



# *Effect of Corporate Social Responsibility on the Performance of Indonesian MSMEs Model Mediation of Innovation and Moderation of Competitiveness*

Retno Cahyaningati  
Accounting Program  
Institut Teknologi dan Bisnis Widya  
Gama Lumajang  
Lumajang, Indonesia  
[retnocahyaningati95@gmail.com](mailto:retnocahyaningati95@gmail.com)

Grahita Chandrarin  
Doctoral Program in Economics,  
Faculty of Economics and Business  
Universitas Merdeka  
Malang, Indonesia  
[grahitac@unmer.ac.id](mailto:grahitac@unmer.ac.id)

Harmono  
Doctoral Program in Economics,  
Faculty of Economics and Business  
Universitas Merdeka  
Malang, Indonesia  
[harmono@unmer.ac.id](mailto:harmono@unmer.ac.id)

Diyah Sukanti Cahyaningsih  
Doctoral Program in Economics,  
Faculty of Economics and Business  
Universitas Merdeka  
Malang, Indonesia  
[diyahsukanti@unmer.ac.id](mailto:diyahsukanti@unmer.ac.id)

**Abstract—** This study examines the relationship between CSR and MSME performance, using innovation as a mediator and competitiveness as a moderator. It collected primary data from 161 MSMEs across 15 districts in Indonesia and employed Smart PLS 3 for data analysis. The findings highlight several key points. First, CSR has a positive influence on MSME performance. Second, innovation significantly contributes to enhancing MSME performance. Third, innovation plays a mediating role in the impact of CSR on MSME performance. Furthermore, competitiveness acts as a moderator, strengthening the connection between CSR and MSME performance.

The study's contributions are noteworthy. It provides a conceptual framework for understanding CSR practices in Indonesian MSMEs, an area previously underexplored. It also empirically validates the role of innovation as a mediator in the CSR-MSME performance relationship. Additionally, the study delves into the importance of competitiveness in amplifying the effects of CSR on MSME performance. By shedding light on these relationships, the research complements and strengthens previous findings regarding the influence of CSR on MSME performance.

**Keywords—** CSR, Innovation, MSME Performance, Competitiveness.

## I. INTRODUCTION

The performance of Micro, Small and Medium Enterprises (MSMEs) refers to the ability of MSMEs to achieve their business goals which reflects the efficiency, effectiveness and competitiveness of companies in carrying out their business activities. MSME performance can be seen from various aspects. Revenue growth is one of the main indicators of MSME performance. If MSMEs can increase their income over time, this can show good performance in terms of competitiveness and market acceptance. Furthermore, profitability can reflect how efficient MSMEs are in generating profits from the sale of products or services. A good level of profitability shows that

MSMEs can manage costs well and generate adequate profits. Efficient MSMEs tend to have lower production costs and can compete better in the market. Market share measures the extent to which MSMEs can control a certain part of the market. If its market share increases, it indicates that the company is successful in attracting more customers and competing well with other competitors.

Corporate Social Responsibility (CSR) is a business practice in which companies contribute voluntarily to improve social and environmental welfare. The role of CSR in improving the performance of Micro, Small and Medium Enterprises (MSMEs) can have several positive influences. Through CSR, MSMEs can build a better image in the eyes of society and customers. This can help MSMEs attract more customers and maintain existing customer loyalty. With a good reputation, MSMEs can gain wider trust and recognition, which has the potential to increase their sales and market share.

MSMEs that adopt CSR well can differentiate themselves from their competitors. If the company can stand out with strong CSR initiatives, consumers may prefer to buy products or use services from these companies compared to competitors who are less concerned about social and environmental responsibility. Some consumers and customers are increasingly choosing products or services produced by MSMEs that are committed to social and environmental responsibility. MSMEs that are active in CSR can reach new markets with environmentally and socially conscious people.

MSMEs that engage in positive CSR initiatives can attract and retain more qualified employees. Employees tend to feel more satisfied and proud to work for companies that care about social and environmental issues, and this can increase employee productivity and loyalty. Besides that, the government often provides incentives and support for companies that actively participate in CSR. In addition,

companies that comply with social and environmental responsibilities can more easily relate to regulators and the government, which in turn can assist in business growth and reduce regulatory risk.

The shift in focus of Corporate Social Responsibility (CSR) towards Micro, Small and Medium Enterprises (MSMEs) is an increasing trend in Indonesia and also in various other countries such as Spain and Vietnam. MSMEs are usually (although not always), built with initial capital to meet the income of the owner's family. Then the company's goals will develop to help others or around to get a decent income. At this stage, MSMEs are already carrying out CSR unknowingly. Some MSMEs even specifically empower underprivileged communities or women who are economically vulnerable.

