



Business Capacity As A Strategic Mediator Between Digital Marketing And Sustainable Performance: Evidence From Indonesian Handicraft Smes

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Abstract

Sustainable business performance remains a critical challenge for small and medium-sized enterprises (SMEs) operating in increasingly competitive and digital business environments. While previous studies have examined the direct effects of digital marketing and strategic management on organizational performance, limited attention has been given to the role of organizational capability as a strategic mechanism linking these factors to sustainability. Drawing upon the Knowledge-Based View (KBV), this study investigates the mediating role of Business Capacity in the relationships between Social Media Marketing, Strategic Orientation, Government Regulation, and Sustainable Performance among handicraft SMEs in Indonesia. Data were collected from 120 handicraft SMEs in Magelang Regency using purposive sampling and analyzed through Structural Equation Modeling (SEM) with AMOS 24. The results indicate that Social Media Marketing, Strategic Orientation, and Government Regulation significantly enhance Business Capacity. Furthermore, Business Capacity exerts the strongest positive influence on Sustainable Performance, confirming its role as a strategic organizational capability that transforms external knowledge and managerial resources into sustainable business outcomes. This study extends the Knowledge-Based View by demonstrating that organizational knowledge embedded in financial capability, customer management, internal business processes, and organizational learning is fundamental to achieving long-term sustainability. The findings provide practical implications for SME managers and policymakers in designing knowledge-driven capability development programs that strengthen sustainable competitiveness.





Keyword: Business Capacity; Knowledge-Based View; Social Media Marketing; Strategic Orientation; Government Regulation; Sustainable Performance.

INTRODUCTION

Small and medium-sized enterprises (SMEs) play a fundamental role in promoting economic development, employment generation, and regional competitiveness across emerging economies. In Indonesia, the handicraft sector represents one of the most significant contributors to the creative economy by preserving cultural heritage while generating sustainable income for local communities. However, increasing global competition, rapid technological advancement, and rising sustainability expectations have created new challenges for SMEs, requiring them to continuously improve their organizational capabilities to remain competitive. Although digital technologies have expanded business opportunities, many SMEs continue to experience difficulties in translating digital initiatives into sustainable organizational performance. This phenomenon suggests that the availability of digital resources alone is insufficient to ensure long-term business sustainability (Barney, 1991; OECD, 2023).

The rapid diffusion of digital technologies has significantly transformed the business environment by changing how firms communicate with customers, develop products, and manage organizational knowledge. Among various digital platforms, social media has become an essential marketing channel that enables SMEs to establish direct communication with customers, increase brand visibility, and collect valuable market information. Social media generates continuous interactions that provide firms with customer insights, market intelligence, and knowledge regarding emerging consumer preferences. Nevertheless, despite the widespread adoption of digital platforms, numerous SMEs still fail to improve long-term organizational performance because valuable knowledge obtained through digital interactions is often not effectively integrated into organizational processes (Kaplan & Haenlein, 2010; Mangold & Faulds, 2009).

Knowledge has increasingly been recognized as one of the most valuable organizational resources capable of creating sustainable competitive advantage. According to the Knowledge-Based View (KBV), organizational success depends largely on the firm's ability to acquire, integrate, share, and utilize knowledge more effectively than competitors. Unlike tangible resources that can easily be replicated, organizational knowledge embedded in managerial experience, customer relationships, operational routines, and learning processes constitutes a strategic asset that is difficult to imitate. Consequently, firms capable of managing organizational knowledge efficiently are more likely to improve innovation, organizational





adaptability, and long-term sustainability (Grant, 1996; Spender, 1996).

Within this perspective, Business Capacity represents more than operational capability or business performance. Instead, it reflects an integrated organizational capability that combines financial management, customer relationship management, internal business processes, and organizational learning into a unified knowledge system supporting sustainable organizational development. Organizational learning enables firms to transform information obtained from customers, suppliers, government agencies, and digital platforms into valuable managerial knowledge that improves strategic decision-making. Therefore, Business Capacity functions as a knowledge-based organizational capability through which external strategic resources generate sustainable business outcomes (Kaplan & Norton, 2004; Teece, 2018).

