




Muhammad Farooq Rehan¹, Muhammad Rizwan Kamran² & Khalid Hussain³

¹Assistant Professor, Lyallpur Business School, Government College University, Faisalabad

²Assistant Professor, Lyallpur Business School, Government College University, Faisalabad

³Lecturer, College of Commerce, Government College University, Faisalabad, Pakistan

KEYWORDS	ABSTRACT
Ethical Leadership, Financial Management Capability, Internal Audit Effectiveness, Competitive Advantage, Entrepreneurial Orientation	This study investigates that how ethical leadership, financial management capability, and internal audit effectiveness shape competitive advantage in SMEs, and examines the mediating role of entrepreneurial orientation. A quantitative cross-sectional survey was administered to SMEs across Punjab, Pakistan covering major manufacturing clusters in sectors such as textiles, glass, light engineering & sports goods. Primary data from 400 respondents were collected using a structured questionnaire adapted from validated scales. The model was tested via structural equation modeling (SEM). Results show that ethical leadership, financial management capability and internal audit effectiveness each have significant positive effects upon competitive advantage. Entrepreneurial orientation mediates these links by translating ethical governance and financial discipline into proactive, innovative market actions. SME leaders should reinforce ethical leadership, strengthen financial systems, and ensure effective internal audits, while nurturing the entrepreneurial orientation to adapt organization capabilities to sustained competitive advantage. The study presents the befitting model integrating finance, ethical leadership, auditing, and entrepreneurship to explain the competitive advantage.
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INTRODUCTION

SMEs are mainstay of most developing economies and Pakistan is not an exception. SMEs contribute greatly to employment, industrial production, and export earnings, which are vital to the economic resilience and growth of a nation. In areas like Punjab, with its manufacturing hubs in Faisalabad, Sialkot, Gujranwala and Lahore, SMEs are a key player in textile, sports goods, light engineering

and glass manufacturing industries. Nevertheless, despite their strategic significance, most of these enterprises have been facing chronic problems in maintaining competitiveness in a market that is gradually becoming globalized (Dvouletý & Blažková, 2021). Competition with foreign companies, high rate of technological changes, poor institutional backing & inefficiencies within organizations usually thwart growth opportunities. It is against background that issues of leadership, governance, financial discipline and entrepreneurial drive have become key factors to determine whether SMEs can survive and thrive in dynamic environments. The research lead to competitive advantage in SMEs has become urgent academic & practical question, in such environments like Pakistan where such companies are exposed to the lack of resources and institutional gaps (Khan, Ma, Akbar, Islam, Ali & Noor, 2024).

The organization's survival is always dependent on the competitiveness of SMEs through innovation, resource optimization, and market orientation. Notably, internal structural deficiencies of the firm's governance, financial management, and internal controls often impede firm's ability to leverage capabilities towards achieving sustained growth and expansion. In economics where institutions are less developed, internal structure relating to the organization's procedures takes on a greater significance, particularly in absence of federal regulation & reasonably developed credit facilities. Organizational levers designed to ensure firm is protected from mismanagement and fraud while nurturing proactive and agile strategies includes ethical leadership, good financial stewardship, and a robust internal audit structure (Lumanauw & Lolowang, 2024). Sound ethics in leadership refers to the organization's choices being made in a just manner embodying integrity. Also, good financial management allocates and utilizes scarce resources while exercising discipline. Finally, a severe internal audit yields accountability tools enabling the firm to defend against potential risks (Premaratna et al., 2025).

The ethical leadership has been defined in the literature of organization behavior as a leadership approach that is based on fairness, honesty, trustworthiness and stakeholder concerns. Leaders with ethical behavior do not only set an example of ethical behavior but also establish organizational cultures that do not encourage opportunism, corruption, and exploitative behavior. The ethical leadership is especially important in SMEs where personal values of the owners and managers of the organizations have a very strong impact on the organizational practices. It conveys integrity to the employees, customers and other external parties and thus promotes long term relationships and trust (Oloba, Olola & Ijiga, 2024). It is suggested that ethical leaders are better placed to develop psychological safety, organizational commitment, and cooperative behavior all of which help the firm to compete successfully. The ethical leadership, however, cannot be the only factor to create competitive advantage in the absence of supportive financial and governance systems. This puts into perspective the complementary nature of financial management capability and internal audit efficiency (Seitei, 2021).

