

# The Mediating Role of Organizational Innovation in the Relationship between Entrepreneur Orientation, HRM Practices and Organizational Performance of SMES

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The prime objective of the current study is to explore the direct relationships between HRM practices, entrepreneurial orientation, organizational innovation and organizational performance. Additionally, the mediating role organizational innovation in the relationship between entrepreneur orientation HRM practices and organizational performance is examined. Numerous studies have investigated EO, HRM practices, organizational innovation, and managerial ties as predictors of organizational performance. However, to the best of the researcher's knowledge, no single study has simultaneously investigated these organizational resources and capabilities and constructed a multivariate model of organizational performance of SMEs. This study explores the aspects of organizational resources and capabilities that lead to performance of SME manufacturing companies in Indonesia, by using resource-based view as the underpinning theory. Firstly, this study investigated the influence of organizational resources of entrepreneurial orientation, HRM practices, organizational innovation, and managerial ties on organizational performance at the organizational level of analysis. Organizational innovation was considered a mediator. By examining the relationships, the present study will provide insights into what contributes to SME performance. The study has employed the survey-based methodology. The response rate is 62 percent. The study has employed the PLS-SEM to achieve the objectives. This study will be

helpful for policymakers and researchers in examining the link between HRM practices, entrepreneurial orientation, organizational innovation and organizational performance in Indonesian SMEs. Finally, this study also provides discussion of hypotheses based on regression analysis result, limitation and recommendation for further study.

**Key words:** *HRM Practices, Entrepreneurial Orientation, Organizational Innovation Organizational Performance, Indonesia.*

## Background

In recent years, there have been calls to do more cross-study researches on the fields of HRM and Entrepreneurship (Della Torre & Solari, 2013). This is because they can benefit greatly from each other as they are closely related. The closer link will direct HRM studies to understand what drives entrepreneurial behaviour and how they can help a new business venture. In addition, this relationship may also help researchers understand how HRM theories can be applied to new and smaller firms (Darcy, Hill, McCabe & McGovern, 2014). This is crucial, as clearly indicated by Darcy et al. (2014), as SMEs have long been considered a second-rate firm by researchers in the field of HRM.

Many HRM researchers conducted their research on large organizations and disregarded small organizations, even though HRM is equally important to smaller organizations. Similarly, in Indonesia, there is also a shortage of studies on HRM in SMEs; so this study is expected to fill the gaps that still exist in the body of literature on the effect of HRM practices on the performance of SMEs in the manufacturing sector (Fabi, Raymond & Lacoursière, 2009). Therefore, this research would add to entrepreneurship and strategic human resource management literatures. It also contributes toward enhancing our understanding of HRM in entrepreneurial firms.

The role of organizational innovation as a mediator in this study was also examined. Previous studies have revealed that organizational innovation has a direct relationship with performance (Gumusluoglu & Ilsev, 2009; Bates & Khasawneh, 2005). In innovation research, there have been several attempts to investigate the relationship between innovation and organizational performance, but less consideration on moderating variables has been given. In fact, studies on the innovation-performance relationship have shown inconsistent findings (Chen & Hou, 2016). Thus, by introducing managerial ties as a moderator, this study will contribute to the existing literature of innovation.

Numerous studies have investigated EO, HRM practices, organizational innovation, and managerial ties as predictors of organizational performance. However, to the best of the researcher's knowledge, no single study has simultaneously investigated these organizational resources and capabilities and constructed a multivariate model of organizational performance of SMEs (Papa, Dezi, Gregori, Mueller & Miglietta, 2018). By considering the organizational resources, the present study offers a unique contribution to the model of organizational performance.

Simultaneous investigation of the predictor variables can give information on the relative usefulness, which could probably be very constructive, of the resources particularly in enhancing organizational performance of SMEs (Sung & Choi, 2018). Finally, this study contributes towards resource-based view theory (RBV) by investigating the effect of organizational resources and capabilities to organization performance of SMEs. The application of RBV is to signify the importance of human resources and organizational resources to achieve performance of SMEs. According to RBV, it is important for firms to manage business processes efficiently and effectively, especially in recognizing the full potential of their resources and capabilities (Tian, Cordery & Gamble, 2016). Thus, from an empirical perspective, investigating the integration of organizational resources and capabilities, such as EO, HRM practices, organizational innovation, and managerial ties in SME manufacturing companies, and assessing the relationships between these variables and performance, will enhance the understanding of organizational challenges, particularly in dealing with limited resources within a smaller organization (Lee, Pak, Kim & Li, 2019).

