

Government and Community Support Strengthening Micro, Small, and Medium Enterprises' Competitive Advantage through Internal Capability

Mustika Dewi^{1*}, Bambang Suseno², Mhd. Harry Azhari As'ad³

Universitas Deli Sumatera, Medan, Indonesia^{1,3}

Tohoku University, Sendai, Japan²

mustikadewi@unds.ac.id^{1*}, bambang.suseno.t5@dc.tohoku.ac.jp², asadmhdharryazhari@unds.ac.id³



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Abstract

Purpose: This study examines the role of government and community support in enhancing Micro, Small, and Medium-sized Enterprises (MSMEs) competitive advantage through internal capabilities. Although external support has been widely recognized as a key driver of MSME performance, few studies have explained how these various support providers enhance competitive advantage through the development of organizational capabilities.

Research Methodology: A quantitative cross-sectional survey of 100 MSMEs affiliated with the North Sumatra Chamber of Commerce and Industry (KADIN) was analysed using PLS-SEM in SmartPLS 3. Internal Capabilities were modeled as a higher-order construct comprising Leadership, Entrepreneurial Motivation, and Financial Competence.

Results: Government support has a significant impact on both internal capabilities and competitive advantage, whilst community support significantly strengthens internal capabilities but does not directly influence competitive advantage. Internal capabilities have a significant positive influence on competitive advantage and act as a mediator in the relationship between external support and competitive advantage.

Conclusions: External support contributes to the competitiveness of MSMEs through various strategic mechanisms, with internal capacity acting as the primary channel for transforming external support into a sustainable competitive advantage.

Limitations: This study employs a cross-sectional design and focuses on MSMEs that are members of KADIN in North Sumatra.

Contributions: This study extends the literature by conceptualizing Internal Capabilities as a higher-order construct integrating Leadership, Entrepreneurial Motivation, and Financial Competence to explain MSME competitive advantage.

Keywords: *Competitive Advantage, Community Support, Government Support, Internal Capability, MSME*

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1. Introduction

Micro, Small, and Medium-sized Enterprises (MSMEs) constitute a key pillar of the Indonesian economy, particularly in North Sumatra Province, where they play a strategic role in creating

employment, reducing unemployment, and promoting equitable income distribution across the population. As shown in Table 1, MSMEs in North Sumatra Province are unevenly distributed across regencies and cities, dominated overwhelmingly by micro-scale enterprises. Medan City accounts for the largest share, followed by Deli Serdang and Langkat regencies, while several regencies in the southern and island areas of the province, such as Nias Utara, Batu Bara, and Samosir, record considerably smaller MSME populations. This uneven distribution reflects the concentration of MSME activity in trade, agriculture, cottage industry, and services as the province's dominant sectors (BPS, 2025; KADIN, 2024; Tambunan, 2021).

Table 1. Number of MSMEs by Regency/City in North Sumatra Province

Regency/City	Year	Micro	Small	Medium	Total MSMEs
City Medan	2023	231.146	263.337	67.778	562.261
Regency Deli Serdang	2023	207.724	107.335	50.056	365.115
Regency Langkat	2023	133.630	43.123	9.266	186.019
Regency Labuhanbatu	2023	106.171	43.123	4.423	153.717
Regency Asahan	2023	101.320	34.256	7.859	143.435
Regency Simalungun	2023	98.732	17.976	7.402	124.110
Regency Serdang Bedagai	2023	78.257	21.634	4.230	104.121
Regency Tapanuli Selatan	2023	66.879	13.926	616	81.421
Regency Tapanuli Tengah	2023	66.350	8.425	1.341	76.116
Regency Nias Selatan	2023	32.039	297	31.041	63.377
City Pematang Siantar	2023	37.728	18.727	5.102	61.557
Regency Mandailing Natal	2023	47.040	9.174	797	57.011
City Binjai	2023	33.321	16.634	3.216	53.171
Regency Karo	2023	24.974	24.038	2.687	51.699
Regency Tapanuli Utara	2023	35.807	6.576	837	43.220
Regency Nias	2023	36.698	3.417	671	40.786
City Padangsidimpuan	2023	26.447	9.839	1.890	38.176
Regency Dairi	2023	29.260	7.866	703	37.829
City Tebing Tinggi	2023	18.863	11.710	2.622	33.195
City Tanjungbalai	2023	18.683	10.917	1.727	31.327
Regency Toba	2023	21.396	6.021	1.655	29.072
City Gunungsitoli	2023	10.365	6.190	10.047	26.602
Regency Humbang Hasundutan	2023	22.574	2.392	337	25.303
Regency Padang Lawas	2023	10.047	13.590	1.609	25.246
Regency Labuhanbatu Selatan	2023	8.861	13.847	747	23.455
City Sibolga	2023	14.279	6.101	139	20.519

Regency/City	Year	Micro	Small	Medium	Total MSMEs
Regency Labuhanbatu Utara	2023	8.850	11.129	351	20.330
Regency Pakpak Bharat	2023	8.721	5.856	5.654	20.231
Regency Padang Lawas Utara	2023	8.100	10.254	1.081	19.435
Regency Nias Barat	2023	5.799	5.715	5.650	17.164
Regency Samosir	2023	13.298	1.885	495	15.678
Regency Batu Bara	2023	2.144	6.315	235	8.694
Regency Nias Utara	2023	6.023	607	217	6.847

Despite this substantial economic footprint, the growth of MSMEs in North Sumatra has not been matched by a proportional improvement in business quality and sustainability. Enterprises continue to face persistent structural challenges, including limited leadership capacity, weak entrepreneurial motivation, and inadequate financial management practices ([DISKOMINFO, 2025](#); [Rina, Gunawan, & Ajulio, 2024](#); [Tristanto, & Wardana, 2018](#)). In response, the Provincial Government of North Sumatra has introduced a range of development programs encompassing licensing facilitation, access to finance, entrepreneurship training, and product promotion. However, official data reveal that only 7.7 per cent of MSMEs in North Sumatra had accessed formal financing as of mid-2025, signaling that structural barriers to effective mentoring, financial literacy, and business administration remain largely unresolved despite these interventions ([Doh, & Kim, 2014](#); [Mavrodieva, Budiarti, Yu, Pasha, & Shaw, 2019](#)). Government and community support has long been regarded as essential in providing access to finance, enhancing entrepreneurial skills, and strengthening regulatory frameworks, yet the persistence of these gaps suggests that external intervention alone has not been sufficient to close the underlying capability deficit among MSME actors ([Edith, & Anwuli, 2024](#); [Martinez, Guercio, & Bariviera, 2022](#)).

This pattern points to a more fundamental problem: current MSME development strategies remain oriented toward short-term, output-based interventions such as financing facilitation, brief training programs, and promotional activities rather than toward strengthening the internal foundations of MSME actors themselves. This has created a mismatch between policy design, which continues to prioritize short-term quantitative outputs, and the actual developmental needs of MSME actors, which lie in building sustainable internal business capabilities.