Financial management capability is the capacity of the firm to plan, control and utilize financial resources in an efficient manner in support of operational and strategic goals. In SMEs this is not well developed since there is not much managerial expertise, no formal training and poor access to external financial advisory services. However, strategic growth requires the capacity to develop

proper budgets, cash flows, analyses of investment opportunities, and the reduction of financial risks. Thus, the better the financial management systems are developed in the company, the more opportunities it can exploit, respond to market changes and invest in the innovations (Isibor, Ewim, Adaga, Bulya & Achumie, 2025). Empirical research confirms the positive relationship between the financial competence and the performance of the company, and it means that the financial discipline can be translated into the long-term sustainability. Ethical leadership adds legitimacy to the financial capability since not only is resource exploitation efficient but also deployment of resources in a morally responsible and stakeholder-interested manner (Bettiol, Capestro, Maria & Micelli, 2023).

Moreover, internal audits help in safeguarding scarce resources from fraud and acts as a protective measure for compliance, thus, serving as a tracker of organizational performance and information system (Febriana, Sumadewa, Anggriani & Zahrah, 2025). More important, when the audits are placed within the context of ethical leadership, they are slowly transforming from a mere tool of control to a helpful instrument for fostering the sustainable organizational development (Betti & Sarens, 2021). The dimensions of an entrepreneurial orientation include innovativeness, proactive attitude, and risk taking; these dimensions the capacity of a firm to perceive and act on chances. An ethical leader builds a moral system of trust, and it is the entrepreneurial orientation that actualizes these values (Matikiti, 2024). In spite of these theoretical contributions, there are still gaps in the literature on SMEs in developing economies. Thus, most of the studies conducted on competitive advantage have been done on big companies where governance structures and financial systems are more advanced. Research on SMEs has tended to focus on innovation, marketing or networking skills, but it has not focused on the integrative power of ethical leadership, financial management and auditing practices.

Although ethical leadership or financial management may have been the subject of study, it has been treated in a largely individualist manner, without probing into the intervening mechanisms that bridge the gap between the two and performance (Randel, 2025). Similarly, internal auditing in SMEs cannot afford to conduct systematic audits. Most companies lack the capacity to maintain competitive stances due to the lack of proper governance and financial frameworks, and not due to the absence of entrepreneurial spirit (Arabeche, Soudani, Brahmi, Aldieri, Vinci & Abdelli, 2022). Some companies fail not because of lack of sufficient financing but because they cannot convert financial discipline into business initiatives; these gaps are compounded by moral lapse and weak internal controls. Thus, it is vital to explain how these variables interact and how entrepreneurial orientation mediates reduction of competitiveness crisis of SMEs in Punjab and other jurisdictions (Tolossa, Singh & Gautam, 2024). The implications of work are practical and theoretical in nature. Theoretically, research will help to advance knowledge by devising framework which incorporates ethical leadership, financial management, auditing and entrepreneurship (Khan, Sheikh, Shamsi & Yu, 2025).

LITERATURE REVIEW

The theory that will guide this research is mainly the Resource-Based View (RBV) and its extension to dynamic capabilities perspective. BV asserts that sustained competitive advantage is attained

by firms that have valuable, rare, inimitable and non-substitutable resources. However, the theory has since then changed to focus on the fact that strategic mobilization of resources rather than their mere possession is what brings about advantage. This understanding pre-conditioned the dynamic capabilities approach that emphasizes mechanisms over which companies combine, re-combine, and refresh resources in reaction to environmental turbulence. Within SME environment where the scarcity of resources and institutional gaps are common, dynamic capabilities like entrepreneurial orientation are important in transforming the intangible resources like ethical leadership, financial management capability, internal audit effectiveness into performance (Isichei, Agbaeze & Odiba, 2020). This perspective is also supported by Stewardship theory which argues that leaders driven by the values of pro-organization are capable of establishing trust-based systems that improve the governance and performance.

