

# ENTREPRENEURIAL INNOVATIVENESS AND ITS IMPACT ON SMES' PERFORMANCES

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## ABSTRACT

*Grounded in the innovation literature and the composition-based view (CBV), this paper develops a framework for assessing the impact of entrepreneurial innovativeness on SMEs' performances. Specifically, this paper investigates the impact of entrepreneurial innovativeness on the four types of firm performance. We employed structural equation modeling partial least square (SEM-PLS) to test our proposed theoretical framework on a dataset of 450 SMEs in the wholesale and retail industry in Malaysia. Our findings revealed that there was a significant positive impact of entrepreneurial innovativeness on three types of business performances namely perceived non-financial, perceived business growth, and perceived performance relative to competitors. However, based on our findings, increased financial performance was not derived from entrepreneurial innovativeness. This study contributes to the existing literature on innovation by assessing the impact of the most influential innovative practices on the four aspects of SMEs' performances in the context of wholesalers and retailers.*

**Keywords:** SMEs' Performances, Composition-Based View (CBV), Entrepreneurial Innovativeness, Innovation.

## INTRODUCTION

A vast literature is evident on the significant positive relationship between innovation and a firm's success (Naranjo-Valencia et al., 2016). Studies also find that innovation strategies increase the scope of firm success in today's competitive world (Taghizadeh Jayaraman, Ismail & Rahman, 2016). Moreover, recently it was concluded that a firm innovativeness leads to the superior firm performance in turbulent business environments (Zawawi et al., 2016). Similarly, other studies have also demonstrated the positive impact of innovation on firm performance (Bartoloni & Baussola, 2018; Ribau, Moreira & Raposo, 2017; Gërguri Rashiti et al., 2017; Tajuddin, Ibrahım & Ismail, 2015). Evidently innovation is believed to be one of the key drivers for the long-term success of a firm in the competitive markets (Naranjo-Valencia, Jiménez-Jiménez & Sanz-Valle et al., 2016). Relatedly, by realizing the importance of innovation for the success of businesses, this study attempts to investigate the influence of innovation on the four types of firm's performances among Malaysian SMEs. Therefore, this study seeks to answer the question "*what is the impact of entrepreneurial innovativeness on a firm's performances namely, perceived financial performance, perceived non-financial performance, perceived business*

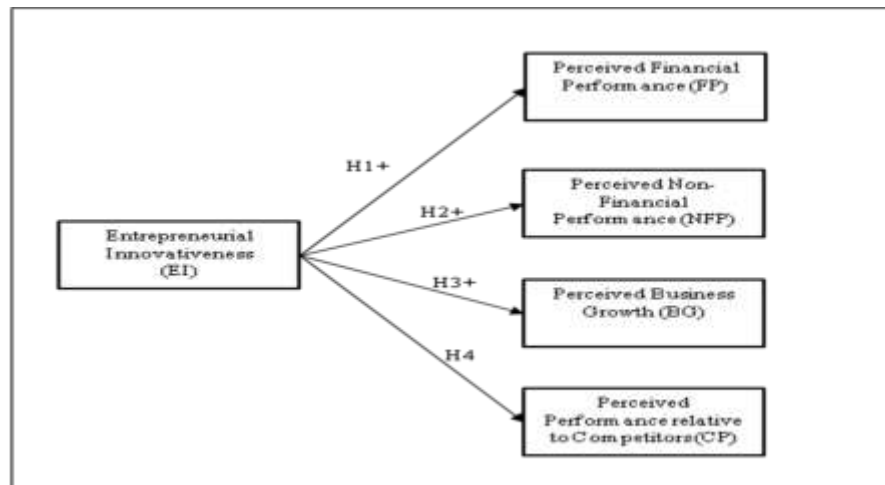
*growth and perceived performance relative to its competitors”?* The next section of this paper deals with the review of the relevant literature.

## LITERATURE REVIEW

### Underlying Theory and Hypothesis Development

This study uses the CBV to describe the concept of innovation for wholesalers and retailers. The CBV explains that firm can be developed, compete and achieve growth without the assistance of core technology, resource advantages or market power (Luo & Child, 2015). The CBV focuses on how ordinary firms with common resources may attain superior business growth by effectively and creatively using the available open resources and distinct integrating capabilities that lead to enhancing the speed and a price-value ratio for large numbers of mass-market consumers. Therefore, the main idea of CBV is that firms can successfully compete and develop without the “*benefit of resource advantages, proprietary technology or market power*” (Luo & Child, 2015) in today’s marketplace. Consequently, CBV can be considered as a theory of survivability.

