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THE ROLE OF THE CREATIVE ECONOMY IN ENHANCING THE COMPETITIVENESS OF TRADITIONAL HERBAL SMES: A MEDIATION ANALYSIS OF INNOVATION CAPABILITY

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Abstract

The rapid development of the creative economy requires traditional herbal small and medium enterprises (SMEs) to improve their competitiveness. However, many herbal SMEs still face challenges in innovation, packaging, and marketing. This study aims to analyze how strengthening innovation capability can enhance the competitiveness of traditional herbal SMEs. The research employed a quantitative approach using a survey of 70 traditional herbal SME owners and managers. Data were analyzed using descriptive statistics, reliability and validity testing, correlation analysis, path analysis, and mediation analysis. The results show that digital media, storytelling, and collaboration positively influence innovation capability, while product innovation has a negative effect. Furthermore, innovation capability strongly mediates the relationship between creative economy elements and competitiveness, with digital media being the most dominant factor. These findings highlight the importance of digital literacy, collaboration, and authentic product narratives in strengthening the competitiveness of traditional herbal SMEs.

Keywords: *creative economy, innovation capability, competitiveness, traditional herbal medicine MSMEs, digital media*

INTRODUCTION

Micro, small, and medium enterprises (SMEs) play a critical role in sustaining Indonesia's economy. In 2023, SMEs contributed 61% to the gross domestic product (GDP), or approximately IDR 9,580 trillion, while absorbing nearly 97% of the total workforce (Fahrika & Roy, 2020; Kementerian Koperasi dan UKM RI, 2023). At the same time, the government has promoted the creative economy as an alternative pathway for sustainable growth. In 2019, the creative economy accounted for 5.45% of GDP with 16.91 million workers involved, and its contribution is projected to rise to 6.10% in 2025 (Mas'ud & Susilo, 2023; Mulyani et al., 2020; Syahbudi et al., 2025). These figures highlight the strategic importance of creative economy growth in strengthening national competitiveness (Hidayat et al., 2024; Setiyawan & Isa, 2022)

One of the industries that bridges cultural heritage and creative potential is the traditional herbal medicine sector, commonly known as *jamu*. The Nguter Herbal Center in Sukoharjo, Central Java, is recognized as one of the largest traditional herbal clusters in Indonesia,

consisting a lot of SMEs engaged in the production and distribution of herbal products. The cluster contributes significantly to local economic activity by supplying traditional herbal products to regional and national markets. Despite its long-standing reputation and production capacity, many herbal SMEs in Nguter continue to face challenges in maintaining competitiveness, particularly in product differentiation, digital marketing adoption, packaging innovation, and market expansion. While demand for health and wellness products continues to increase, many SMEs still rely on traditional business practices and have not fully utilized creative economy strategies to enhance their performance. This situation creates an important research context because the cluster possesses strong cultural and economic potential, yet its competitive advantage remains uneven across businesses. Understanding how creative economy elements can strengthen innovation capability and competitiveness is therefore essential for ensuring the sustainability and growth of traditional herbal SMEs (Purnaningsih et al., 2017; Wicaksono et al., 2018). The area integrates upstream and downstream processes, from raw material processing to product distribution (Albarqi et al., 2019; Batubara et al., 2020). Despite its significance, this sector faces persistent challenges, such as reliance on conventional production methods, limited marketing strategies, restricted access to finance, and underdeveloped business networks (Astuti, 2021; Hasanatun et al., 2024). These obstacles reduce the competitiveness of traditional herbal SMEs, especially compared with modern wellness products that rely heavily on innovation and branding strategies (Hariyanur et al., 2022).

To overcome these barriers, integrating creative economy elements becomes essential. Packaging design, storytelling, digital media adoption, collaboration, and product innovation are believed to enhance the innovation capability of SMEs (Hendrayadi et al., 2023; Sugiyono, 2015, 2020). Innovation capability is a strategic asset that enables organizations to transform creative resources into sustainable competitive advantage (Moreira et al., 2024; Sabarini & Hendayana, 2025). Prior research emphasizes the role of innovation capability as both mediator and moderator in shaping firm performance, particularly through interactions with marketing capability and product development (Aljanabi, 2022; Syahbudi et al., 2025). However, empirical studies focusing on innovation capability within cultural-based industries, such as traditional herbal medicine, remain limited (Mas'ud & Susilo, 2023).