From the methodological perspective, this study provides empirical evidence of the theoretical linkages between the variables examined. To do so, established measures were adopted and adapted to ensure their compatibility with the context of Indonesian SME manufacturing sector. Furthermore, the PLS-SEM path modelling was used to validate the measures and test the hypothesized linkages among the variables (Jeong & Shin, 2019). Systematic assessment of the measures utilized in this study can lead to assist future researchers to produce more reliable and valid measures.

## **Hypothesis and Development**

### ***Organizational Performance***

According to (Namada, 2017), organizations measure their performance for reasons that may differ among organizations. Among the reasons is to identify success, to ensure customer needs are met, to help understand the organization processes, to identify problems and actions to overcome those problems, to ensure decisions are made based on facts, and to indicate the improvement of performance (Minai & Lucky, 2011). Many factors are used as the determinants of organizational performance. (Unick, Bassuk, Richard & Paquette, 2019)

identified agency-level factors and individual factors that might affect agency performance, while (Sarooghi, Libaers & Burkemper, 2015) highlighted the following factors that explain organizational performance factors: environmental factors, structure factors, administration factors, environment and structure factors, strategy and structure factors, and environment and strategy factors. (Avilova, Gulei & Shavyrina, 2015) found that both economic and organizational factors were significant determinants in organizational performance. (Masa'deh, Obeidat & Tarhini, 2016) examined the individual factor (gender) contributions in organizational success and survival. In general, the higher the performance of an organization, the higher the quality of the products and services that will be produced by the organization. The following discusses measures of organizational performance.

Choosing a measurement of organizational performance is a challenge (Vij & Bedi, 2016) because it plays a key role in constructing the strategies of an organization. Fundamentally, the measurement can be financial or non-financial. The financial measurements have traditionally been used as the key measurement of organizational performance. According to (Roychowdhury, Shroff & Verdi, 2019) financial measurements measure the company's direct or indirect financial profitability, earnings, and accounting returns. For example, (Gaur & Kesavan, 2015) evaluated performance by using annual sales growth and rates of return on assets (ROA); (O'Neill, Sohal & Teng, 2016) used the five-year ROA; (Zhao & Murrell, 2016) used two types of financial measurements i.e. ROA and market share. Meanwhile, non-financial measurements are related to customers, employees, or any other related individual's satisfaction, innovation and quality in the business environment. The measurements can also be integrated with the financial data to predict the future profitability, competitive strength, and long-term strategies in enhancing organizational performance. In this area, (Dubey et al., 2017) utilized organizational survival and organizational success (CO's gross earning) to measure performance; (Chahal & Bakshi, 2015) evaluated organizational outcomes, which were the capacity to innovate and competitive situation advantage; (Huang et al., 2016) measured employee turnover, employee productivity and employee commitment; and (Jiménez-Jiménez & Cegarra-Navarro, 2007) used four basic models of non-financial measurements in estimating organizational performance. They were human relations, rational goal, internal process, and open system.

### ***Entrepreneurial Orientation (EO)***

Literatures on entrepreneurship indicate that entrepreneurial orientation (EO) is a primary factor in achieving firm success. (Wales, 2016) defined EO as "the processes, practices and decision-making entrepreneurial acts of managers that lead to new entries". They defined entrepreneurship as a 'new entry' and explained the role of EO in the new entry. Basically, a new entry is the act of entering and setting up new ventures or 58 markets, whether it is totally in a new setting, or from existing firms. (Mthanti & Ojah, 2017) defined EO as the

strategic practices used by organizations in acknowledging and running new businesses. However, according to (Markin, Gupta, Pierce & Covin, 2018), many studies used the EO definition given by (Markin et al., 2018). Other terms used for EO include entrepreneurship, corporate entrepreneurship, intrapreneurship entrepreneurial posture and entrepreneurial strategy-making.

Proactiveness was defined as the pioneering or initiative nature of firms as a method to compete aggressively with other competitive firms. Basically, a proactive firm will be the first in entering a new market and new product introduction, in view of the strategic planning of the future opportunities that had earlier been initiated by (Certo, Holcomb & Holmes Jr, 2009). Risk taking refers to a firm's tendency in engaging with risky projects and starting a new venture although its influences, impact, and successfulness are unknown (Certo et al., 2009). It is the willingness of an entrepreneurship to utilize as well as to allocate more resources to a project without knowing the outcome for the company (Wiklund & Shepherd, 2005).