This mismatch can be understood through the lens of ecosystem theory, which positions Indonesian Chamber of Commerce and Industry (KADIN Indonesia) representing both government and community actors in North Sumatra as a complementary platform for capacity building, communication, information sharing, representation, consultation, facilitation, and advocacy on behalf of Indonesian business actors. As the sole recognized umbrella organization for the business sector under Law No. 1 of 1987, encompassing state-owned, cooperative, and private enterprises, KADIN Indonesia oversees business associations across all economic sectors and provides the resources necessary for business growth ([Stam, 2014](#)). Yet empirical observation shows considerable variation in outcomes: while some MSMEs have evolved into more innovative, adaptive, and competitive enterprises under this support structure, others continue to struggle in enhancing their operational capacity. This divergence suggests that external support does not automatically translate into improved MSME capability, and that government or community assistance does not necessarily produce uniform outcomes across enterprises.

This inconsistency is echoed in the broader literature. Prior studies examining the relationship between government assistance and business performance report mixed findings, even in cases where

internal organizational capabilities are already present by [Bambang and Sutrisno \(2025\)](#), while other research emphasizes that the success and sustainability of MSMEs are ultimately determined by their internal capabilities ([Dewi, Lubis, & Sofiyan, 2025](#)). Taken together, these findings imply that external support functions as a necessary but not sufficient condition for MSME development one whose effectiveness is contingent upon the internal capability of the enterprise itself.

Much of the existing research, however, treats internal capability either as a pre-existing given or examines government and community assistance in isolation from one another, rather than as interacting forces that jointly shape capability formation. Consequently, the process through which internal capabilities encompassing leadership, entrepreneurial motivation, and financial competence actually form through the interplay of government and community support remains conceptually underexplored. This gap between empirical field conditions and the conceptual models typically used in MSME research represents an opportunity to advance MSME theory grounded more explicitly in internal capability development.

The novelty of this study lies in conceptualizing internal capability as a multidimensional higher-order construct comprising leadership, entrepreneurial motivation, and financial competence, rather than treating these organizational factors as independent variables. By integrating them into a unified capability framework, this study clarifies how government and community support are transformed into sustainable competitive advantage among MSMEs, thereby extending the Resource-Based View to conceptualize organizational capability as a combination of complementary strategic capabilities rather than a set of isolated attributes. Accordingly, this study aims to examine the direct effects of government and community support on internal capability and competitive advantage, and to investigate the mediating role of internal capability in transforming government and community support into sustainable competitive advantage among MSMEs in North Sumatra Province.

2. Literature Review

2.1 Government Support

This study focuses on ecosystem support from two main sources: government and community. Government support is provided through policies, training, mentoring, access to financing, and various business development programs. Community support is provided through social networks, business communities, business associations, entrepreneurship forums, and various forms of collaboration that enable the exchange of experiences, learning, and business development. The success and sustainability of MSMEs are also heavily determined by their internal capabilities ([Dewi et al., 2025](#)). In this study, internal capabilities are understood as strategic abilities represented by three main constructs: leadership, entrepreneurial motivation, and financial competence. Internal capabilities namely leadership, entrepreneurial motivation, financial competence, and business competence among MSME actors must go hand in hand with external support to yield significant and long-term impacts.

Government measures to improve credit availability have proven effective in enhancing financial inclusion for SMEs, thereby facilitating their access to financing ([OECD, 2020](#)). Although there has been an improvement in access to finance, skills development, and SME performance thanks to government-backed subsidies and loan guarantees by [Anwar & Li, 2021](#) and [Supari & Anton, 2022](#), government financial support has actually fostered dependency rather than encouraging innovation and competitiveness. This inconsistency points to a significant research gap, whilst also highlighting the limitations of the financial support system in adapting to the evolving needs of SMEs in the digital economy era ([Feng et al., 2023](#); [Huang, 2022](#))

2.2 Community Support

Communities provide a space for knowledge-sharing, mentoring, market networking, and social support that formal government policies cannot always fulfil. A community is a group of people who share a common concern or interest in something they do, or who learn how to do it better as they interact ([Wenger-Trayner et al., 2002](#)). Organisations have a particular ability to create and share knowledge, drawing on various factors, including the provision of tacit knowledge ([Kogut & Zander,](#)

1996; [Nonaka & Takeuchi, 1996](#)). Through continuous interaction and collective learning, communities can strengthen individual capabilities and facilitate the transformation of shared knowledge into practical actions that support sustainable development.

Government support remains comparatively underdeveloped: most studies establish that communities create the translates into measurable internal capability, and community initiative is typically studied in isolation from formal government programs rather than as an interacting source of capability formation. This parallels the inconsistency identified in the government-support literature above: both external supports are theorized to strengthen MSME actors, yet neither stream adequately explains the mechanism by which external support becomes internal capability.

2.3 Internal Capabilities

Internal capabilities related to Human Resources (HR) are key elements that must be addressed and developed in HR management so that MSMEs can achieve their strategic goals and create a competitive advantage. These factors encompass important aspects of HR management that, when optimized, will directly impact organizational performance ([Naidoo, 2021](#)).

Leadership is essential for driving organizational progress amid change and competition by establishing a vision, motivating, organizing, managing, and guiding employees toward higher levels of performance ([Arham & Sulaiman, 2013](#); [Davies et al., 2002](#); [Shahril Othman & Abdul Razak, 2012](#)). Leadership style is strongly linked to organizational performance. Organizational performance, in turn, is closely tied to achieving a competitive advantage ([Ojokuku et al., 2013](#)). The leadership behavior of top management in MSMEs can significantly impact innovation and company performance ([Matzler et al., 2008](#)). Good leadership has been recognized as a key factor in MSME success and the primary cause of failure among MSMEs is inadequate and weak leadership skills ([Fiedler, 1996](#)). Leadership is a critical factor in ensuring the success of MSMEs ([Achang et al., 2006](#); [Sawhney et al., 2020](#)). Transformational leadership is positively related to internal ([Eikelenboom & de Jong, 2019](#); [Kisubi et al., 2022](#))

Entrepreneurial motivation is an entrepreneur's desire to achieve the company's goals, realize its vision, and set the direction and scale of the company's growth ([Wu & Mao, 2020](#)). Entrepreneurial motivation can also encourage young entrepreneurs to engage in entrepreneurial activities, achieve their goals along their entrepreneurial journey, and serve as an internal driving force ([Barba-Sánchez & Atienza-Sahuquillo, 2017](#)). Entrepreneurial motivation is the philosophy and goal-setting behind starting a business ([Kim et al., 2018](#)). Motivation is a key internal factor among entrepreneurs for improving business performance ([Halim et al., 2011](#)). Entrepreneurial motivation is considered a source of the company's capabilities a vital resource for creating sustainable competitive advantage. Internal entrepreneurial factors (entrepreneurial self-efficacy, entrepreneurial motivation, and entrepreneurial leadership) influence business resilience and performance ([Srimulyani et al., 2023](#)).

