International Journal of Applied Business & International Management (IJABIM)
Vol. 11 No. 2, pp.1180-1202, August, 2026
E-ISSN: 2621-2862 P-ISSN: 2614-7432
https://www.ejournal.aibpmjournals.com/index.php/IJABIM

# Beyond ESG Adoption: How Value Co-Creation and Community Engagement Transform Sustainability Practices into Business Performance in Creative SMEs

**Sri Ismulyati[1], Ginta Ginting[1], Andriyansah[1]**
[1]Faculty of Economic and Business, Universitas Terbuka
Jl. Cabe Raya, Pd. Cabe Udik, Kec. Pamulang, Tangerang, Banten 15418, Indonesia
*Corresponding Email: srismu@ecampus.ut.ac.id[1]

**ARTICLE INFORMATION**

**Publication information**

**Research article**

**HOW TO CITE**
Ismulyati, S., Ginting, G., & Andryansah. (2026). Beyond ESG adoption: How value co-creation and community engagement transform sustainability practices into business performance in creative SMEs. *International Journal of Applied Business & International Management (IJABIM), 11*(2), 1180–1202.

**DOI:**
https://doi.org/10.32535/ijabim.v11i2.5062



Received: 16 June 2026
Accepted: 19 July 2026
Published: 20 August 2026

**ABSTRACT**

This study examines how Environmental, Social, and Governance (ESG) practices enhance creative SME performance through value co-creation and community engagement. Drawing on Stakeholder Theory and Service-Dominant Logic, data were collected from 215 owners, managers, and employees of creative SMEs across Java, Indonesia, and analyzed using PLS-SEM. Results show that all ESG dimensions significantly enhance value co-creation and community engagement. Environmental practices exert the strongest effect on value co-creation ($\beta = 0.426$), while social practices have the strongest effect on community engagement ($\beta = 0.454$). Both mechanisms significantly mediate ESG–performance relationships, with the social practices–community engagement–SME performance pathway showing the strongest indirect effect ($\beta = 0.180$, $p < 0.001$). These findings identify collaborative value creation and community-embedded relationships as complementary pathways linking ESG to performance. The study suggests that creative SMEs should integrate sustainability practices with stakeholder collaboration and meaningful community participation to strengthen competitiveness and sustainable business performance.

**Keywords:** ESG practices; value co-creation; community engagement; SME performance; creative SMEs; Indonesia

## INTRODUCTION

The growing pressure on firms to reconcile economic performance with environmental responsibility, social inclusion, and accountable governance has elevated ESG from a peripheral concern to a strategic priority. This transition is particularly relevant to SMEs, which play a substantial role in employment, innovation, and local economic development but often face financial, managerial, technological, and institutional constraints in integrating sustainability into business strategy. These challenges are especially salient for creative SMEs, whose competitiveness frequently depends on local resources, cultural assets, traditional knowledge, craftsmanship, and community relationships. For these firms, sustainability is therefore not merely a compliance issue but a strategic concern closely linked to resource continuity, stakeholder legitimacy, and long-term competitiveness.

Indonesia provides a relevant context for examining these relationships. The creative economy employed approximately 27.4 million people, representing 18.70% of national employment, in 2025 (BPS-Statistics Indonesia, 2025). Creative SMEs operating in culinary products, crafts, fashion, traditional textiles, and other locally rooted activities contribute not only to economic development but also to cultural preservation, local resource utilization, and community participation. Their dependence on locally embedded resources and stakeholder networks makes them particularly appropriate for investigating how sustainability practices can be transformed into business value.

ESG provides a useful framework for understanding this transformation. Recent evidence suggests that sustainability and ESG-related practices can enhance SME financial performance (Momtaz & Parra, 2025). However, establishing a positive ESG - performance relationship explains whether ESG matters, but provides limited insight into how ESG becomes economically valuable. ESG adoption alone may not automatically improve business performance. Rather, its strategic value may depend on firms' ability to translate environmental responsibility, social commitment, and sound governance into stronger stakeholder relationships and collaborative value-creation activities.

Recent studies increasingly support this mechanism-based perspective. Appiah et al. (2025) show that green value co-creation can shape the financial returns generated by green process innovation among SMEs, suggesting that sustainability initiatives require complementary value-creation mechanisms to produce economic benefits. Similarly, Jiang and Lin (2026) demonstrate that ESG performance can facilitate value co-creation by strengthening trust-based relationships with external stakeholders. Together, these findings suggest that the ESG–performance relationship may be better understood as a stakeholder-enabled value-creation process rather than a purely direct relationship.

Value co-creation represents one important mechanism in this process. Service-Dominant Logic conceptualizes value as emerging through interaction and resource integration among multiple actors rather than being produced solely within firm boundaries (Vargo & Lusch, 2004, 2008, 2016). Customers and other stakeholders can therefore contribute knowledge, feedback, resources, and ideas that support innovation and market value. This mechanism is particularly relevant to creative SMEs, where product authenticity, cultural meaning, design innovation, and customer experience often emerge through close interaction with stakeholders. ESG practices that strengthen trust, transparency, and shared values may consequently provide the relational foundation for collaborative value creation.

**International Journal of Applied Business & International Management (IJABIM)**
**Vol. 11 No. 2, pp.1180-1202, August, 2026**
**E-ISSN: 2621-2862 P-ISSN: 2614-7432**
**https://www.ejournal.aibpmjournals.com/index.php/IJABIM**

Community engagement provides a complementary stakeholder mechanism. Local communities may serve simultaneously as sources of knowledge, labor, resources, cultural identity, legitimacy, and market opportunities. Meaningful engagement with these communities can enable creative SMEs to access locally embedded knowledge, reinforce social legitimacy, preserve cultural authenticity, and develop products and solutions that reflect stakeholder needs. Consistent with Stakeholder Theory (Freeman, 1984; Donaldson & Preston, 1995), ESG may therefore generate greater value when responsible business practices encourage stakeholders to participate actively in firm activities and value creation. While value co-creation captures the collaborative integration of resources to generate value, community engagement reflects firms' relational embeddedness and active interaction with their local communities. Examining both mechanisms may thus provide a more comprehensive explanation of how ESG is translated into business performance.

Despite growing research on ESG and SME sustainability, several gaps remain. First, much ESG research has focused on large and publicly listed firms, whereas SMEs operate with different resource constraints, governance structures, and stakeholder relationships. Second, although prior studies have linked sustainability practices to performance and increasingly recognized value co-creation as an important mechanism (Appiah et al., 2025; Jiang & Lin, 2026), limited research has examined value co-creation and community engagement simultaneously as mediating mechanisms linking ESG practices to SME business performance. Third, these relationships remain underexplored among locally embedded creative SMEs in emerging economies, where business value is closely intertwined with cultural resources, community capabilities, and stakeholder participation.

Addressing these gaps, this study examines how ESG practices influence business performance through the mediating roles of value co-creation and community engagement among creative SMEs in Indonesia. Drawing primarily on Stakeholder Theory (Freeman, 1984; Donaldson & Preston, 1995) and Service-Dominant Logic (Vargo & Lusch, 2004, 2008, 2016), the study advances a central argument: ESG does not create business value merely through adoption; rather, it creates value when sustainability practices activate stakeholder engagement and collaborative value-creation processes. Accordingly, ESG is conceptualized as a strategic platform through which creative SMEs mobilize stakeholder relationships and transform sustainability commitments into economic and strategic value.

This study makes three contributions. First, it extends the ESG–performance literature by shifting the focus from whether ESG improves performance to how ESG creates business value, thereby opening the “black box” of the ESG–performance relationship. Second, it integrates value co-creation and community engagement as complementary stakeholder-based mechanisms, extending Stakeholder Theory and Service-Dominant Logic into the ESG–SME context. Third, it extends ESG research to locally embedded creative SMEs in an emerging economy, where cultural assets, local resources, and community relationships constitute important sources of value. Managerially, the study reframes ESG from a predominantly compliance-oriented practice into a stakeholder-driven value-creation strategy capable of strengthening competitiveness, resilience, and sustainable growth.

