

# THE ROLES OF ABSORPTIVE CAPABILITY AND INNOVATIVE CAPABILITY IN IMPROVING EXPORT PERFORMANCE: A PRELIMINARY STUDY

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## ABSTRACT

*This paper aims to identify the roles of innovative capability, especially on absorptive capability in improving Malaysian export performance. Specifically, this paper provides a definition of absorptive capability, innovative capability, and export performance obtained from previous studies. This is a content analysis involving relevant articles that were identified using both electronic and manual bibliographic search methods. Overall, there is empirical evidence on the roles of innovative capability that serve as a mediator in the relationship between absorptive capability and export performance. This study provides one of the few attempts in assessing existing literatures and examining the roles of innovative capability in the relationship between absorptive capability and export performance. Thus, it provides a reference point that can stimulate and guide future research on the roles of innovative capability as dynamic capabilities.*

**Keywords:** Absorptive Capability, Innovative Capability, Export Performance.

## INTRODUCTION

The phenomenon of SME internationalization has been the case for the past few decades and has become more widespread in recent years (Yan et al., 2018). Small and Medium Enterprises (SMEs) are motivated to join the international market, especially in the current business climate (Harris & Moffatt, 2011) to pursue new business opportunities and sustain competitive advantage (Kiran et al., 2013). Indeed, encourage entrepreneurs to get involved in

business can increase their chances survive in a competitive market (Abd Aziz et al., 2019). Increasingly, the involvement of SMEs in the international market has become an important agenda for business expansion among managers and research topics among scholars, particularly when international expansion correlates positively with performance (Prange & Pinho, 2017). Despite the initiatives and development programmes, many Malaysian SMEs have not succeeded in entering the international market (Ismail et al., 2016). The Malaysian SMEs failure rate is 60%, so, further and in-depth work are required by the local authorities (Husin & Ibrahim, 2014) and researchers to identify possible solutions. Pioneering studies have shown that in the field of exports, the internationalization of small firms is considered as an innovation practice of the businesses (Andersen, 1993). In addition, for several years, the Malaysian export sector has contributed significantly to the gross domestic product (Ismail, 2016), and the Ministry of International Trade and Industry (MITI) report showed that foreign trade in Malaysia contributed RM 702 billion in export value in 2012. Exporting is the way for SMEs to reach the foreign market, so the ultimate aim is to achieve superior success in the export market (Ferrerias-Mendez et al., 2019). Therefore, it is essential for SMEs to recognize the factors affecting export performance (Paul et al., 2017).

However, lately SMEs often face the issue of lack of resources and capability such as finance, technology, and skilled labour which become constraints in improving firm performance (Gupta & Bose, 2018; Ramdan et al., 2020) especially in the emerging market context (Manolopoulos et al., 2018). The situation is aggravated when SMEs face problems in terms of scarce resources, issues of the lack of understanding, and skills and commitments – especially when dealing with an increasingly dynamic environment (Venkatraman & Fahd, 2016). According to Rua (2018), absorptive capability is one of the elements in dynamic capabilities that define the ability of the firm to access and use new external information, perceived to be an intangible asset, being essential to success, and relying largely on the level of prior knowledge, since this knowledge can enable the discovery and processing of new knowledge. More specifically, past studies (Cohen & Levinthal, 1994; Jansen et al., 2005; Zahra & George, 2002) explained that absorptive capability is a dynamic capability that is supported by organizational learning to achieve a higher competitive advantage over existing competitors. Many scholars also agreed that absorptive capability is not a goal in itself (Fosfuri & Trinbo, 2008). For instance, Cohen & Levinthal (1990) associated absorptive capability with others like innovative capability, innovative performance, and expectation formation. Furthermore, a study conducted by Brancati et al. (2018) said that innovative capability is a dynamic capability that can maximize absorptive capability that will lead to business success, especially in the export market. Specifically, this study aims to focus on the definition of absorptive capability, innovative capability, export performance, and discussion on the role of innovative capability in maximizing the implementation of absorptive capability that will lead to an increase of export performance in Malaysia.

## **ABSORPTIVE CAPABILITY**

Most studies in the innovation literature support the notion that more innovative firms will perform better than less innovative firms (Bart, 1998; Laursen & Salter, 2006). But what are

the factors of high innovation success? Be aware that the impact of R&D will result in new products or services that are more innovative to the firm (Artz et al., 2010). However, the success of a firm's innovation also depends on the extent to which it can take advantage of new opportunities (Moussa et al., 2018), especially when dealing with external pressures that force firms to make the process of innovation and use external knowledge sources to increase their innovative potential (Simao & Franco, 2018). According to Cohen & Levinthal (1990), the main factor that can increase the firm's ability to acquire external knowledge is through its absorptive capability. This is because the absorptive capability is able to help the firm reconfigure its resource base and adapt to the changing market conditions to achieve competitive advantage (Barney, 1991). Therefore, it is important for firms to develop absorptive capability as they can encourage their innovation behaviour more effectively to lead to organizational change.

