

## ***When Performance Drives Innovation: The Mediating Role of External Networks in Croatia's Local Governance***

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**Abstract:** *This study examines how perceived organisational performance influences innovation capacity within local self-government units (LSGUs) and their locally owned enterprises in Croatia, with a particular focus on the mediating role of external networking. Drawing on Dynamic Capabilities Theory (DCT), the research conceptualises perceived performance not only as an outcome but also as a driver of innovation. Specifically, the study builds on the notion that high performance fosters internal legitimacy and organisational confidence, in turn reducing the risks often associated with experimentation, i.e., innovation, and encouraging public managers to consider shifting scarce resources toward innovative behaviour. The study emphasizes the interaction between this internal readiness of organisations and external networks, namely political, partner, and policymaker connections. The results reveal that perceived performance has a significant and positive effect on innovation capacity. Moreover, all three dimensions of external networking partially mediate this relationship, serving as crucial intermediaries that help convert internal organisational motivating factors into tangible innovative outputs. Among these, partners' networking demonstrating the strongest indirect effect, highlighting the importance of knowledge-sharing and joint problem-solving in public sector. Political networking followed, underscoring the necessity of securing goodwill for resource allocation, while policymaker networking provided the regulatory credibility for making long-term innovative initiatives sustainable. The findings of this research suggest that, while organisational success fosters internal readiness for innovation, translating it into tangible outcomes depends on the strength and quality of external networks. This means that local public managers need to cultivate strategic external partnerships and political relations to sustain innovation capacity and improve service delivery.*

**Keywords:** *public sector innovation, innovation capacity, perceived performance, external networking*

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## **Introduction**

Innovation is a key driver of development and improved organisational performance (Azamela et al., 2022), especially in the public sector, where administrations face complex challenges such as digitalization, demographic shifts, climate change, and global crises (OECD Observatory of Public Sector Innovation, 2022). Through innovation, public institutions can adapt more effectively and respond to citizens' needs with greater legitimacy and impact (Criado et al., 2023). When demonstrating their potential to innovate, they enhance their innovation capacity—the ability not only to innovate once but to continuously generate improvements (Kaur et al., 2022). Previous research has identified multiple antecedents of public sector innovation capacity, including leadership, collaboration, and stakeholder engagement (Novillo-Vilegas et al., 2022; Danso & Opoku, 2025; Azamela et al., 2022). Other studies have examined the importance of digital capabilities, networking, and entrepreneurial orientation (Atobishi et al., 2024; Gullmark, 2021; Lewis et al., 2018). Empirical evidence on the innovation capacity of local self-government units (LSGUs), especially in transition or transition-completed countries like Croatia, is scarce (Klarić, 2021). External networking can play a mediating role by connecting public organisations' internal capacities with external resources and knowledge, thereby influencing the extent to which perceived performance translates into innovation capacity. To better understand innovation in the public sector, research that considers both employees' characteristics and the context in which they operate seems promising.

This paper examines the impact of perceived performance on the innovative capacity of LSGUs (cities and municipalities) and their locally owned enterprises in Croatia. With a specific focus on political networking, partnerships with external actors, and interactions with policymakers, it investigates the mediating role of external networking in this relationship. In such contexts, networking is not only a source of knowledge and resources but also a channel for legitimacy and support that can enhance innovation capacity (Klijn et al., 2025). As Klarić (2021) observes, LSGUs in Croatia and their locally owned enterprises operate under conditions of limited resources, high political oversight, and strong EU-driven regulatory frameworks. The system is characterised by high fragmentation, relatively small territorial units, and limited administrative and fiscal capacities, leaving local governments heavily dependent on central government support. In this context, external networking becomes an important mechanism for compensating for limited local capacities, as cooperation with political actors, partners, and policymakers can provide access to resources, knowledge, and legitimacy that local units by themselves often lack.

By testing this model, the study provides new insights into how local governments and their enterprises can leverage perceived performance and external networking to build stronger innovation capacity and improve their contribution to local development. The conceptual approach of the study was derived from the Dynamic Capabilities Theory (DCT), which emphasises organisations' ability to sense opportunities, seize them, and realign resources in dynamic environments (Azamela

et al., 2022). From the DCT perspective, perceived organisational performance is not only an outcome but also a basis for developing new capabilities, as it reflects how effectively organisations learn, adapt, and transform their resources into innovation capacity through processes and culture (Loureiro et al., 2021). This relationship is further shaped by external networking, which, in this study, is considered a mediator due to its potential to provide organisations with access to complementary resources, knowledge, and partnerships that strengthen this link. Public sector organisations often depend on networks of partners, political actors, and international organisations to mobilise resources and implement change (Jørgensen & Ulhøi, 2010).

