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The Mediating Effect of Innovation Capability Towards Export Performance of Small and Medium Enterprises in Sri Lanka

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Abstract

Export is one of the most important factors influencing economic growth. As a developing country, a systematic action plan is needed to expand the export sector because Sri Lanka's economy is largely dependent on international trade. Small and Medium-Sized Enterprises (SMEs) play a vital role to develop the export performance of a country. entrepreneurial orientation and innovation capabilities are important factors that directly affected on internationalization of SMEs. There is no research done in the past to identify the mediating effect of innovation capability on the relationship between entrepreneurial orientation and export performance. Accordingly, this study intended to fill the gap by testing the mediating effect of innovation capability on the relationship between entrepreneurial orientation and export performance. In this context, the objective of this research is to examine the mediating effect of Innovation capabilities on the relationship between entrepreneurial orientation and export performance of SMEs in Sri Lanka. This study followed a quantitative research design to examine the above relationship by using the processing technique. The examined population in this research are the exporters who have export turnover below Rs. 150 Mn. Data is collected through a structured questionnaire distributed among 200 exporters. Both descriptive and inferential statistical techniques were used to analyze the collected data using SPSS. The study found that innovation capability has a partial mediation effect on the relationship between entrepreneurial orientation and export performance. Accordingly, SMEs should improve the level of entrepreneurial orientation and, innovation capability to improve the export performance of SMEs.

Keywords: *Entrepreneurial Orientation, Innovation Capability, Export Performance, Small and Medium Entrepreneurs, Internationalization.*

Introduction

Small and Medium Enterprises (SMEs) have been recognized as the backbone of an economy (Arinaitwe 2006). Moreover, a significant role played by the SMEs in the economy who are spread worldwide (Philip 2010, Islam at al 2011). They contribute to the economy through providing employment opportunities, reducing income disparities developing skilled and semi-skilled workers, improving entrepreneurial and managerial talent, increasing the balance of payment surplus, and stimulating other economic activities (Kazem and Heijden 2006). At present, globalization is very crucial to the growth of the business. Therefore, SMEs are considered as a strategic tool for the expansion of exports. Past researchers also have explained that internationalization provides benefits for SMEs including better survival prospects (Lee et al., 2012), increased revenue and growth (USITC, 2010), better innovative capability, and improved productivity (Kalinic & Forza, 2012) compared to non-internationalized SMEs. It is

accepted that internationalization is useful for organizations and that helps to obtain better performance and growth.

At present SMEs are actively participated in export activities in most countries and SME contribution to the export sector lies between 30 percent to 50 percent (Wijayarathne and Perera 2018). Nonetheless, in the Sri Lankan context, SME contribution to the export sector is around 4 percent. Accordingly, the SME contribution to total exports is very low. As mentioned by the various researches, the export barriers badly affected the export activities of the SMEs (Jalali (2012) and Ortega (2003). SME exports of Sri Lanka highly depend on few exporting regions and industry sectors. Sri Lankan SME exports consist of primary goods and they use technologically stagnant production practices that could be copied by competitors easily (Kelegama, 2013).

Some researchers have argued that SMEs face difficulties to enter into the international market such as shortage of capital, inadequate infrastructure, absence of innovation, lack of market information, competition, obsolete technology, and lack of labor skills and managerial skill (Yoshino and Hesary, T. (2016). Entrepreneurial orientation has become an important element in internationalization. Therefore, it supports identifying entrepreneurial qualities, find out exploit untapped market opportunities; enhance the capabilities of the respondent of challenges, improve the ability to take risks in the business, identify the opportunities and improve the ability to compete with other established organizations (Wiklund & Shepherd 2005). Therefore, the level of entrepreneurial orientation is an important element to determine the success of their globalization. (Lan Q., & Wu S., 2009). In recent years, SMEs tend to use entrepreneurship principles and adopt innovative approaches to enter the international market. Further, entrepreneurial orientation also helps to increase the export performance of a country and it might encourage entrepreneurs to enter into the export market (Okpara J.O., 2009). On the other hand, Innovation capability also plays a major role to improve SMEs performance (Filipescu et al.,2013) and It helps to improve the technology and product quality of the organization.