One of the key ingredients in characterizing EO is innovativeness. According to (Lumpkin & Dess, 1996), (Keklik, 2018) was the first to highlight the innovation role in the entrepreneurial process through his discussions of the model of "creative destruction". The model explains that entrepreneurial firms need to take the opportunity to engage in innovation activities through the activities of "new combination." The "new combination" reflects introducing new products, new methods of production, penetrating new markets, discovering new sources of raw material, and developing new firms in the industry (S. Ahmad, 2010a). Consistently, previous researchers have also considered innovativeness as an important part of entrepreneurial orientation at the firm level.

Over the years, economic scholars have stressed the consequence of a proactive nature in the entrepreneurial process and later (Kreiser & Davis, 2010; Rauch et al., 2009; Wiklund & Shepherd, 2005) have considered the proactiveness influence in EO. (Miller, 1983) argued that proactiveness is the pioneering or initiative nature of firms as a method to compete with other competing firms aggressively. Pursuing and seeking new opportunities and thoroughly investigating new chances in the marketplace has a valuable impact on entrepreneurship as it determines the effectiveness of a business. (Lumpkin & Dess, 1996) added that proactiveness in EO is crucial because "it suggests a forward-looking perspective that is accompanied with the innovation activities" in an organization. (Kreiser & Davis, 2010) also emphasized that firms need to be aggressive and proactive to ensure the success and survival of their firms.

According to (Nigg, 2017) risk taking "has various meanings, depending on the context in which it applied". Business risk taking, financial risk taking and personal risk taking are examples of risks that an organization faces. Many studies have considered the risk-taking dimension in their study (Shepherd, Wennberg, Suddaby & Wiklund, 2019). Fundamentally,

risk taking refers to a firm's propensity to take on risky projects and to grab new business enterprises even though the influence, impact and successfulness are unknown. (Nigg, 2017) defined risk taking as the proclivity of firms to take bold actions in unknown new markets, which involves huge resources for ventures with uncertain results and a lot of loans. It is the willingness of an entrepreneur to utilize as well as to allocate more resources to a project without knowing the outcome for the company (Wiklund & Shepherd, 2005).

### ***EO and Organizational Performance***

The multi-dimensional construct of EO permits researchers to investigate EO influence on firm performance. While some studies showed that EO had a positive correlation with organizational performance, others failed to find such result (Wiklund & Shepherd, 2005). As stated by (Kreiser & Davis, 2010), the differences in the result may be due to how EO was treated, i.e. as a uni-dimensional or a multi-dimensional construct. The following discusses the multi-dimensionality of EO influence on performance.

The first dimension of EO is innovativeness. It refers to the willingness for putting forth efforts aimed at developing new products, services and processes that are profitable and better than the competitors. It has been argued that innovativeness is important in developing firm success and survival. Several empirical studies found that innovativeness enhanced firm performance. For example, (Wiklund & Shepherd, 2005) found that EO enhanced wealth, better marketplaces, seeking and handling opportunities. In other words, innovativeness puts the organization ahead of its competitors. (Rauch et al., 2009) found the positive impact of EO on SME performance. Being innovative helps SMEs to identify market trends, make quick decisions on products or new developments, and be faster in pursuing new opportunities, which lead to increased organizational performance. In the same (Rauch et al., 2009) found that innovativeness was one of the fundamental dimensions that led to performance improvement in the automotive components industry and wine industry, as the strong buying power of customers accelerated the innovation effort. In a different study on 434 SMEs, (Moreno & Casillas, 2008) revealed positive correlations between EO and performance.

Proactiveness is a second dimension of EO and it refers to the firms' ability in discovering and pursuing new opportunities introducing new products. exploiting the future prospects in order to be better than the competitors. Despite being argued to enhance firm performance, previous studies did not report consistent results. (Wiklund & Shepherd, 2005) investigated four different industries in Australia: wine, automotive components, franchising, and music recording industry. He found that proactiveness was the key dimension in the automotive components industry, but ranked third in the wine and franchise industry, leading him to suggest that the proactiveness dimension might work differently in different industries. For example, the automotive component industry has to develop better quality products than their

competitors and in the franchising industry, proactiveness is critical at the start-up level. Despite the different roles proactiveness plays, (Wiklund & Shepherd, 2005) contended that proactiveness is an important key dimension in improving firm performance. (Rauch et al., 2009) also found that proactiveness was an important influence in determining a firm's success and survival.

