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Why Not All Capabilities Improve Performance: The Mediating Role of Product Innovation in MSMEs

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ABSTRACT- This research investigates the influence of internal organizational and behavioral elements on entrepreneurial performance, specifically product innovation intervening in Micro, Small and Medium Enterprises (MSMEs). In particular, this study examines the role of learning organization, organizational culture, work motivation and entrepreneurial orientation on entrepreneurial performance. This is quantitative research using the survey method with 175 respondents of MSME entrepreneurs in Surabaya, Indonesia. All data were analyzed with Structural Equation Modeling (SEM) to examine both indirect and direct relationships among variables. The results showed that the influence of organizational culture and entrepreneurial orientation on product innovation and performance was positive and significant, learning organization had a positive effect but not significantly through product innovation, both work motivation also affected performance positively but insignificantly. Most importantly, the findings show that product innovation is the most significant determinant of entrepreneurial success and a key mediation mechanism (especially in terms of performance). This research adds to the literature by showing that capabilities-performance relationship is not direct but rather it applies through innovation which acts as key transformational mechanism for impact of internal capabilities on performance. The contextual limitations of learning organization at the MSME level provide important insights with formal structure limiting informal structures to be key drivers of innovation. In practice, the findings indicate that MSME entrepreneurs need to adapt innovation-dominated strategies and create an organizational atmosphere oriented towards creativity, proactiveness, adaptability as these could lead to sustainable business performance.

KEYWORDS- Entrepreneurial Performance; Product Innovation; Learning Organization; Organizational Culture; Work Motivation; Entrepreneurial Orientation; MSMEs.

I. INTRODUCTION

Micro, Small and Medium Enterprises (MSMEs) significantly contributes to promote the economic development not only in developing countries like Indonesia. MSMEs share a great deal of GGDP and work power retention, contributing almost 30% for the public income into Gross Domestic Product and work. MSMEs accounted for about Rp. 3,8 trillion of Indonesia's GDP in only one quarter (Q2), given that it made up around 60% of the economy. as they accounted for 9,580 trillion to GDP and absorbed approximately 97% of the Australian labour force as at 2023 — realised their crucial role in economic development. Moreover, regulatory support stemming from Government Regulation No. 20 year 2008 calls for continuous strengthening and development of MSMEs so as to improve sustainable performance and competitiveness This complement the importance of MSME as they are pivotal players in sustainable business performance especially when an increasingly dynamic and competitive market environment that these enterprises are operating. The fast pace of change in everything from consumer preferences to market conditions means entrepreneurs need to be flexible, creative and innovative. That is where the importance of sharpening skills and learning on a continuous basis comes into play. Organizations need to learn and grow in changing environments which is of great importance for MSMEs trying to survive [1]

Table 1: Selected data for mentoring by the Cooperative, SME, and Trade Office

No	Type of Facility Location of Mentored Businesses	Number of Locations
1	Culinary Tourism Centers	51
2	Developed Markets	12
3	Surabaya Kriya Gallery and Production Center	13
Total		**76**

Source: Surabaya City Cooperative, SME, and Trade Office. 2025

Table 1 further demonstrates the seriousness of the Surabaya City Government in strengthening the MSME sector through various mentoring and business development facilities. The data show that the Cooperative, SME, and Trade Office have developed 76 assisted business locations, consisting of 51 Culinary Tourism Centers, 12 Developed Markets, and 13 Surabaya Kriya Gallery and Production Centers. This indicates that MSMEs in Surabaya are supported not only through regulatory policies but also through concrete business development programs

designed to enhance entrepreneurial capacity, market access, and business sustainability. The dominance of Culinary Tourism Centers also reflects the growing importance of creative and consumer-oriented business sectors in Surabaya's local economy. However, despite the availability of such institutional support, MSMEs still face challenges in transforming internal organizational capabilities into sustainable performance outcomes. Therefore, strengthening organizational learning, organizational culture, work motivation, entrepreneurial orientation, and product innovation becomes increasingly important in ensuring that MSMEs are able to maximize the benefits of these development facilities and maintain competitiveness in dynamic market conditions.

Every region in Indonesia has equal opportunities and rights to develop its SMEs, taking into account each region's specific geographical conditions. In particular, the city of Surabaya has extensive opportunities to develop its existing SMEs, and this has been evidenced by receiving an award from the Ministry of Cooperatives and SMEs of the Republic of Indonesia in the form of: the Cooperative and Small and Medium Enterprise Service Award in 2024, recognizing that in the relevant year, SMEs grew by 30% compared to the achievements reached in 2023, with a total of 150,000 SME units. Given this situation, participation from all parties is needed to advance and empower SMEs, including: the City Government, the Private Sector, and the Community possessing entrepreneurial talent in the City of Surabaya. As part of the implementation of empowering micro, small, and medium enterprises in Surabaya, the following are among the initiatives:

Some of the internal factors that could probably affect entrepreneurial performance include organizational culture [2], work motivation [3] and entrepreneurial orientation. Organizational culture is defined by Susan R. Glazer (1987) [4] as a system of shared meanings that distinguishes one organization from another; this shared meaning is an important determinant of behavior and decision making in organizations. Likewise, motivation is defined as a process whereby psychological (such as the need for power, achievement and affiliation) forces act to direct human behaviour toward goals. At the same time, there is lack of consensus in how the conceptualization of entrepreneurial orientation — the firm-level constructs for promoting innovation, risk-taking and pro-activity towards marketing opportunities [2], [5], [6], [7].

Although these variables have been widely recognized as important determinants of business success, empirical findings regarding their direct impact on performance remain inconsistent. In particular, the role of learning organization in driving innovation and performance has produced mixed results. Some studies suggest that learning organizations positively influence innovation performance [8], [9], yet in practice, especially within MSMEs, learning processes tend to be informal and experience-based rather than systematically structured. This condition may limit the effectiveness of organizational learning in directly generating innovation outcomes.

Moreover, motivation — though theoretically related to performance — does not always lead to better business outcomes. This suggests that the link between internal capabilities and performance is indirect by an intermediary mechanism. In this regard, product innovation will serve as an important mediator. In line with Hamdani et al. (2023) [10], product innovation is defined as an improvement or development of a product for the benefits to consumers [11] and has a significant influence on business performance.

Emerging literature emphasizes that one of the main mediators between internal organizational and behavioral factors and performance is through innovation. Nonetheless, it was found that integrative studies that simultaneously explore the characteristics of learning organization, organizational culture, work motivation and entrepreneurial orientation on innovation and then innovation mediates those impacts upon entrepreneurial performance have rarely done in today's MSMEs in developing areas.

In addition to this, MSMEs also have certain distinctive features such as resource constraints for the organization, informal organizational structures and high-degree owner-driven decision making. These traits can significantly shape the nature of how organizational learning, culture, and motivation function in smaller firms compared with large ones. This underlines the need to understand the mechanism through which these factors enable performance, both as a theoretical and practical concern.