## **1. Theoretical background**

### **1.1 Contextualising innovation capacity in the public sector**

Innovation is now widely acknowledged as a central function of the public sector (Mulgan & Albury, 2003). However, public institutions continue to lag behind private organisations in their innovation efforts (de Vries et al., 2016). Innovation involves developing and effectively implementing new or improved ideas to produce practical, valuable outcomes (Taylor, 2017). Public sector organisations face internal and external pressures to deliver more with fewer resources (Considine et al., 2009; Wanna, 2015). In response to these challenges, scholars have increasingly turned to the concept of public sector innovation capacity. While innovation refers to new ideas and practices, innovation capacity focuses on the organisational abilities and conditions that enable such innovation to be continuously and sustainably implemented (Azamela et al., 2022). This enables continuous innovation to address societal problems. Clausen et al. (2020) found a positive, statistically significant effect of innovation capability on the intensity of innovation in public sector organisations in 29 European countries. Gullmark and Clausen (2023) have demonstrated that innovation capacity allows local government organisations to adopt and generate innovations continuously. Similarly, Kim and Lee (2009) confirmed that strong management capacity drives innovation. Thus, building innovation capacities for LSGUs is extremely important in the contemporary environment (LSE Cities, 2024). City governments face complex short- and long-term responsibilities. However, most operate with limited resources, restricted powers, and under growing political pressure. Developing innovation capacity—through organisational, analytical, partnership, and leadership capabilities—helps them adapt, experiment, and find new solutions that improve both efficiency and citizen satisfaction. Whether such organisations have the capacity to innovate depends on multiple factors (Gieske et al., 2016; Considine et al., 2009). Capacity depends on individual, organisational and networks factors. Innovative capacity needs to be intentionally and strategically built, involving the correct drivers and purpose, fostering an open culture, matching resources to institutional rules, and analysing the initiatives to learn and grow (OECD Observatory of Public Sector

Innovation, 2022). That is crucial for designing and delivering reforms, responding to local and global crises, and shaping a better future for their citizens. Without deliberate effort, public sector innovation remains limited, affecting long-term public value (Gullmark, 2021).

### **1.2 Conceptualising perceived performance**

Organisational performance refers to the extent to which an organisation can efficiently achieve its objectives (Daft, 2010). Performance is most often evaluated using various financial metrics—sales, profits, market share, or growth—all indicators that work well in a private-sector setting. However, beyond actual organisational performance, there is also perceived organisational performance. Although these two are closely linked and interdependent, they remain conceptually separate (Burton et al., 2003). Perceived organisational performance reflects employees' own evaluations of their organisation's success; it plays a crucial role in fostering employees' identification with the organisation and affects their job satisfaction (Carmeli et al., 2007), making it one of the most vital employee-related perceptions that organisations need to manage effectively. Perceptions significantly influence individual behaviour, which, in turn, impacts organisational dynamics and ultimately determines success, often measured through performance (Srivastava, 2008). A range of studies confirm that the results derived from measures of perceived and actual performance are broadly comparable (Dess & Robinson, 1984; Tzafirir, 2005; Darwish et al., 2016). Organisations must pay careful attention to employee motivation and engagement, as these factors are essential in fostering willingness to participate in innovation initiatives (Busch-Casler et al., 2021). Such willingness is further shaped by employees' perceptions of their employer, which are closely linked to their overall job satisfaction (Tsai & Yen, 2020). Therefore, recognising and actively managing these perceptual drivers can be a decisive factor in maintaining innovation capacity and ensuring long-term organisational performance.