This research addresses the gap by employing a quantitative approach to examine the relationships among creative economy elements, innovation capability, and competitiveness in traditional herbal SMEs. Unlike previous studies that focused on efficiency or supply chain

management, this study integrates creative economy dimensions and innovation capability within a single empirical framework (Hendrayadi et al., 2023; Sugiyono, 2020). Unlike previous studies that focused on efficiency or supply chain management (Setiyawan et al., 2024; Setiyawan & Isa, 2022), this study integrates creative economy dimensions with cultural heritage and innovation capability. This provides novelty by connecting digital transformation, cultural values, and innovation strategies within one framework (Aljanabi, 2022; Moreira et al., 2024).

Therefore, the objectives of this research are threefold: first, to analyze the role of creative economy elements in strengthening competitiveness of traditional herbal SMEs; second, to examine the mediating effect of innovation capability in transforming creative resources into competitive advantage; and third, to provide strategic recommendations for enhancing the sustainability and global reach of traditional herbal SMEs in Indonesia (Setiyawan & Rofifudin, 2024).

SMEs and Creative Economy Growth

Prior studies consistently emphasize that SMEs not only drive national economies but also act as catalysts for innovation and employment creation (Kementerian Koperasi & UKM, 2023; Fahrika & Roy, 2020). The creative economy has been recognized as a crucial growth engine, where innovation, culture, and digitalization reshape competitive structures (Mas'ud & Susilo, 2023; Syahbudi, Ramadhani, & Barus, 2025). Researchers argue that SMEs that integrate creative economy elements are better positioned to withstand global competition and economic turbulence (Mulyani, Mafruhah, Ismoyowati, & Istiqomah, 2020; Setiyawan & Isa, 2022). This stream of literature strengthens the logic that embedding creative economy strategies in SMEs—especially those rooted in cultural heritage—can unlock sustainable growth (Hidayat, Qurotulaini, Safitri, & Novitasari, 2024; Setiyawan, Erikawati, & Setyawan, 2024).

Innovation Capability and Competitiveness

Theoretical and empirical research suggests that innovation capability plays a pivotal role in linking resources to outcomes. Studies show that firms with strong innovation capability transform creative inputs into competitive advantage by fostering adaptability, collaboration, and market responsiveness (Aljanabi, 2022; Moreira, Navaia, & Ribau, 2024). Evidence from SMEs highlights that innovation capability enhances not only product development but also organizational learning and marketing effectiveness (Syahbudi et al., 2025; Sabarini & Hendayana, 2025). In the Indonesian context, scholars note that innovation capability allows

SMEs to compete in industries dominated by large players through differentiation and authenticity (Mas'ud & Susilo, 2023; Astuti, 2021). This body of research strengthens the rationale for positioning innovation capability as a mediating factor.

Creative Economy Strategies for SMEs

Research has demonstrated that creative economy strategies—particularly digital platforms, storytelling, and packaging innovation—significantly improve SMEs' market performance (Sugiyono, 2015; Sugiyono, 2020; Hendrayadi, Kustati, & Sepriyanti, 2023). Storytelling builds consumer trust and cultural identity, while digitalization expands market access and lowers transaction costs (Hasanatun et al., 2024; Hidayat et al., 2024). Studies also indicate that collaboration, often framed in the pentahelix model, provides SMEs with access to knowledge and networks that they could not achieve alone (Mas'ud & Susilo, 2023; Setiyawan & Rofifudin, 2024). These findings strengthen the argument that creative economy practices enhance innovation capability and competitiveness in traditional industries.

Challenges in Herbal SMEs

Empirical studies on herbal SMEs highlight persistent obstacles such as reliance on hereditary methods, limited technological adoption, and weak institutional support (Wicaksono, Rahayu, & Mukaromah, 2018; Purnaningsih, Mawasti, & Saraswati, 2017). Research indicates that these barriers hinder innovation and reduce competitiveness compared with modern health and wellness products (Batubara, Purnaningsih, & Mawasti, 2020; Hariyanur, Septiyanti, & Idris, 2022). However, scholars also underline that cultural authenticity and heritage-based branding provide unique advantages if integrated with creative economy elements (Astuti, 2021; Hasanatun et al., 2024). Thus, the literature supports the logic that herbal SMEs need innovation-oriented transformation to remain competitive.