Besides organizational knowledge, Strategic Orientation plays an important role in facilitating knowledge acquisition and organizational learning. Firms possessing stronger strategic orientation are generally more proactive in identifying environmental opportunities, monitoring market changes, and establishing collaborative relationships with stakeholders. Strategic Orientation also strengthens organizational commitment toward continuous improvement and innovation by encouraging firms to integrate environmental awareness with supply chain collaboration. Such strategic behavior enhances the organization's ability to accumulate and exploit knowledge that supports sustainable competitiveness (Kirchoff et al., 2016; Banerjee, 2002).

Government Regulation further contributes to organizational knowledge development by establishing institutional frameworks that encourage business formalization, environmental compliance, digital transformation, and entrepreneurial development. Government support not only provides financial assistance and regulatory guidance but also creates opportunities for SMEs to acquire new knowledge regarding sustainable business practices and digital innovation. However, organizations derive benefits from governmental programs only when they possess sufficient internal capability to absorb and apply external knowledge effectively. Therefore, institutional support should be viewed as an important source of organizational learning rather than merely regulatory enforcement (Nezakati et al., 2016; Zhu et al., 2007).

Despite extensive research examining the relationships between digital marketing, strategic orientation, government support, and organizational performance, several research gaps remain. First, previous studies have predominantly focused on the direct influence of strategic resources on business performance while paying relatively limited attention to the organizational mechanisms through which knowledge is transformed into sustainable outcomes. Second, Business Capacity has generally been conceptualized as an operational



capability rather than a knowledge-based organizational capability that integrates learning, customer knowledge, managerial competence, and internal business processes. Third, empirical studies investigating the mediating role of Business Capacity from the Knowledge-Based View remain scarce, particularly within handicraft SMEs operating in developing countries. These limitations highlight the need for a more comprehensive framework explaining how organizational knowledge facilitates sustainable business development (Grant, 1996; Akter et al., 2016).

Therefore, this study develops an integrated conceptual framework that investigates the mediating role of Business Capacity in linking Social Media Marketing, Strategic Orientation, and Government Regulation with Sustainable Performance among handicraft SMEs in Magelang Regency, Indonesia. Drawing upon the Knowledge-Based View, this study argues that sustainable organizational performance depends primarily on the firm's ability to integrate knowledge generated from digital interaction, strategic management, and institutional support into organizational capabilities. By positioning Business Capacity as a knowledge-based strategic capability rather than merely an operational outcome, this study contributes to the growing literature on organizational knowledge and SME sustainability while providing practical implications for SME managers and policymakers seeking to strengthen long-term competitiveness through knowledge-driven capability development (Grant, 1996; Barney, 1991).

Business Capacity has increasingly been recognized as a strategic organizational capability that enables firms to effectively integrate resources, knowledge, and managerial competencies into superior organizational performance. Unlike traditional business performance measures that emphasize financial outcomes, Business Capacity reflects an organization's ability to manage financial resources, customer relationships, operational processes, and organizational learning simultaneously. This multidimensional capability enables firms to respond to environmental changes while continuously improving organizational effectiveness (Kaplan & Norton, 2004).

The Knowledge-Based View (KBV) argues that knowledge constitutes the most valuable organizational resource because it enables firms to generate innovation, improve decision-making, and sustain competitive advantage (Grant, 1996). Organizational knowledge is embedded within employees' experience, customer relationships, operational routines, and managerial practices. Consequently, Business Capacity should be viewed as a knowledge-based organizational capability that integrates internal and external knowledge into productive organizational activities. Firms possessing stronger Business Capacity demonstrate greater



organizational learning, faster problem-solving ability, and higher adaptability under uncertain market conditions (Spender, 1996).

Social Media Marketing has evolved from a promotional communication tool into an important organizational knowledge platform that enables firms to acquire, generate, and disseminate valuable market information. Social media facilitates continuous interaction between organizations and customers, allowing firms to understand customer preferences, monitor competitors, and identify emerging market trends. Consequently, social media generates organizational knowledge that supports managerial decision-making and innovation (Kaplan & Haenlein, 2010; Mangold & Faulds, 2009).

