

## Conference Paper

# Entrepreneurial Orientation and Sme Performance: Dynamic Capabilities As Mediation Study on Smes in Indonesia

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## Abstract

The purpose of this study to analyze the relationship between entrepreneurial orientation and SMEs performance, entrepreneurial orientation with dynamic capabilities, and dynamic capabilities with SMEs performance. In addition to analyzing whether dynamic capabilities can mediate the relationship between entrepreneurial orientation and SME performance. The research data to be used is SMEs data in Indonesia with primary data through questionnaires and secondary data published by the Government of Indonesia. The research sample is 350 SMEs in Indonesia. Data analysis techniques using SEM. The results showed (1) there was a positive relationship between entrepreneurial orientation and SMEs performance, (2) there was a positive relationship with entrepreneurial orientation with SMEs performance (3) there was a positive relationship between dynamic capabilities and SMEs performance (4) there was a positive relationship with entrepreneurial orientation, SMEs performance through dynamic capabilities as mediation.

**Keywords:** Entrepreneurial Orientation, Dynamic Capabilities, SMEs Performance

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## 1. Introduction

SMEs in Indonesia plays a very important role as economic support. SMEs are the main driver of the economy with the main function of SMEs being able to employ millions of people absorbed in the formal and informal sectors. SMEs have contributed to the formation of Gross Domestic Product (GDP) and the SME sector as a source of foreign exchange through the export of various types of products from SMEs as well as batik.

Indonesian batik is one of the local expertise and works of art and culture typical of Indonesia, of course it needs to be preserved and developed both in production

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and marketing in order to survive, and is unique and difficult to be imitated by others both patterns, designs, materials, and production processes, therefore batik has been known internationally as one of the mainstay SMEs in Indonesia. For this reason, it is very necessary to have competent quality human resources who can compete in the global market era to improve the performance of SMEs that can adapt to a dynamic environment.

To improve the performance of SMEs both in business development and maintaining the loyalty of SMEs customers in Indonesia, naturally, it requires a comprehensive and integrated strategy. In the global market competition, batik SMEs are demanded to continue to develop innovations, by taking into account the structure of the industry by examining from an internal perspective, carefully combining existing resources by combining to gain competitive advantage (Armstrong, 2006). A company that can provide positive, timely, fast and responsive responses with flexible product innovations and integrated management capabilities with effective coordination and appropriately locates internal and external competencies is the winner (Strønen, Hoholm, Kværner, & Støme, 2017). Company performance as a product success and market development, where company performance can be measured through sales growth and market share (Pelham & Wilson, 1996); (Ozmen & Deniz Eris, 2012). Baker and Sinkula's research (1999) states that market orientation and individual learning orientation influence organizational performance which can be measured by indicators of market share growth, the success of new products and overall performance. Good company performance is expressed in three main quantities, namely sales value as indicated by the value of money or unit profits, sales growth as indicated by an increase in product sales and market share as indicated by-product contribution in controlling the product market compared to competitors who ultimately lead to profits company (Ferdinand, 2002);(Mohammad, Massie, Tumewu, & Program, 2019).

The company has done a lot of research performance (Lin, Peng, & Kao, 2008); (Suliyanto & Rahab, 2012); (Ozmen & Eris, 2012); (Khaliq & Saeed, 2015), stated that market orientation has a positive and significant effect on company performance. Different opinions from the results of Gholami and Birjandi's research (2016) that market orientation does not influence company performance. Company performance can be measured through sales growth, profitability and market share (Lin et al., 2008; Suliyanto & Rahab, 2012). In contrast to Gholami & Birjandi (2016) measurement of the company, performance is measured through product performance and customer performance. (Foltean & Feder, 2014).