Theoretically, the concept of absorption capability is related to aspects of firm learning, knowledge management and dynamic capability (Duchek, 2013; Lane et al., 2006). According to Limaj et al. (2016) absorptive capability can be considered as an important dynamic capability for learning and innovation. In fact, knowledge is also suggested as the most important resource (dynamic capability) to firms at the moment (Volberda et al., 2010). Initially, the concept of absorptive capability was introduced by Cohen & Levinthal (1990) who explained the three planned components namely identifying, assimilating and exploiting new knowledge for commercial purposes. In this concept as well, they placed R&D as the centre that carries out the firm's innovation process through the relationship between learning and innovation performance. Thus, in this study, the absorptive capability is defined as the firm's ability to develop a set of organizational routines and strategic processes to implement the process of acquiring, assimilating, transforming, and exploiting new knowledge effectively to create good value to the firm (Jansen et al., 2005; Zahra & George, 2002).

## **INNOVATIVE CAPABILITY**

Innovation can be defined as the introduction and implementation of new ideas and knowledge (Rhee et al., 2010). Innovation also exists through the use of technologies, and depends on a different kind of knowledge (Rajapathirana & Hui, 2018). Whereas, innovative capability is needed in order for the firm to continuously develop innovation especially in the changing business environment (Slater et al., 2010), and innovative capability supports innovation because innovative capability is embedded in a firm's strategies, system, and structure (Gloet & Samson, 2016). In other words, innovation can only be implemented if the firm has the innovative capability (Laforet, 2011), since innovative capability is considered as an important asset for a firm to sustain its competitive advantage, and to organise firm strategy (Rajapathirana & Hui, 2018). Therefore, the concept of innovative capability is highly relevant for a firm to improve its performance especially in the changing business context.

Firstly, innovative capability can be defined from several perspectives and different levels, (Olsson et al., 2010). Innovative capability is one of the elements of organizational cultural creativity, which is an essential element of internal promotion activities, and the ability of the enterprise to consider and adapt in conjunction with the external environments (Akman & Yilmaz, 2008). Secondly, innovative capability is also viewed as the ability of the firm to

enhance their innovation activities as a response to the changing environment (Olsson et al., 2010). The determinants of innovative capability are identified in this study as the determinants that influence organizational capacity as well as environmental changes in the country that will affect a company's capacity to innovate. Several previous researches identified the determinants of organizational innovation that affect organizational capability to innovate – expressed by innovative organizations (Laforet, 2011; Saunila & Ukko, 2011). Therefore, this study defines innovative capability as a firm's ability to respond successfully to the environment, and develop new capabilities that can lead to superior performance (Hurley & Hult, 1998).

### **EXPORT PERFORMANCE**

In most countries, the engagement of SMEs in export activity has increased, so the export strategy plays an important role in the growth of the country (Rua, 2018). The positive export performance of firms will contribute to the growth of the national economy and improve the dynamism of firms, as exports play an important role in the development of a country (Abdghani et al., 2019). Numerous studies have examined export performance determinants. For instance, the relationship between innovation and the intensity of exports was studied by Pla-Barber and Alegre (2007), and found to be positive and important. In their analysis, export intensity was the objective determinant of export performance, which reflected the share of exports in the overall revenue of a given company. Additionally, Azar & Ciabuschi (2016) found that foreign market acceptance of innovation had a positive impact on export performance. New technology, new products, and new technical innovation processes allow the organization to react to the increasingly competitive global market (Zahra & Covin, 1995). Therefore, studies on export performance for SMEs are important to allow SMEs finding the best ways on how to compete in the global market.

Hultman et al. (2009) recognized export performance as a higher-order construct consisting of market performance such as a sales and market share predictor, financial performance indicating profitability, return on investment, as well as customer performance – indicating the response of the venture to customer needs and market pressure. Additionally, Zou & Stan (1998) defined export performance as financial and non-financial measures, and this also includes export effectiveness, export efficiency and on-going export activities in export market (Shoham, 1998). In the review of export performance studies by Chen et al. (2016), export performance was measured in 53 ways and about half were found to be used twice (Acikdilli, Mintu-Wimsatt & Kara, 2020). However, Jusoh & Parnell (2008) described financial measures as the most preferred measure in strategy-performance studies, and it is a primary objective of any organization (Hunt, 1997). Therefore, in this study, export performance is defined based on the company's proceeds of financial statements measured by profit and sales which include the share and intensity of the export market (Acikdilli et al., 2020).

