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The SME Growth Engine: A System Dynamics Model of Learning, Innovation, and Performance

Luis Salinas¹, Muhammad Millah Irsyaddin²

¹Department of Computers Techniques Engineering, Department of Industrial Engineering, New Jersey Institute of Technology 323 Dr. Martin Luther King Jr Blvd, Newark, New Jersey, 07102, USA, usclw2013@gmail.com

²Universitas Winaya Mukti, Indonesia, ibnumillah@unwim.ac.id

Corresponding Author: usclw2013@gmail.com¹

Abstract: Small and medium enterprises (SMEs) need continuous learning and innovation to grow in changing markets. However, SME growth is rarely the result of one factor. Learning creates knowledge, knowledge supports innovation, innovation improves market responsiveness, and better performance can provide resources for further learning and innovation. This study develops a System Dynamics model called the SME Growth Engine to explain these relationships as a feedback system. A systematic literature review is used to identify the main variables and causal relationships, which are then translated into a Vensim-style causal loop structure. The model contains reinforcing loops in which learning, innovation, market responsiveness, and performance support one another, together with a balancing mechanism associated with market dynamism. The model provides a foundation for future stock-flow simulation and scenario testing using real SME data.

Keywords: SME growth, organizational learning, innovation capability, system dynamics, business performance, market responsiveness

INTRODUCTION

Small and medium enterprises contribute to employment, local economic activity, innovation, and income generation. Yet SME growth is not always stable. A firm can grow when it learns quickly and responds to customers, but growth can slow when knowledge is not converted into innovation or when market changes become faster than the firm's ability to respond (Anjaningrum et al., 2024; Zand et al., 2024).

Learning is one of the foundations of this process. An SME learns from customers, employees, suppliers, competitors, and its own experience. The knowledge generated through learning can improve products, processes, marketing, and customer service. Evidence from creative-economy SMEs in East Java shows that organizational learning is connected with SME performance and can support innovation (Anjaningrum et al., 2024).

Innovation provides the next link. Learning alone does not necessarily produce growth; knowledge must be converted into changes that customers value. Research on Indonesian SMEs has examined entrepreneurial orientation, organizational learning, innovation capability, and performance, highlighting the role of learning and innovation in SME development (Yorinda & Kusumastuti, 2024).

Market responsiveness connects innovation with the external environment. SMEs face changing customer preferences, competitors, technology, and market conditions. Research on SMEs in an emerging economy shows that organizational learning capability, innovation, market dynamism, and market responsiveness are interconnected with SME performance (Zand et al., 2024).

These relationships are often tested with cross-sectional statistical methods. However, SME growth develops over time. Successful innovation can improve performance, performance can create resources for new investment, and new investment can increase learning. System Dynamics is useful because it can represent feedback, accumulation, and delays (Viswanathan & Telukdarie, 2021; Arranz et al., 2023).

This study develops the SME Growth Engine, a System Dynamics model focused on organizational learning, knowledge accumulation, innovation capability, market responsiveness, resources for growth, and SME performance. The research asks: how do learning and innovation interact to support SME growth; how does market responsiveness affect the growth process; and how can these relationships be represented dynamically?

Literature Review

Organizational Learning and Knowledge

Organizational learning is the process through which an organization acquires, shares, interprets, and uses knowledge. In SMEs, learning can come from daily work, customer feedback, problem solving, employee experience, and external partners. The result is not only information but also better routines and stronger capacity to respond to change (Anjaningrum et al., 2024).

Evidence from Indonesia shows that organizational learning can contribute to SME performance and support innovation. Learning becomes strategically useful when it is translated into action and new value (Anjaningrum et al., 2024; Ambarwati et al., 2022).

Innovation Capability

Innovation capability is the ability to turn knowledge and ideas into new or improved products, services, processes, or business practices. For SMEs, innovation does not always mean a major technological breakthrough. It can be a new product, faster process, better customer experience, or new distribution method (Yorinda & Kusumastuti, 2024).

Innovation is positioned in the growth engine as the bridge between learning and market outcomes. Research in East Java found innovation positively associated with SME performance, supporting its role in the proposed model (Anjaningrum et al., 2024).

Market Responsiveness and Market Dynamism

Market responsiveness refers to how quickly and effectively a firm responds to customer and market changes. Market dynamism describes how quickly the external environment changes. A more dynamic market creates stronger pressure for responsiveness (Zand et al., 2024).

A useful innovation must reach the market at the right time. Therefore, responsiveness is an important bridge between innovation capability and performance, especially when customer preferences and competitive conditions change rapidly (Zand et al., 2024).

SME Performance and Growth

SME performance can include financial results, productivity, market development, customer outcomes, innovation performance, and business continuity. In a System Dynamics view, performance is not only an outcome; it can also change the resources available for future learning and innovation (Viswanathan & Telukdarie, 2021).

System Dynamics has already been applied to SME performance and development. Research on SME digitalization used stock-flow modelling to examine skills development and digitalization, while research on Indonesian furniture SMEs used System Dynamics to represent production, demand, revenue, and raw-material subsystems (Viswanathan & Telukdarie, 2021; Viswanathan & Telukdarie, 2023).

