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INFLUENCE OF INNOVATION CAPABILITY ON PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KENYA

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ABSTRACT

Background: The importance of small and medium businesses in driving economic growth in Kenya and around the world cannot be overstated. However, large international firms compete fiercely with the majority of these businesses, particularly in emerging countries. The majority of these small enterprises have closed due to their inability to cope with the quickly changing competitive climate. This study sought to examine the influence of innovation capability on the performance of small and medium enterprises in Kenya.

Methodology: Descriptive cross-sectional research design was employed. The target population included small and medium enterprises in Thika town's light industrial area. The entire target population comprised approximately 2400 licensed small and medium enterprises majorly in manufacturing, trade, and service sub-sectors. The study sampled 331 small and medium enterprises owners using stratified random sampling.

Results of the Study: The findings indicated that innovation capability had a positive and significant influence on the performance of small and medium enterprises.

Conclusions and Recommendations: The study concluded that innovation capability contributes positively to small and medium enterprises' performance. The study recommended that small business owners should strengthen their innovation capabilities. They should specifically focus on the following aspects: appropriate allocation of resources, learning culture, managing employees' expectations, and creation of new opportunities. Improving these aspects will result in enhanced business performance.

Keywords: *Innovation capability, Business performance, Small and Medium Enterprises*

INTRODUCTION

Business performance depends on the market performance of the company with clear results (Bennett, Bettis, Gopalan & Milbourn, 2017). This is explained in terms of economic performance, which includes economic impact measures such as return on capital and return on equity, and profit measures such as return on sales and net income, profit, turnover, or return on investment (Dickhuisen, Gorgievski, van Veldhoven & Schalke, 2016). Non-financial metrics include autonomy, customer satisfaction, sales development, workforce development, market share, job satisfaction, and work-life balance (Bennett et al., 2017).

Business efficiency covers many specific areas, including development and profitability (Nason & Wiklund, 2018). It is a permanent and flexible method in which managers and leaders act as partners in a structure that determines how best to work together to achieve desired results. It is the result of operations and contains the actual results of the strategic management process. Given its ability to increase company efficiency, strategic management practices are justified (Addae-Korankye & Aryee, 2021).

Innovation capability is a significant factor in facilitating an innovative organizational culture, comprehension, and responsiveness capacities to the external setting and the features of inner promotion operations (Tsai & Liao, 2017). To take advantage of market possibilities and attain greater efficiency, includes generating fresh thoughts and expertise (Lianto, Dachyar & Soemardi, 2018). Falahat, Tehseen, and Van Horne (2018) observed that capacity for innovation involves resource accessibility; cooperative structure, and problem-solving process.

China has managed to become the second-largest economy in the world, especially after engaging in economic reforms since the late 1970s. Despite playing a significant role in manufacturing products and exporting to different parts of the globe, the Chinese government has realized that depending upon this production model cannot sustain the country's long-term economic growth and development. Hence, the government has tried to invest more in advancing technology, research and innovation, knowledge transfer, and promoting entrepreneurship education (Zhu, Guo, Hou & Chiu, 2021). Ma et al. (2021) explored increasing entrepreneurial capabilities among Chinese entrepreneurs. The research was based on a group of Chinese restaurant owners. There was a growing need to increase systematic knowledge on vital aspects to improve entrepreneurial capabilities among small business owners. Several aspects were pointed out as critical in enhancing the entrepreneurship capability of small businesses in China. These were entrepreneurial training, networks, culture, and attitude.

In Nigeria, the business sector faces numerous challenges, which renders the environment not only difficult for business but resulting in the increasing failure of SMEs in the country (Gwadabe & Amirah, 2017). Studies established that 85 percent of businesses in the country do not survive beyond the first five years of their establishment. Moreover, even the little percentage that manages to sustain beyond five years, collapses between the sixth to tenth years of their existence which leaves only around 5 to 10 percent of the SMEs in business (Bagudu, Khan, & Roslan, 2016). Despite the effort and contribution of the Nigerian government to the development of SMEs, the input of the enterprises including micro-businesses to the country's exportation is as low as 7.27 percent. The lack of entrepreneurial competencies has been identified as the leading cause of business failure in the country (Amini, Arasti & Bagheri, 2018).