MSME financing encompasses various systems that provide capital to support the development and performance of MSMEs ([Abe et al., 2015](#)). The availability of capital at competitive rates influences the funds MSMEs use for their operational activities ([Yoshino & Taghizadeh-Hesary, 2018](#)). Financial resources are vital for MSMEs to grow, develop, and innovate ([Kent Baker et al., 2020](#)). Limited financial resources hinder MSMEs' performance, growth, and innovation, preventing their products and services from entering the market. Many companies fail due to limited financial knowledge, leading them to make incorrect decisions when addressing critical issues ([Rachapaettayakom et al., 2020](#)).

Taken together, these three streams of literature share a common limitation: leadership, entrepreneurial motivation, and financial competence are consistently validated as individual factors in MSME performance, but they are rarely integrated into a single support that both government and community can use to achieve competitive outcomes. This is the specific gap that the study addresses by treating them jointly as the reflective -formative dimensions of internal capability.

2.4 Competitive Advantage

Competitive advantage can be achieved through the support of resources, thereby enabling a company to sustain itself continuously; this is the essence of the Resource-Based View (RBV) theory ([Barney, 2001](#)). According to the RBV theory, the sources of competitive advantage stem from two distinct yet interrelated factors: individual factors and organisational factors ([Davis, Desplaces, Falbe, Welsh, Davis, Desplaces, & Welsh, 2012](#)). A company's potential to remain sustainable or achieve competitive advantage depends on its managerial capabilities and resources, as well as the strategies employed to maximise these resources in response to business challenges and opportunities. Valuable, rare, inimitable, and irreplaceable resources enable businesses to develop and maintain a competitive advantage for superior performance ([Barney, 1991](#); [Collis, & Montgomery, 1995](#); [Grant, 1991](#); [Wernerfelt, 1989](#)).

2.5 Positioning of the Study

Unlike previous studies, which generally examined Leadership, Entrepreneurial Motivation, and Financial Competence as separate organizational factors, this study integrates these three dimensions into a higher-order construct, namely Internal Capability. This conceptualization reflects the view that the three dimensions interact and complement one another in shaping the overall capability of MSMEs, rather than operating independently. By adopting this integrated perspective, the study provides a more comprehensive understanding of how internal capability functions as a strategic mechanism through which external support is transformed into sustainable competitive advantage. The proposed conceptual framework also highlights the mediating role of Internal Capability in explaining the relationships between Government Support, Community Support, and Competitive Advantage. The overall conceptual framework developed in this study is presented in Figure 1:

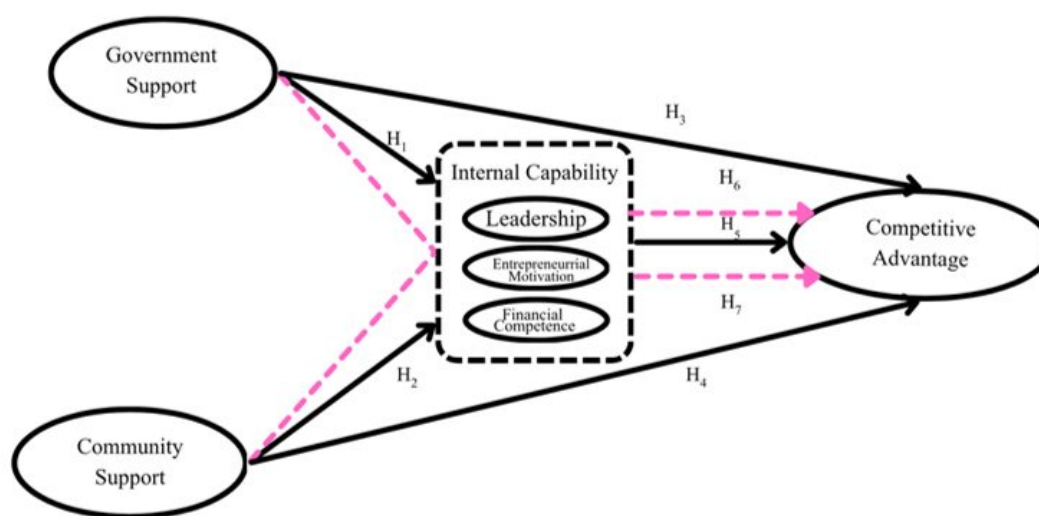


Figure 1. Conceptual framework

Existing studies have largely focused on examining the direct effects of government support, community support, leadership, entrepreneurial motivation, or financial competence on SME performance and competitiveness. However, limited studies have integrated these organizational dimensions into a single capability framework that explains how external support is transformed into competitive advantage. Therefore, this study fills this research gap by proposing Internal Capability as a higher-order construct comprising Leadership, Entrepreneurial Motivation, and Financial Competence, while simultaneously examining its mediating role in the relationship between government support, community support, and competitive advantage. This conceptualization represents the primary novelty of the study and provides a more comprehensive explanation of SMEs' competitive advantage.

3. Research Methodology

This study employs a quantitative approach with an explanatory research design (explanatory research). This approach was chosen as it aims to test the causal relationships between ecosystem support, leadership, entrepreneurial motivation, financial competence, and competitive advantage in MSMEs. The model was tested using the Structural Equation Modelling–Partial Least Squares (SEM-PLS) approach, as it can analyse simultaneous relationships among latent variables, accommodate complex models, and be suitable for theory-oriented (prediction-oriented) research. The population under study in this research consists of MSME operators in North Sumatra who meet the following criteria:

1. MSME operators who are members of the North Sumatra Provincial Chamber of Commerce and Industry (KADIN).
2. The MSMEs included in the study must also hold a business licence and meet the criteria set out in Government Regulation (PP) 2021, Article 35(3), based on capital and sales turnover , This classification is presented in Table 2.

Table 2. MSMEs criteria

Criteria	Micro	Small	Medium
Capital	Maximum 1 billion	1 billion–5 billion	5 billion–10 billion
Sales Turnover	Maximum 2 billion	2 billion–15 billion	15 billion–50 billion

This study employed a purposive sampling technique, whereby respondents were selected based on predefined inclusion criteria. Eligible respondents were MSME owners or managers affiliated with the North Sumatra Chamber of Commerce and Industry (KADIN), possessing a valid business license and meeting the MSME classification stipulated in Government Regulation No. 7 of 2021. Since the exact number of MSMEs meeting these criteria could not be identified, the minimum sample size was determined using the Lemeshow Formula 1:

$$n = \frac{(Z^2 \times P(1 - P))}{E^2} \quad (1)$$

Where:

n = the required sample size.

Z = the desired confidence level

P = the estimated population proportion (if unknown, use 0.5).

E = the desired margin of error.

$$n = \frac{(1,96)^2 \times 0,5(1 - 0,5)}{(0,10)^2} n = \frac{3,8416 \times 0,25}{0,01} n = 96,04 \quad (2)$$

From Formula 2, a confidence level of 95% ($Z = 1.96$), an estimated population proportion of 0.50, and a margin of error of 10% ($E = 0.10$) into the Lemeshow formula, the minimum required sample size was calculated. The computation produced a value of 96.04, which was subsequently rounded up to 97 respondents to ensure that the minimum sample size requirement was satisfied.