So, the purpose of this research is to analyze how learning organization, organizational culture, work motivation and entrepreneurial orientation can affect entrepreneurial performance with product innovation as an intervening variable. This study is expected to enhance our understanding of how internal capabilities are transformed into performance outcomes by examining it on MSMEs in Surabaya, as well as make a remarkable contribution in the literature by highlighting product innovation as a key mediating mechanism.

A. Learning Organization

With environmental changes occurring at a staggering rate, an organizations capability to learn and adapt has become one of the few real critical success factors that determine long term existence. A learning organization is one that continuously expands its capacity to create, acquire, and transfer knowledge, and to use that knowledge to modify its behavior. Fred Luthans [1] has pointed one of the major challenges within firms where organizations need to learn, adapt and develop as per their-burgeoning environment possesses learning as a dynamic capability.

Learning processes among MSMEs are predominantly informal, experience-based and based on the person knowledge of entrepreneurs. This adaptability is allowed by this discretion but may also result in knowledge development that cements structured or systematic innovation, not being achieved. It is already known from prior studies that a learning organization can positively affect innovation performance [8], [9]. Nevertheless, this relation strengthens by embedding the learning processes within the organization.

Thus, learning organization is expected to play a role in enhancing both innovation capability and business performance, although its impact may vary depending on the structural characteristics of MSMEs.

B. Organizational Culture

Organizational culture refers to the beliefs, values, and norms that shape how members of an organization behave. It is a roadmap that guides how those in it connect, engage and tackle challenges. As cited by Stephen P. Robbins and

Timothy A. Judge [2], an organizational culture is a system of shared meanings that makes one organization different from others. Similarly, Glaser et al. [4] defines it as clusters of beliefs, symbols, rituals and mythology that serves to hold an organization together whereas Kartono [12] highlights its role as a set of collective norms of behaviors with a work group.

Organisational culture is important for MSMEs as it helps create an environment of creativity and innovation. An environment that fosters creativity, openness, and collaboration can inspire fresh concepts and the effective execution of products. On the other end of the spectrum, a more inflexible or risk-averse culture might impede innovation efforts.

This is why organizational culture has been identified as a key determinant of product innovation and entrepreneurial performance because it provides the behavioral bedrock over which the business is performed.

Work Motivation

Work motivation represents the internal and external forces that stimulate desire and energy in people to be continually interested, and committed to a job, role or task. In the process of motivation, we begin with physiological or psychological needs that drive behaviour toward a goal [13]. In the same manner, Steven L. McShane and Mary Ann Von Glinow, (2003) [7] motivation is a process that involves the choice of direction, intensity and persistence of voluntary behaviour.

Motivation is one of the most important elements you must have in order to continue exerting effort, handling any key challenges you encounter and going after business opportunities within the entrepreneurial environment. These entrepreneurs are a threat to the market as they hunt for opportunities and improve products. Nevertheless, motivation is not a means to directly improve your performance as it needs to be turned into action in the form of innovation or synergies between dual functions.

Therefore, you can expect motivation to impact product innovation or even performance with the entrepreneur but indirectly, and so on.

C. Entrepreneurial Orientation

The strategic posture of a firm is widely known as entrepreneurial orientation (EO). As defined by Peter F. Drucker [5], entrepreneurial orientation is a relatively stable set of characteristics exhibited by individuals who wish to convert creative ideas into profitable business ventures. On the other hand, G. T. Lumpkin and Gregory G. Dess [6] consider exploiting market opportunities as an important aspect of entrepreneurship orientation for a firm as well some authors characterized entrepreneurial proclivity in relatively explosive terms, such as (i.e., opportunity recognition by small firms).

Entrepreneurial orientation is essential for MSMEs because these enterprises are operating in a relatively unstable, dynamic, and uncertain environment. Those entrepreneurs who take risks; act proactively, and innovate are the most likely to seize new opportunities and maintain competitive advantage over time. This orientation allows for more developing and adapting of products over time in accordance with market changes.

This means so from here, we expect a significant effect of entrepreneurial orientation which to say that the higher the rate per capital for each entity, the more contribution there will be in both product innovation and entrepreneurial performance.

D. Product Innovation

Product innovation is the process of developing or improving a product with value. Product innovation is an improvement of existing products or new products that generates more satisfaction for consumers [11]. In markets where there are many providers competing for the same customers, innovation becomes of utmost importance to continue to be a player.

Experiment data proves that product innovation is the main reason for business success. Hamdani et al. Business performance of product innovation in MSMEs is significantly affected byproduct innovative activity related to concept development for new products [14]. Innovation allows firms to react to shifts in preferences, gain a competitive advantage, and formulate trends that create long-term value.

Product innovation is then not just a result of an internal organizational capacity but also a essential vehicle that connects the two to performance because of its strategic importance.

E. Entrepreneurial Performance

Entrepreneurial performance represents the level of successfully reaching its goals within a certain time frame for a business. You may measure this by use of both financial and non-financial measures, e.g., revenue growth, profitability, or market share. According to Hasibuan [15], performance is the result obtained from an individual or group of people as a lakon based on their actual abilities and work within a certain time limit. And also Koesmono [11] defines performance as the level of success overall in achieving the target and objectives that have been set.

The performance of MSMEs, on the other hand, is subject to several factors including internal resources and capabilities, strategic orientation and innovation activities. High performance is not achieved solely by having a healthy dose of motivation and organisational support, but an ongoing ability to adapt and innovate in the face of market change.

F. Hypotheses

Based on the theoretical review and the relationships among variables discussed in previous studies, this study proposes a conceptual framework illustrating the direct and indirect relationships between organizational and behavioral factors, product innovation, and entrepreneurial performance. As presented in Figure 1, Learning Organization, Organizational Culture, Work Motivation, and Entrepreneurial Orientation are hypothesized to influence Product Innovation as well as Entrepreneurial Performance. In addition, Product Innovation is proposed as a mediating variable that strengthens the relationship between internal organizational capabilities and entrepreneurial performance. The framework reflects the assumption that MSME performance is not only influenced directly by internal organizational factors, but also indirectly through the firm's ability to generate product innovation in response to market changes and competitive pressures.

