

Financial Performance of Small and Medium Enterprises from The Perspective of Organizational Capability, Learning Organization, and Business Ages

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Abstract. In the situation of uncertainty, especially during the COVID-19 pandemic, there is high tension for business actors to innovate so that business processes can hold out. Micro, small, and medium enterprises (MSMEs) are empirically known to survive in various economic waves. This paper sheds light on how the characteristics of MSMEs can perform the organizational and learning capability to affect the company's financial performance to survival. Moreover, this study is an exploratory case study on MSMEs in 21 districts in the city of Medan with a research period from December 3, 2021, to September 15, 2022. The targeting population of this study is 259.812 MSMEs actors who are actively operating and has been identified and fostered by the Cooperative and Small Medium Office of Medan City. A stratified random sampling method is used. The primary data is obtained through a questionnaire, in which 575 respondents returned the questionnaire with complete fields. Furthermore, the secondary information is achieved from the Cooperative and Small-medium City of Medan Office. The validity and reliability testing of research instruments are on 43 MSMEs in the production sector in Deli Serdang Regency, which operates its business in Medan. Data processing is carried out by testing the outer and inner models with the help of SmartPLS 3.0. Then, the model fit test will be seen from the Standardized Root Mean Square Residual (SRMR) calculation results. Thus, this research empirically proves that the organizational capability and learning organization in the MSMEs production sector of Medan City can explain financial performance characteristics.

Keywords: Innovation process, Financial Performance, MSMEs production sector.

1 Introduction

Although micro, small, and medium enterprises (MSMEs) are the backbone of the world economy, most studies focus only on large companies' financial performance analysis [1]. One of the MSMEs' characteristics is asymmetric information, where business owners are more aware of their business conditions than parties outside the business [2]. It can be concluded that there are limited studies in the field of financial performance on MSMEs. Still, they are the primary concern in every government policy to increase their country's economic growth. The

study of organizational capabilities and organizational learning on the financial performance of MSMEs is very little known. So this study attempts to fill this void by looking at the relationship between organizational capacities and organizational learning on financial performance, where the age of business becomes a moderating variable in both exogenous variables (organizational capabilities and organizational learning) to endogenous variables (financial performance).

Developing a capability is expensive; the business's unique way of solving management and activity problems is based on building organizational capabilities that are progressively formed over time [3, 4]. Therefore, understanding the capabilities needed by MSMEs to improve business performance will encourage the realization of MSMEs' capabilities that focus on efforts to enhance the business quality [5]. Furthermore, the position of organizational capabilities has a crucial role; according to Collis (1994) [6], organizational capabilities are identities in explaining various threats to the sustainability of competitive advantage of a business organization. Furthermore, most of the organizational literature focuses on examining the impact of the need for dynamic capabilities to improve organizational performance, particularly in the context of SME operations [5]. Thus, very few studies have discussed core organizational capabilities, which are about organizational capabilities.

Very few oppositions think organizational learning is necessary compensation for all organizations in fast-changing and competitive environments [7]. In learning organizing, there are two views: as a variable and as a root metaphor [8]. Those who believe in learning organizing as a variable assume that learning organizing has specific characteristics and can affect employee behavior and organizational performance. Furthermore, those who think that learning organizing is a root metaphor consider that learning organizing is a culture that takes place in the organization and is considered essential. In this case, learning organization, according to Alagaraja and Herd (2022) [9], answers the need for system-level thinking, focusing on the organization as a whole, including individual-level learning that directly affects employees.

This paper examines how organizational capability, learning organization, and business age contribute to the financial viability of micro, small, and medium enterprises (MSMEs) in the third largest city in Indonesia (i.e., the city of Medan), with particular emphasis on the operation of MSMEs in a developing country context. Furthermore, a study conducted by Hindasah and Nuryakin (2020) [10] concluded that the age of a business or organization has a moderating nature and is significantly proven between organizational learning and financial performance, while the age of a company or organization in organizational capability and financial performance are not confirmed as a moderator. Thus, this study also improves the understanding of business age as a variable in MSMEs as a moderator variable between organizational capability and organizational learning on corporate financial performance.