### **1.3 The role of networks in public sector innovation processes**

To deliver more effective public value, public sector organisations are increasingly connected in networks (Akerboom et al., 2024), i.e., groups of independent organisations and actors that work together through mutual communication and cooperation to achieve a common goal. Public organisations join networks to gain resources and knowledge. That enables them to create a collaborative advantage that delivers public value beyond what can be achieved through individual effort alone (Bianchi et al., 2021). Their success depends on balancing existing programs through inter-organisational cooperation to deliver services more efficiently than through fragmented systems (Provan & Milward, 2002). That includes public, private, and other societal stakeholders who need to collaborate to resolve complex societal issues (Klijn et al., 2025). In the public sector, this may not always be easy, as network participants often disagree on the nature of the problem or support different

solutions to address it. Nevertheless, the traditional approach to dealing with local and global crises, which involves assigning them to special departments within a hierarchy-organised bureaucratic public sphere, no longer holds. To truly manage the issue and deliver new, innovative solutions, these groups need to adopt a new approach that involves cooperation with other stakeholders through networks.

Active and engaged networks are key to successful innovation because they connect organisations, provide resources, and support the implementation of ideas (OECD, 2019). That often includes tasks such as coordinating solutions, experimenting with new approaches, fostering interdepartmental projects, and building networking capacity. At the municipal level, networks can connect policymakers with frontline employees, helping balance central authority with local knowledge and enabling more context-specific improvements (OECD, 2017). External partnerships, when coupled with strong organisational learning, are associated with greater innovation in public service networks, as shown by Lim and Young (2023). Linåker & Runeson (2022) emphasised the importance of establishing a shared network of platform providers to collaborate and share data to increase innovation outputs, which further supports the importance of establishing external partnerships to drive internal innovation capacities.

#### **1.4 Theoretical Framework and Contextualization of the Mediation Model**

Mediation mechanisms in organisational research explain how and why one variable (X) affects another (Y) through a third variable (M), which explains or carries the effect of X on Y (Holland et al., 2016). This deeper understanding not only advances theory but also helps managers and policymakers design more targeted interventions, as highlighted by Walker (2004), who noted the importance of the type of innovation (product or process) and the mediating roles in management–performance relationship. Understanding these mediating relationships is crucial for designing more targeted and effective interventions (Memon et al., 2018).

The current study focuses on the context of Croatian LSGUs. Croatia is a member state of the European Union. The country is a unitary state with three tiers of government: the national level, the regional level—comprising 21 counties (including the City of Zagreb), and the local level—composed of 428 municipalities and 128 towns (OECD, 2021). Croatia has one of the highest concentrations of state-owned enterprises (SOEs) in Europe, with around 260 public companies per million residents, placing it among the largest SOE sectors in both the EU and Central and South-Eastern Europe—regions traditionally marked by significant state ownership and intervention (Thomsen, 2019). Nevertheless, the responsibilities of counties, cities, and municipalities are not clearly defined (Buljan et al., 2021). In general, cities and municipalities take on tasks that directly address citizens' needs, while counties handle other regional functions. Additionally, Croatia is characterised by a pronounced municipal fragmentation, which has long been emphasised as a structural weakness and a central challenge of its intergovernmental fiscal framework (World Bank, 2022).

The National Development Strategy of the Republic of Croatia 2030 (Hrvatski Sabor, 2021) likewise highlights fragmentation as a key obstacle to coordination and cooperation among public bodies. Local administrations often lack sufficient capacity, as reflected in low levels of decentralisation and difficulties in managing EU funds for large-scale investments. In the coming decade, reforms will therefore be intensified in areas such as the judiciary, the fight against corruption, digitalisation of the public sector, and the standardisation of public service quality at the local level. In such a fragmented and capacity-constrained local government system, it becomes particularly important to understand how perceived organisational performance influences innovation capacity. Innovation and organisational performance are deeply interconnected in the public sector; while innovation enables public organisations to adapt, improve service delivery, and respond to emerging societal needs, its successful implementation often depends on the organisation's capacity to mobilise resources, foster a supportive climate, and engage with relevant stakeholders. In turn, organisational performance can create conditions that further encourage innovation, making the relationship between the two both reciprocal and reinforcing. Strengthening innovation can help local government units overcome structural limitations and improve the quality and efficiency of service delivery.