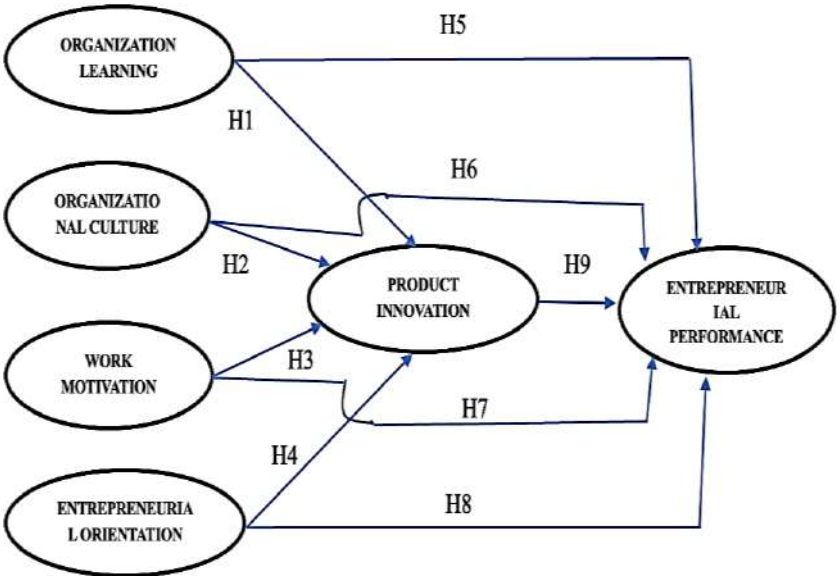

Figure 1: Conceptual Framework

Based on the conceptual framework presented in Figure 1, the following hypotheses are proposed:

H1: Learning Organization has a positive effect on Product Innovation.
H2: Organizational Culture has a positive effect on Product Innovation.
H3: Work Motivation has a positive effect on Product Innovation.
H4: Entrepreneurial Orientation has a positive effect on Product Innovation.
H5: Learning Organization has a positive effect on Entrepreneurial Performance.
H6: Organizational Culture has a positive effect on Entrepreneurial Performance.
H7: Work Motivation has a positive effect on Entrepreneurial Performance.
H8: Entrepreneurial Orientation has a positive effect on Entrepreneurial Performance.
H9: Product Innovation has a positive effect on Entrepreneurial Performance.

II. METHODOLOGY

A. Research Design

This study applies a quantitative, hypothesis testing research design to investigate how organizational and behavioral factors are related to entrepreneurial performance. This study aims to analyze Learning Organization, Organizational Culture, Work Motivation and Entrepreneurial Orientation on Entrepreneurial Performance with Product Innovation as a Mediating Variable.
Here, a cross-sectional survey design was adopted by collecting data from MSME owned entrepreneurs being operated in Surabaya, East Java, Indonesia at one point of time. This design is suitable for evaluating the causal relationship of latent variables using SEM.

B. Population and Sample

The Population of this research is the Micro, Small, and Medium Enterprise (MSME) entrepreneurs in Surabaya Your unit of analysis would be individual business owners or entrepreneurs who manage their businesses directly.
A random sampling technique was used to enable each element of the population an equal chance of selection. In this case a sample size found by Sugiyono [16] usually have an ideal minimum which ranges between 100 to 200 respondents for Quantitative Research. This research gained a total of 175 respondents (n = 175), which is enough for the analysis with SEM, because it achieves the minimum limit.

C. Respondent Profile

The respondent profile provides an overview of the demographic and entrepreneurial characteristics of MSME owners participating in this study. Understanding the profile of respondents is important to describe the background of the business actors and to provide contextual insight into the research findings.

D. Educational Background

Table 2 shows that the majority of respondents have a high school educational background, totaling 110 respondents, followed by 45 respondents with bachelor's degrees, 15 respondents with master's degrees, and 5 respondents with doctoral degrees. These findings indicate that most MSME entrepreneurs in Surabaya operate their businesses with relatively practical and experience-based managerial capabilities rather than advanced academic backgrounds. Nevertheless, the presence of respondents with higher educational qualifications suggests that MSME development in Surabaya also involves entrepreneurs with strong academic and managerial competencies.

Table 2: Respondents' Education

No.	Education	Number
1	High School	110
2	Bachelor's Degree	45
3	Master's	15
4	PhD	5
Total		**175**

E. Age of Respondent

As presented in Table 3, the largest proportion of respondents falls within the age range of 20–25 years, totaling 65 respondents, followed by 26–30 years (45 respondents), above 40 years (40 respondents), and 31–40 years (35 respondents). This distribution indicates that MSME activities in Surabaya are dominated by relatively young entrepreneurs, reflecting the growing interest of younger generations in entrepreneurial activities. The involvement of younger entrepreneurs may also contribute to greater adaptability, creativity, and openness toward innovation and changing market trends.

Table 3: Age of respondents

No	Age (Years)	Total
1	20–25	65
2	26–30	45
3	31–40	35
4	40	40
Total		**175**

F. Entrepreneurial Experience

Table 4 indicates that most respondents have entrepreneurial experience ranging from 1–5 years, with 115 respondents, followed by 6–10 years (45 respondents), 11–20 years (11 respondents), and more than 20 years (4 respondents). These findings suggest that the majority of MSMEs in Surabaya are relatively young businesses that are still in the growth and development stage. This condition reflects a dynamic entrepreneurial environment where business actors are actively seeking opportunities, adapting to market conditions, and developing their business capabilities to sustain competitiveness.

Table 4: Entrepreneurial Experience

No	Duration (Years)	Total
1	1–5	115
2	6–10	45
3	11–20	11
4	20	4
Total		**175**

G. Data Collection and Measurement

This study employs primary data based on a structured questionnaire administered to MSME entrepreneurs. A five-point Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree), with equal intervals between scale points was used to measure all variables. But the thing is since interval scale gives you more room and flexibility to calculate various statistics as compared to other scales, especially in SEM

The items of the questionnaire contained to measure their perceptions on Learning Organization, Organizational Culture, Work Motivation, Entrepreneurial Orientation, Product Innovation and Entrepreneurial Performance.

H. Variable Operationalization

Data Collection and Measurement

This study utilizes primary data collected through a structured questionnaire distributed to MSME entrepreneurs. All variables were measured using a five-point Likert scale, ranging from 1 (strongly disagree) to 5 (strongly agree), with equal intervals between scale points. The use of an interval scale allows for more robust statistical analysis, particularly in SEM.

The questionnaire items were designed to capture respondents' perceptions of each construct, including Learning Organization, Organizational Culture, Work Motivation, Entrepreneurial Orientation, Product Innovation, and Entrepreneurial Performance.

Variable Operationalization-

- Learning Organization (X1): The extent to which individuals and organizations engage in continuous learning to improve knowledge and performance.
- Organizational Culture (X2): Shared values and norms that guide behavior within the organization.
- Work Motivation (X3): Internal and external drivers that influence effort, persistence, and work-related behavior.
- Entrepreneurial Orientation (X4): The tendency to innovate, take risks, and proactively pursue business opportunities.
- Product Innovation (Y1): The development or improvement of products to enhance value for customers.
- Entrepreneurial Performance (Y2: The business level of success as a result of more or less sustained management and development within the time frame you are looking at.

I. Data Analysis Technique

Data were analyzed using Structural Equation Modeling (SEM) employing the AMOS software package [17]. SEM was chosen because it can test relationships between many latent variables at the same time, and direct (unmediated) as well as indirect, mediated unobserved entities present in hypothesized causal pathways [18].

The analysis was carried out in two main steps: Measuring Model Evaluation, including the validity and reliability tests to make sure that the indicators are correctly measuring the constructs. Structural Model Assessment, to examine the hypothesized interactions between variables as mediated by Product Innovation. Absolute Fit Indices, Incremental Fit Index, and Parsimonious Fit index were used to examine the fit of the Model.