The last dimension of EO proposed is the risk-taking dimension. It refers to the proclivity of a firm to adopt risky actions in discovering new markets without ensuring the after effects. Relating risk taking with performance, (Wiklund & Shepherd, 2005) revealed that the risk-taking influences were varied and mixed in certain conditions. (Soininen, Puumalainen, Sjögrén & Syrjä, 2012) found that Thai SMEs were less risk taking but more innovative and proactive than Vietnamese SMEs because the latter had had experienced war and economic mismanagement. (Soininen et al., 2012) showed that new ventures tended to take risks more if they wanted to succeed.

### ***HRM Practices and Organizational Performance***

The current business environment since the 1990s has relied on people's recognition, productivity, and creativity since the leading organizations that applied HRM practices were often followed by higher productivity and better performance. Hence, over the past decade, previous studies have reported the importance of HRM practices in improving organizational performance (Moideenkutty, Al-Lamki & Rama Murthy, 2011). (Carlson, Upton & Seaman, 2006) empirically examined the consequences of HRM practices among a sample of 168 family-owned SMEs. They found that the HR activities--training and development, recruitment package, maintaining morale, performance appraisal, and compensation--positively impacted organizational performance. By using data from Taiwan's high-tech firms (Moideenkutty et al., 2011) found that training and development, teamwork, benefits, HR planning and performance appraisal had a significant effect on employees' productivity and which in turn, improve firm performance. (Brock, Zmud, Kim & Lee, 2005) also found a positive and significant result between HRM practices and performance. According to (Hashim, Ismail & Hassan, 2016) SMEs with more effective HRM practices will have 91 better organizational performance because through better HRM, they can achieve the goals of quality standard from ISO certification.

Although the adoption of HRM practices in Indonesia is growing (Guest, 2011), studies on the effectiveness of the practices are still limited and, if any, considered only a few aspects of HRM. In their study to evaluate the effect of HRM practices on 152 Indonesia n private companies. They found that these practices had a positive and significant impact on the performance of a business. In examining 85 firms in Sarawak found that four HRM practices, namely, employee training, incentives, information technology and performance appraisal,

were positively correlated with organizational performance. (Brock et al., 2005) also found that the implementation of HRM practices had a major influence on the performance of 217 organizations. Studies on the effect of HRM practices on performance in smaller-scale businesses are also increasing.

Job design that provides discretion for their holders, variation and high levels of responsibility is related to job redesign and job enrichment, which are argued to influence the quality of working life of employees, employee well-being and consequently organizational performance. As such, job design should be considered when examining the effects of high performance work system on employee experience of work, employee well-being and job satisfaction and which in turn, improve organizational performance (Brock et al., 2005) found a positive influence of flexibility of work design on returns on equity (de Burgos-Jiménez, Vázquez-Brust, Plaza-Úbeda & Dijkshoorn, 2013) in which the more an organization invests in programs to increase work-life balance, the greater the ROE for that organization and also added that among HRM practices, flexible job design was more significant relationship with firm performance compared to performance-based pay or improving industrial relations. The effect was relatively large in improving the productivity and innovation.

### ***Relationship between EO and Organizational Innovation***

According to Nasution et al., (2011) EO is one of the key drives of innovative actions in any organization. He continued and argued that the innovative action must be in line with the strategic choices of the firm. consistent with the 'strategic choice' perspective of SMEs. According to Nasution et al., (2011), innovation orientation could indirectly foster a culture of stimulating innovation that may develop the innovative capability of the organization. In conclusion, to be successful in implementing innovation within an organization, the owners/managers have to develop a strategic orientation. Strategies for innovation are necessary to ensure the development of innovative capability in the organization, which will lead to innovation success. They have contended that EO drives innovative actions in an organization, consistent with the 'strategic choice' perspective.

The current study viewed proactiveness as a facet of assertiveness, which is related to their decision-making strategies being greater than their competitors. found the great capabilities of 143 proactive behaviour in performing innovations. They highlighted that both proactiveness and risk taking are essential, particularly in SMEs wanting to be innovative. (Hashim et al., 2016) also conceptualized that proactiveness is important to exploit opportunities in a business environment.

Risk-taking is "comprehended by top management as a preference to undertake activities of high or low risks". An entrepreneurial business needs to behave according to entrepreneurial

manner in order to expand the organization's success.(Hashim et al., 2016) argued the capabilities of risk taking as to whether it can increase the level of newness of product innovations in an organization.