The social impact of MSMEs at this level has helped. However, perhaps it is not yet detailed or well structured so the social impact is not visible in the reporting. MSMEs often have strong ties with consumers or the communities where they exist. Because for MSMEs, customers are people they meet every day. It is rare for MSMEs to have a marketing office that is different from the place of production or the office where these MSMEs work. In a simple study, 72% of consumers believe that MSMEs are more likely to have an impact on residents or their communities than large companies. To be able to implement CSR which can then be used as a marketing and branding tool, MSMEs need to carry out structuring and inventory of what activities they have carried out and are included in the CSR category. MSME actors must be directly involved in this process so that they can provide a clear concept in implementing their CSR.

Another key area that needs attention in sustainable development is the role of innovation in enhancing sustainability (Matos, S., Silvestre 2013; Boons, F., Montalvo, C., Quist, J., Wagner 2013). Sustainability-oriented innovation is the integration of social aspects into products, processes and services. Sustainability-oriented innovation describes a direction, which to follow requires deliberate management of economic, social and ecological aspects (Hansen et al, 2009). So they become integrated into the design of new products, processes, and services [4]. MSMEs that perform well tend to be able to innovate and differentiate in their products or services. These innovations can help companies differentiate themselves from competitors and create a competitive advantage. The level of customer satisfaction is an important indicator of MSME performance. Satisfied customers tend to be loyal customers and can provide positive recommendations to others. If MSMEs can provide opportunities for employees to develop and improve their skills, this can reflect good organizational performance in terms of human resource management. (Martinez-Conesa et al, 2017).

Although evidence seems to suggest that CSR and innovation should be considered as important determinants of MSME performance indicators, empirical studies discussing their joint effect on performance are limited. (Mahmoud, MA, Hinson 2012; Gonzalez-Ramos, M., Donate, M., Guadamillas 2014). Another opinion is that CSR cannot directly influence the company's financial performance, but with intangible company mediation, CSR

can improve the company's financial performance. (Surroca, 2010)

Companies that are the most proactive in their CSR activities can also be the best-performing companies. This positive link, however, is moderated by innovation. The influence of CSR on company performance increases through increased innovation performance. Innovation can help to ensure the continuation of a more responsible approach to business, resulting in system-level solutions that are, at the same time, responsible and profitable. Therefore, the focus should be on integrating various activities and tying them to the company's strategy, as this is the only way to generate value. [5].

There are three main contributions to this research. The first is to conceptualize and empirically test CSR carried out by MSMEs in Indonesia, which was previously little done. Second, testing innovation in mediating CSR and MSME performance. Third, exploring competitiveness in increasing or weakening CSR activities in improving MSME performance and to complete and convince the findings in previous studies about how CSR affects MSME performance. This research was conducted in East Java – Indonesia. East Java is one of the provinces in Indonesia that has enormous growth potential. There are several business sectors in East Java which are growing rapidly. Of course, from these sectors it is hoped that the welfare of the community can also increase. The national economy is indeed influenced by various sectors, one of which is the business sector in various provinces such as East Java. Having potential natural and human resources, East Java has a great opportunity to become a developed province. East Java's economy is Indonesia's second-largest economy after Jakarta. Apart from that, another thing that makes East Java's economy very attractive is its geographical location and sea routes. This makes East Java a contributor of 20% of Indonesia's trade volume. East Java's economy is Indonesia's second-largest economy after Jakarta. Apart from that, another thing that makes East Java's economy very attractive is its geographical location and sea routes. This makes East Java a contributor of 20% of Indonesia's trade volume. East Java's economy is Indonesia's second-largest economy after Jakarta. Apart from that, another thing that makes East Java's economy very attractive is its geographical location and sea routes. This makes East Java a contributor of 20% of Indonesia's trade volume.

## II. LITERATURE REVIEW

CSR strategically aims not only for the sake of profitability, but for the company's competitive advantage which in turn will improve the company's performance sustainably [9]. Companies have demonstrated the role of corporate social responsibility more clearly since the 1990s, and on a much broader scale, the concept of CSR includes business ethics, labor practices, reduction of environmental damage from production and other social activities. Studies Mousiolis (2015) has analyzed CSR strategies implemented in multinational companies and SMEs, the results show that SMEs have several organizational characteristics, namely CSR aims to promote the implementation of CSR-related practices. In contrast, multinational corporations have several favorable characteristics for promoting external communication and reporting on CSR, but at the same time

constraining internal corporate policies. Issues such as differences in personnel dedication, and corporate social sensitivity are also important, critical management decisions between SMEs and multinational companies according to how stakeholder engagement influences strategic decision-making.