Table 3. Operationalization of variables

Variable	Dimension	Indicators	Measurement Scale	Sources
Government Support	Government Support	Mentorship	Likert 1–5	Carayannis et al. (2012); Ma et al. (2024)
		Financial Support	Likert 1–5	
		Policy Formulation and Implementation	Likert 1–5	
Community Support	Community Support	Idea Sharing	Likert 1–5	
		Synergy among MSMEs	Likert 1–5	
Internal Capability	Leadership	Stability and dynamism,	Likert 1–5	Banmairuoy et al. (2022); (Vebryana, Herachwati, Nadia, & Akbar, 2024); Yitshaki and Kropp (2016)
		Situational Factors	Likert 1–5	
		The Relationship between Leadership Traits and Behaviour	Likert 1–5	
	Entrepreneurial Motivation	Need for Achievement	Likert 1–5	(Covin & Slevin, 1991); Drucker (1985); Kim et al. (2018)
		Need for Independence	Likert 1–5	
		Financial Freedom	Likert 1–5	
	Financial Competence	Financial Literacy	Likert 1–5	Robinson and Phillips (2001); Song et al. (2008)
		Financial Planning	Likert 1–5	
		Financial Analysis	Likert 1–5	
Competitive Advantage	Competitive Advantage	Valuable	Likert 1–5	Barney (1991)
		Rare	Likert 1–5	
		Inimitable	Likert 1–5	
		Non-substitutable	Likert 1–5	

The calculation yielded a minimum required sample size of 97 respondents. To improve the accuracy and robustness of the statistical estimation, as well as to satisfy the recommended requirements for Partial Least Squares Structural Equation Modeling (PLS-SEM), data were ultimately collected from 100 MSMEs. This sample size exceeds the minimum requirement and is therefore considered adequate to ensure reliable parameter estimation and hypothesis testing. The research instrument consisted of a structured questionnaire developed based on established measurement scales from previous studies. The questionnaire was adapted to suit the context of MSMEs in North Sumatra while maintaining the validity of the original constructs. A summary of the measurement constructs, indicators, and their corresponding literature sources is presented in Table 3.

4. Results and Discussions

4.1 Result

The following figure presents the first-order measurement model, which shows the relationship between indicators and latent constructs at the basic level. The measurement model was evaluated using a two-stage approach, as Internal Capability was modelled as a higher-order construct comprising Leadership, Entrepreneurial Motivation and Financial Competence. The first stage involved assessing the reliability and validity of the first-order constructs before estimating the higher-order construct. The first-order measurement model is presented in Figure 2.

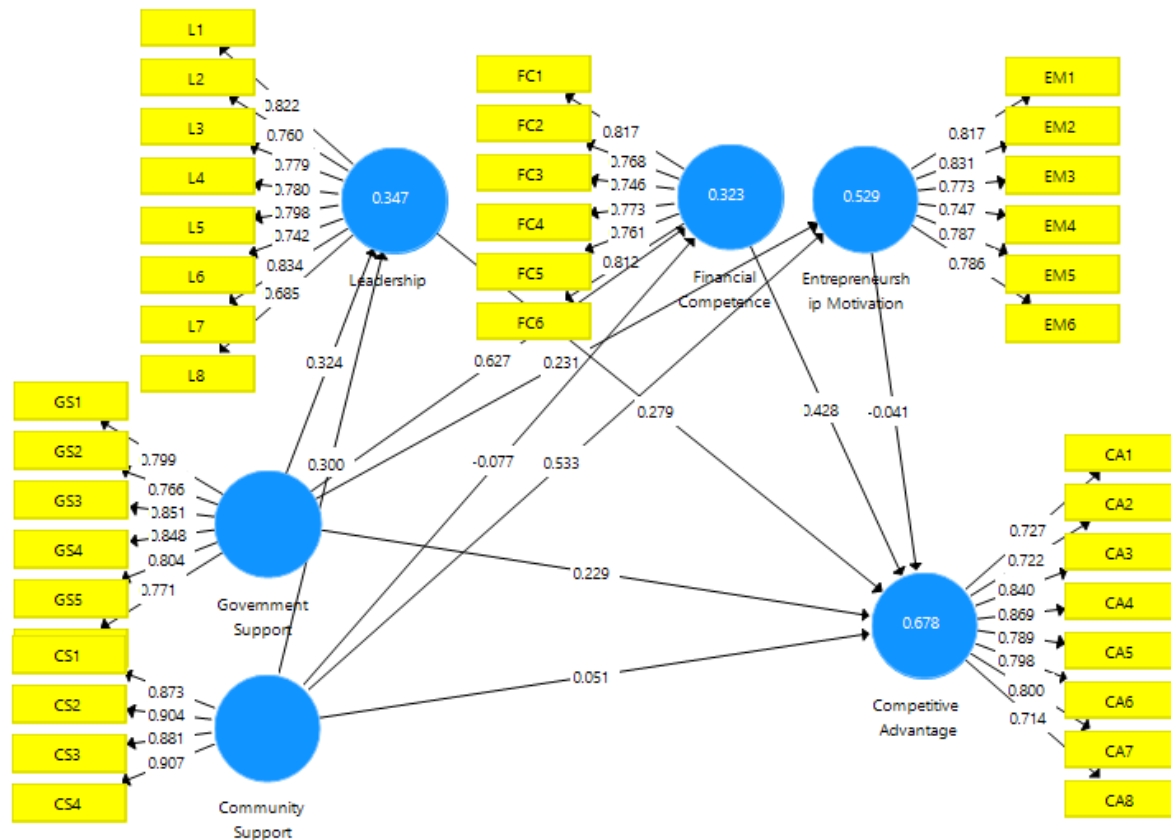


Figure 2. First-order measurement model

In the first-order measurement model, each latent construct is assessed through the relationships between its indicators and the construct itself. This stage is intended to ensure that each indicator adequately represents its construct. Accordingly, evaluation at the first-order level serves as an essential foundation before the analysis proceeds to the second-order level and the structural model.

The results of this stage are used to assess the quality of the research instrument using three criteria: convergent validity, construct reliability, and discriminant validity. If all indicators and constructs meet the specified criteria, the measurement model can be considered suitable for further analysis. Therefore, this section is crucial in ensuring the accuracy and consistency of the measurement of the research variables. After the evaluation of the first-order measurement model is completed, the discussion continues with testing the outer loading of each indicator to determine its contribution to the latent construct. Subsequently, the results of the reliability and convergent validity tests are presented to describe the measurement quality of each research construct.

The outer-loading test indicates that all indicators in the first-order construct have adequate loadings to represent their respective latent constructs. Most indicators are above the required minimum threshold of 0.70, indicating that the convergent validity criterion has been met. This confirms that the indicators contribute strongly to explaining the latent variables. The results of the reliability and convergent validity tests for the first-order construct are presented in the following table, with Cronbach Alpha, Composite Reliability, and Average Variance Extracted (AVE) used as the benchmarks for construct measurement quality.