J. Structural Model Specification

The structural relationships in this study are represented by the following equations:

$Y1 = aX1 + bX2 + cX3 + dX4$

$Y2 = eX1 + fX2 + gX3 + hX4 + iY1$

Where:

X1 = Learning Organization
X2 = Organizational Culture
X3 = Work Motivation
X4 = Entrepreneurial Orientation
Y1 = Product Innovation
Y2 = Entrepreneurial Performance

III. RESULTS AND DISCUSSION

A. Validity and Reliability Tests

Table 5: Validity Statistics

Variable	Indicator	*Corrected Item-Total Correlation*	Description
Learning Organization (X1)	X1.1	0.625	Valid
	X1.2	0.579	Valid
	X1.3	0.706	Valid
	X1.4	0.722	Valid
	X1.5	0.586	Valid
Organizational Culture (X2)	X2.1	0.746	Valid
	X2.2	0.597	Valid
	X2.3	0.753	Valid
	X2.4	0.784	Valid
	X2.5	0.784	Valid
Work Motivation (X3)	X3.1	0.742	Valid
	X3.2	0.710	Valid
	X3.3	0.741	Valid
	X3.4	0.704	Valid
	X3.5	0.710	Valid
Entrepreneurial Orientation (X4)	X4.1	0.812	Valid
	X4.2	0.785	Valid
	X4.3	0.765	Valid
	X4.4	0.678	Valid
	X4.5	0.751	Valid
Product Innovation (Y1)	Y1.1	0.683	Valid
	Y1.2	0.715	Valid
	Y1.3	0.656	Valid
	Y1.4	0.710	Valid
	Y1.5	0.628	Valid
Entrepreneurial Performance (Y2)	Y2.1	0.747	Valid
	Y2.2	0.535	Valid
	Y2.3	0.658	Valid
	Y2.4	0.759	Valid
	Y2.5	0.657	Valid
	Requirement	≥ 0.30	

Source: Processed data

The next test is the reliability test, which is a measure indicating the extent to which a measurement tool can be trusted or relied upon. The reliability analysis used is *internal consistency* reliability, which involves examining *Cronbach's Alpha* coefficient; a value of 0.60 or higher indicates that the questionnaire is reliable [19] . (adds that reliability measures range from 0 to 1; the generally accepted lower limit for *Cronbach's Alpha* is above 0.70 (*good reliability*), with values between 0.60 and 0.70 considered the lower acceptable limit (*acceptable reliability*).

Table 6: Reliability Statistics

Variable	*Cronbach's α*	Number of items	Decision
Learning Organization (X1)	0.833	5	Reliable
Organizational Culture (X2)	0.889	5	Reliable
Work Motivation (X3)	0.877	5	Reliable
Entrepreneurial Orientation (X4)	0.900	5	Reliable
Product Innovation (Y1)	0.859	5	Reliable
Entrepreneurial Performance (Y2)	0.854	5	Reliable
Requirement	≥ 0.70		

Source: Processed data

The reliability test results indicate that all research variables have *Cronbach's Alpha* values above 0.70, namely Learning Organization (0.833), Organizational Culture (0.889), Work Motivation (0.877), Entrepreneurial Orientation (0.900), Product Innovation (0.859), and Entrepreneurial Performance (0.854). This indicates that the questionnaire instrument used has good internal consistency (*good reliability*) and is therefore reliable for measuring each variable. Thus, all statement items in the research variables met the reliability criteria, making the instrument suitable for further analysis.

Table 7: Descriptive Statistics of the Indicator

Variable	Indicator	Min	Max	Mean	SD
Learning Organization (X1)	X1.1	4	5	4.50	0.50
	X1.2	3	5	4.42	0.60
	X1.3	3	5	4.18	0.73
	X1.4	4	5	4.49	0.50
	x1.5	3	5	4.23	0.67
Organizational Culture (X2)	X2.1	3	5	4.31	0.63
	X2.2	3	5	4.39	0.58
	X2.3	3	5	4.37	0.65
	X2.4	3	5	4.31	0.67
	x2.5	3	5	4.26	0.66
Work Motivation (X3)	X3.1	3	5	3.83	0.71
	X3.2	4	5	4.56	0.50
	X3.3	3	5	4.15	0.69
	X3.4	3	5	4.20	0.61
	X3.5	4	5	4.51	0.50
Entrepreneurship Orientation (X4)	X4.1	3	5	4.35	0.61
	X4.2	3	5	4.08	0.69

	X4.3	3	5	4.10	0.69
	X4.4	3	5	4.19	0.63
	X4.5	3	5	3.98	0.70
Product Innovation (Y1)	Y1.1	4	5	4.50	0.50
	Y1.2	3	5	4.38	0.58
	Y1.3	4	5	4.55	0.50
	Y1.4	3	5	4.25	0.64
	Y1.5	4	5	4.45	0.50
Entrepreneurial Performance (Y2)	Y2.1	3	5	4.23	0.62
	Y2.2	4	5	4.50	0.50
	Y2.3	3	5	4.18	0.64
	Y2.4	3	5	4.14	0.65
	Y2.5	4	5	4.49	0.50

Source: Processed data

Table 8: Descriptive Statistics of the Variables

Variable	Mean of variable	Level
Learning Organization (X1)	4.36	Very high
Organizational Culture (X2)	4.33	Very high
Work Motivation (X3)	4.25	Very high
Entrepreneurial Orientation (X4)	4.14	High
Product Innovation (Y1)	4.43	Very high
Entrepreneurial Performance (Y2)	4.31	Very high

Source: Processed data

B. Learning Organization (X1)

Learning organization variable has an average value of 4.36 within the interval 4.20 < mean ≤ 5.00, which also indicates "very high" category. This means that business owners or entrepreneurs in Surabaya have a very high level of organizational learning in running their business. This condition shows that business actors consistently carry out learning processes as well as sharing experiences, ways of working that are more effective, and improving knowledge and skills in managing businesses. Such a level of learning organisation, thus, shows that business players already have a high-awareness to continue growing and adapting more to the dynamics of business and this would surely help them in creating better businesses.

C. Organizational Culture (X2)

With an average organizational culture score of 4.33, we see with the computed interval where 4.20 < mean ≤ 5.00 is categorized as “very strong”. This shows that the values, norms and beliefs that guide business activities have settled into the hearts of Surabaya entrepreneurs. Maintaining a disciplined work attitude, ensuring quality work, and building good working habits in managing the business are manifestations of a strong organizational culture. This condition also causes the entrepreneur to be able to form a suitable working atmosphere or climate for encouraging good cooperation performed by workers in conducting business operations.

D. Work Motivation (X3)

The overall work motivation scores of 4.25 are above the mid category (average = 3.56) and fall into an interval of 4.20 < mean ≤ 5.00 which represents high categories for the score separated on a five-scale ordinal where: Which means business owners are very fired up about running and developing their businesses. Well, this could be one of those motivations that someone may desire when it comes to achieving business success and profits along with personal satisfaction from the success of the business you run. This level of work motivation can be achieved because entrepreneurs have a good work ethic, strong commitment and patience in the face of various challenges that arise in business.