Hypothesis 1: CSR has a positive effect on company performance

Innovative products and services will be critical to future competitive business success. CSR for MSMEs is not easy, but innovation is even more difficult. As companies become more sophisticated concerning corporate sustainability, MSMEs are gradually developing an awareness of the synergy between innovation and sustainability. Adopting CSR practices in developed countries, MSMEs in Indonesia can also implement CSR practices as a strategy to assist MSMEs in retaining quality employees, and increasing innovative capacity. To address research gaps related to the complex relationship between Intellectual capital and CSR on innovation. Therefore the hypothesis that the researcher proposes is as follows:

Hypothesis 2: CSR has a positive effect on innovation

Innovation is looking for opportunities to create new products, new processes and new services compared to competitors[11]. Technological innovations for products and processes are the result of various factors, including the need for increased corporate performance[12]. The skills and knowledge of business actors are needed to generate new ideas that will drive business growth[13]. Companies need to maintain above-average survival based on a first mover strategy and follow trends quickly. The fast pace of innovation reflects the company's ability to speed up activities and tasks related to innovation, so that the research and development process can be completed quickly from idea generation to actual implementation. The existence of the speed of innovation can meet the changing demands of customers and thus will earn more profits and have a larger market share[15]. Thus the hypothesis proposed is as follows:

Hypothesis 3: Innovation has a positive effect on MSME performance

Innovation activities are inherently related to company performance. The determining factor for innovation is the increase in returns from innovations that have been invested. The literature review does show that there is still a low understanding of how CSR initiatives can improve MSME performance through innovation. McWilliams (2005) suggests that investment in research and development is an important aspect for companies that wish to improve performance through the use of CSR as a differentiation strategy. This is proven in studies by Martinez-Conesath Spanish companies that are proactive in CSR activities become companies with the best performance, this is of course with the encouragement of mediation of innovation. In an increasingly evolving business environment, innovation can help to ensure the sustainability of a responsible and sustainable approach to business. Therefore, companies should focus on integrating various activities and tying them with corporate strategy, because this is the only way to generate value. Therefore the researcher hypothesizes:

Hypothesis 4 : Mediating innovation influence between CSR and company performance

Companies that are the most proactive in CSR activities, then these companies can become companies with the best performance, the influence of CSR on company performance can be increased through increased innovation activity and profitable approach, hence the new focus on integrating activities to generate value[5]. The way to increase the value and sustainability of the company, of course, cannot be separated from the competitiveness built by the company. The existence of good strong competitiveness is expected to encourage CSR performance so that it has extraordinary innovation for business continuity which ultimately improves company performance.

Hypothesis 5 :CSR can affect company performance through the mediation of innovation and moderation of competitiveness

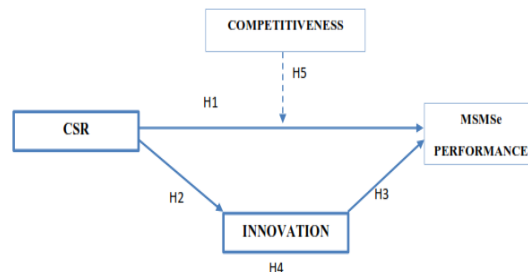


Figure 1. Conceptual framework

### III. METHODS

This study aims to investigate the effect of CSR on MSME performance with Innovation as a mediating variable and moderating competitiveness of MSMEs in Indonesia. The research method used is quantitative method using questionnaire data. Furthermore, questionnaires were distributed to business actors in 15 districts in Indonesia. The data that is shared is a population. For samples using random sampling taken from the questionnaire that returned, namely as many as 161 business actors. The data used is primary data using direct information from business actors.

The research instrument was developed by defining each operational variable by making indicators, then it was reduced to a statement. Each of these variables was measured using a Likert interval scale using a score of 1-5, namely a) Strongly Agree (SS) score of 5, b) Agree (S) score of 4, c) Less Agree (KS) score 3, d) Disagree (TS) score 2, e) Strongly Disagree (STS) score 1. Validity and reliability testing was carried out using a pilot test[17].