## **INNOVATIVE CAPABILITY AS A MEDIATOR IN THE RELATIONSHIP BETWEEN ABSORPTIVE CAPABILITY AND EXPORT PERFORMANCE**

Literatures on absorptive capability show that the creation of internal learning processes within businesses is a prerequisite for external information acquisition (Kesidou & Szirmai, 2008). Absorptive capability is also an organizational process that enables firms to reconfigure their resources (Zahra & George, 2002) and eventually develop new competitive advantage through the creation of new knowledge which is innovative capability. Additionally, Yu-Ming et al. (2018) in their empirical study supported the statement through their discovery of firms having high absorptive capability in acquiring new market information and understanding the customer needs, as they can carry out innovative activities and improve export performance. According to Chen et al. (2009), for firms that are able to acquire, assimilate and apply the new acquired knowledge, they are expected to have the potential to further boost their innovation activities. However, to stimulate the innovation activities, their efforts need to be maximized so that absorptive capability will be more effective in increasing export market, because absorptive capability is a critical component in innovative capability (Pennings & Harianto, 1992). In other words, innovative capability is the mediating role in between absorptive capability and export performance because absorptive capability on its own does not have any significant impact on export performance (Fosfuri & Trinbo, 2008).

Several previous researches (Akman & Yilmaz, 2008; Weerawardena, 2003) explained innovative capability being a company's ability to respond to the changing environment by developing innovative practices like design and creation of new goods or services, new manufacturing techniques, the discovery of new markets, the detection of new sources of supply, and the development of new modes of organization. Innovative capability allows firms to remain ahead of their rivals by encouraging the production of new goods or services that can satisfy consumer requirements (Makri et al., 2017), therefore increasing export performance. For instance, a study by Rodriguez-Serrano and Martin-Armario (2017) towards 102 Spanish born-global SMEs indicated that the success of the SMEs in the global market is determined by their absorptive capability and the implementation of knowledge to the market demand by creating innovative products. Even clearer, previous researches done by Xuemei et al. (2018); Filippetti et al. (2016) indicated that absorptive capability increases firms' innovative capability, and performance. Therefore, it is clear that innovative capability mediates the relationship between absorptive capability and export performance in accordance with the concept of dynamic capability.

### **THEORY OF DYNAMIC CAPABILITIES (DC)**

Absorptive capability and innovative capability are external sources that provide an advantage in competition and improve organizational efficiency, thus building high competitiveness to the organization. This is supported by the theory of dynamic capabilities defined by Teece et al. (1997) – dynamic capabilities are a firm's ability to combine, develop and reconfigure external and internal expertise to respond to the rapidly changing environments, such as the rapid pace of technological change and the uncertain rate of potential market and competition. The literature advocates the viewpoint of dynamic capabilities in illustrating the

context of new or changing business climates (Wilden et al., 2013). The lack of dynamic capabilities would prevent the organization from retaining its competitive edge in the evolving environments (Gnizy et al., 2014). The definition of dynamic capabilities is seen as the most suitable mechanism for SMEs to adapt and reconfigure the firm's level of capital in response to the current market climate of international business, which is highly dynamic, complex and unpredictable (Winter, 2003) in order to develop and remain its competitive ability (Efrat et al., 2018). Dynamic capabilities focus on the best way to integrate, renew, restructure, and recreate resources (Kusunoki et al., 1998). Dynamic capabilities are dynamic in response to environmental changes (Teece et al., 1997). Furthermore, (Chabowski et al., 2018) in their study on exporting literature discovered that dynamic capabilities is the current trend in exporting research. In conclusion, dynamic capability is the best concept in explaining how SMEs achieve a greater performance when dealing with export markets that are fast-growing, and the changing environments with limited resources, skills and technology.

## CONCLUSION

The purpose of this work is to study and determine the definition of absorptive capability and innovative capability, in improving export performance in Malaysia. Thus, it can be concluded that the findings on the roles of innovative capability serve as a mediator in the relationship between absorption capability and export performance. Innovative capability and absorptive capability are dynamic capabilities that are capable of increasing competitiveness in the ever-changing environment. Therefore, investments in R&D are very important to increase innovation in all industries. However, further research should be used to study this problem deeper. Any forms of studies on innovative capability are considered as meaningful. In short, innovative capability serves as a tool to improve export performance.

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