## LITERATURE REVIEW

### Theoretical Foundations

This study primarily draws on Stakeholder Theory, complemented by Service-Dominant Logic (S-D Logic), the Resource-Based View (RBV), and Legitimacy Theory, to explain how ESG practices are translated into business performance through value co-creation and community engagement. Stakeholder Theory provides the central foundation by emphasizing that sustainable value creation depends on firms' relationships with multiple stakeholders (Freeman, 1984; Donaldson & Preston, 1995). In creative SMEs, ESG practices can strengthen trust and encourage customers, communities, suppliers, and business partners to participate in value-creation activities, consistent with recent evidence that ESG performance can foster value co-creation through trust-based stakeholder relationships (Jiang & Lin, 2026). S-D Logic further explains that value emerges through interaction and resource integration among multiple actors rather than being produced solely within firm boundaries (Vargo & Lusch, 2004, 2008, 2016).

The RBV complements this perspective by viewing local resources, cultural knowledge, creative capabilities, reputation, and stakeholder networks as potential sources of sustained competitive advantage (Wernerfelt, 1984; Barney, 1991), while Legitimacy Theory explains how responsible environmental, social, and governance practices align firms with societal expectations and strengthen organizational legitimacy. Together, these perspectives suggest that ESG creates strategic value when firms effectively mobilize locally embedded resources, strengthen stakeholder trust, and enable collaborative participation. Accordingly, value co-creation and community engagement are positioned as key mechanisms through which creative SMEs transform ESG practices into sustainable business performance.

### Hypothesis Development

### ESG Dimensions and Value Co-Creation

ESG practices can strengthen stakeholder trust, reciprocity, and willingness to participate in collaborative value creation. From Stakeholder Theory and Service-Dominant Logic, environmental responsibility can create shared sustainability values that encourage stakeholders to exchange knowledge and resources; socially responsible practices strengthen relational trust and stakeholder participation; and sound governance provides transparency, accountability, and institutional conditions that facilitate collaboration (Freeman, 1984; Vargo & Lusch, 2004, 2016). Recent evidence supports this reasoning. Jiang and Lin (2026) find that stronger ESG performance facilitates value co-creation through improved external financing and trust-based stakeholder relationships, with the social dimension showing the strongest effect. Research on SMEs further shows that stakeholder collaboration and value co-creation are central to translating sustainability capabilities into sustainable outcomes. Accordingly:

**H1:** Environmental practices positively influence value co-creation in creative SMEs.
**H2:** Social practices positively influence value co-creation in creative SMEs.
**H3:** Governance practices positively influence value co-creation in creative SMEs.

### ESG Dimensions and Community Engagement

ESG practices can strengthen firms' relationships with local communities by fostering shared environmental responsibility, social inclusion, and accountable governance. Environmental practices encourage stakeholder participation in resource conservation and sustainability initiatives, while social practices promote inclusion, empowerment, and reciprocal relationships. Governance further supports community engagement through transparency, accountability, and participatory decision-making. Consistent with Stakeholder Theory (Freeman, 1984; Donaldson & Preston, 1995), these practices

International Journal of Applied Business & International Management (IJABIM)
Vol. 11 No. 2, pp.1180-1202, August, 2026
E-ISSN: 2621-2862 P-ISSN: 2614-7432
https://www.ejournal.aibpmjournals.com/index.php/IJABIM

strengthen trust and encourage stakeholders to participate in organizational activities. Recent evidence from SMEs shows that sustainability-oriented stakeholder engagement involves open dialogue with local communities and customers, employee and community involvement, and collaboration with suppliers, governments, and other institutional actors (Matarazzo et al., 2025). Evidence from Indonesia further demonstrates that **local community engagement and good corporate governance significantly contribute to sustainable growth**, highlighting the importance of social and governance mechanisms in strengthening sustainability outcomes (Wulandari et al., 2025). Thus:
**H4:** Environmental practices positively influence community engagement in creative SMEs.
**H5:** Social practices positively influence community engagement in creative SMEs.
**H6:** Governance practices positively influence community engagement in creative SMEs.

**Mediating Roles of Value Co-Creation and Community Engagement**
The central proposition of this study is that ESG does not generate business value merely through adoption; rather, its value emerges when responsible practices activate stakeholder participation and collaborative value creation. ESG practices can strengthen trust and stakeholder relationships, thereby facilitating value co-creation (Jiang & Lin, 2026). In SMEs, value co-creation enables firms to mobilize sustainability-related resources and capabilities into stronger financial outcomes (Appiah et al., 2025), while stakeholder and community engagement promotes dialogue, resource integration, and sustainable value creation (Matarazzo et al., 2025). Evidence from Indonesia further demonstrates that local community engagement significantly contributes to sustainable growth, reinforcing its role in converting stakeholder relationships into organizational outcomes (Wulandari et al., 2025). Accordingly, value co-creation and community engagement are expected to transmit the effects of ESG practices to creative SME performance. Thus:
**H7:** Value co-creation mediates the relationship between environmental practices and creative SME performance.
**H8:** Value co-creation mediates the relationship between social practices and creative SME performance.
**H9:** Value co-creation mediates the relationship between governance practices and creative SME performance.
**H10:** Community engagement mediates the relationship between environmental practices and creative SME performance.
**H11:** Community engagement mediates the relationship between social practices and creative SME performance.
**H12:** Community engagement mediates the relationship between governance practices and creative SME performance.-
The conceptual framework developed in this study is presented in Figure 1.

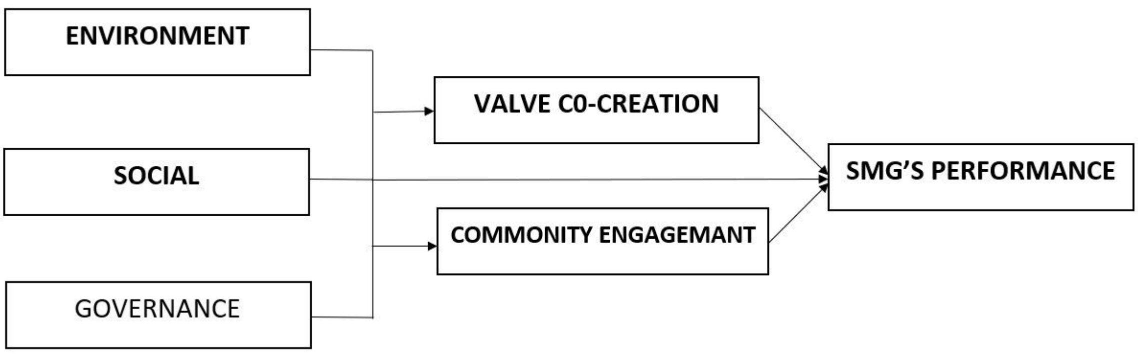


Figure 1. The Conceptual Framework

## RESEARCH METHOD

This study employed a quantitative research design to empirically examine the proposed relationships among the study constructs. The target population comprised creative SMEs operating across Java, Indonesia, particularly those engaged in locally based creative industries such as culinary products, crafts, fashion, traditional textiles, and other creative activities utilizing local resources and cultural assets. Respondents were SME owners, managers employees with sufficient knowledge of their firms' business practices and stakeholder relationships. A purposive non-probability sampling technique was employed based on predefined eligibility criteria. Data were collected through a structured online questionnaire administered via Google Forms between April and July 2026. After data screening and the exclusion of incomplete or invalid responses, 215 valid responses were retained for the final analysis.

The sample size was assessed based on the requirements of structural equation modeling (SEM) and the complexity of the proposed model. Rather than relying solely on a general minimum sample-size threshold, sample adequacy was determined by considering model complexity, the number of structural relationships, expected effect sizes, and statistical power. This approach is consistent with Hair et al. (2019), who emphasize that sample-size requirements for SEM should reflect the characteristics and complexity of the research model. Accordingly, the final sample of 215 respondents was considered adequate for estimating and testing the proposed structural relationships.

The measurement scales were adapted from established studies and contextualized for locally embedded creative SMEs. Environmental, Social, and Governance (ESG) practices were operationalized as three distinct dimensions based on established sustainability and SME-specific ESG measures (Torugsa et al., 2013; Gennari & Salvioni, 2019; Csapi et al., 2026). Environmental practices capture resource efficiency, waste and energy management, and environmental responsibility; social practices reflect employee welfare, social responsibility, equality, and stakeholder relationships; while governance practices assess ethical conduct, transparency, accountability, and responsible business management.
Value co-creation was adapted from
Yi and Gong (2013), capturing stakeholder participation through information sharing, interaction, feedback, and collaborative behaviors. Community engagement was adapted from Goodman et al. (2017, 2021), emphasizing stakeholder participation, collaborative partnerships, shared decision-making, trust, and mutual benefits. SME performance was measured using subjective financial and non-financial performance indicators adapted from Venkatraman and Ramanujam (1986), covering financial, market/customer, operational, and organizational performance.