However, this connection is rarely the result of internal capabilities alone. External linkages, collaborative arrangements, and the ability to navigate complex stakeholder environments often determine whether innovative ideas turn into actual performance outcomes. As such, networking emerges as a critical factor, since many municipalities and locally owned enterprises lack strong cooperative mechanisms and institutional links. Building networks with other public entities, private-sector actors, and research institutions can therefore compensate for the existing weaknesses, fostering knowledge exchange and creating opportunities for innovation-driven performance improvements. That underscores the need to consider not only the internal drivers of innovation, but also the relational mechanisms, particularly those embedded in organisational networks, that bridge innovative capacity and perceived performance. Therefore, the following hypotheses are proposed:

H1: Perceived performance has a significant and positive effect on public sector innovation capacity.

H2: External networking mediates the relationship between perceived performance and public sector innovation capacity.

H2a: Political networking mediates the relationship between perceived performance and public sector innovation capacity.

H2b: Partners' networking mediates the relationship between perceived performance and public sector innovation capacity.

H2c: Policymakers' networking mediates the relationship between perceived performance and public sector innovation capacity.

Testing the mediating role of external networking is crucial to understanding how perceived performance translates into enhanced innovative capacity within LSGUs (cities, municipalities) and the development of their locally owned enterprises.

## **2. Research methodology**

The data for this study were collected as part of a national research project examining the benefits of innovativeness and networking in the Croatian public sector. This study specifically investigates how different types of networking contribute to the relationship between organisational performance and innovation capacity within public sector organisations: cities, municipalities, and their enterprises. The survey sample was based on the Ministry of Justice, Public Administration, and Digital Transformation database (2025a; 2025b). Data collection began at the end of November 2024 and lasted about three months. Respondents received a cover letter explaining the study's purpose and importance, and were assured of anonymity to reduce common method bias.

In total, 425 respondents completed the questionnaire, giving a response rate of 15%. The responses were then reviewed to ensure that participants matched the study's target group. Individuals not in relevant decision-making positions were excluded. That led to the removal of 38 responses, resulting in a final sample of 387 valid participants, which is considered representative of the population (Pavić & Šundalić, 2021). The sample consisted of 65.1% of female participants, with 37.0% of them being between the ages of 41 and 50, following with 28.4% of them being between 31 and 40, 21.4% between the ages of 51 and 60. The rest of the age groups were represented with less than 10% of participants. Almost 80% of the participants had higher education.

### **2.1 Measures**

Innovation capacity was measured using the Public Innovation Capacity Scale developed by Meijer (2019), a self-assessment instrument. The data indicated that the scale could be operationalised as a unidimensional construct, and was therefore utilised in this study as a single measure of overall innovation capacity. Organisational performance was measured as perceived performance relative to other public sector organisations, following Andrews and Beynon (2017). The items assessed the comparative quality of products and services, efficiency and effectiveness, fairness to citizens, consumer satisfaction, employee satisfaction, contribution to social, economic, and environmental well-being, and a general assessment of overall organisational outcomes. External networking was measured using the Managerial Networking Scale (Andrews & Beynon, 2017), capturing the frequency of interactions with key external actors: political; partners, and policymakers.

## **3. Results**

To test the data, a mediation analysis was conducted in IBM SPSS 31. The first step was to assess the scales' internal reliability. Cronbach's alpha coefficients (see Table 2) were calculated for this purpose. The reliability of all scales was

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satisfactory ( $\alpha > .70$ ) in accordance with Nunnally (1978), except for the political networking dimension within the external networking construct ( $\alpha = .522$ ). Although this value indicates only moderate reliability, the scale was retained for further analysis. Since the political networking dimension consisted of only two items, it was considered that short scales are particularly prone to underestimating Cronbach's alpha (Eisinga et al., 2013). Furthermore, the Pearson correlation coefficient between the two items was statistically significant ( $r = .353, p < .001$ ), indicating sufficient inter-item association. The scale was therefore maintained due to its theoretical relevance and alignment with prior research. Additionally, all Pearson correlation coefficients between the study variables, as shown in Table 1, were statistically significant, indicating meaningful associations among the constructs.

**Table 1. Means, standard deviations, reliabilities, and intercorrelations of study variables**

		M	SD	$\alpha$	1.	2.	3.	4.	5.
1.	INN CAP	3.13	.877	.976	1				
2.	PERF	3.71	.721	.937	.666	1			
3.	POLIT NETW	2.61	.951	.522	.461	.291	1		
4.	PART NETW	2.87	.759	.794	.505	.320	.704	1	
5.	POLICY NETW	2.43	.950	.765	.428	.301	.540	.606	1

*Note:* All correlations are statistically significant with  $p < .001$ . INN\_CAP = innovation capacity; PERF = performance; POLIT\_NETW = political networking; PART\_NETW = partners networking; POLICY\_NETW = policymakers networking.

