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Enterprise Risk Management Capabilities and Firm Performance Correlation: The Mediating Role of Innovation Capabilities in Malaysian Manufacturing SMEs Perspective

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Abstract
The performance of small and medium-sized enterprises (SMEs) in Malaysia's manufacturing sector was the main emphasis of the current study. The Malaysian economy has suffered because of the manufacturing sector's SMEs' poor performance and low GDP. Thus, this conceptual research aims to explore the correlation between enterprise risk management capabilities and firm performance. The research also examines the mediating role of innovation capabilities between enterprise risk management capabilities and firm performance. Present research revealed comprehensive discussion on how enterprise risk management capabilities impact firm Malaysian manufacturing SMEs' firm performance. This

research highlighted the key value of enterprise risk management capabilities on firm performance for the consideration of the owner/managers of Malaysian SMEs in the manufacturing sector. In addition, Resource-Based View (RBV) theory was employed in this research to examine the impact of enterprise risk management capabilities on firm performance and the mediation impact of innovation capabilities between enterprise risk management capabilities on firm performance. The research used systematic literature to build its conceptual model. Based on the conceptual model build; present research theorised that the is a positive relationship between ERM (IC and FP); There is also a positive relationship between IC and FP. In addition, the research posits that IC mediate the relationship between ERM and FP. There are several implications of this conceptual framework for theory and practice are discussed. Future research should conduct an empirical testing to analyse the results.
Keywords: Enterprise Risk Management, Financial Literacy, Innovation Capabilities Firm Performance

Introduction

In most of the world's countries, small and medium-sized manufacturing sector are essential to economic growth. They support economic diversification and make a sizable contribution to GDP (Afum et al., 2020; Chatterjee & Bhattacharjee, 2020; Hernita et al., 2021). Furthermore, SMEs' GDP contribution to high-income nations was 55%, whereas it was 60% in emerging economies (Al-Koliby et al., 2022). SMEs have a vital role in fostering innovation and entrepreneurship, lowering national poverty rates, and enhancing societal welfare in addition to their varied contributions to creating job opportunities (OECD, 2017; Zafar & Mustafa, 2017). Moreover, a report from the Canada-OECD Project for ASEAN SMEs (COPAS) states that SMEs account for between 97% and 99% of all firms in the majority of ASEAN countries (OECD, 2021). SMEs contribute significantly not only to Malaysia but also to the rest of the world and Asia (Cheah et al., 2022; Sana et al., 2020).

SMEs sectors in Malaysia are classified into manufacturing, mining and quarrying, construction, services and construction. There are 907,065 SMEs, which represent 98.5% of all enterprises in Malaysia (SME Corp Malaysia, 2020). According to Ramdan et al (2022), the service and manufacturing sectors are commonly acknowledged as the foundation for economic expansion. 13.5% of Malaysia's exports in 2020 came from SMEs, with the manufacturing sector accounting for 9.4% of exports, the services sector for 3.9%, and the agricultural sector for 0.3% (Ramdan et al., 2022). Additionally, Malaysia's manufacturing SMEs have significantly increased the GDP of the nation. Sales in the industrial sector hit RM118.4 billion in February 2021. This figure suggests that improved company performance, inventiveness, and entrepreneurial skills were the driving forces behind the increase in sales (Al-Koliby et al., 2022).

The contribution of SMEs in the growth of the Malaysian economy is undisputed. SMEs made a substantial contribution to the GDP (38.9%) and labour force employment (48.4%) of the nation in 2019 (SME Corp Malaysia, 2021). Even Malaysian SMEs in Malaysia contribute significantly to employment (59%), overall exports (19%), and the number of establishments (97.3%), they are still small in comparison to SMEs in other nations (Chin & Lim, 2018). There are many Malaysian SMEs face multiple competitive disadvantages and struggle to thrive in the market, according to (Cheah et al., 2022). Malaysian small and medium-sized enterprises faced various challenges, such as inadequate resources for innovation Ramdan et al (2022),

high levels of international competitiveness, access to technology, and information and communication (Ruslan et al., 2020).
There are approximately 242,540 small and 19,459 medium-sized businesses in Malaysia, according to the (SME Corp. Malaysia, 2022). Figure 1 shows that the GDP performance of SMEs varied from 13.5% in 2014 to 1.0% in 2021. Even with the minor improvement in 2021, the results are still low when compared to prior years. According to Zulkifli and Omar (2019), the GDP contribution of SMEs serves as a proxy for their performance. Manufacturing SMEs in Malaysia have faced numerous challenges related to technological innovation, research and development, and the lack of knowledge in the labour market (Razak et al., 2018). Previous research has suggested that future investigations should look at the reasons behind the decline in Malaysian SMEs' performance (Cheah et al., 2022) as well as the difficulties which encounter manufacturing SMEs in terms of company performance (Muda & Rahman, 2019).