Data analysis in this study used the Smart PLS 3 test tool. The data analysis method in this study was carried out using a structural equation model (SEM). Structural equation model or SEM is a model that explains the relationship between latent variables so this SEM model is often referred to as analysis of latent variables or linear structural relationships.[18].

### IV. RESULT AND DISCUSSION

This study uses exploratory analysis to identify the latent constructs represented in the 161 original-size items.

Before conducting SEM, the first step is to test the outer model. The relationship between indicators and latent variables looks at the loading factor. If the loading factor is more than 0.6 it can be said to be valid. Furthermore, Validity and Reliability Tests are carried out aiming to find out the existence of abnormal data. So that it can be ensured that the data used is reliable and valid data.

TABLE I. CONSTRUCT RELIABILITY AND VALIDITY

	Cronbach's Alpha	rho_A	Composite reliability	Average Variances Extracted (AVE)
CSR	0.883	0.887	0.906	0.520
Competitiveness	0.835	0.838	0.876	0.503
Innovations	0.826	0.836	0.896	0.742
MSME performance	0.870	0.873	0.900	0.562
Moderating Effect 1	1,000	1,000	1,000	1,000

Source: Data processed by Smart PLS 3 (2023)

In the reliability test there is a minimum value that is expected to be owned, where Cronbach's Alpha is expected to be more than 0.6, Composite Reliability is expected to be more than 0.8 and AVE is expected to be more than 0.5. Table 1 above shows that all variables produce test values that exceed the predetermined minimum limit, meaning that each variable meets the requirements and the data can be said to be reliable and valid.

The next test is to do the R-Square Test. This test was carried out to test the dependent variable and the resulting value is used to see how much the ability of the dependent variable can be explained by independent data. R-Square has a value between 0-1 with the provision that the closer to 1 means the better[19]. In other words, the greater the R-Square value, the closer the relationship between the two variables is.

TABLE II. R-SQUARE

	R Square	R Square Adjusted
Innovations	0.597	0.594
MSME performance	0.686	0.678

Source: Data processed by Smart PLS (2023)

Based on table 2 above, shows an Innovation value of 0.597, meaning that Innovation is influenced by CSR by 60% and 40% is influenced by other variables not examined in this study. Likewise, the MSME Performance variable has a value of 0.686, meaning that MSME performance is influenced by CSR and Innovation by 68.6% and the rest is influenced by other variables not examined.

In the next step, before testing the indirect effect, the researchers first direct influence between variables with the aim that it can be known how much the value of direct and indirect influence between variables. The direct effect between variables can be seen in the table below:

TABLE III. PATH COEFFICIENT

	Original Sample (O)	T Statistics ( O/STDEV )	P Values	Information
CSR -> MSME performance	0.376	3,909	0.000	H1 Accepted
CSR -> Innovation	0.772	14,611	0.000	H2 Accepted
Innovation -> MSME performance	0.232	2,485	0.013	H3 Accepted

Source: Data processed by Smart PLS 3 (2023)

Based on the test results as outlined in Table 3, show that the influence of CSR on MSME performance has a t-statistical significance level of 3.909 greater than 1.96, and a P-Value of 0.000 less than 0.05, this indicates that the relationship between CSR and MSME performance has a significant effect. The original sample of 0.376 indicates a positive effect. So, if CSR has increased, the MSME performance owned by the company will also increase. This shows that H1 is accepted.

The influence of CSR on Innovation has a t-statistical significance level of 14,611 greater than 1.96, and a P-Value of 0,000<0.05 which has a significant influence between CSR and Innovation, the original sample is 0.772, this shows that if CSR has increased, then Innovation will also increase, meaning that H2 is accepted.

As for the effect of innovation on MSME performance, it has a statistic t value of 2.485 which is greater than 1.96. and the p-value of 0.013 is less than 0.05, which means that the relationship between innovation and MSME performance has a significant effect in a positive direction, as evidenced by the original sample value of 0.232. That is, if Innovation increases, MSME performance also increases, then the H3 hypothesis submission is accepted.

The mediation test was conducted to determine the indirect effect or mediation effect of Innovation in influencing the relationship between intellectual capital and company performance. Then the observations were made in the Total Indirect effect table as follows:

TABLE IV. TOTAL INDIRECT EFFECTS

	Original Sample (O)	T Statistics ( O/STDEV )	P Values	Information
CSR -> Innovation -> MSME performance	0.179	2,389	0.017	H4 Accepted

Source: Data processed by Smart PLS 3 (2023)

Based on the results of the PLS processing shown in Table 4, it is known that there is an indirect effect of CSR on Innovation and MSME performance with a t-statistic significance value of 2,389 greater than 1.96 and p-values of 0.017 less than 0.05 which is indicates a significant influence. The original sample value is 0.179 indicating a

positive direction. So from that it can be concluded that Innovation has a mediating role between CSR and MSME performance, if CSR increases, innovation will also increase, and an increase in innovation which in the end can also improve MSME performance the better, so that H4 is accepted.