Empirical Gaps in Research

Although various studies address SMEs, creative economy, and innovation capability, few explicitly examine how innovation capability mediates the relationship between creative economy strategies and competitiveness in cultural industries (Mas'ud & Susilo, 2023; Aljanabi, 2022). Most existing research has been conducted in technology-driven or manufacturing sectors (Setiyawan & Isa, 2022; Syahbudi et al., 2025; Setiyawan, Erikawati, & Setyawan, 2024). This leaves a research gap concerning herbal SMEs, which combine cultural heritage with economic potential (Astuti, 2021; Moreira et al., 2024). Addressing this gap is

crucial for expanding theoretical understanding while generating context-specific recommendations for SME sustainability.

This study builds on the existing literature by integrating creative economy theories, SME innovation studies, and cultural industry perspectives into a single framework. By employing a quantitative empirical approach, this study provides statistical evidence regarding the mediating role of innovation capability in the relationship between creative economy elements and competitive advantage. (Sugiyono, 2015; Sugiyono, 2020; Hendrayadi et al., 2023). Scholars highlight the importance of methodological integration to produce nuanced evidence that informs both theory and practice (Moreira et al., 2024; Sabarini & Hendayana, 2025). The novelty lies in demonstrating how digital platforms, storytelling, and collaboration collectively strengthen innovation capability and, in turn, competitiveness among herbal SMEs (Hasanatur et al., 2024; Setiyawan & Rofifudin, 2024). This approach strengthens theoretical contributions while offering practical solutions for Indonesia's creative economy development.

RESEARCH METHOD

This study employed a quantitative research approach to examine the role of creative economy elements in enhancing the competitiveness of traditional herbal SMEs through innovation capability. The research was conducted at the Nguter Herbal Center, Sukoharjo, Central Java, which is recognized as one of Indonesia's largest traditional herbal industry clusters.

The population consisted of owners and managers of traditional herbal SMEs operating within the cluster. Data were collected using a structured questionnaire distributed directly to respondents. A total of 70 valid responses were obtained and analyzed. The questionnaire items were adapted from previous studies on creative economy, innovation capability, and competitive advantage, and were modified to fit the context of traditional herbal SMEs.

The study examined five dimensions of the creative economy as independent variables, namely packaging design, storytelling, digital media, collaboration, and product innovation. Innovation capability was positioned as the mediating variable, while competitive advantage served as the dependent variable.

Data analysis was carried out using several stages. First, descriptive statistics were employed to describe respondents' perceptions of each variable. Second, reliability and validity tests were conducted to ensure the quality of the measurement instrument. Third, Pearson correlation analysis was used to identify the relationships among variables. Finally, path analysis was performed to examine the direct and indirect effects of creative economy elements on competitive advantage through innovation capability as a mediating variable.

This quantitative approach provides empirical evidence regarding the mechanisms through which creative economy practices contribute to strengthening the competitiveness of traditional herbal SMEs. The analytical framework enables a comprehensive assessment of both direct and mediated relationships among the variables investigated.

RESULTS AND DISCUSSION

Results

Descriptive Analysis

The descriptive results indicate that respondents generally evaluated creative economy elements positively. Packaging design ($M = 4.111$), storytelling ($M = 4.014$), digital media ($M = 3.861$), collaboration ($M = 4.043$), and product innovation ($M = 4.021$) were all rated relatively high. The mediator, innovation capability, obtained a mean of 3.871, while competitive advantage scored 3.977. The distribution plots showed normal patterns with no significant outliers, reinforcing that the sample consistently perceived the relevance of creative economy elements. These results validate the measurement instruments and provide a strong foundation for structural modeling.