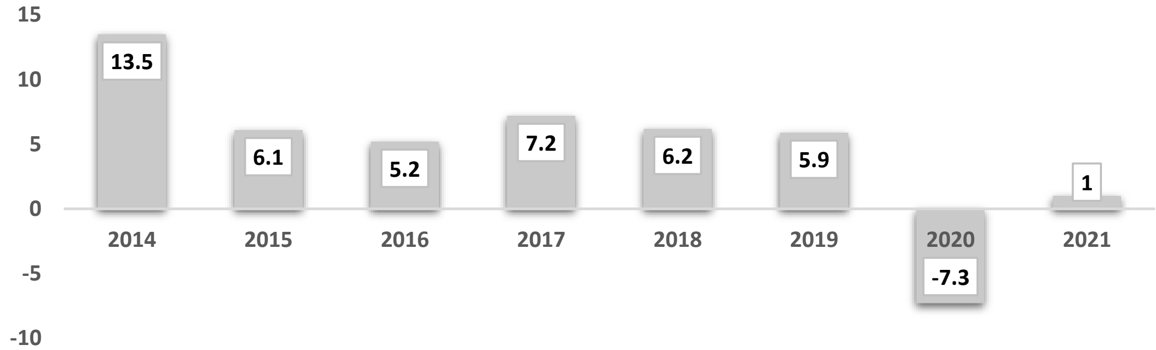

Figure **Error! No text of specified style in document.** Annual Percentage Change of SMEs GDP from 2014-2021 (Source: DOSM, 2022)

Literature Review

Research Related to Firm Performance

Firm performance often defined as how successfully a business achieves its non-financial as well as its financial objectives. Moreover, if a business continuously fails to generate enough revenue and earnings, it could easily go bankrupt and become insolvent (Foster, 2021). The performance of SMEs has received a lot of attention in the past since it affects a company's capacity to meet its goals (Samad, 2022). According to a prior research, a firm's performance is determined by how well it meets its economic objectives, which are linked to providing financial returns to its shareholders (Le & Ikram, 2022). According to Razak et al (2021) an organization's efficacy and efficiency in conducting business, creating wealth, acquiring resources, and internally converting those resources to satisfy organizational objectives can be characterized as firm performance. Furthermore, performance metrics are separated into non-financial and financial categories. Capital market returns, unit cost, profit, and return on investment are examples of financial metrics that quantify a company's performance (Nuhu et al., 2022). In contrast, corporate governance, environmental performance, and employee performance are examples of non-financial performance metrics (Shahwan et al., 2022). Although the manufacturing sector has played a significant role in the expansion of Malaysia's economy, it has faced various obstacles concerning business performance (Muda & Rahman, 2019). Future research should look at the declining firm performance of SMEs in Malaysia, according to recommendations from earlier studies (Cheah et al., 2022; Muda & Rahman, 2019). Present research focused on the financial and non-financial performance of Malaysian

SMEs in the manufacturing sector. The measure of firms' financial and non-financial performance was based on a subjective approach. This means that measuring the respondents' attitudes, beliefs, and perceptions (Sekaran & Bougie, 2016). Past research indicated that subjective measures provide complete information; thus, they are useful for measuring firm performance. Whereas objective measures focus on actual financial data, subjective measures focus on both the financial and non-financial performance of firms using a scale Zulkiffli (2014), subjective measures are considered more appropriate than objective measures because measuring performance only through financial data might not accurately indicate the financial health of a firm (Dawes, 1999).

The financial and non-financial performance of Malaysian SMEs in the manufacturing sector was the main emphasis of the present research. Prior studies indicated that there are several factors ultimately affect a company's performance. According to Mahmod et al. (2018) adopting risk management practices could enable SMEs to overcome uncertainties and improve firm performance. SMEs are also vulnerable to several hazards associated with fraud, human error, system failure, production disruption, financial instability, and political unpredictability. Therefore, in order to prevent business loss, SMEs have to adopt ERM.