The reliability and convergent validity of each construct were tested using Cronbach alpha, composite reliability and Average Variance Extracted (AVE) following an assessment of the first-order measurement model. These measures were used to ensure that the indicators consistently represented their respective latent constructs before proceeding to the evaluation of higher-order constructs. The results are presented in Table 4.

Table 4. Construct reliability and validity first order

Construct	Outer Loading	Cronbach Alpha	Composite Reliability	Average Variance Extracted (AVE)
Government Support	0.766 -0.851	0.893	0.918	0.652
Community Support	0.873 - 0.907	0.914	0.939	0.795
Competitive Advantage	0.714 – 0.869	0.910	0.927	0.615
Leadership	0.685-0.834	0.906	0.924	0.603
Entrepreneurship Motivation	0.747 – 0.831	0.881	0.909	0.625
Financial Competence	0.746 – 0,817	0.872	0.903	0.608

All constructs demonstrate adequate reliability and convergent validity, as evidenced by Cronbach Alpha and Composite Reliability values exceeding 0.70 and Average Variance Extracted (AVE) values above 0.50. Discriminant validity is confirmed by the Fornell-Larcker criterion, where the square roots of the AVEs are greater than the inter-construct correlations. After confirming the reliability and convergent validity of the first-order constructs, discriminant validity was evaluated using the Fornell–Larcker criterion. The results are presented in Table 5.

Table 5. Fornell-larcker criterion first-order

	Government Support	Community Support	Competitive Advantage	Leadership	Entrepreneurs hip Motivation	Financial Competence
Government Support	0.80727	-	-	-	-	-
Community Support	0.78161	0.89145	-	-	-	-
Competitive Advantage	0.64048	0.53188	0.78452	-	-	-
Leadership	0.55848	0.55318	0.72806	0.776	-	-
Entrepreneurship Motivation	0.647	0.713	0.650	0.819	0.791	-
Financial Competence	0.566	0.412	0.650	0.765	0.649	0.780

The Fornell–Larcker results indicate adequate discriminant validity, as the square root of the AVE for each construct exceeds its correlations with other constructs. To further confirm discriminant validity, the Heterotrait–Monotrait Ratio (HTMT) was also assessed. The HTMT results are presented in Table 6.

Table 6. HTMT first-order

	Government Support	Community Support	Competitive Advantage	Leadership	Entrepreneurs hip Motivation	Financial Competence
Government Support	-	-	-	-	-	-
Community Support	0.864	-	-	-	-	-
Competitive Advantage	0.691	0.578	-	0.791	0.703	0.843
Leadership	0.585	0.591	0.791	-	0.921	0.859
Entrepreneurship Motivation	0.681	0.770	0.703	0.921	-	0.743
Financial Competence	0.613	0.445	0.843	0.859	0.743	-

The HTMT results indicate satisfactory discriminant validity, with most values below the recommended threshold of 0.90, confirming that the constructs are empirically distinct. Having established the adequacy of the first-order measurement model, the analysis proceeded to the second-order measurement model. In this study, Internal Capability was modelled as a higher-order construct comprising Leadership, Entrepreneurial Motivation, and Financial Competence. The second-order model, estimated using the two-stage approach, is presented in Figure 3.

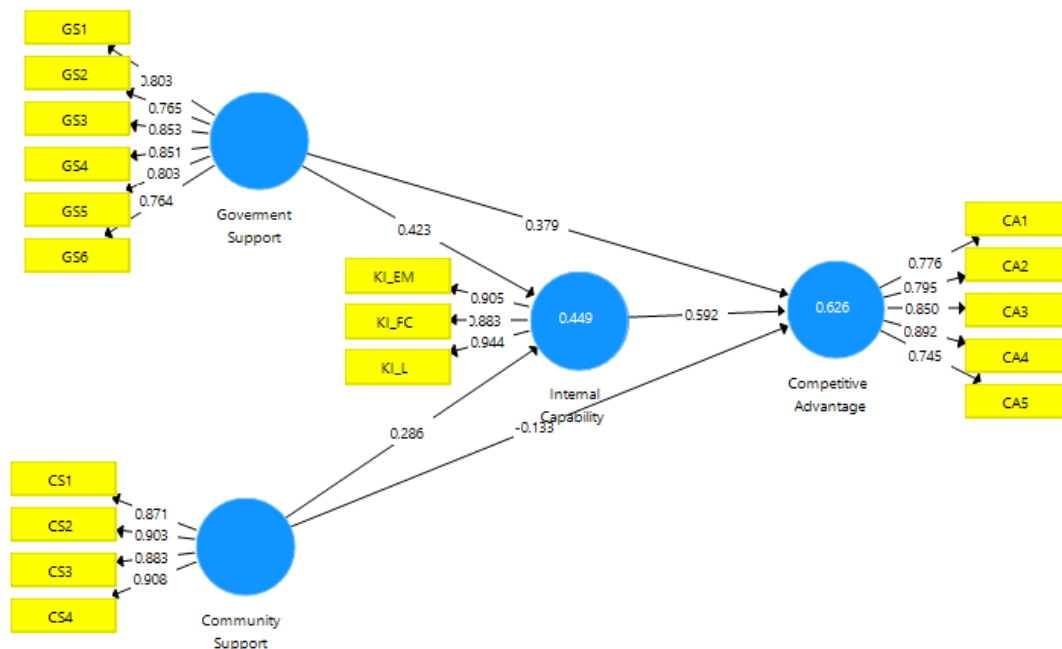


Figure 3. Second-order measurement model

The second-order model captures a more abstract and multidimensional construct than the first-order model. The results indicate that all dimensions are strongly associated with the higher-order construct, confirming that Internal Capability is both conceptually and empirically well represented. The outer loadings of the higher-order dimensions are presented in Table 6, followed by an assessment of reliability and convergent validity using Cronbach Alpha (CA), Composite Reliability (CR), and Average Variance Extracted (AVE). The assessment results for the second-order constructs are presented in Table 7.

Table 7. Construct reliability and validity second-order

	Outer Loading	Cronbach Alpha	Composite Reliability	Average Variance Extracted (AVE)
Internal Capability	0,883-0.944	0.897	0.936	0.830

This finding suggests that Internal Capability is a robust construct both conceptually and empirically, as all its constituent dimensions contribute consistently and strongly. The construct is therefore suitable for subsequent structural model testing. In general, the results of the Construct Reliability and Validity test indicate that all constructs have met the requirements for reliability and convergent validity. The values of Cronbach Alpha, rho_A, and Composite Reliability are all above 0.70, while the AVE values for each construct also exceed 0.50. The measurement model is therefore considered suitable for the next stage of analysis. The discriminant validity test of the second-order model using the Fornell-Larcker criterion is presented in the following table to ensure that the higher-order construct is conceptually distinct from the other constructs.

Discriminant validity was assessed using the Fornell–Larcker criteria following the assessment of reliability and convergent validity of the second-order constructs. According to these criteria, the

square root of the Average Variance Extracted (AVE) for each construct must be greater than its correlation with other constructs, indicating that each latent construct is empirically distinct. The results of the Fornell–Larcker assessment for the second-order model are presented in Table 8.