Finally, a moderation test is carried out to find out whether Competitiveness can affect the relationship between CSR and MSME performance, so observations are made in the Path Coefficients table as follows:

TABLE V. PATH COEFFICIENTS

	Original Sample (O)	T Statistics ((O/STDEV))	P Values	Information
<b>Moderating Effect 1 -&gt; MSME performance</b>	0.103	2,999	<b>0.003</b>	H5 Accepted

Source: Data processed by Smart PLS (2023)

Based on Table 5, the test results show that the t-statistic value of 2,999 is greater than 1.96, and the p-value of 0.003 is less than 0.05, it can be concluded that there is a moderating effect of competitiveness on CSR and MSME performance, meaning that the effect of CSR is getting stronger on MSME performance if the company's competitiveness is high. So it can be said that H5 is accepted. More details on hypothesis testing can be seen in the following figure:

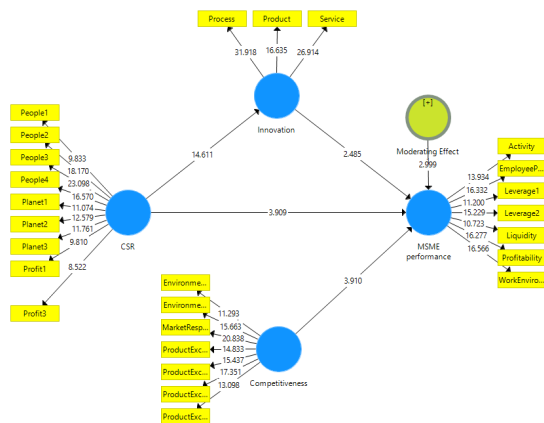


Figure 1. Results Path Coefficients

CSR has become the focus of attention in business practice because more and more companies are realizing the importance of social responsibility and its impact on corporate image, as well as MSMEs, have begun to understand business sustainability so they care about social responsibility, even though the programs being implemented are not as optimal as in large companies, but they have tried to carry out activities that are beneficial to employees and the community. The test results show that the P-value value of 0.000 is less than 0.05 which means that CSR has a significant effect on the performance of MSMEs, this research is in line with research(Tiep et al. 2021;Martinez-

Conesa et al. 2017)but does not support research[8]which shows that there is no direct relationship between corporate responsibility and financial performance. In this study, MSMEs that participate in positive CSR activities such as supporting local communities, the environment, or charity programs can build a good reputation in the eyes of customers. This can increase customer confidence in MSME products or services and encourage sales growth. In a competitive business environment, MSMEs can differentiate themselves from competitors by promoting social and environmental values through CSR. This can attract customers who are more concerned about these issues.

On the other hand, innovation is considered the key to long-term growth and business continuity. CSR data is measured based on social and environmental programs implemented by MSMEs, while the level of innovation is measured using indicators such as the number of new products launched, and improved business processes and business services provided. The results of the study show that there is a positive influence between the implementation of CSR and the level of innovation carried out. MSMEs that are actively involved in CSR tend to have a higher level of innovation, this is evidenced by the P-Value of 0.000. Companies that invest in social responsibility often have better access to additional resources, both in the form of funds and knowledge.

CSR programs often involve employees in social and environmental activities. This can increase employees' sense of belonging and involvement in the company, which in turn can encourage active participation in innovation efforts. MSMEs' efforts to be socially and environmentally responsible not only have a positive impact on society, but can also encourage long-term business growth through sustainable innovation, this research is in line with research(Martinez-Conesa et al. 2017;Sharma & Vredenburg, 1998;Bocquet, Le Bas, Mothe, & Poussing, 2013). CSR for SMEs is not easy, but innovation is even more difficult. As companies become more sophisticated concerning corporate sustainability, they gradually develop an awareness of the synergy between innovation and sustainability[3]. The move towards corporate sustainability requires constant innovation, this should be understood as a core business process, as it is critical to the long term success of the company[22].

ACKNOWLEDGMENT

The Writing Team would like to thank to the Widya Gama Lumajang Institute of Technology and Business for allowing the writing team to take part in conference activities. We also thank all parties who were involved in writing this article.

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