Research Design and Methods

The research's conceptual framework is to broaden the comprehension of the effects of enterprise risk management capabilities, which may have relevance and enhance the performance of Malaysian manufacturing firms. Moreover, this research will yield important insights into how innovation capabilities influence the relationship between enterprise risk management capabilities and firm performance. This conceptual research was produced using comprehensive past studies review. Additionally, as illustrated in Figure 2, the literature review was synthesised using academic research pertinent to the enterprise risk management capabilities, innovation capabilities and firm performance.

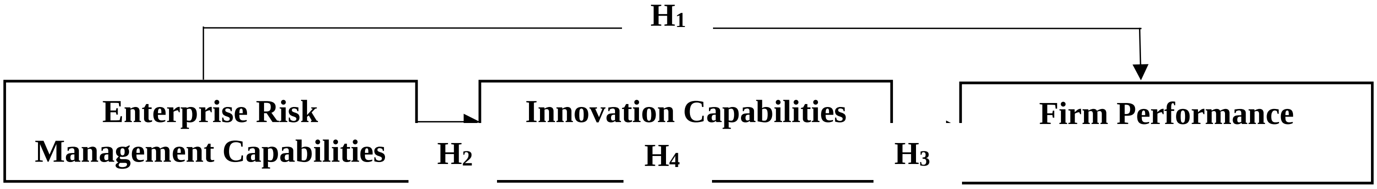

Figure 2 Conceptual Framework.

The research has four (4) hypotheses were developed to investigate the impact of the variables on firm performance. Furthermore, future research might conduct quantitative research (based on survey) to gather the research data. This research employed the resource-based view (RBV) theory. During this conceptual research approach, a reliable method for carrying out a systematic review was employed. The proposed conceptual framework may be empirically tested in the future using the quantitative technique.

Enterprise Risk Management Capabilities and Firm Performance

Enterprise risk management capabilities are defined as the process of organizing, planning, directing, and regulating an organization's actions to lessen or eliminate the impact of any potential risk. An organization's organizational strategy and innovation are strongly impacted by effective enterprise risk management (Lima et al., 2022). Firms face a variety of risks, such as those related to the environment and society, company operations, regulatory compliance, and worker health and safety (Barbosa et al., 2022). Past research found that there is positive correlation between enterprise risk management and firm performance. Adopting ERM efficiently lead to increase the wealth of shareholders. They added that businesses should implement a strong and efficient risk management system to protect themselves against significant risks that could negatively impact their reputation, future prospects, or organizational performance (Malik et al., 2020).

Enterprise risk management is seen as a crucial prerequisite for firms which are looking to achieve exceptional results. According to Fauzi et al (2022), risk management has a critical role in determining whether business start-ups in Malaysia succeed or fail. ERM systems are deemed to lower the direct and indirect costs of earnings volatility, financial crisis, and unfavourable surprises in the financial markets. Additionally, it might enhance the methods used to choose the greatest investment prospects. Therefore, organizations can perform better if they take a comprehensive approach to risk management (Florio & Leoni, 2017). Moreover, through the identification, evaluation, and management of risk, ERM may be crucial to the long-term growth of the company. Implementing ERM is also expected to boost an organization's long-term viability, boost growth and economic efficiency, and boost investor confidence (Shah et al., 2024). Additionally, because of their limited resources, SMEs face greater risks than larger companies. SMEs may be able to overcome uncertainty and enhance company performance by implementing risk management strategies. The reasons behind implementing in risk management application among SMEs in Malaysia are a lack of experience and the related implementation costs (Tan & Lee, 2022). Past studies examined the correlation between enterprise risk management capabilities and firm performance among SMEs in Pakistan. Therefore, past research recommended that further studies should examine the relationship between enterprise risk management capabilities and firm performance (Yang et al., 2018). Based on the above discussion, the following hypothesis was developed:

H_1: There is a positive relationship between enterprise risk management capabilities and firm performance

Enterprise Risk Management Capabilities and Innovation Capabilities

Firms can identify risks and anticipate changes in dynamic environmental circumstances with the help of enterprise risk management. Since it necessitates substantial training, ERM is a vital intangible resource in a company that competitors cannot imitate (Tze et al., 2023). In addition, previous studies have demonstrated that risks are essential to innovation and that further research is needed to fully understand the relationship between innovation and risk. According to Berglund (2007) there is a link between innovation and risk. The clarified that as innovative acts aim to address an uncertain future, they are related to risks. Even though success or failure of businesses in Malaysia is depending on risk management Fauzi et al (2022), it is still in its early stages in most SMEs in Malaysia (Mahmod et al., 2018; Tan & Lee, 2022). Past studies examined the correlation between enterprise risk management capabilities and innovation capabilities. Their research was limited to the companies in Brazil; thus, its findings cannot be generalized. Thus, more research is needed in other sectors and countries to generalize the findings (Etges et al., 2017). Therefore, they recommended that further studies should examine the relationship between enterprise risk management capabilities and innovation capabilities in another context. Therefore, based on the above-mentioned arguments we proposed the following hypothesis:

H_2: There is a positive relationship between enterprise risk management capabilities and innovation capabilities

Innovation Capabilities and Firm Performance

Firm performance refers to whether firms achieve their economic objectives, which are linked to the financial profits to the firm's shareholders (Le & Ikram, 2022). According to prior research, a company's performance is measured by how well it achieves its non-financial as well as financial objectives. Moreover, if a business continuously produces insufficient sales and revenue, it could easily go bankrupt and insolvent (Foster, 2021). In addition, innovative capability is defined as the ability to use a set of tools to support innovation initiatives and enhance firm performance accordingly (Eng et al., 2022). Borah et al (2022), suggested a company's innovation capabilities can also be described as its capacity to implement concepts or practices linked to systems, equipment, programs, procedures, goods, or services.

Innovation considers essential to generating new value that may subsequently be used for financial and societal advantage. Moreover, it entails developing new manufacturing techniques, establishing new management systems, or creating or embracing a novelty that has the potential to revitalize and broaden markets for goods, services, and markets. Therefore, innovation is critical to a company's competitive advantage and long-term viability (Reyes-Gómez et al., 2024). Past research asserted that there is a significant and positive association between innovation capabilities and firm performance (Bahta et al., 2020; Kamalrulzaman et al., 2021; Maldonado-Guzmán et al., 2018). In a previous research, manager/owners were advised to include innovation capabilities in the firm's organizational strategies to improve performance of their firms (Bahta et al., 2020). Siahaan and Tan (2020) argued that SMEs possessing a strong innovation potential can promptly adapt to market uncertainties and sustain their competitive edge over their competitors. Past research proposed that future research could test the effect of innovation capabilities on firm performance in other countries (Gyedu et al., 2021; Maldonado-Guzmán et al., 2018; Manogna & Mishra, 2021). Therefore, based on the above-mentioned arguments we proposed the following hypothesis

H_3: There is a positive relationship between innovation capabilities and firm performance

Enterprise Risk Management Capabilities and Firm Performance: Mediation Role of Innovation Capabilities

Past studies revealed a strong corelation between innovation and firm performance (Agyapong et al., 2017). Past studies suggested that there is a positive relationship between innovation capabilities and SMEs' firm performance (Bahta et al., 2020; Kamalrulzaman et al., 2021; Maldonado-Guzmán et al., 2018). Previous studies have shown that SMEs need to develop their innovative capacities to improve their competitiveness and business success (Hanifah et al., 2019). Enterprise risk management is seen as a crucial prerequisite for businesses looking to achieve exceptional firm performance (Tze Yin et al., 2023). Previous research has demonstrated that firms adopting enterprise risk management capabilities would minimize the negative impact of the external market (Rua et al., 2022).

Based on past studies, there are positive and causal relationship between enterprise risk management capabilities and firm performance Tze Yin et al (2023), enterprise risk management capabilities and innovation capabilities Tze et al (2023); innovation capabilities and firm performance (Agyapong et al., 2017). According to Preacher and Hayes (2014) when the is a positive and causal relationship between the variables of research; a mediating effect may exist. Furthermore, the past study examined the mediating role of innovation capacities on the Saudi firms (Alaskar, 2023). Therefore, past studies recommended that future research should investigate the mediator impact of innovation capacities on firm performance in another context. Therefore, based on the above-mentioned arguments we proposed the following hypothesis:

H_4: Innovation capabilities mediate the relationship between enterprise risk management capabilities and firm performance

Underpinning Theory

The resource-based view (RBV)

The resource-based view (RBV) theory stresses a firm's resource identification, portfolio, deployment, and development in order to generate returns (Saeidi et al., 2019). It illustrates how immobile and imperfectly imitable resources can give businesses a competitive edge (Dahiya, 2021; Khan et al., 2022). According to Ahmed et al (2019), a firm's performance is determined by how well its resources are used. Furthermore, organizations need unique, valuable, uncommon, and non-replaceable resources to ensure long-term sustained firm performance and long-term competitive advantage (Barney, 1991). In order to earn profits and establish a sustainable competitive advantage and company value, companies ought to cultivate or acquire competencies and resources that are distinct, enduring, and difficult for competitors to imitate. As a result, businesses that make optimal use of their resources will do better (Dahiya, 2021).