All constructs were measured using multi-item five-point Likert scales, ranging from 1 ("strongly disagree") to 5 ("strongly agree"), with item wording adapted to the context of creative SMEs. Descriptive statistics, including means and standard deviations, were used to summarize respondent characteristics and responses. Hypotheses were tested using Partial Least Squares Structural Equation Modeling (PLS-SEM), which is appropriate for estimating complex relationships among latent constructs and prediction-oriented models (Chin, 1998). The analysis was conducted using SmartPLS 4 to assess the measurement and structural models and test the proposed hypotheses.

**International Journal of Applied Business & International Management (IJABIM)**
**Vol. 11 No. 2, pp.1180-1202, August, 2026**
**E-ISSN: 2621-2862 P-ISSN: 2614-7432**
**https://www.ejournal.aibpmjournals.com/index.php/IJABIM**

## RESULTS

### Respondent Demographic Characteristics

This study analyzed 215 valid respondents. (SMEs) Respondents represented diverse demographic characteristics (see Table 1), providing sufficient sample variation and broad representation despite the use of purposive sampling.

**Table 1.** Respondents' Profiles

| | Frequency (215) | (%) |
|---|---|---|
| **Occupation** | | |
| Owner/Manager | 157 | 73.02 |
| Employee | 58 | 26.98 |
| **Business Type** | | |
| Cullinary | 75 | 34,88 |
| Fashion | 61 | 28.37 |
| Crafts/Handycrafts | 40 | 18.60 |
| Others (Design &Digital Content, Applications, Music) | 39 | 18.14 |
| **Years in Business** | | |
| <1 Years | 28 | 13.02 |
| 1-3 Years | 72 | 33.48 |
| 4-6 Years | 92 | 42.79 |
| >6 Years | 23 | 10,69 |
| **Number of Employees** | | |
| 1-4 People | 50 | 23,25 |
| 5-10 People | 95 | 44.18 |
| >10 People | 70 | 32,57 |
| **Monthly Revenue** | | |
| <5 Milliom | 53 | 24.65 |
| 5-15 Million | 38 | 17,67 |
| 15-50 Million | 83 | 38.60 |
| >50 Million | 41 | 19,07 |
| Total | 215 | 100.00 |

**Table 1** presents the demographic and business characteristics of the 215 respondents. In terms of occupation, the majority of respondents were owners/managers (73.02%), while 26.98% were employees. Regarding business type, culinary businesses represented the largest group (34.88%), followed by fashion (28.37%), crafts/handicrafts (18.60%), and other creative industries, including design and digital content, applications, and music (18.14%). Most businesses had been operating for 4–6 years (42.79%), followed by 1–3 years (33.49%), less than one year (13.02%), and more than six years (10.70%). In terms of business size, 44.19% employed 5–10 people, 32.56% employed more than 10 people, and 23.26% employed 1–4 people. Regarding monthly revenue, the largest proportion of businesses generated IDR 15–50 million per month (38.60%), followed by those earning less than IDR 5 million (24.65%), more than IDR 50 million (19.07%), and IDR 5–15 million (17.67%).

The findings indicate that the respondents were predominantly owners or managers of relatively established creative SMEs, particularly in the culinary and fashion sectors. Most businesses had operated for more than three years and employed at least five employees, suggesting that the sample largely represents businesses with sufficient operational experience and organizational capacity. Furthermore, the concentration of respondents in the IDR 15-50 million monthly revenue category indicates a moderate level of business activity. Overall, these characteristics provide an appropriate empirical context for examining how sustainability-oriented business practices, including ESG principles, are integrated into business operations and contribute to long-term business performance.

International Journal of Applied Business & International Management (IJABIM)
Vol. 11 No. 2, pp.1180-1202, August, 2026
E-ISSN: 2621-2862 P-ISSN: 2614-7432
https://www.ejournal.aibpmjournals.com/index.php/IJABIM

**Measurement Model**

The measurement model was assessed for construct validity and reliability using outer loadings and Average Variance Extracted (AVE). Following Hair et al. (2022), outer loadings above 0.70 and AVE values above 0.50 indicate adequate convergent validity, confirming that the constructs reliably represent their indicators and are suitable for structural model analysis.

**Table 2. Validity Test Result**

| | Loading Factor | T statistics | P values |
|---|---|---|---|
| CE1 <- Community Engagement | 0.857 | 34.496 | 0.000 |
| CE2 <- Community Engagement | 0.821 | 27.039 | 0.000 |
| CE3 <- Community Engagement | 0.725 | 19.122 | 0.000 |
| CE4 <- Community Engagement | 0.892 | 58.057 | 0.000 |
| CE5 <- Community Engagement | 0.823 | 26.155 | 0.000 |
| ENV1 <- Environtment | 0.841 | 42.807 | 0.000 |
| ENV2 <- Environtment | 0.840 | 28.024 | 0.000 |
| ENV3 <- Environtment | 0.794 | 20.484 | 0.000 |
| ENV4 <- Environtment | 0.828 | 24.947 | 0.000 |
| ENV5 <- Environtment | 0.886 | 46.730 | 0.000 |
| GOV1 <- Government | 0.834 | 25.480 | 0.000 |
| GOV2 <- Government | 0.818 | 27.415 | 0.000 |
| GOV3 <- Government | 0.718 | 17.309 | 0.000 |
| GOV4 <- Government | 0.832 | 28.610 | 0.000 |
| GOV5 <- Government | 0.748 | 16.455 | 0.000 |
| SC1 <- Social | 0.842 | 36.729 | 0.000 |
| SC2 <- Social | 0.813 | 21.784 | 0.000 |
| SC3 <- Social | 0.905 | 52.577 | 0.000 |
| SC4 <- Social | 0.872 | 34.551 | 0.000 |
| SC5 <- Social | 0.831 | 21.108 | 0.000 |
| SP1 <- SME's Performance | 0.902 | 45.871 | 0.000 |
| SP2 <- SME's Performance | 0.817 | 24.028 | 0.000 |
| SP3 <- SME's Performance | 0.839 | 25.770 | 0.000 |
| SP4 <- SME's Performance | 0.843 | 26.706 | 0.000 |
| SP5 <- SME's Performance | 0.874 | 35.222 | 0.000 |
| VCC1 <- Value Co-Creation | 0.888 | 44.035 | 0.000 |
| VCC2 <- Value Co-Creation | 0.867 | 26.902 | 0.000 |
| VCC3 <- Value Co-Creation | 0.757 | 24.113 | 0.000 |
| VCC4 <- Value Co-Creation | 0.744 | 18.298 | 0.000 |
| VCC5 <- Value Co-Creation | 0.852 | 26.266 | 0.000 |

**Table 2** presents the measurement-model validity results. Most indicators exhibited factor loadings above the recommended threshold of 0.70, indicating satisfactory convergent validity. The highest loadings were observed for SC3 (Social; 0.905) and SP1 (SME Performance; 0.902), demonstrating their strong representation of the respective latent constructs. Furthermore, all indicators were statistically significant, with t-statistics exceeding 1.96 and p-values < 0.001. Overall, these results confirm that the indicators reliably and validly measure their respective constructs, providing an adequate measurement foundation for subsequent structural model analysis.

**Table 3. Reliability Test Result**

| | Cronbach's alpha | Composite reliability | Average variance extracted (AVE) |
|---|---|---|---|
| Community Engagement | 0.882 | 0.914 | 0.682 |
| Environtment | 0.894 | 0.922 | 0.703 |
| Government | 0.850 | 0.893 | 0.627 |
| SME's Performance | 0.908 | 0.932 | 0.732 |
| Social | 0.906 | 0.930 | 0.728 |
| Value Co-Creation | 0.880 | 0.913 | 0.678 |

**Table 3** presents the reliability and convergent validity results based on Cronbach’s alpha, composite reliability (CR), and average variance extracted (AVE). All constructs demonstrated strong internal consistency, with composite reliability values exceeding 0.89 and SME Performance recording the highest value (0.932). In addition, all AVE values exceeded the recommended threshold of 0.50, with SME Performance (0.732) and Social (0.728) showing the highest values. Overall, these results confirm satisfactory internal consistency reliability and convergent validity, supporting the adequacy of the measurement model for subsequent structural analysis. These results indicate that the measurement model is reliable and suitable for structural model analysis (Hair et al., 2022).

