

**INFLUENCE OF ENTREPRENEURIAL SKILLS AND INNOVATION ON
PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES (SMEs) REVIEW
FROM THEORETICAL LITERATURE**

ABSTRACT

The Small and Medium Enterprises (SMES) sector plays an increasingly important role in many economies in the world. Innovation is an important issue for many SMEs. Entrepreneurial skills as the skills needed to develop innovative products and services and to generate solutions to emerging needs in the marketplace. Innovation is the creation of a of new products and services in all sectors of the economy, new marketing methods and changes in ways of organizing businesses, in their business practices, workplace organization and external relations. The entrepreneur in SMEs is often engaged in promoting novel products and in relating to relevant clients and partners through effective communication processes and instruments such as word of mouth and personal networking. The secondary data collected was analyzed using descriptive statistics and quantitatively. The data was presented through report writing. The study found out that small medium enterprises have introduced more innovative products and services, have developed and implemented new business methods and services which have improved productions and delivery of services and that innovative marketing and promotion campaigns to find new markets have had significant implication on financial performance of SMEs. There is need for the government to foster innovation amongst SMEs through creation of a business environment conducive for entrepreneurship, creation of awareness and implementation of relevant policies. In terms of improving process innovation SMEs need to focus on improving their core competences. SMEs need to pursue market innovation strategies that focus on product customization and customer intimacy in delivering their products and services.

Key words: Entrepreneurial skills, Innovation, Performance, SMEs,

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1.1 Background of the study

The term “SMES” incorporates a wide range of definitions. The definitions are however based on guidelines surrounding headcount of personnel, sales or assets. For instance Dalberg (2011), Egypt defines SMEs as having more than five personnel but less than fifty employees. Whereas Vietnam on the other hand defines SMEs as having between 10 and 300 employees. The Inter-American Development Bank however defines SMEs as having a maximum of 100 employees and less than \$3 million revenue. Europe defines SMES’s as having manpower of under 250 employees. World Bank defines SMEs as businesses with a maximum of 300 employees and \$15 million annual revenue (Pandya, 2012).

The Small and Medium Enterprises (SMEs) play an important role in the Kenyan Economy. According to the Economic Survey (2006), the sector contributed over 50 percent of new jobs created between the year 2005 and 2010. Despite their significance, past statistics indicate that three out of five businesses fail within the first few months of operation (Kenya National Bureau of Statistics, 2007). According to KNBS (2005), one of the most significant challenges is the negative perception towards SMEs. Potential clients perceive small businesses as lacking the ability to provide quality services and are unable to satisfy more than one critical project simultaneously.

The capacity of SMEs to meet the ever growing expectations of the customer will be determined by their ability to come up with new products and innovations. This will be possible if they read effectively the changing marketing trends and adapt to them effectively.

1.1.1 Entrepreneurial Skills

Entrepreneurial skills are simply business skills, which an individual acquires to enable him function effectively in the turbulent business environment as an entrepreneur or a self-employed individual (Folahan & Omoriyi, 2006). Lyons (2002) described entrepreneurial skills as the skills needed to develop innovative products and services and to generate solutions to emerging needs in the marketplace. Stella (2014) explains entrepreneurial skills as skills or competencies that are critical for any entrepreneur for success in his or her business venture.

Entrepreneurs require a variety of skills in order to successfully manage an enterprise. Wickham, (2006) defines skill as simply knowledge which is demonstrated by action, before going on to add

that SMEs performance results from a combination of industry knowledge, general management skills and personal motivation.

Lazear (2015) maintains that an entrepreneur is not necessarily required to be an expert in any single skill but, instead, is required to be a jack-of-all-trades (JAT). He argues that, in order to be successful, one must be 'sufficiently skilled in a variety of areas to put together the many ingredients required to create a successful business' (Lazear, 2015). Moreover, the JAT view of entrepreneurship is supported by Wagner (2006) who suggests that having a balanced skills mix stimulates entrepreneurship.

The idea that skills can be acquired also underpins the work of Lichtenstein and Lyons (2001) who developed a skills based framework termed the 'Entrepreneurial Development System' (EDS). The EDS framework has been applied to rural areas of the United States to establish both the quantity and quality of an areas' entrepreneurial capital and is based on three main premises:

- (1) ultimate success in entrepreneurship requires the mastery of a set of skills;
- (2) these skills can be developed; and
- (3) entrepreneurs do not all come to entrepreneurship at the same skill level (Lyons, 2003).

This system has also been utilized by Smith, Schallenkamp and Eicholz (2007), who present the skills framework under the headings of technical, managerial, entrepreneurial skills and personal maturity skills.

