THE ROLE OF INNOVATION IN ENHANCING FINANCIAL PERFORMANCE IN YOGYAKARTA'S CREATIVE INDUSTRY

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Abstract

This study explores the impact of various types of innovation—organizational, process, product, and business model innovations—on the financial performance of firms in Yogyakarta's creative industry. The research employs Partial Least Squares Structural Equation Modeling (PLS-SEM) to analyze data collected from 57 creative industry firms. The findings indicate that organizational innovation significantly enhances process and business model innovations, which in turn positively affect financial performance. However, the direct impact of organizational innovation on product innovation is not significant, suggesting the need for a more integrated approach to foster product development. The study highlights the essential of innovative practices and adaptive business models in driving financial success in the creative industry. These insights are crucial for managers and policymakers aiming to boost the financial performance of creative firms through strategic innovation.

Keywords: Organizational Innovation, Process Innovation, Product Innovation, Business Model Innovation, Financial Performance, Creative Industry

1. INTRODUCTION

In the era of digitalization and globalization, the creative industry has evolved into one of the fastest-growing economic sectors, playing a crucial role in the global economy (Müller et al., 2009) as well as in Indonesia that also contribute to country's economy (Aziz et al., 2023; Ulum et al., 2022). The industry creates value through creativity that generates innovation and has the potential to drive economic growth and create jobs (Achdiat et al., 2023). However, the impact of innovation in the creative industry on financial performance is still not fully understood or measured.

While innovation is often associated with improved financial performance, there is also evidence that innovation can hinder financial performance if not managed properly. The substantial costs linked to developing and implementing innovations can place a heavy burden on companies, particularly for SMEs in the creative industry with limited resources. In addition, the risk of innovation failure can also lead to significant financial losses (Lestari et al., 2023).

The creative industry pays more attention to the creative process than the managerial which makes the application of management principles a challenge. Tensions arising from managerial factors can stifle creativity and innovation (Cnossen et al., 2019). Managerial practices that are too rigid or structured can hinder the creative process, ultimately affecting

the company's performance. A managerial approach oriented towards efficiency, productivity, tight control can hinder creativity as employees feel pressured to meet targets and follow strict procedures, which limits their space to innovate (Huber et al., 2017; Lestari et al., 2023; Yuan et al., 2021). The success of new innovations in the creative industry may not depend heavily on key managerial activities, such as handling finances and marketing efforts (Bujor & Avasilcai, 2016).

Research on innovation has traditionally focused on single types, particularly product innovation, without considering other forms or their interrelationships in terms of their impact on the firm performance (Damanpour, 2020; Torres & Augusto, 2020). An in-depth analysis encompassing all types of innovation and their effects on financial performance can offer a fuller and more precise understanding of the opportunities and challenges in the creative industry (Lestari et al., 2023).

Past studies have frequently been undertaken in different geographical or regional contexts, which may have different market conditions and industry dynamics than Yogyakarta. There is still a limited number of studies examining how local factors, including culture, regulations, and market conditions in Yogyakarta, influence the correlation between innovation and financial outcomes (Lestari et al., 2023).

The objective of this study is to bridge the gap by investigating how different kinds of product innovations, processes, organizational structures, and business models impact the economic performance of organizations in the creative industry. Gaining a clearer understanding allows companies to more effectively allocate resources toward innovation and enhance their business strategies.

2. LITERATURE REVIEW

2.1. Innovation in Creative Industry

Innovation is conceptualized as an outcome, process, and mindset (Kahn, 2018). It is a critical driver of competitiveness and growth in the creative industry (Husin et al., 2021). It entails introducing novel products, processes, organizational strategies, and business models designed to enhance the value of creative outputs (Aziz et al., 2023; Galia & Zenou, 2012) and covers innovations in cultural production, merging organizational development, customer interaction, and technological applications (Jaw et al., 2012). The innovation process in creative industries is human-centered, focusing on the company-client relationship.