### ***OP OI***

Researchers tend to agree that organizations innovate for better performance highlighted that organizational innovation adoption results in growth, productivity increase and profit of an organization. And also stressed the increase in work productivity as one of the consequences of OI. found that between process, research and development (R & D), marketing, and product innovation, only process innovation stimulated higher 108 productivity. Additionally, the R & D innovations in medium-sized organizations promise better profits than others. Singla, Stritch & Feeney (2018) mentioned the capabilities of innovation in influencing the economic, institutional, technological, and political environment performance, which also mentioned that the most important consequence of OI is the profits to the organization. By offering their new products or services at lower or better prices than their competitors, the opportunities to gain greater profits also become higher. (Singla et al., 2018)also asserted the consequence of OI in financial performance. They found that the available resources in the organization can be transformed into profits via dynamic capabilities and firm competitiveness.

### ***Human Resource Management (HRM) and OI***

As stated before, a profusion of studies have used HRM practices as the antecedents of OI. According to(Singla et al., 2018), the globalization and combative business environment has inspired organizations to be proactive in their HRM practices as they lead to new innovations such as in products and technologies. HRM practices cover almost everything in the employment management of organizations, 107 as they are a system that attracts, develops, motivates, and retains employees to ensure the success and survival of organizations.

### ***The Mediating Role of Organizational Innovation***

The literature clearly shows that HRM practices and EO have a positive effect on organizational performance. However, what goes on in the “black box” between these two variables and performance relationship remains an under-researched area in SMEs. That is, there is lack of insight into how HRM practices and EO produce value to the organization. By purely investigating the direct relationship between HRM practices and EO with performance, scholars argue that this would reveal a partial overview of performance (Singla et al., 2018). For instances, (Wright, Snell & Dyer, 2005) noted the inconsistent results of HRM practices and organizational effectiveness, suggesting that the relationship is probably

more complicated than originally thought because the primary mechanism explaining how HRM practices relate to organizational performance is not yet established, either theoretically or empirically (Mayson & Barrett, 2006; Mayson & Barrett, 2006; Messersmith, Patel, Lepak & Gould-Williams, 2011). As a result, this research focused on the indirect effect of HRM practices on organizational performance. In this study, organizational innovation was identified as the potential mediator through which HRM practices can affect performance (Farouk, Abu Elanain, Obeidat & Al-Nahyan, 2016; Jiang, Takeuchi & Lepak, 2013). Furthermore, the practices of HRM in SMEs tend to be informal and limited. So, in the context of SMEs, other variables need to be incorporated to explain organizational performance.

### ***Resource Based View***

RBV postulates that a firm has a unique compilation of resources, which can be largely divided into tangible, intangible, and capabilities. RBV proposes intangible resources as key factors for the success of a firm because such resources can support more comprehensive activities than tangible resources. Furthermore, scholars argue that intangible resources are even more important strategically because they are valuable, rare, and hard to replicate, which enable a firm to gain sustainable competitive advantage. In addition, SMEs generally lack tangible resources. Therefore, this study focused on organizational resources, which include intangible resources and capabilities. In this study, organizational resources describe firm-specific resources and capabilities, namely, entrepreneurial orientation (EO), HRM practices, organizational innovation, and managerial ties.