Table 1. Descriptive Statistics

	Valid	Missing	Mean	Std. Deviation	Minimum	Maximum
Packaging Design	70	0	4.111	0.340	3.250	5.000
Storytelling	70	0	4.014	0.450	2.250	5.000
Media_Digital	70	0	3.861	0.486	2.000	4.500
Collaboration	70	0	4.043	0.390	3.000	5.000
Product Innovation	70	0	4.021	0.342	3.000	5.000
Innovation_Capability	70	0	3.871	0.352	3.000	4.600
Competitive Advantage	70	0	3.977	0.431	3.000	4.800

Table 1. Shows a distribution plot indicating a normal tendency without significant outliers. This finding confirms that traditional herbal SME respondents tend to assess creative economy elements positively, while also supporting the validation of the instruments and the structural relationships among the variables

Reliability and Validity Testing

The reliability test confirmed internal consistency, with Cronbach's Alpha of 0.889, exceeding the minimum threshold of 0.70. Although the confirmatory factor analysis (CFA) indices showed low goodness-of-fit (RMSEA = 0.221; CFI = 0.350), the item correlations supported convergent validity. This suggests that despite the complexity of the constructs, the model remained acceptable for subsequent path analysis. The data also revealed strong inter-item reliability, particularly for digital media and collaboration, which correlated perfectly, underscoring their interconnected role in the creative economy framework.

table 2. Frequentist Scale Reliability Statistics

Coefficient	Estimate	Std. Error	95% CI	
			Lower	Upper
Coefficient α	0.889	0.026	0.839	0.939
Mean	120.171	1.084	118.047	122.296

Note. Variables Media Digital and Kolaborasi correlated perfectly.

Source: Processed data, 2025

Table 3. Frequentist Individual Item Reliability Statistics

Item	Coefficient α (if item dropped)		
	Estimate	Lower 95% CI	Upper 95% CI
Packaging Design	0.871	0.807	0.934
Storytelling	0.879	0.822	0.937
Media_Digital	0.865	0.799	0.931
Collaboration	0.865	0.799	0.931
Product Innovation	0.872	0.825	0.920
Innovation_Capability	0.882	0.831	0.934
Competitive Advantage	0.874	0.811	0.937

Source: Processed data, 2025

Table 4. Validity Test

Model	X ²	df	p
Baseline model	2,191.172	378	
Factor model	1,528.305	349	< .001

Source: Processed data, 2025

Correlation Analysis

Pearson's correlation analysis revealed significant positive associations among all variables ($p < 0.01$). The strongest correlations were between product innovation and competitive advantage ($r = 0.651$), digital media and competitive advantage ($r = 0.641$), and storytelling and innovation capability ($r = 0.606$). Packaging design and collaboration also exhibited a high correlation ($r = 0.668$), indicating that creative elements tend to operate synergistically rather than in isolation. These correlations confirmed the appropriateness of testing mediation effects, as the independent variables were significantly related to both the mediator and dependent variable.

Table 5. Pearson's Correlations

		Pearson's r	p
Packaging Design	- Storytelling	0.552	< .001
Packaging Design	- Media_Digital	0.314	.008
Packaging Design	- Collaboration	0.668	< .001
Packaging Design	- Product Innovation	0.634	< .001
Packaging Design	- Innovation_Capability	0.399	< .001
Packaging Design	- Competitive Advantage	0.527	< .001
Storytelling	- Media_Digital	0.381	.001
Storytelling	- Collaboration	0.404	< .001
Storytelling	- Product Innovation	0.527	< .001
Storytelling	- Innovation_Capability	0.606	< .001
Storytelling	- Competitive Advantage	0.531	< .001
Media_Digital	- Collaboration	0.385	< .001
Media_Digital	- Product Innovation	0.562	< .001
Media_Digital	- Innovation_Capability	0.545	< .001
Media_Digital	- Competitive Advantage	0.641	< .001
Collaboration	- Product Innovation	0.576	< .001
Collaboration	- Innovation_Capability	0.442	< .001
Collaboration	- Competitive Advantage	0.523	< .001
Product Innovation	- Innovation_Capability	0.366	.002
Product Innovation	- Competitive Advantage	0.651	< .001
Innovation_Capability	- Competitive Advantage	0.594	< .001

Source: Processed data, 2025

Path Analysis

The path analysis results demonstrated nuanced relationships. Storytelling ($\beta = 0.257$, $p < 0.001$), digital media ($\beta = 0.337$, $p < 0.001$), and collaboration ($\beta = 0.278$, $p = 0.007$) significantly improved innovation capability. Conversely, packaging design was insignificant ($\beta = 0.095$, $p = 0.423$), while product innovation had a significant but negative effect ($\beta = -0.311$, $p = 0.004$). Regarding competitive advantage, only digital media showed a significant positive direct effect ($\beta = 0.402$, $p < 0.001$). The strongest path was from innovation capability to competitive advantage ($\beta = 0.819$, $p < 0.001$), underscoring its central mediating role.