Wohl (2021) highlights that innovation in the creative industry can take various forms, encompassing product innovation, involving the development of new or substantially improved products and services, and process innovation, which focuses on enhancing the efficiency and effectiveness of production methods. Organizational and business model innovations are also crucial, as they enable firms to structure their operations and market strategies in novel ways that can enhance performance. It encompasses cultural production innovations, combining organizational development, client interface, and technology application (Jaw et al., 2012)

Research on innovation types reveals complex interrelationships and synergies. Product and process innovations are closely linked, with product innovation often triggering other types (Whang et al., 2023). García-Piqueres et al. (2020) found that product innovation is

central to innovation strategies, often combined with other types. However, other studies suggest different directions. Organizational innovation positively affects product and process innovation, with a stronger influence on product innovation (Cozzarin, 2017). Business model innovation, combining complementary process, marketing, and organizational innovations, enhances product innovation performance (Tavassoli & Bengtsson, 2018). Employee innovation behavior and organizational backing for innovation are crucial factors in fostering business model innovation (Hock-Doepgen et al., 2024). Thus, referring the arguments above, we hypothesize that:

H1: Organization innovation has positive effect on Process Innovation
H2: Organization innovation has positive effect on Business Model innovation
H3: Organization innovation has positive effect on Product Innovation
H4: Process innovation has positive effect on Product Innovation
H5: Business model innovation has positive effect on Product Innovation

2.2. Financial Performance in Creative Industry

In the creative industry, financial performance is assessed through multiple indicators, including perceived capital growth, financial planning, profitability, and sales target management. Artz et al. (2010) and Cho & Pucik (2005) emphasize that financial performance is influenced by multiple factors, including market conditions, management practices, and innovation activities. The financial performance of companies in the creative industry is notably influenced by their ability to continuously produce and market new and innovative products and services that cater to evolving consumer demands.

In the creative industry, capital growth might not only involve financial assets but also the value of intellectual property, brand reputation, and creative assets (Mukaro et al., 2023). The growth in the value of these assets can be a strong indicator of a creative business's performance. Studies have shown that investment in intellectual property and creative assets can lead to significant capital growth and long-term profitability in the creative industry. Intellectual capital, including human and structural capital, has been shown to impact profitability, employee productivity, and sales growth (Ahangar, 2011)

In the creative industry, financial planning encounters specific difficulties because of the intangible assets and the unpredictability of the market (Ruseva, 2019). SMEs in this sector often struggle to access traditional bank financing (Borin et al., 2018), necessitating alternative funding strategies. These may include communicating with stakeholders, developing partnerships, and improving financial management (Kostini & Raharja, 2019).

Profit measurement is vital for ensuring financial stability and guiding strategic decisions in creative businesses. Profitability modeling helps link specific actions to overall corporate profitability, fostering disciplined thinking about profit drivers (Epstein & Westbrook, 2001).

Effective monetization strategies, including traditional methods like custom work and subscriptions, as well as innovative approaches like crowdfunding, are essential for revenue generation (Golmgrein, 2023; Rijanto, 2021). Creative firms must balance creative performance with economic results, as exceptional creativity doesn't always translate to financial success (Guercini, 2014).

2.3. Relationship Between Innovation and Financial Performance

The link between innovation and financial performance is both complex and varied. Numerous studies have illustrated how innovation can lead to better financial results, such as improved competitiveness and expanded market share (Artz et al., 2010; Cho & Pucik, 2005), other research suggests a more nuanced relationship. Hai et al. (2022) proposes the correlation between innovation output and financial performance follows a U-shaped curve. This model indicates that at low levels of innovation output, financial performance might initially decrease because of high costs and difficulties with market acceptance. However, as innovation output increases and firms achieve economies of scale and market acceptance, financial performance improves significantly.

Innovation has been demonstrated to significantly impact firm performance, although the relationship is intricate. Multiple studies have identified a positive connection between innovation and financial performance (Bigliardi, 2013; Saunila, 2014; Syed et al., 2016). Innovation can improve competitiveness, profitability, and market differentiation (Alam et al., 2013; Bigliardi, 2013). However, some research indicates mixed or negative effects. Padgett & Moura-Leite (2012) discovered that socially beneficial innovation is associated with a decrease in financial performance. Chen & Peng (2019) reported that excessive R&D spending can harm bank performance, while innovation intentions benefit it. Innovation's impact may change based on the size of the firm, the industry in which it operates, and the time frame under analysis (Bigliardi, 2013; Intrisano et al., 2024) .

Innovation can increase firm riskiness while potentially enhancing profitability (Syed et al., 2016). Some firms exhibit high creative performance but poor economic results, possibly due to inadequate business models (Guercini, 2014). Overall, the literature suggests that innovation's effects on performance are nuanced and context-dependent. Thus, referring the arguments above, we hypothesize that:

H6: Business model innovation has positive effect on financial performance
H7: Product Innovation has positive effect on financial performance

3. RESEARCH METHODS

Employing a quantitative approach, this research utilizes Partial Least Squares Structural Equation Modeling (PLS-SEM) to investigate the hypothesized connections among organizational, process, product, and business model innovations, and their impact on financial performance within Yogyakarta's creative industry. PLS-SEM was selected for its appropriateness in exploratory research and its capability to manage complex models with various constructs and indicators (Hair et al., 2022).