According to Zahra and Copin, (1995) this aspect of performance is very important to strengthen financial performance and survival, especially for small companies operating in high-tech environments that are very competitive explained (Alegre, Mesa, & Strange, 2005). In accordance with the results of surveys and pre-research questionnaires that have been carried out, from batik SMEs in Indonesia, it is suspected that there are still some obstacles that are found, among others: (1) very limited capital (2) still lack of quality human resources (3) lack of channels to distribute goods (4) clear legal entity ownership and licensing (5) difficulties in calculating sales turnover due to manual bookkeeping (6) development of digital technology/strategy through online marketing (7) still not yet the maximum ability of SMEs to respond to opportunities competitive advantage (8) SMEs are still not maximal in conducting research and monitoring markets, customers and competitors in running this business because there is still an assumption that bright ideas are not supported by leaders and only add new jobs and feel burdened to be implemented in the company (9) the lack of quality assessment of product and service quality (10) SMEs have not yet utilized their networks to build good relationships with customers, partners and government institutions (11) lack of ability of SMEs to innovate either process innovation, product innovation, marketing innovation and management innovation (12) still lack commitment in the implementation of the company's vision and mission (13) SMEs have not yet maximal in making changes in adjusting to the challenges of dynamic environment development (14) SMEs have not yet maximized in managing assets so that it affects the company's performance. Some opinions indicate that a company that has dynamic capabilities in the organization will increase its work productivity and show the best competence, it will have an impact on employee performance and organizational performance in achieving goals. The implementation of knowledge management in SMEs is very much needed and entrepreneurial orientation determines how to improve SMEs performance through innovation as mediation.

From the pre-research data, the problems experienced by SMEs in developing their businesses include: (1) the company's management system that is not yet optimal in its application, (2) understanding market opportunities are not optimal, (3) marketing strategies that are still less effective in its application, (4) lack of working capital to support the sales strategy, (5) does not meet the standards in the production system.

## 2. Literature Review

### 2.1. Entrepreneurial Orientation

Entrepreneurship refers to nature, character, and characteristics inherent in someone who has a strong will to realize innovative ideas into the real business world and can develop them with resilience. According to Drucker, entrepreneurship is the ability to create something new and different. In simple entrepreneurship is also often interpreted as the principle or ability to entrepreneurship. Entrepreneurship is synonymous with the ability of someone creative, innovative, brave to take risks and always look for opportunities through their potential (Carvalho & Sugano, 2017). The attitude of a true entrepreneur who then develops faster. Entrepreneurship arises when someone dares to develop new businesses and ideas. The entrepreneurship process includes all functions, activities, and actions related to the acquisition of opportunities and the creation of business organizations. Therefore, entrepreneurs are people who obtain opportunities and create organizations to pursue opportunities (Avdelidou-Fischer, 2013).

Gholami and Birjandi's research (2016) found that entrepreneurial orientation had a positive and significant effect on organizational performance. Entrepreneurial orientation is measured through four dimensions: autonomy, risk-taking, acting proactively and aggressively in a competition (Lumpkin & Dess, 1996; Li et al., 2008; Gholami & Birjandi, 2016). Autonomy is an action that is not affected by a team or individual to give birth to a vision or idea. Autonomy is consistent with the view of entrepreneurial independence needed to bring new ideas to completion, unrestrained by the shackles of corporate bureaucracy (Nadrol et al., 2010).

Entrepreneurial orientation is an effort to create value through the introduction of business opportunities, appropriate risk-taking management and through management communication skills to mobilize the human, financial and raw materials or other resources needed to produce projects so that they are carried out well, in words another entrepreneurial orientation is the effort to create value through recognition of business opportunity, the management of risk-taking appropriate to the opportunity and through the communicative and management skills to mobilize human, financial and material resources necessary to bring a project to fruition (Lin et al., 2008).