### **Methodology**

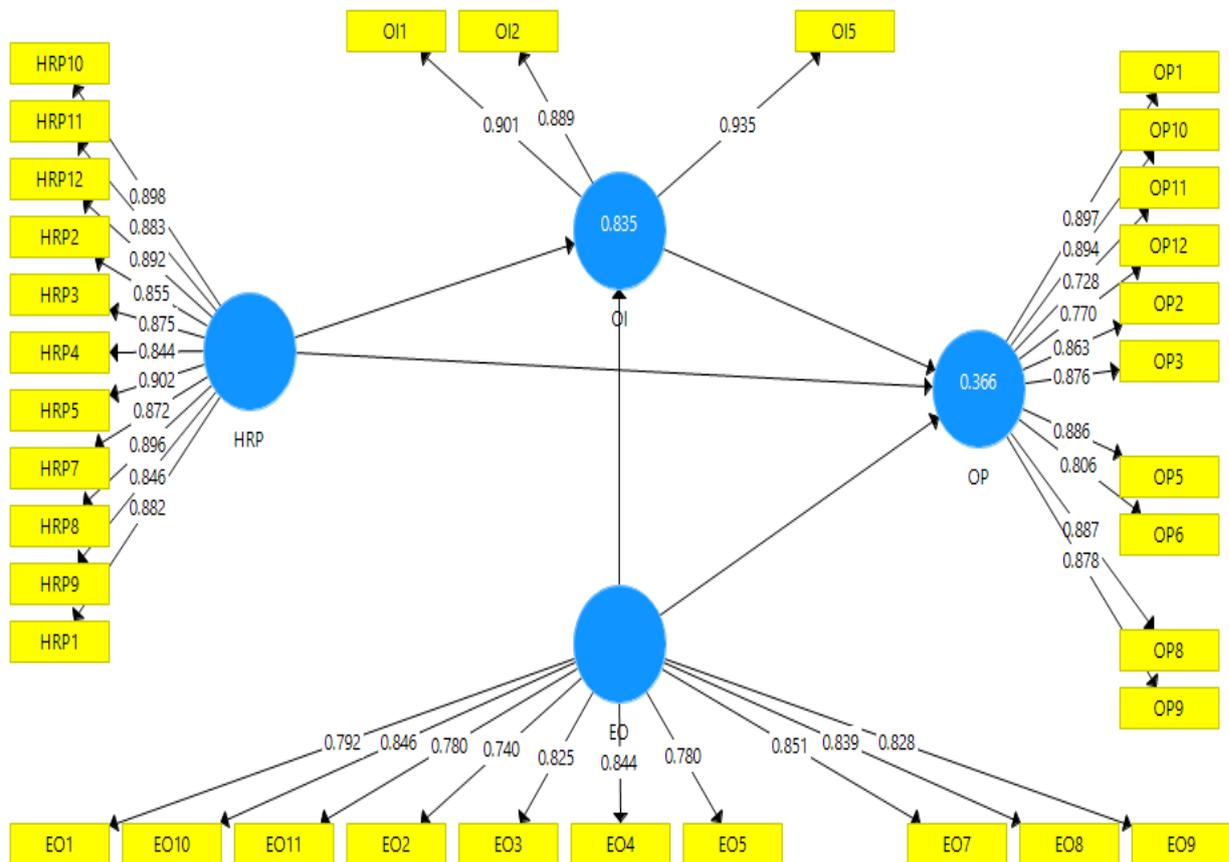
Primarily, the questionnaire was generated in English, and then translated into Bahasa Indonesia, since Bahasa Indonesia is the native language of the targeted respondents i.e. branch managers of Indonesian organizations. The translation is done using a back-translation method, in which firstly the questionnaire is being translated into Bahasa Indonesia and translated back into English. This is done to ensure the reliability and validity of the wordings. For this purpose, two bilinguals provided their services to translate in both ways, without compromising the original content. After translating, both the original English version and the latter English version were compared and finalized after making minor changes. Back translation ensures the near equivalence of the two questionnaires. The Smart PLS v 2.0 is employed for data analysis. It is commonly used by researchers in management and marketing field. A PLS model generally involves two phases; 1) analyzing the outer-model to ensure reliability and validity of the model, and 2) estimating the structural model through obtaining effect size,  $R^2$ , goodness-of-fit, and predictive model relevance. The first phase involves measuring the characteristics of multi-item constructs, as well as discriminant

and convergent validity. Whereas, the second phase involves, the hypotheses testing of proposed relations in the study, using a bootstrapping procedure. The model consisted of items of reflective measurement, which are the generated indicators or variables, where four latent constructs include one dependent, and two independent variables. In addition, a mediating variable also exists in the model, and a total of 16 relations exist among the variables, as proposed in this study. Content validity refers to the extent all the proposed items are suitably measuring the given construct.

## Results

The initial step under PLS analysis is the evaluation of the measurement or outer model. The measurement model determines the internal consistency, reliability of individual item, convergent validity, discriminant and content validity. It involves estimating the goodness-of-fit measures.

**Figure 1.** Measurement Model



Two main criterion were employed for determining the reliability and validity of the measurement model (Ramayah, Lee & In, 2011). The reliability test attempts to determine the consistency of the measuring tool, i.e. what the measure is intended to estimate, whereas, the validity test attempts to estimate the efficiency of a measure to exactly estimate an underlying concept (Hair, Anderson, Babin & Black, 2010; Sekaran & Bougie).