Combined, these theoretical bases endorse concept of components of ethical leadership, financial discipline, governance mechanisms, entrepreneurial behaviors to explain how small and medium-sized enterprises (SMEs) can take the competitive stances in volatile markets (Wu, Majd, Tiao & Shahmirzadi, 2025). This leads to the lack of knowledge how internal audits may become a means of learning and adaptation as opposed to compliance. Extensive body of literature maintains that ethics has a more conclusive power than that of leadership style in here determining organizational performance. Organizational cultures of trust are created through ethical leaders using themselves as examples of integrity and fairness so that the employees are also encouraged to stay on course to organizational goals. It is especially strong in SMEs as there is typically a highly personalized style of leadership where the morality position of the owner-manager sends a very powerful message to the employees and external parties. Selem, Khan, Elsayw and Selim (2025) indicates that ethical leadership enhances job satisfaction, decreases deviant behaviors and OCB and fosters a desirable working environment.

Additional studies show that ethical leadership in the emerging economies is positively related to their innovation potential, trust among stakeholders and sustainability in their performance. These conclusions suggest not only that ethical leadership causes ethical climates but that they enhance strategic capabilities on which competitive advantage is based. Noticeably, the impact of ethical leadership is often mediated by organizational representatives in the form of learning, cooperation, and entrepreneur. The moral leadership offers the cultural base, which motivates entrepreneurial orientation, allowing SMEs to convert ethical pledges into innovative market conducts (Ercantan, Eyupoglu & Ercantan, 2024). Selem et al. (2025), leadership improves workplace satisfaction, reduces deviant behaviors as well as organizational citizenship, and cultivates a positive workplace climate. Other research indicates that ethical leadership in emerging economies is associated with their innovative capacity, stakeholder trust, and performance. These findings imply that ethical leadership not only fosters ethical climate but improves strategic capabilities that form the basis of competitive advantage.

It is also striking that the effect of ethical leadership is often mediated by organizational learners, collaborators, and entrepreneurs. Moral leadership provides a cultural framework that fosters an entrepreneurial orientation, inspiring SMEs to translate their ethical commitments into innovative

market actions (Vrontis, Chaarani, Nemar & Haddad, 2022). In SME's sector, Internal auditing has been noted to promote accountability and improve risk management, although it is less studied. Internal audits, when properly implemented, ensure that controls are in place and functioning, resources are safeguarded, and compliance obligations are met. Due to high degree of informality in SMEs, internal audit functions are not well developed. Nonetheless, data indicates that SMEs which do practice internal auditing enjoy enhanced financial transparency, reduced fraud, and improved decision-making. The effective audits strengthen stakeholder trust in governance and accountability (Boufounou, Eriotis, Kounadeas, Argyropoulos & Pouloupoulos, 2024). In developing countries, internal audits could serve as a learning mechanism to help firms identify inefficiencies and improve competitive positioning. Thus, while understudied in the context of entrepreneurship, internal audits could enhance competitive advantage for firms by reducing risk and fostering organizational learning.

It is anticipated that their impact will rise alongside the entrepreneurial orientation of the firm, which will become more proactive and innovative in striving for results stemming from such audits (Liu, Rahman & Jamil, 2025). This creates a vacuum in explaining how, when embedded in EO, governance and financial mechanisms can lead to competitive advantage of SMEs in the context of uncertainty and resource scarcity (Zahoor & Lew, 2022). This situation constitutes a gap in the SME competitiveness debate, is situationally focused on the ethical leadership, financial acumen, internal audit efficiency, and entrepreneurial orientation as mediating role. Most of these questions arises in Pakistan, mainly due to the informality challenge within regulatory oversight and limited resources. Entrepreneurial orientation is strategic position that has attracted lot of research interest in enabling firms to spot and respond to opportunities. Entrepreneurial orientation has always been linked to firm performance in various contexts and it is defined as innovativeness, proactiveness, and risk-taking. Entrepreneurial orientation takes on special importance in small and middle-sized companies because of the limitation of resources; it balances out resource shortages by increasing creativity and flexibility.