Then the entrepreneurial orientation is an attempt to create value through business opportunities, appropriate risk-taking management, and management communication skills to mobilize human, financial and other raw materials or other available resources to obtain benefits and value from business opportunities. (Lin, 2012);(Jabeen, Alekam,

Aldaoud, Mat, Zureigat, Nahi, Junaidi, 2013) (Baker & Sinkula, 2009); (Patel & D'Souza, 2009); (Lumpkin & Dess, 2001) (Nadrol et al., 2010) indicators used as follows:

1. Autonomy is an action that is not affected by a team or individual to give birth to a vision or idea, autonomy is consistent with the view of entrepreneurial independence needed to bring new ideas to completion, not restricted by the bureaucracy of corporate bureaucracy.
2. Proactive is the first pioneer company to enter new markets, activity is a search for opportunities, forward-looking perspectives are marked by the introduction of new products or new services that are first in the competition and act in anticipation of future demand, anticipating and acting for future changes in the market with new methods and products.
3. Aggressive to competitive is the tendency of companies to intensely and directly challenge competitors to outperform rivals in the market. Aggressive competitive also refers to the level of enthusiasm of the company to be one step further than competitors. Excessive aggression can be risky if the company tries to deal with established competitors.
4. Taking risk is the tendency to engage in high-risk projects and managerial preferences for decisive action to achieve goals. Risk-taking involves taking decisive action by exploring the unknown, borrowing large amounts or allocating significant resources to businesses in an uncertain environment. Willingness to undertake resources for new projects by pursuing opportunities in mind, even though the project already has definite results.

## 2.2. Dynamic Capabilities

Barney (1991) states that “dynamic capabilities are processes embedded in the firm, assuming an organization and empirical lens, rather than an economic and formal modeling one”. Dynamic capabilities are processes that are embedded in the company meaning that these values are already in the company in the form of internal competence (Khaliq & Saeed, 2015).

According to Peteraf (1993) to measure dynamic capabilities is to measure the capabilities or capabilities affected by dynamic market mechanisms and their evolution, “the examine of dynamic capabilities, how those capabilities are influenced by market dynamism and their evolution over time” (Alves, Barbieux, Reichert, Gamarra, & Zawislak, 2017).

Dynamic capabilities are the firms' processes that use resources-specifically the processes to integrate, reconfigure, gain and release resources to match and even create market changes. Dynamic capabilities thus are the organizational and strategic routines by which the firm achieves new resource configurations as the market emerge collide. Split evolve and die". Dynamic capabilities are processes of companies or organizations that use specific resources to match existing market changes with the aim of adjusting to dynamic changes that occur in the market, dynamic capabilities are also a configuration of resources that are in line with product life cycle namely developed markets, impacting, divides, develops and eventually dies / disappears (Nyachanchu, 2017);(Khaliq & Saeed, 2015).

According to Eisenhardt and Martin (2000) states "dynamic capabilities consistency and organizational processes such as product development, alliancing and statistical decision making that create value for firms within dynamic markets by manipulating resources into new value-creating strategies". Dynamic capability is a special strategy that can make strategic conclusions that create new value for companies in dynamic markets by manipulating or changing existing resources to be able to create new strategic values (Khaliq & Saeed, 2015).

"Dynamic capabilities are the antecedent of organizational and strategic routines by which managers alter the resource base - acquire and shed resources, integrate them, and recombine them to generate new value-creating strategies" the meaning is dynamic capabilities are overall organizations or companies and strategy routines where managers can change these resources together and combine well to create a new strategic value (Grant, 1996); (Pisano, 1994); (Teece, Pisano, & Shuen, 1997).

According to Helfat and Peteraf (2003), a dynamic capability is an approach to understanding a company's business based on the basic theory of resources that enables unique company capabilities to develop. "Dynamic capabilities are the approaches to understand business firm builds upon the basic assumptions of resource-based theory through its assertions that these unique firm capabilities develop over time" (Khaliq & Saeed, 2015). Jiao (2013) argues "dynamic capabilities are the development of management capabilities and difficult to imitate the combination of organizational functional, technological and technological skills to change existing operational mechanisms to meet new customer needs and finally to improve performance". Dynamic capabilities are a form of management capability that is difficult to be imitated by a functional organization and technological capability to change operational mechanisms to find new customer needs and the ultimate goal is to improve performance (Xin, Song, Fuji, & Zexia, 2018).

"Dynamic capabilities are the entrepreneurial ability to adapt to rapidly changing environments". Entrepreneurial orientation is to have an innovative character, proactive and risk challenger, dynamic capabilities can be categorized into entrepreneurial abilities that can adapt to dynamic market changes (Teece et al., 1997).