Study by (Stevenson, 1993) argues that entrepreneurs need innovative skills which comprise of the cognitive skills like creativity and behavioral skills like problem-solving. The study further argues that the main reason entrepreneurs are successful is their abilities to imagine, innovate and work around challenges within their environment. Nevertheless, skills alone are not largely effective as the local government should be involved directly in providing funds for capital investment in order to promote entrepreneurial ventures (Faizan & Haque, 2016).

Empirical studies of (Hamm, 2002; Whetten & Cameron, 2005; Scudder 2001) have revealed that entrepreneurial skills influence the growth and operations of SMEs. The success of entrepreneurs rely on the identification of competencies for start-ups and established businesses, as well as their survival and early-year growth. The study of Whetten and Cameron (2005) categories these skills

into three groups namely “personal, interpersonal and basic management skills”. Managerial level personnel are more adaptive and use social support constructively (Haque, Aston, &Kozlovski, 2018). Hence, adaptability is a skill that could be used by having higher social orientation.

1.1.2 Innovation

Innovation is defined as the process through which an invention or idea is translated into a good or a service from which value can be derived (Kantor, 2001). Innovation can be related to new products or services, new production processes, new marketing techniques, and new organizational or managerial structures. It also involves new technology, intellectual property, business, and physical activity (Mazzarol & Reboud 2008). Managers of SMES’s behind small firms enjoy the advantage of flexibility and responsiveness and if able to respond quickly to innovative ideas could easily stir the progress of the company. SMEs which engage in innovation perform better (Mazzarol & Reboud 2008).

According to Laforet (2011) innovation for SMEs is driven by a vision to be successful, and improve on working conditions for a particular organization. Innovation creates positive outcomes for SMES’s such as an improved reputation, a credible image, increased operational efficiency, lower costs upon growth benefits, better business performance, attracting a more skilled workforce, better in-house expertise and further openings for innovation. Innovation in an SMES however needs to be approached systematically by the management of a company to manage the possibility of incurring operational issues, having financial costs, uncontrollable business growth, loss of a good image and reputation due to poor innovations, employee and clientele issues. (Laforet, 2011).

Innovation has helped in the growth of several businesses, however it also backfires on some of the feasibility study if not properly done. Kiraka (2013) notes that the success of many innovations is measured in financial terms which is not always the outcome hence for those who want immediate returns always get disappointed as coming up with innovative ideas involves use of financial and human resources in the business which might not be available. Studies have also noted various benefits that come along with innovation. Hafeez (2013) for example mentioned

product diversification, creating new markets, customer loyalty, brand awareness, business survival and meeting the customer expectations as some of the few benefits when a business embraces innovation.

Performance is often defined simply in terms of output terms such as quantified objectives or profitability. Armstrong (2006) defines performance as both behavior and results. This definition covers the achievement of expected levels as well as objective setting and review. According to Ginsbert (1985), there are three different levels of performance within organizations. They are distinguished as the financial performance, business performance and organization effectiveness, although the latter has been subsequently known as organizational performance. Performance is the key interest of every business manager or owner. The overall performance of the organization depends on proper management of the three levels, which fall within the jurisdiction of top, middle and lower management.

1.2 Statement of the Problem

Abor & Quartey, (2010) highlight that SMES's are largely driven by entrepreneurial skills. A lack of effective management through processes impacts on an SMES's ability to grow and could lead to the ultimate failure of a business. An entrepreneur's core strengths and skills are the paramount factors that determine the success of a business venture. SMES's are opened every year and only 80% make it through the first year of operation, 66% make it through the 2nd year, 50% manage the fifth year and only 30% make it to the 10th year (USA Bureau of Labor Statistics, 2017). The Kenyan environment presents an alarming situation where 400,000 SMES's fail every year without making it to the first anniversary, 2.2 million SMES's have been closed in between 2011 and 2016 due to operational challenges in costs, financing, and management and a lack of innovation.

Previous studies have been done assessing factors influencing performance of SMEs in general for example Kinyua (2014), did a study on Factors Affecting the Performance of Small and Medium Enterprises in the Jua kali sector in Nakuru Town, Kenya. There are no studies evaluating the influence of entrepreneurial skills and innovation on performance of small and medium enterprises (SMES).