**Table 4. Discriminant Validity Fornell Larcker Criterion**

| | CE | ENV | GOV | SP | SC | VCC |
|---|---|---|---|---|---|---|
| Community Engagement | **0.826** | | | | | |
| Environtment | 0.592 | **0.838** | | | | |
| Government | 0.571 | 0.174 | **0.792** | | | |
| SME's Performance | 0.809 | 0.615 | 0.592 | **0.855** | | |
| Social | 0.707 | 0.312 | 0.409 | 0.722 | **0.853** | |
| Value Co-Creation | 0.823 | 0.607 | 0.592 | 0.815 | 0.660 | **0.824** |

**Table 4** presents the Fornell–Larcker criterion used to assess discriminant validity. The square root of the AVE for each construct, represented by the diagonal values (e.g., Community Engagement = 0.826, Environment = 0.838, and SME Performance = 0.855), exceeded its correlations with the other constructs. These results indicate satisfactory discriminant validity, confirming that Environment, Social, Governance, Value Co-Creation, Community Engagement, and SME Performance represent empirically distinct constructs. Thus, the measurement model demonstrates adequate construct distinctiveness for subsequent structural model analysis. These findings demonstrate satisfactory discriminant validity and support the robustness of the measurement model, consistent with Hair et al. (2022), providing a reliable foundation for subsequent structural analysis (see Figure 2).

**Figure 2.** Structural Model

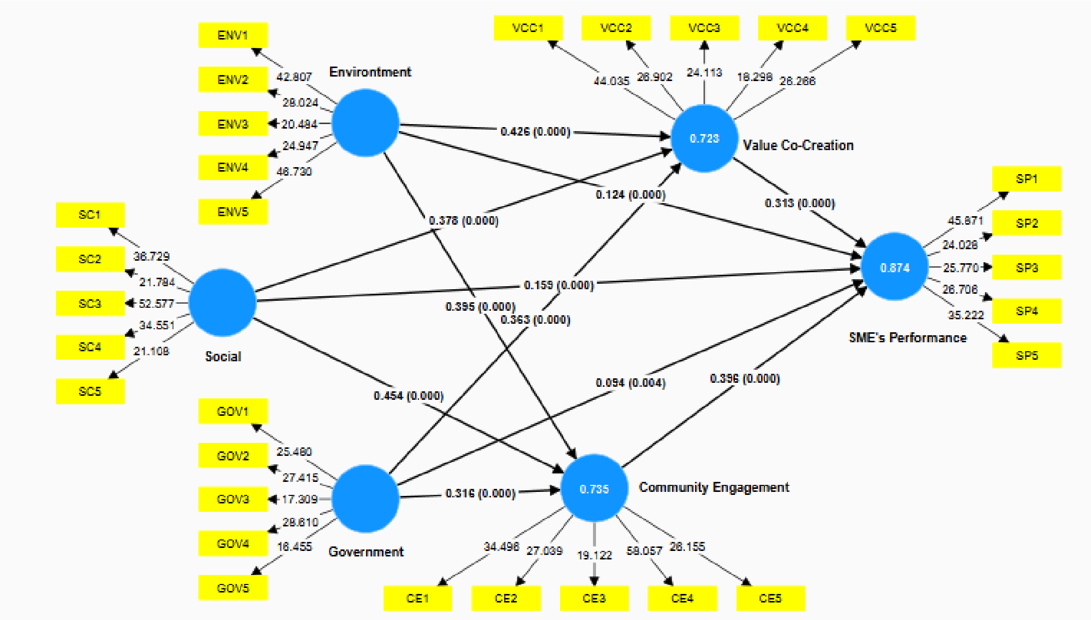

**Table 5.** R**-Square and Q-Square Test**

| | $R^2$ | $Q^2$ |
|---|---|---|
| Community Engagement | 0.735 | 0.495 |
| SME's Performance | 0.874 | 0.629 |
| Value Co-Creation | 0.723 | 0.483 |

**Table 5** presents the $R^2$ and $Q^2$ values, indicating the model's explanatory and predictive power. The $R^2$ value for SME Performance (0.874) shows that 87.4% of its variance is explained by the model, indicating substantial explanatory power. Similarly, Community Engagement ($R^2$ = 0.735) and Value Co-Creation ($R^2$ = 0.723) demonstrate substantial explained variance. Moreover, all $Q^2$ values were above zero—0.495 for Community Engagement, 0.629 for SME Performance, and 0.483 for Value Co-Creation—confirming the model's predictive relevance. Overall, these results demonstrate strong explanatory and predictive performance in explaining how ESG practices, value co-creation, and community engagement contribute to creative SME performance.

**Table 6. Effect Size (F-Square Test)**

| | f-square |
|---|---|
| Community Engagement -> SME's Performance | 0.286 |
| Environtment -> Community Engagement | 0.532 |
| Environtment -> SME's Performance | 0.060 |
| Environtment -> Value Co-Creation | 0.590 |
| Government -> Community Engagement | 0.314 |
| Government -> SME's Performance | 0.038 |
| Government -> Value Co-Creation | 0.395 |
| Social -> Community Engagement | 0.602 |
| Social -> SME's Performance | 0.088 |
| Social -> Value Co-Creation | 0.398 |
| Value Co-Creation -> SME's Performance | 0.188 |

**Table 6** presents the effect sizes ($f^2$) of the structural relationships. The largest effects were observed for Social → Community Engagement ($f^2$ = 0.602) and Environment → Value Co-Creation ($f^2$ = 0.590), indicating substantial contributions to their respective endogenous constructs. In contrast, Governance → SME Performance ($f^2$ = 0.038) and Environment → SME Performance ($f^2$ = 0.060) showed relatively small direct effects, suggesting that their influence on performance may operate more strongly through Value Co-Creation and Community Engagement. Overall, the results highlight the particularly important roles of social and environmental practices in fostering stakeholder engagement and collaborative value creation within creative SMEs.

**Table 7. Fit Model Summary**

| | Saturated model | Estimated model |
|---|---|---|
| SRMR | 0.063 | 0.064 |
| d_ULS | 1.822 | 1.931 |
| d_G | 1.282 | 1.312 |
| Chi-square | 1425.794 | 1430.352 |
| NFI | 0.753 | 0.752 |

### Hypothesis Testing

Hypothesis testing was conducted using PLS-SEM in SmartPLS. Hypotheses were supported when the bootstrapping results showed t-values > 1.96 and p-values ≤ 0.05, indicating significant relationships between constructs. This procedure provides robust empirical evidence for evaluating the proposed model.

**Table 8. Hypothesis Testing: Direct and Indirect Effects**

| Hyphotesis | Variabel Relationship | Path Coeff | T statistics | P values |
|---|---|---|---|---|
| **Direct Effect** | | | | |
| H1 | Environtment -> Value Co-Creation | 0.426 | 11.024 | 0.000 |
| H2 | Social -> Value Co-Creation | 0.378 | 8.070 | 0.000 |
| H3 | Government -> Value Co-Creation | 0.363 | 9.985 | 0.000 |
| H4 | Environtment -> Community Engagement | 0.395 | 9.507 | 0.000 |
| H5 | Social -> Community Engagement | 0.454 | 10.691 | 0.000 |
| H6 | Government -> Community Engagement | 0.316 | 7.916 | 0.000 |
| **Indirect Effect** | | | | |
| H7 | Environtment -> Value Co-Creation -> SME's Performance | 0.134 | 3.610 | 0.000 |
| H8 | Social -> Value Co-Creation -> SME's Performance | 0.118 | 3.219 | 0.001 |
| H9 | Government -> Value Co-Creation -> SME's Performance | 0.114 | 3.797 | 0.000 |
| H10 | Environtment -> Community Engagement -> SME's Performance | 0.156 | 4.903 | 0.000 |

International Journal of Applied Business & International Management (IJABIM)
Vol. 11 No. 2, pp.1180-1202, August, 2026
E-ISSN: 2621-2862 P-ISSN: 2614-7432
https://www.ejournal.aibpmjournals.com/index.php/IJABIM

| | | | | |
|---|---|---|---|---|
| H11 | Social -> Community Engagement -> SME's Performance | 0.180 | 4.731 | 0.000 |
| H12 | Government -> Community Engagement -> SME's Performance | 0.125 | 4.524 | 0.000 |