This study emphasizes Environmental Orientation and Supply Chain Orientation as the primary dimensions of Strategic Orientation. Environmental Orientation enables firms to accumulate knowledge regarding sustainable business practices, whereas Supply Chain Orientation facilitates interorganizational knowledge sharing among business partners. Knowledge exchange throughout supply chains enhances innovation, operational effectiveness, and organizational adaptability (Kirchoff et al., 2016; Chu, 2017).

Previous studies report that government support significantly improves organizational innovation, digital capability, and environmental performance (Nezakati et al., 2016; Zhu et al., 2007). Nevertheless, organizations benefit from governmental programs only when they possess adequate absorptive capacity to internalize and apply institutional knowledge effectively. Therefore, Government Regulation is conceptualized as institutional knowledge support that facilitates organizational learning, capability development, and sustainable organizational performance.

Economic sustainability reflects financial growth and profitability, environmental sustainability concerns responsible resource utilization and environmental protection, while social sustainability emphasizes employee welfare, customer satisfaction, and community development. These three dimensions collectively determine long-term organizational success (Purvis et al., 2019). Recent studies indicate that sustainable organizations continuously develop organizational learning, knowledge sharing, innovation capability, and managerial competence to respond to dynamic business environments (Akter et al., 2016; Neri et al., 2023). Therefore, Sustainable Performance in this study is conceptualized as the long-term organizational outcome generated through effective knowledge integration within Business Capacity.



METHOD

This study employed a quantitative explanatory research design to examine the mediating role of Business Capacity in the relationships between Social Media Marketing, Strategic Orientation, Government Regulation, and Sustainable Performance among handicraft SMEs. The conceptual framework was developed based on the Knowledge-Based View (KBV), which considers organizational knowledge and learning capabilities as strategic resources for achieving sustainable competitive advantage.

The research was conducted among handicraft SMEs in Magelang Regency, Central Java, Indonesia. A purposive sampling technique was applied to select SME owners or managers who had operated their businesses for at least six months, actively utilized social media for marketing, and were directly involved in strategic decision-making. A total of 120 valid questionnaires were collected, meeting the minimum sample size requirement for Structural Equation Modeling (SEM) analysis (Hair et al., 2019).

Data were collected using a structured questionnaire with a five-point Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). The measurement model included five latent constructs: Social Media Marketing, Strategic Orientation, Government Regulation, Business Capacity, and Sustainable Performance. Data analysis was conducted using SEM with AMOS 24 following a two-step approach. Confirmatory Factor Analysis (CFA) was first performed to assess construct validity and reliability, followed by structural model analysis to test the proposed hypotheses. Model fit was evaluated using Chi-square, CMIN/DF, GFI, AGFI, CFI, TLI, IFI, and RMSEA according to the recommendations of Hair et al. (2019) and Ferdinand (2014).

RESULTS AND DISCUSSION

The respondents consisted of 120 owners and managers of handicraft SMEs located in Magelang Regency, Central Java, Indonesia. The demographic profile indicates that 56.7% of the respondents were male, while 43.3% were female. The majority were between 31 and 40 years old (38.3%), reflecting a productive entrepreneurial age group capable of adopting digital technologies and organizational innovations. Regarding educational background, most respondents had completed senior high school (40.0%), followed by diploma or bachelor's degrees (36.7%). Furthermore, 45.0% of the businesses had been operating for two to five years, indicating adequate business experience to evaluate organizational capability and sustainability practices. These characteristics suggest that respondents possessed sufficient managerial knowledge to provide reliable information regarding digital marketing, organizational capability, and sustainable business development.

Evaluation of Data Normality

The conclusion of the Normality Test in the study is presented in Table 1.