1.3 General Objective

An assesSMEsnt of the influence of entrepreneurial skills and innovation on performance of small and medium enterprises (SMES)

1.4 Specific Objectives

1.4.1 To examine the influence of business entrepreneurial skills on performance of small and medium enterprises (SMES)

1.4.2 To determine the influence of innovation on performance of small and medium enterprises (SMES)

1.5 Significance of the Study

This study will be significant in enabling policy makers to analyze major factors contributing to the performance of SMEs in order to put in place the right support structures to enable the survival of this industry which is critical to the success of any economy especially in developing countries. This study will also be resourceful in providing information for development agencies and researchers who may use it in educating, equipping and training entrepreneurs and executive management teams in companies to give room for the growth of this sector. Entrepreneurs and SMES managers will also benefit significantly from this study which they can use as a tool to improve on their practices and make it possible for them to excel in their small and medium business ventures.

The government of Kenya can use the findings for the research to assist in policy formulation and development of a framework for performance of small and medium enterprises (SMEs). Policy-makers will use the knowledge and data to adjust or strengthen the position in businesses policy formulation.

1.6 Scope of the Study

The main purpose of this research was to assess the influence of business entrepreneurial skills and innovation on performance of small and medium enterprises (SMEs). It focused on the business entrepreneurial skills and innovation as the specific objectives.

2.0 LITERATURE REVIEW

2.1 Schumpeter Theory of Innovation

According to Schumpeter (1935) Innovation is a specific process that is distinct from the combinations commonly carried out in the production process. In fact, although production is nothing other than a particular combination of productive forces, defined as coefficients of production or functions of production, in linking input and output, innovation must be put into focus.

Schumpeter's theory therefore states that whenever an economy or a sector of an economy adapts itself to a change in its data in the way that traditional theory describes, the economy or an industry or some firms in an industry do something else, something that is outside of the range of existing practice. It specifies that innovation could occur from within itself and not as a response to an event. He therefore further states that, if at a given moment, the same quantity of a good or a product costs less than previously or if the cost of productive factors has not decreased, that means that innovation has occurred.

2.2 Empirical Studies

Schumpeter (1935) argued that a business without innovation and entrepreneurship cannot stand the test of time. This concept has been proven by several studies which have shown a positive relationship between innovation and the performance of SMEs. Several scholars have noted this import and have come with varied conclusions on this relationship. The survival of the business is also dependent on how innovative the business is (Polevoi, 2003). He found out that the businesses that come up with new products are able to weather the storm of change in the customer tastes and preferences. This helps in the performance and the growth of the business and this makes it survive.

Innovation and skills are strongly related to the performance of SMEs. A study by (Ruth, 2011) found a strong correlation between the two elements. Kiraka, (2013) also did a study on Innovation and Small, Micro and Medium Enterprises in Kenya and he found out the growth was more

significant in those SMEs that embraced innovation and came up with new ideas. He, however noted that not all innovative activities were successful. Some faced rejection from the markets where consumers maintained status quo and were always afraid to try new products and hence stuck to what they already believed in. Therefore convincing them to purchase the improved product or service was a serious challenge.

2.3 Performance of Small and Medium Enterprises (SMEs)

According to Sebikari (2014), SMEs performance can be measured objectively by return on investment, market share, profitability and sales growth. Objective values are measured using collected quantitative data. According to Kithae, Gakure, and Munyao (2017), the employment trend of the small enterprises sector in Kenya between 2014 and 2016 was noticeable. The total employment was estimated at 6.4 million persons, and which was almost entirely attributed to the increase in employment in SMEs.

Brem, Kreusel, and Neusser (2011) indicated that as SMEs resources increase, so may their investment expectations, leading to an increase in demand for products, services and labour. From resource-based perspective, SMEs performance can be evaluated by their profitability, turnover, and market share and job creation being measured by number of employees.

Performance measures may be in terms of profit, growth in sales, stake holders satisfaction, competitive position and success in launching new products. Factors determining the performance of SMES include entrepreneur education, raw materials, entrepreneur competencies, technology. According to Sarwoko, Surachman, Armanu, and Hadiwidjojo (2013), performance of SMEs is determined by the characteristics of the owner. The overall entrepreneurial competencies are attributes of the entrepreneurship which include attitudes, beliefs, knowledge, skills, abilities, personality, and behaviour which is directed to achieve success. SMEs performance will be influenced by the skill and the ability.

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter looked at the suitable research methodology, the population involved in the study, the sample selected to participate in the study, the criteria used in selecting the sample, relevant data collection methods and procedures, as well as the data analysis methods that enabled the researcher find answers on the objective of the study.

3.2 Research Design

Descriptive research design was used for this research. It involves the use of relative variables and scientific methods to describe and analyze behavior. The intention of the researcher is purely to observe and describe the subject being studied without exerting any form of influence on the subjects. This study was descriptive in nature and involved quantitative analysis of data.