According to Griffith and Harvey (2000), dynamic capabilities are to unite, develop, configure company competencies capable of dealing with changes in nature quickly. "Dynamic capabilities are the capabilities of enterprises to address rapidly and reconfigure internal and external competences as to address rapidly changing environment" (Gaye & Dogan, 2013).

Dynamic capabilities, namely how the ability of managers of companies or organizations in integrating, building and configuring the competencies of companies or organizations both from internal sources and those from external sources to be able to adapt to rapid environmental changes, thus making these internal and external competencies the source of sustainable competitive advantage. Dynamic capabilities are a form of knowledge that can create value for companies both with the results of innovation and transformation of inputs into outputs to obtain sustainable competitive. Small and medium businesses (SMEs) in Indonesia need a comprehensive and integrated approach to improve business development and maintain customer loyalty to improve organizational performance better.

Dynamic capabilities can improve innovation and performance of small and medium enterprises (SMEs). In the global market competition, companies are required to continue to develop innovation, by taking into account the structure of the industry by examining from an internal perspective, carefully combining existing resources by combining to obtain core competencies and competitive advantage (Prahalal & Hamel, 1997). Competition in the global market is a company that can provide positive, timely, fast and responsive services with flexible product innovations and integrated management capabilities with effective coordination and places internal competencies and external competencies appropriately (Strønen et al., 2017).

The company's business model can create and deliver value to customers with the right mechanism. The business model shows the flow of costs, income, and profits and the success of a business depends on the design of the business model and its implementation according to Teece, 2018 (Teece, 2018).

Dynamic capabilities in this business model are companies having the ability to perceive and capture new opportunities and reconfigure resources and capabilities and opportunities that are detected and environmental changes that can create and maintain competitiveness following the opinion (Breznik & Hisrich, 2014).

The design of the model depends on the capability of the company in terms of the capability of accuracy, implementation and transformation of the business model as the output of dynamic capabilities at a higher stage. The dynamic capability has become an organizational routine and managerial expertise and is the company's ability to integrate, build and reconfigure internal competencies that are following current environmental conditions with a changing business environment. The strength of a company's dynamic capabilities is key in its ability to sustain long-term profits including redesigning or adjusting business models (Teece, 2018).

Dynamic capability is something broad from dynamic resources, processes, and capabilities in which a company must continuously build, adapt and reconfigure internal and external competencies to adapt to the development of the business environment. Dynamic capability functions as the company's capability for its partners. Development and coordination of company resources and corporate partners to make changes in the market and business environment. The strength of the company's dynamic capabilities determines the speed and level of ability of the company's resources in adjusting its business model according to the needs and aspirations of customers, this can be achieved by observing opportunities periodically and changing aspects and culture of the company to be more proactive towards new threats and opportunities along with business development/business (Teece, 2018).

Dynamic capability according to Teece (2018) in the business model consists of three components, namely:

1. Sensing is identifying opportunities by always observing the environment and looking for opportunities that arise within or outside the company's boundaries.
2. Seizing is when there is an opportunity then its potential and value are captured to be learned by choosing the right technology or better understanding the target customers.
3. Transforming / Reconfiguring is when opportunities are perceived and captured then the company reconfigures resources to adjust changes and opportunities in the corporate environment.

### 2.3. SMEs Performance

Business performance is a result that is made by the management continuously (Helfert, 2000). The intended outcome is the result of many individual decisions, Keban (2004) revealed that organizational performance is something that illustrates the extent to



which a group has carried out all the main activities to achieve the vision and mission of the institution.

Business performance is at the component of organizational effectiveness, encompassing both financial and market indicators (Venkatraman & Ramanujam, 1987: 120); (Patrick, 2018). This means that business performance is a component of an effective organization consisting of financial and market indicators.