Table 8. Fornell-Larcker criterion second order

	Government Support	Community Support	Internal Capability	Competitive Advantage
Government Support	0.807			
Community Support	0.781	0.891		
Internal Capability	0.646	0.616	0.911	
Competitive Advantage	0.657	0.528	0.755	0.813

The Fornell-Larcker criterion results indicate that the square root of AVE for each construct on the main diagonal is higher than its correlations with the other constructs in the corresponding rows and columns. The Heterotrait-Monotrait (HTMT) ratio was evaluated for second-order constructs to provide further evidence of discriminant validity.

Table 9. HTMT Second-Order

	Government Support	Community Support	Internal Capability	Competitive Advantage
Government Support	-	-	-	-
Community Support	0.864	-	-	-
Internal Capability	0.706	0.678	-	-
Competitive Advantage	0.727	0.584	0.847	-

The results presented in Table 9 show that all HTMT values are below the recommended threshold of 0.90, indicating that the constructs are empirically distinct from one another. This finding confirms that each latent construct measures a unique conceptual domain and does not exhibit excessive overlap with the other constructs in the research model. Therefore, the HTMT criterion provides additional evidence supporting the discriminant validity of the second-order measurement model, demonstrating that the proposed constructs are sufficiently differentiated and appropriate for subsequent structural model analysis.

4.1.1 Structural Model Results

This section presents the evaluation of the structural model, including R-squared values, effect sizes, predictive relevance, and hypothesis-testing results via bootstrapping. The coefficient of determination for the endogenous constructs in the research model is presented in the following table, which is used to assess the model's explanatory power for the endogenous variables. The structural model was evaluated by analysing the coefficients, the coefficient of determination (R^2), the effect size (f^2), and the predictive relevance (Q^2). The results of the structural model evaluation are presented in Table 10.

Table 10. R2,F2,Q2

Construct	R2	R2Adjusted	F2	Q2
Internal Capability	0.449	0.438	0.515	0.358

Construct	R ²	R ² Adjusted	F ²	Q ²
Competitive Advantage	0.626	0.614	0.515	0.378
Government Support-competitive advantage	-	-	0.133	-
Community Support-Competitive Advantage	-	-	0,017	-

The coefficient of determination test produced an R-Square value of 0.626 for Competitive Advantage and 0.449 for Internal Capability, with adjusted R Square values of 0.614 and 0.438, respectively. Based on the f-square interpretation criteria, values of 0.017 and 0.058 are classified as very small or weak effects, while values of 0.133 and 0.127 indicate small effects. The value of 0.515 indicates a large effect on Competitive Advantage. The cross-validated redundancy test shows Q^2 values of 0.378 for Competitive Advantage and 0.358 for Internal Capability. Since both values are above zero, it can be concluded that the model has adequate predictive relevance for the endogenous variables.

Table 11. Model fit

	Saturated Model	Estimated Model
SRMR	0.093	0.093

In addition to assessing the measurement and structural models, the overall model fit was evaluated to determine the adequacy of the proposed PLS-SEM model. Model fit was assessed using the Standardised Root Mean Square Residual (SRMR). The model fit results are presented in Table 11.

These results indicate that the SRMR remains within an acceptable range, although it does not reflect a high level of model fit. The research model therefore provides a reasonable fit and is suitable for further analysis. The results of the direct effects among the constructs are presented in the following table, with path coefficients, t-statistics, and p-values used to assess the significance of each hypothesis.

The proposed hypotheses were tested using a bootstrapping procedure after ensuring the adequacy of the measurement and structural models. The significance of the direct relationships was assessed using path coefficients (β), t-statistics, and p-values. The bootstrapping results for the direct effects are presented in Table 12.

Table 12. Bootstrapping direct effect

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (O/STDEV)	P Values
Government Support -> Internal Capability	0.423	0.436	0.119	3.548	0.000
Community Support -> Internal Capability	0.286	0.288	0.129	2.222	0.026
Government Support -> Competitive Advantage	0.379	0.373	0.159	2.376	0.018

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (O/STDEV)	P Values
Community Support -> Competitive Advantage	-0.133	-0.125	0.121	1.098	0.272
Internal Capability -> Competitive Advantage	0.592	0.594	0.122	4.843	0.000

The results show that the path Community Support → Competitive Advantage has a coefficient of -0.133, a t-statistic value of 1.098, and a p-value of 0.272, indicating that the effect is not significant. In contrast, the path Community Support → Internal Capability shows a positive and significant effect, with a coefficient of 0.286, a t-statistic value of 2.222, and a p-value of 0.026. The path Government Support → Competitive Advantage also shows a positive and significant effect, with a coefficient of 0.379, a t-statistic value of 2.376, and a p-value of 0.018. Likewise, the path Government Support → Internal Capability is significant, with a coefficient of 0.423, a t-statistic value of 3.548, and a p-value of 0.000.

The path Internal Capability → Competitive Advantage shows the largest coefficient among all direct paths, namely 0.592, with a t-statistic value of 4.843 and a p-value of 0.000, indicating a positive and significant effect. These findings confirm that Internal Capability is the strongest driver of Competitive Advantage in this research model. The results of the indirect effect testing in the research model are presented in the following table, which assesses the mediating role of variables in the relationships among constructs.

The bootstrapping procedure was used to test the mediating role of Internal Ability and indirect effects. The significance of each indirect relationship was assessed using the indirect path coefficient (β), the t-statistic, and the p-value. The bootstrapping results for specific indirect effects are presented in Table 13.

Table 13. Specific indirect effect

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (O/STDEV)	P Values
Government Support -> Internal Capability -> Competitive Advantage	0.250	0.267	0.109	2.289	0.022
Community Support -> Internal Capability -> Competitive Advantage	0.169	0.165	0.074	2.283	0.022

The path Government Support → Internal Capability → Competitive Advantage also yields a coefficient of 0.250, a t-statistic value of 2.289, and a p-value of 0.022, indicating a significant indirect effect. The indirect effect test shows that the path Community Support → Internal Capability → Competitive Advantage has a coefficient of 0.169, a t-statistic value of 2.283, and a p-value of 0.022, indicating that the indirect effect is significant. This confirms that Internal Capability mediates the relationship between Community Support and Competitive Advantage. Internal Capability therefore functions as a mediating variable in the relationship between Government Support and Competitive Advantage.