METHOD

This study uses a qualitative System Dynamics approach supported by a systematic literature review. The review identifies variables and relationships related to organizational learning, innovation capability, market responsiveness, market dynamism, SME performance, and growth resources. The relationships are then translated into a causal loop diagram using Vensim-style notation (Viswanathan & Telukdarie, 2021; Arranz et al., 2023).

The modelling process follows problem definition, variable identification, causal-loop construction, and stock-flow formulation. The present paper develops the causal structure; parameter values should later be estimated from longitudinal SME data or validated expert estimates rather than invented (Arranz et al., 2023).

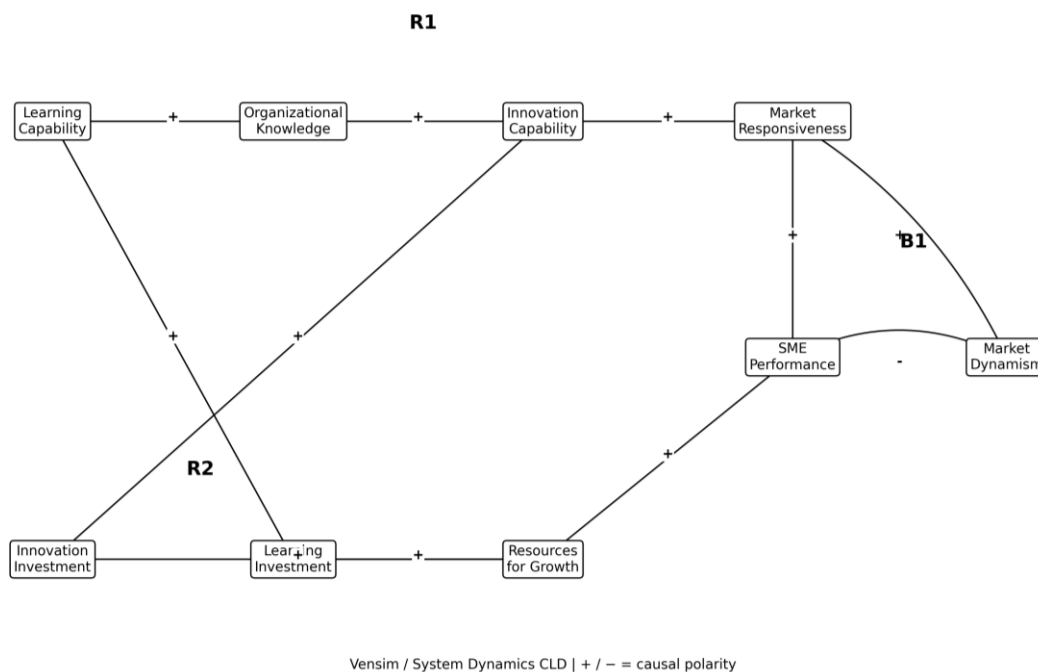


Figure 1. The SME Growth Engine: Causal Loop Diagram using Vensim/System Dynamics notation.

Source: Author's synthesis based on Viswanathan and Telukdarie (2021), Arranz et al. (2023), Anjaningrum et al. (2024), and Zand et al. (2024).

Reinforcing Growth Loop

R1 starts with learning capability. Better learning increases organizational knowledge, which strengthens innovation capability. Innovation improves market responsiveness, which can improve SME performance. Better performance can increase resources for growth and allow further investment in learning and innovation. This creates a reinforcing cycle that can accelerate growth when conditions are supportive (Anjaningrum et al., 2024; Zand et al., 2024).

R2 emphasizes reinvestment in learning and innovation. When performance improves, management has more room to allocate resources to capability development. This can strengthen the knowledge base and the next cycle of innovation (Viswanathan & Telukdarie, 2021; Arranz et al., 2023).

Balancing Mechanism

B1 represents market pressure. As market dynamism increases, SMEs need to respond faster. If responsiveness does not grow at the same rate, performance may be constrained. This prevents the growth engine from being interpreted as unlimited growth (Zand et al., 2024).

Growth can also create complexity. More customers, products, employees, and transactions require stronger coordination and learning. If capability does not grow with the business, the growth process can slow down (Arranz et al., 2023).

Main Variables

Variable	Role	Meaning	Supporting references
Learning Capability	Stock	Accumulated ability to learn	Anjaningrum et al. (2024); Zand et al. (2024)
Organizational Knowledge	Stock	Knowledge retained for decisions	Anjaningrum et al. (2024)
Innovation Capability	Auxiliary	Ability to convert knowledge into value	Yorinda & Kusumastuti (2024)
Market Responsiveness	Auxiliary	Ability to respond to market change	Zand et al. (2024)
SME Performance	Outcome	Business results	Anjaningrum et al. (2024); Viswanathan & Telukdarie (2023)
Resources for Growth	Auxiliary	Resources for further investment	Viswanathan & Telukdarie (2021); Arranz et al. (2023)
Market Dynamism	External factor	Speed of market change	Zand et al. (2024)
Learning Investment	Flow	Resources for learning	Viswanathan & Telukdarie (2021)
Innovation Investment	Flow	Resources for innovation	Arranz et al. (2023)

Source: Author's synthesis from the literature cited in the table.

