

The Influence of Innovation on SMEs Business Performance in the Manufacturing Sector

Nur Yuhainis Ab Wahab ^{#1}, Yusrinadini Zahirah Yusuff ^{#2}, Rusnifaezah Musa ^{#3}, Rushanim Hashim ^{#4}

¹ Universiti Pendidikan Sultan Idris, Malaysia

² Universiti Malaysia Kelantan, Malaysia

^{3,4} Universiti Utara Malaysia, Malaysia

Corresponding author

¹yuhainis@fpe.upsi.edu.my

Abstract— Nowadays, small and medium-sized enterprises (SMEs) play an important role in contributing to the country's economic growth. Overall, the contribution of SMEs to the Gross Domestic Product (GDP) are increased year by year. However, there are few studies showed that SMEs business performance are still inconsistent and need improvement. Therefore, the Malaysian government through the budget of 2016, has been working to ensure business sustainability, and also support the development and long-term growth of the SMEs. This study aims to investigate the relationship between innovation and business performance among SMEs in Malaysia. A sample of 155 SMEs data has successfully collected through a survey. The collected data was analysed by using the Multiple Regression Analysis. The findings revealed that innovation had a significant positive effect on the SMEs firm business performance. The findings has strengthen the theory of resource-based view (RBV) by filling in the scarcity of research on innovation as well as contributed to the significance of this study.

Keywords — Business performance, innovation, small and medium-sized enterprises (SMEs)

1. Introduction

SMEs continued remain to be one of the major economic contributors to the regional economic recovery process despite poor economic performance [1]. SMEs are the backbone of a country's economic development and its interest have been recognized by most countries in the world [2]. Among the key interests and roles of SMEs in supporting economic growth is the contribution to one-third of GDP and creation of employment opportunities for over 4 million workers or 60 percent of the total labor force [3]. SMEs are also be seen as an important component of Malaysian economic drivers [4].

In the [5], a survey was conducted on all SMEs in Malaysia. This survey has been conducted every year since 2009 by SME Corporation Malaysia for the purpose of monitoring and evaluating SME business performance and prospects in Malaysia. The results of the study showed inconsistent trend in SMEs business performance.

According to [6], a lot of SMEs showed poor performance and high failure rate in managing their firms. The World Bank reports that one of the factors that influenced the performance of SMEs in Malaysia is the implementation of innovation which could be a key driver of performance as well as provide significant impact on overall productivity. The emphasized of innovation has been highlighted because it is a very important catalyst to improve SMEs growth. Therefore, without adoption of innovation, SMEs might not achieve their full potential [7].

2. Literature Review

2.1 Business Performance

Performance can be referred as a work of achievement and the result of it [8]. It also can reflect the success of the firm through the growth and improve productivity. Performance also involves managers, partners, and people who run the business and lead to a continuous and flexible process [9]. [10], defined the business performance as the ability to operate to meet the needs of the business major shareholders. The performance of business could help to determine the direction of a business, either successful or fail [11]. Business performance is very important in a firm especially when good performance could benefit the firms in terms of better resource management, wealth generation and employment opportunities [12].

Measuring business performance is very important because it can help entrepreneurs to understand the firm's position in making comparisons with competitors in the market. In addition, the performance and measurement of the business is able to provide information to the firm in order to take appropriate action if any applicable changes needed in order to ensure the future of the firm [13]. However, there are still some difficulties in measuring business performance which are also become an important issue in doing research. Previous studies conducted by scholars have also used various methods for measuring performance in various angles [14]. Therefore, in the context of this

study, the researchers have chosen to measure business performance subjectively and use self-report technique where business performance was measured using 11 performance items as suggested by [15] Gupta and Govindarajan (1984).

2.2 Innovation

Innovation has become one of the key strategies used in firms to achieve competitive advantage and improve performance. In fact, past studies have found that innovation is a valuable tool, enabling a firm to gain greater capabilities by responding and adapting to the changing environment [16]. Thus, firms can seek new opportunities in the market and exploit the firm's capabilities to a greater extent than its competitors. Schumpeter, was one of the early thinkers who described innovation in a firm [17]. He has stated that firms need to implement innovations to renew the value of their assets [18].

Innovation refers to a firm's ability to find new and better ways to identify, acquire and execute tasks (e.g. processes, products, services, management and administration systems, organizational structure and marketing methods) within the organization [19]. Previous empirical studies have shown that the importance of innovation is a major driver of firm performance [20] and contributes to firms' readiness to adapt to changes in the internal and external environment [21], [22].

In addition, there are various definitions of innovation given by previous researchers. [23] viewed the term innovation as the creation of a new product or process, while [24] referred innovation as a new way of delivering better quality or value. Innovation from the views of [25] is a new knowledge or creation of ideas. Meanwhile, [26], defined organizational innovation as embracing a new idea or behavior for the organization, involving all dimensions of organizational activity, such as new products or services, new technology production processes, administrative structures or systems and new plans or programs in the organization. According to [27], there is still no consensus among scholars on how innovation should be measured. This is due to firms adopting different innovations. Each of the definitions of innovation represents different aspects such as the perspective of innovation, the level of innovation and the type of innovation that determine the elements of innovation and how they are measured [28]. Hence, based on the differences of innovations discussed above, the researcher will use the definitions and instruments developed by [19] to avoid ambiguity especially during the study being undertaken.

2.3 The Relationship Between Innovation and Business Performance

Studies on the relationship between innovation and performance have attracted interest among academics who understand innovation as a factor that will contribute to the creation of competitive advantages for firms and new models for business management [29]. However, recent studies have reported that the relationship between innovation and business performance has mixed results and inconsistencies. Some researchers have found that there is a significant positive relationship between innovation and performance while some have found a significant negative or no significant relationship [30],[31].