2. Literature Reviews and Hypotheses

2.1. Organizational capability affecting organizational financial performance

Organizational capability can be defined as the ability of an organization to manage its business sensitively in response to rapid environmental developments [10]. In this case, Collis (1994) [6] divides three categories of capability, namely: the ability to reflect the performance of the primary activities of a company, such as a plant layout, distribution logistics, and marketing campaigns, more efficiently than competitors. Then the second category of capability is the ability to share the

theme of growth in the company's activities, such as processes that are continually repeated in the company's activities, including manufacturing flexibility, product innovation, responsiveness to market trends, and short development cycles. Furthermore, the third category is the company's ability to recognize the intrinsic value or the ability to realize a novel strategy before competitors. A shortage of studies on organizational capability can affect financial performance in SMEs. One of the studies that prove the relationship between financial performance and organizational capabilities is the result of a study conducted by Hindasah and Nuryakin (2020)[10], which obtained a significant positive effect on organizational capabilities toward financial performance. At the same time, organizational capabilities and business age do not have a moderating position between financial performance and organizational capabilities.

2.2. Learning organization affecting organizational financial performance

A learning organization can be defined as always prioritizing continuous learning at every level of work. Empirical evidence between learning organizations and return on investment (ROI) is quite challenging [11]. Then, Ellinger (2002) [11] identified seven characteristics of an organization that leads to the concept of a learning organization, including:

- There are opportunities in the continuous learning process.
- Promote inquiry and dialogue
- Support collaboration and team learning
- Build a system to capture and disseminate learning
- Empower people to a collective vision.
- Connecting the organization with its environment
- Utilized a leadership model that supports individual, group, and corporate learning.

Research by Garcia et al. (2007) [12] on 401 Spanish companies, both large companies, and SMEs, proves that organizational learning positively affects performance directly or indirectly through corporate innovation. Furthermore, in a study that has been conducted by Hindasah and Nuryakin (2020)[10], organizational learning significantly influences business financial performance, and business age is proven to be a moderating between learning organizations and financial performance. In this case, the hypothesis in this study is:

H1: Learning organization affects the financial performance of MSMEs in Medan City.

H2: Organizational capabilities affect the financial performance of Medan City MSMEs.

H3: Age of business moderates organizational learning and financial performance of MSMEs in Medan City.

H4: Age of business moderates organizational capabilities and financial performance of Medan City MSMEs.

3. Research Methodology

This study was conducted in 21 sub-districts in Medan, with a research period from December 3, 2021, to September 15, 2022. The object of this research is MSMEs in the production sector. The total population in this study is around 259,812 MSMEs¹ actors. The research sample is about 816

¹SMEs data in Indonesia can be seen on the website of the Ministry of Cooperatives and SMEs at the address: <http://umkm.depkop.go.id/>.

MSMEs operate as production sectors. A stratified random sampling method is used. Furthermore, the primary data is obtained through questionnaires to 816 MSMEs working in Medan City, in which 575 respondents returned the questionnaire with complete fields. The questionnaire instrument formed is a replication of the study conducted by Hindasah and Nuryakin (2020)[10] dan Baah et al. [13]. All items on the questionnaire were tested for the reliability and validity of each item per variable.

This study consists of four variables, two exogenous variables (organizational capabilities and organizational learning), one moderating variable (business age), and one endogenous variable (financial performance). In this case, organizational capacities have six reflective indicators, and organizational learning has five reflective indicators. Furthermore, the financial performance variable has nine reflective indicators. Data analysis was carried out using non-parametric statistics, namely partial least square analysis, with the help of the Smart PLS 3.0 application. Moreover, Standardized Root Mean Square Residual (SRMR) is used to see the model's goodness of fit, where the SRMR value below 0.10 can be identified by the model in the goodness of fit position [14].