**Hypothesis Testing Results**
**Direct Effect**
**H1:** Environmental Practices → Value Co-Creation. Environmental practices had a positive and significant effect on value co-creation (β = 0.426, p < 0.001), supporting H1. This finding indicates that environmentally responsible practices enhance creative SMEs' ability to engage customers and business partners in collaborative value creation and innovation.
**H2:** Social Practices → Value Co-Creation. Social practices positively influenced value co-creation (β = 0.378, p < 0.001), supporting H2. Socially responsible practices, including local workforce empowerment and responsible employment practices, can strengthen stakeholder trust and facilitate greater participation in knowledge sharing, feedback, and collaborative innovation.
**H3:** Governance Practices → Value Co-Creation. Governance practices had a positive and significant effect on value co-creation (β = 0.363, p < 0.001), supporting H3. Transparency, accountability, and ethical business practices provide a trust-based environment that encourages customers and business partners to participate in collaborative value-creation activities.
**H4:** Environmental Practices → Community Engagement. Environmental practices positively influenced community engagement (β = 0.395, p < 0.001), supporting H4. Environmentally responsible initiatives appear to extend beyond internal operations by strengthening SMEs' relationships and engagement with local communities.
**H5:** Social Practices → Community Engagement. Social practices showed the strongest effect on community engagement (β = 0.454, p < 0.001), supporting H5. This finding highlights the importance of local employment, social responsibility, and community-oriented practices in fostering stronger community participation and support.
**H6:** Governance Practices → Community Engagement. Governance practices positively affected community engagement (β = 0.316, p < 0.001), supporting H6. Transparent and accountable governance can strengthen community trust and facilitate more open, collaborative relationships between creative SMEs and their local stakeholders.

**Indirect Effect**
**H7:** Environmental Practices → Value Co-Creation → SME Performance. Value co-creation significantly mediated the relationship between environmental practices and SME performance (β = 0.134, p < 0.001), supporting H7. This suggests that environmental practices enhance performance when translated into collaborative innovation and value creation with stakeholders.
**H8:** Social Practices → Value Co-Creation → SME Performance. Value co-creation significantly mediated the effect of social practices on SME performance (β = 0.118, p = 0.001), supporting H8. Socially responsible practices foster stakeholder collaboration, which can strengthen innovation, competitiveness, and business performance.
**H9:** Governance Practices → Value Co-Creation → SME Performance. The indirect effect of governance practices on SME performance through value co-creation was significant (β = 0.114, p < 0.001), supporting H9. Transparent and accountable governance facilitates collaborative value creation, thereby contributing to stronger business performance.
**H10:** Environmental Practices → Community Engagement → SME Performance. Community engagement significantly mediated the relationship between environmental

International Journal of Applied Business & International Management (IJABIM)
Vol. 11 No. 2, pp.1180-1202, August, 2026
E-ISSN: 2621-2862 P-ISSN: 2614-7432
https://www.ejournal.aibpmjournals.com/index.php/IJABIM

practices and SME performance (β = 0.156, $p < 0.001$), supporting H10. Environmental initiatives can generate stronger performance outcomes when they foster active community participation and support.

**H11**: Social Practices → Community Engagement → SME Performance. Community engagement significantly mediated the relationship between social practices and SME performance (β = 0.180, $p < 0.001$), supporting H11. Notably, this was the **strongest indirect effect**, indicating that socially responsible practices create greater business value when they strengthen community involvement and support.

**H12:** Governance Practices → Community Engagement → SME Performance. Community engagement significantly mediated the relationship between governance practices and SME performance (β = 0.125, $p < 0.001$), supporting H12. Transparent and responsible governance strengthens community trust and engagement, which subsequently contributes to SME performance and long-term competitiveness.

## DISCUSSION

### ESG Practices and Value Co-Creation

The findings demonstrate that all three ESG dimensions environmental, social, and governance practices positively contribute to value co-creation, reinforcing the view that sustainability practices can function as relational mechanisms rather than merely as compliance requirements. This finding is consistent with Stakeholder Theory, which suggests that responsible business practices strengthen stakeholder relationships and facilitate participation in organizational value creation (Freeman, 1984; Donaldson & Preston, 1995). It also supports Service-Dominant Logic, whereby value emerges through interaction, resource integration, and collaboration among multiple actors (Vargo & Lusch, 2004, 2016). More recent evidence similarly demonstrates that stronger ESG performance facilitates value co-creation by strengthening trust-based relationships with external stakeholders (Jiang & Lin, 2026). Importantly, Jiang and Lin (2026) identify the social dimension as particularly influential, highlighting the importance of relationships with employees, customers, and communities in collaborative value creation. Recent SME research further shows that stakeholder engagement through dialogue, participation, and inter-organizational cooperation facilitates sustainable value co-creation (Matarazzo et al., 2025).

The positive role of environmental practices suggests that environmentally responsible activities can become a platform for collaborative value creation. For creative SMEs, practices such as sustainable sourcing, waste reduction, resource efficiency, recycling, and environmentally responsible production can provide opportunities for customers and business partners to contribute ideas and participate in developing more sustainable products. This finding extends recent evidence showing that green value co-creation enables SMEs to better convert environmental and green innovation capabilities into business outcomes (Appiah et al., 2025). A recent systematic review likewise identifies stakeholder collaboration and value co-creation as important mechanisms through which SMEs translate green capabilities into environmental, economic, and social performance. Thus, environmental responsibility should not be viewed solely as an operational practice; it can become a collaborative resource through which SMEs differentiate products and generate market value.

The significant effect of social practices further indicates that responsible relationships with employees, customers, communities, and other stakeholders provide an important relational foundation for value co-creation. Practices involving local employment, employee welfare, fair treatment, community empowerment, and stakeholder responsiveness can build trust and reciprocity, increasing stakeholders' willingness to share knowledge, provide feedback, and participate in innovation. This interpretation is consistent with Matarazzo et al. (2025), who show that sustainable value co-creation in SMEs is supported by open dialogue with customers and local communities, stakeholder involvement, and cooperation with suppliers and institutional actors. It is also consistent with Jiang and Lin (2026), who find that the social pillar plays a particularly prominent role in explaining ESG-driven value co-creation.

Similarly, the positive influence of governance practices demonstrates that collaborative value creation requires an institutional foundation of transparency, accountability, and ethical conduct. For SMEs, where business relationships are often informal and highly dependent on owner–manager relationships, governance practices can reduce uncertainty and strengthen stakeholder confidence. Transparent decision-making, ethical conduct, and openness to stakeholder input can therefore create a safer relational environment for customers and partners to contribute knowledge and resources. This finding complements Jiang and Lin's (2026) argument that ESG facilitates value co-creation partly by reducing information asymmetry and strengthening trust-based stakeholder relationships.

These findings are particularly relevant to Indonesian creative SMEs, whose competitive value frequently originates from locally embedded resources such as traditional craftsmanship, cultural knowledge, local commodities, community networks, and customer relationships. Unlike larger firms, however, creative SMEs often face constraints in finance, technology, managerial capabilities, and access to formal innovation systems. Under such conditions, sustainability investments may not automatically generate commercial returns. The challenge is therefore to convert responsible environmental, social, and governance practices into stakeholder participation and collaborative innovation. Evidence from developing-country SMEs similarly shows that environmental investments generate stronger financial benefits when firms possess complementary value co-creation capabilities (Appiah et al., 2025). The findings therefore carry an important strategic implication. ESG creates value not simply because creative SMEs adopt sustainable practices, but because those practices can activate stakeholders as participants in the value-creation process. Environmental responsibility provides shared sustainability goals, social responsibility strengthens relational trust, and governance provides transparency and accountability; together, these conditions enable customers, communities, and business partners to contribute knowledge and resources to innovation. This is particularly urgent for Indonesian creative SMEs facing increasingly sustainability-conscious markets while simultaneously operating under resource constraints. ESG should therefore move beyond a compliance-oriented approach toward a stakeholder-driven value-creation capability, through which locally embedded resources and stakeholder relationships are transformed into innovation, differentiation, and sustainable competitive value.

**ESG Practices and Community Engagement**

The findings demonstrate that environmental, social, and governance practices all strengthen community engagement, indicating that ESG extends beyond internal sustainability management to shape how creative SMEs interact with their surrounding communities. This result is consistent with Stakeholder Theory, which emphasizes that firms create sustainable value by developing mutually beneficial relationships with multiple stakeholder groups (Freeman, 1984; Donaldson & Preston, 1995). It also supports Legitimacy Theory, as responsible business practices can strengthen organizational acceptance and stakeholder trust by aligning business conduct with societal expectations. Recent evidence similarly highlights stakeholder engagement as an important mechanism through which SMEs embed sustainability into collaborative relationships and sustainable value creation (Matarazzo et al., 2025).