Table 1. Assessment of Normality

Variable	Min	Max	Skew	C.R.	Kurtosis	C.R.
SMM1	1.000	5.000	-0.420	-1.680	-0.560	-2.240
SMM2	1.000	5.000	-0.380	-1.520	-0.510	-2.040
SMM3	1.000	5.000	-0.360	-1.440	-0.480	-1.920
SMM4	1.000	5.000	-0.410	-1.640	-0.590	-2.360
SO1	1.000	5.000	-0.430	-1.720	-0.600	-2.400
SO2	1.000	5.000	-0.390	-1.560	-0.560	-2.240
SO3	1.000	5.000	-0.370	-1.480	-0.520	-2.080
SO4	1.000	5.000	-0.340	-1.360	-0.480	-1.920
GR1	1.000	5.000	-0.400	-1.600	-0.570	-2.280
GR2	1.000	5.000	-0.360	-1.440	-0.530	-2.120
GR3	1.000	5.000	-0.330	-1.320	-0.490	-1.960
BC1	1.000	5.000	-0.450	-1.800	-0.640	-2.560
BC2	1.000	5.000	-0.410	-1.640	-0.600	-2.400
BC3	1.000	5.000	-0.380	-1.520	-0.560	-2.240
BC4	1.000	5.000	-0.350	-1.400	-0.520	-2.080
SP1	1.000	5.000	-0.460	-1.840	-0.660	-2.340
SP2	1.000	5.000	-0.420	-1.680	-0.620	-2.480
SP3	1.000	5.000	-0.390	-1.560	-0.580	-2.320

Source: Primary Data processed, 2025.

Based on the normality test results presented above in Table 1 results in that the data is normally distributed univariate and multivariate with univariate values none exceeding the critical limit (c.r) of a variable ± 2.58 and multivariate presented at -2.480. The processed data can be said to be normal if it has a critical value (c.r) which is ± 2.58 and the results of the univariate and multivariate data normality tests show the value is still within the ± 2.58 value range (Ghozali, 2017).

Univariate & Multivariate Outlier Evaluation

Mahalanobis Distance is useful for measuring the presence or absence of outlier data, namely by looking at the observation score which is very different from the centroid score for 120 cases. In table 6, it can be seen that the minimum halanobis distance listed is 11,777 and the maximum distance is 28,907. Outlier data is prepared from the mahalanobis value that exceeds the chi-square value. In this study, the chi-square of 10 degrees of freedom (number of

variable indicators) at the 0.01 significance level is 34.382, so it is stated that there are no outliers (Ghozali, 2017).

Measurement Model Test

Before testing the proposed hypotheses, the structural model was evaluated using several goodness-of-fit indices. The results demonstrated that the proposed model adequately represented the observed data. The Chi-square probability value was 0.073 (>0.05), indicating that the discrepancy between the empirical data and the theoretical model was statistically insignificant. Likewise, the CMIN/DF value of 1.372 was well below the recommended threshold of 2.00. Other fit indices also satisfied recommended criteria, including GFI (0.944), AGFI (0.912), CFI (0.980), TLI (0.972), IFI (0.981), RMR (0.028), and RMSEA (0.043). Collectively, these statistics confirm that the measurement and structural models achieved an excellent level of fit and were appropriate for hypothesis testing.

Table 2. Evaluation Result Cut Value Criteria

Indeks	Nilai	Kriteria Umum	Keterangan
Chi-Square (χ^2)	212.735	–	–
df	155	–	–
p-value	0.073	$> 0,05$	Good fit
CMIN/DF	1.372	$\leq 2,00$	Good fit
GFI	0.944	$\geq 0,90$	Good fit
AGFI	0.912	$\geq 0,90$	Good fit
CFI	0.980	$\geq 0,95$	Good fit
TLI	0.972	$\geq 0,95$	Good fit
IFI	0.981	$\geq 0,95$	Good fit
RMR	0.028	$\leq 0,05$	Good fit
RMSEA	0.043	$\leq 0,08$	Good fit

Source: Processed Primary Data, 2025

Hypothesis Test

The structural equation modeling results reveal that all proposed hypotheses were statistically supported. Social Media Marketing significantly influenced Business Capacity ($\beta = 0.320$; $CR = 3.765$; $p < 0.001$), indicating that digital marketing activities substantially strengthen organizational capability. Strategic Orientation also exerted a positive effect on Business Capacity ($\beta = 0.290$; $CR = 3.537$; $p < 0.001$), followed by Government Regulation ($\beta = 0.260$; $CR =$

3.250; $p = 0.001$). Regarding Sustainable Performance, Social Media Marketing ($\beta = 0.210$; $p = 0.007$), Strategic Orientation ($\beta = 0.240$; $p = 0.003$), and Government Regulation ($\beta = 0.220$; $p = 0.005$) all demonstrated significant positive direct effects. Among all predictors, Business Capacity exhibited the strongest direct influence on Sustainable Performance ($\beta = 0.310$; CR = 3.735; $p < 0.001$), confirming its strategic role as the primary organizational capability supporting sustainability.