Kenya is faced with increasing challenges of unemployment, low levels of entrepreneurial activities, and poor firm performance. This has resulted in the problem of unsustainable economic growth and development (Musambayi, 2018). Since the country adopted the devolved system of government in 2010, there has been a huge demand from county government officials as well as the entrepreneurs operating in the areas on how to provide innovative leadership for entrepreneurial performance and development. Jonas (2017) identified the impacts of entrepreneurial capabilities on the performance of private colleges in Kenya, including market orientation, entrepreneurial orientation, advertising capability, and social orientation. The study showed that entrepreneurial capabilities had a positive impact on the private university's performance. This study has practical implications for the theoretical advancement of university entrepreneurial capability. Additionally, the outcomes of the study provide insights into universities' management on the strategic choices they can make to enhance their performance in the fast-changing environment.

Small businesses are critical to sustainable development in almost any economy. In all countries, SMEs make a major contribution to gross domestic product (GDP) and job creation (Clarke, Li & Xu, 2016). There is no conventional definition of SMEs, but the definition of SMEs globally is shaped by the number of employees and annual turnover. More than 95 percent of the world's businesses are small and medium enterprises, Japan has more than 99 percent of total businesses, Singh, Mondal and Das (2020) say India has about 80 percent, Gyimah, Appiah and Lussier (2020) say South Africa has 91 percent while Ghana owns about 92 percent of the total number of companies. Kenya Session Report No. 2 of 2005 categorizes companies according to the number of permanent employees. Organizations with fewer than five employees are categorized as micro, with 5 to 49 employees as small, 50 to 99 employees as a medium, and with 100 or more employees as large. Company (Meeting Report 2, 2005). The current study focuses on companies with 99 or less employees.

SMEs play an important role in economic development in developing countries, especially by creating jobs and contributing to GDP, and therefore the outcomes of SMEs are very important for the nation. SMEs in Kenya are providers of trade, agriculture, manufacturing, and services. SMEs in Kenya accounted for 18% of GDP in 2003, 20% in 2007, and 25% in 2012 (Kenya Economic Survey, 2016). Despite ample government and economic support from NGOs, as well as other non-financial incentives, endowments, and favorable public policies, representation of SMEs in Kenya remains difficult. Three out of five SMEs fail in their first three years of operation, according to a report from Session No. 2. 2005 in Kenya. The increasing failure rate of SMEs in the country reflects poor efficiency and a lack of competitiveness.

STATEMENT OF THE PROBLEM

The Small and Medium Enterprise sub-sector in Kenya is seen as an important economic engine since it provides income and jobs to a large part of the people (Mutula, 2018). According to the Kenya Economic Survey Report (2020), SMEs contributed 79.8% of new jobs in Kenya. The sub-sector contributes more than 20% of the country's gross domestic output (RoK, 2020). Despite the role of SMEs in the Kenyan economy, the National Bureau of Statistics of Kenya reported in 2016 that a total of 2.2 million SMEs closed in five years. The failed businesses were in industries such as wholesale, retail, and car and motorcycle repair which accounted for around 73.5% of all closures (KNBS, 2020). The report also found that three out of five companies failed in their first three years of operation. Businesses found in the last two years were more susceptible to closing,

accounting for 61.3% of the total number of businesses closed. The failure of SMEs leads to job losses, leading to increased insecurity, low financial liquidity, and financial decline (KNBS, 2020).

Waithaka (2017) identifies a lack of intellectual capital and infrastructure, as well as political stability, as important threats to the survival and stability of small businesses in Pakistan. Lack of skills makes it impossible for SMEs to compare and compete both domestically and globally. Therefore, inadequate intellectual capacity makes SMEs fail to survive in a highly competitive environment (Shamsuddin et al., 2017). Furthermore, Akbar, Omar, Wadood, and Al-Subari (2017) mention the lack of working capital as the main reason for closing small businesses. At the local level, Koech (2016) recognizes the capital market, costs, access to capital, collateral conditions, capital management, and registration fees as factors that influence the development of small businesses. However, no known local study had focused on the innovation capability and performance of SMEs. It is on this premise that the current study sought to fill the research gap by examining the influence of innovation capability on the performance of SMEs in Kenya.

THEORETICAL FRAMEWORK

The study was anchored on the innovation diffusion theory developed by Rogers (1995). The theory says that diffusion of innovation is based on the concept of spontaneous or scheduled spread of fresh concepts involving the implementation of an innovation. Rogers describes innovation as a perceived fresh concept, practice, or object (Rogers, 1995). The theory emphasizes that the perception of change is essential and that it should be regarded as an innovation if and when the concept appears new to the prospective adopter.