4.2 Discussions

4.2.1 The Effect of Government Support on Internal Capability

The test results show that government support has a positive and significant effect on internal capability, with a coefficient of 0.423, a t-statistic of 3.548 and a p-value of 0.000. These findings indicate that government support can significantly strengthen the internal capability of MSMEs. Support in the form of policies, mentoring, training and access to government financing can help MSMEs improve their internal capabilities, namely leadership, entrepreneurial competence and motivation. Consequently, government support not only has a direct impact on competitiveness but also acts as a key driver for enhancing internal capability. The government contributes by formulating policies, facilitating access to finance, supporting education and mentoring, and offering market assistance to business operators. This finding is consistent with previous studies showing that government support contributes to SME capability development by improving access to strategic resources, institutional assistance, and business development programs ([Alkahtani et al., 2020](#)). These studies suggest that government intervention enhances not only business performance but also the organizational capability required to sustain long-term competitiveness. The government is a key actor responsible for creating an enabling entrepreneurial environment through policy formulation, financial support, education, mentoring, and market access ([Stam, 2015](#)). Such ecosystem support enables SMEs to develop stronger organizational capability before achieving superior business performance. This argument is further reinforced by the Resource-Based View (RBV), which posits that external resources create sustainable competitive advantage only when they are transformed into valuable organizational capabilities.

4.2.2 The Effect of Community Support on Internal Capability

The test results demonstrate that Community Support has a positive and significant effect on Internal Capability, with a coefficient of 0.286, a t-statistic value of 2.222, and a p-value of 0.026. Thus, the hypothesis that community support has a positive effect on internal capability is supported by the data.

This finding indicates that the stronger the community support received, the better the organization's internal capability will be. Community support can encourage the development of knowledge, collaboration, motivation, and resource exchange, which, in turn, strengthen the organization's internal capability. Community support is therefore one of the important factors in building a stronger foundation for internal capability. According to Social Capital Theory, community networks create organizational value by enabling firms to access knowledge, information, and complementary resources that strengthen organizational capability ([Adler & Kwon, 2002](#); [Nahapiet & Ghoshal, 1998](#)). Similarly, Entrepreneurial Ecosystem Theory emphasizes that entrepreneurial communities promote learning, networking, and collaboration, which enhance firms' capability development and long-term sustainability ([Isenberg, 2011](#); [Stam, 2015](#)).

4.2.3 The Effect of Government Support on Competitive Advantage

The analysis indicates that government support has a positive, statistically significant effect on competitive advantage, as evidenced by a coefficient of 0.379 and a t-statistic of 2.376, and a p-value of 0.018. These findings suggest that government support is essential in enhancing MSME competitiveness. Such support may take the form of policies, facilities, access to information, training, or other assistance that enables MSMEs to grow more competitively. The greater the government support received, the greater the opportunity for MSMEs to achieve a competitive advantage in an increasingly competitive environment.

The results of this study are also consistent with previous research, which found that government support through policies, financing, mentoring, business development programmes, and facilitating access to strategic resources, as well as strengthening business networks, plays a significant role in improving the performance and competitiveness of MSMEs ([Jalali, 2026](#); [Siregar et al., 2025b](#)). Entrepreneurs with strong political and governmental connections can rapidly gain a sustainable competitive advantage amidst a volatile market ([Khan et al., 2021](#); [Li et al., 2008](#)).

4.2.4 The Effect of Community Support on Competitive Advantage

Empirical findings indicate that community support does not have a significant influence on competitive advantage, as indicated by a path coefficient of -0.133, a t-statistic of 1.098, and a p-value of 0.272. These results suggest that community support has not yet directly enhanced MSMEs' competitive advantage. The role of community support is indirect: it first strengthens the organisation's internal capacity before influencing competitive advantage. This contrasts with recent studies, which have found a relationship between social capital and competitive advantage, and that this relationship can improve company performance ([Matthias Wenzel et al., 2020](#); [Teece, 2020](#)). In other words, the influence of community support requires an intermediary process for its impact on competitive advantage to become more apparent. Firms with better access to network resources will have a greater competitive advantage and generate higher profits ([Naruetharadhol et al., 2023](#); [Ou et al., 2015](#)). This suggests that community relationships essentially strengthen organisational learning, knowledge sharing and the capacity for innovation before influencing organisational performance. Consequently, the contribution of community support tends to be indirect rather than direct, as its benefits depend on the firm's ability to absorb and utilise external knowledge.

This interpretation aligns with the Absorptive Capacity Theory, which argues that organizations benefit from external knowledge only if they can acquire, assimilate, transform, and utilize it ([Cohen & Levinthal, 1990](#); [Noya et al., 2025](#)). Similarly, Social Capital Theory explains that community networks create organizational value by facilitating trust, collaboration, and knowledge exchange; however, these relationships only contribute to organizational performance after they have strengthened the organization's internal capabilities and the findings indicate that social capital is essential for the development of Small And Medium-Sized Enterprises (SMEs) by promoting innovation, collaboration, and access to vital resources. Additionally, management strategies, including microfinance initiatives, entrepreneurial ecosystems, and social entrepreneurship, offer effective ways to utilize community resources ([Adler & Kwon, 2002](#); [Marlina, 2024](#); [Nahapiet & Ghoshal, 1998](#)).

This study expands the existing literature by demonstrating that community support should not be viewed as a direct source of competitive advantage. Rather, its strategic value lies in the strengthening of Internal Capabilities, which in this study are conceptualized as a high-level construct comprising leadership, entrepreneurial motivation, and financial competence. These findings suggest that external community resources generate competitive advantage only when they are transformed into organizational capabilities. Consequently, various external supporting actors create organizational value through different strategic mechanisms: government support contributes both directly and indirectly to competitive advantage, whilst community support contributes indirectly by first strengthening internal capabilities.

4.2.5 The Effect of Internal Capability on Competitive Advantage

The test results show that internal capabilities have a positive and significant influence on competitive advantage, with a coefficient of 0.592, a t-statistic of 4.843, and a p-value of 0.000. These findings confirm that internal capabilities are a key determinant of competitive advantage. Organisations with strong internal capabilities are better able to manage resources, respond to environmental changes, and create greater value than their competitors. Therefore, internal capabilities are a key factor in achieving sustainable competitive advantage. Previous research has shown that internal capacity significantly impacts the performance of MSMEs ([Arif & Herawan, 2026](#)). A company's ability to integrate, build and reorganise internal and external competencies contributes to sustainable competitive advantage and improved performance and local community support and external partnerships significantly enhance organizational capability and business performance, with local community support exerting a stronger influence. Moreover, innovation and dynamic capabilities are critical for improving performance, highlighting that the integration of community support and organizational capability is essential for achieving sustainable competitiveness in dynamic business environments ([Mathivathanan, Govindan, & Haq, 2017](#); [Seo, & Lee, 2019](#)).

The findings are also supported by previous empirical studies demonstrating that stronger organizational capability contributes significantly to SMEs' innovation, business performance, and long-term competitiveness ([Barney, 1991](#); [Teece, Pisano, & Shuen, 1997](#)). However, unlike previous studies that examined leadership, entrepreneurial motivation, or financial competence as independent organizational factors, this study conceptualizes Internal Capability as a higher-order construct integrating these three complementary dimensions. This integrated perspective provides a more concise explanation of how SMEs develop organizational capability to achieve sustainable competitive advantage. This study therefore extends the existing literature by demonstrating that sustainable competitive advantage is driven by the combined effect of Leadership, Entrepreneurial Motivation, and Financial Competence, which together constitute Internal Capability. These findings reinforce the argument that external support creates organizational value only when it strengthens SMEs' internal capability, making Internal Capability the central mechanism through which sustainable competitive advantage is achieved.