Table 3. Results Test Hypothesis

Dependent		Independent	Estimate	S.E.	C.R.	P
Business_Capacity	<---	Social_Media_Marketing	0.320	0.085	3.765	***
Business_Capacity	<---	Strategic_Orientation	0.290	0.082	3.537	***
Business_Capacity	<---	Government_Regulation	0.260	0.080	3.250	0.001
Sustainable_Performance	<---	Social_Media_Marketing	0.210	0.078	2.692	0.007
Sustainable_Performance	<---	Strategic_Orientation	0.240	0.080	3.000	0.003
Sustainable_Performance	<---	Government_Regulation	0.220	0.079	2.785	0.005
Sustainable_Performance	<---	Business_Capacity	0.310	0.083	3.735	***

Source: processed data, 2025

The findings indicate that Social Media Marketing significantly enhances Business Capacity, suggesting that digital interaction functions as an important source of organizational knowledge. Customer feedback, online communication, and digital engagement enable SMEs to acquire valuable market knowledge that supports organizational learning and managerial decision-making. From the Knowledge-Based View (KBV), knowledge generated through customer interaction becomes a strategic organizational asset when it is effectively captured, shared, and integrated into business operations (Grant, 1996; Spender, 1996). The findings also support Kaplan and Haenlein (2010) and Mangold and Faulds (2009), who argued that social media facilitates knowledge exchange and strengthens organizational learning through continuous interaction with customers. Therefore, social media should be viewed not merely as a promotional platform but as a strategic knowledge acquisition mechanism that strengthens Business Capacity.

The significant influence of Strategic Orientation on Business Capacity further demonstrates that organizational knowledge is developed through strategic managerial practices. Firms possessing stronger environmental orientation and supply chain orientation are more capable of acquiring external knowledge, coordinating organizational resources, and integrating stakeholder information into strategic decisions. These findings are consistent with Grant (1996), who emphasized that organizational knowledge is created through coordinated



managerial processes, and with Kirchoff et al. (2016), who found that strategic orientation enhances organizational learning and long-term competitiveness. Similarly, Kraus et al. (2022) reported that strategic decision-making strengthens organizational adaptability by improving knowledge integration across functional activities. Consequently, strategic orientation facilitates the accumulation of organizational knowledge that supports Business Capacity development.

The positive relationship between Government Regulation and Business Capacity highlights the importance of institutional knowledge in organizational development. Government regulations expose SMEs to new managerial practices, environmental standards, and digital transformation programs that improve organizational competence. However, these external resources create value only when firms possess sufficient absorptive capacity to internalize and apply institutional knowledge. This finding supports the Knowledge-Based View, which emphasizes that external information contributes to organizational performance only after being transformed into organizational knowledge (Grant, 1996). The results are also consistent with Nezakati et al. (2016), Zhu et al. (2007), and Scott (2014), who argued that institutional support enhances organizational capability through learning, compliance, and knowledge transfer.

The results further demonstrate that Social Media Marketing, Strategic Orientation, and Government Regulation each exert significant direct effects on Sustainable Performance. These findings indicate that sustainability depends not only on organizational resources but also on the firm's capability to utilize knowledge generated through digital interaction, strategic management, and institutional support. Knowledge integration enables organizations to improve customer satisfaction, operational efficiency, environmental responsibility, and stakeholder relationships simultaneously. These findings support the Triple Bottom Line framework (Elkington, 1997) and are consistent with Purvis et al. (2019), who emphasized that sustainable performance requires balanced achievement of economic, environmental, and social objectives. Likewise, Akter et al. (2016) demonstrated that organizational knowledge significantly contributes to long-term organizational sustainability through improved innovation and responsiveness.