The empirical research carried out in emerging economies proves that entrepreneurial orientation acts as a mediator that connects organizational capabilities with competitive advantage (Isichei et al., 2020). As an example, the ethical leadership creates trust and psychological safety, but the entrepreneurial orientation directs them to innovative behavior and responsiveness to the market. Likewise, financial management competence constrains resource discipline, and entrepreneurial orientation reallocates these resources to ventures that give rise to differentiation and growth. The internal audits can identify inefficiencies; however, the entrepreneurial orientation can change the identified inefficiencies into an action plan. As a result, the mechanism of the behavior in terms of which the resources and the governance practices of a firm are transformed into the sustainable competitive advantage is the entrepreneurial orientation. (Arabeche, Soudani, Brahmi, Aldieri, Vinci & Abdelli, 2022). Empirical scholarship identifies variability in the way such relationships manifest across diverse contexts. In the high-income economies, the operators of small and medium-enterprise usually enjoy strong formal institutions that offer access to credit, enforce law standards, and offer audit services.

By contrast, in developing economies like Pakistan, SMEs work in an environment where they lack institutional capacity, have limited resources, and where informality is pervasive, and so internal mechanisms of the organization, including ethical leadership, financial management capability and the quality of internal audits, become vital substitutes of failed external institutions. Recent studies in South Asia also reveal that SMEs managed by ethically minded and financially skilled managers are likely to survive, innovate and embark on internationalization (Elbanna, Begum & Mauji, 2024). Few studies have focused on a combination of these variables in an integrated model hence leaving big gap in knowledge on how governance, financial discipline and entrepreneurship interact to create competitive advantage in SMEs (Veiga, Marnoto, Mota & Rexhepi, 2024). It is on this theoretical and empirical basis that the present study hypothesizes that ethical leadership, financial management ability and internal audit effectiveness have positive impact on competitive advantage in SMEs. It is believed that ethical leadership will lead to competitive advantage through building trust, integrity and commitment to stakeholders, that further leads to innovation and differentiation.

RESEARCH METHODOLOGY

The current study used a quantitative research design to examine the connection between ethical leadership, financial management ability, internal audit effectiveness, entrepreneurial orientation and competitive advantage in small and medium sized enterprises. A quantitative methodology was deemed to be suitable since it permits systematic measurement of constructs, hypothesis testing of relationships, and statistical methods to generalize the results of a study to a specific population. The research philosophy that was adopted in the study was positivism, which believes that reality can be observed and measured using empirical data. This school of thought focuses on application of structured tools, numerical results, and statistical modelling to evaluate theoretical propositions, thus making the research process reliable, reproducible and objective. The sample of the study included SMEs that operated in Pakistan and especially in province of Punjab. Punjab was chosen due to its being the home of the largest and most vibrant SME clusters in manufacturing industries like textile, light engineering, sports goods and glassware. Thus, these clusters offer representative backgrounds to current study of the dynamics of competitiveness in the resource-constrained but entrepreneurial settings.

In these industries, the researchers targeted the owners of SMEs, senior managers and departmental heads as they are directly involved in leadership, financial decision-making as well as internal governance procedures that can influence the variables under study. Since SMEs in Pakistan are usually owner-managed or family-run, it was assumed that respondents at this level would have comprehensive knowledge of the operations and strategic orientation of the firm. A sample size of 400 respondents was established which is deemed sufficient in structural equation modeling and is in line with statistical recommendations on achieving the reliable estimates in parameters. The sampling strategy was a multi-stage one that was both feasible and representative. Therefore, the geographical strata identified were major industrial clusters in Faisalabad, Sialkot, Gujranwala and Lahore. In each of the clusters, industries pertinent towards the SME manufacturing sector were chosen. The firms were then randomly sampled within these clusters, and one respondent per firm-

preferably the owner, senior manager, or senior staff with decision-making authority- was invited to participate in the survey.

