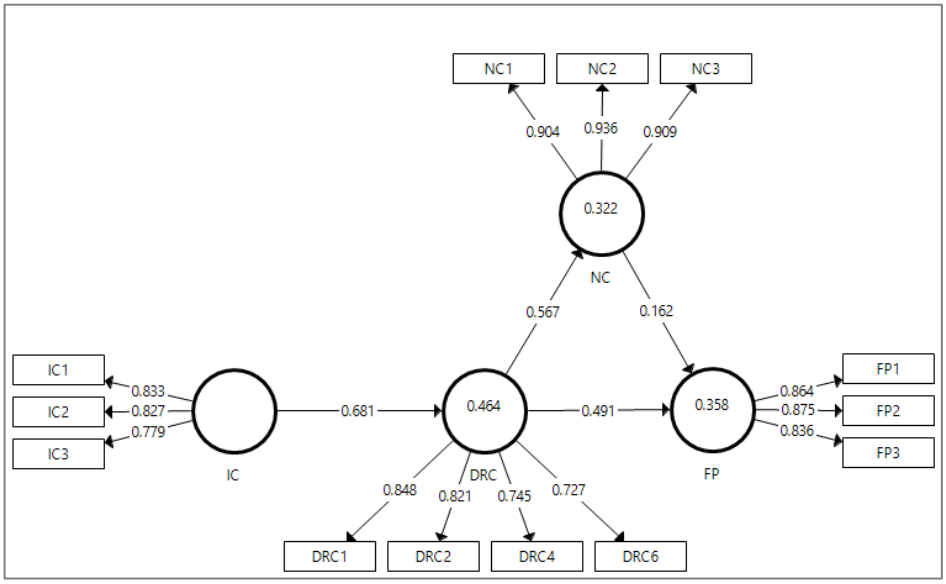

Figure 1 Standardized SEM calculation results

Hypothesis Testing

H1 was supported ($\beta = 0.681$, $t = 18.630$, $p < 0.001$), indicating that innovation capability positively and significantly influences dynamic relational capability. This suggests that higher innovation capability among SMEs in the fashion industry strengthens their ability to manage adaptive relationships. H2 was also supported ($\beta = 0.567$, $t = 11.060$, $p < 0.001$), confirming that dynamic relational capability positively and significantly affects networking capapability, meaning that stronger relational capacity enhances SMEs ability in the fashion industry to establish and manage business networks.

H3 was supported (β = 0.162, t = 2.633, p = 0.009), showing that networking capapability has a positive and significant effect on financial performance. This implies that broader and more effective networks contribute to improved financial outcomes. H4 was also supported (β = 0.491, t = 6.905, p < 0.001), demonstrating that dynamic relational capability directly and positively influences financial performance, with adaptive and sustainable relationships yielding better financial results. Finally, H5 was supported (β = 0.334, t = 5.987, p < 0.001), indicating that dynamic relational capability mediates the relationship between innovation capability and financial performance. This finding highlights that innovation capability enhances financial outcomes indirectly by strengthening business relationships among SMEs in the fashion industry.

Table 6 Results of the Direct and Indirect Effects

Hypothesis	Structural path	Beta (β)	Std Dev	T-value	P-value	Decision
H1	innovation capability → dynamic relational capability	0.681	0.037	18.630	0.000	Supported
H2	dynamic relational capability → networking capability	0.567	0.051	11.060	0.000	Supported
H3	networking capability → financial performance	0.162	0.062	2.633	0.009	Supported
H4	dynamic relational capability → financial performance	0.491	0.071	6.905	0.000	Supported
H5	innovation capability → dynamic relational capability→ financial performance	0.334	0.056	5.987	0.000	Supported

DISCUSSION

This study examined the role of innovation capability in enhancing the financial performance of SMEs in Central Java's fashion industry, using the Resource–Advantage (R-A) theory as the conceptual framework. Innovation capability is a critical driver of growth, value creation, and resilience, enabling SMEs to respond to changing market demands and strengthen competitiveness. From an R-A theory perspective, competitive advantage arises when firms leverage unique, difficult-to-imitate resources—such as innovation, relational networks, and market knowledge—to achieve superior performance (Hunt and Morgan, 1995).

The results confirm that higher innovation capability leads to stronger dynamic relational capability. Under the R-A theory, innovation capability is viewed as a strategic resource that provides comparative advantage by offering superior benefits to customers (Hunt and Morgan, 1995). Empirical evidence supports this view, showing that highly innovative SMEs are more adept at building long-term customer and partner relationships by delivering market-relevant solutions (Pigola et al. (2023). For SMEs in Central Java's fashion industry, innovation capability can be leveraged to identify emerging trends, develop creative products and services, and expand business networks (Pigola et al., 2023; Sabahi and Parast, 2020; Wang et al., 2023). Practical examples include introducing online ordering systems or personalized product designs, which can improve brand awareness and, in turn, enhance performance (Pramadyanto, 2022).

Dynamic relational capability was also found to significantly strengthen networking capapability. In R-A theory terms, this capability transforms business relationships—such as collaborations with suppliers, local designers, and distributors—into strategic assets that contribute to sustainable advantage (Hunt and Morgan, 1995). Prior studies on creative SMEs highlight how effective relationship management improves resource access and network reliability (Batra, 2020; Chuang, 2020; Manurung and Kurniawan, 2021). In practice, SMEs in Central Java's fashion industry can enhance this capability by offering affordable offline and online store options, collaborating with local artisans, and using social media to engage customers. These strategies enable firms to extend market reach and strengthen network resilience.