The reliability of an indicator is estimated through observing each measure of the outer loadings' concepts (Hair Jr et al., 2014). A rule of thumb has been suggested by (Hair Jr et al., 2014) to keep those items having loadings ranging from 0.40-0.70. In case of present study, 12 out of 40 items exhibited lower loadings i.e. even below 0.40. Therefore, 28 items have been held, since they exhibited loadings ranging from 0.501-0.951. Reliability or internal consistency referred as the degree of scale items to estimate the same construct. Composite reliability and Cronbach alpha are the commonly used estimators for measuring the reliability of an organizational research instrument (Peterson & Kim, 2013). Although, enough discussion has been made regarding the best and most powerful technique for measuring reliability. Since, Cronbach alpha is a universally used method but it somehow underrates the internal consistency of a measure (Hair et al., 2010; Sekaran & Bougie). Whereas, the composite reliability criteria is jointly employed with SEM-PLS models, as it is a more powerful technique as compared to the Cronbach alpha criterion (Fornell, 1981 #65). The coefficient of composite reliability in present study are chosen to estimate the reliability of each measure. The Cronbach alpha presumes that without observing the definite role of each loading, all items contribute equally to measure its construct (Götz, Liehr-Gobbers & Krafft, 2010). Although, the explanation of internal consistency with the coefficient of composite reliability has been developed as a rule of thumb, which is suggested by . Furthermore, (Hair Jr et al., 2014) suggested that the coefficient of composite reliability should be equal or higher than 0.70. The coefficients for each construct are presented in the Table 4.10, ranging from 0.774-0.894. All the composite reliability coefficients are satisfying the minimum level i.e. above 0.70 level, showing adequate internal consistency of all the measures.

**Table 1: Reliability**

	<b>Cronbach's Alpha</b>	<b>rho_A</b>	<b>Composite Reliability</b>	<b>Average Variance Extracted (AVE)</b>
<b>EO</b>	<b>0.943</b>	<b>0.946</b>	<b>0.951</b>	<b>0.662</b>
<b>HRP</b>	<b>0.970</b>	<b>0.971</b>	<b>0.973</b>	<b>0.769</b>
<b>OI</b>	<b>0.894</b>	<b>0.898</b>	<b>0.934</b>	<b>0.826</b>
<b>OP</b>	<b>0.957</b>	<b>0.961</b>	<b>0.963</b>	<b>0.723</b>

According to Hair Jr et al., (2014)) the convergent validity refers to “the level items explicitly represent the intended latent construct as well as correlate with other measures of the same construct”. A specific measure is considered to be convergent if item loadings for the related latent construct exhibits value greater than 0.50. There are three principles for assessing the convergent validity, these are: 1) the composite reliability of each item must be above 0.70; 2) the factor loadings for each item must be adequate at level of significance; 3) the value for AVE must be above 0.50.

**Table 2:** Outer loadings

	<b>EO</b>	<b>HRP</b>	<b>OI</b>	<b>OP</b>
<b>EO1</b>	<b>0.792</b>			
<b>EO10</b>	<b>0.846</b>			
<b>EO11</b>	<b>0.780</b>			
<b>EO2</b>	<b>0.740</b>			
<b>EO3</b>	<b>0.825</b>			
<b>EO4</b>	<b>0.844</b>			
<b>EO5</b>	<b>0.780</b>			
<b>EO7</b>	<b>0.851</b>			
<b>EO8</b>	<b>0.839</b>			
<b>EO9</b>	<b>0.828</b>			
<b>HRP10</b>		<b>0.898</b>		
<b>HRP11</b>		<b>0.883</b>		
<b>HRP12</b>		<b>0.892</b>		
<b>HRP2</b>		<b>0.855</b>		
<b>HRP3</b>		<b>0.875</b>		
<b>HRP4</b>		<b>0.844</b>		
<b>HRP5</b>		<b>0.902</b>		
<b>HRP7</b>		<b>0.872</b>		
<b>HRP8</b>		<b>0.896</b>		
<b>HRP9</b>		<b>0.846</b>		
<b>OI1</b>			<b>0.901</b>	
<b>OI2</b>			<b>0.889</b>	
<b>OI5</b>			<b>0.935</b>	
<b>OP1</b>				<b>0.897</b>
<b>OP10</b>				<b>0.894</b>
<b>OP11</b>				<b>0.728</b>
<b>OP12</b>				<b>0.770</b>
<b>OP2</b>				<b>0.863</b>
<b>OP3</b>				<b>0.876</b>

<b>OP5</b>				<b>0.886</b>
<b>OP6</b>				<b>0.806</b>
<b>OP8</b>				<b>0.887</b>
<b>OP9</b>				<b>0.878</b>
<b>HRP1</b>		<b>0.882</b>		

Another criterion is the discriminant validity, Byrne, (2010) suggested that discriminant validity observes the extent a construct is different from all the other constructs. Putting differently, it is the extent a particular variable differs from all the other variables. The greater the discriminant validity the more distinctive nature a variable possesses which may not be possessed by other variables. The discriminant validity for present study was determined by taking square roots of the AVE, which must be higher than the correlations between the latent variables (Fornell & Larcker, 1981). It can be done by comparing the square roots of AVE and the relations between the latent constructs. Therefore, the present study determined the discriminant validity following the criterion recommended by (Chin, 1998).