The majority of studies focus on the impact of entrepreneurial orientation and innovation capabilities on firm performance. However, limited research was conducted to find out the indirect effect of entrepreneurial orientation on the business performance in SMEs. Some research studies were conducted base on developed countries but it is difficult to find out studies base on SMEs in developing countries. Accordingly, it is very important to conduct a study to fill the gap by testing the mediating effect of innovation capability on the relationship between entrepreneurial orientation and export performance of the SME sector in Sri Lanka. There are three key objectives of this study; (1) to examining the effect of entrepreneurial orientation and innovation capability on export performance (2) to examine the direct effect of entrepreneurial orientation on innovation capability and (3) to measure the mediating effect of innovation capability on the relationship between entrepreneurial orientation and export performance.

Conceptual Framework and Hypotheses

Basically, the model has been divided into three stages. Stage one of the model depicts the influence of entrepreneurial orientation on the export performance of SMEs in Sri Lanka. This study has identified five dimensions of Entrepreneurial Orientation such as innovativeness, proactiveness, risk-taking, competitive aggressiveness, and autonomy. Stage two depicts the influence of innovation capability on export performance and entrepreneurial orientation effect on innovation capabilities. The final stage depicts the influence of the mediating effect of innovation capabilities on the relationship between entrepreneurial orientation and export performance.

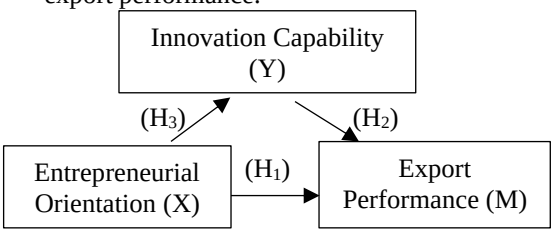

Figure 01: Conceptual Framework of the study

Entrepreneurial Orientation and Export Performance

Several efforts have been taken to identify the impact of entrepreneurial orientation on the export performance of firms in various countries and most of the researches have explained that a strong relationship can be seen in the improvement of export performance in a firm. (Wiklund, 1999; Zahra and Garvis 2000; Lumpkin and Dess 2001). Accordingly, Zahra et al. (2000) explained that entrepreneurial activities help to enhance market opportunities to reach the international market. Many researchers have identified a positive relationship between EO and export performance (Rauch, Wiklund, Limpkin, & Frese, 2009). But, few studies have explained the negative relationship between entrepreneurial orientation and export performance (George, Wood, & Khan, 2001).

H_1- Entrepreneurial Orientation positively influences on export performance of SMEs in Sri Lanka.

Innovation Capability and Export Performance

Several types of research have explained that innovation can influence the firm's export performance both positively and negatively. Accordingly, Ussahawanitchakit (2007) explained that firms who are engaged in export business have exploited that how innovative capabilities influence to increase the export performance. Aranda et al. (2001) argued that innovation is one of the most core value creation activities and a competitive weapon for firms who are engaged in the export business. That can be helped to firms to create new ideas to develop products, services, and processes to enable them to increase performance and attain a competitive edge (Jantunen, 2005). Mohammod, Massie, and Tumewu (2019) recently examined the effect of innovation capability on a firm's performance and found that innovation capability has a positive effect on a firm's performance in SME's in Manado.

H_2- Innovation capabilities positively influence on export performance of SMEs in Sri Lanka.