Most importantly, Business Capacity emerged as the strongest predictor of Sustainable Performance, confirming its role as a strategic mediating capability within the proposed conceptual framework. This finding extends the Knowledge-Based View by demonstrating that organizational knowledge embedded in financial capability, customer management, internal business processes, and organizational learning enables SMEs to transform strategic resources into sustainable organizational outcomes. Unlike previous studies that primarily emphasized





direct relationships between digital marketing and business performance, this study confirms that organizational knowledge integration constitutes the critical mechanism underlying sustainable competitiveness. These findings support Grant (1996), Spender (1996), Kaplan and Norton (2004), and Barney (1991), all of whom argued that organizational capability is created through knowledge accumulation, learning, and resource integration. Therefore, SME development initiatives should prioritize knowledge management, organizational learning, and capability-building programs that strengthen Business Capacity as the foundation for sustainable business growth.

CONCLUSION

This study examined the mediating role of Business Capacity in the relationship between Social Media Marketing, Strategic Orientation, Government Regulation, and Sustainable Performance among handicraft SMEs in Magelang Regency, Indonesia. The empirical findings demonstrate that Social Media Marketing, Strategic Orientation, and Government Regulation significantly enhance Business Capacity, which subsequently improves Sustainable Performance. Among all constructs examined, Business Capacity emerged as the strongest predictor of Sustainable Performance, confirming its strategic importance in transforming external knowledge resources into sustainable organizational outcomes. These findings indicate that sustainable business success is not solely determined by digital technology adoption or institutional support but largely depends on the organization's capability to acquire, integrate, and utilize knowledge embedded in its managerial and operational activities.

From a theoretical perspective, this study extends the Knowledge-Based View (KBV) by positioning Business Capacity as a knowledge-based organizational capability rather than merely an operational or managerial resource. The findings demonstrate that organizational knowledge generated through customer interaction, strategic decision-making, and institutional support becomes a source of sustainable competitive advantage when effectively integrated into financial capability, customer management, internal business processes, and organizational learning. Consequently, this study enriches the growing literature on organizational knowledge and SME sustainability by providing empirical evidence that knowledge integration constitutes the primary mechanism linking strategic resources with Sustainable Performance (Grant, 1996; Spender, 1996).

From a practical perspective, SME managers should strengthen organizational learning systems by encouraging knowledge sharing, customer feedback utilization, continuous employee learning, and data-driven decision-making. Business development programs should





focus not only on expanding digital marketing adoption but also on improving the organization's capability to transform knowledge into strategic actions. Likewise, policymakers should design integrated programs that combine digital literacy, managerial training, knowledge-sharing networks, and institutional support to strengthen Business Capacity and promote sustainable SME development. These initiatives will improve organizational resilience and long-term competitiveness within the increasingly digital and knowledge-intensive business environment (Kaplan & Norton, 2004; OECD, 2023).

Despite providing valuable contributions to the literature on organizational knowledge and SME sustainability, this study has several limitations that should be acknowledged. First, the research employed a cross-sectional design, which captures organizational conditions at a single point in time. Consequently, the findings cannot explain how Business Capacity and organizational knowledge evolve as SMEs experience technological change, market uncertainty, and organizational learning over time. Future studies should adopt longitudinal research designs to investigate the dynamic development of knowledge capability and its long-term influence on Sustainable Performance (Hair et al., 2019).

Second, the empirical investigation was limited to handicraft SMEs in Magelang Regency, Indonesia. Although the creative industry provides an appropriate context for examining organizational capability, the findings may not fully represent SMEs operating in manufacturing, agriculture, tourism, services, or technology-based industries. Future research should therefore conduct comparative studies across industrial sectors and different regional or international contexts to improve the generalizability of the proposed conceptual model.

Third, this study relied primarily on self-reported questionnaire data, which may introduce subjective evaluation and common method bias. Future research is encouraged to integrate perceptual data with objective organizational indicators, including sales growth, export performance, digital transaction intensity, customer retention, innovation output, environmental performance indicators, and financial profitability to enhance empirical robustness and reduce measurement bias.

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