Previous study by [25] have found that there is a significant positive relationship between innovation and business performance in sales, profitability and market dominance in their study of small SME firms. It is found that in line with other previous studies, innovation has been positively related to profitability, sales growth, market dominance, return on investment and assets such as those by [32], [33], and [34]. [35], also found that innovation had a positive effect and was able to expand market share leading to profitability growth and strengthening overall business performance.

In addition, [19] study of Dubai-based SME firms have shown that innovation variables are statistically significantly positively related to all measures of business performance namely sales growth, profit growth, return on investment, market share and customer satisfaction. The analysis of the study also found that innovation can enhance productivity and profitability in a competitive market. Innovation is an option for Dubai-based SMEs as firms that have entered the market with innovation can better understand their customer needs, competitors' actions and technological developments and gain access to new products, services and market space. This finding was supported by [36] and [37], who found that there is a significant positive relationship between innovation and business performance but at different levels based on the type of innovation the firm develops.

However, there are some studies showing the opposite result. The results of [38] study of 23 manufacturing sectors in Taiwan found that, in general, Taiwanese SME firms that spend on innovation tend to have low performance and exhibit significant negative relationships. This finding is supported by [39] showing a significant negative relationship with firm performance. [39] conclude that innovation can increase exposure to market risk, increased firm costs, employee dissatisfaction, or unreasonable changes. Meanwhile, [40] study found that innovation has no significant relationship with

firm profitability. This factor is due to firms investing in capital investment and it takes a long time to get a return. In other words, the decision made by entrepreneurs to engage in innovation is more than long-term investment to ensure the continued success and future survival of the firm.

3. Methodology

The purpose of this study is to examine the relationship between innovation and business performance among SMEs firms in the manufacturing sector in Malaysia. The manufacturing sector is selected as it is the second largest contributor to the Malaysian economy [41]. The sample for this study is the SMEs firms in the manufacturing sector (excluding micro-size firms) operating in Malaysia. Data was collected based on firms registered with the Small and Medium-Sized Enterprises Corporation Malaysia [41].

The respondents of this study are the SMEs in the manufacturing sector in Malaysia. However, each of the SME is represented by the top management of a firm, such as the owner, founder, Chief Executive Officer (CEO), director, chairman or manager. They have been selected as the respondents of this study as they have the full information about the journey and the overall operating activities of their business firms [17]. This research was used quantitative research methodology through cross sectional study by using a survey method. Meanwhile for sample selection, a strata sampling technique was employed. A total of 1071 questionnaires were distributed and 175 questionnaires were successfully returned. However, only 155 questionnaires could be used for further analysis. The data was analysed using the Statistical Packages for Social Science (SPSS). Multiple Regression Analysis was conducted to identify the influence of innovation on SMEs business performance.

4. Results

From the study, it has shown that the effect of innovation on dependent variables has been tested at a significant level of 99 per cent and utilised p-value 0.01. The regression analysis results showed that the innovation variable had significant impact on the performance of the firm's business as described in Table 1. The results showed that this variable explains 54.0 percentage of the variance in business performance ($R^2 = 0.540$, $F = 89.284$, $p < 0.01$) which indicated that a 1-unit increase in innovation would increase business performance by 0.540 and will significantly improve the business performances of SMEs ($P < 0.01$). Therefore, it can be concluded that the innovation variable has been successful to be used as a predictor which is

significant with the business performance where is innovation at ($\beta = 0.324$, $t = 5.884$, $p < 0.01$).

Table 1 Regression Analysis of Independent Variables and Dependent Variable

Variables	β	t	Sig.
Innovations	0.324	5.884	0.000*
R	0.735		
R ²	0.540		
Adjusted R ²	0.534		
Standard Error of Expected Values	0.35317		
F	89.284		
Sig. F	0.000		
Durbin Watson	2.002		
N	155		

Dependent variable: Business performance

Significant levels: * $p < 0.01$

5. Discussion

The regression results revealed that innovation has significant positive relationship with business performance. This findings proved that the SMEs is focused in emphasizing the development and research activities (R&D), creation of new ideas, usage of recent technologies, forming new processes work and production methods, and introducing new product line-up that increased the firm's business performance. The findings has strengthen the Resource-Based View (RBV) theory where the firm's internal resources such as innovation is a very important asset that needs to be take care of in order to maintained the growth and the stability firm's business performance [42], [43]. The source refers to any type of significant asset (tangible) or insignificant (intangible) that owned and considered by the firm as the strength of company [43]. The findings of this study is also parallel with the other studies such as by [32], [33], [25], [35], [34] and [19], in which all of them have confirmed in their studies that adoption of innovation in their work process will improve the business performance [44].

6. Conclusion

In conclusion, the adoption of innovation in business operation will benefit every firm in terms of economic and competitive advantage as well as positive impression to the business performance [45-48]. Thus, this study has fulfilled the bridge of knowledge by strengthening the limited empirical evidence by assessing the influence of innovation on business performance of the SMEs firms especially

in the manufacturing sector in Malaysia. For future study, it is recommended to take into consideration both unidimensional and multidimensional approach simultaneously when measuring the innovation variable in order to compare the findings from different sector such as manufacturing, service and agriculture. These three sectors are the most important sectors that supporting the growth of SMEs achievements in Malaysia. Therefore, it is suggested that future studies to include these three sectors of the SMEs for data diversity and enrichment.

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