Resource-Based View Theory and Enterprise Risk Management

One of the most prominent theories used in enterprise risk management research is resource-based view (RBV) theory (Bogodistov & Wohlgemuth, 2017; Mishra et al., 2019; Saeidi et al., 2019). According to RBV theory, enterprise risk management is an important intangible resource that is valuable, potentially hard to copy, and creates a competitive advantage that leads to better performance (Tze Yin et al., 2023). As an underpinning theory in business risk management research, RBV is regarded as one of the most prominent theories (Bogodistov & Wohlgemuth, 2017; Mishra et al., 2019; Saeidi et al., 2019). According to RBV theory, enterprise risk management is an important intangible resource that is valuable, potentially hard to copy, and creates a competitive advantage that leads to better performance (Tze Yin et al., 2023). RBV is considered one of the most notable theories used as an underlying theory in enterprise risk management research (Bogodistov & Wohlgemuth, 2017; Mishra et al., 2019; Saeidi et al., 2019). Enterprise risk management is a crucial intangible resource, and based on RBV theory, it is a valuable resource which could be difficult to imitate, and which generates a competitive advantage, resulting in superior performance (Tze Yin et al., 2023). Hence, RBV theory was employed in this research to examine the impact of enterprise risk management capabilities on firm performance.

Resource-Based View Theory and Innovation Capabilities

Competitive advantages created by idiosyncratic resources and competencies can help businesses perform better (Borah et al., 2022; Khan et al., 2022). Previous studies examined

the importance of leveraging a company's resources to build innovation capabilities and offer creative goods and services (Borah et al., 2022). RBV theory has been used in earlier research to explain the connection between business performance and innovation capacities (Shou et al., 2017). As a result, the RBV theory was applied in this research to explain how innovation capabilities and firm performance are related.
Innovation capabilities, which are derived from RBV theory, enable businesses to perform better when they create and manage their resources and capabilities. According to the RBV hypothesis, businesses that manage their resources creatively and effectively can create economic value (Kamal et al., 2023). In addition, the RBV hypothesis states that a company's capacity to generate distinctive and unique skills determines its level of success. Thus, corporations get a competitive edge when they acquire uncommon and inimitable resources and competencies. When deployed properly, innovative capabilities are seen as a firm's asset (Ahmed et al., 2019).

Design/methodology/approach
The conceptual research construct thorough analysis of books, journal articles, conference materials, and proceedings related to the topic and systematic review was conducted. The theoretical framework was developed in light of the scale of the literature review and the differences between the research (Figure 2). The literature research indicates that prior research has indicated a positively relationship between enterprise risk management capabilities and firm performance. Past studies also found positive correlation between innovation capabilities and firm performance. According to the review of prior literature, innovation capabilities has also positive association between enterprise risk management capabilities and firm performance.

Results and Discussion
This conceptual paper was developed based on prior studies, conference materials, conference proceedings, and books related with the topic. Therefore, based on variances between the previous research the theoretical framework was finalized (Figure 2). According to past studies findings, there are significant and positive relationship between enterprise risk management capabilities, innovation capabilities and firm performance.

Research Implication
This research adds to the current body of knowledge available about Malaysian manufacturing SMEs' performance. The results of this research should give the Malaysian government important information about what has to be enforced more on manufacturing SMEs in order to improve their performance. Empirical evidence suggests that this research is crucial for Malaysian policymakers to design appropriate policies for enhancing manufacturing SMEs in Malaysia. This is based on the conclusions of previous research. Therefore, according to this conceptual research, enterprise risk management capabilities and innovation capabilities has significant impact on firm performance.

Conclusion and Future Research
This research aimed to assess the declining firm performance of Malaysia manufacturing SMEs. The present research explored the correlation between enterprise risk management capabilities and firm performance. The research also discussed the mediating impact of innovation capabilities between enterprise risk management capabilities and firm

performance. Thus, to achieve superior performance Malaysian manufacturing SMEs should utilize the enterprise risk management capabilities and innovation capabilities. This conceptual framework might be empirically investigated in future research. Further studies should investigate a moderator between enterprise risk management capabilities and innovation capabilities has significant and firm performance. Future research might test other independent variables which could enhance the presented theoretical model. Future research might also be conducted in another context, in a different sector.

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