Table 6. Path Analysis

Hypothesis	Path	Coefficient (β)	p-value	Significance	Description
H1	Storytelling → Innovation Capability	0.257	< 0.001	Significant (+)	Positive effect
H2	Digital Media → Innovation Capability	0.337	< 0.001	Significant (+)	Positive effect
H3	Collaboration → Innovation Capability	0.278	0.007	Significant (+)	Positive effect
H4	Packaging Design → Innovation Capability	0.095	0.423	Not significant	No effect
H5	Product Innovation → Innovation Capability	-0.311	0.004	Significant (-)	Negative effect
H6	Storytelling → Competitive Advantage	n/a	> 0.05	Not significant	No effect
H7	Digital Media → Competitive Advantage	0.402	< 0.001	Significant (+)	Positive effect
H8	Collaboration → Competitive Advantage	n/a	> 0.05	Not significant	No effect

H9	Packaging Design → Competitive Advantage	0.305	0.068	Not significant (marginal)	Tendency toward positive effect
H10	Product Innovation → Competitive Advantage	n/a	> 0.05	Not significant	No effect
H11	Innovation Capability → Competitive Advantage	0.819	< 0.001	Significant (+, strong)	Very strong effect

Source: Processed data, 2025

Mediation Effects

Mediation testing revealed that innovation capability served as a partial mediator for storytelling (indirect effect = 0.210, $p < 0.001$), digital media (0.276, $p < 0.001$), and collaboration (0.227, $p = 0.007$). Packaging design showed no significant mediation, while product innovation demonstrated a suppression effect, with negative indirect impact (-0.255 , $p = 0.004$) counteracting its direct positive association. Overall, digital media emerged as the most dominant factor (total effect = 0.493), followed by collaboration (0.339), packaging design (0.331), storytelling (0.299), and product innovation (0.065).

Table. 7 Mediation Effect

Creative Economy Variables → Competitive Advantage	Indirect Effect	p-value	Direct Effect	p-value	Total Effect	Interpretation
Storytelling	0.210	< 0.001	0.089	0.312	0.299	Full mediation. The indirect effect is significant, while the direct effect is insignificant, indicating that storytelling enhances competitive advantage through innovation capability.
Digital	0.276	< 0.001	0.217	< 0.001	0.493	Partial mediation. Both direct and

Media						indirect effects are significant, indicating that digital media improves competitive advantage directly and through innovation capability. This is the most influential factor.
Collaboration	0.227	0.007	0.112	0.156	0.339	Full mediation. The indirect effect is significant, whereas the direct effect is insignificant, suggesting that collaboration contributes to competitive advantage through innovation capability.
Packaging Design	0.078	0.423	0.253	0.068	0.331	No mediation. The indirect effect is insignificant, while the direct effect is marginally significant, indicating that packaging design contributes mainly through a direct pathway
Product Innovation	-0.255	0.004	0.320	0.028	0.065	Suppression effect (inconsistent mediation). The indirect and direct effects are significant but in opposite directions, suggesting that product innovation may weaken innovation capability while simultaneously enhancing competitive advantage through other mechanisms.

Source: Processed data, 2025

Discussion

Creative Economy as a Driver of Competitiveness

The study reaffirms that creative economy elements are crucial in shaping competitiveness among traditional herbal SMEs. Digital media emerged as the most influential factor, consistent with previous studies that underscore digital transformation as a key driver for SMEs in creative industries (Hendrayadi, Kustati, & Sepriyanti, 2023; Hidayat, Qurotulaini, Safitri, & Novitasari, 2024). The findings align with the Resource-Based View (RBV), which

posits that firms can gain competitive advantage by leveraging unique and valuable resources (Barney, 1991). In this case, digital platforms act as a strategic resource that enables SMEs to enhance visibility, expand markets, and connect with broader consumer bases at relatively low cost.

