

## Abstract

Small and Medium Enterprises (SMEs) play an important role in the Malaysian economy, contributing 31.20 percent to the Malaysia GDP in 2009. However, studies have shown that many SMEs have failed to achieve their objectives due to the lack of human resources and organizational capabilities. Studies have shown that human resource (HR) practices are one of the important factors contributing towards organizational performance. Another vital factor is the company's policy on innovation. This study proposes to investigate the effect of the company's policy on innovation on the relationship between the HR practices and organizational performance.

This study covers three constructs: HR practices, company's policy on innovation and organizational performance. The HR practices involve incentive compensation, training, selective hiring, performance evaluation, organization of work, sharing information, job security and social activities as well as sports through the mediation variable (Hyman, 1955; MacCorquodale & Meehl, 1948) how a company's policy on innovation could lead to the organizational performance. It also examines the relationship between the eight independent variables, the mediating variable (company's policy on innovation) and the dependent variable (organizational performance).

For this study, 475 questionnaires were distributed to respondents who were owners and employees, both of middle and top management level in cross sectional SMEs in Klang Valley. The respond rate was 45%.

The data collected was analysed using the Statistical Package for Social Sciences (SPSS) Windows Version 18. The results revealed that there is a significant positive relationship between HR practices and organizational performance in SMEs in the Klang Valley. Further, the company's policy on innovation mediates the relationship between organization of work and training.

**Keywords:** Human resources; human resource practices; company's policy on innovation; organizational performance; Small and Medium Enterprises