Company performance is a factor that is often used to measure the impact of the strategy set by the company as a product market achievement where each company has an interest in knowing the market performance of its products. Market performance of the product, measured by an increase in sales, increased market growth and market share. (Ferdinand, 2002); (Avdelidou-Fischer, 2013). Pelham and Wilson (1996: 31) define company performance as product success and market development, where company performance can be measured through sales growth and market share. Baker and Sinkula's (1999) research states that entrepreneurial orientation individually influences organizational performance which can be measured by indicators of market share growth, the success of new products and overall performance. Good company performance is expressed in three main quantities, namely sales value as indicated by the value of money or unit profits, sales growth as indicated by an increase in product sales and market share as indicated by-product contribution in controlling the product market compared to competitors who ultimately lead to profits the company in accordance with the opinion of Ferdinand, 2002 (Avdelidou-Fischer, 2013).

Company performance or business performance or organizational performance is the result of activities carried out by the organization within a certain period (Hult, Hurley, & Knight, 2004). Company performance has been widely researched, Baker and Sinkula (1999); Lin et al., (2008); (Suliyanto & Rahab, 2012) shows that market orientation has a positive and significant effect on company performance. (Ozmen & Eris, 2012); (Haroon, Muhammad, Saifoul, & Noor, 2016); (Khaliq & Saeed, 2015) stated the same thing that market orientation had a positive and significant effect on company performance. Different opinions from the results of Gholami and Birjandi's research (2016) that market orientation does not influence company performance. Company performance can be measured through sales growth, profitability and market share (Li et al, 2008); (Suliyanto & Rahab, 2012). In contrast to Gholami and Birjandi (2016) measurement of the company, performance is measured through product performance and customer performance.

The performance of UKM is the same as company performance because SMEs is a type of small and medium business. The performance of SMEs in Indonesia in terms of (1) added value, (2) business units, labor, and productivity, (3) export value. Added value is

the performance of the Indonesian economy created by SMEs this year when compared to the previous year. Business units and labor are total business units in Indonesia and labor is the total workforce available in business units or SMEs, productivity or results of a business. SME exports are the products of SMEs exported abroad which have increased from year to year. The performance of small and medium businesses is a result that is made by the management continuously. The intended outcome is the result of many individual decisions (Helfert, 2000); (Mohammad et al., 2019); (Avdelidou-Fischer, 2013). The indicators used are as follows:

1. Sales growth: indicated by an increase in product sales.
2. Profitability: the value of money or unit profit.
3. Market share: product contribution in controlling the product market compared to competitors who ultimately lead to company profits.

From some of the opinions above, it can be synthesized that the performance of the company / SMEs is a result made by the management/company continuously and is the result of the decisions of many individuals to achieve corporate goals both small and medium enterprises.

### 3. Research Hypothesis

The research hypothesis is:

H1: There is a positive relationship between entrepreneurship orientation and SME performance.

H2: There is a positive relationship between dynamic capabilities and SME performance.

H3: There is a positive relationship between entrepreneurial orientation and dynamic capabilities.

H4: There is a positive relationship between entrepreneurship orientation and SME performance

through dynamic capabilities as mediation.

### 4. Methodology

The sampling method used is purposive sampling, is taking sample based on criteria determined by the pitch of the researcher. Sample criteria used are respondents who