The quantitative data for this study comprises several key constructs consisting of organizational innovation, process innovation, product innovation, business model innovation, and financial performance. Each construct is measured using validated scales to ensure reliability and validity. Organizational innovation is measured using dimensions that capture the overall innovative practices within the organization. Process innovation is measured by the degree to which new or substantially improved production or delivery methods are adopted. Product innovation is assessed based on the introduction of new or significantly enhanced goods or services, while business model innovation is evaluated by the implementation of new business models or major enhancements to existing ones.

Financial performance is measured by perceived capital growth, financial planning, profitability, and sales target management (Ahangar, 2011).

The study uses a sample of 57 creative industry firms located in Yogyakarta. This sample size is selected to ensure adequate. Structured questionnaires measured using Likert-scale (1-5) are distributed to senior management or executives responsible for innovation and financial management within their companies in Yogyakarta's creative industry.

The theoretical model developed for this study hypothesizes several relationships between the constructs which can be illustrated in the following diagram:

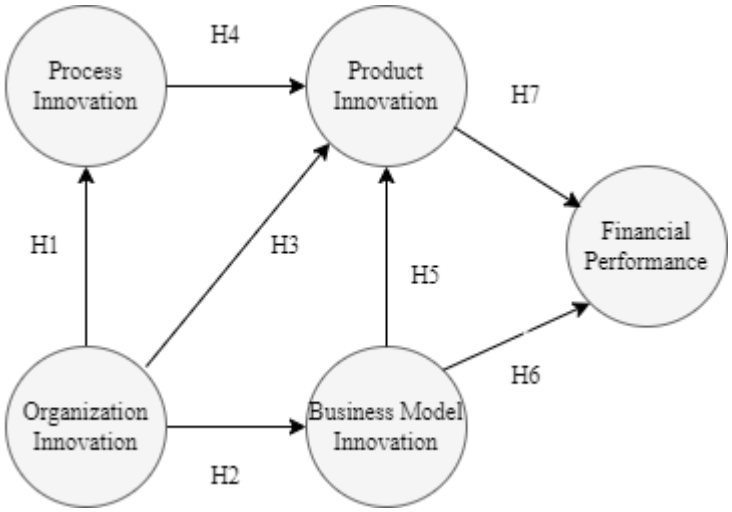

Figure 1. Research Framework

4. RESULTS AND DISCUSSION

4.1. Research Results

4.1.1. Validity Test

The reliability and validity of the measurement model were both confirmed as satisfactory. The outer loading of each of the indicators has a value above 0.7, which indicates that the indicators are reliable and have a strong correlation with their respective constructs. Given their high validity, these indicators are preserved in the model since they effectively explain a large portion of the variance in the latent construct.

High outer loadings imply that the variance captured by the constructs from their indicators is substantial, thus ensuring that the constructs are well-defined by their respective indicators. All constructs had composite reliability scores above the recommended threshold of 0.7, and Average Variance Extracted (AVE) values were greater than 0.5, demonstrating satisfactory convergent validity.

Discriminant validity is evaluated to confirm that a construct is genuinely separate from other constructs according to empirical standards. The table likely illustrates the Fornell-Larcker criterion, which compares the square root of Average Variance Extracted (AVE) values with the correlations between constructs.

Table 1. Discriminant Validity - Fornell Larcker Criterion

Variable	Business Model Innovation	Organization Innovation	Perceived Financial Performance	Process Innovation	Product Innovation
Business Model Innovation	0.738	0.621	0.521	0.629	0.507
Organization Innovation	0.621	0.949	0.580	0.459	0.477
Perceived Financial Performance	0.521	0.580	0.790	0.488	0.500
Process Innovation	0.629	0.459	0.488	0.866	0.719
Product Innovation	0.507	0.477	0.500	0.719	0.806

The Fornell-Larcker criterion for discriminant validity confirms that all constructs in the table are distinct, as the square root of the Average Variance Extracted (AVE) for each construct is greater than its correlations with other constructs, demonstrating that the constructs are clearly defined and effectively measured by their indicators. This suggests that the model possesses good discriminant validity, and each construct captures phenomena that other constructs do not.