3.4 Data Analysis

The secondary data collected was analyzed using descriptive statistics and quantitatively. The data was presented through report writing.

4.0 RESULTS AND FINDINGS

The study established that there is a significant relationship between entrepreneurial skills, innovation and financial performance of SMEs. From the research, for SMEs to remain they have to introduce new products/services. Besides, the introduction of new product/service, technological newness in product and product/service differentiation (improve old products/services to compliment customers' needs) has resulted in positive influence on the financial performance of SMEs.

The study found out that there is a positive significant relationship between process innovation and financial performance of SMEs as SMEs have developed and implemented new business methods and services which have improved production and delivery of services of most SMEs. The SMEs have applied entrepreneurial skills, new technology and new combination of materials in production which have enhanced process innovation which has resulted in improved the performance of the SMEs. This can be seen from the research that improved business processes

and introduction of superior materials was worthwhile for SMEs in order to maintain sustainable competitiveness.

The study established that SMEs who implemented market innovation and entrepreneurial skills got a boost of increased sales resulting in high revenues. The study also established that SMEs should respond to customer complaints in time, introduce new market approaches (online marketing) and offer special delivery packages. This has significantly influenced the relationship between market innovation and financial performance of SMEs.

5.0 Summary of Findings, Conclusion and Recommendations

5.1 Summary of findings

Entrepreneurial skills and product/service innovation affect financial performance of SMEs as the introduction of new product/service, technological newness in product and product/service differentiation has influenced financial performance of SMEs. In comparison with competitors, the enterprises have introduced more innovative products and services.

Entrepreneurial skills and process innovation affects financial performance among SMEs consequently SMEs have developed and implemented new business methods and services which have improved production and delivery of services of most SMEs.

The SMEs have applied new technology and new combination of materials in production which have enhanced process innovation which in turn has improved the performance of the SMEs. Market innovation from the research has significant implication on financial performance of SMEs. Indeed most SMEs have managed to deliver special products flexibly according to customers' orders and that the application of online transaction, innovative marketing and promotion campaigns to find new markets has a positive significant implication on financial performance of SMEs.

5.2 Conclusions

Entrepreneurial skills and product/service innovation affect financial performance of SMEs as the introduction of new product/service, technological newness in product and product/service differentiation has influenced financial performance of SMEs. In comparison with competitors, the enterprises have introduced more innovative products and services.

Process innovation affects financial performance among SMEs consequently SMEs have developed and implemented new business methods and services which have improved production and delivery of services of most SMEs.

The SMEs have applied new technology and new combination of materials in production which have enhanced process innovation which in turn has improved the performance of the SMEs.

Market innovation from the research has significant implication on financial performance of SMEs.

Indeed most SMEs have managed to deliver special products flexibly according to customers' orders and that the application of online transaction, innovative marketing and promotion campaigns to find new markets has a positive significant implication on financial performance of SMEs.

5.3 Recommendations

In order for the SMEs to successfully achieve high product and service innovation both the government and enterprise management need to create a business environment conducive for entrepreneurship and enterprise creation in which innovative firms have scope to expand their product innovation. There is also need for the government to develop and implement a broad range of mutually reinforcing and supportive policies that promote best practice policies which support company innovation such as those affecting patent, labour markets, taxes, competition, financial markets and business registration laws. They should also support the emergence and maintenance of innovative business through spinouts or collaborative development, promoting product development partnerships and attracting similar actors to come forward for creating a positive ambiance for product and service innovation, while at the same time improving the availability of market information and strengthening co-operation among firms, for instance in the fields of market intelligence, design and branding.

There is need for the government to enhance SMEs awareness and knowledge of all elements of the intellectual property system through greater interaction between intellectual property offices, SMEs support institutions, and business associations, national and regional governments. These elements include patents, trademarks, industrial designs, utility models, trade secrets, copyright and related rights, plant varieties and non-original databases. Strengthen the integration of

intellectual property issues in programmes and policy initiatives aimed at fostering innovation in SMEs.

In terms of improving process innovation, SMEs need to focus on improving their core competences. Furthermore, they need to cooperate with external partners to recompense for other competences and resources, especially in case of new product development.

SMEs need to pursue market innovation strategies that focus on product customization and customer intimacy in delivering their products and services while at the same time cultivating relationships with a small number of captive customers. This market intimacy will help SMEs make up for lack of resources for market intelligence as the customers will be able to offer them information on their current need and any changes in market competition.

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