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The Innovation-Performance Linkage: Empirical Evidence of Malaysian Manufacturing SMEs

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Abstract

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It has long been acknowledged that SMEs contribute significantly to the overall economic performance in Malaysia. However, SMEs in Malaysia are yet to reach their full potential. To improve the performance of SMEs, understanding its drivers is crucial. Previous research found that organization which have a more innovative behavior are likely to initiate an organizational change that could affect organizational performance. Thus, the aim of this study is to investigate the relationship between organizational innovation and organizational performance of Malaysian SMEs. Therefore, this article discusses the concept of organizational innovation, organizational performance and end with the findings of the organizational innovation-organizational performance linkage. Data was collected from SMEs in manufacturing sectors. A total of 321 self-administered questionnaires were used for gathering data from the respondents. Smart PLS 2.0 was used to test the hypotheses. The result reveals a positive relationship between organizational innovation and organizational performance. This study is useful for future researchers, entrepreneurs and policy makers in realizing the importance of organizational innovation towards enhancing SMEs performance.

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Keywords: Organizational Innovation; Organizational Performance; Small and Medium Enterprises (SMEs); Manufacturing Sector; Malaysia.

1. Introduction

Based on *The Economic Census 2011: Profile of Small and Medium Enterprises* (SME Census 2011), SMEs in Malaysia represent the majority of the businesses, constituting 97.3% of the total



business establishments. They offer employment to about 59% of the total employees and contribute about 32% to the GDP as well as 19% to the total export in 2010. However, SMEs in Malaysia have still a long way towards achieving the targets set in the SME Masterplan. According to this plan, SMEs is expected to provide 62% of the total employment, 41% of the GDP, and 25% of the total export by 2020 (NSDC, 2012b).

The existing environment characterized by rapid changes in global businesses and the continuing liberalization pressures occurring from economic and financial crises have provided new challenges as well as opportunities for Malaysian SMEs. It is vital to comprehend its drivers in order to improve the production of SMEs. With the launch of the SME Masterplan 2012-2020, SMEs have to take a new approach to accelerating their growth by focusing on productivity and innovation. The role of innovation has been highlighted as the key factor affecting the performance of Malaysian SMEs particularly to drive productivity (NSDC, 2012a).

However, comparative studies revealed that the innovation level of Malaysian firms was far below that of the high-income countries and even at par or higher than that of the middle-income countries (NSDC, 2012b). Despite the implementation of various initiatives to create a national innovation system to facilitate innovation, many SMEs do not participate. SMEs also often lack of manpower, funds, and time to carry out research and development (R&D) activities and product commercialization. Upgraded technology is likewise viewed as a cost instead of an investment which results in poor technology commitment by SMEs (NCDC, 2012b). Hence, to address this constraints, the entrepreneur or owners/managers of SMEs should have the advantage of innovation to compete with larger established businesses in order to succeed in business (Rosenbusch, Brinckmann, & Bausch, 2011). As a result, the goal of this study is to assess the bond between organizational innovation and organizational performance.

2. A Brief Review of Literature

2.1 Organizational Performance (OP) and Organizational Innovation (OI)

Organizational performance is defined as the outstretch to which proprietor of SMEs perceive their organizational performance in four dimensions, namely, (1) Satisfaction with financial performance such as profitability, sales turnover, sales growth, return on investment and market share; (2) Satisfaction with non-financial performance such as customer satisfaction, customer retention, relationship with suppliers, business image, workplace industrial relations and work-life balance; (3) Performance relative to competitors in terms of return on sale, cash flow, net profit, market share and return on investment; and (4) Business growth in terms of changes in sales, market share and cash flow (Ahmad, Wilson, and Kummerow, 2011).