Wholesale and retail SMEs operate in turbulent business environments where they face the critical issue of survivability because of intense competition within the industry. Therefore, it is very essential for managers and entrepreneurs to know how to survive in such a dynamic business environment. We feel that CBV can be very helpful to assist SMEs in their survival through existing resources. For instance, innovativeness has been considered as the key resource of SMEs, however, innovative practices in wholesale and retailing context, such as changes in packaging or appearance of existing products, improvement in quality for the existing products, introduction of the new products and services and engaging new suppliers etc., are neither rare nor unique practices or resources and are easy to copy or are even substitutable by the rivals. Therefore, these types of common innovative practices that exist in almost all SMEs are easily accessible within the business environment. Thus, based on CBV, innovation is considered as an ordinary resource and as an independent variable of our research framework. Additionally, four types of firm performances, including perceived financial performance, perceived non-financial performance, perceived business growth, and perceived performance relative to competitors have been used as the dependent variables in this study’s conceptual model. The conceptual model is illustrated in Figure 1.



**FIGURE 1**  
**CONCEPTUAL MODEL**

### **Innovativeness and Perceived Financial Performance**

It has been widely acknowledged that innovation is a key source for achieving a competitive edge for all firms (Bilton & Cummings, 2009; Weerawardena, 2003; Bharadwaj, Varadarajan & Fahy, 1993). A number of studies have empirically found the positive impact of innovation on financial performance of firms under various contexts (Wang, 2014; Bigliardi, 2013; Laforet, 2011). For instance, it was found that financial performance of firms increased with the increase in innovation level in the context of the food machinery industry (Bigliardi, 2013). Innovations result in positive outcomes such as the good image and reputation of SMEs, as well as an increase in cost benefits and operational efficiency leading towards superior financial performance (Laforet, 2011). Likewise, a longitudinal survey of 607 high-technology firms also indicated innovation as the key driver of firm performance (Wang, 2014). Moreover, innovativeness aids firms in developing new capabilities that allow them to attain superior profitability (Falahat, Knight & Alon, 2018; Falahat & Migin, 2017; Hogan & Coote, 2014; Calantone, Cavusgil & Zhao, 2002; Sadikoglu & Zehir, 2010). Although the impact of innovation on firm performances has been studied in various contexts, studies on innovation in the retail context are lacking (Djellal Gallouj & Miles, 2013; Drejer, 2004). Nonetheless, firms that are involved in various innovative behaviours can realize positive performance outcomes (Hogan & Coote, 2014). Consistent with the above arguments, the following hypothesis on the direct and positive influence of innovativeness on perceived financial performance is articulated:

*H1: Innovativeness has a positive impact on perceived financial performance.*

### **Innovativeness and Perceived Non-Financial Performance**

Firms practicing innovativeness are able to respond to the needs of their customers (Sadikoglu & Zehir, 2010; Calantone, Cavusgil & Zhao, 2002). Thus, only satisfied customers will again purchase the products and services from the firm whose innovative practices have satisfied their expectations and needs. Therefore, it can be said that innovation leads to customer satisfaction and retention. Moreover, when the organisation is successful in satisfying and retaining their customers for the long term due to their innovative practices, this results in superior financial performance. This superior performance could then lead to managers and owners achieving increased work-life balance. However, the link has still not been fully studied in the retail sector. However, there is evidence in existing studies that innovation has a positive influence on customer satisfaction and retention. Thus, based on the above discussion, the associated hypothesis is as follows:

*H2: Innovativeness has a positive impact on perceived non-financial performance.*

### **Innovativeness and Perceived Business Growth**

There is limited evidence available regarding the impact of innovation on performance in the context of the service sector. Research suggests there is positive impact of innovation on growth (Mansury & Love, 2008). Several studies have found positive impact of innovation on business growth under various contexts. For instance, the assessment of a firm's innovation capability determines that the innovation capability of a firm is related to the long-term growth of businesses in the context of China (Yang, 2012). Similarly, by studying a sample of 113 Andalusian firms in the construction industry, Martínez-Román, Tamayo & Gamero (2017) found a positive impact of innovation on firm growth. The foregoing argument leads to the development of the following hypothesis:

*H3: Innovativeness has a positive impact on perceived growth performance.*

### **Innovativeness and Perceived Performance Relative to Competitors**

Currently, firms are operating in environments that are characterized by changing customer demands, ever increasing global competition, uncertainty, and rapid technical changes (Droge et al., 2008). Therefore, it is critical for firms to achieve success and competitive advantage in through innovation (Prajogo & Ahmed 2006). This is because innovative firms are more flexible and can quickly respond to change (Drucker, 1998). Dynamism or dynamic environments demonstrate the uncertainty in customer demands and the unpredictable actions of competitors. Therefore, firms in turbulent business environments usually strive to innovate their products by various means in order to meet the unexpected demands of customers and to compete successfully within their respective industry (Prajogo, 2016; Lumpkin & Dess, 2001). Many studies have highlighted that dynamic and competitive business environments create a driving force on the innovative practices of firms (Baron & Tang, 2011; Wang & Chen, 2010; Freel, 2005). This is due to the ever-changing tastes and preferences of customers and the actions

of competitors which require firms to use innovative practices to respond to such threats (Prajogo, 2016; Tripsas, 2008; Tidd, 2001). Thus, the innovative practices used by the firms may actually impact firm performance relative to their competitors in uncertain business environments. In light of the above arguments, the following hypothesis was developed:

*H4: Innovativeness has a positive impact on perceived performance relative to competitors.*

## METHODOLOGY

Primary data were collected using quota sampling via a survey in 13 states of Peninsular Malaysia including Malacca, Johor, Kuala Lumpur, Negeri Sembilan, Putrajaya, Selangor, Perlis, Kedah, Pahang, Terengganu, Perak, Penang, and Kelantan. We have determined the sample size using G\*Power 3. We received 450 usable questionnaires. The seven items used to measure entrepreneurial innovativeness were adapted from the local studies of Idris (2010) and Juri (2009). The present study adapts a scale from the study of Ahmad et al. (2011) which constitutes four types of perceived firm performances. The four performances measures namely (a) perceived satisfaction with financial performance, (b) perceived satisfaction with non-financial performance, (c) perceived satisfaction with business growth (d) perceived performance relative to competitors.

## DATA ANALYSIS

We used structural equation modeling partial least square (SEM-PLS) using Smart PLS 3.0 software to analyse the data. Following the two-stage approach recommended by Hair et al. (2017), we examined the measurement model (validity and reliability of the measures) and structural model (hypothesis testing).

### Measurement Model

Hypothesis	Std Beta	Std Error	p_values	Result
H1: Entrepreneurial Innovativeness -> Financial Performance	0.104	0.072	0.152	Not Supported
H2: Entrepreneurial Innovativeness -> Non- Financial Performance	0.188	0.044	***0.000	Supported
H3: Entrepreneurial Innovativeness -> Growth Performance	0.178	0.057	***0.002	Supported
H4: Entrepreneurial Innovativeness -> Performance Relative to Competitors	0.107	0.063	*0.089	Supported

Note: \* p<0.1, \*\*p<0.05, \*\*\*p<0.01

For reliability, we examined each item's loadings and composite reliability. For validity, we examined average variance extracted (AVE) for convergent validity (AVE>0.5) and the

heterotrait-monotrait ratio of correlations (HTMT) for discriminant validity ( $HTMT < 0.90$ ) based on the recommended value by Henseler, Ringle & Sarstedt (2015) accordingly. The satisfactory result for the measurement model was found due to its adequate reliability, convergent validity and discriminant validity. The following section presents the structural model analysis and hypotheses testing (Table 1).

### Assessment of the Structural Model

Table 1 illustrates the result of hypotheses testing. Direct positive and significant impact of innovativeness was found on perceived business growth, perceived performance relative to competitors, and on perceived non-financial performance. On the other hand, we found that innovativeness has no impact on perceived financial performance.

The coefficients of determination ( $R^2$ ) was 0.011 for perceived financial performance (FP), 0.035 for perceived non-financial performance (NFP), 0.032 for perceived growth performance (GP) and 0.012 for perceived performance relative to competitors. Thus, based on Cohen's (1988) guidelines for assessing the value of  $R^2$ , the  $R^2$  values are considered weak as they are less than 0.13. As for the  $Q^2$  values of the dependent variables, including perceived financial performance, perceived non-financial performance, perceived growth performance, and perceived performance relative to competitors is above 0. Thus, our proposed model has an adequate predictive relevance.

### CONCLUSION

This study aimed to assess the impact of innovativeness on four measures of business performances including perceived financial performance, perceived non-financial performance, perceived growth performance, and perceived performance relative to competitors. The results revealed the positive and significant impact of innovativeness on all three perceived performance measures, except for perceived financial performance. This indicates that the existing innovative practices in wholesalers and retailers do not have a perceptible effect on financial performance. Hereinafter, with innovative practices, SMEs in the wholesale and retail industry are not able to generate superior financial performance. This may be due to little and ineffective innovative practices in Malaysian SMEs businesses and the huge dynamism faced by Malaysian SMEs. Moreover, the weak and non-significant impact of innovativeness on perceived financial performance is consistent with many other studies that also found negative or weak influence of innovativeness on a firm's financial performances (Gunday, Ulusoy, Kilic & Alpan, 2011; Zhang, 2011). Consequently, the findings of reveal that innovativeness as an ordinary resource, is not a strong predictor of perceived financial performance. However, the results regarding the positive influence of innovativeness on the remaining three perceived measures of firm performance, including perceived non-financial performance, perceived business growth, and perceived performance relative to competitors, are consistent with many other studies that already provided empirical evidence regarding the positive influence of entrepreneurial

innovativeness on SMEs performances (Tajuddin et al., 2015; De Clercq et al., 2011; Chen & Huang, 2009; Droge et al., 2008; Prajogo, 2006).

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