Source: Authors' contribution.

To test the mediating effect of different dimensions of external networking on the relationship between perceived performance and innovation capacity, a series of regression analyses was conducted. For each mediator, two models were tested. In the first model, perceived performance and the selected networking dimension were simultaneously entered as predictors of innovation capacity to estimate their direct effects (paths b and c'). In the second model, perceived performance was regressed on the mediator to test path a. Indirect effects were calculated manually by multiplying the unstandardised coefficients of paths a and b (i.e.,  $a \times b$ ). Although the bootstrapping procedure with 5,000 resamples was applied, SPSS did not provide a direct confidence interval for the indirect effect. Therefore, the significance of the mediation was interpreted based on the bias-corrected 95% confidence intervals obtained separately for path a (from the second model) and path b (from the first model). If both intervals excluded zero, the indirect effect was considered potentially significant. The regression results testing the mediating role of external networking in the relationship between perceived performance and innovation capacity are given in Table 2.

**Table 2. Regression results testing the mediating role of external networking in the relationship between perceived performance and innovation capacity in public sector organisations**

	B	SE	t	VIF	95% BCa CI
<b>Model 1: The mediating role of political networking</b>					
<i>Path b and c'; R<sup>2</sup> = .521; F = 208.857***</i>					
PERF → INN_CAP (c')	.706	.045	15.729***	1.093	[.615, .801]
POLIT_NETW → INN_CAP (b)	.269	.034	7.909***	1.093	[.197, .342]
<i>Path a; R<sup>2</sup> = .521; F = 208.857***</i>					
PERF → POLIT_NETW (a)	.384	.064	5.968***	1.000	[.244, .525]
<i>Indirect effect (Path c)</i>					
PERF × POLIT_NETW → INN_CAP (a × b = c)	.103				
<b>Model 2: The mediating role of partners networking</b>					
<i>Path b and c'; R<sup>2</sup> = .535; F = 220.991***</i>					
PERF → INN_CAP (c')	.681	.560	15.211***	1.121	[.590, .770]
PART_NETW → INN_CAP (b)	.371	.321	8.722***	1.121	[.291, .453]
<i>Path a; R<sup>2</sup> = .108; F = 46.397***</i>					
PERF → PART_NETW (a)	.345	.051	6.812***	1.000	[.213, .477]
<i>Indirect effect (Path c)</i>					
PERF × PART_NETW → INN_CAP (a × b = c)	.123				
<b>Model 3: The mediating role of policymakers networking</b>					
<i>Path b and c'; R<sup>2</sup> = .500; F = 192.007***</i>					
PERF → INN_CAP (c')	.718	.046	15.596***	1.100	[.624, .809]
POLICY_NETW → INN_CAP (b)	.231	.035	6.617***	1.100	[.167, .295]
<i>Path a; R<sup>2</sup> = .091; F = 38.412***</i>					
PERF → POLICY_NETW (a)	.397	.064	6.198***	1.000	[.232, .548]
<i>Indirect effect (Path c)</i>					
PERF × POLICY_NETW → INN_CAP (a × b = c)	.092				

Note: For abbreviations, please see Table 1. \*\*\* p < .001

Source: Authors' contribution

In the mediation analysis using political networking, the regression model, including both perceived performance and political networking as predictors of innovation

capacity, was statistically significant. Both predictors, i.e., perceived performance and political networking, had significant effects. In the second model, perceived performance significantly predicted political networking, accounting for 8.5% of the variance. The product of the two coefficients ( $a \times b$ ) indicated an indirect effect of  $B = .103$ . When it comes to mediation through partners' networking, the regression model with both perceived performance and partners as predictors of innovation capacity was also statistically significant, with both predictors significant. Perceived performance significantly predicted partners in the second model, accounting for 10.8% of the variance. The product of the coefficients ( $a \times b$ ) indicated an indirect effect of  $B = .123$ . The regression model testing mediation through policymakers' networking (including perceived performance and policymakers as predictors of innovation capacity) was also statistically significant, with both predictors having significant effects. In the second model, perceived performance significantly predicted policy makers, accounting for 9.1% of the variance. The product of the two coefficients ( $a \times b$ ) indicated an indirect effect of  $B = .092$ .