It is indicated that the presence of innovation is seen as causing uncertainty in the minds of prospective adopters in the theory of innovation diffusion (Berlyne, 1962). In this situation, the absence of predictability and data relates to uncertainty. Rogers (1995) further defines diffusion among members of a communicating social network as a method of data exchange driven by the need to decrease uncertainty. Uncertainty, along with the comparative probabilities of each of these solutions, can be regarded as the degree to which a set of solutions are viewed to the occurrence of some case. Those engaged in considering innovation adoption are encouraged to search for data to decrease this uncertainty (Rogers 1995).

The theory argues that data is embodied by technological innovation, so its implementation acts to decrease uncertainty. According to Rogers (1995), the spread of innovation is subject to five significant features including its comparative benefit, compatibility, complexity, trialability, and observability.

The theory of innovation diffusion linked innovation capability to the performance of SMEs in the current research. The theorist emphasized the aspect of creating fresh thoughts that can assist improve an organization's performance. Similarly, it should be possible for small companies to create fresh thoughts that would assist them to improve their performance. The ideas could be in terms of new products or improved products and services.

EMPIRICAL REVIEW

Rajapathirana and Hui (2018) studied the connection between innovation capability and the various aspects of corporate performance including innovation, market, and economic performance covering the Sri Lankan insurance subsector. The results showed that the two

variables had an important powerful connection. Their research is related to the present study since they both concentrate on the capacity for innovation and firm results. The two studies, however, concentrate on the distinct nation and industry contexts. The research was carried out in Kenya and concentrated on the SMEs sub-sector.

Alam, Arumugam, Nor, Kaliappan, and Fang (2017) assessed current literature on organization innovation capacities and their impact on results as measured by marketing and economic elements. The results suggested that the ability of strong innovation to impact company performance, advertising performance, and eventually impact economic performance. The research used marketing and financial aspects as measures of performance. Similarly, the current study adopted some of the financial aspects such as profitability to measure the performance of SMEs in Kenya.

Dalvand, Moshabaki, and Karampour (2015) evaluated the effect of innovation capability on export firms' performance and used descriptive research. The research concentrated on particular elements of innovation: operational, allocating resources, capacity for organization, culture, and learning. The results stated that export firms' performance in innovation capabilities has a favorable and substantial impact. Their research, however, concentrated on export companies, while the current research concentrated on SMEs.

Lilly and Juma (2014) used a descriptive sample design of 30 banks to investigate the effectiveness of strategic innovation on bank performance in Thailand. The data were analyzed using descriptive statistics and correlation analysis, and the results revealed that the bank's strategic innovation actions had a significant impact on the bank's performance. There is a link between cost management and strategic innovation, continual quality improvement, inventive measures, and productivity. The study was carried out in Indonesia, which explains the disparities in scope. The current study was conducted in Kenya.

Nduati (2020) examines the impact of strategic innovation on the performance of Kenyan manufacturing enterprises through a literature study. The stakeholder theory is used in this investigation. This paper employs a literature review methodology to identify major concerns by reviewing the relevant empirical literature. To investigate the influence of strategic innovation on the employment of manufacturing enterprises in Kenya, a critical evaluation of the empirical literature was done. Product innovation strategies, process innovations, market innovations, and technology breakthroughs all have a positive and significant impact on manufacturing company productivity. The study concludes that the company's key performance areas have improved significantly and positively, largely due to the implementation of strategic innovation strategies, including market innovation strategies and product innovation strategies. This study is based on a desktop research design and thus demonstrates methodological omissions. This study has chosen a descriptive research design.

RESEARCH METHODOLOGY

The study adopted a descriptive cross-sectional research design. The study's target population constituted small and medium enterprises in Thika town’s light industrial area, Kiambu County in Kenya. The entire target population comprised approximately 2400 licensed small and medium enterprises majorly in manufacturing, trade, and service sub-sectors. The study sampled 331 small and medium enterprises owners using stratified random sampling. Primary data was gathered using semi-structured questionnaires. Both quantitative and qualitative data were collected. Quantitative

data were evaluated using descriptive statistics, that is, means standard deviations, frequencies, and percentages, as well as Pearson correlation and regression inferential statistics. Thematic analysis was used to analyze qualitative data.

RESULTS AND DISCUSSIONS

Descriptive Statistics on Innovation Capability

The study sought to determine the influence of innovation capability on the performance of small and medium enterprises in Kenya. The respondents were requested to rate their agreement or otherwise against each statement posed to them, using a 5-level Likert scale (strongly disagree meant a one, disagree was a two, neutral was a three, agree was a four and strongly agree was a five). The statements posted to respondents sought to ascertain their views regarding innovation capability.