Daft (1978) characterized organizational innovation as the adoption of new ideas or behaviors via an organization. Damanpour (1991), Damanpour and Evan (1984), Damanpour and Gopalakrishnan (1998) added that the process denotes to generating, developing and implementing new ideas or behaviors to the organization during the adoption phase. This research relates organizational innovation as the expand to which the proprietor of SMEs see the process of accepting, adopting and

implementing new ideas in the organization through product, process and managerial innovations (Che-Ha & Mohd-Said, 2008, 2012; Damanpour, 1991).

Organizational innovation demonstrates a strong influence on organizational performance (Kitapci, Aydin, & Celik, 2012; Lee & Hsieh, 2010; McDermott & Prajogo, 2012; Rosenbusch et al., 2011). The capability of an organization to innovate allows a diversity of strategies and opportunities to be pursued in order to enhance growth and survival. An organization that emphasizes innovation activities have higher impact on their employees' sense of commitment and productivity (Rosenbusch et al., 2011; Zhou, Gao, Yang, & Zhou, 2005). Therefore, ability to innovate can be an effective strategic capability for SMEs to address problems related to small size and new ventures. Literature indicates that SMEs that cultivate innovation can have better performance than those mainly focusing on the creation of innovative products and services (Rosenbusch et al., 2011). Indeed, some scholars argue that firms will be more successful in responding to their environment if they have greater capacity to innovate (e.g. Avlonitis & Salavou, 2007; Calantone, Cavusgil, & Zhao, 2002; Hult, Hurley, & Knight, 2004; Keskin, 2006; Rhee, Park, & Lee, 2010). This enables SMEs to develop new capabilities that can lead to competitive advantage and ultimately, achieve superior performance. Thus, the following hypothesis was developed:

H1: Organizational innovation is positively related to organizational performance

3. Area Of Study

3.1 Population and Sample size

This study aims at the manufacturing sectors in SMEs, which denotes in manufacturing, manufacturing-related services and agro-based industries in firms with full-time employees between 5 to 150 in the West Peninsular of Malaysia (Kedah, Penang, Selangor, Wilayah Persekutuan and Johor). Listing of companies are based on the SME Corp. directory (SME Corp. Malaysia, 2012). The manufacturing sector was chosen because it supplied to the excessive growth of 7.6% to SME GDP growth in 2011 as compared to the agricultural and service sectors (each 6.4%) (NSDC, 2012a) as well as much higher in average productivity than other sectors (NSDC, 2012b). Solely, 332 firms turned up as samples and 321 usable questionnaires were reviewed. The top management of the firms, the owners/managers are the respondents for this study. They were counted as the exemplar of the company with substantial intelligence over the study.

3.2 Instrument Development

Current study adapts a scale by Ahmad et al. (2011) which includes four dimensions of perceived organizational performance (Ahmad, Ramayah, Wilson, & Kummerowidh, 2010; Ahmad et al., 2011; Gholami, Sulaiman, Ramayah, & Molla, 2013; Rai, Patnayakuni, & Seth, 2006). The four dimensions are, 1) Satisfaction with financial performance, 2) Satisfaction with non-financial performance, 3) Performance relative to competitors, and 4) Business growth. The items of organizational innovation were modified from Che Ha and Mohd Said (2012), which comprises of managerial innovation, product innovation and process innovation.

3.3 Data Analysis

The data were analyzed using Smart PLS 2.0.M3 (Ringle, Wende, & Will, 2005). Two-staged processes were involved: the evaluation of the reliability and validity of the measurement model and the evaluation of the structural model. Figure 1 shows the research model for this study, which displays the loading for each item and beta values.