RESULTS AND DISCUSSION

Model Formulation

The stock-flow model can represent learning capability as an accumulation: $\text{Learning Capability}(t) = \text{Learning Capability}(t-dt) + (\text{Learning Development} - \text{Learning Loss}) \times dt$. Organizational knowledge can increase through learning and decline when knowledge becomes obsolete or is not retained. These equations define the model structure and are not empirical estimates (Viswanathan & Telukdarie, 2021).

Innovation capability can be formulated as a function of organizational knowledge, learning capability, and innovation investment. Market responsiveness can depend on innovation capability and market understanding. SME performance can then be influenced by responsiveness and innovation, while performance creates resources that feed back into learning and innovation (Anjaningrum et al., 2024; Zand et al., 2024).

The next stage should assign parameter values, initial stocks, time units, and delays in Vensim. Validation should include structure verification, dimensional consistency, extreme-

condition tests, sensitivity analysis, and comparison with historical SME data where available (Arranz et al., 2023).

Scenario Design

Three scenarios are proposed for future simulation: baseline with low learning and innovation investment; capability building with higher learning investment; and growth acceleration with coordinated high learning and innovation investment. The purpose is to compare system behavior, not to declare one scenario universally superior.

Scenario	Learning investment	Innovation investment	Question
Baseline	Low	Low	How does growth behave with limited capability investment?
Capability building	High	Medium	Does stronger learning strengthen the innovation cycle?
Growth acceleration	High	High	What happens when learning and innovation are developed together?

Source: Author's scenario design based on the feedback logic in Viswanathan and Telukdarie (2021), Arranz et al. (2023), and Zand et al. (2024).

Discussion

The SME Growth Engine brings together relationships that are often studied separately. Learning builds knowledge, knowledge supports innovation, innovation improves responsiveness, and responsiveness can improve performance. Performance then changes the resources available for the next learning and innovation cycle (Anjaningrum et al., 2024).

The model explains why learning should not be treated only as training. Learning becomes strategically valuable when it changes organizational knowledge and improves the ability to innovate. Evidence from Indonesian SMEs similarly links learning and innovation with performance (Yorinda & Kusumastuti, 2024; Ambarwati et al., 2022). Market responsiveness gives the growth engine an external connection. SMEs do not grow in isolation. Their learning and innovation must create value for customers, and the value of innovation depends partly on how quickly the firm responds to market change (Zand et al., 2024).

System Dynamics adds a time dimension. A learning program may not immediately produce innovation, and innovation may take time to affect performance. Likewise, improved performance may only later create enough resources for another investment cycle. These delays can produce different growth patterns even when SMEs make similar investments (Viswanathan & Telukdarie, 2021; Arranz et al., 2023).

Theoretical and Managerial Implications

The theoretical contribution is to conceptualize SME growth as a feedback system rather than a one-way chain of determinants. The model connects organizational learning, innovation capability, market responsiveness, performance, and reinvestment in one dynamic structure (Anjaningrum et al., 2024; Zand et al., 2024).

For managers, the practical lesson is to build a simple learning cycle: collect information, discuss what was learned, test an improvement, measure the result, and share the lesson. Managers should also protect resources for innovation and monitor market responsiveness alongside current performance (Anjaningrum et al., 2024; Zand et al., 2024).

CONCLUSION AND SUGGESTIONS

Conclusion

The SME Growth Engine explains growth as a continuing interaction among learning, knowledge, innovation, market responsiveness, and performance. Learning creates knowledge, knowledge supports innovation, innovation strengthens responsiveness, and responsiveness can improve performance. Performance can then create resources for another cycle of learning and innovation.

The model contains reinforcing loops that can accelerate growth when learning and innovation support one another, while market dynamism can create balancing pressure when the organization's response capacity does not keep pace. The proposed Vensim/System Dynamics structure provides a foundation for future stock-flow simulation, parameter estimation, validation, and scenario testing.

Limitations

This paper presents a conceptual System Dynamics model and does not claim that its parameters have already been empirically calibrated. It should therefore be treated as a research framework rather than a forecasting instrument. Future research should collect longitudinal data on learning investment, knowledge accumulation, innovation activity, market responsiveness, revenue, productivity, and reinvestment. These data can be used to calibrate and validate the Vensim model (Arranz et al., 2023; Viswanathan & Telukdarie, 2021).

Recommendation

Future research should validate the proposed SME Growth Engine using longitudinal SME data, parameter calibration, sensitivity analysis, and scenario simulation to strengthen the model's empirical applicability.

Author Contribution

All authors made significant contributions to this study, including research conceptualization, development of the theoretical framework, literature review, System Dynamics model development, analysis and interpretation of results, manuscript preparation, scholarly revision, and final approval of the manuscript for publication. All authors confirm that they have read and approved the final version of the article.

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