Although SPSS did not provide a straightforward bootstrap confidence interval for the indirect effect(s), the significance and confidence intervals of the observed individual paths indicate that the mediating role exists, supporting all hypotheses. They show that political networking, partners' networking, and policy makers' networking partially mediate (Hayes, 2018) the relationship between perceived performance and innovative capacity. This emphasizes that these networking dimensions play an important, but not exclusive, role in promoting innovation. All three models demonstrated features of complementary mediation (Zhao et al., 2010).

#### **4. Discussion and conclusions**

Public services are the primary means by which people (citizens, businesses, and organisations) interact with governments (Thijs et al., 2022). Thus, the mission of each public sector institution is to provide accessible, reliable, and effective services that meet citizens' needs and support social well-being. Innovation helps governments achieve this mission by enabling them to adapt, respond more effectively, and build legitimacy and trust. It is the responsibility of public sector leaders to plan for the future and explore possible innovations that can improve citizens' lives (OECD Observatory of Public Sector Innovation, 2022). Innovation should be the core activity in policymaking and public administration. That is particularly important for developing economies such as Croatia, where institutional constraints and external pressures both hinder and encourage innovation at the local level. Strengthening institutional capacities and improving territorial organisation are therefore essential to ensure more effective governance and service delivery (Klarić, 2021).

This study examined how perceived performance affects the innovative capacity of public sector organisations, specifically LSGUs and their enterprises. The first hypothesis (H1) proposed a significant and positive effect of perceived performance on innovation capacity, which was supported by the results. This finding aligns with

the notion that organisational success, particularly when measured through non-financial, people-centric indicators (such as aforementioned), is an important predictor of organisational behaviour, including innovative behaviour. High performance provides several key benefits. First, organisations perceived as highly effective enjoy greater internal legitimacy, which is crucial for gaining the benefits of innovative behaviour, such as readiness for change and experimentation (Rao et al., 2008). Second, high performance generates internal confidence among employees and encourages managers to shift attention and organisational resources into innovation, making such organisations more willing and capable of engaging in the inherently risky process of innovation (Demircioglu & Audretsch, 2017). That highlights that innovation in the public sector is not solely driven by performance; it also heavily depends on dynamic managerial action (Bøtcher Jacobsen & Bøgh Andersen, 2014). Therefore, to ensure high perceived performance effectively translates into innovative organisational behaviour, public sector managers must actively leverage the social relationships they build with both internal and external stakeholders. While internal stakeholders provide critical insights and operational support, external networks offer resources, knowledge, and legitimacy. External networking plays a crucial role in shaping how public organisations translate perceived performance into tangible innovation outcomes (Pittaway et al., 2004), particularly through political ties, partnerships with external actors, and interactions with policymakers. The findings of this study confirm the central role of external networks by supporting H2, which hypothesised that external networking mediates the relationship between perceived performance and innovation capacity. Specifically, the analysis revealed a partial mediation effect across all three dimensions of external networking, highlighting their importance as key channels through which organisational success turns into innovative potential. While perceived performance (direct effect) describes internal determinants for innovation, such as motivation and readiness, external networks (indirect effect) serve as channels that transform these internal determinants into viable innovative outputs. Among the three tested dimensions, partners' networking (H2b) showed the strongest indirect effect ( $B = .123$ ). This finding highlights the vital role of partnerships in effective business management, particularly in the public sector (Kolk et al., 2008), where public value, as an outcome of successful management, represents a fundamental pillar of societal advancement. That suggests that the positive effects of strong organisational performance are more likely to translate into innovation capacity when public sector managers actively engage with external partners, sharing knowledge, experience, and expertise (Silva et al., 2016). Organisational success, partnerships, and innovation form a cyclical process. First, successful organisations are more attractive to external partners. They seek industry leaders and high performers to initiate collaboration. These partnerships then feed the innovation process by increasing readiness to experiment, openness to knowledge-sharing, and enabling joint problem-solving (Brettel & Cleven, 2011). In turn, innovation makes organisations more successful, creating a continuous loop of growth. Following partners' networking, political networking (H2a) demonstrated the second