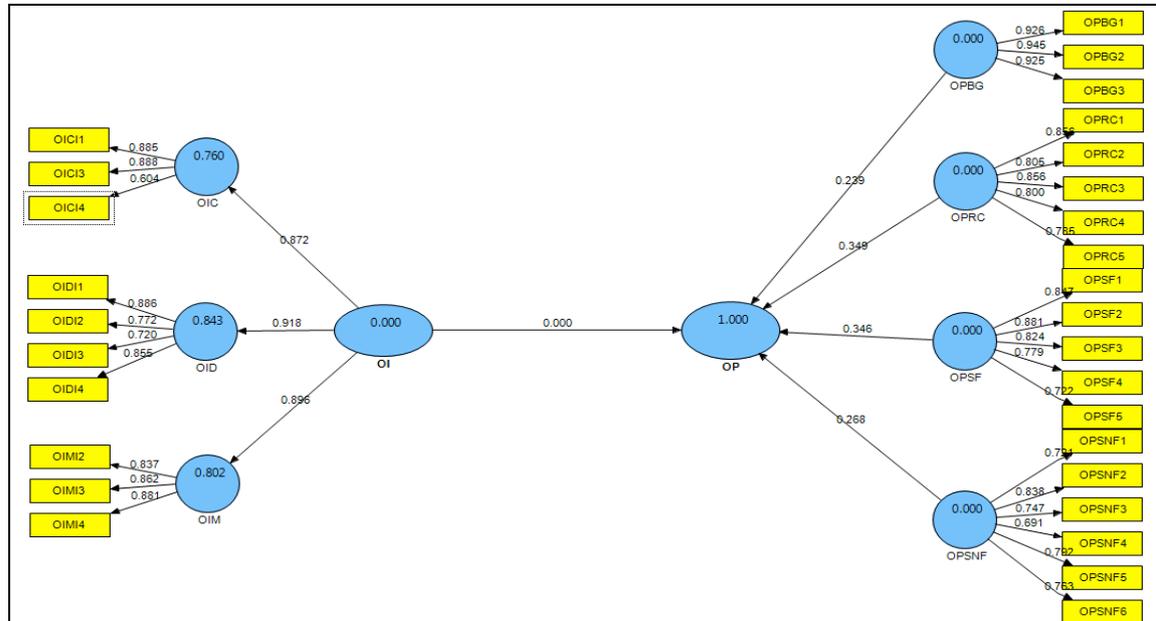


Fig. 1. Research model of the study

4. Findings

4.1 Hypothesis Testing

This study employed the two-stage approach in examining the the relationship between organizational innovation and organizational performance. The findings from the output of the algorithm and bootstrapping PLS-SEM devoted that organizational innovation has a positive significant association with organizational performance ($\beta= 0.697, t = 2,153, p < 0.01$), as shown in Table 1. Therefore, the hypothesis is supported.

Table 1. Path Coefficients and Hypotheses Testing

Hypothesis	Relationship	Beta	SE	t-value	Decision
H1	OI -> OP	0.697	0.038	2.153**	Supported

5. Conclusion and Discussion

Findings from this study have strengthen the previous researches demonstrating a direct positive connection between organizational innovation and organizational performance (Kitapci et al., 2012; Lee & Hsieh, 2010; McDermott & Prajogo, 2012; Rosenbusch et al., 2011). Thus, it can be concluded that organizational innovation was found to be a primary predictor of organizational performance of

SMEs. It shows that the more the organizations are involved with innovative activities, the more the organization can improve organizational performance.

As a conclusion, this study suggests that SMEs can still achieve higher performance through innovative activities carried out within the organization. This indicates the role of organizational innovation in the context of Malaysian SMEs is more prominent in influencing the performance of the organization. Organizational innovation seeks to impact directly on the performance of the organization and this study also proved there is a strong relationship between organizational innovation and organizational performance.

This study aims to contribute towards the theoretical consistency of knowledge through the investigation of the relationship between OI and OP in SMEs. It is also useful for future researchers, entrepreneurs and policy makers in perceiving the impact of OI in enriching organizational performance. Specifically, this article highlights not only the importance of issues related to OI, but also verifies that the OI performs an essential mantle in constructing a significant competitive advantage for the SMEs. In due course, it assures a good organizational performance. It is advisable for owners/managers of SMEs to develop the innovation activities in order to improve their performance. By doing so, a corporate innovative culture can be instituted across all levels in the organization. When this happens, organizational performance will be enhanced and reliance of SMEs on the government support can be reduced to make the organizations more competitive.

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