This methodology involved combination of stratified and purposive sampling, that would increase the generalizability of results and also ensure that the respondents were knowledgeable enough to give the right information. The questionnaire was a structured questionnaire adapted to previously validated measurement scales to provide reliability and content validity. Ethical leadership was based on existing leadership behavior scales; financial management capability was measured by items on budgeting, planning and control systems; internal audit effectiveness was captured using items on risk management, internal control, compliance; entrepreneurial orientation was measured based on innovativeness, proactiveness and risk-taking; and competitive advantage was measured on differentiation, market responsiveness and sustainability of performance. The questionnaire had a Likert-scale format, whereby the respondents could state the level of agreement or disagreement with statements associated with each construct. Similarly, the pilot test was conducted on a small sample of managers of SMEs before the full-scale administration, and some minor changes were made in the wording. The mode of administration was a cross-sectional survey, i.e., the data were gathered at one time.

The questionnaires were also administered face-to-face within the industrial clusters, and in other instances, by email to ensure that the maximum number of people was covered. Data was collected through trained research assistants who visited firms and explained the purpose of the study and ensured voluntary participation. Thus, the respondents were guaranteed of confidentiality and anonymity and their participation was voluntary. Ethical issues were also addressed by educating the participants about their rights, not providing confidential or-specific information, and having them sign informed consent before collecting data. The study followed the acceptable research ethics guidelines, since it did not interfere with the privacy and dignity of the respondents, was transparent in the communication process, and limited the data utilization to scholarly purposes. Data was analyzed with Structural Equation Modeling (SEM), a powerful multivariate statistical method that allows the testing of many relationships between latent constructs at the same time. SEM was chosen due to its ability to allow a thorough analysis of both direct and indirect impact as such it aligned with the study of the mediating nature of entrepreneurial orientation. Data analysis was done in two steps.

RESULTS OF STUDY

Table 1 Reliability Analysis

	CA	RHO_A	CR	AVE
Competitive Advantage	0.87274	0.89654	0.90209	0.57313
Entrepreneurial Orientation	0.82598	0.83212	0.86294	0.51294
Ethical Leadership	0.87774	0.88705	0.90185	0.50444
Financial Management Capability	0.77514	0.79155	0.83802	0.50951
Internal Audit Effectiveness	0.70686	0.70317	0.73823	0.50485

The evaluation of reliability indicates constructs all have satisfactory to high internal consistency and convergent validity. Cronbach Alpha values are high (above 0.82) and composite reliability is also high (above 0.86) indicating that there is good reliability and AVE values are above 0.50 indicating good convergent validity. Financial Management Capability is also within acceptable reliability levels (alpha = 0.77514; CR = 0.83802) and the AVE is also sufficient (0.50951). Internal Audit Effectiveness is not as reliable as the other items (alpha = 0.70686; CR = 0.73823), but it is still within minimum acceptable levels and its AVE (0.50485) is within standard criterion. Generally, the findings support the fact that measurement scales are reliable and show acceptable convergent validity of constructs.

Table 2 Validity Analysis (HTMT)

	CA	EO	EL	FMC
Competitive Advantage (CA)				
Entrepreneurial Orientation (EO)	0.76823			
Ethical Leadership (EL)	0.39888	0.39646		
Financial Management Capability (FMC)	0.3725	0.37962	0.57597	
Internal Audit Effectiveness	0.54079	0.3946	0.38988	0.43684

The HTMT (Heterotrait-Monotrait Ratio) analysis shows that constructs possess good discriminant validity since all values are below the generally accepted value of 0.85. The highest correlation is between Entrepreneurial Orientation and Competitive Advantage (0.76823), indicating a rather high, still acceptable correlation. Ethical Leadership presents moderate correlations with Financial Management Capability (0.57597) and Competitive Advantage (0.39888) and rest of correlations between the Internal Audit Effectiveness and the other constructs (ranging between 0.38988 and 0.54079) are modest. In general, the findings affirm that the constructs are not identical to each other, nonetheless still, they have significant theoretical relations, which proves the validity of the measurement model.