Mediating Effect of Innovation Capability

As explained by Guan, Ma (2003); Zahra et al. (2006) Innovation capabilities play a vital role to improve product development capacity and develop managerial skills and production processes. Innovative capabilities are recognized as a major tool with a high level of proactivity, risk-taking, and innovation and that could enable SMEs to develop and innovate new products and markets and that could be helped to improve their level of entrepreneurism (Preda, 2013). Rauch, Wiklund, Lumpkin, and Frese (2009) explained that entrepreneurial orientation can be recognized as a strategic process of decision-making that assists SMEs by creating competitive advantages including innovation. Therefore, innovation can be considered an important activity and can be used for the development of new products, processes, and management systems (Lumpkin & Dess, 1996; Wiklund & Shepherd, 2005). Meliá et al. (2010) explained that innovative firms can transform their resources and processes and structures to enter into new international markets. Filipescu et al. (2013) explained that innovation and exports have a mutual relationship. Accordingly, innovative firms can be able to enter into foreign markets easily. As explained by Posner (1961), the continuity of exports of a country depends on the usage of new technology for their production processes. Innovation activities are the most important elements in determining a firm's strategic decision related to export activities (Cassiman, Golovko, & Martínez-Ros, 2010).

H_3 Entrepreneurial Orientation positively influences on the innovation capacity of SMEs.

H_4 Innovation capabilities mediating the relationship between Entrepreneurial Orientation and export performance of SMEs in Sri Lanka.

Research Methodology

Population, Sample and Sampling Method

The population of this study consists of exporters in Sri Lanka with an export turnover of less than Rs.150 Mn. The exporters who have export turn over less than Rs. 150 Mn.

considered as SME exporter by the EDB. The target group was identified through the custom database available at the Sri Lanka Export Development Board (EDB). EDB maintains a database for exporters and it represents 3940 exporters. Table 01 shows the exporters available in the database maintained by the EDB.

Table 01: Number of Exporters by Export Turnover 2018

Item	No of exporters	Export Value - 2018 US$ - Mn.	Percentage %
Total	3940	11,890	
Turn Over below Rs.150 Mn.	3095	451	4%
Turn Over above Rs.150 Mn.	845	11,439	96%

Source: database - Sri Lanka export development board

The study population was limited to SME exporters with an export turnover of less than Rs.150 Mn. per annual and it consists of 3095 exporters in Sri Lanka. Most research studies mentioned that it is difficult to collect data from the whole population due to practical difficulties such as money, time, and transport. Therefore, it is needed to select a representative sample to generalize the conclusions on the population with reasonable confidence (Singh, 2007).

Since it is difficult to study this entire population, this study has selected 200 SME exporters as a sample. The sample size was determined under the confidence level of 99% and a margin of error of 3 percent based on the operational population (Bartlett, Kotrlik, and Higgins, 2001). The stratified proportional random sampling method was used to select the required sample for this study since it is the most appropriate sampling method. Exporters (T/O below Rs. 150 Mn.) covering all product sectors were identified separately and the number of SMEs were selected randomly using a simple random table stated in 02.

Table 02: Distribution of the Sample

Product Sectors	Population (No of Exporters)	Percentage out of total no. of SMEs	Required no. of SMEs for the sample
Apparel	337	10	33
Spices &Allied Products	244	10	24
Fish &Fisheries	196	5	10
Rubber Product	131	10	13
Coconut &Coconut based products	327	5	16
Floriculture	152	2	7
Foods & Beverages	241	5	12
Ornamental Fish	59	2	1
Gem &Jewellery	227	7	16
Fruit &Vegetables	348	5	17
Ceramic &Porcelain	220	5	11
Wooden Products	195	2	3
Footwear &Leather products	175	5	8
Ship &Boat Building	16	10	1
Electronic Products	228	10	22
Light Engineering	337	2	6
Total	3095		200

The data was gathered through a questionnaire to examine the influence of the moderating effect of innovation capability on the relationship between entrepreneurial orientation and export performance.

Measurement of Variables

Entrepreneurial Orientation and Innovation Capabilities

The main independent variable is entrepreneurial orientation and the majority of studies have used three dimensions of entrepreneurial orientation i.e. innovativeness, pro-activeness, and risk-taking. However, this study focused on five dimensions including another two dimensions i.e. competitive aggressiveness and autonomy. The relevant indicators were adopted from Venter, A (2014); George & Helen (2007), and Abdullahi, Kunya, Bustani & Usman (2019). Innovation capabilities of SMEs were adopted from Gurhan, Gunduz, Kemal & Lutfihak (2011), and both variables were measured through 5-point scale statements ranging from "strongly agree" to "strongly disagree. Aranda et al. (2001) argued that innovation is one of the most core value creation activities and a competitive weapon for firms who are engaged in the export business. Mohammod, Massie & Tumewu (2019) recently examined the effect of innovation capability on a firm's performance and found that innovation capability has a positive effect and significance on a firm's performance in SMEs in Manado. Filipescu et al. (2013) explained that innovation and exports have a mutual relationship.