4. Result and Discussion

For approximately ten months, field research was conducted on 575 MSMEs respondents; the results of testing the outer model based on the PLS Algorithm with maximum iterations of 500 obtained nine indicators with a loading value below 0.7 or insignificant in the range of 0.05. In this case, two indicators are in the financial performance variable, three are in the learning organization variable, and four are in the organizational capacity variable. Meanwhile, the calculation results of SmartPLS 3.0 in the outer model test are as follows:

	Business Ages	Financial Performance	Learning Organization	Moderating Effect Learning Organization*Business Age	Moderating Effect Organizational Capacity*Business Age	Organizational Capacity
BA	1.000					
FP1		0.709				
FP2		0.749				
FP3		0.699				
FP4		0.462				
FP5		0.857				
FP6		0.842				
FP7		0.797				
FP8		0.857				
FP9		0.861				
LO1			0.577			
LO2			0.685			
LO3			0.726			
LO4			0.806			
LO5			0.698			
Learning Organization * Business Ages				1.023		
OC2						0.731
OC3						0.668
OC4						0.691
OC5						0.635
OC6						0.766
Organizational Capacity * Business Ages					1.028	
OC1						0.635

Source: Smart PLS 3.0 (PLS Algorithm)

Fig. 1. Assessment of Outer Model

After identifying the indicator results that are not significant at 0.05, proceed with Bootstrapping to see the significance of the inner model. It shows that learning organization on financial performance is positively significant with a P-Value of 0.020. Then, organizational capability positively and directly impacts financial performance with a P-Value of 0.000. Furthermore, the

moderating variable (business age) proved insignificant, where the P-Value was in the range of 0.333. Then, from the results of checking the SRMR obtained, the model in this study obtained SRMR values below 0.10, which are as follows:

Model Fit			
Fit Summary		rms Theta	
	Saturated Model	Estimated Model	
SRMR	0.090	0.090	
d_ULS	1.890	1.889	
d_G	0.658	0.658	
Chi-Square	2117.402	2117.474	
NFI	0.684	0.684	

Source: Smart PLS 3.0 (PLS Algorithm)

Fig. 2. Goodness of fit Model

Path Coefficients						
	Mean, STDEV, T-Values, P-Values	Confidence Intervals	Confidence Intervals Bias Corrected	Samples		
	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (O /STDEV)		P Values
Business Ages -> Financial Performance	-0.042	-0.043	0.043	0.968		0.333
Learning Organization -> Financial Performance	0.112	0.115	0.048	2.334		0.020
Moderating Effect Learning Organization*Business Age -> Financial Performance	0.013	0.016	0.050	0.267		0.789
Moderating Effect Organizational Capacity*Business Age -> Financial Performance	-0.087	-0.092	0.057	1.546		0.122
Organizational Capacity -> Financial Performance	0.266	0.274	0.047	5.677		0.000

Source: Smart PLS 3.0 (PLS Bootstrapping)

Fig. 3. Assessment of Inner Model

This empirical evidence strengthens and eliminates some of the results of a study conducted by Hindasah and Nuryakin (2020)[10], where business age in MSMEs in Medan city proved unable to act as a moderating variable between learning organization and financial performance.

5. Conclusions and suggestions

Calculation of survey results is in progress in this study. In addition, the bibliography is still being studied to see the results of studies on organizational capability, learning organization, and financial performance in MSMEs. Through this paper, the authors hope to obtain input from other researchers in contributing expertise in deepening organizational capacity, organizational learning, and financial performance in MSMEs.

The author hopes that through this paper, various subsequent articles will focus on the phenomenon of financial performance in the MSMEs production sector by linking organizational capabilities and organizational learning. This situation is because research in the MSMEs sector is immensely challenging Ellinger (2002) [11].

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