Environmental practices appear to strengthen community engagement by creating shared sustainability interests between SMEs and local stakeholders. For creative SMEs that depend on local commodities and natural resources, responsible sourcing, waste reduction, resource efficiency, and environmentally conscious production are often directly visible to surrounding communities. Such practices can encourage community participation while strengthening the perception that business growth is aligned with local environmental interests. This is particularly relevant in Indonesia, where traditional creative industries frequently operate within communities that simultaneously provide labor, cultural knowledge, raw materials, and social legitimacy. Evidence from Indonesian batik SMEs, for example, shows that ESG implementation includes material-waste management alongside occupational health, safety, and community engagement, illustrating the close connection between environmental responsibility and community-based business practices (Amsal & Hastuti, 2025).

The particularly prominent role of social practices reinforces the relational nature of creative SMEs. Local employment, employee welfare, fair treatment, community empowerment, and socially responsible business practices create tangible benefits for communities and can strengthen reciprocity, identification, and trust. This finding is consistent with recent Indonesian evidence showing that the social pillar of ESG is closely associated with community empowerment and engagement (Wati & Hermawan, 2025). More broadly, Matarazzo et al. (2025) demonstrate that sustainable value creation in SMEs is supported by dialogue with local communities, community involvement, and collaboration with customers and other stakeholders. Social responsibility therefore appears to function not simply as an ethical obligation but as a relational capability that connects creative SMEs with their local ecosystems.

Governance practices also contribute to community engagement by establishing transparency, accountability, and trust. This finding is particularly important for SMEs, where governance is often informal and strongly centered on owner-managers. Recent evidence from Indonesian MSMEs indicates that ESG implementation remains fragmented and context-dependent, with governance frequently relying on owner values and relational trust rather than formalized structures (Pramono et al., 2026). In this context, transparent communication, ethical decision-making, openness to stakeholder input, and accountable business practices can reduce uncertainty and strengthen community confidence. Consistent with this interpretation, recent Indonesian evidence shows that both local community engagement and good corporate governance contribute significantly to sustainable growth (Wulandari et al., 2025).

These findings are particularly significant for Indonesian creative SMEs, where business competitiveness is often inseparable from local communities. Products such as batik, handicrafts, traditional fashion, culinary products, and other locally rooted creative goods derive value not only from physical inputs but also from cultural knowledge, craftsmanship, authenticity, and community identity. Community engagement therefore represents more than a social responsibility activity; it provides access to knowledge, legitimacy, local networks, and collaborative resources that may be difficult for resource-constrained SMEs to develop internally. The urgency is heightened by evidence that Indonesian MSMEs continue to face limitations in ESG literacy, governance formalization, resources, and institutional support, making locally grounded stakeholder relationships particularly important for sustainability implementation.

Overall, the findings suggest that the three ESG dimensions perform complementary roles in building community engagement: environmental practices create shared sustainability interests, social practices strengthen reciprocity and community identification, and governance practices provide the trust and accountability required for sustained collaboration. This extends the interpretation of ESG beyond compliance by demonstrating its potential to function as a mechanism of social embeddedness. For Indonesian creative SMEs, the strategic challenge is therefore not simply to adopt ESG practices, but to translate them into meaningful community relationships. Such engagement is increasingly important for preserving local resources and cultural authenticity while strengthening the legitimacy, resilience, and long-term competitiveness of creative SMEs.

**The Mediating Role of Value Co-Creation**

The mediation results provide important evidence that value co-creation serves as a mechanism through which environmental, social, and governance practices are translated into creative SME performance. Rather than generating business value automatically, ESG practices appear to become economically productive when they stimulate interaction, resource integration, and collaborative value creation with stakeholders. This finding supports Service-Dominant Logic, which conceptualizes value as emerging through resource integration among multiple actors (Vargo & Lusch, 2004, 2008, 2016), and Stakeholder Theory, which emphasizes stakeholder relationships as a foundation for sustainable value creation (Freeman, 1984; Donaldson & Preston, 1995). It is also consistent with recent evidence showing that ESG performance can strengthen value co-creation through trust-based stakeholder relationships (Jiang & Lin, 2026).

For environmental practices, the mediation effect suggests that initiatives such as responsible sourcing, resource efficiency, waste reduction, and sustainable production generate stronger business outcomes when stakeholders are involved in transforming these initiatives into new products, processes, and market value. This finding is consistent with Appiah et al. (2025), who demonstrate among SMEs in a developing economy that green value co-creation enables firms to better orchestrate green process innovation and enhance its financial benefits. Recent evidence also indicates that value co-creation, facilitated by stakeholder collaboration, can help SMEs convert green capabilities into broader sustainability outcomes (Appiah et al., 2025). Thus, environmental responsibility becomes strategically valuable not simply through efficiency gains, but through the firm's ability to collaboratively transform sustainability initiatives into differentiated market offerings.

The mediation of social practices through value co-creation further highlights the relational foundation of sustainable SME performance. Practices related to employee welfare, local employment, fair treatment, social responsibility, and stakeholder responsiveness can strengthen trust and reciprocity, but their business value becomes greater when these relationships generate knowledge sharing, customer feedback, collaborative problem solving, and innovation. This interpretation is consistent with Jiang and Lin (2026), who find that the social pillar has the strongest association with value co-creation among the ESG dimensions, emphasizing the importance of relationships with employees, customers, and communities. Matarazzo et al. (2025) similarly demonstrate that sustainable value co-creation among SMEs emerges through dialogue with local communities and customers, stakeholder involvement, and collaboration with suppliers and institutional actors.

Similarly, the mediation of governance practices indicates that transparency, accountability, ethical conduct, and openness to stakeholder input create conditions that facilitate collaborative value creation. Governance itself may not generate innovation or market value directly; rather, it reduces relational uncertainty and provides the trust required for customers, suppliers, and business partners to share knowledge and resources. This interpretation complements Jiang and Lin (2026), who show that ESG facilitates value co-creation partly through stronger trust-based stakeholder relationships and reduced information constraints. Governance can therefore be understood as an enabling infrastructure for co-creation rather than merely an administrative or compliance mechanism.

These mediation effects are particularly important in the context of Indonesian creative SMEs. Creative businesses frequently depend on combinations of local commodities, craftsmanship, cultural knowledge, customer insights, and stakeholder networks. However, resource constraints can limit their ability to independently convert ESG investments into commercially valuable innovations. This challenge is consistent with recent SME literature showing that sustainability outcomes depend not only on possessing green resources or capabilities, but also on firms' ability to mobilize them through stakeholder collaboration and value co-creation (Appiah et al., 2025). A recent systematic review of 108 studies similarly concludes that value co-creation and stakeholder collaboration play important roles in enabling SMEs to integrate sustainability into their business models and improve environmental, economic, and social performance.

The urgency of this finding lies in the risk that ESG adoption among resource-constrained creative SMEs becomes symbolic or operationally isolated from market value creation. Investments in sustainable materials, employee welfare, community responsibility, or transparent governance may impose additional costs without generating proportional business returns if customers and other stakeholders remain passive. Value co-creation addresses this challenge by transforming stakeholders from recipients of ESG initiatives into active contributors to product development, innovation, knowledge sharing, and market differentiation. Evidence from developing-country SMEs supports this mechanism, showing that value co-creation can strengthen the performance benefits derived from sustainability-related capabilities and innovation (Appiah et al., 2025).

Overall, the mediation findings refine the conventional ESG–performance argument. The strategic value of ESG lies not merely in adopting responsible practices, but in what creative SMEs are able to do with those practices through stakeholder collaboration. Environmental practices provide sustainability-related resources and opportunities, social practices create relational trust and reciprocity, and governance practices provide transparency and accountability; value co-creation subsequently converts these foundations into innovation and market value. The findings therefore position value co-creation as a stakeholder-based conversion mechanism through which ESG practices become economically productive, providing a more nuanced explanation of how sustainability contributes to the performance and long-term competitiveness of creative SMEs.

**The Mediating Role of Community Engagement**

The mediation results demonstrate that community engagement is an important mechanism through which environmental, social, and governance practices are translated into creative SME performance. These findings extend the conventional ESG–performance perspective by showing that responsible practices generate stronger business value when they strengthen firms' relationships with local communities. From a Stakeholder Theory perspective, communities are not merely recipients of corporate responsibility initiatives but strategic stakeholders that provide knowledge, resources, legitimacy, networks, and social support (Freeman, 1984; Donaldson & Preston, 1995). This interpretation is consistent with recent SME research showing that stakeholder engagement through open dialogue, community involvement, and multi-actor collaboration supports sustainable value creation and competitive advantage (Matarazzo et al., 2025).