Export Performance

The performance of the firm was measured using financial and non-financial measurements includes the sales growth of export, the sales volume of export, profit contribution of export, and Satisfaction with export operations. The export variable measurement was adopted from Godwin, Joseph & Muhammed (2013). Most organizations do not maintain financial reports properly and they reluctant to disclose financial data to the third party. Therefore, owners/managers were asked questions to identify the trend of the indicators during the last three years. These indicators were measured through a five-point liker scale indicating "highly increased" "increased", "moderate", "decreased" and "highly decreased".

Findings and Discussion

Table 03 shows the summary of the reliability test for the independent variables (entrepreneurial orientation and innovation capability) and dependent variable (export performance).

Table 03: Reliability Test results

Construct	**Cronbach's Alpha**	**Number of Items**
Entrepreneurial Orientation	.807	25
Innovation Capabilities	.917	6
Export Performance	.857	4

According to table 03, the Cronbach's Alpha value of the three variables is higher than the accepted level.

Descriptive Analysis of respondents

Table 04 shows age, gender, marital status, level of education, and prior business experience before entering into the business.

Table 04: Characteristics of the sample

Characteristics		Total	Percentage
Age of the Owner/manager	20-30 Years	18	13
	31-40 Years	33	23
	41-50 Years	37	26
	51-60 Years	42	29
	61-70 Years	11	8
	More than 70 years	2	1
	Total	**143**	**100**
Gender	Female	10	7
	Male	133	93
	Total	**143**	**100**
Marital Status of the	Single	14	10

respondents			
	Married	129	90
	Total	**143**	**100**
Educational qualification of respondents	Below GCE (O/L)	4	3
	GCE (O/L)	7	5
	GCE (A/L)	30	21
	Certificate/Diploma	32	22
	Professional Qualification	24	17
	Graduate	38	26
	Post Graduate	8	6
	Total	**143**	**100**
Prior Business Experience	Yes	91	64
	No	52	36
	Total	**143**	**100**

As shown in table 04, the majority of respondents are in the age category of 51-60 years which is 29 percent and according to the above table, a total of 133 respondents (93%) in this study are men while only 10 (7%) are women. Further, as mentioned in the above 90 percent of them are married and 10 percent of them are single and the majority of them are having a degree which is 26 percent of total respondents. According to the above table, 64 percent of them are having the prior business experience to enter into international business.

The profile characteristics of SMEs

The profile characteristics consist of age of the business, legal form of the firm, export turnover of the firm, total No. of employees, whether the business is a family business or not, and the nature of the business. The following table shows the descriptive analysis of the profile characteristics of SME owners/managers.

Table 05: The profile characteristics of SMEs

Characteristics		Total	Percentage
Age of the business	Less than 5 Years	25	17
	5-10 years	36	25
	11-15 years	33	23
	16-20 years	26	18
	More than 20 years	23	16
	Total	**143**	**100**
Legal Status of the company	Proprietorship	26	18
	Partnership	46	32
	Private Limited Company	71	50
	Total	**143**	**100**
Annual Turn Over of the companies	Less than 25 Mn.	43	30
	25 Mn. - 50 Mn.	49	35
	50 Mn. - 100 Mn.	26	18
	100 Mn. - 150 Mn.	25	17
	Total	**143**	**100**
Number of employees of the organizations	10-50 employees	40	28
	51-100 employees	53	37
	101-200 employees	36	25
	201-300 employees	14	10
	Total	**143**	**100**
Whether Business is a family business	Yes	88	62
	No	55	38