Figure 1 Measurement Model

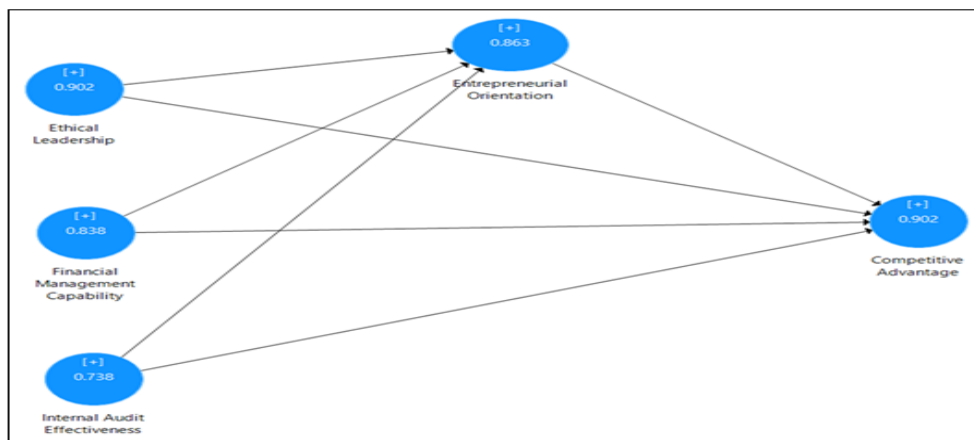


Table 3 PLS SEM Direct Effect

	OS	SM	SD	TS	PV
Entrepreneurial Orientation -> CA	0.60416	0.60456	0.02457	24.58848	0
Ethical Leadership -> CA	0.11869	0.11746	0.02995	3.96247	0.00008
Ethical Leadership -> EO	0.22436	0.22019	0.04601	4.87653	0
Financial Management Capability -> CA	0.06732	0.06713	0.02866	2.34903	0.01902
Financial Management Capability -> EO	0.13033	0.13041	0.04392	2.96729	0.00308
Internal Audit Effectiveness -> CA	0.18168	0.18236	0.02634	6.89765	0
Internal Audit Effectiveness -> EO	0.21149	0.21158	0.03985	5.30713	0

The PLS-SEM direct effect results indicated that all the hypothesized relationships are significant with p-values being well below the 0.05 level. The strongest positive impact is on Competitive Advantage and this indicates that Entrepreneurial Orientation is the most influential predictor. Ethical Leadership has a significant effect on the CA and Entrepreneurial Orientation and thus it plays a role in both direct and indirect pathways. Financial Management Capability also has a positive impact on the Competitive Advantage and Entrepreneurial Orientation, but with smaller effect. The efficiency of the internal audit has been proved to have significant positive impact on competitive advantage as well as entrepreneurial orientation. The empirical results reveal that entrepreneurial orientation is the key agent of the competitive advantage improvement; however, the degree of ethical leadership, financial management strengths, and internal audit strengths are also doing the firm handiwork with the entrepreneurial behaviour, as well as with the overall competitive performance.