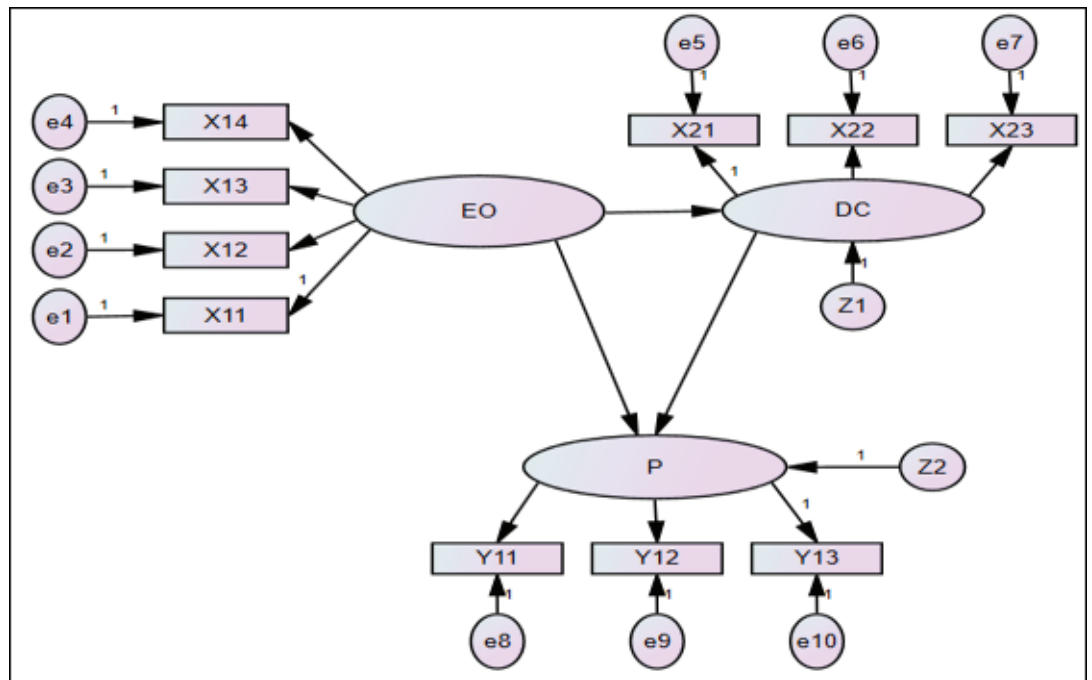


Figure 1: Research Model Framework

have been operating at least 5 years of business in batik industries as many as 350 respondents. In this study, an analysis tool used is structural equation modeling (SEM) version 24.

## 5. Result and Discussions

### 5.1. Hypothesis Testing

The results of the hypothesis analysis are as follows:

TABLE 1: Hypothesis Testing

|    | Variable |    | Estimate | S.E. | C.R.  | P   | Label  |
|----|----------|----|----------|------|-------|-----|--------|
| DC | <—       | EO | .404     | .089 | 4.553 | *** | par_9  |
| P  | <—       | EO | .405     | .103 | 3.941 | *** | par_8  |
| P  | <—       | DC | .547     | .085 | 6.461 | *** | par_10 |

Source: Primary data processed in 2019

Based on the analysis it is known that the analyzed model is a recursive model with a sample size of 350. Chi-Square value = 61,844 with df = 32 and probability 0,080. The Chi-Square results show that the null hypothesis which states the model is the same as empirical data is accepted which means the model is fit. Testing of the four hypotheses proposed in this study was carried out by analyzing the value of the Critical Ratio (CR)