	Total	143	100
Nature of the Business	Only to Export Market	80	56
	Both Export and Local Market	63	44
	Total	**143**	**100**

As indicated in table 05, the age distribution of the firm is concerned, the majority of SMEs prevail in their business from 5 to 10 years and 50 percent of SMEs have private limited companies. Further, the Majority of respondents are having export turn over 25 Mn- 50 Mn. which is 35 percent of the total respondents and 37 percent of SMEs are having 51-100 employees. The above table depicts that 62 percent of SMEs are from family businesses while 38 percent of SMEs are not having a family business background and also the above table shows 56 percent of SMEs are supplying their products only to the export market.44 percent of SMEs are supplying their production both export and local market.

The following table 06 displays the summary of the measured constructs of entrepreneurial orientation, innovation capability.

Table 06: Entrepreneurial orientation and Innovation capability levels

	N	Minimum	Maximum	Mean	Std. Deviation
Entrepreneurial Orientation	143	2.96	4.36	3.6604	.27854
Innovation Capabilities	143	2.00	4.83	3.4149	.61599
Valid N (listwise)	143				

As depicts in table 06, the mean value of entrepreneurial orientation is 3.66, and the mean value of innovation capability is 3.41. The standard deviation of entrepreneurial orientation and innovation capability is 0.28 and 0.61 respectively. Accordingly, the above summary depicts the mean values of all the variables with acceptable standard deviations ($s < 0.8$). Therefore, the values can be considered acceptable for this study.

This study examined the influence of each dimension of entrepreneurial orientation (innovativeness, Autonomy, Risk Taking, Competitive Aggressiveness & Pro-activeness) on the export performance of SMEs. It's R Square value is 0.311 (Adjusted R square 0.285). Table number 07 shows the result of multiple regression analysis of each dimension of entrepreneurial orientation and export performance.

Table 7: Multiple Regression Analysis Result – each Dimension of Entrepreneurial Orientation and Export Performance.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.623	.542		-1.149	.252
	Innovativeness	.332	.101	.265	3.305	.001
	Proactiveness	.237	.121	.158	1.964	.052
	Risk-taking	.162	.121	.115	1.344	.181
	Cog_Aggress	.051	.106	.038	.483	.630
	Autonomy	.282	.132	.196	2.135	.035

Dependent Variable: Export Performance

The results of table 07 shows that innovativeness and autonomy has a significant impact on ($p<0.05$), export performance. However, pro-activeness, risk-taking and Competitive Aggressiveness didn't show a significant impact on export performance.

The mediating effect of innovation capabilities on the relationship between entrepreneurial orientation and export performance was examined using the Process technique proposed by Hayes, A.F. (2013) which is widely used.

Table 08 shows the results of the mediating effect test showing both the direct and indirect effect of the entrepreneurial orientation on the export performance.

Table 08 - Model Summary of mediating effect

Model	R	R Square	MSE	F	df1	df 2	P
	.4346	.1889	.3100	32.8307	1.0000	141.0000	.0000

Table 09: Direct and indirect effect of innovation capability on the relationship between entrepreneurial orientation and export performance.

		Coefficients	Se	t	p	LLCI	ULCI	Standardized coefficients
	(Constant)	-.1031	.6157	-.1674	.8673	-1.3203	1.1142	
	Entrepreneurial_ Orientation	.9611	.1677	5.7298	.0000	.6295	1.2927	.4346

The direct effect of entrepreneurial orientation on export performance

Effect	Se	t	p	LLCI	ULCI	c'_ps	c'_cs
.6576	.1356	4.8487	.0000	.3895	.9258	1.1761	.3276

Indirect effect(s) of entrepreneurial orientation on export performance

	Effect	BootSE	BootLLCI	BootULCI
Innovation	.4239	.0939	.2562	.6196

Partially standardized indirect effect(s) of entrepreneurial orientation on export performance

	Effect	BootSE	BootLLCI	BootULCI
Innovation	.7580	.1460	.4879	1.0585

Completely standardized indirect effect(s) of entrepreneurial orientation on export performance

	Effect	BootSE	BootLLCI	BootULCI
Innovation	.2111	.0420	.1321	.2972

The results in table 9 support the mediation effect hypothesis as it can be observed from the results that the bootstrap 95% confidence interval does not include zero. Therefore, innovation capabilities mediate the relationship between entrepreneurial orientation and export performance.