International Journal of Applied Business & International Management (IJABIM)
Vol. 11 No. 2, pp.1180-1202, August, 2026
E-ISSN: 2621-2862 P-ISSN: 2614-7432
https://www.ejournal.aibpmjournals.com/index.php/IJABIM

The mediating role of community engagement in the environmental practices–performance relationship suggests that environmental responsibility becomes more economically valuable when it generates community participation and support. Practices such as responsible sourcing, waste reduction, resource efficiency, and environmentally responsible production can create shared interests between SMEs and communities, particularly when local livelihoods and natural resources are closely interconnected. Community involvement can subsequently provide local knowledge, legitimacy, and collaborative resources that help SMEs transform environmental initiatives into stronger market positioning and sustainable business outcomes. Importantly, recent Indonesian evidence indicates that sustainability outcomes are not necessarily driven by environmental technology alone; social and institutional mechanisms, particularly local community engagement, can play a critical role in generating sustainable growth (Wulandari et al., 2025).

The mediation of social practices through community engagement is particularly important because it represents the most prominent indirect pathway among the community-engagement mechanisms examined. This suggests that social responsibility creates business value not only through internal employee-related benefits but also by strengthening the SME's embeddedness within its surrounding community. Local employment, fair treatment, community empowerment, and socially responsible activities can generate reciprocity and trust, which encourage communities to provide knowledge, advocacy, collaboration, and continued support. Matarazzo et al. (2025) similarly show that SME sustainability-oriented engagement is characterized by dialogue with local communities and customers, direct involvement of communities and employees, and cooperation with broader ecosystem actors. This finding therefore positions community engagement as a relational bridge between social responsibility and business performance, rather than treating social ESG merely as an ethical obligation.

Community engagement also mediates the relationship between governance practices and SME performance, indicating that transparency and accountability generate greater business value when they are recognized and reciprocated by local stakeholders. For small firms, where formal governance mechanisms may be less developed than in large corporations, transparent communication, ethical decision-making, and openness to stakeholder input can strengthen community trust and legitimacy. Such trust can facilitate cooperation, reduce relational uncertainty, and strengthen access to community-based resources and networks. This interpretation is supported by recent evidence from Indonesia showing that both local community engagement and good corporate governance contribute significantly to sustainable growth (Wulandari et al., 2025).

These mediation effects are particularly relevant to Indonesian creative SMEs because their competitiveness is often socially and culturally embedded. Batik, handicrafts, traditional fashion, culinary products, and other locally rooted creative industries frequently depend on community-based craftsmanship, cultural knowledge, local commodities, informal networks, and place-based identity. Consequently, communities may simultaneously function as suppliers of knowledge and labor, custodians of cultural authenticity, customers, collaborators, and sources of legitimacy. This differs from a conventional firm-centric model in which communities are treated primarily as external beneficiaries of corporate social responsibility. For locally embedded creative SMEs, community relationships can constitute part of the firm's strategic resource base.

However, this dependence also creates an important challenge. Creative SMEs often operate under resource, managerial, technological, and market constraints, while community relationships may remain informal and dependent on personal networks. Indonesian evidence shows that MSMEs continue to face constraints in managerial capabilities, innovation, and community participation, particularly when attempting to develop culturally rooted businesses. Under these conditions, ESG initiatives may remain fragmented or symbolic unless SMEs develop mechanisms that enable communities to participate meaningfully in sustainability activities, product development, local sourcing, cultural preservation, and business decision-making. Community engagement therefore needs to move beyond occasional CSR activities toward sustained dialogue, participation, and mutually beneficial collaboration.

Overall, the findings reveal that community engagement functions as a stakeholder-based conversion mechanism through which ESG practices become business value. Environmental responsibility creates shared ecological interests, social responsibility builds reciprocity and community identification, and responsible governance strengthens trust and legitimacy. Community engagement subsequently converts these ESG foundations into access to local knowledge and resources, stakeholder support, legitimacy, resilience, and ultimately stronger SME performance. The findings therefore suggest that for locally embedded creative SMEs, sustainability is not solely a firm-level capability; it is also a community-embedded capability created through relationships between businesses and the local ecosystems in which they operate.

## CONCLUSION

This study demonstrates that ESG practices constitute an important strategic foundation for strengthening the performance and long-term competitiveness of creative SMEs. Environmental, social, and governance practices contribute not only to responsible business conduct but also to stronger stakeholder relationships and collaborative value creation. More importantly, the findings reveal that the business value of ESG does not arise merely from its adoption. Rather, ESG becomes economically productive when sustainability practices activate stakeholders through value co-creation and community engagement. These two mechanisms enable creative SMEs to transform environmental responsibility, social commitment, and responsible governance into innovation, stakeholder support, resource access, legitimacy, and ultimately stronger business performance. The strong explanatory and predictive power of the structural model further supports the relevance of this stakeholder-based perspective in explaining sustainable performance among creative SMEs.

The findings therefore extend the conventional ESG - performance perspective by identifying two complementary pathways through which ESG creates business value. Value co-creation represents a collaborative value-creation pathway, through which customers and business partners contribute knowledge, feedback, resources, and ideas to innovation. Community engagement represents a community-embedded relational pathway, through which sustainability practices strengthen trust, legitimacy, local participation, and ecosystem support. This distinction is particularly relevant to Indonesian creative SMEs, whose competitiveness is often rooted in local commodities, craftsmanship, cultural knowledge, community relationships, and place-based identity. Thus, sustainability in creative SMEs should not be viewed solely as an internal organizational capability, but also as a stakeholder- and community-embedded capability.

From a managerial perspective, creative SMEs should move beyond viewing ESG as a compliance requirement or moral obligation and integrate it into their core value-creation strategy. Firms should actively involve customers, communities, suppliers, and business partners in product development and sustainability-oriented innovation; prioritize resource efficiency, responsible waste management, local employment, and community empowerment; and strengthen transparency, accountability, and ethical decision-making. Community engagement should also move beyond occasional social initiatives toward continuous dialogue, participation, and mutually beneficial collaboration. Such practices can help resource-constrained SMEs mobilize external knowledge and capabilities while strengthening stakeholder trust and market legitimacy.

Overall, the study suggests that the strategic challenge for creative SMEs is not simply to adopt ESG, but to convert ESG into value. This requires firms to connect responsible environmental, social, and governance practices with collaborative innovation and meaningful community participation. For Indonesian creative SMEs facing increasing sustainability expectations, market competition, and resource constraints, embedding ESG within stakeholder relationships offers a viable pathway toward greater resilience, differentiation, and sustainable competitive performance. In this sense, ESG provides the sustainability foundation, while value co-creation and community engagement provide the mechanisms through which that foundation is transformed into enduring business value.

## LIMITATION

Despite its contributions, this study has several limitations that provide opportunities for future research. First, the cross-sectional design limits the ability to capture how ESG practices, value co-creation, community engagement, and SME performance evolve over time; longitudinal studies are therefore needed to examine their dynamic and potentially causal relationships. Second, the study relies on self-reported data from SME owners or managers, which may introduce common method and social desirability biases. Future research could incorporate objective performance indicators and data from multiple stakeholders, including employees, customers, and local communities. Third, the study focuses on creative SMEs in Java, Indonesia, which may limit the generalizability of the findings to other regions, industries, and institutional contexts. Comparative studies across regions, countries, and creative subsectors would strengthen external validity. Finally, future research could examine additional boundary conditions, such as digital capabilities, innovation capability, stakeholder pressure, organizational resilience, and institutional support, to determine when and under what conditions ESG is most effectively transformed into business value.

## ACKNOWLEDGMENT

The authors express gratitude to those who have had the pleasure of cooperating during this study or research.

## DECLARATION OF CONFLICTING INTERESTS

The authors have declared no potential conflicts of interest concerning the study, authorship, and/or publication of this article.

## REFERENCES

Amsal, J. F., & Hastuti, T. D. (2025). The implementation of ESG practices: A case study of Batik small and medium-sized enterprises in Lasem. Jurnal Akuntansi Bisnis, 23(1), 77–100.