strongest (and still highly significant) indirect effect ( $B = .103$ ) in the mediating relationship between perceived performance and innovative capacity, emphasising the importance of political stakeholders and their support for public sector organisations. Public sector managers seek to build goodwill among politicians to be perceived as a reliable partner and to develop strong, trusting relationships (Ihlen & Raknes, 2022). High organisational performance can contribute to stronger goodwill, which is crucial since public resource allocation, such as public funds, is in the hands of politicians (Romer & Rosenthal, 1978). The ability of high-performing organisations to secure support enables them to move forward with their innovative ideas. It should be noted that, while internal reliability for this scale was moderate ( $\alpha = .522$ ), the strong statistical significance of the mediation effect and its theoretical grounding confirm the role of political networking. When considering LSGUs, where political support can be a decisive factor, networking is crucial for securing political backing for innovation.

Finally, the mediating role of policymakers' networking (H2c) was also confirmed, showing a significant, yet smallest, indirect effect ( $B = .092$ ), proving the importance of relationships with actors at higher institutional levels (Considine et al., 2009), where power dynamics shape such social exchanges (Markovsky et al., 1988). Policymakers represent a crucial link for public sector managers, as they establish the regulatory and policy frameworks that shape organisational behaviour (Riege & Lindsay, 2006). Higher performance provides organisations with credibility and legitimacy among policymakers (Suchman, 1995), enabling them to advocate for policy changes or adjustments. In this way, public sector managers can secure recognition for successful innovations, gain support for new initiatives, and achieve their integration into the wider public governance system, thereby sustaining long-term innovative capacity beyond the local context.

Overall, the findings of this study emphasise that innovation in LSGUs (cities and municipalities) and their locally owned enterprises emerges from a complex interaction between organisational performance and managerial networking activities. While a higher perception of performance provides the internal foundation for innovation, translating it into tangible outcomes depends on how effectively public sector managers utilise their external networks. The findings confirming mediation effects underscore that innovation is a socially embedded process shaped by inter-organisational collaboration, political goodwill, and institutional support. These insights have both theoretical and practical implications. Theoretically, this study contributes to the understanding of innovation in the public sector and its drivers. It expands the knowledge of how performance stimulates organisations to innovate and explains the role social networks have in this process, in line with the postulates of Dynamic Capabilities Theory (DCT), which highlights organisations' ability to identify opportunities, act on them, and adapt their resources to changing environments (Azamela et al., 2022). In practice, it highlights the importance of external social networks for public sector managers, which can help sustain innovation capacity by strengthening relationships with key stakeholders, such as partners, politicians, and policymakers. Ultimately, this study demonstrates how

fostering innovation in the public sector requires not only improving internal processes and performance but also cultivating strong social relationships across the public governance system.

The limitations of this study primarily stem from its methodology. It is a cross-sectional study based on respondents' self-perceptions, which may have influenced their current emotions and states of mind. Therefore, longitudinal studies are recommended to capture the dynamics of the three-variable interplay over time. Another limitation lies in the relatively low response rate, which may raise concerns about sample bias. Future research could, thus, aim to include a larger number of participants, particularly from locally owned enterprises. The sample was selected from publicly available email addresses, suggesting that some potentially valuable contacts could not be reached. To overcome the limitations of quantitative research, future studies could combine the quantitative model applied here with qualitative insights, e.g., interviews, focus groups, or case studies, to gain a more in-depth understanding of networking activities and their potential effects on innovation capacity. Finally, this research could be extended to cross-country and cross-regional analyses to provide comparative insights into how different institutional, cultural, and policy environments shape the relationship between networking and innovation capacity across contexts. In those studies, it would also be helpful to include other administrative or performance-based data (e.g., budget execution rates, project implementation success, or innovation adoption metrics) to complement perception-based measures and enhance the validity of findings.

Nevertheless, this study makes an important contribution to both theory and practice by empirically examining the mechanisms through which networking and organisational performance foster innovation capacity in the public sector. Understanding these relationships is essential for strengthening innovation in public organisations, which increasingly operate in complex, dynamic, and resource-constrained environments. It lays an important foundation for future studies and practical strategies to enhance public sector adaptability and long-term development.

### **Conflict of interest**

The author(s) declared no potential conflicts of interest with respect to the research, authorship, and/or publication of this article.

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