E. Entrepreneurial Orientation (X4)

The average score for entrepreneurial orientation was found to be 4.14, falling under the interval 3.40 < mean ≤ 4.20 (high category). This shows the entrepreneurs in Surabaya are already have a positive mental attitude, namely the courage to take risks, the ability to find opportunities and how proactive they are related capability business development. Despite being in the high category, this score is lower than scores of some other variables indicating that there is a room for improvement in relation to entrepreneurial orientation especially regarding innovation, courage in facing uncertainty and building more aggressive strategy.

F. Product Innovation (Y1)

An average product innovation score of 4.43, within the range of 4.20 < mean ≤ 5.0 is considered a very high category. This means that the entrepreneurs of Surabaya are extremely active in adapting and renewing the product they offer to consumers. The innovation goes in terms of quality, design, feature addition or the development of new products that better meet market demands. Such a significant amount of product innovation suggests that entrepreneurs are extremely capable at reinventing their own products to align with emerging market trends and consumer desires.

G. Entrepreneurial Performance (Y2)

The average entrepreneurial performance score is 4.31, in which category range are 4.20 < mean ≤ 5.00 (= very high). This indicates that entrepreneurs in Surabaya can achieve very high business success level. This performance is depicted in increased sales, profits and expansion of businesses as well as competition and sustainment of business activities. This notable efficiency around entrepreneurship additionally suggests that business owners have the ability to handle their resources optimally to produce complementary commercial results.

The normality test results show a *multivariate* c.r. of -1.105, which falls within the range of –1.96 to +1.96 at a 5% significance level; therefore, it can be concluded that the data are *multivariate* normally distributed. Thus, the analysis can proceed to the next stage (See the table 9).

Table 9: Multivariate Normality

Test	Kurtosis	c.r *multivariate*	Conclusion
Multivariate normality	-7.323	-1.105	The c.r. falls within the range of ±1.96, so the data is multivariate normally distributed

Source: Processed data

Table 10: Fit Measures for the Measurement Model

Fit Measure		Critical Value	Measurement Model	
			Index value	Decision
Absolute Fit Indices	Probability	> 0.05	0.075	Good fit
	Cmin/DF	≤ 2.00	1.162	Good fit
	GFI	≥ 0.90	0.858	Marginal fit
	RMSEA	≤ 0.08	0.031	Good fit
	SRMR	≤ 0.08	0.053	Good fit
Incremental Fit Indices	CFI	≥ 0.95	0.972	Good fit
	TLI	≥ 0.95	0.969	Good fit
Parsimony Fit Indices	AGFI	≥ 0.90	0.828	Marginal fit

Source: Processed data

Table 10 shows the results of the model fit evaluation for the measurement model, yielding criteria that are all acceptable (*good fit* and *marginal fit*), so the measurement model is acceptable. *A good fit* means the model fit is good, while *a marginal fit* means the model fit is within acceptable limits.

H. Structural Model Analysis

i) Structural model fit

Once the *measurement model* analysis stage is complete, the next stage is the *structural model* analysis. The following are the results of the full structural model estimation using Amos v.30 (See the figure 2).

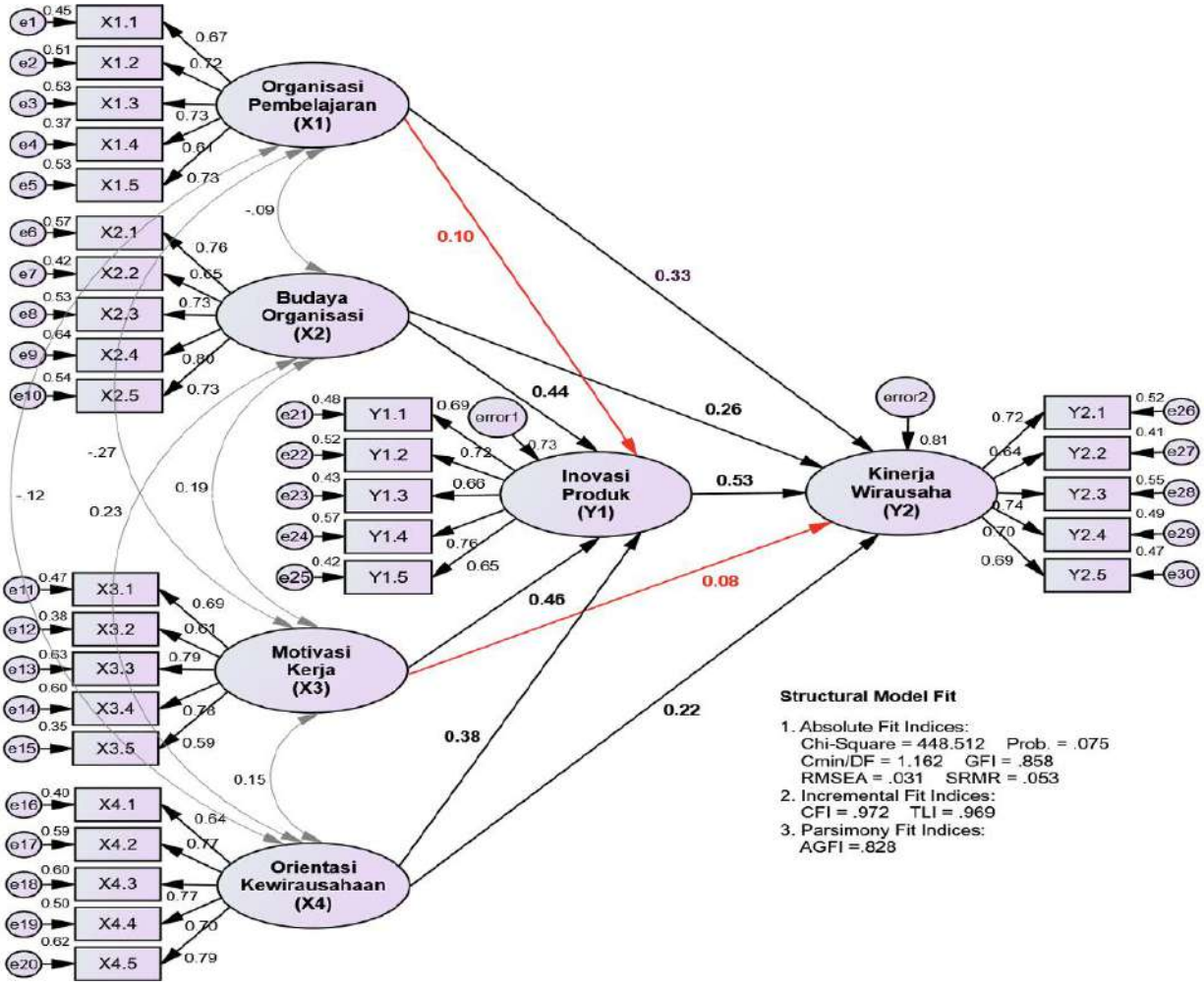

Figure 2: Assessing the Structural Model (Source: Processed data)

The results of the calculations for the *goodness-of-fit* indices generated by the structural model are as follows:

The results of the structural model fit test show that all criteria *for absolute fit indices, incremental fit indices,* and *parsimony fit indices* have been met (*marginal fit* and *good*

fit), so the structural model is acceptable, and next, the significance of the influence between variables is tested, both direct and indirect influences.

ii) Analysis of the direct effect

The next stage of *structural model* analysis is *testing structural relationships* in the *direct effect* pathways, namely examining the parameter estimates of the relationships between variables that represent each theoretical hypothesis. A hypothesis is accepted if the path parameter is statistically significant with the direction of influence consistent with the prediction; that is, the path parameter must be greater than zero for a positive direction and less than zero for a negative direction [20].