**Table 3:** Discriminant Validity

	<b>EO</b>	<b>HRP</b>	<b>OI</b>	<b>OP</b>
<b>EO</b>	<b>0.913</b>			
<b>HRP</b>	0.872	<b>0.877</b>		
<b>OI</b>	0.886	0.662	<b>0.909</b>	
<b>OP</b>	0.792	0.762	0.738	<b>0.850</b>

With the establishment of a measurement model, the next step is to estimate the structural model for developing an overall relation with a model. Moreover, in a recent study, Henseler & Sarstedt, (2013) stated that model validation can be sufficiently assessed through the goodness-of-fit criteria. For instance, while employing PLS path models having reproduced data, it has been argued that goodness-of-fit criteria is unsuitable, as it fails to distinguish among the invalid and valid models. With respect to recent development, a two-step procedure has been adopted by authors for estimating and reporting the PLS-SEM path results, following. Furthermore, the structural model is assessed for the study. Furthermore, a bootstrapping procedure is applied having 5000 bootstrap samples, in order to examine the significant role played by the path coefficients (Hair Jr et al., 2014).

**Table 4:** Direct Relations

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics ( O/STDEV )	P Values
EO -> OI	1.288	1.279	0.058	22.165	<b>0.000</b>
EO -> OP	0.428	0.430	0.178	2.404	<b>0.016</b>
HRP -> OI	0.461	-0.451	0.068	6.784	<b>0.000</b>
HRP -> OP	0.188	0.191	0.178	5.056	<b>0.000</b>
OI -> OP	0.204	0.205	0.153	4.327	<b>0.000</b>

**Table 5:** Direct relations

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics ( O/STDEV )	P Values
EO -> OI -> OP	0.262	0.261	0.196	4.337	<b>0.000</b>
HRP -> OI -> OP	-0.094	-0.091	0.070	4.343	<b>0.000</b>

Through R2 value, the predictive power can be analysed for the endogenous variables. The variables near to 0 are considered non-significant. High predictive accuracy is reflected by the value of R2 in the range of 0-1. The values of R2 such as 0.75, 0.50 and 0.25 are considered considerable, fair and weak respectively. In this research study, the value of R2 comes out to be 0.835 and 0.366 in OI and OP respectively, which reflects that almost 83.5 percent variation in OI, 36.6 percent in OP is defined, by the independent variables.

**Table 6.** R-square

	R Square
OI	0.835
OP	0.366

## Conclusions

This study explored the aspects of organizational resources and capabilities that lead to performance of SME manufacturing companies in Indonesia by using a resource-based view as the underpinning theory. Firstly, this study investigated the influence of organizational resources of entrepreneurial orientation, HRM practices, organizational innovation, and managerial ties on organizational performance at the organizational level of analysis. Organizational innovation was considered a mediator. By examining the relationships, the present study will provide insights into what contributes to SME performance.

Earlier studies have shown that economic factors and organizational factors are the leading research streams related to organizational performance in business policy. Economic factors emphasize the market factors in determining organizational success and survival (e.g., industry variables, market share and firm size), while organizational factors deliberate on the behavioural and sociology paradigms within the business environment (e.g., goal emphasis and human resources). However, some researchers found that the organizational factors are more important in influencing organizational performance than the economic factors. Numerous studies have investigated EO, HRM practices, organizational innovation, and managerial ties as predictors of organizational performance. However, to the best of the researcher's knowledge, no single study has simultaneously investigated these organizational resources and capabilities and constructed a multivariate model of organizational performance of SMEs.

The prime objective of the current study is to explore the direct relationships between HRM practices, entrepreneurial orientation, organizational innovation and organizational performance. Additionally, the mediating role organizational innovation in the relationship between entrepreneur orientation HRM practices and organizational performance. The study has employed the survey-based methodology; the response rate is 62 percent. The study has employed the PLS-SEM to achieve the objectives. This study will be helpful for policymakers and researchers in examining the link HRM practices, entrepreneurial orientation, organizational innovation and organizational performance in Indonesian SMEs. Finally, this study also provides a discussion of hypotheses based on regression analysis result, limitation and recommendation for further study.

The findings of the study reveal that the more an organization invests in programs to increase work-life balance, the greater the ROE for that organization. Further, in addition to HRM practices, flexible job design possesses a more significant relationship with firm performance compared to performance-based pay or improving industrial relations. The effect was relatively large in improving the productivity and innovation.

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