Conclusion

As indicated in this study the majority of entrepreneurs/managers fall in the age group of 51-60 years and the majority of with 65.12% of entrepreneurs and managers being men. Further, an entrepreneur should have sufficient knowledge and educational qualifications to survive in the export market. Respondents have sufficient education qualifications (38 of the respondent are graduated). Most of them have prior experience in the export market and it is an important criterion to enter into the export market. According to the analysis of the study, 25 percent of businesses had an

operational export experience of 5 -10 years. Further, the majority of export companies have good experience in the local market and the international market as well. i.e. most companies are well-established companies in the local market and 35 percent of SMEs have reported an annual export turnover of Rs.25 Mn. Rs. 50 Mn. It was found that most businesses operated in the sectors such as food and beverages, ornamental fish, coconut and coconut-based products, wooden products and footwear products, etc. Those sectoral contributions to the export sector are very low. As depicts in table 4.9, 37 percent of SMEs have employees 51- 100 nos. and 28 percent of SMEs have employees 10 – 50 nos. As mentioned in table 4.10, 62 percent of SMEs are family businesses.

This study revealed that there is a positive impact of entrepreneurial orientation on the export performance of SMEs. Further, the researcher analyzed the effect of each dimension of entrepreneurial orientation on export performance and It is revealed that only innovativeness and autonomy positively influence on export performance of SMEs. Moreover, Atuahene-Gima & Ko, (2001) also mentioned that Entrepreneurial orientation allows SMEs to improve their abilities and creativity that produce higher possibilities to increase the level of innovation and competitive advantages. Since it is very important to improve the level of entrepreneurship within the SEMs to improve SMEs' export performance level. Further, SME owners advance the level of innovativeness and autonomy because of these two factors more significant than another dimension of Entrepreneurial orientation. On the other hand, the study result revealed the direct effect of entrepreneurial orientation and innovation capabilities on export performance. Moreover, the relationship between entrepreneurial orientation and export performance is mediated by innovation capabilities.

Recommendations

Among the dimensions of entrepreneurial orientation, innovativeness and autonomy provide better results in order to increase export performance. Since entrepreneurs and managers are encouraged to improve their education level and improve their knowledge about the business environment to improve the success of SMEs. Moreover, the owner/manager of SMEs should be more innovative in their business activities. Therefore, the training programs and workshops should be designed to improve the innovation capability of owners/managers and employees of the organization and also recommended to change the education system of the country. In addition to that policy, the decision can be made regarding the development of an SME sector in Sri Lanka and develop them to enter into the international market as their contribution to the export sector is very low. Since the researcher suggests designing training programs for entrepreneurs to educate on the international market and design financial assistance programs to encourage SMEs internationalization, etc.

Limitations and Suggestions for Future Research

This study considered only exporters who are engaging in exporting tangible products but service exporters are not covered through this research. Since future researchers can conduct the same research covering both manufacturing and service-related SMEs. In this study, the sample has been selected from the database maintained by the Sri Lanka Export Development Board and it contains 3095 SME exporters with export turnover below Rs. 150 Mn. This study has used 200 SMEs as the sample out of 3095 SMEs where the sample represents a population of 6.4% only. If the sample size was bigger than the used sample size the results may be changed. Moreover, the Researcher suggests doing the same research considering various product sectors of export including a great sample of exporters. This study SME was defined based on export turnover criteria but then again conduct the same research using additional criteria to define export SMEs and export performance. In this study, there are only two independent variables (entrepreneurial orientation and innovation capability) used to measure the impact on export performance. For further researchers could use variables such as entrepreneurial intention,

entrepreneurship education & attitudes towards behavior.

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