In *testing structural relationships*, hypothesis testing is conducted to assess the significance of the relationships between variables, using the *critical ratio* (*CR*) and *the* p-value. The significance of the relationship between variables is determined by the criterion that if the *CR* value is ≥ 1.96 or the *p-value* is ≤ the 5% significance level, then a significant relationship between those variables is concluded to exist.

The following are the results of *the structural relationship analysis* conducted to test each research hypothesis based on the SEM output:

Table 11: Summary of Direct Effect Testing

No	*Structural relationship*	*Std. Estimate*	*SE*	*C.R.*	*P-value*	Hypothesis decision
1	X1→ Y1	0.103	0.072	1.477	0.140	H_1 rejected
2	X2 → Y1	0.441	0.058	5.469	0.000	H_2 accepted
3	X3 → Y1	0.462	0.061	5.368	0.000	H_3 accepted
4	X4 → Y1	0.379	0.076	4.511	0.000	H_4 accepted
5	X1 → Y2	0.330	0.102	4.308	0.000	H_5 accepted
6	X2 → Y2	0.259	0.094	2.586	0.010	H_6 accepted
7	X3 → Y2	0.076	0.097	0.726	0.468	H_7 rejected
8	X4 → Y2	0.218	0.108	2.353	0.019	H_8 accepted
9	Y1 → Y2	0.534	0.223	3.117	0.002	H_9 accepted

Notes:

X1: Learning Organization — Y1: Product Innovation

X2: Organizational Culture — Y2: Entrepreneurial Performance

X3: Work Motivation

X4: Entrepreneurial Orientation

Source: Processed data

Based on Table 11 above, the following can be explained:

- The results of the first hypothesis test indicate that a learning organization (X1) has no significant effect on product innovation (Y1). This is indicated by a standard coefficient (Std. Estimate) of 0.103, a Critical Ratio (C.R.) of 1.477, and a p-value of 0.140, which is greater than the significance level of 0.05. Thus, the first hypothesis stating that learning organizations influence product innovation is rejected (H1 rejected). The lack of significance in this effect may occur because most of the businesses operated by the respondents are still small or medium-sized, so the organizational learning process has not yet taken place formally and systematically as in large companies. In small businesses, learning is often individual and unstructured, relying more on the personal experience of the business owner than on a planned organizational learning system. Additionally, product innovation in small businesses often emerges spontaneously as a response to changes in consumer preferences or market competition pressures, rather than as a result of a structured organizational learning process. This situation prevents learning organizations from significantly driving product innovation. These findings contradict those reported by Wijiabudula, and Zehir [21], who found that learning organizations influence product innovation
- The results of the second hypothesis test indicate that organizational culture (X2) has a positive and significant influence on product innovation (Y1). This is indicated by a standard coefficient (Std. Estimate) of 0.441, a Critical Ratio (C.R.) of 5.469, and a p-value of 0.000, which is smaller than the significance level of 0.05. Thus, the second hypothesis stating that organizational culture influences product innovation is accepted (H2 accepted). These results indicate that the stronger the values and work norms implemented within a business, the higher the level of product innovation produced. A positive organizational culture— , such as openness to new ideas, good cooperation, and a commitment to business development—can create an environment that fosters creativity and product innovation in business activities. These research results align with the findings of Sujoko (2026) [22] on "Start-up Organizational Culture Supporting Product Innovation"
- The results of the third hypothesis test indicate that work motivation (X3) has a positive and significant influence on product innovation (Y1). This is indicated by a standard coefficient (Std. Estimate) of 0.462, a Critical Ratio (C.R.) of 5.368, and a p-value of 0.000, which is smaller than the significance level of 0.05. Thus, the third hypothesis stating that work motivation influences product innovation is accepted (H3 accepted). These results indicate that the higher the work motivation possessed by entrepreneurs, the greater their ability to create and develop product innovations. A strong drive to achieve business success, increase profits, and ensure business sustainability can motivate entrepreneurs to continuously update their products to remain competitive in the market. These research results align with the findings by Yunal and Indriyani (2013) [14]: Entrepreneurial motivation has a positive and significant influence on product innovation in the Pottery Craft Business in West Lombok
- The results of the fourth hypothesis test indicate that entrepreneurial orientation (X4) has a positive and significant influence on product innovation (Y1). This is indicated by a standard coefficient (Std. Estimate) of 0.379, a Critical Ratio (C.R.) of 4.511, and a p-value of 0.000, which is smaller than the significance level of 0.05. Thus, the fourth hypothesis stating that entrepreneurial orientation influences product innovation is accepted (H4 accepted). These results indicate that the higher the entrepreneurial orientation possessed by business actors, the higher the level of product innovation produced. A proactive attitude in

identifying opportunities, the courage to take risks, and the ability to generate new ideas are key factors driving business owners to engage in product development and renewal to enhance business competitiveness. These findings align with those reported by Ansofa and Hatammimi (2025) [23], who found that entrepreneurial orientation has a positive and significant effect on new product development performance among fashion SMEs in Bandung.