Figure 2 Structural Equational Model

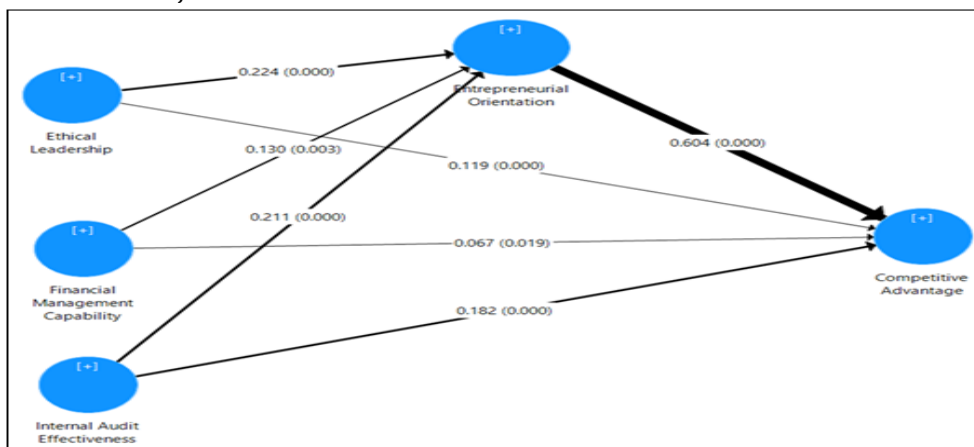


Table 4 Mediating Effect

	OS	SM	SD	TS	PV
Ethical Leadership -> EO -> CA	0.13555	0.13308	0.02816	4.8133	0
Financial Management Capability -> EO -> CA	0.07874	0.07872	0.02642	2.98024	0.00295
Internal Audit Effectiveness -> EO -> CA	0.12777	0.12768	0.02336	5.46906	0

The mediation analysis shows that the entrepreneurial orientation has significant mediating role between ethical leadership and competitive advantage. Moreover, the findings also indicated that entrepreneurial orientation mediate the relationship between financial management capability and competitive advantage. Lastly, the results also indicated that the entrepreneurial orientation strengthen the relationships between internal audit effectiveness and competitive advantage in the current study.

DISCUSSION & CONCLUSION

The findings of current research clearly show the positive and significant relationships between each direct as well as mediating effect. More specifically, findings shows that ethical leadership, financial management skills, and efficient internal audit systems all affect competitive advantage of small and medium-sized enterprises (SMEs). At the same time, entrepreneurial orientation acts as a channel that turns governance and financial resources into tangible competitive results. This finding aligns with the Resource-Based View and the dynamic capabilities approach. Thus, these frameworks suggest that resources and governance processes do not lead to lasting competitiveness unless they are effectively used. Ethical leadership builds trust, honesty, and hard work. Strong financial management ensures that limited resources are used effectively. Good internal auditing fosters accountability and supports organizational learning and growth. However, entrepreneurial orientation changes these abilities into the innovative, proactive behaviors that directly influence competitiveness.

Consequently, the governance and financial systems cannot function in the isolation; they require entrepreneurial spirit to improve resilience and differentiate strategies in a highly competitive environment. Financial management capability is theorized to enhance the competitive advantage through the ability to allocate resource and invest in strategic opportunities. In this connection, it is argued that internal audit effectiveness helps in generating competitive advantage since it ensures accountability, reduces risks, and creates opportunities to make improvements. The internal audits can identify inefficiencies; however, the entrepreneurial orientation can change the identified inefficiencies into an action plan. It is however hypothesized that the relationships are mediated by entrepreneurial orientation. In this regard, in particular, entrepreneurial orientation can transform the principles of ethical leadership, the art of financial management, and the lessons of internal audits into such proactive, innovative, and risk-taking behaviour that can directly contribute to the competitive advantage.

In this way, the concept of entrepreneurial orientation is defined as the most important process that mobilizes organizational resources and governance systems into sustainable competitiveness amid the SMEs in manufacturing clusters in Punjab. Overall, the findings reveal that a mix of governance mechanisms and entrepreneurial attitudes promotes competitiveness. The structural and cultural foundations are built by ethical leaders, financial management, and internal audits. However, it is the entrepreneurial orientation that transforms these foundations into distinctive behaviors for SMEs in competitive markets. When viewed through lens of dynamic capabilities, results indicate that competitive advantage in SMEs is not just about owning resources. Instead, it relates to how entrepreneurs actively mobilize and reshape resources to attain advantage. A novel & progressive

culture can turn traditional weaknesses in governance and finance into strengths, especially in SME clusters in Punjab.

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