4.1.2. Direct Effect Test

Table 2. Direct Effect Test

Relationship	Original sample (O)	t-value	P values
Organization Innovation -> Process Innovation (H1)	0.459	3.830	0.000
Organization Innovation -> Business Model Innovation (H2)	0.621	7.464	0.000
Organization Innovation -> Product Innovation (H3)	0.193	1.795	0.073
Process Innovation -> Product Innovation (H4)	0.640	5.464	0.000
Business Model Innovation -> Product Innovation (H5)	-0.016	0.090	0.929
Business Model Innovation -> Financial Performance (H6)	0.361	3.428	0.001
Product Innovation -> Perceived Financial Performance (H7)	0.317	3.046	0.002

There is a statistically significant path coefficient in the link between organizational innovation and process innovation ($\beta = 0.459$, $t = 3.830$, $p < 0.01$), supporting Hypothesis 1. This indicates that higher levels of organizational innovation are associated with significant improvements in process innovation within the creative industry firms in Yogyakarta.

A strong positive effect was observed for the path leading from organizational innovation to business model innovation ($\beta = 0.621$, $t = 7.464$, $p < 0.01$), validating

Hypothesis 3. This demonstrates that innovative organizational practices are crucial drivers for developing new or significantly improved business models.

There was no significant relationship found between organizational innovation and product innovation ($\beta = 0.193$, $t = 1.795$, $p > 0.05$), thus not supporting Hypothesis 2. This suggests that, in this sample, organizational innovation alone does not directly lead to significant advancements in product innovation.

Process innovation had a significant effect on product innovation ($\beta = 0.640$, $t = 5.464$, $p < 0.01$), supporting Hypothesis 4. This implies that advancements in process innovation have a beneficial impact on product innovation, pointing to a collaborative relationship.

The connection between business model innovation and product innovation was not statistically significant ($\beta = -0.016$, $t = 0.090$, $p > 0.05$), thus not supporting Hypothesis 5. The result indicates that business model innovation does not have a direct and significant impact on product innovation in this case.

There was a significant path coefficient observed in the relationship between business model innovation and financial performance ($\beta = 0.361$, $t = 3.428$, $p < 0.01$), supporting Hypothesis 6. This finding highlights that firms that innovate their business models experience better perceived financial performance.

The path coefficient for the connection between product innovation and financial performance was significant ($\beta = 0.317$, $t = 3.046$, $p < 0.01$), supporting Hypothesis 7. This indicates that product innovation directly contributes to enhanced financial performance, demonstrating the value of continual product development and improvement.

4.1.3. Indirect Effect Test

Table 3. Indirect Effect Tests

Relationship	Original sample (O)	t-statistic	p-value
Organization Innovation -> Process innovation -> product innovation-> financial performance	0.093	1.979	0.048
Organization innovation -> business model innovation -> product innovation -> financial performance	-0.003	0.084	0.933
Organization innovation -> business model innovation -> financial performance	0.224	2.917	0.004
Organization innovation -> product innovation -> financial innovation	0.061	1.412	0.158

Organizational Innovation → Process Innovation → Product Innovation → Financial Performance

The substantial positive indirect influence (path coefficient: 0.093, p-value: 0.048) indicates that organizational innovation enhances process innovation, which subsequently drives product innovation and ultimately improves financial performance. This pathway underscores the importance of process improvements as a foundational step that supports product development and financial gains. It suggests that firms should focus on refining their internal processes to foster product innovation and achieve better financial outcomes.

Organizational Innovation → Business Model Innovation → Product Innovation → Financial Performance

This pathway was found to be not significant (path coefficient: -0.003, p-value: 0.933), indicating that business model innovation does not significantly mediate The association between organizational innovation and financial performance through product innovation. This points to the fact that changes in the business model alone may not directly translate into financial benefits via product innovation. It implies that other factors or more direct pathways may be more influential in leveraging organizational innovation for financial performance.

Organizational Innovation → Business Model Innovation → Financial Performance

The significant positive indirect effect (path coefficient: 0.224, p-value: 0.004) highlights that business model innovation directly mediates the correlation between organizational innovation and financial performance. This result underscores the importance of innovative business models in turning organizational changes into financial achievements. It indicates that firms can achieve significant financial improvements by focusing on innovative business models that enhance operational efficiency and create new revenue streams.

Organizational Innovation → Product Innovation → Financial Performance

Although this pathway was not significant (path coefficient: 0.061, p-value: 0.158), This implies a positive but not statistically significant relation among organizational innovation and financial performance via the intermediary role of product innovation. This implies that while product innovation is important, it may not be the sole or most direct route through which organizational innovation impacts financial performance. Other mediating factors, such as process or business model innovations, might play a more crucial role.