- The results of the fifth hypothesis test indicate that a learning organization (X1) has a positive and significant influence on entrepreneurial performance (Y2). This is indicated by a standard coefficient (Std. Estimate) of 0.330, a Critical Ratio (C.R.) of 4.308, and a p-value of 0.000, which is smaller than the significance level of 0.05. Thus, the fifth hypothesis stating that a learning organization influences entrepreneurial performance is accepted (H5 accepted). These results indicate that the higher the level of learning occurring within a business, the higher the resulting entrepreneurial performance. An entrepreneur's ability to continuously learn, improve work processes, and develop knowledge and skills in running a business can enhance business management effectiveness, thereby contributing to increased business success. These research results align with a study conducted by Wijiabudula and Zehir (2016) [21], which found that a learning organization influences business/company performance
- The results of the sixth hypothesis test indicate that organizational culture (X2) has a positive and significant influence on entrepreneurial performance (Y2). This is indicated by a standard coefficient (Std. Estimate) of 0.259, a Critical Ratio (C.R.) of 2.586, and a p-value of 0.010, which is smaller than the significance level of 0.05. Thus, the sixth hypothesis stating that organizational culture influences entrepreneurial performance is accepted (H6 accepted). These results indicate that the stronger the values, norms, and work habits implemented in a business, the better the entrepreneurial performance achieved. A positive organizational culture can create a disciplined, collaborative, and goal-oriented work environment, thereby enhancing productivity and business success in the face of market competition. These findings align with those reported by Abdullah et al. (2017) [24], who also found a significant effect of organizational culture on entrepreneurial performance.
- The results of the seventh hypothesis test indicate that work motivation (X3) has a positive but non-significant effect on entrepreneurial performance (Y2). This is indicated by a standard coefficient (Std. Estimate) of 0.076, a Critical Ratio (C.R.) of 0.726, and a p-value of 0.468, which is greater than the significance level of 0.05. Thus, the seventh hypothesis stating that work motivation influences entrepreneurial performance is rejected (H7 rejected). These results indicate that the level of work motivation possessed by entrepreneurs does not directly have a significant influence on improving entrepreneurial performance in Surabaya. This situation may occur because entrepreneurial performance is not solely determined by individual motivational factors but is also influenced by various other factors such as product innovation capabilities, marketing strategies, market conditions, and the availability of business resources. In many cases, an entrepreneur may possess high work motivation; however, if this is not accompanied by the ability to create product innovations or implement appropriate business strategies, a significant improvement in business performance will not occur. Therefore, in the context of this study, work motivation plays a more indirect role through increased product innovation rather than exerting a direct influence on entrepreneurial performance. The results of this study contradict the findings of Jon et al. (2025) [3], who reported that work motivation has a positive and significant effect on the performance of business operators in the culinary tourism sector in Labuan Bajo, West Manggarai.
- The results of the eighth hypothesis test indicate that entrepreneurial orientation (X4) has a positive and significant influence on entrepreneurial performance (Y2). This is indicated by a standard coefficient (Std. Estimate) of 0.218, a Critical Ratio (C.R.) of 2.353, and a p-value of 0.019, which is smaller than the significance level of 0.05. Thus, the eighth hypothesis stating that entrepreneurial orientation influences entrepreneurial performance is accepted (H8 accepted). These results indicate that the higher the entrepreneurial orientation possessed by business owners, the better the business performance achieved. A proactive attitude in identifying business opportunities, the courage to take risks, and the ability to innovate and adapt to market changes are key factors driving improvements in entrepreneurial performance when facing business competition. These research findings align with those of Jon et al. (2025) [3], who found that entrepreneurial orientation has a positive and significant effect on the performance of business owners in the culinary tourism sector in Labuan Bajo, West Manggarai.
- The results of the ninth hypothesis test indicate that product innovation (Y1) has a positive and significant effect on entrepreneurial performance (Y2). This is indicated by a standard coefficient (Std. Estimate) of 0.534, a Critical Ratio (C.R.) of 3.117, and a p-value of 0.002, which is smaller than the significance level of 0.05. Thus, the ninth hypothesis stating that product innovation influences entrepreneurial performance is accepted (H9 accepted). These results indicate that the higher the level of product innovation undertaken by entrepreneurs, the higher the resulting business performance. Entrepreneurs' ability to create new products, improve product quality, and adapt products to consumer needs and preferences can enhance business competitiveness, attract market interest, and drive increased sales and business success. These findings align with the research conducted by Wijiabudula and Zehir (2016) [21], which also found that product innovation influences business/company performance.

iii) Analysis of the indirect effect

The next stage in *the structural model* analysis is *testing the structural relationships* in the *indirect effect* pathway. Hypothesis testing to assess the significance of the indirect effect is conducted in the same manner, using the *critical ratio* (*CR*) and probability value (*p-value*). If the *CR* value is ≥ 1.96 or the *p-value* is ≤ the 5% significance level, it is concluded that there is a significant mediating effect.

After testing the significance of the mediating effect, the next step is to determine the nature of the mediation. The nature of the mediation can be identified by examining the mediating effect: if the direct effect of the exogenous variable on the endogenous variable is significant, and the indirect effect through the mediating variable also occurs via a significant pathway, it is termed *partial mediation* or *complementary mediation;* conversely, if the direct effect of the exogenous variable on the endogenous variable is not significant, while the indirect effect through the mediating variable follows a significant path, it is termed *"full mediation"* or *"perfect mediation"* [25].

The following are the results *of testing structural relationships* in the context of testing indirect effects based on SEM output:

Table 12: Summary of the indirect effect testing

Indirect Effect	*Std. Estimate*	*SE*	*CR*	*P-value*	Mediation Property
X1→ Y1→ Y2	0.055	0.068	1.088	0.091	*No mediation*
X2→ Y1→ Y2	0.236	0.100	2.210	0.012	*Partial mediation*
X3→ Y1→ Y2	0.247	0.098	2.327	0.006	*Full mediation*
X4→ Y1→ Y2	0.203	0.094	2.521	0.007	*Partial mediation*

Notes:

X1: Learning Organization Y1: Product Innovation

X2: Organizational Culture Y2: Entrepreneurial Performance

X3: Work Motivation

X4: Entrepreneurial Orientation

Source: Processed data results

Analysis of the indirect effects shows that the test results for learning organization (X1) through product innovation against entrepreneurial performance are as follows: path coefficient = 0.055, C.R. = 1.088, p-value = 0.091> 0.05; therefore this indicates an insignificant direct effect on learning organization X1 and entrepreneurial performance through an intervening variable product innovation Interestingly, these results are contradictory to Wijiabudulaand and Zehir (2016) [21] study results that says product innovation plays a mediating role in between learning organization leads firm performance.

On the other hand, the path from organizational culture (X2) to entrepreneurial performance where product innovation has a standard coefficient of 0.236, C.R. 2.210 and p value of <0.012, so that it can be said that product innovation is proven to mediate partially between organizational culture with entrepreneur performance

The effect of work motivation (X3) on entrepreneurial performance through product innovation is characterized by a standard coefficient value of 0.247 with a C.R of 2.327 and p value of 0.006 < 0.05, which means that product innovation here acts as a full mediator in this path.

As for the path of entrepreneurial orientation (X4) to entrepreneurial performance through product innovation, it has a standard coefficient of 0.203 with a C.R. of 2.521 and a p-value of 0.007, which is less than 0.05; thus, product innovation was found to partially mediate the relationship between entrepreneurial orientation and entrepreneurial performance.