The findings in Table 1 reveal that majority of the respondents with an aggregate mean score of 4.3 and a standard deviation of 0.7 agreed with statements on innovation capability. The participants agreed with the statements that they are capable of making proper allocation of business resources to enhance performance (mean=4.3), they have inculcated a learning culture among their staff and this leads to creativeness and enhanced productivity (mean=4.2), their business can meet the needs of the customers and this builds on customer loyalty(mean=4.4), their business can manage the expectations of the employees and this enhances performance (mean=4.3) and they always look for new opportunities or create new opportunities every day (mean=4.4).

The findings were consistent with Rajapathirana and Hui (2018) assertion that innovation capability was significantly connected with firm performance. The findings imply that the respondents demonstrated innovation capabilities in their businesses. In particular, several key aspects of innovation capability emerged. These are; appropriate allocation of resources, learning culture, customer focus, managing employees' expectations, and creation of new opportunities. These aspects are likely to boost the performance of SMEs.

Table 1: Descriptive Statistics on Innovation Capability

Statement(N=285)	SD	D	N	A	SA	M	S.DEV
I am capable of making proper allocation of business resources to enhance performance.	0.4%	4.9%	3.2%	50.9%	40.7%	4.3	0.8
I have inculcated a learning culture among my staff and this leads to creativeness and enhanced productivity	0.0%	7.4%	8.1%	43.9%	40.7%	4.2	0.9
My business can meet the needs of the customers and this builds on customer loyalty.	0.0%	1.1%	7.0%	46.3%	45.6%	4.4	0.7
My business can manage the expectations of the employees and this enhances performance.	0.0%	2.5%	7.0%	50.5%	40.0%	4.3	0.7
I always look for new opportunities or create new opportunities every day.	0.0%	2.5%	5.6%	44.6%	47.4%	4.4	0.7
Aggregate mean						**4.3**	**0.7**

The business owners/ managers were asked to state other ways in which innovation capability in business can be demonstrated. The respondents highlighted several key aspects of innovation capabilities that entrepreneurs should look out for. These included: creativity, initiation, teamwork, networking, collaboration, visioning, enterprising and intelligent risk-taking. The adoption and implementation of these innovation capability aspects are likely to enhance the performance of small and medium enterprises.

Descriptive Statistics on Business Performance

The dependent variable in this study was the performance of small and medium enterprises in Kenya. The respondents were requested to rate their agreement or otherwise against each statement posed to them, using a 5-level Likert scale (strongly disagree meant a one, disagree was a two, neutral was a three, agree was a four and strongly agree was a five). The statements sought to find out respondents' views regarding business performance.

The findings in Table 2 reveal that majority of the respondents with an aggregate mean score of 3.6 and a standard deviation of 1.1 agreed with statements on business performance. The respondents agreed with the statements that they have increased the number of products/services since the start of the business (mean=3.5), their sales volumes have increased since the start of the business (mean=3.6), their business profits have increased since the start of the business (mean=3.8), the number of their customers has increased since the start of the business (mean=3.5), their market presence has expanded since the start of the business (mean=3.5), and the quality of products/ and services has improved since the start of the business (mean=3.7).

The findings imply that the respondents illustrated that their business performance has experienced an improvement in several ways. The particular ways in which the business performance has increased include an increase in several products/services, sales volumes, increase in profits, increase in the number of customers, market share growth and increase in returns from investment. The study, therefore, aimed to establish whether the improvement in business performance was associated with entrepreneurial capability aspects.

Table 2: Descriptive Statistics on Business Performance

Statement(N=285)	SD	D	N	A	SA	M	S.DEV
I have increased the number of products/services since the start of the business.	1.8%	22.1%	24.2%	29.8%	22.1%	3.5	1.1
My sales volumes have increased since the start of the business.	0.4%	20.7%	22.1%	33.0%	23.9%	3.6	1.1
My business profits have increased since the start of the business.	0.0%	16.5%	13.3%	41.4%	28.8%	3.8	1.0
The number of my customers has increased since the start of the business.	0.7%	22.5%	25.3%	27.4%	24.2%	3.5	1.1
My market presence has expanded since the start of the business.	1.8%	20.4%	24.9%	31.6%	21.4%	3.5	1.1
The quality of products/ and services has improved	0.0%	19.3%	24.6%	28.4%	27.7%	3.7	1.1
Aggregate mean						**3.6**	**1.1**

The respondents were requested to rate their business performance using the scale: 1 (below 20%); 2 (21-40%); 3 (41-60%); 4 (61-80%); 5 (above 80%) for the past 5 years. The findings in Table 3 indicate that on average, the profit for most SMEs improved by 21-40% between 2016 and 2020. However, the findings indicate a decline in profits from 2019 to 2020. In 2020, most businesses reported profit growth of less than 20%. Similarly, the number of customers for most of the SMEs improved by 21-40% during the measurement period. However, the findings indicate a decline in the number of customers for most businesses from 2019 to 2020. The number of customers for most businesses grew by less than 20% in 2020. Further, sales for most businesses grew by 21-40% during the measurement period. However, in 2020, the sales grew by less than 20%, which was a decline from 41-60% growth in the previous year 2019.