4.2. Discussion

4.2.1. Direct effects

1) The effect of organization innovation on Process Innovation

The findings highlight the essential role of organizational innovation in advancing process and business model innovations in Yogyakarta's creative sector. The significant positive relationship between organizational innovation and process innovation points to the importance of cultivating an innovative culture to enhance internal processes. This finding aligns with previous research suggesting that organizational structures and practices that promote innovation can lead to improved operational efficiencies and capabilities (Cozzarin, 2017).

2) The effect of organization innovation on business model innovation

The strong positive impact of organizational innovation on business model innovation further emphasizes the need for creative industry firms to continuously innovate their business models to remain competitive. This relationship indicates that firms that invest in organizational innovation are more capable of developing innovative business models that can adapt to changing market dynamics and consumer preferences (Hock-Doepgen et al., 2024). The implementation of innovative organizational structures that promote cross-

functional teams can enhance a company's ability to develop and implement new business models (Stoiber et al., 2023).

3) The effect of organization innovation on product innovation

Interestingly, the straightforward connection between organizational innovation and product innovation was not significant. This suggests that other factors, such as market conditions, customer feedback, or technological advancements, may have a more significant impact on driving product innovation than organizational innovation by itself. This finding also points to the possibility that how organizational innovation affects product innovation could be mediated through innovations in processes, among other types (Phan, 2019). The effectiveness of organizational innovation may depend on other moderating factors such as firm size, market conditions, and the existing innovation culture within the organization (Xie et al., 2021).

4) The effect of process innovation on product innovation

The notable relationship between process innovation and product innovation emphasizes how these two types of innovation rely on each other. By improving processes, companies can develop better products, as streamlined processes enhance quality, cut costs, and speed up the time-to-market. This conclusion validates the concept that process innovation is a fundamental catalyst for product innovation within the creative industry (Kosta & Busho, 2019). Process innovation often significantly impacts product innovation by improving efficiency, reducing costs, and enabling new product features or entirely new products. Research indicates that process innovation can improve a firm's capability to launch new products by refining the production process, making it more adaptable and responsive to market needs (Ahmed et al., 2020).

5) The effect of business model innovation on product innovation

The insignificant relationship between business model innovation and product innovation indicates that, while altering the business model is important for overall performance, they do not necessarily translate directly into new or improved products. This could be due to the specific nature of the creative industry, where product innovation may rely more heavily on creative inputs and market trends than on business model changes (Tavassoli & Bengtsson, 2018).

6) The effect of business model innovation on financial performance

The significant positive relationship between business model innovation and financial performance underscores the importance of continuously evolving business models to improve financial outcomes. Firms that innovate their business models are likely to see better financial performance, demonstrating the value of aligning business strategies with market demands and technological advancements performance (Bigliardi, 2013; Saunila, 2014; Syed et al., 2016).

7) The effect of product innovation on financial performance

The notable relationship between product innovation and financial performance highlights that continuous improvement and development of products are key to improving

financial results. These findings align with previous research by Nyamao & Tari (2023) who found that innovative product development directly contributes to better financial outcomes This highlights the importance of investing in product innovation to achieve competitive advantage and financial success.

4.2.2. Indirect effects

The indirect effect analysis provides significant insights into how different forms of innovation mediate the relationship between organizational innovation and financial performance.

The significant positive indirect effect of organizational innovation on financial performance through business model innovation emphasizes how essential innovative business models are for turning organizational changes into financial gains. This result supports studies that stress the strategic importance of business model innovation for developing new revenue sources and boosting efficiency, leading to better financial outcomes.

The analysis also identifies non-significant pathways, such as the indirect effect of organizational innovation on financial performance through product innovation and through business model innovation to product innovation and then to financial performance. These findings suggest that while organizational innovation is crucial, its direct pathway through product innovation alone may not be the most influential. Instead, other factors or more direct pathways, such as business model innovation, could play a more important role in capitalizing on organizational innovation to achieve financial success.

5. CONCLUSION

Overall, these insights are crucial for managers and policymakers in Yogyakarta's creative industry. Emphasizing organizational and process innovation can significantly improve business models and products, ultimately leading to better financial performance. The significant relationships observed in this study emphasize the multifaceted nature of innovation within firms. Organizational innovation significantly impacts financial performance through process and business model innovations, while its effect through product innovation alone is less clear. This comprehensive strategy ensures that organizational changes are effectively translated into tangible financial benefits, supporting long-term growth and competitive advantage. Exploring potential mediators in the relationship between organizational innovation and product innovation could provide a more comprehensive understanding of innovation dynamics in the creative sector in future research.

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