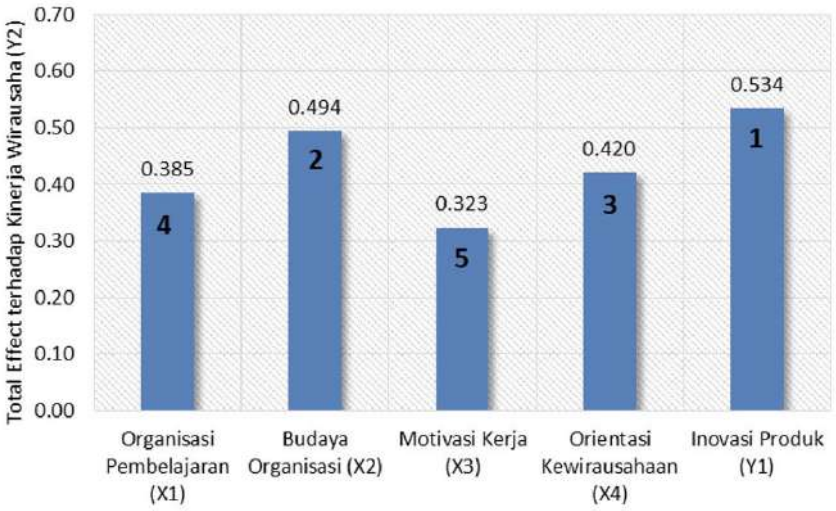

Figure 3: Total Effect (Source: Processed data results)

These findings indicate that product innovation plays a crucial role as a mechanism bridging the influence of various internal factors on the improvement of entrepreneurial performance. Organizational culture and entrepreneurial orientation not only have a direct impact on business performance but can also enhance performance by fostering increased product innovation generated by entrepreneurs. Meanwhile, work motivation does not have a significant direct influence on entrepreneurial performance; however, it can enhance performance when

directed toward efforts to create product innovation, making product innovation the key factor linking work motivation to business success. On the other hand, learning- t organizations do not play a significant role in driving performance through product innovation, indicating that the learning process within the business has not yet been effectively translated into product innovations that impact business performance improvement.

iv) Analysis of the total effect

The analysis of *the total effect* of each variable on entrepreneurial performance is the sum of its direct and indirect effects. The *total effect* value does not need to be calculated manually but is automatically calculated by the Amos software, the results of which are presented in Figure 3 above:

The results of the total effect analysis indicate that product innovation (Y1) has the greatest total effect on entrepreneurial performance with a value of 0.534, followed by organizational culture (X2) at 0.494, entrepreneurial orientation (X4) at 0.420, learning organization (X1) at 0.385, and work motivation (X3) at 0.323. These findings indicate that product innovation is the most dominant factor in enhancing entrepreneurial performance in Surabaya. This means that entrepreneurs' ability to create new products, improve product quality, and adapt products to market needs plays a crucial role in boosting business success. Additionally, organizational culture and entrepreneurial orientation also have a relatively significant influence on business performance, indicating that strong work values along with proactive and innovative attitudes among entrepreneurs can drive a significant improvement in business performance.

IV. IMPLICATION FOR RESEARCH AND PRACTICE

A. Theoretical Implications

This study offers important contributions to entrepreneurship and small business management literature in the context of micro, small- and medium-scale enterprises (MSMEs) in developing economies.

The findings run against the intuitive belief that learning organization leads to increased product innovation. Although previous research has shown that the role of organizational learning is to positively contribute to increased innovation, we demonstrate such relationships may not exist in MSMEs where informal processes are prevalent and unstructured. This indicates that the efficacy of learning organization is quite conditional on organizational context, which also expands existing boundary conditions of learning organization theory.

Second, this study emphasizes the differentiated roles of internal capabilities on performance. While the indirect effect of work motivation is through product innovation, both direct and indirect effects of organizational culture and entrepreneurial orientation are also found on entrepreneurial performance. This finding adds to the literature by making it clear that not all internal factors affect performance through the same mechanism.

Third, the study highlights product innovation as a mediating mechanism. Instead of being treated simply as an outcome variable, the data empirically shows how product innovation can be used functionally as a transformational mechanism that connects internal organizational and behavioral factors to performance outcomes. This backs and adds to the current perspectives that innovation is a core contributor to competitive advantage.

Lastly, the results enhance the emerging capability-based management literature that argues MSMEs should be understood as inherently situational. The findings demonstrate that theoretical models created in large organizational settings may not be completely suitable for small and medium companies if we do not take into account the specific structural and behavioral aspects within these types of organizations.

B. Practical Implications

The results of the study generate relevant management insights for MSME practitioners, policy-makers and business development institutions.

MSME entrepreneurs should focus on product innovation as one of the most important ways to improve business performance. The results also reveal that besides organization, innovation very strongly affects performance; with insight this means attempts to maintain product quality, create new products and cater to changes in consumer tastes play a key role in remaining competitive.

Secondly, you need innovative and performance-driven culture within the organization. Entrepreneurs ought to embrace values that cultivate creativity, open-mindedness, teamwork; since these things produce a climate in which innovations/updates are consistently produced.

Third, entrepreneurship should be developed on purpose especially in regards to risk taking and proactiveness and opportunity recognition. Entrepreneurs with a higher tendency to discover new opportunities and adapt themselves to changing market conditions have a greater degree of innovation and performance than other entrepreneurs.

Work motivation is important but should not be treated as the cause of performance, a fourth point. Motivation, on the other hand, must be directed towards useful endeavors specific to innovation. Pace yourself: You can train on sudden death with motivation as a driver however you need to teach skills that turn motivation into business wins.

The fifth finding indicates that MSMEs should be more organized in ensuring systematic learning processes, which will be an important component of innovation. Meaning, programs can be designed in a more structured manner to enhance knowledge sharing, training and capability development which will act as key resources for policymakers and support institutions.

C. Future Research Directions

The present study ultimately introduces a number of future research directions. The research may want to add other mediating or moderating variables, such as digital capability, market orientation, or knowledge management practices on the relation between internal capabilities and performance [7], [26], [27].

Second, due to this research conducting its analysis on cross-sectional data, longitudinal research design is suggested as they are more adequate in detecting dynamic changes in MSME performance over time.

Third, future work could broaden the study to different areas or sectors to improve external validity and explore possible contextual heterogeneity.

Finally, qualitative or mixed-method approaches may yield more nuanced understandings of the learning, motivation and innovation processes in MSMEs, especially concerning why some relationships weren't effects.

V. CONCLUSION

The study purpose is to investigate learning organization, organizational culture, work motivation and entrepreneurial orientation affecting entrepreneurial performance with product innovation variable mediating between MSMEs in Surabaya.

The research provides evidence that not all internal capabilities necessarily translate into performance results. Organizational culture and entrepreneurial orientation have a significant effect on both product innovation and entrepreneurial performance, but learning organization does not significantly influence product innovation, and work motivation does not directly affect entrepreneurial performance. This indicates that the relationship between internal capabilities and performance may not be strictly linear.

Most significantly this study identifies product innovation as the crucial mediating mechanism connecting new venture characteristics and entrepreneurial outcomes. It turns out that product innovation has the largest impact on performance but also acts as a vital mediating link between motivation & other organizational constructs and measurable business outcomes.

Theoretically, it contributes by showing how the success and possible failure of organizational and behavioral factors are accordingly context-dependent among small-size firms with relatively informal organizations and resource-constrained capabilities. It also reinforces the idea that innovation should not be seen as simply an output, but rather as a mediating force capturing how activity translates to performance.

In practical manner, the findings imply MSME entrepreneurs should focus on innovation-oriented strategies and developing organisational climate that supports creativity and proactivity. To produce real performance improvements, efforts to motivate and learn should be focused on what can be acted upon — in particular product innovation.

CONFLICTS OF INTEREST

The authors declare that they have no conflicts of interest.

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