Networking capapability can improve the financial performance of SMEs in the fashion industry. In line with R-A theory, unique business networks serve as a source of sustainable competitive advantage (Hunt and Morgan, 1995), enhancing marketing and distribution performance through improved network accessibility and effective customer relationship management (Nupus and Ichwanudin, 2021). Networking capapability also functions as an isolating mechanism, protecting firms from competitive pressures (Hunt and Morgan, 1995). In practice, collaborations with batik artisans or fabric manufacturers can stimulate innovation and strengthen competitiveness (Mulyana and Wasitowati, 2021), while knowledge sharing within networks creates comparative advantages (Hunt and Morgan, 1995). Empirical evidence confirms that such networking significantly enhances both innovation and overall performance (Garousi Mokhtarzadeh et al., 2020), particularly during market crises when resilience and adaptability are critical (Wegner, Foguesatto, et al., 2023).

Dynamic relational capability also contributes directly to the financial performance of SMEs in the fashion industry. Consistent with the R-A theory perspective, this capability represents a unique, rare, and hard-to-imitate resource that fosters sustainable competitive advantage (Hunt and Morgan, 1995). Relational capability has been shown to improve SMEs performance (Abdul Rahman et al., 2023), especially in fashion, where building customer trust drives adaptability and agility. SMEs in the fashion industry owners and managers can strengthen this capability through relational knowledge sharing—an R-A theory–aligned mechanism for integrating unique resources. Practical approaches include creating online communities, such as Facebook or WhatsApp groups, to share fashion trends and collect customer feedback, thereby reinforcing partnerships. Research indicates that dynamic social media interactions enhance brand loyalty (Ngo and Vu, 2021), while community-based relational initiatives improve SMEs performance (Suarniki et al., 2019).

The findings also reveal that dynamic relational capability serves as a strategic bridge between innovation capability and financial performance. From the R-A theory perspective, this bridging role creates sustainable competitive advantage by combining unique relational resources with innovation capability (Hunt and Morgan, 1995). SMEs in the fashion industry can develop this capability through several approaches. First, collaborating with partners in design and service innovation can generate valuable network resources that drive performance, as seen in the Central Java batik industry (Ranatiwi and Mulyana, 2018). Second, personalizing customer experiences through testimonials and direct engagement builds strong, inimitable relationships that enhance business outcomes (Suryawijaya and Wardhani, 2023) Third, establishing customer communities fosters loyalty and creates imperfectly mobile resources that protect competitive advantage (Sarjiyanto et al., 2023). Collectively, these strategies demonstrate how dynamic relational capability, when integrated with innovation, acts as a critical driver of performance among SMEs in the fashion industry, supporting the emphasis placed by Nyamrunda et al. (2021).

CONCLUSIONS

The study demonstrates that dynamic relational capability significantly enhances both innovation capability and financial performance among SMEs in the fashion industry, echoing previous findings (Bahta et al., 2020; Waseem et al., 2018; YuSheng and Ibrahim, 2020). Innovation capability, when supported by strong relational networks, increases customer recognition and overall organizational performance (Aljuboori et al., 2021; Tang et al., 2023).

Within the R-A theory framework, the development of unique, customer-valued relational resources emerges as a key driver of financial success (Hunt and Morgan, 1996). The results reaffirm that innovation capability acts as a precursor to dynamic relational capability, which in turn strengthens financial outcomes, consistent with earlier studies (Aljuboori et al., 2021; AlNuaimi et al., 2021).

For practitioners, two strategic recommendations are offered. First, SMEs should develop innovation capability as a means of increasing value creation and long-term sustainability (Ferreira et al., 2020; Pascual-Fern´andez et al., 2021; Saunila, 2020). Second, strengthening dynamic relational capability through sustainable partnerships, intensive communication, knowledge sharing, and flexible collaboration can lead to substantial performance improvements (Nyamrunda et al., 2021).

Theoretical Implications

This research extends R-A theory in the context of SMEs in the fashion industry by demonstrating how dynamic relational capability functions as a critical differentiator. Well-managed relational resources act as isolating mechanisms that protect competitive advantage (Hunt and Morgan, 1995)**.** The findings show that integrating innovation and dynamic relationship management reinforces the theory's emphasis on resource integration for market success. The study also expands the theory by illustrating how the combination of dynamic capability and innovation fosters rapid adaptation to fashion trends, thereby creating a defensible market position.

Practical Implications

For owners and managers of fashion industry SMEs in Central Java, the results provide actionable strategies to enhance market competitiveness. Developing dynamic relational capability through collaborative

approaches with customers can improve loyalty and brand attachment. Personalizing customer experiences—such as collecting and showcasing testimonials or fostering community-based loyalty programs—can strengthen reputation and trust. Building strong networks with strategic partners, including suppliers and designers, can further consolidate the firm's competitive position in both domestic and regional markets.

Limitations and Future Research

While the study provides valuable insights, it is subject to certain limitations. The use of purposive sampling may limit the generalizability of the findings, as the sample might not fully reflect the diversity of SMEs in the fashion industry. Future research should seek broader representation based on firm size and geographic distribution. Additionally, the focus on the fashion sector leaves scope for exploring other creative industries, such as culinary businesses and handicrafts. Comparative studies across sectors could provide a more comprehensive understanding of how innovation capability interacts with relational resources to influence performance.

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