Appiah, L. O., Essuman, D., Forson, C. A., Boso, N., & Annan, J. (2025). Green process innovation and financial performance in small and medium-sized enterprises in a developing country: Role of resource orchestration. Journal of Business Research, 189, 115210. https://doi.org/10.1016/j.jbusres.2025.115210

Badan Pusat Statistik. (2025, November 17). BPS: Creative economy employs 27.4 million workers in 2025. BPS-Statistics Indonesia. https://www.bps.go.id/en/news/2025/11/17/805/bps--creative-economy-employs-27-4-million-workers-in-2025.html

Barney, J. (1991). Firm resources and sustained competitive advantage. Journal of Management, 17(1), 99–120. https://doi.org/10.1177/014920639101700108

Chin, W. W. (1998). The partial least squares approach to structural equation modeling. In G. A. Marcoulides (Ed.), Modern methods for business research (pp. 295–336). Lawrence Erlbaum Associates.

Csapi et al. (2026). Do ESG-related managerial capabilities pay off for SMEs? Evidence from the Small and Medium-Sized Enterprise ESG Capability Measure (SM-ESG). Corporate Social Responsibility and Environmental Management.

Donaldson, T., & Preston, L. E. (1995). The stakeholder theory of the corporation: Concepts, evidence, and implications. Academy of Management Review, 20(1), 65–91. https://doi.org/10.5465/amr.1995.9503271992

Freeman, R. E. (1984). Strategic management: A stakeholder approach. Pitman.

Gennari, F., & Salvioni, D. M. (2019). CSR committees on boards: The impact of the external country level factors. Journal of Management and Governance, 23(3), 759–785. https://doi.org/10.1007/s10997-018-9442-8

Goodman, M. S., Sanders Thompson, V. L., Johnson, C. A., Gennarelli, R., Drake, B. F., Bajwa, P., Witherspoon, M., & Bowen, D. (2017). Evaluating community engagement in research: Quantitative measure development. Journal of Community Psychology, 45(1), 17–32. https://doi.org/10.1002/jcop.21828

Hair, J. F., Jr., Black, W. C., Babin, B. J., & Anderson, R. E. (2019). Multivariate data analysis (8th ed.). Cengage.

Hair, J. F., Jr., Howard, M. C., & Nitzl, C. (2020). Assessing measurement model quality in PLS-SEM using confirmatory composite analysis. Journal of Business Research, 109, 101–110. https://doi.org/10.1016/j.jbusres.2019.11.069

Hughes, M., Hughes, P., Hodgkinson, I., Chang, Y. Y., & Chang, C. Y. (2022). Knowledge-based theory, entrepreneurial orientation, stakeholder engagement, and firm performance. Strategic Entrepreneurship Journal, 16, 633–665. This study explicitly connects stakeholder engagement with firm performance.

Jiang, Y., & Lin, H. (2026). Bridging sustainability and value co-creation: The financial and strategic role of ESG performance. International Review of Economics & Finance, 105, 104861. https://doi.org/10.1016/j.iref.2025.104861

Matarazzo, M., Oduro, S., & Gennaro, A. (2025). Stakeholder engagement for sustainable value co-creation: Evidence from Made in Italy SMEs. Business Ethics, the Environment & Responsibility, 34(2), 347–361. https://doi.org/10.1111/beer.12654.

Momtaz, P. P., & Parra, I. M. (2025). Is sustainable entrepreneurship profitable? ESG disclosure and the financial performance of SMEs. Small Business Economics, 64, 1535–1564. https://doi.org/10.1007/s11187-024-00981-5

Pramono, T., Nugroho, Y. A., Waruwu, H., Fauji, A., & Jainuri. (2026). Integrating ESG principles in MSME management: A qualitative study of governance and accountability in Banten, Indonesia.

Suchman, M. C. (1995). Managing legitimacy: Strategic and institutional approaches. Academy of Management Review, 20(3), 571–610. https://doi.org/10.5465/amr.1995.9508080331

Torugsa, N. A., O'Donohue, W., & Hecker, R. (2013). Proactive CSR: An empirical analysis of the role of its economic, social and environmental dimensions on the association between capabilities and performance. Journal of Business Ethics, 115(2), 383–402. https://doi.org/10.1007/s10551-012-1405-4

Tsai, F.-S., Cabrilo, S., Chou, H.-H., Hu, F., & Tang, A. D. (2022). Open innovation and SME performance: The roles of reverse knowledge sharing and stakeholder relationships. Journal of Business Research, 148, 433–443. https://doi.org/10.1016/j.jbusres.2022.03.051

Vargo, S. L., & Lusch, R. F. (2004). Evolving to a new dominant logic for marketing. Journal of Marketing, 68(1), 1–17. https://doi.org/10.1509/jmkg.68.1.1.24036

Vargo, S. L., & Lusch, R. F. (2008). Service-dominant logic: Continuing the evolution. Journal of the Academy of Marketing Science, 36(1), 1–10. https://doi.org/10.1007/s11747-007-0069-6

Vargo, S. L., & Lusch, R. F. (2016). Institutions and axioms: An extension and update of service-dominant logic. Journal of the Academy of Marketing Science, 44(1), 5–23. https://doi.org/10.1007/s11747-015-0456-3

Venkatraman, N., & Ramanujam, V. (1986). Measurement of business performance in strategy research: A comparison of approaches. Academy of Management Review, 11(4), 801–814. https://doi.org/10.5465/AMR.1986.4283976

Wati, V. I., & Hermawan, M. S. (2025). Empowering communities: Unraveling the social pillar of ESG in Indonesia's agricultural sector. Pakistan Journal of Life and Social Sciences, 23(1), 3889–3900

Wernerfelt, B. (1984). A resource-based view of the firm. Strategic Management Journal, 5(2), 171–180. https://doi.org/10.1002/smj.4250050207

Wulandari, S. S., Daiman, Malaihollo, C. A., Syakyakirti, Tanubrata, D., & Pratiwi, D. I. (2025). Building long-term value: A practical guide to integrating ESG into business strategies. Sustainable Futures, 10, 100955. https://doi.org/10.1016/j.sftr.2025.100955

Yi, Y., & Gong, T. (2013). Customer value co-creation behavior: Scale development and validation. Journal of Business Research, 66(9), 1279–1284. https://doi.org/10.1016/j.jbusres.2012.02.026

## ABOUT THE AUTHOR(S)

**1st Author**
Sri Ismulyaty is a lecturer in the Management Study Program, Faculty of Economics and Business, Universitas Terbuka, Indonesia, and currently serves as Director of Universitas Terbuka Bandar Lampung. She received her undergraduate education in management from Institut Manajemen Koperasi Indonesia (IKOPIN) and earned her Master of Science degree from Universitas Gadjah Mada. Her academic and research interests encompass management, tourism management, tourism governance, entrepreneurship, organizational management, and sustainable tourism development. Her recent work has particularly addressed destination governance, environmentally responsible tourism behavior, community-based tourism, and sustainability in tourism development. She has extensive experience in university administration, distance higher education, research, and academic publication. ORCID: 0009-0006-0343-8560.
Email: srismu@ecampus.ut.ac.id

**2nd Author**
Ginta Ginting is Professor of Management in the Faculty of Economics and Business, Universitas Terbuka, Indonesia. She earned her bachelor's degree in Management from Universitas Brawijaya, her Master of Business Administration from Edith Cowan University, Australia, and her doctoral degree in Management from Universitas Padjadjaran. Her research interests include marketing management, strategic marketing, consumer behavior, tourism management, sustainable tourism, entrepreneurship, community-based tourism, environmentally responsible behavior, and digital customer experience. Her recent research has examined halal tourism, destination attachment, environmental responsibility among tourists, creative tourism,

and sustainable destination development. She has extensive experience in teaching, research, academic leadership, and open and distance higher education. ORCID: 0000-0002-5139-6370.
Email: ginta@ecampus.ut.ac.id

**3rd Author**
Andriyansah is an Associate Professor of Management in the Faculty of Economics and Business, Universitas Terbuka, Indonesia. He earned his bachelor's degree in Economics from STIE Widya Wiwaha, his Master of Management degree from Universitas Islam Indonesia, and his doctoral degree from Universitas Diponegoro. He joined Universitas Terbuka in 2008 after serving as a lecturer at Akademi Manajemen Belitung from 2004 to 2008. He has also held academic leadership positions, including Head of the Doctoral Program in Management Science. His principal research interests include strategic marketing management, ergo-iconical values, tourism management, organizational and marketing performance, SME competitiveness, and distance education. His recent scholarship also addresses green innovation, digital learning, and the application of ergo-iconic approaches in management and distance education. ORCID: 0000-0002-4851-2617. Scopus Author ID: 57194765014.
Email: andri@ecampus.ut.ac.id