4.2.6 The Indirect Effect of Government Support on Competitive Advantage through Internal Capability

The mediation analysis indicates that Internal Capability significantly mediates the relationship between Government Support and Competitive Advantage ($\beta = 0.250$, $t = 2.289$, $p = 0.022$). Thus, government support does not generate competitive advantage solely through direct intervention. Its effectiveness is contingent upon the translation of government initiatives into organizational capability. Policies, financial assistance, mentoring, and institutional facilitation offer strategic resources; however, these resources contribute to competitive advantage only when they enhance SMEs' internal capability.

This finding clarifies the process by which government intervention creates organizational value. Government support does not automatically enhance competitiveness, as external assistance cannot be directly converted into superior organizational performance. Government programs become strategically valuable when they strengthen SMEs' Leadership, Entrepreneurial Motivation, and Financial Competence, thereby enabling firms to manage resources efficiently, adapt to market changes, and capitalize on business opportunities. Internal Capability thus serves as the mechanism through which government support is transformed into sustainable competitive advantage.

Therefore, internal capacity plays an important mediating role in the relationship between government support and competitive advantage; human resources, managerial skills, and professional development, along with institutional quality and networks, have a statistically significant influence on MSME performance ([Alite et al., 2025](#)). This result aligns with the Resource-Based View (RBV), which posits that sustainable competitive advantage arises from valuable organizational capabilities rather than from external resources alone. Similarly, Entrepreneurial Ecosystem Theory asserts that government plays a strategic role by establishing an enabling environment through policies, financing, education, and institutional support that foster entrepreneurial capability ([Isenberg, 2011](#); [Stam, 2015](#)). These theoretical perspectives indicate that government support is effective only when external resources are internalized into firm-specific capabilities that competitors find difficult to replicate, highlighting the importance of internalization as the pathway to competitive advantage.

This study contributes to the literature by demonstrating that Internal Capability functions as the organizational mechanism that transforms government support into competitive advantage. Furthermore, Internal Capability is conceptualized as a higher-order construct that integrates Leadership, Entrepreneurial Motivation, and Financial Competence. These findings suggest that government support should be assessed not only by the quantity of assistance provided but also by its effectiveness in enhancing SMEs' internal capability, which is critical for achieving sustainable competitive advantage.

4.2.7 The Indirect Effect of Community Support on Competitive Advantage through Internal Capability

The mediation analysis demonstrates that Community Support exerts a positive and significant indirect effect on Competitive Advantage through Internal Capability ($\beta = 0.169$, $t = 2.283$, $p = 0.022$).

These results indicate that community support does not directly generate competitive advantage but instead contributes indirectly by enhancing SMEs' internal capability. Community networks facilitate knowledge sharing, collaboration, mentoring, and resource exchange, which become valuable only when integrated into organizational capabilities. Knowledge acquired through interorganizational networks contributes to firm performance only after it is absorbed and integrated into organizational capabilities. In the SME context, social capital enhances business competitiveness mainly by strengthening innovation capability rather than by directly improving competitive advantage ([Inkpen & Tsang, 2005](#); [Sulistyo & Ayuni, 2019](#)). One explanation is that entrepreneurial communities primarily provide intangible resources, such as information, business experience, networking opportunities, and entrepreneurial learning. These resources do not automatically enhance organizational performance; they must first be internalized as firm-specific capabilities.

This study advances the literature by demonstrating that Internal Capability is the primary organizational mechanism by which external support translates into sustainable competitive advantage. In contrast to previous studies that examined government support and community support separately, this research compares their distinct strategic roles and conceptualizes Internal Capability as a higher-order construct comprising Leadership, Entrepreneurial Motivation, and Financial Competence. The findings thus offer a more comprehensive explanation of how various forms of external support contribute to SMEs' long-term competitiveness.

5. Conclusions

5.1 Conclusion

The findings of this study have significant implications for policymakers, the entrepreneurial community, and MSME practitioners. Firstly, government support programmes should not only focus on providing financial assistance and regulatory incentives but also on strengthening the internal capabilities of MSMEs. Capacity-building initiatives need to emphasise leadership development, entrepreneurial motivation and financial competence through structured mentoring, managerial training, business coaching and digital financial literacy programmes. Such interventions are considered more effective in creating sustainable competitive advantage than financial assistance alone, as they can enhance MSMEs' ability to make optimal use of external resources.

Secondly, entrepreneurial communities and business associations should be positioned not merely as networking platforms, but also as ecosystems for capability development. Community-based activities, such as peer learning, business mentoring, collaborative problem-solving, and knowledge-sharing forums, need to be designed to facilitate the transfer of entrepreneurial knowledge and managerial experience that can strengthen the internal capabilities of MSMEs. These findings emphasise that the effectiveness of community support should be evaluated by its contribution to capability development, rather than solely by the number of networking activities carried out.

Thirdly, SME practitioners need to understand that external support alone is insufficient to achieve sustainable competitive advantage. Government programmes, community networks and external partnerships should be viewed as strategic learning opportunities that enable firms to strengthen their leadership skills, entrepreneurial motivation and financial competence. SMEs that successfully internalise these external resources tend to be better able to develop superior organisational capabilities and maintain a competitive advantage in an increasingly dynamic business environment.

Overall, this study confirms that the success of external support programmes should be evaluated not only by the amount of assistance provided but also by their effectiveness in transforming external resources into stronger internal capabilities. Consequently, future SME development policies need to prioritise capability development as the primary mechanism through which external support can generate sustainable competitive advantage.

5.2 Research Limitations

This study is limited by its cross-sectional design and its focus on government support and community support as the primary external determinants of competitive advantage. However, these limitations do

not undermine the validity of the findings, as the study was designed to examine structural relationships among the proposed constructs. Future research is encouraged to adopt longitudinal designs, incorporate additional external support actors, such as digital platforms, examine additional organizational capabilities, including innovation, digital, and organizational learning.

5.3 Suggestions and Directions for Future Research

Future research is encouraged to expand the proposed model by incorporating a broader range of external support actors, such as universities, financial institutions, digital platforms, industry associations, and private-sector partnerships, to provide a more comprehensive understanding of the factors influencing MSMEs' competitive advantage. In addition, future studies should examine other strategic organizational capabilities, including innovation capability, digital capability, organizational learning, and knowledge management capability, as potential mechanisms linking external support to competitive advantage. Methodologically, longitudinal research is recommended to capture the dynamic development of MSMEs' internal capabilities over time, while applying Covariance-Based Structural Equation Modeling (CB-SEM) or Multi-Group Analysis (MGA) across different industries, regions, and SME sizes would strengthen the robustness and generalizability of the proposed model

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Author Contributions

MD contributed to conceptualization, methodology, investigation, data curation, and writing original draft. MHAA contributed to formal analysis and data interpretation. BS contributed to writing review & editing, and supervision. All authors have read and approved the final version of the manuscript.

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