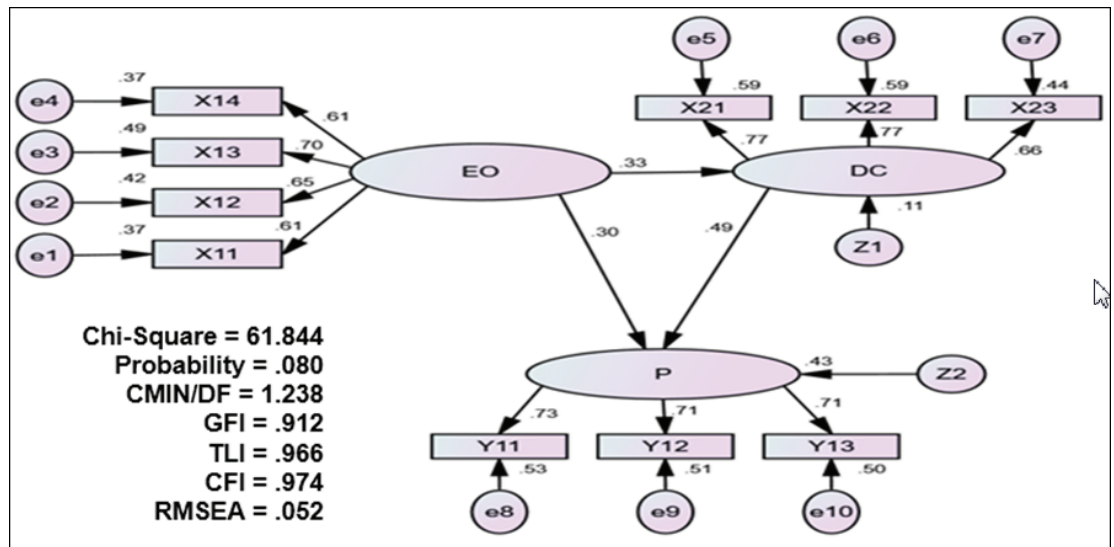


Figure 2: SEM Output Results

and the probability of a causal relationship. Based on Table 1 presented, hypothesis testing can be explained as follows:

### 5.1.1. Hypothesis Testing 1

**H1: Entrepreneurial orientation has a positive and significant effect on dynamic capabilities.**

The estimated parameter for testing the effect of dynamic capabilities on the performance of SMEs shows a CR value of 4,553 with a probability of 0,000. Because the probability value <0.05, it can be concluded that the dynamic capabilities variable is proven to be positively and significantly influential on the performance of SMEs. The results of the research prove that hypothesis 1 was tested.

### 5.1.2. Hypothesis Testing 2

**H2: Entrepreneurial orientation has a positive and significant effect on SME performance.**

The estimated parameter for testing the effect of dynamic capabilities on innovation shows a CR value of 3,941 with a probability of 0,000. Because the probability value <0.05, it can be concluded that the dynamic capabilities variable is proven to be positively and significantly influential on the performance of SMEs. The results of the research prove that hypothesis 2 has been tested.

### 5.1.3. Hypothesis Testing 3

#### **H3: Dynamic capabilities have a positive and significant effect on SME performance.**

The estimated parameter for testing the effect of innovation on company performance shows a CR value of 6,461 with a probability of 0,000. Therefore the probability value  $<0.05$ , it can be concluded that the innovation variable is proven to have a positive and significant effect on SME performance. Research results prove. The results of the study prove the tested hypothesis 3.

### 5.1.4. Hypothesis Testing 4

#### **H4: Entrepreneurial orientation has a positive and significant effect on the performance of SMEs through dynamic capabilities**

The estimated parameter for testing the effect of dynamic capabilities on the performance of SMEs mediated by innovation shows a CR value of 4,553 and 3,941 with a probability of 0,000. The effect of entrepreneurial orientation on SME performance through dynamic capabilities is  $3,941 \times 4,553 = 17,943$ . The value of the indirect effect is greater than the direct effect. Thus the entrepreneurial orientation has a positive and significant effect on the performance of SMEs through dynamic capabilities. The results of the research prove that hypothesis 4 is tested.

## 6. Conclusions

Entrepreneurial orientation the main variable has a major influence on developing the dynamic capability, help to increase the company performance in especially in the batik industries in Indonesia. Now the practitioners will know that for the direct correlation to the company's performance, dynamic capabilities has a greater influence than the entrepreneurial orientation factors, this is also inline what the studied from (Basuki, Arief, & Propheto, 2015); (Gaye & Dogan, 2013); (Patel & D'Souza, 2009), (Monteiro, Soares, & Rua, 2019) while in the indirect correlation entrepreneurial orientation has a greater influence than the dynamic capability to the performance of the company. Whilst dynamic capabilities also influence improved performance companies, but having smaller factors compared with entrepreneurial orientation and SMEs performance. With this research, we will provide some several contributions to management research and practice. The main contribution of this research to the theory are:

1. Provide evidence that the having of the entrepreneurial orientation, dynamic capabilities are necessary, for achieving superior company performance;
2. For direct correlation, the entrepreneurial orientation has a greater influence comparing the other variables, for indirect correlation (through dynamic capabilities) has a greater impact on the company performance, and;
3. Provide the operationalization of entrepreneurial orientation, dynamic capabilities, and SMEs performance to be used in future research, such as to the other industries sectors.

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## Conflict of Interest

The authors have no conflict of interest to declare.

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