Table 3: Change in business performance

	2016	2017	2018	2019	2020	Average mean
Profits	1.6	1.58	1.59	3.59	1.4	1.95
Number of customers	1.52	1.48	1.52	3.51	1.2	1.85
Sales	1.46	1.49	1.55	3.48	1.4	1.88

Correlation Analysis

The correlation analysis was used to show the relationship between the variables in terms of strength and direction. The results in Table 4 reveal that innovation capability (r =.749**, P = .000), had a strong positive and significant correlation with the performance of small and medium enterprises. The r-value shows that the relationship between the independent and dependent variables is very strong. This implies that an increase in innovation capability is significantly correlated with an increase in business performance. The results were similar to those of Alam, Arumugam, Nor, Kaliappan, and Fang (2017) who established that a strong connection existed between innovation capability and company performance. Dalvand, Moshabaki, and Karampour (2015) also found that the relationship between innovation capabilities and firm performance was positive and significant.

Table 4: Correlation Matrix

		Business performance	Innovation capability
Business performance	Pearson Correlation	1	
	Sig. (2-tailed)		
Innovation capability	Pearson Correlation	.749**	1
	Sig. (2-tailed)	.000	

** Correlation is significant at the 0.01 level (2-tailed).

Influence of Innovation Capability on Business Performance

The study sought to determine the influence of innovation capability on the performance of small and medium enterprises in Kenya. The independent variable (innovation capability) was regressed on the dependent variable (business performance). Tables 5, 6, and 7 provide a model summary, ANOVA, and coefficient results respectively.

Results in Table 5 indicate that innovation capability explains 56.2% (R^2= .562) of the total variations in the performance of small and medium enterprises. These results confirm the output of the correlation in Table 4 that a positive and significant relationship exists between innovation capability and business performance.

Table 5: Model Summary; Innovation Capability and Business Performance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.749a	0.562	0.56	0.30238

a Predictors: (Constant), X

The regression ANOVA model in Table 6 reveals an F statistic of 362.695 and a reported P-value of 0.000. The *P*-value is less than the alpha value ($P < .05$), the proposed model is therefore statistically significant (good fit) in predicting the dependent variable.

Table 6: ANOVA; Innovation Capability and Business Performance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	33.162	1	33.162	362.695	.000b
	Residual	25.875	283	0.091		
	Total	59.036	284			

a Dependent Variable: Y

b Predictors: (Constant), X

Since all the factors of innovation capability and predictor have identical (Likert) scales and the constant value is significant, the study preferred interpreting the B-coefficients rather than the beta coefficients. Consequently, the value of regression weights shown in Table 7 indicates that innovation capability had a significantly positive influence on the performance of small and medium enterprises (β=0.984 $P < .000$).

The study agreed with Karabulut (2015) findings that innovation contributes to organizational performance. Ngumi (2014) also established that innovation enhances firm performance. He particularly found that innovations had statistically significant effects on revenue, asset returns, and profitability of banking institutions.

The estimated model becomes:

Y = -0.625 + 0.984 X

Where;

Y=Performance of SMEs, X= Innovation capability

Table 7: Coefficients; Innovation Capability and Business Performance

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	-0.625	0.222		-2.812	0.005
	X	0.984	0.052	0.749	19.045	0.000

a Dependent Variable: Y

CONCLUSION

The study concluded that innovation capability has a positive and statistically significant influence on the performance of small and medium enterprises. The implication is that innovation capability is critical in determining the performance of SMEs. Several innovation capability key aspects include appropriate allocation of resources, learning culture, managing employees' expectations, and creation of new opportunities.

RECOMMENDATIONS

Based on the findings, innovation capability had a positive and significant influence on the performance of small and medium enterprises. This study, therefore, recommends that SME

owners should strengthen their innovation capabilities. They should specifically focus on the following aspects: appropriate allocation of resources, learning culture, managing employees' expectations, and creation of new opportunities. Improving these aspects will result in enhanced business performance.

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