Innovation Capability as a Dynamic Capability

The strong mediating role of innovation capability resonates with the theory of Dynamic Capability, which suggests that organizations must continuously integrate, build, and reconfigure resources to address rapidly changing environments (Teece, Pisano, & Shuen, 1997). Storytelling and collaboration were found to be significant only when mediated by innovation capability, indicating that these elements must be translated into concrete innovation practices to deliver competitive advantage. This supports prior research demonstrating that innovation capability acts as a bridge between intangible creative resources and tangible performance outcomes (Aljanabi, 2022; Moreira, Navaia, & Ribau, 2024).

The Paradox of Product Innovation

Interestingly, product innovation had a negative effect on innovation capability and did not significantly enhance competitiveness. This finding contrasts with much of the innovation literature, which typically emphasizes the positive role of product development (Sabarini & Hendayana, 2025; Syahbudi, Ramadhani, & Barus, 2025). One possible explanation is that herbal SMEs lack sufficient resources and consumer research to ensure that product innovations align with market demands. As a result, innovation efforts may lead to higher costs without delivering proportional benefits. This highlights the paradox that innovation, while generally beneficial, may backfire when not strategically managed or supported by adequate capabilities.

Cultural Heritage as a Competitive Asset

The findings indicate that cultural authenticity, remains a valuable source of differentiation for herbal SMEs. Storytelling allows SMEs to frame their products not merely as commodities but as cultural experiences tied to tradition and health. This finding is consistent with studies on cultural-based industries, where heritage and authenticity enhance consumer loyalty (Astuti, 2021; Hasanatun et al., 2024). However, the effectiveness of cultural narratives depends on their integration with modern marketing channels such as digital platforms, highlighting the need for hybrid strategies that combine tradition with innovation.

Policy and Managerial Implications

The results carry important implications for both policymakers and SME managers. For policymakers, the dominance of digital media underscores the urgency of improving digital infrastructure and literacy among rural and traditional SMEs. Programs that provide training in e-commerce, digital branding, and storytelling could significantly enhance SMEs' competitiveness. For managers, the findings suggest that innovation should not be pursued indiscriminately. Instead, SMEs must align innovation efforts with consumer needs, focus on collaborative partnerships, and leverage digital tools to amplify cultural narratives. Collaborative ecosystems involving academia, government, industry, and communities (pentahelix) should also be strengthened to overcome financial and knowledge barriers (Mas'ud & Susilo, 2023; Setiyawan & Rofifudin, 2024).

CONCLUSIONS

This study examined the role of creative economy elements in strengthening the competitiveness of traditional herbal SMEs, with innovation capability positioned as a mediating variable. The results highlight that digital media, storytelling, and collaboration significantly enhance innovation capability, while packaging design shows no effect and product innovation demonstrates a paradoxical negative influence. Among the variables, digital media emerged as the most dominant factor, both directly and indirectly influencing competitiveness.

The findings confirm that innovation capability acts as a strong mediator, transforming creative resources into sustainable competitive advantage. This supports the theoretical perspectives of the Resource-Based View and Dynamic Capability, which emphasize the importance of leveraging and reconfiguring resources to achieve superior performance. The study also uncovers an important insight that innovation efforts, if not aligned with market needs and consumer expectations, may reduce rather than increase competitiveness.

Practically, the results suggest that SME owners should prioritize digital adoption, build authentic storytelling strategies, and strengthen collaborative networks to overcome resource limitations. For policymakers, the findings indicate the need to provide training in digital literacy, financial support, and infrastructure development to empower SMEs within Indonesia's creative economy framework.

Despite its contributions, this study is limited by its sample size and scope, which was restricted to one herbal cluster. Future research is encouraged to expand the sample, employ longitudinal data, and explore additional variables such as institutional support and consumer perception to deepen understanding of competitiveness in cultural-based industries.

In conclusion, this research demonstrates that the integration of creative economy elements and innovation capability provides a viable pathway for enhancing the competitiveness and sustainability of traditional herbal SMEs in Indonesia.

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